

# Saul Centers



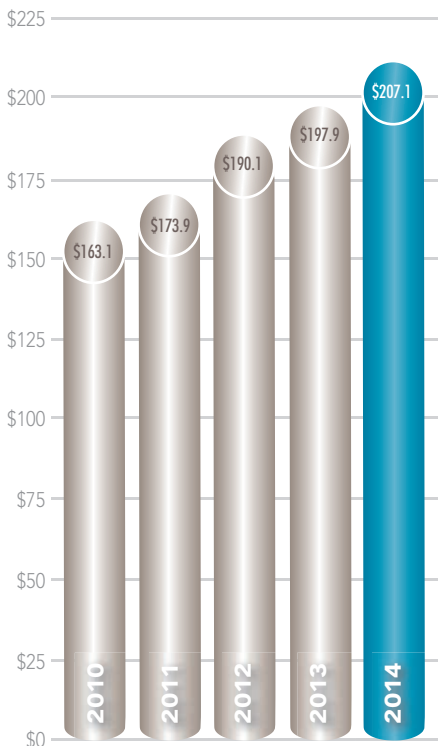
## 2014 ANNUAL REPORT to Shareholders



Saul Centers, Inc. is a self-managed, self-administered equity Real Estate Investment Trust (REIT) headquartered in Bethesda, Maryland. Saul Centers operates and manages a real estate portfolio comprised of 59 properties which includes (a) 56 community and neighborhood shopping centers and mixed-use properties with approximately 9.3 million square feet of leasable area and (b) three land and development properties. Over 85% of the Company's property operating income is generated by properties in the metropolitan Washington, DC/Baltimore area.

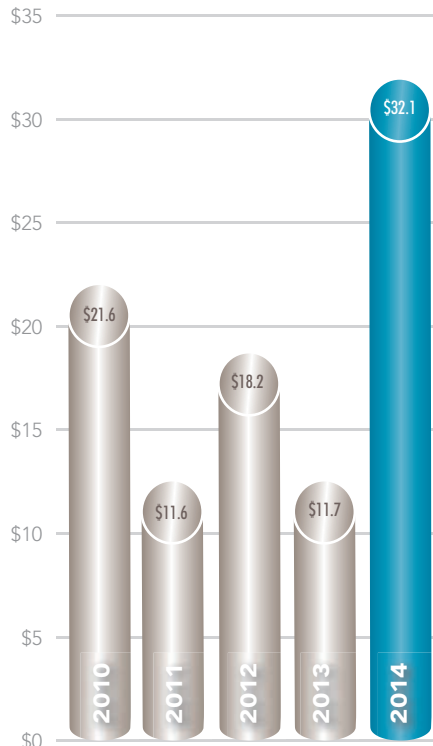
### TOTAL REVENUE

(In millions)



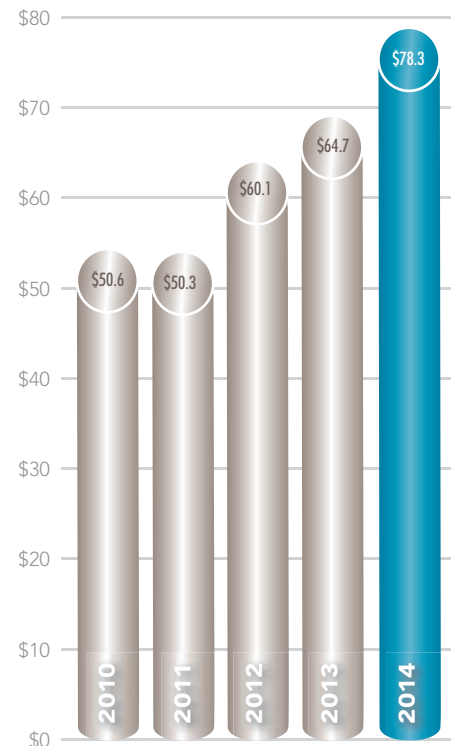
### NET INCOME

Available to Common Stockholders  
(In millions)



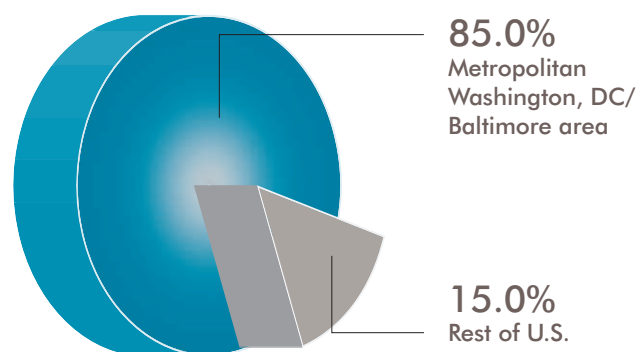
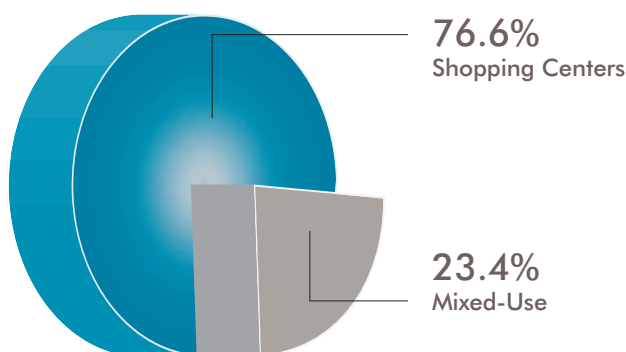
### FUNDS FROM OPERATIONS\*

Available to Common Shareholders  
(In millions)



\* Funds From Operations (FFO) is a non-GAAP financial measure. See page 25 for a definition of FFO and reconciliation from Net Income.

# PORTFOLIO COMPOSITION BASED ON 2014 PROPERTY OPERATING INCOME



	Year ended December 31,				
	2014	2013	2012	2011	2010
<b>Summary Financial Data</b>					
Total Revenue	\$207,092,000	\$197,897,000	\$190,092,000	\$173,878,000	\$163,108,000
Net Income Available to Common Stockholders	\$ 32,102,000	\$ 11,661,000	\$ 18,234,000	\$ 11,593,000	\$ 21,623,000
FFO Available to Common Shareholders	\$ 78,281,000	\$ 64,684,000	\$ 60,100,000	\$ 50,309,000	\$ 50,556,000
Weighted Average Common Stock Outstanding (Diluted)	20,821,000	20,401,000	19,700,000	18,949,000	18,377,000
Weighted Average Shares and Units Outstanding	27,977,000	27,330,000	26,614,000	24,740,000	23,793,000
Net Income Per Share Available to Common Stockholders (Diluted)	\$ 1.54	\$ 0.57	\$ 0.93	\$ 0.61	\$ 1.18
FFO Per Share Available to Common Shareholders (Diluted)	\$ 2.80	\$ 2.37	\$ 2.26	\$ 2.03	\$ 2.12
Common Dividend as a Percentage of FFO	56%	61%	64%	71%	68%
Interest Expense Coverage <sup>a</sup>	3.15	2.98	2.68	2.62	3.22
<b>Property Data</b>					
Number of Operating Properties <sup>b</sup>	56	56	57	58	55
Total Portfolio Square Feet	9,339,000	9,333,000	9,489,000	9,543,000	8,901,000
Shopping Center Square Feet	7,886,000	7,880,000	7,877,000	7,933,000	7,293,000
Mixed-Use Square Feet	1,453,000	1,453,000	1,612,000	1,610,000	1,608,000
Average Percentage Leased <sup>c</sup>	94%	93%	91%	90%	91%

(a) Interest expense coverage equals (i) operating income before the sum of interest expense and amortization of deferred debt expense, predevelopment expenses, acquisition related costs, and depreciation and amortization of deferred leasing costs divided by (ii) interest expense.

(b) Excludes development parcels (Ashland Square Phase II and New Market from 2009 to 2012 and Ashland Square Phase II, New Market and Park Van Ness in 2013 and 2014).

(c) Average percentage leased for 2014, 2013, 2012 and 2011 excludes Clarendon Center residential, which averaged 98%, 98%, 98% and 97% leased, respectively.



601 Pennsylvania Avenue, Washington, DC

# MESSAGE to Shareholders

*Overall portfolio occupancy improved to 94.4% as of December 31, 2014, a substantial increase from the low of 90.0% as of December 31, 2011.*

**T**hroughout 2014, interest rates remained at historically low levels and the U.S. economy continued its slow and steady expansion. As a result, real estate fundamentals continued to improve. Both leasing rates and occupancy levels within the Saul Centers portfolio of shopping centers and mixed-use properties trended positive. Overall portfolio occupancy improved to 94.4% as of December 31, 2014, a substantial increase from the low of 90.0% as of December 31, 2011. Deal volume in 2014 was strong with 290 executed leases comprising 1.38 million square feet of retail and office space, a new historic high volume from our 287 leases in 2013.

Small shop leasing percentage (in-line spaces less than 10,000 square feet) improved to 91.1% from 89.7% at the start of 2014 and our shopping centers ended the year with only two anchor tenant vacancies (spaces more than 25,000 square feet) out of 68 total anchors. New and renewal shopping center cash rents increased by 3.9% on a same space basis, the third consecutive year of rental rate improvement following the last recession. In addition, our office properties have recently experienced an increase in demand in our core submarkets. As of the end of February 2015, 93.4% of our 1.1 million square feet of commercial space in the Washington, D.C. metropolitan area was leased, an increase from 90.3% as of December 31, 2014.

## Mixed-Use Performance

The Company's two largest assets as measured by property operating income are Clarendon Center and 601 Pennsylvania Avenue, which contribute over 69% of the mixed-use property operating income. Together, they consist of 390,000 square feet of office space with only 13,000 square feet vacant and only 9,000 square feet expiring during 2015 (without a new tenant commitment executed). This low amount of rollover space serves to minimize cash flow declines in our commercial space as office markets continue their recovery.

While office demand has increased, office rents remain under pressure. During 2014, our base rental rates on 183,000 square feet of new and renewal office deals, on a same space basis, declined by 5.7%. On the residential side of our mixed-use portfolio, occupancy at Clarendon Center's Lyon Place apartments continued at a strong monthly average of 97.7% during 2014, with rents improving by 2.7% over expiring levels.

## Shopping Center Results

Consumer spending is the primary driver of the U.S. economy, accounting for over 65% of economic activity. With today's low interest rate environment, an unemployment rate at 5.5%, and reduced gasoline prices, consumer confidence has improved, but has not yet translated into retail spending. Increased savings and, in the Washington, D.C. region, rising housing costs, appear to be suppressing growth in consumer spending. As a result, sales reported by our retail tenants remained unchanged compared to 2013 amounts. Despite the lack of growth, on a same space basis, our retail tenants' sales averaged a healthy \$340 per square foot, and grocery store sales, a large component of that number, averaged over \$490 per square foot.

Healthy tenant sales generally lead to higher tenant retention throughout the portfolio. During 2014, 75% of tenants with expiring base rents renewed their leases, second only to our 78% renewal rate in 2013. From 2008 through 2012, the average renewal rate was 68%. Higher tenant retention is desirable because rental income continues uninterrupted and tenant improvement and re-leasing costs are minimized.

The recent recession negatively impacted the operating results of our Loudoun County, Virginia and Florida shopping centers to a greater extent than others. These nine grocery anchored shopping centers comprising 1.3



million square feet of rentable space, produced over 12.9% of our 2014 property operating income. On a combined basis, the leasing percentages of these properties dropped from a 2007 pre-recession high of 96.2% to 90.5% in 2010. While rental rates remain under pressure, steadily improving market conditions have increased retail tenant demand, resulting in a leasing percentage of 93.8% at year-end 2014.

While there continues to be steady job growth and modest wage inflation, we remain cautiously optimistic for the strength of real estate fundamentals looking into 2015.

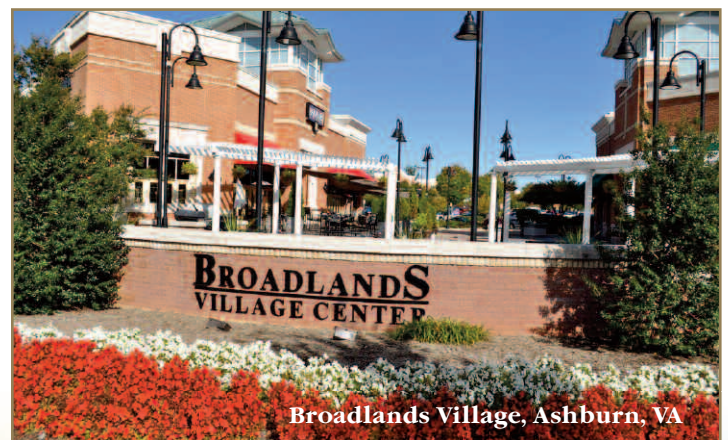
## 2014 Operating Results

Total revenue increased to \$207.1 million in 2014, from \$197.9 million in the prior year. Net income available to common stockholders was \$32.1 million (\$1.54 per diluted share) compared to \$11.7 million in 2013. Two major items explained the majority of the \$20.4 million improvement in 2014 net income available to common stockholders. The prior year's higher predevelopment and depreciation charges related to the Park Van Ness project and higher redemption charges in 2013, arising from the

initial issuance of our 6.875% Series C preferred stock, combined to contribute \$15.1 million of the improvement in 2014 compared to 2013.

Funds From Operations (FFO) available to common shareholders (after deducting preferred stock dividends and preferred stock redemption charges) increased 21.0% to \$78.3 million (\$2.80 per diluted share) from \$64.7 million (\$2.37 per diluted share) in 2013. Adjusting for the prior year's higher Park Van Ness predevelopment charges and higher preferred stock redemption charges totaling \$7.1 million, 2014 FFO per share increased by 8.7% over 2013 FFO.

Same property operating income increased 4.4%, with shopping centers improving 5.4% and mixed-use properties growing by 1.2%. Same property results exclude operating income from properties not in operation for the entirety of the comparable reporting periods. Two property related events, both at the Seven



Broadlands Village, Ashburn, VA



Boca Valley Plaza, Boca Raton, FL



**Park Van Ness, Washington, DC  
(artist's rendering)  
Construction progress photo March 12, 2015**



Corners shopping center, had a one-time positive impact on 2014 results: (1) a \$1.6 million bankruptcy settlement and collection related to a former tenant and (2) a \$0.7 million impact of a 50,000 square foot lease termination in order to accommodate the expansion of our very successful Home Depot store. Excluding these two events, overall same center property operating income increased 2.8% in 2014.

## Development & Construction Pipeline

Our external growth strategy continued to focus on assembling land adjacent to Metro Stations in the metropolitan Washington, D.C. area. Since quality grocery-anchored shopping center acquisitions have been priced to extremes over the past few years, our acquisition program has focused on identifying and purchasing underutilized transit-oriented sites which provide zoning for mixed-use residential and commercial redevelopment. During 2014, we added 3.6 acres, currently operating as one- and two-story retail stores, to our holdings at the Twinbrook Metro Station along Rockville Pike in Montgomery County, Maryland. When combined with our adjacent 1500 Rockville Pike, the total 10.3 acres fronting Rockville Pike will support up to 1.2 million square feet of mixed-use development. We also acquired two contiguous sites on Glebe Road, totaling 2.3 acres, currently operating as single-level retail stores, conveniently located near the Ballston Metro Station in Arlington, Virginia. These sites have a combined mixed-use development potential of up to 450,000 square feet.

Along with our prior 2010 through 2012 assemblage of 7.6 acres at the White Flint Metro Station, also along Rockville Pike in Montgomery County, Maryland, these three sites at Ballston, Twinbrook and White Flint provide us with a 10-plus year development pipeline. The construction schedule for over 3.0 million square feet of new mixed-use residential and commercial space will be determined by the site and building plan approval process and market conditions.

Construction continues on Park Van Ness, our 224,000 square foot apartment/retail building. This new luxury apartment project has a prestigious and convenient location between Connecticut Avenue and the scenic and quiet Rock Creek Park, and is a short walk from the Metro's Red Line Station at Van Ness. Construction is up to the 8th level of the 11-story building, and will include 271 apartments and 9,000 square feet of street-level retail. Amenities will include a rooftop swimming pool, community room, fitness center and several outdoor landscaped courtyards overlooking the park. Total development costs are estimated to be \$93 million, with approximately \$35 million expended as of March 1, 2015. Construction is scheduled to be substantially completed in the first quarter of 2016.



Thruway, Winston Salem, NC

## Property Dispositions

While we pride ourselves on acquiring and developing properties for a long-term hold within our portfolio, we have periodically disposed of an asset. Such dispositions occur when we determine the asset has limited cash flow growth potential or when it is not in our core market, and when attractive pricing is offered. During 2014, we sold the 70,000 square foot Giant shopping center, located in Baltimore, Maryland. This represented only our fourth property disposition in 22 years, with others located in Oklahoma, Kentucky and Baltimore.

## Balance Sheet Summary

In late 2014, decreased U.S. Treasury yields again resulted in lowered rates on new issues of preferred stock. We took the opportunity to issue an additional \$40 million of our 6-7/8% Series C preferred stock and used the proceeds to redeem all of our remaining outstanding 8% Series A preferred stock. As a result, our weighted average cost of preferred equity was reduced to 6.875% from 7.13%, a savings of \$450,000 per year. We had no mortgage notes maturing in 2014. Because long term interest rates remained low, we decided to refinance all of our 2015 and a portion of our 2016 debt

maturities. During the fourth quarter, we rate-locked two 15-year loans, totaling \$46 million, with a weighted average interest rate of 3.79%. Subsequent to these loan closings, the weighted average interest rate of our debt will be 5.3%, with no fixed rate debt maturities scheduled prior to early 2018. Our Park Van Ness construction-to-permanent loan has begun funding, with substantially all of our cash equity requirement invested in the development as of March 1, 2015.

Also during 2014, we extended the maturity of our revolving line of credit to June 2018 and reduced line interest costs by 0.20% while increasing the total available borrowings from \$175 to \$275 million. Our interest expense coverage grew to 3.14 times, as of December 31, 2014, and our leverage was a comfortable 34.2% debt to total capitalization. Our prudent corporate leverage and a total of \$232 million of undrawn credit line availability as of March 1, 2015 combine to provide financial capacity available to fund our proposed future development activities.

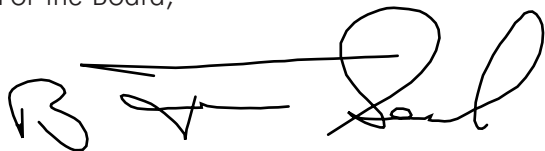
We continue to focus on long term cash flow appreciation and value creation through selective development and redevelopment with a geographic focus in the Washington, D.C. metropolitan area and the



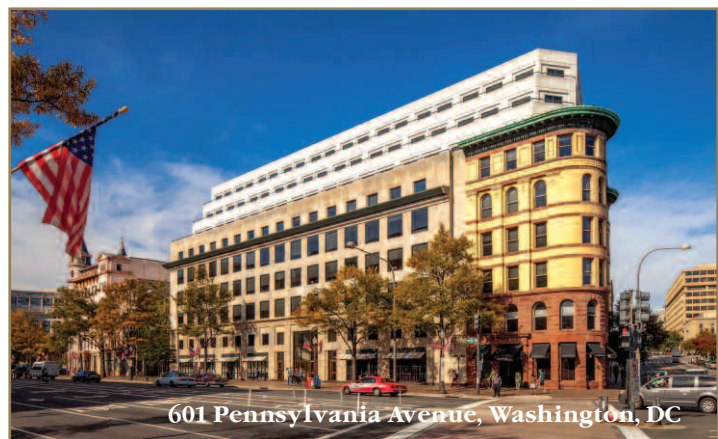
*We take pride in our 20-year success, derived from a well located in-fill portfolio of real estate assets and, more importantly, from our talented and driven team of professionals, who develop, lease and manage our properties.*

Southeastern U.S. This consistent strategy, continuing since our August 1993 initial public offering, has produced a 12.1% compounded annual return to our shareholders (including dividends) through December 31, 2014. Our Board recently approved a 7.5% increase in our quarterly common stock dividend to \$0.43 per share. On an annualized basis, this dividend rate reflects a conservative 61% payout of 2014 FFO. During this 20-year period, we have also reduced leverage to 34% from 50%, as measured by debt to total capitalization, providing adequate funding capacity to continue our growth during the coming years. We take pride in our 20-year success, derived from a well located in-fill portfolio of real estate assets and, more importantly, from our talented and driven team of professionals, who develop, lease and manage our properties.

For the Board,



B. Francis Saul II  
March 16, 2015





As of December 31, 2014, 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 75% of the portfolio's gross leasable area.

## PORTFOLIO PROPERTIES

PROPERTY/LOCATION	GROSS LEASABLE SQUARE FEET	PROPERTY/LOCATION	GROSS LEASABLE SQUARE FEET
<b>Shopping Centers</b>			
Ashburn Village, Ashburn, VA	221,273	Olde Forte Village, Ft. Washington, MD	143,577
Ashland Square Phase I, Dumfries, VA	23,120	Olney, Olney, MD	53,765
Beacon Center, Alexandria, VA	358,071	Orchard Park, Dunwoody, GA	87,885
BJ's Wholesale Club, Alexandria, VA	115,660	Palm Springs Center, Altamonte Springs, FL	126,446
Boca Valley Plaza, Boca Raton, FL	121,269	Ravenwood, Baltimore, MD	93,328
Boulevard, Fairfax, VA	49,140	11503 Rockville Pk / 5541 Nicholson Ln, Rockville, MD	40,249
Briggs Chaney MarketPlace, Silver Spring, MD	194,347	1500/1580/1582/1584 Rockville Pike, Rockville, MD	110,128
Broadlands Village, Ashburn, VA	159,734	Seabreeze Plaza, Palm Harbor, FL	146,673
Countryside Marketplace, Sterling, VA	137,662	Marketplace at Sea Colony, Bethany Beach, DE	21,677
Cranberry Square, Westminster, MD	141,450	Seven Corners, Falls Church, VA	574,831
Cruse MarketPlace, Cumming, GA	78,686	Severna Park Marketplace, Severna Park, MD	254,174
Flagship Center, Rockville, MD	21,500	Shops at Fairfax, Fairfax, VA	68,762
French Market, Oklahoma City, OK	244,718	Smallwood Village Center, Waldorf, MD	174,749
Germantown, Germantown, MD	27,241	Southdale, Glen Burnie, MD	484,035
730/750 N. Glebe Rd., Arlington, VA	18,874	Southside Plaza, Richmond, VA	371,761
The Glen, Woodbridge, VA	136,440	South Dekalb Plaza, Atlanta, GA	163,418
Great Eastern, District Heights, MD	255,398	Thruway, Winston-Salem, NC	362,056
Great Falls Center, Great Falls, VA	91,666	Village Center, Centreville, VA	146,032
Hampshire Langley, Takoma Park, MD	131,700	Westview Village, Frederick, MD	97,145
Hunt Club Corners, Apopka, FL	101,522	White Oak, Silver Spring, MD	480,676
Jamestown Place, Altamonte Springs, FL	96,341	<b>TOTAL SHOPPING CENTERS</b>	<b>7,886,304</b>
Kentlands Square I, Gaithersburg, MD	114,381	<b>Mixed-Use Properties</b>	
Kentlands Square II, Gaithersburg, MD	247,783	Avenel Business Park, Gaithersburg, MD	390,683
Kentlands Place, Gaithersburg, MD	40,648	Clarendon Center – North, Arlington, VA	108,387
Lansdowne Town Center, Leesburg, VA	189,422	Clarendon Center – South, Arlington, VA	293,565
Leesburg Pike Plaza, Baileys Crossroads, VA	97,752	(includes 244 apartments comprising 188,671 square feet)	
Lumberton Plaza, Lumberton, NJ	192,718	Crosstown Business Center, Tulsa, OK	197,127
Metro Pike Center, Rockville, MD	67,488	601 Pennsylvania Ave., Washington, DC	227,021
Shops at Monocacy, Frederick, MD	109,144	Washington Square, Alexandria, VA	236,376
Northrock, Warrenton, VA	99,789	<b>TOTAL MIXED-USE PROPERTIES</b>	<b>1,453,159</b>
		<b>TOTAL PORTFOLIO</b>	<b>9,339,463</b>

Selected Financial Data .....	Page 10
Management’s Discussion and Analysis of Financial Condition and Results of Operations .....	Pages 11-29
Quantitative and Qualitative Disclosures About Market Risk .....	Page 29
Management’s Report on Internal Control Over Financial Reporting .....	Page 29
Report of Independent Registered Public Accounting Firm .....	Page 30
Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting .....	Page 31
Consolidated Balance Sheets .....	Page 32
Consolidated Statements of Operations .....	Page 33
Consolidated Statements of Comprehensive Income .....	Page 34
Consolidated Statements of Stockholders’ Equity .....	Page 35
Consolidated Statements of Cash Flows .....	Page 36
Notes to Consolidated Financial Statements .....	Pages 37-58

# SELECTED FINANCIAL DATA

	Years Ended December 31,				
	2014	2013	2012	2011	2010
<i>(In thousands, except per share data)</i>					
<b>Operating Data:</b>					
Total revenue	\$ 207,092	\$ 197,897	\$ 190,092	\$ 173,878	\$ 163,108
Total operating expenses	155,163	162,628	154,996	142,442	120,300
Operating income	51,929	35,269	35,096	31,436	42,808
Non-operating income:					
Change in fair value of derivatives	(10)	(7)	36	(1,332)	—
Loss on early extinguishment of debt	—	(497)	—	—	(5,405)
Gain on sale of property	6,069	—	—	—	—
Gain on casualty settlements	—	77	219	245	2,475
Income from continuing operations	57,988	34,842	35,351	30,349	39,878
Discontinued operations	—	—	4,429	(55)	3,307
Net income	57,988	34,842	39,780	30,294	43,185
Income attributable to the noncontrolling interest	(11,045)	(3,970)	(6,406)	(3,561)	(6,422)
Net income attributable to Saul Centers, Inc.	46,943	30,872	33,374	26,733	36,763
Preferred stock redemption	(1,480)	(5,228)	—	—	—
Preferred dividends	(13,361)	(13,983)	(15,140)	(15,140)	(15,140)
Net income available to common stockholders	\$ 32,102	\$ 11,661	\$ 18,234	\$ 11,593	\$ 21,623
<b>Per Share Data (diluted):</b>					
Net income available to common stockholders:					
Continuing operations	\$ 1.54	\$ 0.57	\$ 0.70	\$ 0.61	\$ 1.00
Discontinued operations	—	—	0.23	—	0.18
Total	\$ 1.54	\$ 0.57	\$ 0.93	\$ 0.61	\$ 1.18
Basic and diluted shares outstanding:					
Weighted average common shares - basic	20,772	20,364	19,649	18,889	18,267
Effect of dilutive options	49	37	51	60	110
Weighted average common shares - diluted	20,821	20,401	19,700	18,949	18,377
Weighted average convertible limited partnership units	7,156	6,929	6,914	5,791	5,416
Weighted average common shares and fully converted limited partnership units - diluted	27,977	27,330	26,614	24,740	23,793
<b>Dividends Paid:</b>					
Cash dividends to common stockholders <sup>(1)</sup>	\$ 32,346	\$ 29,205	28,135	\$ 27,062	\$ 26,186
Cash dividends per share	\$ 1.56	\$ 1.44	\$ 1.44	\$ 1.44	\$ 1.44
<b>Balance Sheet Data:</b>					
Real estate investments (net of accumulated depreciation)	\$ 1,163,542	\$ 1,094,776	\$ 1,112,763	\$ 1,091,448	\$ 927,250
Total assets	1,266,987	1,198,675	1,207,309	1,192,569	1,013,888
Total debt, including accrued interest	860,601	823,328	831,121	835,459	713,997
Preferred stock	180,000	180,000	179,328	179,328	179,328
Total stockholders' equity	339,257	315,126	307,289	293,206	239,813
<b>Other Data:</b>					
Cash flow provided by (used in):					
Operating activities	\$ 86,568	\$ 73,527	\$ 78,423	\$ 55,669	\$ 62,887
Investing activities	\$ (83,589)	\$ (26,034)	\$ (46,873)	\$ (201,500)	\$ (98,239)
Financing activities	\$ (8,148)	\$ (42,329)	\$ (31,740)	\$ 145,186	\$ 27,713
Funds from operations <sup>(2)</sup> :					
Net income	\$ 57,988	\$ 34,842	\$ 39,780	\$ 30,294	\$ 43,185
Real property depreciation and amortization	41,203	49,130	40,112	35,298	28,379
Real property depreciation - discontinued operations	—	—	77	102	198
Gain on property dispositions and casualty settlements	(6,069)	(77)	(4,729)	(245)	(6,066)
Funds from operations	93,122	83,895	75,240	65,449	65,696
Preferred stock redemption	(1,480)	(5,228)	—	—	—
Preferred dividends	(13,361)	(13,983)	(15,140)	(15,140)	(15,140)
Funds from operations available to common shareholders	\$ 78,281	\$ 64,684	\$ 60,100	\$ 50,309	\$ 50,556

(1) During 2014, 2013, 2012, 2011, and 2010, shareholders reinvested \$9.3 million, \$20.7 million, \$23.1 million, \$19.8 million and \$16.7 million, respectively, in newly issued common stock through the Company's dividend reinvestment plan.

(2) Funds from operations (FFO) is a non-GAAP financial measure and is defined in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations-Funds From Operations."

# 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 25, 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 should be read in conjunction with the other sections of this Annual Report on Form 10-K, including the consolidated financial statements and notes thereto beginning on page 32. Historical results set forth in Selected Financial Information and the Consolidated Financial Statements 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 Center 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 below-market-rent leases 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 acquisitions, redevelopments and renovations.

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. In 2014, in separate transactions, the Company purchased three adjacent properties, with approximately 57,400 square feet of retail space, for an aggregate \$25.2 million. Combined, the four properties total 10.3 acres and are zoned for up to 1.2 million square feet of rentable mixed-use space. The Company is actively engaged in a plan for redevelopment but has not committed to any timetable for commencement of construction.

Also in 2012, the Company purchased, for \$12.2 million, including acquisition costs, approximately 20,100 square feet of retail space located on the east side of Rockville Pike near the White Flint Metro station 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. When combining these two properties with our Metro Pike shopping center on the west side of Rockville Pike, the Company's holdings at White Flint total 7.6 acres which are zoned for a development potential of up to 1.5 million square feet of mixed-use space. The Company is actively engaged in a plan for redevelopment but has not committed to any timetable for commencement of construction.

During 2013, the Company completed negotiation of lease termination agreements with the tenants of Van Ness Square. Costs incurred related to those termination arrangements were 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 \$3.3 million in 2013. The Company is in the process of developing a primarily residential project with street-level retail. In connection with the demolition of the existing structure, approximately \$580,000 and \$503,000 of predevelopment expenses were recognized in 2013 and 2014, respectively.

In 2014, in separate transactions, the Company purchased two adjacent properties, with approximately 18,900 square feet of retail space, on North Glebe Road in Arlington, Virginia, for an aggregate \$42.8 million. Combined, the properties total 2.3 acres and are zoned for up to 450,000 square feet of rentable mixed-use space. The Company is actively engaged in a plan for redevelopment but has not committed to any timetable for commencement of construction.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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 positioned 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.

During the most recent downturn in the national real estate market, which began in 2008, 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, were initially less severe than in many other areas of the country. Even though economic conditions in the local economies, where the majority of the Company's properties are located, have improved over recent years, issues facing the Federal government relating to spending cuts and budget policies have resulted in continued elevated vacancy rates in many sub-markets, thus pressuring rental rate growth. While overall consumer confidence appears to have improved, retailers continue to be cautious about new store openings. 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, continues to improve and increased to 94.4% at December 31, 2014, from 93.9% at December 31, 2013.

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, 2014, amortizing fixed-rate mortgage debt with staggered maturities from 2015 to 2034 represented approximately 91.5% of the Company's notes payable, thus minimizing refinancing risk. The Company has one fixed-rate debt maturity scheduled for 2015 and which was refinanced on March 3, 2015. The Company's variable-rate debt consists of a \$14.5 million bank term loan secured by the Northrock shopping center, a \$15.1 million bank term loan secured by the Metro Pike Center and \$43.0 million outstanding under the unsecured revolving line of credit. As of December 31, 2014, the Company has loan availability of approximately \$231.6 million under its \$275.0 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 accreted

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

as additional lease revenue over the remaining contractual lease period. If the fair value of the below market lease intangible includes fair value associated with a renewal option, such amounts are not accreted until the renewal option is exercised. If the renewal option is not exercised the value is recognized at that time. 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.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### ALLOWANCE FOR DOUBTFUL ACCOUNTS – CURRENT AND DEFERRED RECEIVABLES

Accounts receivable primarily represent amounts accrued and unpaid from tenants in accordance with the terms of the respective leases, subject to the Company's revenue recognition policy. Receivables are reviewed monthly and reserves are established with a charge to current period operations when, in the opinion of management, collection of the receivable is doubtful. In addition to rents due currently, accounts receivable include amounts representing minimum rental income accrued on a straight-line basis to be paid by tenants over the remaining term of their respective leases. Reserves are established with a charge to income for tenants whose rent payment history or financial condition casts doubt upon the tenant's ability to perform under its lease obligations.

### LEGAL CONTINGENCIES

The Company is subject to various legal proceedings and claims that arise in the ordinary course of business, 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 same property operating income are non-GAAP financial measures of performance and improve the comparability of these measures by excluding the results of properties which were not in operation for the entirety of the comparable reporting periods.

We define same property revenue as total revenue minus the sum of interest income and revenue of properties not in operation for the entirety of the comparable reporting periods, and we define same property operating income as net income plus the sum of interest expense and amortization of deferred debt costs, depreciation and amortization, general and administrative expense, loss on the early extinguishment of debt (if any), predevelopment expense and acquisition related costs, minus the sum of interest income, the change in the fair value of derivatives, gains on property dispositions (if any) and the results of properties which were not in operation for the entirety of the comparable periods.

Other REITs may use different methodologies for calculating same property revenue and same property operating income. Accordingly, our same property revenue and same property operating income may not be comparable to those of other REITs.

Same property revenue and same property operating income are used by management to evaluate and compare the operating performance of our properties, and to determine trends in earnings, because these measures are not affected by the cost of our funding, the impact of depreciation and amortization expenses, gains or losses from the acquisition and sale of operating real estate assets, general and administrative expenses or other gains and losses that relate to ownership of our properties. We believe the exclusion of these items from revenue and operating income is useful because the resulting measures capture the actual revenue generated and actual expenses incurred by operating our properties.

Same property revenue and same property operating income are measures of the operating performance of our properties but do not measure our performance as a whole. Such measures are therefore not substitutes for total revenue, net income or operating income as computed in accordance with GAAP.

The tables below provide reconciliations of total revenue and operating income under GAAP to same property revenue and operating income for the indicated periods. The same property results include 49 Shopping Centers and six Mixed-Use properties for each period.

#### SAME PROPERTY REVENUE

(In thousands)	Year ended December 31,	
	2014	2013
Total revenue	\$ 207,092	\$ 197,897
Less: Interest income	(75)	(69)
Less: Acquisitions, dispositions and development properties	(2,103)	(1,223)
Total same property revenue	\$ 204,914	\$ 196,605
Shopping centers	\$ 152,282	\$ 144,502
Mixed-Use properties	52,632	52,103
Total same property revenue	\$ 204,914	\$ 196,605

The \$8.3 million increase in same property revenue for 2014 compared to 2013 was primarily due to (a) a \$0.31 per square foot increase in base rent (\$2.6 million) and (b) a 123,218 square foot increase in leased space (\$2.2 million), (c) a bankruptcy settlement and collection related to a former tenant at Seven Corners (\$1.6 million), (d) increased expense recovery income (\$1.1 million) and (e) the impact of a lease termination at Seven Corners (\$0.7 million).



# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### SAME PROPERTY OPERATING INCOME

(In thousands)	Year Ended December 31,	
	2014	2013
Net income	\$ 57,988	\$ 34,842
Add: Interest expense and amortization of deferred debt costs	46,034	46,589
Add: General and administrative	16,961	14,951
Add: Depreciation and amortization of deferred leasing costs	41,203	49,130
Add: Predevelopment expenses	503	3,910
Add: Acquisition related costs	949	106
Add: Change in fair value of derivatives	10	7
Add: Loss on early extinguishment of debt	—	497
Less: Gains on property dispositions	(6,069)	(77)
Less: Interest income	(75)	(69)
Property operating income	157,504	149,886
Less: Acquisitions, dispositions & development property	(1,787)	(719)
Total same property operating income	\$ 155,717	\$ 149,167
Shopping centers	\$ 118,817	\$ 112,708
Mixed-Use properties	36,900	36,459
Total same property operating income	\$ 155,717	\$ 149,167

Same property operating income increased \$6.5 million for 2014 compared to 2013 due primarily to (a) a \$0.31 per square foot increase in base rent (\$2.6 million) and (b) a 123,218 square foot increase in leased space (\$2.2 million), (c) a bankruptcy settlement and collection related to a former tenant at Seven Corners (\$1.6 million), (d) increased expense

recovery income (\$1.1 million) and (e) the impact of a lease termination at Seven Corners (\$0.7 million) partially offset by (f) higher property operating expenses (\$2.2 million).

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

### REVENUE

(Dollars in thousands)	Year ended December 31,			Percentage Change	
	2014	2013	2012	2014 from 2013	2013 from 2012
Base rent	\$ 164,599	\$ 159,898	\$ 152,777	2.9 %	4.7%
Expense recoveries	32,132	30,949	30,391	3.8 %	1.8%
Percentage rent	1,492	1,575	1,545	(5.3)%	1.9%
Other	8,869	5,475	5,379	62.0 %	1.8%
Total revenue	\$ 207,092	\$ 197,897	\$ 190,092	4.6 %	4.1%

Base rent includes \$2.0 million, \$3.0 million, and \$3.8 million, for the years 2014, 2013, and 2012, respectively, to recognize base rent on a straight-line basis. In addition, base rent includes \$1.9 million, \$1.7 million, and \$1.5 million, for the years 2014, 2013, and 2012, respectively, to recognize income from the amortization of in-place leases.

Total revenue increased 4.6% in 2014 compared to 2013 primarily due to (a) a \$0.43 per square foot increase in base rent (\$3.7 million), (b) a 107,062 square foot increase in leased

space (\$1.9 million), (c) higher expense recoveries (\$1.2 million), (d) a bankruptcy settlement and collection related to a former tenant at Seven Corners (\$1.6 million) and (e) the impact of a lease termination at Seven Corners (\$0.7 million). Total revenue increased 4.1% in 2013 compared to 2012 primarily due to \$7.1 million of higher base rent (a) generated by properties acquired or developed in 2012 (the "New 2012 Properties") (\$2.3 million), (b) increases throughout the portfolio (\$6.6 million) partially offset by (c) Van Ness Square (\$2.0 million). A discussion of the components of revenue follows.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### BASE RENT

The \$4.7 million increase in base rent in 2014 compared to 2013 was attributable to (a) a \$0.30 per square foot increase in base rent (\$2.6 million) and (b) a 107,062 square foot increase in leased space (\$1.9 million). The \$7.1 million increase in base rent in 2013 compared to 2012 was attributable to (a) the New 2012 Properties (\$2.3 million) and (b) increases throughout the portfolio (\$6.6 million) partially offset by (c) Van Ness Square (\$2.0 million).

### EXPENSE RECOVERIES

Expense recovery income increased \$1.2 million in 2014 compared to 2013 primarily due to higher snow removal costs incurred in early 2014. Expense recovery income increased \$0.6 million in 2013 compared to 2012.

### OTHER REVENUE

Other revenue increased \$3.4 million in 2014 compared to 2013 due primarily to (a) a bankruptcy settlement and collection related to a former tenant at Seven Corners (\$1.6 million) and (b) a lease termination fee at Seven Corners (\$1.9 million). Other revenue increased \$0.1 million in 2013 compared to 2012.

## OPERATING EXPENSES

(Dollars in thousands)	Year ended December 31,			Percentage Change	
	2014	2013	2012	2014 from 2013	2013 from 2012
Property operating expenses	\$ 26,479	\$ 24,559	\$ 23,794	7.8 %	3.2 %
Provision for credit losses	680	968	1,151	(29.8)%	(15.9)%
Real estate taxes	22,354	22,415	22,325	(0.3)%	0.4 %
Interest expense and amortization of deferred debt costs	46,034	46,589	49,544	(1.2)%	(6.0)%
Depreciation and amortization of deferred leasing costs	41,203	49,130	40,112	(16.1)%	22.5 %
General and administrative	16,961	14,951	14,274	13.4 %	4.7 %
Acquisition related costs	949	106	1,129	795.3 %	(90.6)%
Predevelopment expenses	503	3,910	2,667	(87.1)%	46.6 %
Total operating expenses	\$ 155,163	\$ 162,628	\$ 154,996	(4.6)%	4.9 %

Total operating expenses decreased 4.6% in 2014 compared to 2013 primarily due to \$8.0 million of additional depreciation expense recorded in 2013 and \$3.4 million of lower predevelopment expenses related to Park Van Ness partially offset by \$1.9 million of higher property operating expenses caused by snow removal costs in early 2014. Total operating expenses increased 4.9% in 2013 compared to 2012 primarily due to \$8.0 million of additional depreciation expense and \$1.2 million of higher predevelopment expenses related to the redevelopment of Park Van Ness.

### PROPERTY OPERATING EXPENSES

Property operating expenses increased \$1.9 million in 2014 compared to 2013 primarily due to a \$1.5 million increase in snow removal costs. Property operating expenses increased \$765,000 in 2013 compared to 2012.

### 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 \$288,000 decrease in 2014 compared to 2013 as well as the \$183,000 decrease in 2013 compared to 2012 reflect a general improvement in the retail economy and lack of significant bankruptcy losses among the Company's various tenants.

### REAL ESTATE TAXES

Real estate taxes decreased \$61,000 in 2014 compared to 2013. Real estate taxes increased \$90,000 in 2013 compared to 2012.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### INTEREST AND AMORTIZATION OF DEFERRED DEBT COSTS

Interest expense decreased \$0.6 million in 2014 compared to 2013 primarily due to a \$0.5 million increase in the amount of interest capitalized. Interest expense decreased \$3.0 million in 2013 compared to 2012 primarily due to a 30 basis point decrease in the average cost of debt to 5.54% from 5.84%.

### DEPRECIATION AND AMORTIZATION

Depreciation and amortization of deferred leasing costs decreased by \$7.9 million in 2014 compared to 2013 and increased \$9.0 million in 2013 compared to 2012 primarily due to \$8.0 million of additional depreciation expense in 2013 on the building at the former Van Ness Square as a result of the reduction of its useful life to four months effective January 1, 2013.

### GENERAL AND ADMINISTRATIVE

General and administrative costs increased \$2.0 million in 2014 compared to 2013 primarily due to \$1.1 million of accrued severance costs. General and administrative costs increased in 2013 compared to 2012 primarily due to (a) increased consulting expense (\$495,000) and (b) increased stock option expense (\$245,000).

### ACQUISITION RELATED COSTS

Acquisition related costs in 2014 totaling approximately \$0.9 million relate to the purchases of 1580, 1582 and 1584 Rockville Pike and 730 and 750 N. Glebe Road. Acquisition related costs in 2013 totaling approximately \$0.1 million relate to the purchase of a retail pad with a 7,100 square foot restaurant located in Gaithersburg, Maryland which is contiguous with and an expansion of the Company's other Kentlands assets. Acquisition related costs in 2012 totaling approximately \$1.1 million relate to the December 2012 purchases of 1500 Rockville Pike and 5541 Nicholson Lane.

### PREDEVELOPMENT EXPENSES

Predevelopment expenses in 2014, 2013 and 2012 represent costs, primarily lease termination and demolition costs, incurred with the repositioning and redevelopment of Van Ness Square.

### GAIN ON CASUALTY SETTLEMENT

Gain on casualty settlement in 2013 and 2012 reflect insurance proceeds received in excess of the carrying value of assets damaged during a hail storm at French Market in 2012. The insurance proceeds funded substantially all of the restoration of the damaged property.

### LOSS ON EARLY EXTINGUISHMENT OF DEBT

On September 4, 2013, the Company closed on a 15-year, non-recourse \$18.0 million mortgage loan secured by Seabreeze Plaza. The loan matures in 2028, bears interest at a fixed rate of 3.99%, requires monthly principal and interest

payments totaling \$94,900 based on a 25-year amortization schedule and requires a final payment of \$9.5 million at maturity. Proceeds were used to pay off the \$13.5 million remaining balance of existing debt secured by Seabreeze Plaza which was scheduled to mature in May 2014 and the Company incurred \$497,000 of related debt extinguishment costs.

### GAIN ON SALES OF PROPERTIES

Gain on sale of property in 2014 resulted from the April 2014 sale of Giant Center shopping center. 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.

### IMPACT OF INFLATION

Inflation has remained relatively low during 2014 and 2013. 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 \$17.3 million at December 31, 2014 and 2013, respectively. The changes in cash and cash equivalents during the years ended December 31, 2014 and 2013 were attributable to operating, investing and financing activities, as described below.

<i>(In thousands)</i>	Year Ended December 31,	
	2014	2013
Net cash provided by operating activities	\$ 86,568	\$ 73,527
Net cash used in investing activities	(83,589)	(26,034)
Net cash used in financing activities	(8,148)	(42,329)
Increase (decrease) in cash and cash equivalents	\$ (5,169)	\$ 5,164

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### OPERATING ACTIVITIES

Net cash provided by operating activities increased \$13.0 million to \$86.6 million for the year ended December 31, 2014 compared to \$73.5 million for the year ended December 31, 2013. 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 increased \$57.6 million to \$83.6 million for the year ended December 31, 2014 from \$26.0 million for the year ended December 31, 2013. Investing activities in 2014 primarily reflect tenant improvements and capital expenditures (\$15.0 million), the Company's development activities (\$17.8 million) and the acquisition of various retail real estate assets (\$57.5 million). Net cash used in investing activities decreased \$20.8 million to \$26.0 million for the year ended December 31, 2013 from \$46.9 million for the year ended December 31, 2012. Investing activities in 2013 primarily reflect (a) tenant improvements and capital expenditures (\$14.0 million), (b) the Company's development activities (\$7.3 million) and (c) the acquisition of various retail real estate assets (\$5.1 million).

### FINANCING ACTIVITIES

Net cash used in financing activities was \$8.1 million and \$42.3 million for the years ended December 31, 2014 and 2013, respectively. Net cash used in financing activities in 2014 primarily reflects:

- preferred stock redemption payments totaling \$40.0 million;
- the repayment of mortgage notes payable totaling \$22.1 million;
- the repayment of amounts borrowed under the revolving credit facility totaling \$47.0 million;
- distributions to common stockholders totaling \$32.3 million;
- distributions to holders of convertible limited partnership units in the Operating Partnership totaling \$11.1 million;
- distributions made to preferred stockholders totaling \$13.5 million; and
- payments of \$1.3 million for financing costs of mortgage notes payable

which was partially offset by:

- proceeds of \$39.3 million received from the sale of Series C preferred stock;
- proceeds of \$90.0 million received from revolving credit facility draws;
- proceeds of \$8.9 million from the issuance of limited partnership units in the Operating Partnership under the dividend reinvestment program;

- proceeds of \$15.6 million from the issuance of common stock under the dividend reinvestment program, directors deferred plan and the exercise of stock options; and
- proceeds of \$5.4 million received from construction loan draws.

Net cash used in financing activities for the year ended December 31, 2013 primarily reflects:

- repayments of \$180.0 million on the revolving credit facility;
- preferred stock redemption payments totaling \$139.3 million;
- the repayment of mortgage notes payable totaling \$71.3 million;
- distributions to common stockholders totaling \$29.2 million;
- distributions to holders limited partnership units in the Operating Partnership totaling \$10.0 million
- distributions to preferred stockholders totaling \$14.6 million; and
- payments of \$3.2 million for financing costs of new mortgage loans;

which was partially offset by:

- proceeds of \$135.2 million received from the sale of Series C preferred stock;
- proceeds received from mortgage notes payable totaling \$101.6 million;
- proceeds of \$142.0 million from revolving credit facility;
- proceeds of \$4.1 million from the issuance of limited partnership units in the Operating Partnership under the dividend reinvestment program; and
- proceeds of \$22.3 million received from the issuance of common stock under the dividend reinvestment program and from the exercise of stock options.

### 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.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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. The Company is developing Park Van Ness, a primarily residential project with street-level retail. The total cost of the project, excluding predevelopment expense and land costs, is expected to be approximately \$93.0 million, a portion of which will be funded with a \$71.6 million construction-to-permanent loan and the remainder will be funded with the Company's working capital, including its existing line of credit. The Company may also redevelop certain of the Current Portfolio Properties and may develop additional freestanding out-parcels or 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, 2014, the Company had unfunded contractual payment obligations of approximately \$130.3 million, excluding operating obligations, due within the next 12 months. The table below shows the total contractual payment obligations as of December 31, 2014.

(Dollars in thousands)	CONTRACTUAL PAYMENT OBLIGATIONS					Total
	One Year or Less	2 - 3 Years	Payments Due By Period			
			4 - 5 Years	After 5 Years		
Notes Payable:						
Interest	\$ 42,950	\$ 80,005	\$ 69,034	\$ 135,069	\$ 327,058	
Scheduled Principal	23,192	48,175	48,311	135,752	255,430	
Balloon Payments	14,885	28,879	131,542	426,652	601,958	
Subtotal	81,027	157,059	248,887	697,473	1,184,446	
Ground Leases (1)	176	352	353	9,186	10,067	
Corporate Headquarters Lease (1)	894	1,839	—	—	2,733	
Development Obligations	38,949	9,738	—	—	48,687	
Tenant Improvements	9,270	1,744	277	—	11,291	
Total Contractual Obligations	\$ 130,316	\$ 170,732	\$ 249,517	\$ 706,659	\$ 1,257,224	

(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, 2014, included cash balances of \$12.1 million and borrowing avail-

ability of approximately \$231.6 million on its revolving line of credit, will be sufficient to meet its contractual obligations for the foreseeable future.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### PREFERRED STOCK ISSUES

In March 2013, the Company redeemed 60% of its then-outstanding 8% Series A Cumulative Redeemable Preferred Stock (the "Series A Stock") and all of its 9% Series B Cumulative Redeemable Preferred Stock. In December 2014, the Company redeemed the remaining outstanding Series A Stock.

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 (the "Series C Stock"), providing net cash proceeds of approximately \$135.2 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 was paid on April 15, 2013 and covered the period from February 12, 2013 through March 31, 2013. The Series C 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.

In November 2014, the Company sold, in an underwritten public offering, 1.6 million depositary shares of the Series C Stock (the "Additional Series C Stock"). The Company received proceeds of approximately \$39.3 million from the offering and used the proceeds to redeem its outstanding Series A Stock. The Additional Series C Stock represents a new issuance of additional depositary shares representing shares of Series C Stock.

### 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 190,177 and

468,014 shares under the Plan at a weighted average discounted price of \$46.85 and \$43.52 per share during the years ended December 31, 2014 and 2013, respectively. The Company issued 196,183 and 88,309 limited partnership units under the Plan at a weighted average price of \$45.25 and \$46.93 per unit during the year ended December 31, 2014 and 2013, respectively. The Company also credited 7,461 and 7,148 shares to directors pursuant to the reinvestment of dividends specified by the Directors' Deferred Compensation Plan at a weighted average discounted price of \$47.08 and \$43.92 per share, during the years ended December 31, 2014 and 2013, 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, 2014.

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.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a summary of notes payable as of December 31, 2014 and 2013:

(Dollars in thousands)	NOTES PAYABLE		Interest Rate*	Scheduled Maturity*
	Year Ended December 31,			
	2014	2013		
Fixed rate mortgages:	\$ 15,399 (a)	\$ 16,128	7.45%	Jun-2015
	32,049 (b)	33,246	6.01%	Feb-2018
	35,398 (c)	36,937	5.88%	Jan-2019
	11,454 (d)	11,949	5.76%	May-2019
	15,819 (e)	16,501	5.62%	Jul-2019
	15,761 (f)	16,419	5.79%	Sep-2019
	14,014 (g)	14,610	5.22%	Jan-2020
	10,881 (h)	11,159	5.60%	May-2020
	9,535 (i)	9,921	5.30%	Jun-2020
	41,441 (j)	42,462	5.83%	Jul-2020
	8,346 (k)	8,649	5.81%	Feb-2021
	6,100 (l)	6,233	6.01%	Aug-2021
	35,222 (m)	35,981	5.62%	Jun-2022
	10,718 (n)	10,930	6.08%	Sep-2022
	11,587 (o)	11,795	6.43%	Apr-2023
	14,909 (p)	15,598	6.28%	Feb-2024
	16,750 (q)	17,123	7.35%	Jun-2024
	14,535 (r)	14,849	7.60%	Jun-2024
	25,639 (s)	26,153	7.02%	Jul-2024
	30,429 (t)	31,093	7.45%	Jul-2024
	30,253 (u)	30,894	7.30%	Jan-2025
	15,735 (v)	16,087	6.18%	Jan-2026
	115,291 (w)	118,128	5.31%	Apr-2026
	35,125 (x)	36,075	4.30%	Oct-2026
	39,932 (y)	40,974	4.53%	Nov-2026
	18,645 (z)	19,118	4.70%	Dec-2026
	69,397 (aa)	70,856	5.84%	May-2027
	17,281 (bb)	17,718	4.04%	Apr-2028
	33,140 (cc)	34,391	3.51%	Jun-2028
	17,462 (dd)	17,895	3.99%	Sep-2028
	5,391 (ee)	—	4.88%	Sep-2032
	11,119 (ff)	—	8.00%	Apr-2034
Total fixed rate	784,757	789,872	5.70%	9.3 Years
Variable rate loans:				
	43,000 (gg)	—	LIBOR + 1.45%	Jun-2018
	14,525 (hh)	14,802	LIBOR + 1.65%	Feb-2016
	15,106 (ii)	15,394	LIBOR + 1.65%	Feb-2016
Total variable rate	72,631	30,196	LIBOR + 1.53%	2.5 Years
Total notes payable	\$ 857,388	\$ 820,068	5.36%	8.7 Years

\* Interest rate and scheduled maturity data presented as of December 31, 2014. Totals computed using weighted averages.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

- (a) 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 \$729,000 was amortized during 2014.
- (b) 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 \$1.2 million was amortized during 2014.
- (c) 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 \$1.5 million was amortized during 2014.
- (d) 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 \$495,000 was amortized during 2014.
- (e) 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 \$682,000 was amortized during 2014.
- (f) 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 \$658,000 was amortized during 2014.
- (g) 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 \$596,000 was amortized during 2014.
- (h) 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 \$278,000 was amortized during 2014.
- (i) 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 \$386,000 was amortized during 2014.
- (j) 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 \$1,021,000 was amortized during 2014.
- (k) 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 \$303,000 was amortized during 2014.
- (l) 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 \$133,000 was amortized during 2014.
- (m) 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 \$759,000 was amortized during 2014.
- (n) 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 \$212,000 was amortized during 2014.
- (o) 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 \$208,000 was amortized during 2014.
- (p) 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 \$689,000 was amortized during 2014.
- (q) 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 \$373,000 was amortized during 2014.
- (r) 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 \$314,000 was amortized during 2014.
- (s) 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 \$514,000 was amortized during 2014.
- (t) 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 \$664,000 was amortized during 2014.
- (u) 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 \$641,000 was amortized during 2014.
- (v) 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 \$352,000 was amortized during 2014.
- (w) 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 \$2.8 million was amortized during 2014.
- (x) 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 \$950,000 was amortized during 2014.
- (y) 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 \$1,042,000 was amortized during 2014.
- (z) 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 \$473,000 was amortized during 2014.
- (aa) 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 \$1.5 million was amortized during 2014.
- (bb) The loan is collateralized by Hampshire Langley and requires equal monthly principal and interest payments of \$95,400 based upon a 25 - year amortization schedule and a final payment of \$9.5 million at loan maturity. Principal of \$437,000 was amortized in 2014.
- (cc) The loan is collateralized by Beacon Center and requires equal monthly principal and interest payments of \$203,200 based upon a 20-year amortization schedule and a final payment of \$11.4 million at loan maturity. Principal of \$1,251,000 was amortized in 2014.
- (dd) The loan is collateralized by Seabreeze Plaza and requires equal monthly principal and interest payments of \$94,900 based upon a 25-year amortization schedule and a final payment of \$9.5 million at loan maturity. Principal of \$433,000 was amortized in 2014.



# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

- (ee) The loan is a \$71.6 million construction-to-permanent facility that is collateralized by and will finance a portion of the construction costs of Park Van Ness. During the construction period, interest will be funded by the loan. After conversion to a permanent loan, monthly principal and interest payments totaling \$413,500 will be required based upon a 25-year amortization schedule. A final payment of \$39.6 million will be due at maturity.
- (ff) The Company entered into a sale-leaseback transaction with its Olney property and is accounting for that transaction as a secured financing. The arrangement requires monthly payments of \$60,400 which increase by 1.5% on May 1, 2015, and every May 1 thereafter. The arrangement provides for a final payment of \$14.7 million and has an implicit interest rate of 8.0%. Negative amortization in 2014 totaled \$119,000.
- (gg) The loan is a \$275.0 million unsecured revolving credit facility. Interest accrues at a rate equal to the sum of one-month LIBOR plus a spread of 145 basis points. The line may be extended at the Company's option for one year with payment of a fee of 0.15%. Monthly payments, if required, are interest only and vary depending upon the amount outstanding and the applicable interest rate for any given month.
- (hh) The loan is collateralized by Northrock and requires monthly principal and interest payments of approximately \$47,000 and a final payment of \$14.2 million at maturity. Principal of \$277,000 was amortized during 2014.
- (ii) The loan is collateralized by Metro Pike Center and requires monthly principal and interest payments of approximately \$48,000 and a final payment of \$14.8 million at loan maturity. Principal of \$288,000 was amortized during 2014.

The carrying value of properties collateralizing the mortgage notes payable totaled \$895.5 million and \$907.2 million as of December 31, 2014 and 2013, 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, 2014, the Company was in compliance with all such covenants:

- maintain tangible net worth, as defined in the loan agreement, of at least \$542.1 million plus 80% of the Company's net equity proceeds received after March 2014;
- 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); and
- 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).

### 2015 FINANCING ACTIVITY

On March 3, 2015, the Company closed a 15-year, \$30.0 million non-recourse mortgage loan secured by Boulevard and Shops at Fairfax shopping centers in Fairfax, Virginia. The loan matures in 2030, bears interest at a fixed rate of 3.69%, requires monthly principal and interest payments totaling \$153,300 based on a 25-year amortization schedule and a final payment of \$15.5 million at maturity. Proceeds of the loan were used to repay in full the existing 7.45% mortgage in the amount of \$15.2 million, which was scheduled to mature in June 2015 and to pay down outstanding balances under the revolving credit facility.

### 2014 FINANCING ACTIVITY

On June 24, 2014, the Company amended and restated its revolving credit facility. The unsecured revolving credit facility, which can be used for working capital, property acquisitions, development projects or letters of credit was increased to \$275.0 million. The revolving credit facility matures on June 23, 2018, 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. The interest rate under the facility is variable and equals the sum of one-month LIBOR and a margin that is based on the Company's leverage ratio, and which can range from 145 basis points to 200 basis points.

### 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 \$14.8 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.

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.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

On March 19, 2013, the Company closed on a 15-year, non-recourse \$18.0 million mortgage loan secured by Hampshire Langley. The loan matures in 2028, bears interest at a fixed rate of 4.04%, requires monthly principal and interest payments totaling \$95,400 based on a 25-year amortization schedule and requires a final payment of \$9.5 million at maturity.

On April 10, 2013, the Company paid in full the \$6.9 million remaining balance on the mortgage loan secured by Cruse Marketplace.

On May 28, 2013, the Company closed on a 15-year, non-recourse \$35.0 million mortgage loan secured by Beacon Center. The loan matures in 2028, bears interest at a fixed rate of 3.51%, requires monthly principal and interest payments totaling \$203,200 based on a 20-year amortization schedule and requires a final payment of \$11.4 million at maturity.

On September 4, 2013, the Company closed on a 15-year, non-recourse \$18.0 million mortgage loan secured by Seabreeze Plaza. The loan matures in 2028, bears interest at a fixed rate of 3.99%, requires monthly principal and interest payments totaling \$94,900 based on a 25-year amortization schedule and requires a final payment of \$9.5 million at maturity. Proceeds were used to pay off the \$13.5 million remaining balance of existing debt secured by Seabreeze Plaza which was scheduled to mature in May 2014 and the Company incurred \$497,000 of related debt extinguishment costs.

On October 25, 2013 the Company closed on a \$71.6 million construction-to-permanent loan which will partially finance the construction of Park Van Ness. The loan bears interest at 4.88% and during the construction period it will be fully recourse to Saul Centers and accrued interest will be funded by the loan. Following the completion of construction and lease-up, and upon achieving certain debt service coverage requirements, the loan will convert to a non-recourse, permanent mortgage at the same interest rate, with principal amortization computed based on a 25-year schedule.

### 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 \$63.0 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, 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.

### 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.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### FUNDS FROM OPERATIONS

In 2014, the Company reported Funds From Operations ("FFO")<sup>1</sup> available to common shareholders (common stockholders and limited partner unitholders) of \$78.3 million, a 21.0% increase from 2013 FFO available to common shareholders of \$64.7 million. The following table presents a reconciliation from net income to FFO available to common shareholders for the periods indicated:

	Year ended December 31,				
(Dollars in thousands)	2014	2013	2012	2011	2010
Net income	\$ 57,988	\$ 34,842	\$ 39,780	\$ 30,294	\$ 43,185
Subtract:					
Gains on property sales	(6,069)	—	(4,510)	—	(3,591)
Gain on casualty settlement	—	(77)	(219)	(245)	(2,475)
Add:					
Real estate depreciation – discontinued operations	—	—	77	102	198
Real estate depreciation and amortization	41,203	49,130	40,112	35,298	28,379
FFO	93,122	83,895	75,240	65,449	65,696
Subtract:					
Preferred dividends	(13,361)	(13,983)	(15,140)	(15,140)	(15,140)
Preferred stock redemption	(1,480)	(5,228)	—	—	—
FFO available to common shareholders	\$ 78,281	\$ 64,684	\$ 60,100	\$ 50,309	\$ 50,556
Average shares and units used to compute FFO per share	27,977	27,330	26,614	24,740	23,793
FFO per share	\$ 2.80	\$ 2.37	\$ 2.26	\$ 2.03	\$ 2.12

<sup>1</sup> 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.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### ACQUISITIONS, REDEVELOPMENTS AND RENOVATIONS

Management anticipates that during the coming year the Company will continue activities related to the redevelopment of Van Ness Square and may develop additional freestanding out-parcels 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 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 significant acquisitions, developments, redevelopments and renovations which affected the Company's financial position and results of operations in 2014, 2013, and 2012.

#### 1500, 1580, 1582 AND 1584 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.

In January 2014, the Company purchased for \$8.0 million a single-tenant retail property with a 12,100 square foot CVS Pharmacy located at 1580 Rockville Pike in Rockville, Maryland, and incurred acquisition costs of \$0.2 million.

In April 2014, the Company purchased for \$11.0 million a single-tenant retail property with a 40,700 square foot furniture store located at 1582 Rockville Pike in Rockville, Maryland, and incurred acquisition costs totaling approximately \$0.2 million. Concurrently with the purchase, the Company sold to the same party, for \$11.0 million, the 53,765 square foot Olney Center located in Olney, Maryland.

In December 2014, the Company purchased for \$6.2 million a single-tenant retail property with a 4,600 square foot restaurant located at 1584 Rockville Pike in Rockville, Maryland, and incurred acquisition costs totaling approximately \$0.2 million.

The properties at 1580, 1582 and 1584 Rockville Pike are contiguous with and an expansion of the Company's assets at 1500 Rockville Pike. When combined with 1500 Rockville Pike, the four properties comprise 10.3 acres which are zoned for development potential of up to 1.2 million square feet of mixed-use space. The Company is actively engaged in a plan for redevelopment but has not committed to any timetable for commencement of construction.

#### OLNEY

Simultaneously with the sale of Olney Center, the Company entered into a lease of the property with the buyer and the Company continues to operate and manage the property. The lease term is 20 years and the Company has the option to purchase the property for \$14.6 million at the end of the lease term. The purchaser has the right to sell the property to the Company at any time from and after April 2016 at a price equal to \$11.0 million increased by 1.5% annually beginning January 1, 2015 and continuing each January thereafter. The Company has accounted for this transaction as a secured financing.

#### 5541 NICHOLSON LANE

In December 2012, the Company purchased for \$12.2 million, including acquisition costs, approximately 20,100 square feet of retail space, located on the east side of Rockville Pike near the White Flint Metro station 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 mixed-use space. When combining these two properties with our Metro Pike Center on the west side of Rockville Pike, the Company's holdings at White Flint total 7.6 acres which are zoned for a development potential of up to 1.5 million square feet of mixed-use space. The Company is actively engaged in a plan for redevelopment but has not committed to any timetable for commencement of construction.

#### 730, 750 N. GLEBE ROAD

In August 2014, the Company purchased for \$40.0 million a single-tenant retail property with a 16,900 square foot automobile dealership located at 750 N. Glebe Road in Arlington, Virginia, and incurred acquisition costs of \$0.4 million. In December 2014, the Company purchased for \$2.8 million an adjacent single-tenant retail property with a 2,000 square foot store, and incurred acquisition costs of \$40,400. The properties comprise 2.3 acres of land which is zoned for development potential of up to 450,000 square feet of mixed-use space. The Company is actively engaged in a plan for redevelopment but has not committed to any timetable for commencement of construction.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### PARK VAN NESS

The Company continues to develop Park Van Ness, a 271-unit residential project with approximately 9,000 square feet of street-level retail, below street-level structured parking, and amenities including a community room, landscaped courtyards, a fitness room and a rooftop pool and deck. Construction is projected to be completed in the first quarter of 2016. When complete, the structure will comprise 11 levels, five of which will be below street level. Concrete is currently being poured on the seventh level. The total cost of the project, excluding predevelopment expense and land (which the Company has owned), is expected to be approximately \$93.0 million, a portion of which will be financed with a \$71.6 million construction-to-permanent loan. Costs incurred through December 31, 2014, total approximately \$27.0 million, of which \$5.4 million has been financed by the loan.

### PROPERTY SALES

#### WEST PARK

In July 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, 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, the carrying amounts of the associated assets and liabilities were \$488,000 and \$22,000, respectively. There was no debt associated with the property.

#### GIANT CENTER

In April 2014, the Company sold for \$7.5 million the 70,040 square foot Giant Center located in Milford Mill, Maryland and recognized a \$6.1 million gain. As of March 31, 2014, the carrying amounts of the associated assets and liabilities were \$0.5 million and \$0.1 million, respectively. There was no debt on 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
2014	50	6	7,886,304	1,453,159	95.0%	90.8%
2013	50	6	7,880,269	1,452,742	94.5%	90.5%
2012	50	7	7,877,200	1,612,200	93.4%	82.8%

The 2014 Shopping Center leasing percentage includes the five properties acquired in 2014 and excludes the Giant Center, which was sold in 2014. There is no change in 2014 in the properties that comprise the Mixed-Use leasing percentage. The Clarendon Center residential component was 95.9% leased at December 31, 2014. On a same property basis, which excludes the impact of properties not in operation for the entirety of the comparable periods, the Shopping Center leasing percentage increased to 95.0% from 94.5% and the Mixed-Use leasing percentage increased to 90.8% from 90.5%. The overall portfolio leasing percentage, on a comparative same property basis, increased to 94.4% at December 31, 2014 from 93.9% at December 31, 2013. The 2014 Shopping Center same center leasing percentage increased as a result of a net increase in space leased of approximately 35,500 square feet. The 2014 Mixed-Use percentage leased increased as a result of a net increase in space leased of approximately 4,300 square feet.

There were no changes from the prior year in the properties that comprise the 2013 Shopping Centers percentage leased. The 2013 Mixed-Use percentage leased excludes Park Van Ness, which was taken out of service in March 2013 and is currently being redeveloped. The Clarendon Center residential component was 99.2% leased at December 31, 2013. On a same property basis, Shopping Center leasing percentages increased to 94.5% from 93.4% and Mixed-Use leasing percentages increased to 90.5% from 87.7%. The overall portfolio lease percentage, on a comparative same property basis, ended the year at 93.9%, an increase from 92.6% at year end 2012. The 2013 Shopping Centers percentage leased was impacted by a net increase of 88,600 square feet, 70,800 square feet of which resulted from improved leasing of small shop space (spaces totaling 10,000 square feet or less) throughout the portfolio. The 2013 Mixed-Use percentage leased was impacted by a net increase of 34,500 square feet, the majority of which resulted from improved leasing at Avenel Business Park.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The 2012 Shopping Centers percentage leased 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 percentage leased includes 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, Shopping Centers percentage leased increased to 93.5% from 91.6% and Mixed-Use percentage leased decreased to 82.5% from 85.8%. The overall portfolio percentage leased, on a comparative same center basis, ended the year at 91.9%, an increase from 90.7% at year end 2011. The 2012 Shopping Center percentage leased was 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 percentage leased was 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 following table shows selected data 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.

### SELECTED LEASING DATA

Year ended December 31,	Square Feet	Number of Leases	Base Rent per Square Foot	
			New/Renewed Leases	Expiring Leases
2014	1,224,700	276	\$ 18.60	\$ 18.26
2013	1,471,000	276	19.56	19.75
2012	1,579,000	256	16.39	16.30

Additional information about commercial leasing activity during the three months ended December 31, 2014, is set forth below. The below information includes leases for space which had not been previously leased during the period of the Company's ownership, either a result of acquisition or development.

### COMMERCIAL LEASING ACTIVITY

	New Leases	Renewed Leases
Number of leases	20	33
Square feet	66,568	132,014
Per square foot average annualized:		
Base rent	\$ 21.41	\$ 15.73
Tenant improvements	(3.08)	(0.11)
Leasing costs	(0.84)	(0.06)
Rent concessions	(0.20)	(0.03)
Effective rents	\$ 17.29	\$ 15.53

During 2014, the Company entered into 234 new or renewed apartment leases. The monthly rent per square foot for these leases increased to \$3.46 from \$3.37. During 2013, the Company entered into 228 new or renewed apartment leases. The monthly rent per square foot for these leases increased to \$3.37 from \$3.24. 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.

As of December 31, 2014, 838,240 square feet of Commercial space was subject to leases scheduled to expire in 2015. Below is information about existing and estimated market base rents per square foot for that space.

### EXPIRING LEASES

	Total
Square feet	838,240
Average base rent per square foot	\$ 17.29
Estimated market base rent per square foot	\$ 17.34

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to certain financial market risks, the most predominant being fluctuations in interest rates. Interest rate fluctuations are monitored by management as an integral part of the Company's overall risk management program, which recognizes the unpredictability of financial markets and seeks to reduce the potentially adverse effect on the Company's results of operations.

The Company may, where appropriate, employ derivative instruments, such as interest rate swaps, to mitigate the risk of interest rate fluctuations. The Company does not enter into derivatives or other financial instruments for trading or speculative purposes. On June 29, 2010, the Company entered into an interest rate swap agreement with a \$45.6 million notional amount to manage the interest rate risk associated with \$45.6 million of variable-rate mortgage debt. The swap agreement was effective July 1, 2010, terminates on July 1, 2020 and effectively fixes the interest rate on the mortgage debt at 5.83%. The aggregate fair value of the swap at December 31, 2014 was approximately \$3.2 million and is reflected in accounts payable, accrued expenses and other liabilities in the consolidated balance sheet.

The Company is exposed to interest rate fluctuations which will affect the amount of interest expense of its variable rate debt and the fair value of its fixed rate debt. As of December 31, 2014, the Company had variable rate indebtedness totaling \$72.6 million. If the interest rates on the Company's variable rate debt instruments outstanding at December 31, 2014 had been one percent higher, our annual interest expense relating to these debt instruments would have increased by \$726,310, based on those balances. As of December 31, 2014, the Company had fixed-rate indebtedness totaling \$784.8 million with a weighted average interest rate of 5.70%. If interest rates on the Company's fixed-rate debt instruments at December 31, 2014 had been one percent higher, the fair value of those debt instruments on that date would have decreased by approximately \$43.4 million.

### 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 (2013 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, 2014, 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 31 in this Annual Report.

# REPORT

## OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of Saul Centers, Inc.

We have audited the accompanying consolidated balance sheets of Saul Centers, Inc. as of December 31, 2014 and 2013, 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, 2014. 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, 2014 and 2013, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 2 to the consolidated financial statements, the Company changed its method for reporting discontinued operations effective January 1, 2014.

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, 2014, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated March 6, 2015 expressed an unqualified opinion thereon.

Ernst & Young LLP  
McLean, Virginia  
March 6, 2015



The Board of Directors and Stockholders of Saul Centers, Inc.

We have audited Saul Centers, Inc.'s internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (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, 2014, 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, 2014 and 2013 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, 2014 of Saul Centers, Inc. and our report dated March 6, 2015 expressed an unqualified opinion thereon.

Ernst & Young LLP  
McLean, Virginia  
March 6, 2015

# CONSOLIDATED BALANCE SHEETS

<i>(Dollars in thousands, except per share amounts)</i>	December 31, 2014	December 31, 2013
<b>Assets</b>		
Real estate investments		
Land	\$ 420,622	\$ 354,967
Buildings and equipment	1,109,276	1,094,605
Construction in progress	30,261	9,867
	1,560,159	1,459,439
Accumulated depreciation	(396,617)	(364,663)
	1,163,542	1,094,776
Cash and cash equivalents	12,128	17,297
Accounts receivable and accrued income, net	46,784	43,884
Deferred leasing costs, net	26,928	26,052
Prepaid expenses, net	4,093	4,047
Deferred debt costs, net	9,874	9,675
Other assets	3,638	2,944
<b>Total assets</b>	<b>\$ 1,266,987</b>	<b>\$ 1,198,675</b>
<b>Liabilities</b>		
Mortgage notes payable	\$ 808,997	\$ 820,068
Revolving credit facility payable	43,000	—
Construction loan payable	5,391	—
Dividends and distributions payable	14,352	13,135
Accounts payable, accrued expenses and other liabilities	23,537	20,141
Deferred income	32,453	30,205
<b>Total liabilities</b>	<b>927,730</b>	<b>883,549</b>
<b>Stockholders' equity</b>		
Preferred stock, 1,000,000 shares authorized:		
Series A Cumulative Redeemable, 16,000 shares issued and outstanding in 2013	—	40,000
Series C Cumulative Redeemable, 72,000 and 56,000 shares issued and outstanding, respectively	180,000	140,000
Common stock, \$0.01 par value, 30,000,000 shares authorized, 20,947,141 and 20,576,616 shares issued and outstanding, respectively	209	206
Additional paid-in capital	287,995	270,428
Accumulated deficit	(173,774)	(172,564)
Accumulated other comprehensive loss	(1,894)	(1,392)
<b>Total Saul Centers, Inc. stockholders' equity</b>	<b>292,536</b>	<b>276,678</b>
Noncontrolling interests	46,721	38,448
<b>Total stockholders' equity</b>	<b>339,257</b>	<b>315,126</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 1,266,987</b>	<b>\$ 1,198,675</b>

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

# CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands, except per share amounts)	For The Year Ended December 31,		
	2014	2013	2012
<b>Revenue</b>			
Base rent	\$ 164,599	\$ 159,898	\$ 152,777
Expense recoveries	32,132	30,949	30,391
Percentage rent	1,492	1,575	1,545
Other	8,869	5,475	5,379
Total revenue	207,092	197,897	190,092
<b>Operating expenses</b>			
Property operating expenses	26,479	24,559	23,794
Provision for credit losses	680	968	1,151
Real estate taxes	22,354	22,415	22,325
Interest expense and amortization of deferred debt costs	46,034	46,589	49,544
Depreciation and amortization of deferred leasing costs	41,203	49,130	40,112
General and administrative	16,961	14,951	14,274
Acquisition related costs	949	106	1,129
Predevelopment expenses	503	3,910	2,667
Total operating expenses	155,163	162,628	154,996
<b>Operating income</b>	51,929	35,269	35,096
Change in fair value of derivatives	(10)	(7)	36
Loss on early extinguishment of debt	—	(497)	—
Gain on sales of properties	6,069	—	—
Gain on casualty settlement	—	77	219
<b>Income from continuing operations</b>	57,988	34,842	35,351
<b>Discontinued operations</b>			
Loss from operations of properties sold	—	—	(81)
Gain on sales of properties	—	—	4,510
Income from discontinued operations	—	—	4,429
<b>Net Income</b>	57,988	34,842	39,780
<b>Noncontrolling interests</b>			
Income from continuing operations attributable to noncontrolling interests	(11,045)	(3,970)	(5,693)
Income from discontinued operations attributable to noncontrolling interests	—	—	(713)
Income attributable to noncontrolling interests	(11,045)	(3,970)	(6,406)
<b>Net income attributable to Saul Centers, Inc.</b>	46,943	30,872	33,374
Preferred stock redemption	(1,480)	(5,228)	—
Preferred dividends	(13,361)	(13,983)	(15,140)
<b>Net income available to common stockholders</b>	\$ 32,102	\$ 11,661	\$ 18,234
<b>Per share net income available to common stockholders</b>			
Basic:			
Continuing operations	\$ 1.55	\$ 0.57	\$ 0.70
Discontinued operations	—	—	0.23
	\$ 1.55	\$ 0.57	\$ 0.93
Diluted:			
Continuing operations	\$ 1.54	\$ 0.57	\$ 0.70
Discontinued operations	—	—	0.23
	\$ 1.54	\$ 0.57	\$ 0.93

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

# CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in thousands)	For The Year Ended December 31,		
	2014	2013	2012
<b>Net income</b>	\$ 57,988	\$ 34,842	\$ 39,780
<b>Other comprehensive income</b>			
Unrealized gain (loss) on cash flow hedge	(675)	2,897	(932)
<b>Total comprehensive income</b>	57,313	37,739	38,848
Comprehensive income attributable to noncontrolling interests	(10,874)	(4,706)	(6,164)
<b>Total comprehensive income attributable to Saul Centers, Inc.</b>	46,439	33,033	32,684
Preferred stock redemption	(1,480)	(5,228)	—
Preferred dividends	(13,361)	(13,983)	(15,140)
<b>Total comprehensive income available to common stockholders</b>	\$ 31,598	\$ 13,822	\$ 17,544

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

# CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

<i>(Dollars in thousands, except per share amounts)</i>	Preferred Stock	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive (Loss)	Total Saul Centers, Inc.	Noncontrolling Interest	Total
<b>Balance, December 31, 2011</b>	\$ 179,328	\$ 193	\$ 217,829	\$(144,659)	\$ (2,863)	\$ 249,828	\$ 43,378	\$ 293,206
Issuance 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)
<b>Balance, December 31, 2012</b>	179,328	201	246,557	(154,830)	(3,553)	267,703	39,586	307,289
Issuance of 56,000 shares of Series C preferred stock	140,000	—	(4,807)	—	—	135,193	—	135,193
Partial redemption of 24,000 shares of Series A preferred stock	(60,000)	—	2,212	(2,216)	—	(60,004)	—	(60,004)
Full redemption of 31,731 shares of Series B preferred stock	(79,328)	—	3,007	(3,012)	—	(79,333)	—	(79,333)
Issuance of common stock:								
475,162 shares pursuant to dividend reinvestment plan	—	5	20,667	—	—	20,672	—	20,672
56,002 shares due to exercise of employee stock options and issuance of directors' deferred stock	—	—	2,792	—	—	2,792	—	2,792
Issuance of 88,309 partnership units pursuant to dividend reinvestment plan	—	—	—	—	—	—	4,144	4,144
Net income	—	—	—	30,872	—	30,872	3,970	34,842
Change in unrealized loss on cash flow hedge	—	—	—	—	2,161	2,161	736	2,897
Preferred stock distributions:								
Series A	—	—	—	(3,213)	—	(3,213)	—	(3,213)
Series B	—	—	—	(1,468)	—	(1,468)	—	(1,468)
Series C	—	—	—	(6,095)	—	(6,095)	—	(6,095)
Common stock distributions	—	—	—	(21,988)	—	(21,988)	(7,467)	(29,455)
Distributions payable preferred stock:								
Series A, \$50.00 per share	—	—	—	(800)	—	(800)	—	(800)
Series C, \$42.97 per share	—	—	—	(2,406)	—	(2,406)	—	(2,406)
Distributions payable common stock (\$0.36/share) and distributions payable partnership units (\$0.36/unit)	—	—	—	(7,408)	—	(7,408)	(2,521)	(9,929)
<b>Balance, December 31, 2013</b>	180,000	206	270,428	(172,564)	(1,392)	276,678	38,448	315,126
Issuance of 16,000 shares of Series C preferred stock	40,000	—	(740)	—	—	39,260	—	39,260
Redemption of 16,000 shares of Series A preferred stock	(40,000)	—	1,475	(1,475)	—	(40,000)	—	(40,000)
Issuance of common stock:								
197,638 shares pursuant to dividend reinvestment plan	—	2	9,262	—	—	9,264	—	9,264
172,887 shares due to exercise of employee stock options and issuance of directors' deferred stock	—	1	7,570	—	—	7,571	—	7,571
Issuance of 196,183 partnership units pursuant to dividend reinvestment plan	—	—	—	—	—	—	8,877	8,877
Net income	—	—	—	46,943	—	46,943	11,045	57,988
Change in unrealized loss on cash flow hedge	—	—	—	—	(502)	(502)	(173)	(675)
Preferred stock distributions:								
Series A	—	—	—	(3,049)	—	(3,049)	—	(3,049)
Series C	—	—	—	(7,219)	—	(7,219)	—	(7,219)
Common stock distributions	—	—	—	(24,937)	—	(24,937)	(8,597)	(33,534)
Distributions payable preferred stock:								
Series C, \$42.97 per share	—	—	—	(3,094)	—	(3,094)	—	(3,094)
Distributions payable common stock (\$0.40/share) and distributions payable partnership units (\$0.40/unit)	—	—	—	(8,379)	—	(8,379)	(2,879)	(11,258)
<b>Balance, December 31, 2014</b>	\$180,000	\$ 209	\$ 287,995	\$(173,774)	\$ (1,894)	\$ 292,536	\$ 46,721	\$ 339,257

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

# CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)	For the Year Ended December 31,		
	2014	2013	2012
<b>Cash flows from operating activities:</b>			
Net income	\$ 57,998	\$ 34,842	\$ 39,780
Adjustments to reconcile net income to net cash provided by operating activities:			
Change in fair value of derivatives	10	7	(36)
Gain on sale of property	(6,069)	—	(4,510)
Gain on casualty settlement	—	(77)	(219)
Depreciation and amortization of deferred leasing costs	41,203	49,130	40,189
Amortization of deferred debt costs	1,327	1,257	1,576
Non cash compensation costs of stock grants and options	1,240	1,145	952
Provision for credit losses	680	968	1,151
Increase in accounts receivable and accrued income	(3,320)	(3,669)	(3,240)
Additions to deferred leasing costs	(4,048)	(5,876)	(5,362)
Increase in prepaid expenses	(60)	(152)	(54)
(Increase) decrease in other assets	(694)	353	9,573
Increase (decrease) in accounts payable, accrued expenses and other liabilities	1,149	(3,286)	(930)
Decrease in deferred income	(2,838)	(1,115)	(447)
Net cash provided by operating activities	86,568	73,527	78,423
<b>Cash flows from investing activities:</b>			
Acquisitions of real estate investments (1)	(57,494)	(5,124)	(34,050)
Additions to real estate investments	(14,986)	(13,999)	(12,680)
Additions to development and redevelopment projects	(17,788)	(7,316)	(7,913)
Proceeds from sale of properties	6,679	—	5,818
Proceeds from casualty settlement	—	405	1,952
Net cash used in investing activities	(83,589)	(26,034)	(46,873)
<b>Cash flows from financing activities:</b>			
Proceeds from mortgage notes payable (1)	—	101,600	83,500
Repayments on mortgage notes payable	(22,071)	(71,308)	(117,595)
Proceeds from construction loans payable	5,391	—	—
Proceeds from revolving credit facility	90,000	142,000	38,000
Repayments on revolving credit facility	(47,000)	(180,000)	(8,000)
Additions to deferred debt costs	(1,264)	(3,219)	(2,199)
Proceeds from the issuance of:			
Common stock	15,596	22,292	27,784
Partnership units	8,877	4,144	—
Series C preferred stock	39,260	135,221	—
Preferred stock redemption payments:			
Series A preferred	(40,000)	(60,000)	—
Series B preferred	—	(79,328)	—
Preferred stock redemption costs	—	(9)	—
Distributions to:			
Series A preferred stockholders	(3,849)	(5,213)	(8,000)
Series B preferred stockholders	—	(3,253)	(7,140)
Series C preferred stockholders	(9,625)	(6,095)	—
Common stockholders	(32,346)	(29,205)	(28,135)
Noncontrolling interests	(11,117)	(9,956)	(9,955)
Net cash used in financing activities	(8,148)	(42,329)	(31,740)
Net increase (decrease) in cash and cash equivalents	(5,169)	5,164	(190)
Cash and cash equivalents, beginning of year	17,297	12,133	12,323
Cash and cash equivalents, end of year	\$ 12,128	\$ 17,297	\$ 12,133
Supplemental disclosure of cash flow information:			
Cash paid for interest	\$ 45,443	\$ 45,743	\$ 48,302

(1) The 2014 acquisition of real estate and proceeds from notes payable each exclude \$11,000 in connection with the sale and leaseback of the Company's Olney property.

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 significant properties acquired, developed and/or disposed of by the Company since January 1, 2012.

Name of Property	Location	Type	Year of Acquisition/ Development/ Disposal
<b>ACQUISITIONS</b>			
1500 Rockville Pike	Rockville, Maryland	Shopping Center	December 2012
5541 Nicholson Lane	Rockville, Maryland	Shopping Center	December 2012
1580 Rockville Pike	Rockville, Maryland	Shopping Center	January 2014
1582 Rockville Pike	Rockville, Maryland	Shopping Center	April 2014
750 N. Glebe Road	Arlington, Virginia	Shopping Center	August 2014
730 N. Glebe Road	Arlington, Virginia	Shopping Center	December 2014
1584 Rockville Pike	Rockville, Maryland	Shopping Center	December 2014
<b>DEVELOPMENTS</b>			
Park Van Ness	Washington, DC	Mixed-Use	2013/2014
<b>DISPOSITIONS</b>			
West Park	Oklahoma City, Oklahoma	Shopping Center	July 2012
Belvedere	Baltimore, Maryland	Shopping Center	December 2012
Giant Center	Milford Mill, Maryland	Shopping Center	April 2014

As of December 31, 2014, the Company's properties (the "Current Portfolio Properties") consisted of 50 shopping center properties (the "Shopping Centers"), six mixed-use properties which are comprised of office, retail and multi-family residential uses (the "Mixed-Use Properties") and three (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-used 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, 2014, 32 of the Shopping Centers were anchored by a grocery store and offer primarily day-to-day necessities and services. Two retail tenants, Giant Food (4.5%), a tenant at nine Shopping Centers, and Safeway (2.5%), a tenant at eight Shopping Centers, individually accounted for 2.5% or more of the Company's total revenue for the year ended December 31, 2014.

### 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. In certain circumstances, such as if the building is vacant and the Company intends to demolish the building in the near term, the entire purchase price will be allocated to land.

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. If the fair value of the below market lease intangible includes fair value associated with a renewal option, such amounts are not accreted until the renewal option is exercised. If the renewal option is not exercised the value is recognized at that time. 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 either (a) expensed as incurred when related to business combinations or (b) capitalized to land and/or building when related to asset acquisitions.



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 2014, 2013, or 2012.

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 \$688,900, \$170,000, and \$42,300 during 2014, 2013, and 2012, 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. Depreci-

ation expense and amortization of leasehold improvements, which is included in Depreciation and amortization of deferred leasing costs in the Consolidated Statements of Operations, for the years ended December 31, 2014, 2013, and 2012, was \$35.9 million, \$43.2 million, and \$34.6 million, respectively. Repairs and maintenance expense totaled \$11.9 million, \$10.3 million, and \$9.9 million for 2014, 2013, and 2012, 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 and are amortized, using the straight-line method, over the term of the lease or the remaining term of an acquired lease. 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. Collectively, deferred leasing costs totaled \$26.9 million and \$26.1 million, net of accumulated amortization of approximately \$21.6 million and \$16.6 million, as of December 31, 2014 and 2013, respectively. Amortization expense, which is included in Depreciation and amortization of deferred leasing costs in the Consolidated Statements of Operations, totaled approximately \$5.3 million, \$5.9 million, and \$5.5 million, for the years ended December 31, 2014, 2013, and 2012, 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. The following table shows the components of construction in progress.

<i>(In thousands)</i>	December 31,	
	2014	2013
Park Van Ness	\$ 26,998	\$ 7,901
Other	3,263	1,966
Total	\$ 30,261	\$ 9,867

## 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 \$0.7 million and \$0.6 million, at December 31, 2014 and 2013, respectively.

(In thousands)	Year ended December 31,		
	2014	2013	2012
Beginning Balance	\$ 572	\$ 1,208	\$ 671
Provision for Credit Losses	680	968	1,160
Charge-offs	(575)	(1,604)	(623)
Ending Balance	\$ 677	\$ 572	\$ 1,208

In addition to rents due currently, accounts receivable also includes \$38.7 million and \$37.2 million, at December 31, 2014 and 2013, respectively, net of allowance for doubtful accounts totaling \$0.3 million and \$0.5 million, 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, 2014 are held in non-interest bearing accounts at various banks. From time to time the Company may maintain deposits with financial institutions in amounts in excess of federally insured limits. The Company has not experienced any losses on such deposits and believes it is not exposed to any significant credit risk on those deposits.

## 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 \$9.9 million and \$9.7 million, net of accumulated amortization of \$5.9 million and \$4.5 million at December 31, 2014 and 2013, 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. The results of operations of West Park and Belvedere for the year ended December 31, 2012 are included in the statements of operations as "Loss from operations of properties sold." The 2014 sale of Giant Center is accounted for under the new discontinued operations guidance discussed below in Recently Issued Accounting Standards and, therefore, is not presented as 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, 2014, 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 2014, 2013, and 2012. The tax basis of the Company's real estate investments was approximately \$1.2 billion and \$1.1 billion as of December 31, 2014 and 2013, respectively. With few exceptions, the Company is no longer subject to U.S. federal, state, and local tax examinations by tax authorities for years before 2008.

## 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.

The Company has a stock plan, which was originally approved in 2004, amended in 2008 and 2013 and which expires in 2023, for the purpose of attracting and retaining executive officers, directors and other key personnel (the "Stock Plan"). Pursuant to the Stock 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, 2014, the directors' deferred fee accounts comprise 232,262 shares.

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, 2014, 2013, and 2012. 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 \$112,900, \$124,400, and \$110,000, for the years ended December 31, 2014, 2013, and 2012, respectively.

## NONCONTROLLING INTEREST

Saul Centers is the sole general partner of the Operating Partnership, owning a 74.2% common interest as of December 31, 2014. 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, 2014, 2013, and 2012, options totaling 106,875, 112,500, and 117,500, respectively, are not dilutive because the average share price of the Company’s common stock was less than the exercise prices. The treasury stock method was used to measure the effect of the dilution.

**BASIC AND DILUTED SHARES OUTSTANDING**

(Shares in thousands)	December 31,		
	2014	2013	2012
Weighted average common shares outstanding - Basic	20,772	20,364	19,649
Effect of dilutive options	49	37	51
Weighted average common shares outstanding - Diluted	20,821	20,401	19,700
Average share price	\$ 49.09	\$ 45.44	\$ 40.94

**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.

**RECENTLY ISSUED ACCOUNTING STANDARDS**

In April 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-08, “Presentation of Financial Statements (Topic 205) and Property Plant and Equipment (Topic 360)” (“ASU 2014-08”). ASU 2014-08 changes the requirements for reporting discontinued operations such that disposals of components of an entity will be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity’s operations. ASU 2014-08 also requires additional disclosures about discontinued operations. ASU 2014-08 is effective for annual periods beginning after December 15, 2014, and interim periods within those years and early adoption is permitted. The Company retrospectively adopted ASU 2014-08 on April 15, 2014. The adoption of ASU 2014-08 did not have a material impact on the Company’s financial condition or results of operations.

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers” (“ASU 2014-09”). ASU 2014-09 will replace most existing revenue recognition guidance and will require an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 is effective for annual periods beginning after December 15, 2016, and interim periods within those years and early adoption is not permitted. ASU 2014-09 must be applied retrospectively by either restating prior periods or by recognizing the cumulative effect as of the first date of application. We have not yet selected a transition method and are evaluating the impact that ASU 2014-09 will have on our consolidated financial statements and related disclosures.

**RECLASSIFICATIONS**

Certain reclassifications have been made to prior years to conform to the presentation used for year ended December 31, 2014.

**3. REAL ESTATE ACQUIRED**

**1500, 1580, 1582 AND 1584 ROCKVILLE PIKE**

In December 2012, the Company purchased for \$22.4 million 1500 Rockville Pike, and incurred acquisition costs of \$0.6 million. In January 2014, the Company purchased for \$8.0 million 1580 Rockville Pike and incurred acquisition costs of \$0.2 million. In April 2014, the Company purchased for \$11.0 million 1582 Rockville Pike and incurred acquisition costs of \$0.2 million. In December 2014, the company purchased for \$6.2 million 1584 Rockville Pike and incurred acquisition costs of \$0.2 million. These retail properties are contiguous with each other and are located in Rockville, Maryland.

**730 AND 750 GLEBE ROAD**

In August 2014, the Company purchased for \$40.0 million, 750 N. Glebe Road and incurred acquisition costs of \$0.4 million. In December 2014, the Company purchased for \$2.8 million 730 N. Glebe Road, and incurred acquisition costs of \$40,400. These retail properties are contiguous and are located in Arlington, Virginia.

**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.

**KENTLANDS PAD**

In August 2013, the Company purchased for \$4.3 million, a retail pad with a 7,100 square foot restaurant located in Gaithersburg, Maryland, which is contiguous with and an expansion of the Company's other Kentlands assets, and incurred acquisition costs of \$106,000.

**HUNT CLUB PAD**

In December 2013, the Company purchased for \$0.8 million, including acquisition costs, a retail pad with a 5,500 square foot vacant building located in Apopka, Florida, which is contiguous with and an expansion of the Company's other Hunt Club asset.

**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 2014, the Company purchased five properties at an aggregate cost of \$68.0 million, and incurred acquisition costs of \$0.9 million. The purchase prices were allocated to the assets acquired and liabilities assumed based on their fair value as shown in the following table.

**PURCHASE PRICE ALLOCATION OF ACQUISITIONS**

<i>(In thousands)</i>	1580 Rockville Pike	1582 Rockville Pike	750 N. Glebe Road	730 N. Glebe Road	1584 Rockville Pike	Total
Land	\$ 9,600	\$ 9,742	\$ 38,224	\$ 2,683	\$ 5,798	\$ 66,047
Buildings	2,200	828	1,327	78	440	4,873
In-place Leases	513	849	449	39	249	2,099
Above-Market Rent	—	—	—	—	—	—
Below-Market Rent	(4,313)	(419)	—	—	(337)	(5,069)
Total Purchase Price	\$ 8,000	\$ 11,000	\$ 40,000	\$ 2,800	\$ 6,150	\$ 67,950

During 2013, the Company purchased two properties at a cost of \$5.1 million and incurred acquisition costs of \$106,000. Of the total purchase price, \$2.0 million was allocated to buildings and \$3.1 million was allocated to land. No amounts were allocated to in-place, above-market, or below-market leases.

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.

The gross carrying amount of lease intangible assets included in deferred leasing costs as of December 31, 2014 and 2013 was \$24.0 million and \$21.9 million, respectively, and accumulated amortization was \$18.0 million and \$16.7 million, respectively. Amortization expense totaled \$1.3 million, \$2.0 million and \$2.0 million, for the years ended December 31, 2014, 2013, and 2012, respectively. The gross carrying amount of below market lease intangible liabilities included in deferred income as of December 31, 2014 and 2013 was \$29.9 million and \$24.8 million, respectively, and accumulated amortization was \$11.9 million and \$10.0 million, respectively. Accretion income totaled \$1.9 million, \$1.7 million, and \$1.6 million, for the years ended December 31, 2014, 2013, and 2012, respectively. The gross carrying amount of above market lease intangible assets included in accounts receivable as of December 31, 2014 and 2013 was \$1.0 million and \$1.0 million, respectively, and accumulated amortization was \$996,700 and \$974,100, respectively. Amortization expense totaled \$23,000, \$45,000 and \$60,000, for the years ended December 31, 2014, 2013 and 2012, respectively.

As of December 31, 2014, 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
2015	\$ 1,252	\$ 2	\$ 1,787
2016	988	1	1,722
2017	796	1	1,701
2018	737	1	1,617
2019	550	—	1,473
Thereafter	1,739	—	9,670
Total	\$ 6,062	\$ 5	\$ 17,970

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

The Saul Organization holds a 25.8% limited partnership interest in the Operating Partnership represented by 7,198,721 limited partnership units, as of December 31, 2014. 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, 2014, 814,000 units were eligible for conversion.

The impact of the Saul Organization's 25.8% 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, 2014, 2013, and 2012, were 27,977,500, 27,330,100, and 26,613,900, respectively.

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

At December 31, 2014, outstanding debt totaled \$857.4 million, of which \$784.8 million was fixed rate debt and \$72.6 million was variable rate debt. The Company's outstanding debt totaled \$820.1 million at December 31, 2013, of which \$789.9 million was fixed rate debt and \$30.2 million was variable rate debt. At December 31, 2014, the Company had a \$275.0 million unsecured revolving credit facility, which can be used for working capital, property acquisitions or development projects. The revolving credit facility matures on June 23, 2018, 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, 2014, based on the value of the Company's unencumbered properties, approximately \$231.6 million was available under the line, \$43.0 million was outstanding and approximately \$448,000 was committed for letters of credit. The interest rate under the facility is variable and equals the sum of one-month LIBOR and a margin that is based on the Company's leverage ratio and which can range from 145 basis points to 200 basis points. As of December 31, 2014, the margin was 145 basis points.

Saul Centers is a guarantor of the revolving credit facility, of which the Operating Partnership is the borrower. Saul Centers guarantees a portion of the Northrock bank term loan (approximately \$7.5 million of the \$14.5 million outstanding at December 31, 2014) and the Metro Pike Center bank loan (approximately \$7.8 million of the \$15.1 million outstanding at December 31, 2014) and all of the Park Van Ness construction-to-permanent loan. All other notes payable are non-recourse.

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 2027, bears interest at a fixed rate of 5.84%, requires equal monthly principal and interest payments totaling \$463,200 based upon a 25-year amortization schedule and a final payment of \$42.3 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, 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. 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 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 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 \$14.8 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.

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.

On March 19, 2013, the Company closed on a 15-year, non-recourse \$18.0 million mortgage loan secured by Hampshire Langley. The loan matures in 2028, bears interest at a fixed rate of 4.04%, requires monthly principal and interest payments totaling \$95,400 based on a 25-year amortization schedule and requires a final payment of \$9.5 million at maturity.

On April 10, 2013, the Company paid in full the \$6.9 million remaining balance on the mortgage loan secured by Cruse Marketplace.

On May 28, 2013, the Company closed on a 15-year, non-recourse \$35.0 million mortgage loan secured by Beacon Center. The loan matures in 2028, bears interest at a fixed rate of 3.51%, requires monthly principal and interest payments totaling \$203,200 based on a 20-year amortization schedule and requires a final payment of \$11.4 million at maturity.

On September 4, 2013, the Company closed on a 15-year, non-recourse \$18.0 million mortgage loan secured by Seabreeze Plaza. The loan matures in 2028, bears interest at a fixed rate of 3.99%, requires monthly principal and interest payments totaling \$94,900 based on a 25-year amortization schedule and requires a final payment of \$9.5 million at maturity. Proceeds were used to pay off the \$13.5 million remaining balance of existing debt secured by Seabreeze Plaza which was scheduled to mature in May 2014 and the Company incurred \$497,000 of related debt extinguishment costs.

On October 25, 2013 the Company closed on a \$71.6 million construction-to-permanent loan which will partially finance the construction of Park Van Ness. The loan bears interest at 4.88% and during the construction period it will be fully recourse to Saul Centers and accrued interest will be funded by the loan. Following the completion of construction and lease-up, and upon achieving certain debt service coverage requirements, the loan will convert to a non-recourse, permanent mortgage at the same interest rate, with principal amortization computed based on a 25-year schedule.

On June 24, 2014, the Company amended and restated its revolving credit facility. The Company unsecured revolving credit facility, which can be used for working capital, property acquisitions, development projects or letters of credit was increased to \$275.0 million. The revolving credit facility matures on June 23, 2018, 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. The interest rate under the facility is variable and equals the sum of one-month LIBOR and a margin that is based on the Company's leverage ratio, and which can range from 145 basis points to 200 basis points.

The following is a summary of notes payable as of December 31, 2014 and 2013:

**NOTES PAYABLE**

(Dollars in thousands)	Year Ended December 31,		Interest Rate*	Scheduled Maturity*
	2014	2013		
Fixed rate mortgages:	\$ 15,399 (a)	\$ 16,128	7.45%	Jun-2015
	32,049 (b)	33,246	6.01%	Feb-2018
	35,398 (c)	36,937	5.88%	Jan-2019
	11,454 (d)	11,949	5.76%	May-2019
	15,819 (e)	16,501	5.62%	Jul-2019
	15,761 (f)	16,419	5.79%	Sep-2019
	14,014 (g)	14,610	5.22%	Jan-2020
	10,881 (h)	11,159	5.60%	May-2020
	9,535 (i)	9,921	5.30%	Jun-2020
	41,441 (j)	42,462	5.83%	Jul-2020
	8,346 (k)	8,649	5.81%	Feb-2021
	6,100 (l)	6,233	6.01%	Aug-2021
	35,222 (m)	35,981	5.62%	Jun-2022
	10,718 (n)	10,930	6.08%	Sep-2022
	11,587 (o)	11,795	6.43%	Apr-2023
	14,909 (p)	15,598	6.28%	Feb-2024
	16,750 (q)	17,123	7.35%	Jun-2024
	14,535 (r)	14,849	7.60%	Jun-2024
	25,639 (s)	26,153	7.02%	Jul-2024
	30,429 (t)	31,093	7.45%	Jul-2024
	30,253 (u)	30,894	7.30%	Jan-2025
	15,735 (v)	16,087	6.18%	Jan-2026
	115,291 (w)	118,128	5.31%	Apr-2026
	35,125 (x)	36,075	4.30%	Oct-2026
	39,932 (y)	40,974	4.53%	Nov-2026
	18,645 (z)	19,118	4.70%	Dec-2026
	69,397 (aa)	70,856	5.84%	May-2027
	17,281 (bb)	17,718	4.04%	Apr-2028
	33,140 (cc)	34,391	3.51%	Jun-2028
	17,462 (dd)	17,895	3.99%	Sep-2028
	5,391 (ee)	—	4.88%	Sep-2032
	11,119 (ff)	—	8.00%	Apr-2034
Total fixed rate	784,757	789,872	5.70%	9.3 Years
Variable rate loans:				
	43,000 (gg)	—	LIBOR + 1.45%	Jun-2018
	14,525 (hh)	14,802	LIBOR + 1.65%	Feb-2016
	15,106 (ii)	15,394	LIBOR + 1.65%	Feb-2016
Total variable rate	72,631	30,196	LIBOR + 1.53%	2.5 Years
Total notes payable	\$ 857,388	\$ 820,068	5.36%	8.7 Years

\* Interest rate and scheduled maturity data presented as of December 31, 2014. Totals computed using weighted averages.



- (a) 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 \$729,000 was amortized during 2014.
- (b) 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 \$1.2 million was amortized during 2014.
- (c) 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 \$1.5 million was amortized during 2014.
- (d) 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 \$495,000 was amortized during 2014.
- (e) 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 \$682,000 was amortized during 2014.
- (f) 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 \$658,000 was amortized during 2014.
- (g) 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 \$596,000 was amortized during 2014.
- (h) 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 \$278,000 was amortized during 2014.
- (i) 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 \$386,000 was amortized during 2014.
- (j) 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 \$1,021,000 was amortized during 2014.
- (k) 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 \$303,000 was amortized during 2014.
- (l) 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 \$133,000 was amortized during 2014.
- (m) 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 \$759,000 was amortized during 2014.
- (n) 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 \$212,000 was amortized during 2014.
- (o) 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 \$208,000 was amortized during 2014.
- (p) 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 \$689,000 was amortized during 2014.
- (q) 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 \$373,000 was amortized during 2014.
- (r) 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 \$314,000 was amortized during 2014.
- (s) 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 \$514,000 was amortized during 2014.
- (t) 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 \$664,000 was amortized during 2014.
- (u) 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 \$641,000 was amortized during 2014.
- (v) 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 \$352,000 was amortized during 2014.
- (w) 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 \$2.8 million was amortized during 2014.
- (x) 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 \$950,000 was amortized during 2014.
- (y) 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 \$1,042,000 was amortized during 2014.
- (z) 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 \$473,000 was amortized during 2014.
- (aa) 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 \$1.5 million was amortized during 2014.
- (bb) The loan is collateralized by Hampshire Langley and requires equal monthly principal and interest payments of \$95,400 based upon a 25-year amortization schedule and a final payment of \$9.5 million at loan maturity. Principal of \$437,000 was amortized in 2014.
- (cc) The loan is collateralized by Beacon Center and requires equal monthly principal and interest payments of \$203,200 based upon a 20-year amortization schedule and a final payment of \$11.4 million at loan maturity. Principal of \$1,251,000 was amortized in 2014.
- (dd) The loan is collateralized by Seabreeze Plaza and requires equal monthly principal and interest payments of \$94,900 based upon a 25-year amortization schedule and a final payment of \$9.5 million at loan maturity. Principal of \$433,000 was amortized in 2014.

- (ee) The loan is a \$71.6 million construction-to-permanent facility that is collateralized by and will finance a portion of the construction costs of Park Van Ness. During the construction period, interest will be funded by the loan. After conversion to a permanent loan, monthly principal and interest payments totaling \$413,500 will be required based upon a 25-year amortization schedule. A final payment of \$39.6 million will be due at maturity.
- (ff) The Company entered into a sale-leaseback transaction with its Olney property and is accounting for that transaction as a secured financing. The arrangement requires monthly payments of \$60,400 which increase by 1.5% on May 1, 2015, and every May 1 thereafter. The arrangement provides for a final payment of \$14.7 million and has an implicit interest rate of 8.0%. Negative amortization in 2014 totaled \$119,000.

- (gg) The loan is a \$275.0 million unsecured revolving credit facility. Interest accrues at a rate equal to the sum of one-month LIBOR plus a spread of 145 basis points. The line may be extended at the Company's option for one year with payment of a fee of 0.15%. Monthly payments, if required, are interest only and vary depending upon the amount outstanding and the applicable interest rate for any given month.
- (hh) The loan is collateralized by Northrock and requires monthly principal and interest payments of approximately \$47,000 and a final payment of \$14.2 million at maturity. Principal of \$277,000 was amortized during 2014.
- (ii) The loan is collateralized by Metro Pike Center and requires monthly principal and interest payments of approximately \$48,000 and a final payment of \$14.8 million at loan maturity. Principal of \$288,000 was amortized during 2014.

The carrying value of the properties collateralizing the mortgage notes payable totaled \$895.5 million and \$907.2 million, as of December 31, 2014 and 2013, 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, 2014.

- maintain tangible net worth, as defined in the loan agreement, of at least \$542.1 million plus 80% of the Company's net equity proceeds received after March 2014;
- 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 2.0 x on a trailing four-quarter basis (interest expense coverage); and
- 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).

Mortgage notes payable at each of December 31, 2014 and 2013, totaling \$51.0 million, are guaranteed by members of the Saul Organization. As of December 31, 2014, 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
2015	\$ 14,885	\$ 23,192	\$ 38,077
2016	28,879	23,496	52,375
2017	—	24,679	24,679
2018	70,748 (a)	24,822	95,570
2019	60,794	23,489	84,283
Thereafter	426,652	135,752	562,404
Total	\$ 601,958	\$ 255,430	\$ 857,388

(a) Includes \$43.0 million outstanding under the line of credit.

The components of interest expense are set forth below.

## INTEREST EXPENSE

(In thousands)	Year ended December 31,		
	2014	2013	2012
Interest incurred	\$ 45,396	\$ 45,502	\$ 48,010
Amortization of deferred debt costs	1,327	1,257	1,576
Capitalized interest	(689)	(170)	(42)
Total	\$ 46,034	\$ 46,589	\$ 49,544

Deferred debt costs capitalized during the years ending December 31, 2014, 2013 and 2012 totaled \$1.3 million, \$3.2 million and \$2.2 million, respectively.

## 6. LEASE AGREEMENTS

Lease income includes primarily base rent arising from non-cancelable leases. Base rent (including straight-line rent) for the years ended December 31, 2014, 2013, and 2012, amounted to \$164.6 million, \$159.9 million, and \$152.8 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 RENT PAYMENTS

(In thousands)	
2015	\$ 152,661
2016	135,703
2017	116,025
2018	96,439
2019	73,626
Thereafter	275,551
Total	\$ 850,005

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, 2014, 2013, and 2012, amounted to \$32.1 million, \$30.9 million, and \$30.4 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, \$1.6 million, and \$1.5 million, for the years ended December 31, 2014, 2013, and 2012, 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, \$176,000, and \$176,000, for the years ended December 31, 2014, 2013, and 2012, respectively. The future minimum rental commitments under these ground leases are as follows:

(In thousands)	LONG-TERM LEASE OBLIGATIONS						
	Year ending December 31,						
	2015	2016	2017	2018	2019	Thereafter	Total
Beacon Center	\$ 60	\$ 60	\$ 60	\$ 60	\$ 60	\$ 2,541	\$ 2,841
Olney	56	56	56	56	57	3,760	4,041
Southdale	60	60	60	60	60	2,885	3,185
Total	\$ 176	\$ 176	\$ 176	\$ 176	\$ 177	\$ 9,186	\$ 10,067

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, 2014, 2013, and 2012 was \$840,800, \$850,600, and \$850,000, 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, 2014, 2013, and 2012 reflect noncontrolling interest of \$11.0 million, \$4.0 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 "Series A 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 2013, the Company redeemed 60% of its then-outstanding Series A Stock. In December 2014, the Company redeemed the remaining outstanding Series A Stock. Costs associated with the redemptions were charged against accumulated deficit in the respective periods.

In March 2008, the Company sold 3,173,115 depository shares, each representing 1/100th of a share of 9% Series B Cumulative Redeemable Preferred Stock (the "Series B Stock"). The depository 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 depository 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 depository 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 2013, the Company redeemed all of its Series B Stock. Costs associated with the redemption were charged against accumulated deficit.

On February 12, 2013, the Company sold, in an underwritten public offering, 5.6 million depository shares, each representing 1/100th of a share of 6.875% Series C Cumulative Redeemable Preferred Stock ("Series C Stock"), and received net cash proceeds of approximately \$135.2 million. The depository shares may be redeemed on or after February 12, 2018 at the Company's option, in whole or in part, at the \$25.00 liquidation preference plus accrued but unpaid dividends. The depository shares pay an annual dividend of \$1.71875 per share, equivalent to 6.875% of the \$25.00 liquidation preference. The first dividend was paid on April 15, 2013 and covered the period from February 12, 2013 through March 31, 2013. The Series C 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 depository 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 November 12, 2014, the Company sold, in an underwritten public offering, 1.6 million depository shares of Series C Stock and received net cash proceeds of approximately \$39.3 million (the "Additional Series C Stock"). The terms of Additional Series C Stock are identical to the Series C Stock.

## 9. RELATED PARTY TRANSACTIONS

The Chairman and Chief Executive Officer, the President and Chief Operating Officer, the Executive Vice President-Chief Legal and Administrative Officer 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, \$369,000, and \$379,000, for 2014, 2013, and 2012, respectively. All amounts deferred by employees and contributed by 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, 2014, 2013, and 2012, the Company contributed three times the amount deferred by employees. The Company's expense, included in general and administrative expense, totaled \$192,800, \$191,300, and \$238,000, for the years ended December 31, 2014, 2013, and 2012, respectively. All amounts deferred by employees and the Company are fully vested. The cumulative unfunded liability under this plan was \$1.8 million and \$1.6 million, at December 31, 2014 and 2013, 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, 2014, 2013, and 2012, which included rental expense for the Company's headquarters lease (see Note 7. Long Term Lease Obligations), totaled \$7.4 million, \$6.3 million, and \$6.0 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, 2014 and 2013, accounts payable, accrued expenses and other liabilities included \$543,000 and \$499,000, respectively, representing billings due to the Saul

Organization for the Company's share of these ancillary costs and expenses.

The Company has entered into a shared third-party predevelopment cost agreement with the B. F. Saul Real Estate Investment Trust, a member of the Saul Organization (the "Predevelopment Agreement"). The Predevelopment Agreement, which expires on December 31, 2015, and which may be extended to December 31, 2016, relates to the sharing of third-party predevelopment costs incurred in connection with the planning of the future redevelopment of certain adjacent real estate assets in the Twinbrook area of Rockville, Maryland. The costs will be billed by the third-parties on a pro rata basis based on the acreage owned by each entity and neither party is obligated to advance funds to the other.

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 \$427,300, \$447,300, and \$372,000, for the years ended December 31, 2014, 2013, and 2012, respectively.

Effective as of September 4, 2012, the Company entered into a consulting agreement with B. F. Saul III, one of the Company's former presidents, whereby Mr. Saul III provided certain consulting services to the Company as an independent contractor and was paid at a rate of \$60,000 per month. The consulting agreement included certain noncompete, nonsolicitation and nondisclosure covenants, and expired in September 2014. During 2014, 2013 and 2012 such consulting fees totaled \$495,000, \$720,000 and \$225,000, respectively.

## 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.

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 and further amended at the 2013 Annual Meeting (the "Amended 2004 Plan"). The Amended 2004 Plan, which terminates in 2023, provides for grants of options to purchase up to 2,000,000 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 Com-

mittee 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 May 6, 2005, the Compensation Committee granted options to purchase 162,500 shares (35,500 incentive stock options and 127,000 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 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 165,000 shares (27,560 incentive stock options and 137,440 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 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 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 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 195,000 shares (65,300 incentive stock options and 129,700 nonqualified stock options) to fifteen Company officers and thirteen 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 \$297,375 were assigned to the officer options and director options, respectively. Because the directors' options vested immediately, the entire \$297,375 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 277,500 shares (26,157 incentive stock options and 251,343 nonqualified stock options) to fifteen Company officers and fourteen 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 \$1.4 million and \$257,250 were assigned to the officer options and director options, respectively. Because the directors' options vested immediately, the entire \$257,250 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 10, 2013, the Compensation Committee granted options to purchase 237,500 shares (35,592 incentive stock options and 201,908 nonqualified stock options) to fifteen Company officers and fourteen Company Directors (the "2013 options"), which expire on May 9, 2023. The officers' 2013 Options vest 25% per year over four years and are subject to early expiration upon termination of employment. The directors' 2013 options were immediately exercisable. The exercise price of \$44.42 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 2013 Options to be \$1.5 million, of which \$1.3 million and \$0.3 million were assigned to the officer options and director options, respectively. Because the directors' options vested immediately, the entire \$0.3 million 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 option was vested.

Effective May 9, 2014, the Compensation Committee granted options to purchase 200,000 shares (29,300 incentive stock options and 170,700 nonqualified stock options) to eighteen Company officers and twelve Company Directors (the "2014 options"), which expire on May 8, 2024. The officers' 2014 Options vest 25% per year over four years and are subject to early expiration upon termination of employment. The directors' 2014 Options were immediately exercisable. The exercise price of \$47.03 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 2014 Options to be \$1.3 million, of which \$1.2 million and \$109,500 were assigned to the officer options and director options, respectively. Because the directors' options vested immediately, the entire \$109,500 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, 2014, 2013 and 2012:

**STOCK OPTIONS ISSUED TO DIRECTORS**

Grant date	5/6/2005	5/1/2006	4/27/2007	4/25/2008	4/24/2009	5/7/2010	5/13/2011	5/4/2012	5/10/2013	5/9/2014	Subtotals
Total grant	30,000	30,000	30,000	30,000	32,500	32,500	32,500	35,000	35,000	30,000	317,500
Vested	30,000	30,000	30,000	30,000	32,500	32,500	32,500	35,000	35,000	30,000	317,500
Exercised	22,500	10,000	—	—	20,000	10,000	10,000	10,000	7,500	—	90,000
Forfeited	—	2,500	7,500	7,500	—	2,500	2,500	—	—	—	22,500
Exercisable at											
December 31, 2014	7,500	17,500	22,500	22,500	12,500	20,000	20,000	25,000	27,500	30,000	205,000
Remaining unexercised	7,500	17,500	22,500	22,500	12,500	20,000	20,000	25,000	27,500	30,000	205,000
Exercise price	\$ 33.22	\$ 40.35	\$ 54.17	\$ 50.15	\$ 32.68	\$ 38.76	\$ 41.82	\$ 39.29	\$ 44.42	\$ 47.03	
Volatility	0.198	0.206	0.225	0.237	0.344	0.369	0.358	0.348	0.333	0.173	
Expected life (years)	10.0	9.0	8.0	7.0	6.0	5.0	5.0	5.0	5.0	5.0	
Assumed yield	6.91%	5.93%	4.39%	4.09%	4.54%	4.23%	4.16%	4.61%	4.53%	4.48%	
Risk-free rate	4.28%	5.11%	4.65%	3.49%	2.19%	2.17%	1.86%	0.78%	0.82%	1.63%	
Gross value at grant date	\$ 71,100	\$ 143,400	\$ 285,300	\$ 254,700	\$ 222,950	\$ 287,950	\$ 297,375	\$ 257,250	\$ 278,250	\$ 109,500	\$ 2,207,775
Expensed in											
previous years	71,100	143,400	285,300	254,700	222,950	287,950	297,375	—	—	—	1,562,775
Expensed in 2012	—	—	—	—	—	—	—	257,250	—	—	257,250
Expensed in 2013	—	—	—	—	—	—	—	—	278,250	—	278,250
Expensed in 2014	—	—	—	—	—	—	—	—	—	109,500	109,500
Future expense	—	—	—	—	—	—	—	—	—	—	—

**STOCK OPTIONS ISSUED TO OFFICERS AND GRAND TOTALS**

Grant date	5/6/2005	4/27/2007	5/13/2011	5/4/2012	5/10/2013	5/9/2014	Subtotals	Grand Totals
Total grant	132,500	135,000	162,500	242,500	202,500	170,000	1,045,000	1,362,500
Vested	118,750	67,500	105,625	56,250	50,625	—	398,750	716,250
Exercised	115,750	3,528	46,889	30,000	15,625	—	211,792	301,792
Forfeited	13,750	67,500	43,750	135,000	30,000	—	290,000	312,500
Exercisable at								
December 31, 2014	3,000	63,972	47,486	26,250	35,000	—	175,708	380,708
Remaining unexercised	3,000	63,972	71,861	77,500	156,875	170,000	543,208	748,208
Exercise price	\$ 33.22	\$ 54.17	\$ 41.82	\$ 39.29	\$ 44.42	\$ 47.03		
Volatility	0.207	0.233	0.330	0.315	0.304	0.306		
Expected life (years)	8.0	6.5	8.0	8.0	8.0	7.0		
Assumed yield	6.37%	4.13%	4.81%	5.28%	5.12%	4.89%		
Risk-free rate	4.15%	4.61%	2.75%	1.49%	1.49%	2.17%		
Gross value at grant date	\$ 413,400	\$ 1,339,200	\$ 1,366,625	\$ 1,518,050	\$ 1,401,300	\$ 1,349,800	\$ 7,388,375	\$ 9,596,150
Estimated forfeitures	35,100	62,000	387,550	889,690	280,468	168,749	1,823,557	1,823,557
Expensed in								
previous years	378,300	1,277,200	186,347	—	—	—	1,841,847	3,404,622
Expensed in 2012	—	—	270,391	104,724	—	—	375,115	632,365
Expensed in 2013	—	—	235,350	157,083	209,027	—	601,460	879,710
Expensed in 2014	—	—	217,475	157,092	283,910	196,848	855,325	964,825
Future expense	—	—	69,512	209,461	627,895	984,203	1,891,071	1,891,071

Weighted average term of remaining future expense 2.7 years

	OPTION ACTIVITY					
	2014		2013		2012	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at January 1	753,625	\$ 42.55	570,840	\$ 41.04	674,585	\$ 40.40
Granted	200,000	47.03	237,500	44.42	277,500	39.29
Exercised	(167,917)	37.71	(49,715)	33.15	(149,995)	31.03
Expired/Forfeited	(37,500)	43.56	(5,000)	52.16	(231,250)	43.56
Outstanding December 31	<u>748,208</u>	44.79	<u>753,625</u>	42.55	<u>570,840</u>	41.04
Exercisable at December 31	<u>380,708</u>	44.85	<u>413,000</u>	42.42	<u>377,715</u>	41.41

The intrinsic value of options exercised in 2014, 2013, and 2012, was \$2.0 million, \$0.6 million and \$1.6 million, respectively. The intrinsic value of options outstanding and exercisable at year end 2014 was \$9.3 million and \$4.7 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, 2014, the final trading day of calendar 2014, the closing price of \$57.19 per share was used for the calculation of aggregate intrinsic value of options outstanding and exercisable at that date. At December 31, 2014, there were no options with an exercise price in excess of the market closing price. The weighted average remaining contractual life of the Company's exercisable and outstanding options at December 31, 2014 are 5.4 and 7.0 years, respectively.

## 11. NON-OPERATING ITEMS

Gain on casualty settlement in 2013 and 2012 reflect insurance proceeds received in excess of the carrying value of assets damaged during a hail storm at French Market in 2012. 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 3.65% and 4.85%, would be approximately \$886.4 million and \$828.7 million as of December 31, 2014 and 2013, respectively, compared

to the carrying value of \$784.8 million and \$789.9 million at December 31, 2014 and 2013, 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.

	SWAPS FAIR VALUE		
	Year ended December 31,		
(In thousands)	2014	2013	2012
Increase (decrease) in fair value:			
Recognized in earnings	\$ (10)	\$ (7)	\$ 36
Recognized in other comprehensive income	(675)	2,897	(932)
Total	<u>\$ (685)</u>	<u>\$ 2,890</u>	<u>\$ (896)</u>

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 agreement terminates



on July 1, 2020. As of December 31, 2014, the fair value of the interest-rate swap was approximately \$3.2 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 rein-

vesting 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 \$1.56 per share in 2014 and \$1.44 per share during each of 2013 and 2012, Series A preferred stock dividends of \$2.41 per share in 2014 and \$2.00 per depository share during each of 2013 and 2012, Series B preferred stock dividends of \$0.99 and \$2.25 per share during 2013 and 2012, respectively, and Series C preferred stock dividends of \$1.72 and \$1.09 per depository share during 2014 and 2013, respectively. Of the common stock dividends paid, \$1.56 per share, \$0.96 per share, and \$0.95 per share, represented ordinary dividend income in 2014, 2013, and 2012, respectively and \$0.48 per share and \$0.49 per share, represented return of capital to the shareholders in 2013 and 2012, respectively. All of the preferred stock dividends paid were considered ordinary dividend income.

The following summarizes distributions paid during the years ended December 31, 2014, 2013, and 2012, and includes activity in the Plan as well as limited partnership units issued from the reinvestment of unit distributions:

(Dollars in thousands, except per share amounts)	Total Distributions to			Common Stock Shares Issued	Dividend Reinvestments		Average Unit Price
	Preferred Stockholders	Common Stockholders	Limited Partnership Unitholders		Discounted Share Price	Limited Partnership Units Issued	
<b>Distributions during 2014</b>							
October 31	\$ 3,856	\$ 8,348	\$ 2,879	40,142	\$ 52.71		
July 31	3,206	8,314	2,879	57,696	46.79		
April 30	3,206	8,269	2,838	60,212	44.14	104,831	\$ 44.77
January 31	3,206	7,415	2,521	39,588	45.15	91,352	45.80
Total 2014	\$ 13,474	\$ 32,346	\$ 11,117	197,638		196,183	
<b>Distributions during 2013</b>							
October 31	\$ 3,206	\$ 7,388	\$ 2,489	48,836	\$ 46.27	88,309	\$ 46.93
July 31	3,206	7,327	2,489	138,019	45.21		
April 30	4,364	7,272	2,489	142,839	42.85		
January 31	3,785	7,218	2,489	145,468	41.67		
Total 2013	\$ 14,561	\$ 29,205	\$ 9,956	475,162		88,309	
<b>Distributions during 2012</b>							
October 31	\$ 3,785	\$ 7,120	\$ 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	6,947	2,489	163,429	34.44		
Total 2012	\$ 15,140	\$ 28,135	\$ 9,956	595,388			

In December 2014, the Board of Directors of the Company authorized a distribution of \$0.40 per common share payable in January 2015, to holders of record on January 16, 2015. As a result, \$8.4 million was paid to common shareholders on January 30, 2015. Also, \$2.9 million was paid to limited partnership unitholders on January 30, 2015 (\$0.40 per Operating Partnership unit). The Board of Directors authorized preferred stock dividends of \$0.4297 per Series C depository share to

holders of record on January 7, 2015. As a result, \$3.1 million was paid to preferred shareholders on January 15, 2015. These amounts are reflected as a reduction of stockholders' equity in the case of common stock and preferred stock dividends and noncontrolling interests 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 2014 and 2013.

(In thousands, except per share amounts)

	2014			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Revenue	\$ 52,947	\$ 52,286	\$ 50,595	\$ 51,264
Operating income before loss on early extinguishment of debt, gain on casualty settlement, and noncontrolling interests	12,713	14,423	12,479	12,314
Gain on sales of properties	—	6,069	—	—
Net income attributable to Saul Centers, Inc.	10,287	16,054	10,106	10,496
Net income available to common shareholders	7,081	12,847	6,900	5,274
Net income available to common shareholders per diluted share	0.34	0.62	0.33	0.25

	2013			
	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
Revenue	\$ 49,186	\$ 48,809	\$ 49,756	\$ 50,146
Operating income before loss on early extinguishment of debt, gain on casualty settlement, and noncontrolling interests	3,388	7,711	11,959	12,211
Net income attributable to Saul Centers, Inc.	4,984	6,594	9,398	9,896
Net income (loss) available to common shareholders	(4,608)	3,387	6,192	6,690
Net income (loss) available to common shareholders per diluted share	(0.23)	0.17	0.30	0.33

## 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 2014 presentation.

<i>(In thousands)</i>	Shopping Centers	Mixed-Use Properties	Corporate and Other	Consolidated Totals
<b>As of or for the year ended December 31, 2014</b>				
Real estate rental operations:				
Revenue	\$ 154,385	\$ 52,632	\$ 75	\$ 207,092
Expenses	(33,781)	(15,732)	—	(49,513)
Income from real estate	120,604	36,900	75	157,579
Interest expense and amortization of deferred debt costs	—	—	(46,034)	(46,034)
General and administrative	—	—	(16,961)	(16,961)
Subtotal	120,604	36,900	(62,920)	94,584
Depreciation and amortization of deferred leasing costs	(28,082)	(13,121)	—	(41,203)
Acquisition related costs	(949)	—	—	(949)
Predevelopment expenses	—	(503)	—	(503)
Change in fair value of derivatives	—	—	(10)	(10)
Gain on sale of property	6,069	—	—	6,069
Net income (loss)	\$ 97,642	\$ 23,276	\$ (62,930)	\$ 57,988
Capital investment	\$ 66,508	\$ 23,760	\$ —	\$ 90,268
Total assets	\$ 946,819	\$ 307,901	\$ 12,267	\$ 1,266,987
<b>As of or for the year ended December 31, 2013</b>				
Real estate rental operations:				
Revenue	\$ 145,219	\$ 52,609	\$ 69	\$ 197,897
Expenses	(30,729)	(17,213)	—	(47,942)
Income from real estate	114,490	35,396	69	149,955
Interest expense and amortization of deferred debt costs	—	—	(46,589)	(46,589)
General and administrative	—	—	(14,951)	(14,951)
Subtotal	114,490	35,396	(61,471)	88,415
Depreciation and amortization of deferred leasing costs	(27,340)	(21,790)	—	(49,130)
Acquisition related costs	(106)	—	—	(106)
Predevelopment expenses	—	(3,910)	—	(3,910)
Change in fair value of derivatives	—	—	(7)	(7)
Loss on early extinguishment of debt	—	—	(497)	(497)
Gain on casualty settlement	77	—	—	77
Net income (loss)	\$ 87,121	\$ 9,696	\$ (61,975)	\$ 34,842
Capital investment	\$ 18,232	\$ 8,207	\$ —	\$ 26,439
Total assets	\$ 888,109	\$ 293,512	\$ 17,054	\$ 1,198,675

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

<i>(In thousands)</i>	Shopping Centers	Mixed-Use Properties	Corporate and Other	Consolidated Totals
<b>As of or for the year ended December 31, 2012</b>				
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)
Acquisition related costs	(1,129)	—	—	(1,129)
Predevelopment expenses	—	(2,667)	—	(2,667)
Change in fair value of derivatives	—	—	36	36
Gain on casualty settlement	219	—	—	219
Gains on sales of properties	4,510	—	—	4,510
Loss from operations of property sold	(81)	—	—	(81)
Net income (loss)	\$ 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

## 17. SUBSEQUENT EVENTS

The Company has reviewed operating activities for the period subsequent to December 31, 2014 and prior to the date that financial statements are issued, March 6, 2015, and determined there are no subsequent events that are required to be disclosed.

## 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 more than the required amount in 2014 and 2013. Distributions by the Company to common stockholders and holders of limited partnership units in the Operating Partnership were \$43.5 million and \$39.2 million in 2014 and 2013, respectively. Distributions to preferred stockholders were \$13.5 million and \$14.6 million in 2014 and 2013, respectively. 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, prior to distributions on the common stock.

The Company paid four quarterly distributions totaling \$1.56, \$1.44 and \$1.44 per common share during 2014, 2013 and 2012, respectively. The annual distribution amounts paid by the Company exceeded 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. All of the 2014 common dividends were treated as taxable dividends. Of the \$1.44 per common share dividend paid in 2013, 67% was treated as a taxable dividend and 33% was treated as a return of capital. Of the \$1.44 per common share dividend paid in 2012, 66% was treated as a taxable dividend income and 34% was treated as a return of capital. No assurance can be given regarding what portion, if any, of distributions in 2015 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.

## MARKET INFORMATION

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 Company's shares of common stock were reported by the New York Stock Exchange for each quarter of 2014 and 2013 as follows:

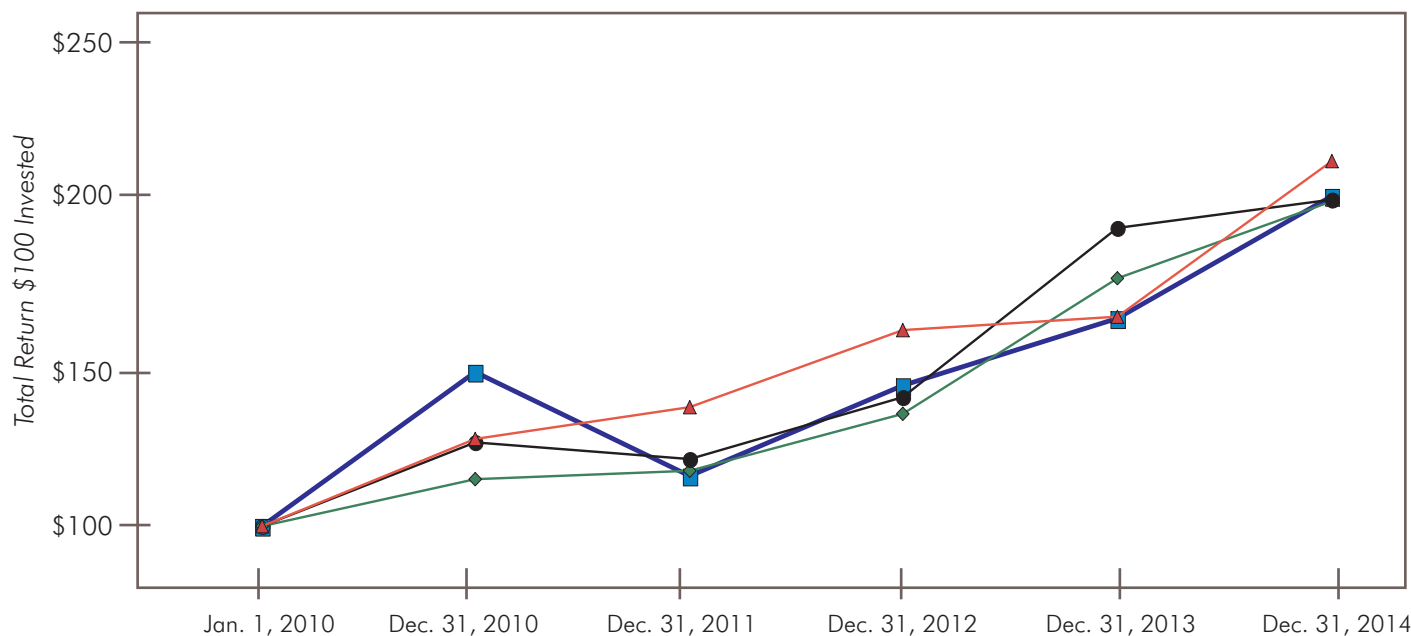
Period	Share Price	
	High	Low
October 1, 2014 – December 31, 2014	\$ 58.56	\$ 46.83
July 1, 2014 – September 30, 2014	\$ 50.35	\$ 45.98
April 1, 2014 – June 30, 2014	\$ 50.53	\$ 45.51
January 1, 2014 – March 31, 2014	\$ 48.20	\$ 45.06
October 1, 2013 – December 31, 2013	\$ 49.19	\$ 45.86
July 1, 2013 – September 30, 2013	\$ 48.49	\$ 43.10
April 1, 2013 – June 30, 2013	\$ 47.83	\$ 42.66
January 1, 2013 – March 31, 2013	\$ 44.94	\$ 41.43

On March 3, 2015, the closing price was \$54.64 per share  
The approximate number of holders of record of the common stock was 205 as of March 3, 2015.

# 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, 2010.

## Comparison of Cumulative Total Return



	Jan. 1, 2010	Dec. 31, 2010	Dec. 31, 2011	Dec. 31, 2012	Dec. 31, 2013	Dec. 31, 2014
■ Saul Centers	\$100	\$150	\$116	\$145	\$167	\$207
◆ S&P 500	\$100	\$115	\$117	\$136	\$180	\$205
● Russell 2000	\$100	\$127	\$122	\$141	\$196	\$206
▲ NAREIT Equity	\$100	\$128	\$139	\$164	\$168	\$218

## DIRECTORS

### **B. Francis Saul II**

Chairman and Chief Executive Officer

### **J. Page Lansdale**

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

### **Charles R. Longworth**

Chairman Emeritus, Colonial  
Williamsburg Foundation

### **Patrick F. Noonan**

Founder/Chairman Emeritus,  
The Conservation Fund

### **H. Gregory Platts**

Senior Vice President and  
Treasurer, Emeritus,  
National Geographic Society

### **Andrew M. Saul II**

Chief Executive Officer  
Genovation Cars

### **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

### **J. Page Lansdale**

President and Chief  
Operating Officer

### **Christine N. Kearns**

Executive Vice President – Chief  
Legal and Administrative Officer

### **Scott V. Schneider**

Senior Vice President,  
Chief Financial Officer,  
Treasurer and Secretary

### **Debra Stencel**

Senior Vice President and  
General Counsel

### **Joel A. Friedman**

Senior Vice President,  
Chief Accounting Officer

### **Christopher H. Netter**

Senior Vice President, Retail Leasing

### **Steven N. Corey**

Senior Vice President, Office Leasing

### **John F. Collich**

Senior Vice President,  
Acquisitions and Development

### **Donald A. Hachey**

Senior Vice President, Construction

### **Charles W. Sherren, Jr.**

Senior Vice President, Management

## COUNSEL

Pillsbury Winthrop  
Shaw Pittman LLP  
Washington, DC 20037

## INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Ernst and Young LLP  
McLean, Virginia 22102

## WEB SITE

[www.saulcenters.com](http://www.saulcenters.com)

## EXCHANGE LISTING

New York Stock  
Exchange (NYSE) Symbol:  
Common Stock: BFS  
Preferred Stock: 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 2014, 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





Seven Corners, Falls Church, VA

## Annual Meeting of Stockholders

The Annual Meeting of Stockholders will be held at 11:00 a.m., local time, on May 8, 2015, 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

7501 Wisconsin Avenue, Suite 1500E

Bethesda, MD 20814-6522

Phone: (301) 986-6200

Website: [www.saulcenters.com](http://www.saulcenters.com)