

SAUL CENTERS INC
Form 10-K
March 12, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2011

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from **to**

Commission File number 1-12254

SAUL CENTERS, INC.

(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of

52-1833074
(I.R.S. Employer

incorporation or organization)

Identification No.)

7501 Wisconsin Avenue, Suite 1500, Bethesda, Maryland 20814-6522

(Address of principal executive offices) (Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, Par Value \$0.01 Per Share	New York Stock Exchange
Depository Shares each representing 1/100 th of a share of 8% Series A	New York Stock Exchange
Cumulative Redeemable Preferred Stock, Par Value, \$0.01 Per Share	

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Depository Shares each representing 1/100th of a share of 9% Series B
Cumulative Redeemable Preferred Stock, Par Value, \$0.01 Per Share

New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: N/A

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act Yes No .

Indicate by check mark whether registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in the definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

The number of shares of Common Stock, \$0.01 par value, outstanding as of March 1, 2012 was 19,458,000.

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the closing price of the registrant's Common Stock on the New York Stock Exchange on June 30, 2011 was \$454.1 million.

DOCUMENTS INCORPORATED BY REFERENCE:

Registrant incorporates by reference into Part III (Items 10, 11, 12, 13 and 14) of this Annual Report on Form 10-K portions of registrant's definitive Proxy Statement for the 2012 Annual Meeting of Stockholders to be filed with the Securities Exchange Commission pursuant to Regulation 14A. The definitive Proxy Statement will be filed with the Commission not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

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PART I

Cautionary Statement Regarding Forward-Looking Statements

Certain statements contained herein constitute forward-looking statements as such term is defined in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are not guarantees of performance. Our future results, financial condition and business may differ materially from those expressed in these forward-looking statements. You can find many of these statements by looking for words such as plans, intends, estimates, anticipates, expects, believes or similar expressions in this Form 10-K. These forward-looking statements are subject to numerous assumptions, risks and uncertainties. Many of the factors that will determine these items are beyond our ability to control or predict. For further discussion of these factors, see Item 1A. Risk Factors in this Form 10-K.

For these statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. You are cautioned not to place undue reliance on our forward-looking statements, which speak only as of the date of this Form 10-K or the date of any document incorporated by reference. All subsequent written and oral forward-looking statements attributable to us or any person acting on our behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. We do not undertake any obligation to release publicly any revisions to our forward-looking statements to reflect events or circumstances after the date of this Form 10-K.

Item 1. Business

General

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.

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.

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-use properties, and the management functions related to the transferred properties. Since its formation, the Company has developed and purchased additional properties.

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The following table lists the properties acquired and/or developed by the Company since January 1, 2009.

Name of Property	Location	Type	Square Footage	Date of Acquisition/ Development
<i>Acquisitions</i>				
11503 Rockville Pike	Rockville, MD	Shopping Center	20,000	2010
Metro Pike Center	Rockville, MD	Shopping Center	67,000	2010
4469 Connecticut Ave	Washington, DC	Mixed-Use	3,000	2011
Kentlands Square II	Gaithersburg, MD	Shopping Center	241,000	2011
Severna Park MarketPlace	Severna Park, MD	Shopping Center	254,000	2011
Cranberry Square	Westminster, MD	Shopping Center	141,000	2011
<i>Developments</i>				
Northrock	Warrenton, VA	Shopping Center	103,000	2009
Westview Village	Frederick, MD	Shopping Center	101,000	2009
Clarendon Center North	Arlington, VA	Mixed-Use	108,000	2010/2011
Clarendon Center South	Arlington, VA	Mixed-Use	294,000	2010/2011

As of December 31, 2011, the Company's properties (the Current Portfolio Properties) consisted of 51 shopping center properties (the Shopping Centers), seven mixed-use properties which are comprised of office, retail and multi-family residential uses (the Mixed-Use Properties) and two (non-operating) development properties. Shopping Centers and Mixed-Use Properties represent reportable business segments for financial reporting purposes. Revenue, net income, total assets and other financial information of each reportable segment are described in Note 16 to the Consolidated Financial Statements contained in Item 8 of this Form 10-K.

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

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Organizational Structure

The Company conducts its business through the Operating Partnership and/or directly or indirectly owned subsidiaries. The following diagram depicts the Company's organizational structure and beneficial ownership of the common and preferred stock of Saul Centers calculated pursuant to Rule 13d-3 of the Exchange Act as of December 31, 2011.

- (1) The Saul Organization's ownership percentage in Saul Centers reported above does not include units of limited partnership interest of the Operating Partnership held by The Saul Organization. In general, most units are convertible into shares of the Company's common stock on a one-for-one basis. However, not all of the units may be convertible into the Company's common stock because (i) the articles of incorporation limit beneficial and constructive ownership (defined by reference to various Code provisions) to 39.9% in value of the Company's issued and outstanding equity securities, which comprise the ownership limit and (ii) the convertibility of some of the outstanding units is subject to approval of the Company's stockholders.

Management of the Current Portfolio Properties

The Operating Partnership manages the Current Portfolio Properties and will manage any subsequently acquired or developed properties. The management of the properties includes performing property management, leasing, design, renovation, development and accounting duties for each property. The Operating Partnership provides each property with a fully integrated property management capability, with approximately 63 employees and with an extensive and mature network of relationships with tenants and potential tenants as well as with members of the brokerage and property owners' communities. The Company currently does not, and does not intend to, retain third party managers or provide management services to third parties.

The Company augments its property management capabilities by sharing with The Saul Organization certain ancillary functions, at cost, such as information technology and payroll services, benefits administration and in-house legal services. The Company also shares insurance administration expenses on a pro rata basis with The Saul Organization. Management believes that these arrangements result in lower costs than could be obtained by contracting with third parties. These arrangements permit the Company to capture greater economies of scale in purchasing from third party vendors than would otherwise be available to the Company alone and to capture internal economies of scale by avoiding payments representing profits with respect to functions provided internally. The terms of all sharing arrangements with The Saul Organization, including payments related thereto, are specified in a written agreement and are reviewed annually by the Audit Committee of the Company's Board of Directors.

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The Company subleases its corporate headquarters space from The Saul Organization at the Company's share of the cost. A discussion of the lease terms are provided in Note 7, Long Term Lease Obligations, of the Notes to Consolidated Financial Statements.

Principal Offices

The principal offices of the Company are located at 7501 Wisconsin Avenue, Suite 1500, Bethesda, Maryland 20814-6522, and the Company's telephone number is (301) 986-6200. The Company's internet web address is www.saulcenters.com. Information contained on the Company's website is not part of this report. The Company makes available free of charge on its website its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after the reports are electronically filed with, or furnished to, the Securities and Exchange Commission (SEC). Alternatively, you may access these reports at the SEC's website: www.sec.gov.

Policies with Respect to Certain Activities

The following is a discussion of the Company's operating strategy and certain of its investment, financing and other policies. These strategies and policies have been determined by the Board of Directors and, in general, may be amended or revised from time to time by the Board of Directors without a vote of the Company's stockholders.

Operating Strategies

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. Community and neighborhood shopping centers typically provide reliable cash flow and steady long-term growth potential. Management actively manages its property portfolio by engaging in strategic leasing activities, tenant selection, lease negotiation and shopping center expansion and reconfiguration. The Company seeks to optimize tenant mix by selecting tenants for its shopping centers that provide a broad spectrum of goods and services, consistent with the role of community and neighborhood shopping centers as the source for day-to-day necessities. Management believes that such a synergistic tenancing approach results in increased cash flow from existing tenants by providing the Shopping Centers with consistent traffic and a desirable mix of shoppers, resulting in increased sales and, therefore, increased cash flows.

Management believes there is potential for long term growth in cash flow as existing leases for space in the Shopping Centers expire and are renewed, or newly available or vacant space is leased. The Company intends to renegotiate leases where possible and seek new tenants for available space in order to 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 will also seek growth opportunities in its Washington, DC metropolitan area mixed-use portfolio, primarily through development and redevelopment, as evidenced by the recent completion of the development of Clarendon Center in Arlington County, Virginia. Management also intends to negotiate lease renewals or to re-lease available space in the Mixed-Use Properties, while considering the strategic balance of optimizing short-term cash flow and long-term asset value.

It is management's intention to hold properties for long-term investment and to place strong emphasis on regular maintenance, periodic renovation and capital improvement. Management believes that characteristics such

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as cleanliness, lighting and security are particularly important in community and neighborhood shopping centers, which are frequently visited by shoppers during hours outside of the normal work-day. Management believes that the Shopping Centers and Mixed-Use Properties generally are attractive and well maintained. The Shopping Centers and Mixed-Use Properties will undergo expansion, renovation, reconfiguration and modernization from time to time when management believes that such action is warranted by opportunities or changes in the competitive environment of a property. During 2011, 2010 and 2009, the Company redeveloped or expanded two of its operating properties, Smallwood Village Center and Seven Corners, and developed two new shopping centers, Westview Village and Northrock. Additionally, the Company has completed the construction of Clarendon Center, a mixed-use development containing ground floor retail, office and multi-family residential units. The Company will continue its practice of expanding existing properties by undertaking new construction on outparcels suitable for development as free standing retail or office facilities.

Investment in Real Estate or Interests in Real Estate

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 retail redevelopments and renovations.

The Company recently acquired three Giant Food-anchored shopping centers located in the Maryland suburbs of the Washington, DC and Baltimore metropolitan area. The three centers, Kentlands Square II, Severna Park MarketPlace and Cranberry Square, total 636,000 square feet of leasable area, of which 98% is leased. The \$170.9 million purchase price, including acquisition costs, was financed with (1) \$60.0 million from two bridge loans secured by Kentlands Square II and Cranberry Square; (2) a \$38.0 million non-recourse permanent loan secured by Severna Park MarketPlace; (3) approximately \$17.1 million in cash and borrowings from the Company's revolving credit facility; and (4) \$55.8 million from the issuance of equity to a related party. In light of the limited amount of quality properties for sale and the escalated pricing of properties that the Company has been presented with or has inquired about over the past year, management believes acquisition opportunities for investment in existing and new Shopping Center and Mixed-Use Properties in the near future is uncertain. Because of its conservative capital structure, including its cash and capacity under its revolving credit facility, management believes that the Company is 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.

In evaluating a particular redevelopment, renovation, acquisition, or development, management will consider a variety of factors, including (i) the location and accessibility of the property; (ii) the geographic area (with an emphasis on the Washington, DC/Baltimore metropolitan area and the southeastern region of the United States) and demographic characteristics of the community, as well as the local real estate market, including potential for growth and potential regulatory impediments to development; (iii) the size of the property; (iv) the purchase price; (v) the non-financial terms of the proposed acquisition; (vi) the availability of funds or other consideration for the proposed acquisition and the cost thereof; (vii) the fit of the property with the Company's existing portfolio; (viii) the potential for, and current extent of, any environmental problems; (ix) the current and historical occupancy rates of the property or any comparable or competing properties in the same market; (x) the quality of construction and design and the current physical condition of the property; (xi) the financial and other characteristics of existing tenants and the terms of existing leases; and (xii) the potential for capital appreciation.

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

The Company intends to engage in such future investment or development activities in a manner that is consistent with the maintenance of its status as a REIT for federal income tax purposes and that will not make the

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Company become regulated as an investment company under the Investment Company Act of 1940, as amended. Equity investments in acquired properties may be subject to existing mortgage financings and other indebtedness or to new indebtedness which may be incurred in connection with acquiring or refinancing these investments.

Investments in Real Estate Mortgages

While the Company's current portfolio and business objectives emphasize equity investments in commercial and neighborhood shopping centers and mixed-use properties, the Company may, at the discretion of the Board of Directors, invest in mortgages, participating or convertible mortgages, deeds of trust and other types of real estate interests consistent with its qualification as a REIT. The Company does not presently invest, nor does it intend to invest, in real estate mortgages.

Investments in Securities of or Interests in Persons Engaged in Real Estate Activities and Other Issues

Subject to the requirements to maintain REIT qualification, the Company may invest in securities of other REITs, other entities engaged in real estate activities or securities of other issuers, including for the purpose of exercising control over such entities. The Company does not presently invest, nor does it intend to invest, in any securities of other REITs.

Dispositions

In 2010, the Company sold its Lexington property for \$8.1 million and recognized a gain of \$3.6 million. The Company may elect to dispose of other properties if, based upon management's periodic review of the Company's portfolio, the Board of Directors determines that such action would be in the best interest of the Company's stockholders.

Capital Policies

The Company has established a debt capitalization policy relative to asset value, which is computed by reference to the aggregate annualized cash flow from the properties in the Company's portfolio rather than relative to book value. The Company has used a measure tied to cash flow because it believes that the book value of its portfolio properties, which is the depreciated historical cost of the properties, does not accurately reflect the Company's ability to incur indebtedness. Asset value, however, is somewhat more variable than book value, and may not at all times reflect the fair market value of the underlying properties. 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. Given the Company's current debt level, it is management's belief that the ratio of the Company's debt to total asset value is below 50% as of December 31, 2011.

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, subject to maintaining compliance with financial covenants within existing debt agreements. The Company selectively continues to refinance or renegotiate the terms of its outstanding debt in order to achieve longer maturities, and obtain generally more favorable loan terms, whenever management determines the financing environment is favorable.

The Company intends to finance future acquisitions and developments and to make debt repayments by utilizing the sources of capital then deemed to be most advantageous. Such sources may include undistributed operating cash flow, secured or unsecured bank and institutional borrowings, proceeds from the Company's Dividend Reinvestment and Stock Purchase Plan, proceeds from the sale of properties and private and public offerings of debt or equity securities. Borrowings may be at the Operating Partnership or Subsidiary Partnerships level and securities offerings may include (subject to certain limitations) the issuance of Operating Partnership interests convertible into common stock or other equity securities.

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Other Policies

The Company has the authority to offer equity or debt securities in exchange for property and to repurchase or otherwise acquire its common stock or other securities in the open market or otherwise, and may engage in such activities in the future. The Company expects, but is not obligated, to issue common stock to holders of units of the Operating Partnership upon exercise of their redemption rights. The Company has not engaged in trading, underwriting or agency distribution or sale of securities of other issuers other than the Operating Partnership and does not intend to do so. The Company has not made any loans to third parties, although the Company may in the future make loans to third parties. In addition, the Company has policies relating to related party transactions discussed in Item 1A. Risk Factors.

Competition

As an owner of, or investor in, community and neighborhood shopping centers and mixed-use properties, the Company is subject to competition from an indeterminate number of companies in connection with the acquisition, development, ownership and leasing of similar properties. These investors include investors with access to significant capital, such as domestic and foreign corporations and financial institutions, publicly traded and privately held REITs, private institutional investment funds, investment banking firms, life insurance companies and pension funds.

Competition may reduce properties available for acquisition or development or increase prices for raw land or developed properties of the type in which the Company invests. The Company faces competition in providing leases to prospective tenants and in re-letting space to current tenants upon expiration of their respective leases. If tenants decide not to renew or extend their leases upon expiration, the Company may not be able to re-let the space. Even if the tenants do renew or the Company can re-let the space, the terms of renewal or re-letting, including the cost of required renovations, may be less favorable than current lease terms or than expectations for the space. This risk may be magnified if the properties owned by our competitors have lower occupancy rates than the Company's properties. As a result, these competitors may be willing to make space available at lower prices than the space in the Current Portfolio Properties.

Management believes that success in the competition for ownership and leasing property is dependent in part upon the geographic location of the property, the tenant mix, the performance of property managers, the amount of new construction in the area and the maintenance and appearance of the property. Additional competitive factors impacting the Company's properties include the ease of access to the properties, the adequacy of related facilities such as parking, and the demographic characteristics in the markets in which the properties compete. Overall economic circumstances and trends and new properties in the vicinity of each of the Current Portfolio Properties are also competitive factors.

Finally, retailers at our Shopping Centers face increasing competition from outlet stores, discount shopping clubs and other forms of marketing goods, such as direct mail, internet marketing and telemarketing. This competition may reduce percentage rents payable to us and may contribute to lease defaults or insolvency of tenants.

Environmental Matters

The Current Portfolio Properties are subject to various laws and regulations relating to environmental and pollution controls. The impact upon the Company from the application of such laws and regulations either prospectively or retrospectively is not expected to have a materially adverse effect on the Company's property operations. As a matter of policy, the Company requires an environmental study be performed with respect to a property that may be subject to possible environmental hazards prior to its acquisition to ascertain that there are no material environmental hazards associated with such property.

Employees

As of March 1, 2012, the Company employed approximately 63 persons, including seven leasing officers. None of the Company's employees are covered by collective bargaining agreements. Management believes that its relationship with employees is good.

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Recent Developments

The current economic situation, including constraints on credit availability, high unemployment and lower housing values, has had an effect on the Company's results of operations. During 2011, four of the Company's significant tenants were involved in bankruptcy proceedings. Blockbuster Video has rejected leases at two locations. Two other leases were transferred to Dish Network Corp. and store operations have continued. Borders Bookstore has liquidated all of its stores including its single location with the Company at Thruway. Superfresh (a) closed its Lumberton, New Jersey store effective April 18, 2011 and rejected this lease and (b) announced its plan to accept the lease at the Company's Shops at Fairfax, which is currently subleased to Super H Grocery. Syms Corporation filed for bankruptcy protection and closed its Syms store at Seven Corners Center. These bankruptcy proceedings are the only known bankruptcies involving the Company's significant tenants.

With the decline in overall consumer spending, retailers continue to struggle with declining sales and limited access to capital. Vacancies remain elevated compared to pre-recession levels. Our overall portfolio leasing percentage, on a comparative same center basis, at December 31, 2011 was 89.4%, a decrease from 91.1% at December 31, 2010. The 2011 commercial leasing percentages were adversely impacted by a net decrease of approximately 140,000 square feet of leased space, of which approximately 98,000 square feet was caused by the Syms, SuperFresh and Borders Books bankruptcies and the balance resulting from the early lease termination of a local grocer. As of March 1, 2012, a total of 61,000 square feet of these four vacant spaces had been leased.

Because of a conservative capital structure, the Company's liquidity has not been significantly affected by the recent turmoil in the credit markets. First, the ratio of total debt to the estimated fair value of its assets is less than 50%, which allows the Company to obtain additional secured borrowings if necessary. Second, as of December 31, 2011, amortizing fixed-rate mortgage debt with staggered maturities from 2012 to 2026, represented approximately 97% of the Company's notes payable, thus minimizing refinancing risk. Third, the Company's only 2012 fixed-rate debt maturity is in October, for which the Company has received a loan commitment to refinance. The remaining floating-rate debt of the Company is comprised of a \$15.1 million loan secured by Northrock shopping center and \$8.0 million outstanding under the \$150.0 million unsecured revolving credit facility.

Acquisition and Development Activity

A significant contributor to the Company's recent growth in its Shopping Center portfolio has been its land acquisitions and subsequent development, redevelopment of existing centers and operating property acquisition activities. Redevelopment activities reposition the Company's centers to be competitive in the current retailing environment. These redevelopments typically include an update of the facade, site improvements and reconfiguring tenant spaces to accommodate tenant size requirements and merchandising evolution. During the period January 1, 2009 through February 29, 2012, the Company developed two neighborhood Shopping Centers and acquired six operating neighborhood shopping center properties. Since January 1, 2009, the Company's leasable area has grown by approximately 16.4% (1.3 million square feet), from 8.2 million square feet to approximately 9.5 million square feet.

2011 / 2010 / 2009 Acquisitions, Developments and Redevelopments

Ashland Square Phase I

On December 15, 2004, the Company purchased for \$6.3 million, a 19.3 acre parcel of land in Manassas, Prince William County, Virginia. The Company has an approved site plan to develop a grocery-anchored neighborhood shopping center totaling approximately 160,000 square feet. Capital One Bank operates a branch on the site and the Company previously executed a lease with CVS. The Company is in the process of completing site work for two pads. CVS will construct a 13,000 square foot pharmacy building and the Company will construct a 6,500 square foot building which it expects to lease to a restaurant. Both facilities are projected to be completed in the fourth quarter of 2012, at a cost to the Company of approximately \$3.0 million. The balance of the center is being marketed to grocers and other retail businesses, with a development timetable yet to be finalized.

Smallwood Village Center

On January 27, 2006, the Company acquired the 198,000 square foot Smallwood Village Center, located on 25 acres within the St. Charles planned community of Waldorf, Maryland. The center was acquired for a purchase price of \$17.5 million subject to the assumption of an \$11.3 million mortgage loan, and was 68.0% leased at December 31, 2011. The Company completed construction during mid-2009 of capital improvements to improve access to the center, reconfigure portions of the center and upgrade the center's façade and common areas. The cost of the redevelopment was approximately \$6.9 million and the redeveloped center totals approximately 173,000 square feet.

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Clarendon Center

In late 2010, the Company substantially completed construction of a mixed-use project which includes approximately 42,000 square feet of retail space, 171,000 square feet of office space, 244 apartments and 600 underground parking spaces, on two city blocks, adjacent to the Clarendon Metro Station in Arlington County, Virginia. Development costs are expected to total approximately \$195.0 million upon the completion of final office tenant improvements.

The south block consists of 11 floors of residential area (244 units) alongside eight floors of office space (76,000 square feet), both atop ground floor retail space (29,000 square feet) leased to Trader Joe's, Circa Café and Burke & Herbert Bank. The first office tenant began occupancy in December 2010, and the first retail occupancy occurred in January 2011. Currently, all of the retail tenants are operating. The north block consists of five floors of office space (95,000 square feet) atop ground floor retail (13,000 square feet). The building shell certificate of occupancy was received in early February 2011, and Airline Reporting Corporation (68,000 square feet) took occupancy in late March 2011. As of December 31, 2011, 196,000 square feet (92.4%) of the combined retail and office space was leased.

On December 26, 2010, tenants began occupancy of the apartments. By April 28, 2011, the apartments were 98.8% leased, and as of December 31, 2011, 243 of the 244 apartments were leased and occupied.

Westview Village

In November 2007, the Company purchased for \$5.0 million, a 10.4 acre site in the Westview development on Buckeystown Pike (MD Route 85) in Frederick, Maryland. Construction was substantially completed in 2009 on a development that totals approximately 101,000 square feet of commercial space, including 60,000 square feet of retail shop space, 11,000 square feet of retail pads and 30,000 square feet of professional office space. Total construction and development costs, including land, lease-up and tenant improvement costs, are projected to be approximately \$26.5 million. As of December 31, 2011, 45,000 square feet of retail space and 13,000 square feet of office space, or approximately 57.0% of the total space, had been leased.

Northrock

In January 2008, the Company purchased for \$12.5 million, approximately 15.4 acres of undeveloped land in Warrenton, Virginia, located at the southwest corner of the U. S. Route 29/211 and Fletcher Drive intersection. The Company constructed Northrock shopping center, a neighborhood shopping center totaling approximately 103,000 square feet of leasable area. Approximately 77.8% of the project was leased at December 31, 2011, including a 52,700 square foot Harris Teeter supermarket store, 18,822 square feet of small shop space, and pad leases with Capital One Bank and Longhorn Steakhouse. Total construction and development costs, including land, lease-up and tenant improvement costs, are projected to be approximately \$27.9 million.

Seven Corners

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

11503 Rockville Pike

On October 1, 2010, the Company purchased for \$15.6 million, including acquisition costs, approximately 20,000 square feet of retail space located on the east side of Rockville Pike (Route 355), near the White Flint Metro Station in Montgomery County, Maryland. The property, which was fully leased to two tenants at December 31, 2011, is zoned for up to 297,000 square feet of rentable mixed use space. The Company does not anticipate redeveloping the property in the foreseeable future.

Metro Pike Center

On December 17, 2010, the Company purchased for \$34.3 million, including acquisition costs, approximately 67,000 square feet of retail space located on the west side of Rockville Pike (Route 355) near the White Flint Metro Station in Montgomery County, Maryland. The property was acquired subject to the assumption of a \$16.2 million mortgage loan and a corresponding interest rate swap with a fair value of \$0.5 million. The property, which was 76.4% leased at December 31, 2011, is zoned for up to 807,000 square feet of rentable mixed use space. The Company does not anticipate redeveloping the property in the foreseeable future.

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4469 Connecticut Ave

On February 17, 2011, the Company purchased for \$1.7 million, including acquisition costs, approximately 3,000 square feet of retail space located adjacent to the Company's Van Ness Square in Washington DC. The property is unoccupied as of December 31, 2011.

Kentlands Square II

On September 23, 2011, the Company purchased for \$74.5 million Kentlands Square II, and incurred acquisition costs of \$1.1 million. Kentlands Square II is a 241,000 square foot neighborhood shopping center located in Gaithersburg, Maryland, in Montgomery County, the state's most populous and affluent county. More than 38,000 households, with annual household incomes averaging over \$114,000, are located within a three-mile radius of the center. The center was constructed in 1993, is 100% leased and is anchored by a 61,000 square foot Giant Food supermarket and a 104,000 square foot Kmart. The property is adjacent to the Company's Kentlands Square I, which is anchored by Lowe's Home Improvement and Kentlands Place.

Severna Park MarketPlace

On September 23, 2011, the Company purchased for \$61.0 million Severna Park MarketPlace, and incurred acquisition costs of \$0.8 million. Severna Park MarketPlace is a 254,000 square foot neighborhood shopping center located in Severna Park, Maryland, in Anne Arundel County. More than 15,000 households, with annual household incomes averaging over \$112,000, are located within a three-mile radius of the center. The center was constructed in 1974 and renovated in 2000, is 100% leased and is anchored by a 63,000 square foot Giant Food supermarket and a 92,000 square foot Kohl's.

Cranberry Square

On September 23, 2011, the Company purchased for \$33.0 million Cranberry Square, and incurred acquisition costs of \$0.5 million. Cranberry Square is a 140,000 square foot neighborhood shopping center located in Westminster, Maryland, in Carroll County. More than 12,000 households, with annual household incomes averaging over \$72,000, are located within a three-mile radius of the center. The center was constructed in 1991, is 91.2% leased and is anchored by a 56,000 square foot Giant Food supermarket and a 24,000 square foot Staples.

Item 1A. Risk Factors

RISK FACTORS

Carefully consider the following risks and all of the other information set forth in this Annual Report on Form 10-K, including the consolidated financial statements and the notes thereto. If any of the events or developments described below were actually to occur, the Company's business, financial condition or results of operations could be adversely affected.

In this section, unless the context indicates otherwise, the terms Company, we, us and our refer to Saul Centers, Inc., and its subsidiaries, including the Operating Partnership.

The global financial crisis and economic slowdown may have an adverse impact on our business, our tenants' business and our results of operations.

The continuation or worsening of the recent credit market disruption and global economic crisis may continue to have an adverse effect on the fundamentals of our business and results of operations, including overall market occupancy and rental rates. While recent economic data appear to reflect some stabilization of the economy and credit markets, a continuation of these challenging economic conditions could have a negative effect on the financial condition of our tenants or lenders, which may expose us to increased risks of default by these parties.

In the event of a continuation of this disruption in the economy and capital markets, there can be no assurance we will not experience material adverse effects on our business, financial condition, results of operations or real estate values.

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Potential consequences of a continuation of the credit crisis and global economic slowdown include:

the financial condition of our tenants, many of which operate in the retail industry, may be adversely affected, which may result in tenant defaults under their leases due to bankruptcy, lack of liquidity, operational failures or for other reasons;

the ability to borrow on terms and conditions that we find acceptable, or at all, may be limited, which could reduce our ability to pursue acquisition and development opportunities and refinance existing debt, reduce our returns from acquisition and development activities and increase our future interest expense;

reduced values of our properties may limit our ability to dispose of assets at attractive prices and may reduce the ability to refinance loans; and

one or more lenders under our credit facility could fail and we may not be able to replace the financing commitment of any such lenders on favorable terms, or at all.

Revenue from our properties may be reduced or limited if the retail operations of our tenants are not successful.

The global and domestic economies have recently experienced a significant contraction of credit markets and resulting slowdown in business and consumer spending. We believe that consumers in recent years have cut back their discretionary spending in response to credit constraints, unemployment, a reduction in home equity values, highly volatile fuel and other commodity prices, and general economic uncertainty. Revenue from our properties depends primarily on the ability of our tenants to pay the full amount of rent due under their leases on a timely basis. The amount of rent we receive from our tenants generally will depend in part on the success of our tenants' retail operations, making us vulnerable to general economic downturns and other conditions affecting the retail industry. Some tenants may terminate their occupancy due to an inability to operate profitably for an extended period of time, impacting the Company's ability to maintain occupancy levels.

Any reduction in our tenants' ability to pay base rent or percentage rent may adversely affect our financial condition and results of operations. Small business tenants and anchor retailers which lease space in the Company's properties may experience a deterioration in their sales or other revenue, or experience a constraint on the availability of credit necessary to fund operations, which in turn may adversely impact those tenants' ability to pay contractual base rents and operating expense recoveries. Some of our leases provide for the payment, in addition to base rent, of additional rent above the base amount according to a specified percentage of the gross sales generated by the tenants. Decreasing sales revenue by retail tenants could adversely impact the Company's receipt of percentage rents required to be paid by tenants under certain leases.

Our ability to increase our net income depends on the success and continued presence of our shopping center anchor tenants and other significant tenants.

Our net income could be adversely affected in the event of a downturn in the business, or the bankruptcy or insolvency, of any anchor store or anchor tenant. Our largest shopping center anchor tenant is Giant Food, which accounted for 4.3% of our total revenue for the year ended December 31, 2011. The closing of one or more anchor stores prior to the expiration of the lease of that store or the termination of a lease by one or more of a property's anchor tenants could adversely affect that property and result in lease terminations by, or reductions in rent from, other tenants whose leases may permit termination or rent reduction in those circumstances or whose own operations may suffer as a result. This could reduce our net income.

We may experience difficulty or delay in renewing leases or leasing vacant space.

We derive most of our revenue directly or indirectly from rent received from our tenants. We are subject to the risks that, upon expiration, leases for space in our properties may not be renewed, the space and other vacant space may not be re-leased, or the terms of renewal or re-lease, including the cost of required renovations or concessions to tenants, may be less favorable than previous lease terms. Constraints on the availability of credit to office and retail tenants, necessary to purchase and install improvements, fixtures and equipment, and fund start-up business expenses, could impact the Company's ability to procure new tenants for spaces currently vacant in existing operating properties or properties under development. As a result, our results of operations and our net income could be reduced.

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We have substantial relationships with members of The Saul Organization whose interests could conflict with the interests of other stockholders.

Influence of Officers, Directors and Significant Stockholders.

Three of our executive officers, Mr. Saul II, his son and our President, B. Francis Saul III, and Thomas H. McCormick, our Senior Vice President and General Counsel, are members of The Saul Organization, and persons associated with The Saul Organization constitute four of the 14 members of our Board of Directors. In addition, as of December 31, 2011, Mr. Saul II had the potential to exercise control over 7,687,000 shares of our common stock representing 40.0% of our issued and outstanding shares of common stock. Mr. Saul II also beneficially owned, as of December 31, 2011, 6,914,000 units of the Operating Partnership. In general, these units are convertible into shares of our common stock on a one-for-one basis except for 1,498,000 units which are not currently convertible. The ownership limitation set forth in our articles of incorporation is 39.9% in value of our issued and outstanding equity securities (which includes both common and preferred stock). As of December 31, 2011, Mr. Saul II and members of The Saul Organization owned common stock representing approximately 31.2% in value of all our issued and outstanding equity securities. Members of the Saul Organization are permitted under our articles of incorporation to convert Operating Partnership units into shares of common stock or acquire additional shares of common stock until The Saul Organization's actual ownership of common stock reaches 39.9% in value of our equity securities. As of December 31, 2011, 3,545,000 of the 6,914,000 units of the Operating Partnership would have been permitted to convert into additional shares of common stock, and would have resulted in Mr. Saul II and members of The Saul Organization owning common stock representing approximately 39.9% in value of all our issued and outstanding equity securities.

As a result of these relationships, members of The Saul Organization will be in a position to exercise significant influence over our affairs, which influence might not be consistent with the interests of some, or a majority, of our stockholders. Except as discussed below, we do not have any written policies or procedures for the review, approval or ratification of transactions with related persons.

Management Time.

Our Chief Executive Officer, President, Senior Vice President-Chief Accounting Officer and Senior Vice President and General Counsel are also officers of various entities of The Saul Organization. Although we believe that these officers spend sufficient management time to meet their responsibilities as our officers, the amount of management time devoted to us will depend on our specific circumstances at any given point in time. As a result, in a given period, these officers may spend less than a majority of their management time on our matters. Over extended periods of time, we believe that our Chief Executive Officer and Senior Vice President and General Counsel will spend less than a majority of their management time on Company matters, while our President and Senior Vice President-Chief Accounting Officer may or may not spend less than a majority of their time on our matters.

Exclusivity and Right of First Refusal Agreements.

We will acquire, develop, own and manage shopping center properties and will own and manage other commercial properties, and, subject to certain exclusivity agreements and rights of first refusal to which we are a party, The Saul Organization will continue to develop, acquire, own and manage commercial properties and own land suitable for development as, among other things, shopping centers and other commercial properties. Therefore, conflicts could develop in the allocation of acquisition and development opportunities with respect to commercial properties other than shopping centers and with respect to development sites, as well as potential tenants and other matters, between us and The Saul Organization. The agreement relating to exclusivity and the right of first refusal between us and The Saul Organization generally requires The Saul Organization to conduct its shopping center business exclusively through us and to grant us a right of first refusal to purchase commercial properties and development sites in certain market areas that become available to The Saul Organization. The Saul Organization has granted the right of first refusal to us, acting through our independent directors, in order to minimize potential conflicts with respect to commercial properties and development sites. We and The Saul Organization have entered into this agreement in order to minimize conflicts with respect to shopping centers and certain of our commercial properties.

Shared Services.

We share with The Saul Organization certain ancillary functions, such as computer and payroll services, benefits administration and in-house legal services. The terms of all sharing arrangements, including payments related thereto, are reviewed periodically by our Audit Committee, which is comprised solely of independent directors. Included in our general and administrative expenses or capitalized to specific development projects, for

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the year ended December 31, 2011, are charges totaling \$6.1 million, related to such shared services, which included rental payments for the Company's headquarters lease, which were billed by The Saul Organization. Although we believe that the amounts allocated to us for such shared services represent a fair allocation between us and The Saul Organization, we have not obtained a third party appraisal of the value of these services.

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 our insurance program. Such commissions and fees amounted to approximately \$341,000 for the year ended December 31, 2011.

Related Party Rents.

We sublease space for our corporate headquarters from a member of The Saul Organization, the building of which is owned by another member of the Saul Organization. The 10-year lease commenced in March 2002 and provides for base rent escalated at 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 a portion of the total rental payments based on a percentage proportionate to the number of employees employed by each party. The Company's rent expense for the year ended December 31, 2011 was \$945,000. Although the Company believes that this lease has terms comparable to what would have been obtained from a third party landlord, it did not seek bid proposals from any independent third parties when entering into its new corporate headquarters lease. The Company is nearing completion of negotiation of a five-year extension of the lease.

Conflicts Based on Individual Tax Considerations.

The tax basis of members of The Saul Organization in our portfolio properties which were contributed to certain partnerships at the time of our initial public offering in 1993 was substantially less than the fair market value thereof at the time of their contribution. In the event of our disposition of such properties, a disproportionately large share of the gain for federal income tax purposes would be allocated to members of The Saul Organization. In addition, future reductions of the level of our debt, or future releases of the guarantees or indemnities with respect thereto by members of The Saul Organization, would cause members of The Saul Organization to be considered, for federal income tax purposes, to have received constructive distributions. Depending on the overall level of debt and other factors, these distributions could be in excess of The Saul Organization's bases in their Partnership units, in which case such excess constructive distributions would be taxable.

Consequently, it is in the interests of The Saul Organization that we continue to hold the contributed portfolio properties, that a portion of our debt remains outstanding or is refinanced and that The Saul Organization guarantees and indemnities remain in place, in order to defer the taxable gain to members of The Saul Organization. Therefore, The Saul Organization may seek to cause us to retain the contributed portfolio properties, and to refrain from reducing our debt or releasing The Saul Organization guarantees and indemnities, even when such action may not be in the interests of some, or a majority, of our stockholders. In order to minimize these conflicts, decisions as to sales of the portfolio properties, or any refinancing, repayment or release of guarantees and indemnities with respect to our debt, will be made by the independent directors.

Ability to Block Certain Actions.

Under applicable law and the limited partnership agreement of the Operating Partnership, consent of the limited partners is required to permit certain actions, including the sale of all or substantially all of the Operating Partnership's assets. Therefore, members of The Saul Organization, through their status as limited partners in the Operating Partnership, could prevent the taking of any such actions, even if they were in the interests of some, or a majority, of our stockholders.

The amount of debt we have and the restrictions imposed by that debt could adversely affect our business and financial condition.

As of December 31, 2011, we had approximately \$831.9 million of debt outstanding, \$808.8 million of which was long-term fixed-rate debt secured by 41 of our properties and \$23.1 million of which was variable-rate debt due under a secured bank loan (\$15.1 million) and our revolving credit facility (\$8.0 million).

We currently have a general policy of limiting our borrowings to 50 percent of asset value, i.e., the value of our portfolio, as determined by our Board of Directors by reference to the aggregate annualized cash flow from our portfolio. Our organizational documents contain no limitation on the amount or percentage of indebtedness which

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we may incur. Therefore, the Board of Directors could alter or eliminate the current limitation on borrowing at any time. If our debt capitalization policy were changed, we could increase our leverage, resulting in an increase in debt service that could adversely affect our operating cash flow and our ability to make expected distributions to stockholders, and in an increased risk of default on our obligations.

We have established our debt capitalization policy relative to asset value, which is computed by reference to the aggregate annualized cash flow from the properties in our portfolio rather than relative to book value. We have used a measure tied to cash flow because we believe that the book value of our portfolio properties, which is the depreciated historical cost of the properties, does not accurately reflect our ability to borrow. Asset value, however, is somewhat more variable than book value, and may not at all times reflect the fair market value of the underlying properties.

The amount of our debt outstanding from time to time could have important consequences to our stockholders. For example, it could:

require us to dedicate a substantial portion of our cash flow from operations to payments on our debt, thereby reducing funds available for operations, property acquisitions and other appropriate business opportunities that may arise in the future;

limit our ability to obtain any additional financing we may need in the future for working capital, debt refinancing, capital expenditures, acquisitions, development or other general corporate purposes;

make it difficult to satisfy our debt service requirements;

limit our ability to make distributions on our outstanding common and preferred stock;

require us to dedicate increased amounts of our cash flow from operations to payments on our variable rate, unhedged debt if interest rates rise;