

Saul Centers



1998

Annual Report

to shareholders

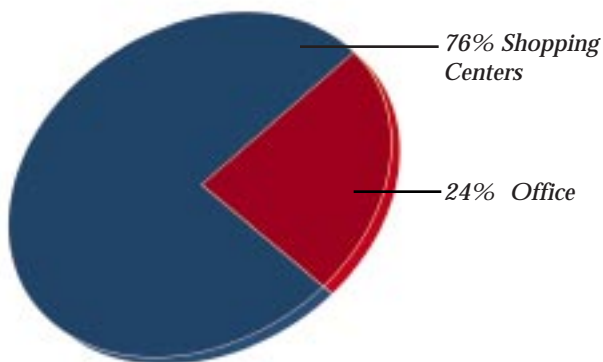




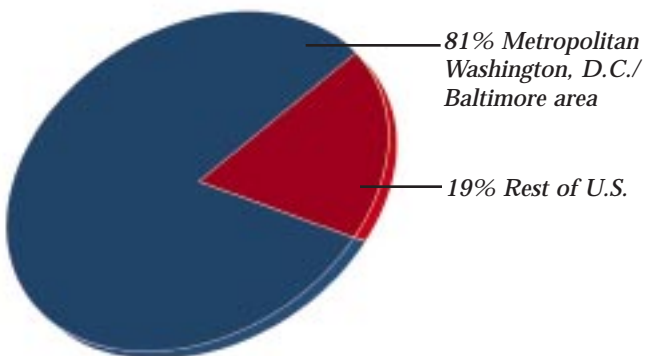
Portfolio Composition

BASED ON PROPERTY OPERATING INCOME

Property Type



Geographic Location

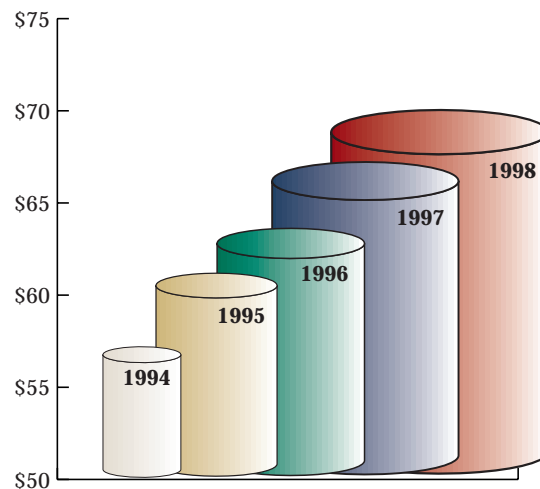


Historic

OPERATING PERFORMANCE

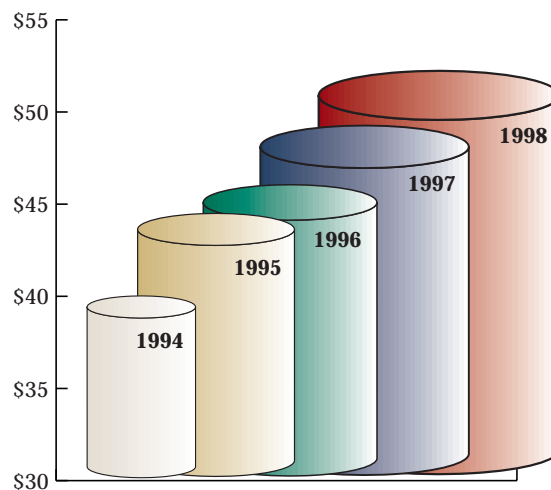
Total Revenues

(in millions)



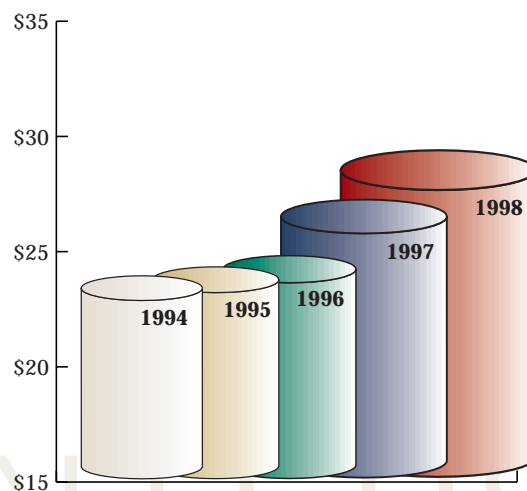
Property Operating Income

(in millions)



Funds From Operations

(in millions)



*Shares of
Saul Centers
are traded on
the New York
Stock Exchange
under the
symbol “BFS.”*



Saul Centers, Inc. is a self-managed, self-administered equity real estate investment trust headquartered in Chevy Chase, Maryland. Saul Centers currently operates and manages a real estate portfolio of 34 community and neighborhood shopping center and office properties totaling approximately 5.9 million square feet of leasable area. Approximately 80% of the cash flow is generated from properties in the suburban Washington, D.C./Baltimore area.

Saul Centers' primary operating strategy is to focus on continuing its program of internal growth, renovations, and expansions of community and neighborhood shopping centers, which primarily service the day-to-day necessities and services subsector of the overall retail market. The Company plans to supplement its growth through selective development of new office and retail properties and acquisitions of operating properties as appropriate opportunities arise.

Financial

HIGHLIGHTS



Another Active and Exciting Year

“Revenue growth was driven by a strong 7.3% increase in 1998 base rents from stabilizing redevelopments, improved rental rates on expiring leases and leasing percentage increases.”

	Year ended December 31,				
	1998	1997	1996	1995	1994
Summary Financial Data:					
Total Revenues	\$ 70,583,000	\$ 67,717,000	\$ 64,023,000	\$ 61,469,000	\$ 57,397,000
Funds From Operations (a)	\$ 29,768,000	\$ 27,637,000	\$ 25,122,000	\$ 24,636,000	\$ 24,192,000
Average Shares Outstanding (assuming operating partnership units fully converted)	17,233,047	16,690,417	16,423,984	16,284,666	16,272,263
Funds From Operations Per Share	\$ 1.73	\$ 1.66	\$ 1.53	\$ 1.51	\$ 1.49
Property Data:					
Number of Properties	34	33	33	32	32
Total Portfolio Square Feet	5,901,000	5,821,000	5,806,000	5,657,000	5,632,000
Shopping Center Square Feet	4,990,000	4,953,000	4,938,000	4,789,000	4,765,000
Office Square Feet	714,000	671,000	671,000	671,000	670,000
Industrial Square Feet	197,000	197,000	197,000	197,000	197,000
Average Percentage Leased	90%	90%	89%	90%	90%

More detailed financial information is available from the Company's Annual Report Form 10-K.

(a) Funds From Operations, presented on a fully converted basis and the most widely accepted measure of operating performance for real estate investment trusts, is defined as net income before extraordinary and non-recurring items, and before real estate depreciation and amortization. All years are presented in conformance with the National Association of Real Estate Investment Trusts' guidelines adopted effective January 1, 1996.

Message

TO OUR SHAREHOLDERS

Financial Highlights

1998 marked a year of increased earnings, improved leasing levels, and continued significant accomplishments in the areas of redevelopment, renovation and tenant upgrades. Funds From Operations (FFO) increased 7.7% to \$29,768,000 for the year ended December 31, 1998 compared to \$27,637,000 for the 1997 year. FFO is presented on a fully converted basis and is the most widely accepted measure of operating performance for real estate investment trusts (REITs). FFO is defined as net income before extraordinary and non-recurring items and before real estate depreciation and amortization. For the quarter ended December 31, 1998, FFO increased 6.6% to \$7,864,000 compared to \$7,374,000 for the 1997 quarter. On a per share basis, FFO was \$1.73 per share for the 1998 year, a 4.3% increase over the prior year. For the quarter ended December 31, 1998, FFO increased 2.0% to \$0.45 per share over the comparable 1997 quarter.

During 1998, the Company paid four quarterly distributions of \$0.39 per share to shareholders, of which 74.2% was taxable as

ordinary income and 25.8% represented a non-taxable return of capital. The annual dividend of \$1.56 compared to 1998 FFO of \$1.73 represents an FFO payout ratio of 90.2%. The Company's annual payout ratio has been reduced in each of the past five years, allowing the Company to retain additional capital for reinvestment into its assets, while at the same time, increasing dividend coverage.

Total returns, price appreciation combined with dividend yield, in all sub-sectors of the REIT industry were negative in 1998; however relatively strong retail sales and overall stability in the

performance of retailers' stocks helped retail REITs outperform other sectors. With a year-end dividend yield of 10.0% compared to an approximately 7.5% average yield for all equity REITs and a near 5.5% yield for the 30 year bond, we continue to view Saul Centers as an attractive long term vehicle for both yield and total return to investors.



Message

TO OUR SHAREHOLDERS



Property Operations

Total revenues for 1998 increased 4.2% to \$70.6 million compared to \$67.7 million for 1997. For the quarter ended December 31, 1998, revenues increased 1.7% to \$18.1 million compared to \$17.8 million for the 1997 quarter. Revenue growth was driven by a strong 7.3% increase in 1998 base rents from stabilizing redevelopments, improved rental rates on expiring leases and leasing percentage increases. Property gross margins improved in 1998 from 73.3% to 74.8%, a product of aggressive asset management which resulted in both revenue increases and a 2% decrease in operating expenses.

In 1998, same center operating income increased 4.2% for the shopping center portfolio, 8.3% for the office properties and 5.1% overall. The Company's same center shopping center growth throughout the past 15-years has averaged a compounded annual rate of 7.0%. Space leased to tenants averaged 89.9% for 1998 compared to the 1997 average of 89.5%; however significant fourth quarter leasing activity increased the year-end 1998 percentage leased to 92.1%. This current leasing percentage is a five year high for the Company.

The widespread credit tightening in REIT industry capital markets during the latter part of 1998 had little impact on

Saul Centers, as the Company has historically relied upon an internal growth operating strategy which requires a limited amount of external capital. During the past five years, the Company has adapted to changing shopping patterns and shopper demographics by "de-malling" outdated mini-malls and by expanding and renovating its shopping centers to accommodate today's most successful retailers. During 1998 and 1999, Saul Centers continued and has plans to continue with this defined operating strategy of internal growth through redevelopment, expansion and renovation.



“Eighteen of our 30 shopping centers are anchored by a supermarket and other retailers which offer mainly everyday convenience, non-branded and non-discretionary goods and services.”

Real estate is primarily a location business. The Mid-Atlantic region, the Company's primary market area, remains strong economically with few signs of overbuilding. According to an industry demographic report conducted in 1998, the Company ranks among the top five shopping center REITs in terms of the population count and the household incomes of those residents living within 3 miles of the centers. As always, the marketing of retail space in today's environment requires continuous attention to the synergy of tenant mixes and consideration of the shopping needs of a center's trade area.

New shopping trends such as the explosion of Internet commerce and online shopping in 1998 are making headlines as a new form of retailing. In general, however, it is currently believed that electronic retail will have very little impact on neighborhood and community centers in economically and demographically stable trade

areas because of the products and services they offer—namely, convenience and necessary goods and services such as groceries, restaurants, dry cleaning, hair and nail salons, etc. Eighteen of our 30 shopping centers are anchored by a supermarket and other retailers which offer mainly everyday convenience, non-branded and non-discretionary goods and services.

Redevelopment Activities

Shopping Centers

The major component of Saul Centers' growth has been the redevelopment of older shopping centers to fit current requirements and to keep pace with changing retail patterns. The Company's major 1998 redevelopment and renovation activities focused on Beacon Center, French Market, Shops at Fairfax and Thruway shopping centers.

Beacon Center, located in Alexandria, Virginia, began 1998 as a 290,000 square foot grocery-anchored shopping center with an enclosed mall section. The Company redeveloped the center by replacing the enclosed mall with a new Lowe's home improvement superstore and 8,000 square feet of new small shop space. The completed center will total over 350,000 square feet, with Lowe's and Giant Food providing a stable tenant base while occupying over 55% of the center. The enclosed mall has been demolished and a building pad has been prepared for the commencement of construction of the 148,000 square foot Lowe's store and garden center. Construction of the new shop space has been completed and is fully leased to service tenants including Starbucks, a hair salon and a dry cleaners. Lowe's is expected to open in the summer of 1999.

Redevelopment of the Beacon Center in Alexandria, Virginia to include a new Lowe's home improvement superstore, scheduled to open in the summer of 1999.



Message

TO OUR SHAREHOLDERS



French Market, located in Oklahoma City, Oklahoma, is a 213,000 square foot grocery-anchored shopping center. In February 1998, we commenced construction on a facade renovation and retenanting of a 103,000 square foot anchor space. Construction of the first three new spaces, Bed, Bath and Beyond, Lakeshore Learning and BridesMart, was completed during the year, and these tenants are currently open

for business. A lease is expected to be completed shortly with a national retailer for 25,000 square feet. The final 20,000 square feet of space is currently under negotiation.

Thruway is a 345,000 square foot center located in Winston-Salem, North Carolina and anchored by Harris Teeter and Fresh Market grocery stores, Eckerd Drugs and SteinMart. The Company renovated the facade of this shopping center in 1997. During 1998, the Company successfully retenanted two anchor spaces which became available after one retailer's bankruptcy and the closing of a former Woolworth's store. New leases were signed for a 25,000 square foot Borders bookstore and an 8,200 square foot Zany

Brainy children's educational toy store.

Final governmental approvals have been obtained for the redevelopment of the Company's 61,000 square foot Shops at Fairfax located in the city of Fairfax, Virginia, one of Washington, D.C.'s most prosperous suburbs. The main building of this shopping center contained an enclosed mini-mall of approximately 30,000 square feet which has been demolished in preparation for the development of a 53,000 square foot SuperFresh grocery store and 7,500 square feet of new service tenant space. Completion of construction is scheduled for the fall of 1999. This redevelopment is an opportunity to create value by providing more efficient parking and new landscaping,



Newly renovated French Market in Oklahoma City, Oklahoma (left) and Thruway in Winston-Salem, North Carolina (right).



Tenants enjoy a spectacular view of the Nation's Capitol from 601 Pennsylvania Avenue balconies.



Message

TO OUR SHAREHOLDERS

and repositioning the property as a very desirable grocery anchored neighborhood shopping center.

Office Activity

Demand for space in the office submarkets in which the Company operates remains healthy. The 741,000 square feet of high-rise office and office/flex space which the Company currently owns is over 95% leased. In April 1998, we acquired a newly constructed, 100% leased office/flex building adjacent to our Avenel Business Park in Gaithersburg, Maryland.

The building contains 46,000 square feet of leaseable area.

In July, we began construction of an additional 27,000 square feet of space at Avenel. These buildings were substantially completed in January 1999, with 30% of the new space under lease prior to building shell completion, and 46% currently leased. The Avenel Business Park now contains over 350,000 square feet of space in eleven one-story office/flex buildings targeting users primarily in the life sciences and technology industries. Avenel is currently over 93% leased.

The Company just commenced its most significant development of the past five years. The Company will construct a new 230,000 square foot Class A mixed-use office/retail complex along North Washington Street

in Northern Virginia's historic Old Town Alexandria. The project is well located on a two acre site along Alexandria's main street. Demolition of the Company's existing 41,500 square foot building, formerly leased to Mastercraft furniture, commenced in February 1999. Construction is scheduled to be completed by the summer of 2000. The project will be comprised of two four-story buildings presenting a brick and cast stone exterior facade to blend well with the surrounding historic neighborhood. Each building will feature a glass curtain wall overlooking a spacious courtyard. Amenities will include 3-story atrium lobbies, a fitness center, concierge service, a 600 space parking structure and the latest computerized energy management system.

Rendering of the 230,000 square foot mixed-use office/retail complex to be constructed in Old Town Alexandria, Virginia.



The street level will have 45,000 square feet of retail space. Office space will total 185,000 square feet, with the top floor containing walk-out terraces. A \$38 million construction loan was closed in January 1999, which is anticipated to fund all project costs.

Capitalization

The past year was a period of generally sound real estate fundamentals but very turbulent capital market behavior. The Company's need to access new sources of debt and equity capital in 1998 and 1999 has been minimal. Fixed rate debt currently comprises 93% of total outstanding indebtedness, the majority of which was procured in 1996 and 1997.

The weighted average maturity of the Company's \$273 million fixed rate debt is over 13 years and the weighted average interest rate is an attractive 7.9%. We have a comfortable level of credit line borrowing capacity of approximately \$40 million, providing available capital for our defined business plan of internal growth through redevelopment, renovation and expansion.

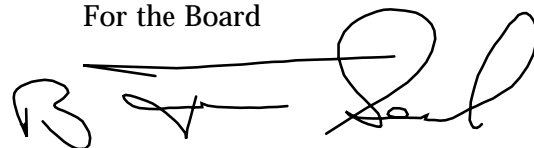
At year end 1998, the Company had total combined debt and equity capitalization of over \$560 million. With \$291 million of total debt, this capital structure provides the benefits of prudent leverage and a comfortable interest coverage ratio of 2.4 during the latest

quarter of operations, an increase from 2.3 a year earlier.

With expectations of modest economic growth widely predicted for 1999, we view our portfolio as one of solid real estate fundamentals and positioned for continued cash flow growth. The success of our core internal growth strategy into the year 2000 hinges primarily on what has sustained our past growth – the prime location of the vast majority of our assets.

On behalf of our Board of Directors, we remain committed to our plan of internal growth through renovation and redevelopment and we wish to express our thanks to you, our shareholders, for your investment in our future.

For the Board



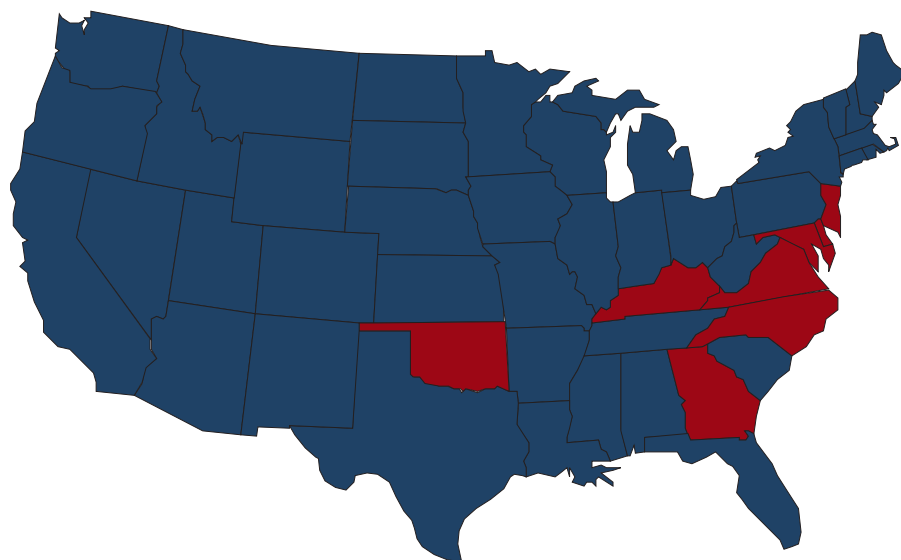
B. Francis Saul II
Chairman of the Board

March 3, 1999



Portfolio

PROPERTIES



Saul Centers' properties are located primarily in the suburban Washington, D.C./Baltimore area, representing 69% of the portfolio's gross leasable area.

SHOPPING CENTERS	Location of Property	Gross Leasable Square Feet	SHOPPING CENTERS (Cont.)	Location of Property	Gross Leasable Square Feet
Ashburn Village	Ashburn, VA	108,204	Shops at Fairfax	Fairfax, VA	60,703
Beacon Center	Alexandria, VA	355,736	Southdale	Glen Burnie, MD	479,749
Belvedere	Baltimore, MD	54,941	Southside Plaza	Richmond, VA	352,964
Boulevard	Fairfax, VA	56,578	Sunshine City	Atlanta, GA	167,591
Clarendon	Arlington, VA	6,940	Thruway	Winston-Salem, NC	345,194
Clarendon Station	Arlington, VA	4,868	Village Center	Centreville, VA	142,881
Flagship Center	Rockville, MD	21,500	West Park	Oklahoma City, OK	77,810
French Market	Oklahoma City, OK	213,668	White Oak	Silver Spring, MD	480,156
Germantown	Germantown, MD	26,241	Shopping Center Total		4,989,468
Giant	Baltimore, MD	70,040	OFFICE PROPERTIES		
The Glen	Lake Ridge, VA	112,639	Avenel Business Park	Gaithersburg, MD	331,445
Great Eastern	District Heights, MD	255,448	601 Pennsylvania Avenue	Washington, DC	225,153
Hampshire Langley	Langley Park, MD	134,425	Van Ness Square	Washington, DC	157,697
Leesburg Pike	Baileys Crossroads, VA	97,888	Office Properties Total		714,295
Lexington Mall	Lexington, KY	315,747	INDUSTRIAL PROPERTY		
Lumberton Plaza	Lumberton, NJ	189,898	Crosstown Business Center	Tulsa, OK	197,135
North Washington	Alexandria, VA	41,500	Industrial Property Total		197,135
Olney	Olney, MD	53,765	TOTAL PORTFOLIO PROPERTIES		
Park Road Center	Washington, DC	106,650			5,900,898
Ravenwood	Baltimore, MD	87,750			
Seven Corners	Falls Church, VA	567,994			

Report

OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors of Saul Centers, Inc.:

We have audited the accompanying consolidated balance sheets of Saul Centers, Inc. (a Maryland corporation) and subsidiaries as of December 31, 1998 and 1997 and the related consolidated statements of operations, stockholders' equity and cash flows for the three years ended December 31, 1998, 1997 and 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. 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 financial position of Saul Centers, Inc. and subsidiaries as of December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the three years ended December 31, 1998, 1997 and 1996 in conformity with generally accepted accounting principles.

As explained in Note 2 to the financial statements, effective June 30, 1998, the Company changed its method of accounting for percentage rent.

Arthur Andersen LLP
Washington, D.C.
February 8, 1999



Saul Centers, Inc.

CONSOLIDATED BALANCE SHEETS

<i>(Dollars in thousands)</i>		December 31,	
	1998		1997
Assets			
Real estate investments			
Land	\$ 64,339	\$	65,630
Buildings and equipment	283,722		269,638
	<u>348,061</u>		<u>335,268</u>
Accumulated depreciation	(101,910)		(92,615)
	<u>246,151</u>		<u>242,653</u>
Construction in progress	4,506		974
Cash and cash equivalents	2,395		688
Accounts receivable and accrued income, net	6,347		6,190
Prepaid expenses	6,873		5,423
Deferred debt costs, net	3,604		3,853
Other assets	1,158		1,161
Total assets	<u>\$ 271,034</u>	<u>\$</u>	<u>260,942</u>
Liabilities			
Notes payable	\$ 290,623	\$	284,473
Accounts payable, accrued expenses and other liabilities	14,856		13,093
Deferred income	2,839		1,430
Total liabilities	<u>308,318</u>		<u>298,996</u>
Minority interests			
	<u>--</u>		<u>--</u>
Stockholders' equity (deficit)			
Common stock, \$0.01 par value, 30,000,000 shares authorized, 12,836,378 and 12,428,145 shares issued and outstanding, respectively	129		124
Additional paid-in capital	31,967		20,447
Accumulated deficit	(69,380)		(58,625)
Total stockholders' equity (deficit)	<u>(37,284)</u>		<u>(38,054)</u>
Total liabilities and stockholders' equity	<u>\$ 271,034</u>	<u>\$</u>	<u>260,942</u>

The accompanying notes are an integral part of these statements.

Saul Centers, Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands, except per share amounts)	For the Years Ended December 31,		
	1998	1997	1996
Revenue			
Base rent	\$ 55,542	\$ 51,779	\$ 49,814
Expense recoveries	9,911	9,479	9,301
Percentage rent	2,755	2,948	2,924
Other	2,375	3,511	1,984
Total revenue	<u>70,583</u>	<u>67,717</u>	<u>64,023</u>
Operating expenses			
Property operating expenses	7,830	8,075	8,069
Provision for credit losses	418	505	457
Real estate taxes	6,128	6,084	5,914
Interest expense	22,627	20,308	18,509
Amortization of deferred debt expense	419	1,729	2,857
Depreciation and amortization	12,578	10,642	10,860
General and administrative	3,393	3,379	3,095
Total operating expenses	<u>53,393</u>	<u>50,722</u>	<u>49,761</u>
Operating income	17,190	16,995	14,262
Non-operating item			
Sales of interest rate protection agreements	<u>--</u>	<u>(4,392)</u>	<u>(972)</u>
Net income before extraordinary item, cumulative effect of change in accounting method and minority interests	17,190	12,603	13,290
Extraordinary item			
Early extinguishment of debt	(50)	(3,197)	(587)
Cumulative effect of change in accounting method	<u>(771)</u>	<u>--</u>	<u>--</u>
Net income before minority interests	<u>16,369</u>	<u>9,406</u>	<u>12,703</u>
Minority interests			
Minority share of income	(4,354)	(2,483)	(3,430)
Distributions in excess of earnings	<u>(2,886)</u>	<u>(4,371)</u>	<u>(3,422)</u>
Total minority interests	<u>(7,240)</u>	<u>(6,854)</u>	<u>(6,852)</u>
Net income	<u>\$ 9,129</u>	<u>\$ 2,552</u>	<u>\$ 5,851</u>
Net income per share (basic and dilutive)			
Net income before extraordinary item, cumulative effect of change in accounting method and minority interests	\$ 1.00	\$ 0.76	\$ 0.81
Extraordinary item	--	(0.19)	(0.04)
Cumulative effect of change in accounting method	<u>(0.05)</u>	<u>--</u>	<u>--</u>
Net income before minority interests	<u>\$ 0.95</u>	<u>\$ 0.57</u>	<u>\$ 0.77</u>
Net income	<u>\$ 0.72</u>	<u>\$ 0.21</u>	<u>\$ 0.49</u>

The accompanying notes are an integral part of these statements.

Saul Centers, Inc.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

<i>(Dollars in thousands, except per share amounts)</i>	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Total
Stockholders' equity (deficit):				
Balance, December 31, 1995	\$ 119	\$ 12,511	\$ (29,097)	\$ (16,467)
Issuance of 257,454 shares of common stock	2	3,439	--	3,441
Net income	--	--	5,851	5,851
Distributions (\$1.17 per share)	--	--	(14,036)	(14,036)
Distributions payable (\$.39 per share)	<u>--</u>	<u>--</u>	<u>(4,729)</u>	<u>(4,729)</u>
Balance, December 31, 1996	121	15,950	(42,011)	(25,940)
Issuance of 275,374 shares of common stock	3	4,497	--	4,500
Net income	--	--	2,552	2,552
Distributions (\$1.17 per share)	--	--	(14,334)	(14,334)
Distributions payable (\$.39 per share)	<u>--</u>	<u>--</u>	<u>(4,832)</u>	<u>(4,832)</u>
Balance, December 31, 1997	124	20,447	(58,625)	(38,054)
Issuance of 408,233 shares of common stock	5	6,629	--	6,634
Issuance of 405,532 convertible limited partnership units in the Operating Partnership	--	4,891	--	4,891
Net income	--	--	9,129	9,129
Distributions (\$1.17 per share)	--	--	(14,899)	(14,899)
Distributions payable (\$.39 per share)	<u>--</u>	<u>--</u>	<u>(4,985)</u>	<u>(4,985)</u>
Balance, December 31, 1998	<u>\$ 129</u>	<u>\$ 31,967</u>	<u>\$ (69,380)</u>	<u>\$ (37,284)</u>

The accompanying notes are an integral part of these statements.

Saul Centers, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOW

<i>(Dollars in thousands)</i>	For the Years Ended December 31,		
	1998	1997	1996
Cash flows from operating activities:			
Net income	\$ 9,129	\$ 2,552	\$ 5,851
Adjustments to reconcile net income to net cash provided by operating activities:			
Minority interests	7,240	6,854	6,852
Loss on sale of interest rate protection agreements	--	4,392	972
Cumulative effect of change in accounting method	771	--	--
Loss on early extinguishment of debt	50	3,197	587
Depreciation and amortization	12,997	12,371	13,717
Provision for credit losses	418	505	457
Increase in accounts receivable	(1,346)	(406)	(45)
Increase in prepaid expenses	(2,742)	(1,426)	(1,136)
Decrease (increase) in other assets	3	2,548	(961)
Increase (decrease) in accounts payable and other liabilities	1,763	(1,640)	3,019
Increase (decrease) in deferred income	1,409	(11)	364
Other, net	(6)	--	--
Net cash provided by operating activities	<u>29,686</u>	<u>28,936</u>	<u>29,677</u>
Cash flows from investing activities:			
Additions to real estate investments	(6,607)	(4,377)	(4,469)
Additions to construction in progress	(8,169)	(11,717)	(3,566)
Net cash used in investing activities	<u>(14,776)</u>	<u>(16,094)</u>	<u>(8,035)</u>
Cash flows from financing activities:			
Proceeds from notes payable	20,900	223,600	98,620
Repayments on notes payable	(18,407)	(212,388)	(98,442)
Proceeds from sale of interest rate protection agreements	--	1,370	681
Note prepayment fees	--	(95)	--
Additions to deferred debt expense	(220)	(3,159)	(961)
Proceeds from the issuance of common stock and convertible limited partnership units in the Operating Partnership	11,648	4,500	3,441
Distributions to common stockholders and holders of convertible limited partnership units in the Operating Partnership	(27,124)	(26,020)	(25,617)
Net cash used in financing activities	<u>(13,203)</u>	<u>(12,192)</u>	<u>(22,278)</u>
Net increase (decrease) in cash	1,707	650	(636)
Cash, beginning of year	688	38	674
Cash, end of year	<u>\$ 2,395</u>	<u>\$ 688</u>	<u>\$ 38</u>
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest net of amount capitalized	\$ 22,575	\$ 19,804	\$ 18,829

The accompanying notes are an integral part of these statements.

Notes

TO CONSOLIDATED FINANCIAL 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. The authorized capital stock of Saul Centers consists of 30,000,000 shares of common stock, having a par value of \$0.01 per share, and 1,000,000 shares of preferred stock. Each holder of common stock is entitled to one vote for each share held. 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". Saul Centers operates as a real estate investment trust under the Internal Revenue Code of 1986, as amended (a "REIT").

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, Chevy Chase Bank, F.S.B. and certain other affiliated entities (collectively, "The Saul Organization"). On August 26, 1993, 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") 26 shopping center properties, one office property, one research park and one office/retail property and the management functions related to the transferred properties. Since its formation, the Company has purchased three additional community and neighborhood shopping center properties, an office property and a land parcel which it developed into a neighborhood shopping center. The Company is currently in the predevelopment and approval process of converting a shopping center to an industrial/warehouse use. Therefore, as of December 31, 1998, the Company's properties (the "Current Portfolio Properties") consisted of 29 operating shopping center properties (the "Shopping Centers"), a property planned to be converted to an industrial/warehouse facility (the "Industrial Property") and four predominantly office properties (the "Office Properties"). To facilitate the placement of collateralized mortgage debt, the Company established Saul QRS, Inc. and SC Finance Corporation, each of which is a wholly owned subsidiary of Saul Centers. Saul QRS,

Inc. was established to succeed to the interest of Saul Centers as the sole general partner of Saul Subsidiary I Limited Partnership.

As a consequence of the transactions constituting the formation of the Company, Saul Centers serves as the sole general partner of the Operating Partnership and of Saul Subsidiary II Limited Partnership, while Saul QRS, Inc., Saul Centers' wholly owned subsidiary, serves 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.

Basis of Presentation

The accompanying financial statements of the Company have been 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 office properties, primarily in the Mid-Atlantic region. A majority of the Shopping Centers are anchored by several major tenants. Eighteen of the 30 Shopping Centers are anchored by a grocery store and offer primarily day-to-day necessities and services. As of December 1998, no single Shopping Center accounted for more than 11.4% of the total Shopping Center gross leasable area. Only one retail tenant, Giant Food, at 7.1%, accounted for more than 1.7% of the Company's 1998 total revenues. No office tenant other than the United States General Service Administration, at 10.4%, accounted for more than 1.8% of 1998 total revenues.

Notes

TO CONSOLIDATED FINANCIAL STATEMENTS

Principles of Consolidation

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

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

Real Estate Investment Properties

Real estate investment properties are stated at the lower of depreciated cost or fair value less cost to sell. Management believes that these assets have generally appreciated in value and, accordingly, the aggregate current value exceeds their aggregate net book value and also exceeds the value of the Company's liabilities as reported in these financial statements. These financial statements are prepared in conformity with generally accepted accounting principles, and accordingly, do not report the current value of the Company's real estate assets.

Interest, real estate taxes and other carrying costs are capitalized on projects under construction. Once construction is substantially complete and the assets are placed in service, rental income, direct operating expenses, and depreciation associated with such properties are included in current operations. Expenditures for repairs and maintenance are charged to operations as incurred. Repairs and maintenance expense totaled \$2,616,000, \$2,479,000 and \$2,730,000, for calendar years 1998, 1997, and 1996, respectively, and is included in operating expenses in the accompanying financial statements.

Interest expense capitalized totaled \$215,000, \$297,000 and \$384,000, for calendar years 1998, 1997 and 1996, respectively.

In the initial rental operations of development projects, a project is considered substantially complete and

available for occupancy upon completion of tenant improvements, but no later than one year from the cessation of major construction activity. Substantially completed portions of a project are accounted for as separate projects. Depreciation is calculated using the straight-line method and estimated useful lives of 33 to 50 years for buildings and up to 20 years for certain other improvements. Leasehold improvements are amortized over the lives of the related leases using the straight-line method.

Accounts Receivable and Accrued Income

Accounts receivable primarily represent amounts currently due from tenants in accordance with the terms of the respective leases. In addition, accounts receivable included \$1,442,848, \$1,663,000 and \$1,913,000, at December 31, 1998, 1997 and 1996, respectively, representing minimum rental income accrued on a straight-line basis to be paid by tenants over the term of the respective leases. Receivables are reviewed monthly and reserves are established with a charge to current period operations when, in the opinion of management, collection of the receivable is doubtful. Accounts receivable in the accompanying financial statements are shown net of an allowance for doubtful accounts of \$657,000, \$506,000 and \$427,000, at December 31, 1998, 1997 and 1996, respectively.

Allowance for Doubtful Accounts			
<i>(In thousands)</i>	For the Years Ended		
	December 31,		
	1998	1997	1996
Beginning Balance	\$ 506	\$ 427	\$ 169
Provision for Credit Losses	418	505	457
Charge-offs	(267)	(426)	(199)
Ending Balance	<u>\$ 657</u>	<u>\$ 506</u>	<u>\$ 427</u>

Deferred Debt Costs

Deferred debt costs consists of fees and costs incurred to obtain long-term financing and interest rate protection agreements. These fees and costs are being amortized over the terms of the respective loans or agreements. Deferred debt costs in the accompanying financial statements are shown net of accumulated amortization of \$589,000, \$171,000 and \$6,240,000, at December 31, 1998, 1997 and 1996, respectively.

Notes

TO CONSOLIDATED FINANCIAL STATEMENTS

Revenue Recognition

Rental and interest income is accrued as earned except when doubt exists as to collectibility, in which case the accrual is discontinued. 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 in accordance with generally accepted accounting principles. Expense recoveries represent 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 the expenses are incurred. Additional rental income based on tenant's revenues ("percentage rent") is accrued at the time a tenant reports sales exceeding a specified breakpoint.

Income Taxes

The Company made an election to be treated, and intends to continue operating so as to qualify as a REIT under sections 856 through 860 of the Internal Revenue Code of 1986, as amended, commencing with its taxable year ending December 31, 1993. A REIT generally will not be subject to federal income taxation on that portion of its income that qualifies as REIT taxable income to the extent that it distributes at least 95% of its REIT taxable income to stockholders and complies with certain other requirements. Therefore, no provision has been made for federal income taxes in the accompanying financial statements. As of December 31, 1998 and 1997, the total tax basis of the Company's assets was \$296,658,000 and \$288,082,000, and the tax basis of the liabilities was \$298,280,000 and \$293,223,000, respectively.

Directors' Deferred Compensation Plan

A Deferred Compensation Plan was established by Saul Centers, effective January 1, 1994, for the benefit of its directors and their beneficiaries. Before the beginning of any calendar year, a director may elect to defer all or part of his or her director's fees to be earned in that year and the following years. A director has the option to have deferred director's fees paid in cash, in shares of common stock or in a combination of cash and shares of common stock. If the director elects to have the deferred fees paid in stock, the number of shares allocated to the director is determined based on the market value of the common stock on the day the

deferred director's fee was earned. Deferred compensation of \$180,550, \$144,500 and \$118,950, has been reported in the Consolidated Statements of Operations for the years ended December 31, 1998, 1997 and 1996, respectively. The Company has registered 70,000 shares for use under the plan. As of December 31, 1998, 54,185 shares had been credited to the directors' deferred fee accounts.

New Accounting Pronouncements

In June 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 130 "Reporting Comprehensive Income" which establishes standards for the reporting and display of comprehensive income in the Company's financial statements. The Company adopted this standard in the first quarter of 1998. The Company had no comprehensive income during the year ended December 31, 1998.

In September 1997, the FASB issued SFAS No. 131 "Disclosures about Segments of an Enterprise and Related Information" which establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports issued to shareholders. It also established standards for related disclosures about products and services, geographic areas, and major customers. Disclosures required by this new standard are presented in Note 16.

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" which establishes accounting and reporting standards for derivative instruments and hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. SFAS 133 is effective for fiscal years beginning after June 15, 1999. The Company doesn't own derivative instruments nor does it engage in hedging activities, and therefore expects that SFAS 133 will not have an impact on the Company's financial condition or its results of operations.

Notes

TO CONSOLIDATED FINANCIAL STATEMENTS

Change In Accounting Method

On May 21, 1998, the Emerging Issues Task Force ("EITF") discussed Issue 98-9 "Accounting for Contingent Rent In Interim Financial Periods" and reached a consensus that lessors should defer the accounting recognition of contingent rent, such as percentage rent, until the specific tenant sales breakpoint is achieved. The Company's prior accounting method, which was permitted under generally accepted accounting principles, recognized percentage rent when a tenant's achievement of its sales breakpoint was considered probable. This EITF consensus was implemented retroactively to January 1, 1998, as a change in accounting method. The new accounting method did not affect the amount of percentage rent income reported on an annual basis, but did impact the recognition of percentage rent income reported on an interim basis by increasing revenues the Company reported in the first and fourth quarters and decreasing revenues reported in the second and third quarters. The change in accounting method has no impact on the Company's cash flows. As a result of adoption of EITF Issue 98-9, the Company recorded a \$771,000 charge for the cumulative effect of change in accounting method, which is included in the consolidated statement of operations for the year ended December 31, 1998.

Construction in Progress

Construction in progress includes the costs of active development projects and other predevelopment project costs. Development costs include direct construction costs and indirect costs such as architectural, engineering, construction management and carrying costs consisting of interest, real estate taxes and insurance. Construction in progress balances as of December 31, 1998 and 1997 are as follows:

Construction in Progress		
<i>(In thousands)</i>	December 31,	
	<u>1998</u>	<u>1997</u>
Avenel V	\$ 2,800	\$ --
French Market	949	807
Shops At Fairfax	702	--
Other development costs	<u>55</u>	<u>167</u>
Ending Balance	<u>\$ 4,506</u>	<u>\$ 974</u>

Cash and Cash Equivalents

Cash and cash equivalents includes cash and short-term investments with maturities of three months or less.

Per Share Data

Per share data is calculated in accordance with SFAS No. 128, "Earnings Per Share". The Company has no dilutive securities, therefore, basic and diluted earnings per share are identical. Net income before minority interests is presented on a fully converted basis, that is, assuming the limited partners exercise their right to convert their partnership ownership into shares of Saul Centers and is computed using weighted average shares of 17,233,047, 16,690,417 and 16,423,984, shares for the years ended December 31, 1998, 1997 and 1996, respectively. Per share data relating to net income after minority interests is computed on the basis of 12,643,639, 12,297,254 and 12,030,821, weighted average common shares for the years ended December 31, 1998, 1997 and 1996, respectively.

Reclassifications

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

3. MINORITY INTERESTS- HOLDERS OF CONVERTIBLE LIMITED PARTNERSHIP UNITS IN THE OPERATING PARTNERSHIP

The Saul Organization has a 27.2% limited partnership interest, represented by 4,798,695 convertible limited partnership units, in the Operating Partnership, as of December 31, 1998. These Convertible Limited Partnership Units are convertible into shares of Saul Centers' common stock on a one-for-one basis, provided the rights may not be exercised at any time that The Saul Organization owns, directly or indirectly, in the aggregate more than 24.9% of the outstanding equity securities of Saul Centers. The impact of the Saul Organization's 27.2% limited partnership interest in the Operating Partnership is reflected as minority interests in the accompanying financial statements.

Notes

TO CONSOLIDATED FINANCIAL STATEMENTS

4. NOTES PAYABLE

December 31, 1998

The Company assumed a \$3.7 million loan when it acquired Avenel IV on April 1, 1998. In September 1998, the Company closed a \$6.4 million permanent fixed rate loan to replace the variable rate loan assumed on the acquisition of Avenel IV. The balance of the loan, \$2.7 million, was used to fund construction of the new Avenel V development. The new loan term is 13 years and requires monthly principal and interest payments based upon a 25 year amortization schedule and an interest rate of 7.09%. Borrowings totaled \$18.0 million on the Company's \$60.0 million unsecured revolving credit facility at December 31, 1998, leaving \$42.0 million available for future use. Notes payable totaled \$290.6 million at December 31, 1998, as follows:

Notes Payable			
<i>(In thousands)</i>	<u>Principal Outstanding</u>	<u>Interest Rate</u>	<u>Scheduled Maturity</u>
Mortgage Notes Payable	\$ 144,814 (a)	7.67% fixed	October 2012
	79,464 (b)	8.52% fixed	December 2011
	37,515 (c)	7.88% fixed	January 2013
	10,629 (d)	7.25% fixed	May 2004
	<u>201</u>	8.00% fixed	January 2000
Subtotal	272,623		
Revolving Credit Facility	<u>18,000 (e)</u>	6.82% variable	September 2000
Total Notes Payable	<u>\$ 290,623</u>		

(a) The loan is collateralized by nine shopping centers.

(b) The loan is collateralized by Avenel Business Park, Van Ness Square and four shopping centers - Ashburn Village, Leesburg Pike, Lumberton Plaza and Village Center. The loan was amended during 1998 to include new borrowings of \$6.4 million at a rate of 7.09%. Avenel IV and Avenel V (under construction at year-end 1998) were added as collateral. The 8.52% blended interest rate is the weighted average of the initial loan rate and the additional borrowings rate.

(c) The loan is collateralized by 601 Pennsylvania Avenue.

(d) For the final five years of the term of the loan, beginning in June 1999, the interest rate is fixed at the 1-year Treasury Securities rate effective March 16, 1999 plus 2.00%. The loan is collateralized by The Glen shopping center.

(e) The facility is a revolving credit facility totaling \$60.0 million. Interest expense is calculated based upon the 1,2,3 or 6 month LIBOR rate plus a spread of 1.375% to 1.625% (determined by certain debt service coverage and leverage tests) or upon the bank's reference rate plus 1/2% at the Company's option. The line may be extended one year with payment of a fee of 1/4% at the Company's option. The interest rate in effect on December 31, 1998 was based on a weighted average LIBOR of 5.32% and spread of 1.5%.

Notes

TO CONSOLIDATED FINANCIAL STATEMENTS

Notes payable balances outstanding at December 31, 1998 have a weighted average remaining term of 12.5 years, and a weighted average interest rate of 7.84%. Of the \$290.6 million total debt at December 31, 1998, \$272.6 million was fixed rate (93.8% of the total notes payable) and \$18.0 million was variable rate (6.2% of the total notes payable). The December 31, 1998 depreciated cost of properties collateralizing the mortgage notes payable totaled \$192.0 million.

Notes payable of \$272.4 million at December 31, 1998 require monthly installments of principal and interest, with principal amortization on schedules averaging approximately 20 years. The \$0.2 million note requires monthly interest and an annual principal payment of \$0.1 million. The remaining notes payable totaling \$18.0 million at December 31, 1998 require monthly installments of interest only. Notes payable at December 31, 1998 totaling \$211.0 million are guaranteed by members of The Saul Organization.

As of December 31, 1998, the scheduled maturities of all debt for years ended December 31, are as follows:

Debt Maturity Schedule	
<i>(In thousands)</i>	
1999	\$ 5,256
2000	23,648
2001	6,057
2002	5,735
2003	6,215
Thereafter	243,712
	<u>\$ 290,623</u>

December 31, 1997

During 1997 the Company repaid a total of \$185.5 million of variable rate mortgage notes which were outstanding at December 31, 1996, with the net proceeds of a \$147.0 million 15-year fixed rate mortgage note and a \$38.5 million 16-year fixed rate mortgage note. The \$44.0 million secured revolving credit facility in effect at December 31, 1996 was replaced with a \$60.0 million unsecured revolving credit facility during 1997. Notes payable totaled \$284.5 million at December 31, 1997.

Notes payable balances outstanding at December 31, 1997 had a weighted average remaining term of 13.7 years, and a weighted average interest rate of 7.90%. Of the \$284.5 million total debt at December 31, 1997, \$271.0 million was fixed rate (95.3% of the total notes payable) and \$13.5 million was variable rate (4.7% of the total notes payable). The December 31, 1997 depreciated cost of properties collateralizing the mortgage notes payable totaled \$192.7 million. Notes payable of \$270.7 million at December 31, 1997 required monthly installments of principal and interest, with principal amortization on schedules averaging approximately 20 years. The \$0.3 million note required monthly interest and an annual principal payment of \$0.1 million. The remaining notes payable totaling \$13.5 million at December 31, 1997 required monthly installments of interest only. Notes payable at December 31, 1997 totaling \$209.1 million were guaranteed by members of The Saul Organization.

5. LEASE AGREEMENTS

Lease income includes primarily base rent arising from noncancellable commercial leases. Base rent for the years ended December 31, 1998, 1997 and 1996, amounted to \$55,542,000, \$51,779,000 and \$49,814,000, respectively. Future base rent under noncancellable leases for years ended December 31, are as follows:

Future Base Rental Income	
<i>(In thousands)</i>	
1999	\$ 55,984
2000	50,574
2001	45,356
2002	38,343
2003	31,287
Thereafter	261,869
	<u>\$ 483,413</u>

The majority of the leases also provide for rental increases and expense recoveries based on increases in the Consumer Price Index or increases in operating expenses, or both. These increases generally are payable in equal installments throughout the year based on estimates, with adjustments made in the succeeding year.

Notes

TO CONSOLIDATED FINANCIAL STATEMENTS

Expense recoveries for the years ended December 31, 1998, 1997 and 1996 amounted to \$9,911,000, \$9,479,000 and \$9,301,000, 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 \$2,755,000, \$2,948,000 and \$2,924,000, for the years ended December 31, 1998, 1997 and 1996, respectively.

6. LONG-TERM LEASE OBLIGATIONS

Certain properties are subject to noncancellable long-term leases which apply to land underlying the Shopping Centers. Certain of the leases provide for periodic adjustments of the basic 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 financial statements is minimum ground rent expense of \$152,000 for each of the years ended December 31, 1998, 1997, and 1996. The minimum future rental commitments under these ground leases are as follows:

Ground Lease Rental Commitments		
<i>(In thousands)</i>		
	Annual 1999-2003	Total Thereafter
Beacon Center	\$ 47	\$ 3,465
Olney	45	4,646
Southdale	60	3,365
	<u>\$ 152</u>	<u>\$11,476</u>

The Company's Flagship Center consists of two developed outparcels 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.

7. SHAREHOLDERS' EQUITY AND MINORITY INTERESTS

The Consolidated Statement of Operations for the year ended December 31, 1998 includes a charge for minority interests of \$7,240,000, consisting of \$4,354,000 related to The Saul Organization's share of the net income for the year and \$2,886,000 related to distributions to minority interests in excess of allocated net income for the year. The charge for the year ended December 31, 1997 of \$6,854,000 consists of \$2,483,000 related to The Saul Organization's share of net income for the year and \$4,371,000 related to distributions to minority interests in excess of allocated net income for the year. The charge for the year ended December 31, 1996 of \$6,852,000 consists of \$3,430,000 related to The Saul Organization's share of the net income for the year and \$3,422,000 related to distributions to minority interests in excess of allocated net income for the year.

8. RELATED-PARTY TRANSACTIONS

In April 1998, the Company purchased, through its operating partnership, a 46,227 square foot office/flex property known as Avenel IV. The \$5,600,000 purchase price consisted of \$3,657,000 in variable rate debt assumption, with the balance paid through the issuance of 105,922 new units in Saul Centers' operating partnership. The seller was a member of The Saul Organization.

Chevy Chase Bank, F.S.B. leases space in twelve of the properties. Total rental income from Chevy Chase Bank, F.S.B. amounted to \$1,192,000, \$1,181,000 and \$1,063,000, for the years ended December 31, 1998, 1997 and 1996, respectively.

The Chairman and Chief Executive Officer, the President and a Senior Vice President of the Company are officers of The Saul Organization but devote a substantial amount of time to the management of the Company. The annual compensation for these officers is fixed by the Compensation Committee of the Board of Directors.

Notes

TO CONSOLIDATED FINANCIAL STATEMENTS

The Company shares with The Saul Organization on a prorata basis certain ancillary functions such as computer and payroll services and insurance expense based on management's estimate of usage or time incurred, as applicable. Also, The Saul Organization subleases office space to the Company. The terms of all such arrangements with The Saul Organization, including payments related thereto, are periodically reviewed by the Audit Committee of the Board of Directors. Included in general and administrative expense for the years ended December 31, 1998, 1997 and 1996, are charges totaling \$1,685,000, \$1,624,000 and \$1,229,000, related to shared services, of which \$1,480,000, \$1,436,000 and \$1,073,000, was paid during the years ended December 31, 1998, 1997 and 1996, respectively.

9. STOCK OPTION PLAN

The Company has established a stock option plan for the purpose of attracting and retaining executive officers and other key personnel. The plan provides for grants of options to purchase a specified number of shares of common stock. A total of 400,000 shares are available under the plan. The 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.

The Compensation Committee has granted options to purchase a total of 180,000 shares (90,000 shares from incentive stock options and 90,000 shares from non-qualified stock options) to five Company officers. The options vested 25% per year over four years, have an exercise price of \$20 per share and a term of ten years, subject to earlier expiration upon termination of employment. A total of 170,000 of the options expire September 23, 2003 and 10,000 expire September 24, 2004. As of December 31, 1998, all 180,000 of the options were fully vested. No compensation expense has been recognized as a result of these grants.

10. NON-OPERATING ITEM- SALES OF INTEREST RATE PROTECTION AGREEMENTS

The Company sold a portion of its interest rate protection agreements with a notional value of \$87 million in November 1996 and all of the remaining agreements with a notional value of \$162.8 million in October 1997. The sales resulted in the write-off of unamortized costs in excess of the proceeds received totaling \$4,392,000 and \$972,000, for the years ended December 31, 1997 and 1996, respectively.

11. EXTRAORDINARY ITEM-EARLY EXTINGUISHMENT OF DEBT

The consolidated statements of operations for the years ending December 31, 1998, 1997 and 1996, include \$50,000, \$3,197,000 and \$587,000, respectively, related to the write-off of deferred financing costs on loans that were prepaid.

12. FAIR VALUE OF FINANCIAL INSTRUMENTS

Statement of Financial Accounting Standards No. 107, "Disclosure about Fair Value of Financial Instruments," requires disclosure about fair value for all financial instruments. The carrying values of cash, accounts receivable, accounts payable and accrued expenses are reasonable estimates of their fair value. Based on interest rates currently available to the Company, the carrying value of the variable rate credit line payable is a reasonable estimation of fair value, because the debt bears interest based on short-term interest rates. Based upon management's estimate of borrowing rates and loan terms currently available to the Company for fixed rate financing in the amount of the total notes payable, the fair value is not materially different from its carrying value.

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 aggregate, will not have a material adverse impact on the Company or the Current Portfolio Properties.

Notes

TO CONSOLIDATED FINANCIAL STATEMENTS

14. DISTRIBUTIONS

In December 1995, the Company established a Dividend Reinvestment and Stock Purchase Plan (the "Plan"), to allow its stockholders and holders of limited partnership interests an opportunity to buy additional shares of Common Stock by reinvesting all or a portion of their dividends or distributions. The Plan provides for investing in newly issued shares of Common Stock at a 3 percent discount from market price without payment of any brokerage commission, service charges or other expenses. All expenses of the Plan are paid by the Company. The January 31, 1996 dividend was the initial dividend payment date when the Company's stockholders and holders of limited partnership interests could participate in the Plan.

Of the distributions paid during 1998, \$1.16 per share represented ordinary dividend income and \$0.40 per share represented return of capital to the shareholders. The following summarizes distributions paid during the years ended December 31, 1998, 1997 and 1996, including activity in the Plan:

	<u>Total Distributions to</u>		<u>Dividend Reinvestment Plan</u>		
	<u>Common</u>	<u>Limited Partner</u>	<u>Common</u>	<u>Units</u>	<u>Discounted</u>
	<u>Stockholders</u>	<u>Unitholders</u>	<u>Issued</u>	<u>Issued</u>	<u>Share Price</u>
	<i>(In thousands)</i>				
Distributions during 1998					
January 30	\$ 4,848	\$ 1,713	94,304	--	\$ 16.19
April 30	4,886	1,755	90,856	80,733	17.40
July 29	4,923	1,786	101,739	106,010	16.01
October 30	4,964	1,827	105,756	112,867	15.40
	<u>\$ 19,621</u>	<u>\$ 7,081</u>	<u>392,655</u>	<u>299,610</u>	
Distributions during 1997					
January 31	\$ 4,740	\$ 1,713	58,728	--	\$ 16.01
April 30	4,764	1,713	68,913	--	15.16
July 31	4,792	1,715	63,291	--	16.98
October 31	4,818	1,713	72,901	--	17.10
	<u>\$ 19,114</u>	<u>\$ 6,854</u>	<u>263,833</u>		
Distributions during 1996					
January 31	\$ 4,640	\$ 1,713	56,050	--	\$ 14.19
April 30	4,663	1,713	58,980	--	13.94
July 31	4,687	1,713	67,421	--	12.61
October 31	4,714	1,713	64,154	--	14.19
	<u>\$ 18,704</u>	<u>\$ 6,852</u>	<u>246,605</u>		

In December 1998, 1997 and 1996, the Board of Directors of the Company authorized a distribution of \$0.39 per share payable in January 1999, 1998 and 1997, to holders of record on January 15, 1999, January 16, 1998 and January 17, 1997, respectively. As a result, \$5,007,000, \$4,832,000 and \$4,729,000 was paid to common shareholders on January 29, 1999, January 30, 1998 and January 31, 1997, respectively. Also,

\$1,871,000, \$1,713,000 and \$1,713,000 was paid to limited partnership unitholders on January 29, 1999, January 30, 1998 and January 31, 1997 (\$0.39 per Operating Partnership unit), respectively. These amounts are reflected as a reduction of stockholders' equity and are included in accounts payable in the accompanying financial statements.

Notes

TO CONSOLIDATED FINANCIAL STATEMENTS

15. INTERIM RESULTS (UNAUDITED)

The following summary presents the results of operations of the Company for the quarterly periods of years 1998 and 1997.

(In thousands, except per share amounts)

	Three Months Ended			
	12/31/1998	9/30/1998	6/30/1998	3/31/1998
Revenues	\$ 18,100	\$ 17,650	\$ 17,505	\$ 17,143
Net income before extraordinary item and minority interests	3,774	4,427	4,326	4,478
Extraordinary item-Early extinguishment of debt	--	(50)	--	--
Minority interests	(1,873)	(1,827)	(1,827)	(1,713)
Net income	<u>\$ 1,901</u>	<u>\$ 2,550</u>	<u>\$ 2,499</u>	<u>\$ 2,765</u>
Per Share Data:				
Net income before extraordinary item and minority interests	<u>\$ 0.21</u>	<u>\$ 0.26</u>	<u>\$ 0.25</u>	<u>\$ 0.27</u>
Net income	<u>\$ 0.15</u>	<u>\$ 0.20</u>	<u>\$ 0.20</u>	<u>\$ 0.22</u>
	12/31/1997	9/30/1997	6/30/1997	3/31/1997
Revenues	\$ 17,386	\$ 17,145	\$ 16,624	\$ 16,562
Net income before extraordinary item and minority interests	(238)	4,381	4,211	4,249
Extraordinary item-Early extinguishment of debt	(2,828)	--	--	(369)
Minority interests	(1,713)	(1,715)	(1,713)	(1,713)
Net income	<u>\$ (4,779)</u>	<u>\$ 2,666</u>	<u>\$ 2,498</u>	<u>\$ 2,167</u>
Per Share Data:				
Net income before extraordinary item and minority interests	<u>\$ 0.01</u>	<u>\$ 0.26</u>	<u>\$ 0.25</u>	<u>\$ 0.26</u>
Net income	<u>\$ (0.39)</u>	<u>\$ 0.22</u>	<u>\$ 0.20</u>	<u>\$ 0.18</u>

In June 1998, the Company adopted a new accounting method as directed by the Emerging Issues Task Force (EITF) Issue 98-9 "Accounting for Contingent Rent In Interim Financial Periods" which reallocated the amount of annual percentage rent income recognized in its quarterly reports. (See Note 2, Summary of Significant Accounting Policies-Change In Accounting Method.) The Company adopted the new accounting method during the second quarter of 1998, retroactive to January 1, 1998. The Company reported revenues and net income, of \$34,833,000 and \$4,678,000, respectively, for the six months ended June 30, 1998. The six month results included additional percentage rent income of \$185,000 and the cumulative effect of change in accounting method of (\$771,000), which would have been reported in the first quarter had the accounting method been then adopted. The 1998 second, third and fourth quarter interim results presented above reflect application of the new accounting method. The 1998 first quarter and 1997 interim results do not reflect the allocation of percentage rent income earned in accordance with the new accounting method and therefore are not comparable with the 1998 results. The application of the change in accounting method had no impact on the Company's cash flows nor the amount of revenues reported for the years ended December 31, 1998 and 1997.

Notes

TO CONSOLIDATED FINANCIAL STATEMENTS

16. BUSINESS SEGMENTS

The company has two reportable business segments: Shopping Centers and Office Properties. The accounting policies of the segments presented below are the same as those described in the summary of significant accounting policies (see Note 1). The Company evaluates performance based upon income from real estate for the combined properties in each segment.

(Dollars in thousands)

	Shopping Centers	Office Properties	Corporate and Other	Consolidated Totals
1998				
Real estate rental operations:				
Revenues	\$ 52,622	\$ 17,871	\$ 214	\$ 70,707
Expenses	(9,650)	(4,723)	(127)	(14,500)
Income from real estate	42,972	13,148	87	56,207
Interest expense & amortization of debt costs			(23,046)	(23,046)
General and administrative			(3,393)	(3,393)
Subtotal	42,972	13,148	(26,352)	29,768
Depreciation and amortization	(8,758)	(3,694)	(126)	(12,578)
Early extinguishment of debt			(50)	(50)
Cumulative effect of accounting method change			(771)	(771)
Minority interests			(7,240)	(7,240)
Net income	\$ 34,214	\$ 9,454	\$ (34,539)	\$ 9,129
Annual capital investment	\$ 11,807	\$ 2,892	\$ 77	\$ 14,776
Total assets	\$ 178,459	\$ 70,182	\$ 22,393	\$ 271,034
1997				
Real estate rental operations:				
Revenues	\$ 51,258	\$ 16,302	\$ 351	\$ 67,911
Expenses	(9,972)	(4,691)	(195)	(14,858)
Income from real estate	41,286	11,611	156	53,053
Interest expense & amortization of debt costs			(22,037)	(22,037)
General and administrative			(3,379)	(3,379)
Subtotal	41,286	11,611	(25,260)	27,637
Depreciation and amortization	(7,144)	(3,373)	(125)	(10,642)
Sale of interest rate protection agreements			(4,392)	(4,392)
Early extinguishment of debt			(3,197)	(3,197)
Minority interests			(6,854)	(6,854)
Net income	\$ 34,142	\$ 8,238	\$ (39,828)	\$ 2,552
Annual capital investment	\$ 15,240	\$ 849	\$ 5	\$ 16,094
Total assets	\$ 174,556	\$ 67,016	\$ 19,370	\$ 260,942
1996				
Real estate rental operations:				
Revenues	\$ 47,809	\$ 16,021	\$ 429	\$ 64,259
Expenses	(10,117)	(4,323)	(236)	(14,676)
Income from real estate	37,692	11,698	193	49,583
Interest expense & amortization of debt costs			(21,366)	(21,366)
General and administrative			(3,095)	(3,095)
Subtotal	37,692	11,698	(24,268)	25,122
Depreciation and amortization	(7,134)	(3,600)	(126)	(10,860)
Early extinguishment of debt			(587)	(587)
Minority interests			(6,852)	(6,852)
Net income	\$ 30,558	\$ 8,098	\$ (32,805)	\$ 5,851
Annual capital investment	\$ 7,451	\$ 436	\$ 148	\$ 8,035
Total assets	\$ 164,727	\$ 69,308	\$ 29,460	\$ 263,495

Management's

DISCUSSION AND ANALYSIS

of Financial Condition and Results of Operations

GENERAL

The following discussion is based on the consolidated financial statements of the Company as of December 31, 1998 and for the year ended December 31, 1998. Prior year data is based on the Company's consolidated financial statements as of December 31, 1997 and 1996 and for the years ended December 31, 1997 and 1996.

LIQUIDITY AND CAPITAL RESOURCES

The Company's principal demands for liquidity are expected to be distributions to its stockholders, debt service and loan repayments, 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 95% of its "real estate investment trust taxable income," as defined in the Internal Revenue Code of 1986, as amended. The Company anticipates that operating revenues will provide the funds necessary for operations, debt service, distributions, and required recurring capital expenditures. Balloon principal repayments are expected to be funded by refinancings.

Management anticipates that during the coming year the Company may: 1) redevelop certain of the Shopping Centers, 2) develop additional freestanding outparcels or expansions within certain of the Shopping Centers, 3) acquire existing neighborhood and community shopping centers and/or office properties and 4) develop new shopping center or office sites. Acquisition and development of properties are undertaken only after careful analysis and review, and management's determination that such property is expected to provide long-term earnings and cash flow growth. During the coming year, any developments, expansions or acquisitions are expected to be funded with bank borrowings from the Company's credit line, construction financing or other external capital resources available to the Company.

The Company expects to fulfill its long range requirements for capital resources in a variety of ways, including undistributed cash flow from operations, secured or unsecured bank and institutional borrowings, private or public offerings of debt or equity securities and proceeds from the sales of properties. Borrowings may be at the Saul Centers, Operating Partnership or Subsidiary Partnership level, and securities offerings may include (subject to certain limitations) the issuance of additional limited partnership interests in the Operating Partnership which can be converted into shares of Saul Centers common stock.

Management believes that the Company's current capital resources, including approximately \$42,000,000 of the Company's credit line which was available for borrowing as of December 31, 1998, will be sufficient to meet its liquidity needs for the foreseeable future.

Management's

DISCUSSION AND ANALYSIS

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FINANCIAL INFORMATION

In 1998, the Company reported Funds From Operations (FFO) of \$29,768,000 on a fully converted basis. This represents a 7.7% increase over 1997 FFO of \$27,637,000. The following table represents a reconciliation from net income before minority interests to FFO:

Funds From Operations Schedule			
<i>(Dollars in thousands)</i>			
	For the Years Ended December 31,		
	1998	1997	1996
Net income before minority interests	\$ 16,369	\$ 9,406	\$ 12,703
Depreciation and amortization of real property	12,578	10,642	10,860
Debt restructuring losses:			
Disposition of interest rate protection agreements.	4,392	972	--
Write-off unamortized loan costs	50	3,197	587
	<u>28,997</u>	<u>27,637</u>	<u>25,122</u>
Retroactive impact of change in accounting method (1)	<u>771</u>	<u>--</u>	<u>--</u>
Funds From Operations (2)	<u>\$ 29,768</u>	<u>\$ 27,637</u>	<u>\$ 25,122</u>

- (1) Retroactive to January 1, 1998, the Company began recognition of percentage rent income in accordance with a new accounting pronouncement.
- (2) FFO, as defined by the National Association of Real Estate Investment Trusts, is calculated as net income excluding gains or losses from debt restructuring and sales of property, plus depreciation and amortization, and after adjustments for unconsolidated partnerships and joint ventures. FFO does not represent cash generated from operating activities in accordance with generally accepted accounting principles and is not necessarily indicative of cash available to fund cash needs, which is disclosed in the 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, 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 supplemental measure of operating performance and along with cash flow from operating activities, financing activities and investing activities, it provides investors with an indication of the ability of the Company to incur and service debt, to make capital expenditures and to fund other cash needs. FFO may not be comparable to similarly titled measures employed by other REITs.

Cash flow from operating activities, financing activities and investing activities are as follows:

<i>(Dollars in thousands)</i>			
	For the Years Ended December 31,		
	1998	1997	1996
Cash flow provided by (used in):			
Operating activities	\$ 29,686	\$ 28,936	\$ 29,677
Investing activities	14,776	(16,094)	(8,035)
Financing activities	13,203	12,192	(22,278)

Management's

DISCUSSION AND ANALYSIS

of Financial Condition and Results of Operations

CAPITAL STRATEGY AND FINANCING ACTIVITY

The Company's capital strategy is to maintain a ratio of 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. Management believes that current total debt remains less than 50% percent of total asset value.

In April 1998, the Company purchased, through its operating partnership, 46,227 square feet of office/flex space known as Avenel IV. The \$5,600,000 purchase price consisted of \$3,657,000 in variable rate debt assumption, with the balance paid through the issuance of 105,922 new units in Saul Centers' operating partnership. In September 1998, the Company closed a \$6.4 million permanent loan to repay the variable rate debt assumed with the April 1998 acquisition previously described, and to finance the development of the 27,000 square foot Avenel V. The new loan term is 13 years, maturing in December 2011, and requires monthly principal and interest payments based on a 25 year amortization schedule and an interest rate of 7.09%. This loan is a part of a cross-collateralized mortgage pool totaling \$79.5 million at December 31, 1998. See "Notes to Consolidated Financial Statements, Note 4- Notes Payable".

In January 1999, the Company closed a \$38 million construction loan, which is anticipated to fully fund the development costs associated with the 230,000 square foot mixed-use office/retail complex which the Company is constructing in Old Town Alexandria, Virginia. The loan has an initial three year term with an interest rate of LIBOR plus 1.90%, with the spread over LIBOR declining as leasing of the office and retail space proceeds.

As of February 20, 1998, outstanding borrowings on the Company's \$60 million unsecured credit line totalled \$18 million, leaving \$42 million of credit availability. This availability provides the Company with capital to pursue new redevelopment, renovation, and expansion opportunities within its portfolio. The Company has fixed interest rates on approximately 93% of its total debt outstanding, which now has a weighted remaining term of over 12 years.

REDEVELOPMENT, RENOVATIONS AND ACQUISITIONS

The Company has been selectively involved in redevelopment, renovation and acquisition activities. It continues to evaluate land parcels for retail and office development and potential acquisitions of operating properties for opportunities to enhance operating income and cash flow growth. The Company also continues to take advantage of redevelopment, renovation and expansion opportunities within the portfolio, as demonstrated by its activities at French Market, Beacon Center, Shops at Fairfax, Avenel, and North Washington Street.

In February 1998, the Company commenced construction on a facade renovation and retensing of a 103,000 square foot anchor space at the 213,000 square foot French Market center in Oklahoma City, Oklahoma. The Company had successfully negotiated the termination of a below market Venture lease in the fourth quarter of 1997. Construction and retensing of the first three new spaces, a 41,000 square foot Bed, Bath and Beyond, an 8,000 square foot Lakeshore Learning, a children's educational toy store and an 8,000 square foot BridesMart formal wear retailer were completed in 1998. The Company is conducting negotiations with prospective tenants for the remaining 38,000 square feet. The redevelopment included a complete facade renovation of the 103,000 square foot building which incorporates new anchor tenant architectural features, new storefronts, tenant signage and decorative awnings.

The Company has signed a lease with Lowe's Companies for a new 148,000 square foot home improvement superstore and garden center at the Beacon Center in Alexandria, Virginia. The lease has an initial term of twenty years. The area leased by Lowe's consists of approximately 100,000 square feet of existing space and 48,000 square feet of new building area. Beacon Center's central enclosed mall area was demolished and construction has commenced on the Lowe's store, which is scheduled to open in the summer of 1999. The center's other tenants include anchors Giant Food, Marshalls and Office Depot, with a complement of small shop space and restaurants. The 356,000 square feet Beacon Center is now over 99% leased. In addition to the new home improvement store, 8,000 square feet of new small shop space adjacent to Lowe's and Giant has been constructed and is fully occupied.

Management's

DISCUSSION AND ANALYSIS

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The Company commenced another significant redevelopment during 1998 when it signed a lease with SuperFresh for a new 53,000 square foot grocery store at the Shops at Fairfax, located in Fairfax, Virginia. A portion of the shopping center which includes a small enclosed mall was demolished to allow SuperFresh to occupy a new building, with construction projected to be completed in the fall of 1999. An additional 7,500 square feet of shop space will be constructed adjacent to the supermarket. The facade of the adjacent Boulevard shopping center, also owned by the Company, is being renovated and modernized. This renovation was driven by a new 12,000 square foot lease with Party City, which replaced a previous lease with below market rents. Redevelopment plans also include new landscaping and a more efficient parking scheme, which should enhance the property as a desirable neighborhood shopping center.

Office development and acquisition activities were an integral part of the Company's focus during 1998, and substantial efforts in this area will continue throughout 1999. In February 1999, the Company announced that it will develop a new 230,000 square foot Class A mixed-use office/retail complex along North Washington Street in historic Old Town Alexandria in Northern Virginia. The project is well located on a two acre site along Alexandria's main street. Demolition of the Company's existing 41,500 square foot building, formerly leased to Mastercraft furniture, commenced in February 1999. Construction is scheduled for completion by the summer of 2000. Two twin four-story buildings will feature a brick and cast stone exterior facade with a glass curtain wall overlooking a spacious courtyard. Amenities will include 3-story atrium lobbies, a fitness center, concierge service, a 600 space parking structure and the latest computerized energy management system. The street level will have 45,000 square feet of retail space. Office space totals 185,000 square feet, with the top floor containing walk-out terraces.

On April 1, 1998, the Company purchased, through its operating partnership, a newly constructed, 100% leased office/flex building (Avenel IV) located adjacent to its Avenel Business Park (Phases I-III) in Gaithersburg, Maryland. Avenel IV contains 46,227 square feet of net leasable area, which increased the Company's Avenel Business Park by 16%, to 332,000 square feet. An

independent appraisal determined the purchase price of \$5,600,000. The seller is a member of The Saul Organization and is an existing limited partner in the operating partnership.

In July 1998, the Company began development of approximately 27,000 square feet of additional office/flex space at Avenel Business Park on excess land that it owns. Construction of this new project (Avenel V) was substantially completed during January 1999. Approximately 46% of the space is leased, while leases are in negotiation for a portion of the remaining newly developed space. Including this new development, Avenel Business Park is currently over 93% leased.

PORTFOLIO LEASING STATUS

At December 31, 1998, the portfolio consisted of twenty nine Shopping Centers, four Office Properties and one Industrial Property, all of which are located in seven states and the District of Columbia. The Office Properties consist of one office property and one office/retail property, both located in the District of Columbia, and one research park located in a Maryland suburb of Washington, D.C.

At December 31, 1998, 92.1% of the Company's 5.9 million square feet of leasable space was leased to tenants, as compared to 89.0% at December 31, 1997. The shopping center portfolio was 95.2% leased at December 31, 1998 versus 90.6% as of December 31, 1997. The Office Properties were 95.4% leased at December 31, 1998 compared to 96.8% as of December 31, 1997. The overall improvement in the year-end 1998 leasing percentage was primarily caused by the Company's successful leasing at recently renovated shopping centers: Seven Corners, Great Eastern and Beacon Center.

RESULTS OF OPERATIONS

The following discussion compares the results of the Company for the year ended December 31, 1998 with the year ended December 31, 1997, and compares the year ended December 31, 1997 with the year ended December 31, 1996. This information should be read in conjunction with the accompanying consolidated financial statements and the notes related thereto.

Management's

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YEARS ENDED DECEMBER 31, 1998 AND 1997

Base rent increased to \$55,542,000 in 1998 from \$51,779,000 in 1997, representing a \$3,763,000 (7.3%) increase. The increase in base rent resulted primarily from improved occupancy at the redeveloped Seven Corners and Beacon Center, increased minimum rents on lease rollover from three tenants previously paying percentage rent, and to a lesser extent, generally higher rents on lease renewals.

Expense recoveries increased to \$9,911,000 in 1998 from \$9,479,000 in 1997, representing an increase of \$432,000 (4.6%). The equal increases in common area maintenance expense recoveries and real estate tax expense recovery occurred due to improved occupancy primarily at Seven Corners and the addition of the Avenel IV property to the Company's portfolio during 1998.

Percentage rent was \$2,755,000 in 1998, compared to \$2,948,000 in 1997, representing a decrease of \$193,000 (6.5%). This decrease resulted primarily from the rollover of three leases into higher paying base rent in lieu of percentage rent.

Other income, which consists primarily of parking income at two of the Office Properties, kiosk leasing, temporary leases and payments associated with early termination of leases, was \$2,375,000 in 1998, compared to \$3,511,000 in 1997, representing a decrease of \$1,136,000 (32.4%). The decrease in other income resulted from two large lease termination payments collected from former tenants at Seven Corners and Beacon Center in 1997.

As a consequence of the foregoing, the 1998 total revenues of \$70,583,000 represented an increase of \$2,866,000 (4.2%) over total 1997 revenues of \$67,717,000.

Operating expenses, which consist mainly of repairs and maintenance, utilities, payroll and insurance expense, decreased \$245,000 (3.0%) to \$7,830,000 in 1998 from \$8,075,000 in 1997.

The provision for credit losses was \$418,000 in 1998 compared to \$505,000 in 1997, representing a decrease of \$87,000 (17.2%). The decrease resulted from fewer uncollectible rent receivables resulting from tenants vacating their space prior to lease expiration.

Real estate taxes were \$6,128,000 in 1998 compared to \$6,084,000 in 1997, representing an increase of \$44,000 (0.7%).

Interest expense was \$22,627,000 in 1998 compared to \$20,308,000 in 1997, representing an increase of \$2,319,000 (11.4%). This increase is primarily attributable to higher interest rates resulting from the Company's October 1997 refinancing and conversion of approximately \$147.0 million of its mortgage debt from interest rate capped floating rate loans to longer term, fixed rate loans. New debt associated with the acquisition of Avenel IV in April 1998 also added approximately \$210,000 to interest expense in 1998.

Amortization of deferred debt expense decreased \$1,310,000 (75.8%) to \$419,000 in 1998 from \$1,729,000 in 1997. The decrease in the 1998 expense resulted from the elimination of amortization on interest rate protection agreements with notional values of \$162.8 million sold during the fourth quarter of 1997, and reduced amortization because new debt costs related to the October 1, 1997 refinancings are being amortized over a longer term than the prior debt costs.

Depreciation and amortization expense increased \$1,936,000 (18.2%) from \$10,642,000 in 1997 to \$12,578,000 in 1998. The increase resulted from the non-recurring write-off of unamortized tenant improvement costs due to the early termination of tenant leases at Beacon Center and Shops At Fairfax redevelopments and increased recurring expense related to new assets placed in service during 1998 and the latter half of 1997.

General and administrative expense, which consists primarily of administrative payroll and other overhead expenses, was \$3,393,000 in 1998 compared to \$3,379,000 in 1997, representing an increase of \$14,000 (0.4%).

Management's

DISCUSSION AND ANALYSIS

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Non-operating item, sales of interest rate protection agreements, resulted in a loss of \$4,392,000 in 1997 due to the write-off of unamortized costs in excess of sale proceeds received when the Company sold its remaining interest rate protection agreements. No such sales occurred in 1998.

Extraordinary item, early extinguishment of debt, resulted in losses of \$50,000 and \$3,197,000, in 1998 and 1997, respectively. The losses in each period resulted from the write-off of unamortized loan costs when the Company refinanced a portion of its loan portfolio.

YEARS ENDED DECEMBER 31, 1997 AND 1996

Base rent increased to \$51,779,000 in 1997 from \$49,814,000 in 1996, representing a \$1,965,000 (3.9%) increase. The increase in base rent resulted primarily from increased rents received at the redeveloped Seven Corners, Leesburg Pike and Thruway shopping centers, and to a lesser extent, increased shopping center rents at several properties due to improved leasing and generally higher rents on lease renewals.

Expense recoveries increased to \$9,479,000 in 1997 from \$9,301,000 in 1996, representing an increase of \$178,000 (1.9%). The increase in expense recoveries resulted primarily from real estate tax recovered from tenants at the recently redeveloped Seven Corners center.

Percentage rent was \$2,948,000 in 1997, compared to \$2,924,000 in 1996, representing an increase of \$24,000 (0.8%). This increase resulted from generally improved reported sales throughout the portfolio.

Other income, which consists primarily of parking income at two of the Office Properties, kiosk leasing, temporary leases and payments associated with early termination of leases, was \$3,511,000 in 1997, compared to \$1,984,000 in 1996, representing an increase of \$1,527,000 (77.0%). The increase in other income resulted from two large lease termination payments.

As a consequence of the foregoing the 1997 total revenues of \$67,717,000 represented an increase of \$3,694,000 (5.8%) over total revenues of \$64,023,000 in 1996.

Operating expenses, which consist mainly of repairs and maintenance, utilities, payroll and insurance expense, increased \$6,000 (0.1%) to \$8,075,000 in 1997 from \$8,069,000 in 1996.

The provision for credit losses was \$505,000 in 1997 compared to \$457,000 in 1996, representing an increase of \$48,000 (10.5%). The increase resulted primarily from the provision required for a shopping center tenant which vacated its space prior to lease expiration.

Real estate taxes were \$6,084,000 in 1997 compared to \$5,914,000 in 1996, representing an increase of \$170,000 (2.9%). This increase was generally attributable to increased tax assessments at the Company's shopping center properties, particularly its redeveloped Seven Corners and Leesburg Pike shopping centers.

Interest expense was \$20,308,000 in 1997 compared to \$18,509,000 in 1996, representing an increase of \$1,799,000 (9.7%). The increase is primarily attributable to higher interest rates resulting from the Company's refinancing and conversion of approximately \$263 million of its mortgage debt from floating rate loans to longer term, fixed-rate loans during the period November 1996 through October 1997.

Amortization of deferred debt expense decreased \$1,128,000 (39.5%) to \$1,729,000 in 1997 from \$2,857,000 in 1996. The decrease in the 1997 year's expense resulted from the elimination of amortization on interest rate protection agreements with notional values of \$162.8 million and \$87.0 million, sold during the fourth quarters of 1997 and 1996, respectively, and reduced loan cost amortization because new debt costs are being amortized over a longer term than the prior debt costs.

Depreciation and amortization expense decreased \$218,000 (2.0%) from \$10,860,000 in 1996 to \$10,642,000 in 1997. The decrease resulted primarily from a non-recurring write-off of tenant improvement costs in 1996 upon the early termination of tenant leases.

Management's

DISCUSSION AND ANALYSIS

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General and administrative expense, which consists primarily of administrative payroll and other overhead expenses, was \$3,379,000 in 1997 compared to \$3,095,000 in 1996, representing an increase of \$284,000 (9.2%). The increase in 1997 expenses resulted from generally higher personnel expenses.

Non-operating item, sales of interest rate protection agreements, resulted in losses of \$4,392,000 and \$972,000, in 1997 and 1996, respectively, due to the write-off of unamortized costs in excess of sale proceeds received when the Company sold a portion of its interest rate protection agreements.

Extraordinary item, early extinguishment of debt, resulted in losses of \$3,197,000 and \$587,000, in 1997 and 1996, respectively. The losses in each period resulted from the write-off of unamortized loan costs when the Company refinanced a portion of its loan portfolio.

YEAR 2000 ISSUE

The year 2000 issue relates to whether computer systems will properly recognize date sensitive information to allow accurate processing of transactions and data relating to the year 2000 and beyond. In addition, the year 2000 issue relates to whether non-Information Technology (IT) systems that depend upon embedded electronic technology will recognize the year 2000. Systems that do not properly recognize such information could generate erroneous information or fail.

In 1995, the Company contracted to replace virtually all of its management information and accounting systems and install a local area network (LAN). One of the selection criteria of the new software and hardware was that they be fully year 2000 compliant. The new LAN and management and accounting information systems have been installed. Therefore, the Company's management information and accounting systems are fully year 2000 compliant. As a result of its efforts, the Company does not expect to incur any additional expense for its information systems related to the year 2000 issue.

The Company's property management staff has conducted a comprehensive review of its non-IT systems at its shopping centers and office buildings to determine whether any computer hardware and software in mechanical systems (i.e. escalators, elevators, security, heating, ventilating and air conditioning systems, etc.) are not year 2000 compliant. Management expects repairs and replacements required to make its non-IT systems year 2000 compliant will cost less than \$100,000 and will be completed prior to July 1999.

The Company believes there is risk that its operations may be affected by vendors and tenants who are unable to perform as contracted due to their own year 2000 exposure. It is very difficult to identify "the most reasonably likely worst case scenario" at this time. The Company's potential exposure is wide spread; however there is no known or expected major direct exposure. The Company believes that the most likely worst case exposure is at this indirect level where vendors and tenants fail to perform their obligations to the Company. For example, the Company believes it is possible that certain tenants' information systems may fail, which may delay the payment of rents. To help minimize this risk, the Company sent a letter to each tenant prior to January 1, 1999 advising the tenant that rent payments due January 1, 2000 must be paid on-time. These reminders will be sent twice again later in 1999. The Company's leases contain provisions empowering it to take certain actions to enforce its right to the timely payment of rent, regardless of the tenant's year 2000 exposure. While it is not possible at this time to determine the likely impact of these potential problems, the Company will continue to evaluate these areas and develop contingency plans, as appropriate.

Corporate

INFORMATION

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Senior Vice President

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EXCHANGE LISTING

New York Stock Exchange
Symbol: BFS

10-K REPORT

A copy of the Saul Centers, Inc.
annual report to the Securities and
Exchange Commission on Form
10-K may be obtained at no cost to
stockholders by writing to:

Investor Relations
Saul Centers, Inc.
8401 Connecticut Avenue
Chevy Chase, Maryland 20815

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 closing price of the stock on the dividend payment date.

To receive more information please call the plan administrator at 1-800-446-2617 and request to speak with a service representative or write:

First Chicago Trust Company of New York
Attention: Dividend Reinvestment Department
P.O. Box 2598
Jersey City, NJ 07303-2598

Certain matters discussed within this Annual Report are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and as such may involve known and unknown risks, uncertainties, and other factors which may cause the actual results, performance or achievements of Saul Centers to be different from any future results, performance or achievements expressed or implied by such forward-looking statements. Although Saul Centers believes the expectations reflected in such forward-looking statements are based upon reasonable assumptions, it can give no assurance that its expectations will be attained. These risks are detailed from time to time in the Company's filings with the Securities and Exchange Commission.

STOCK PRICES

Period	Share Price	
	High	Low
Fourth Quarter, 1998	\$16 ³ / ₄	\$15 ³ / ₈
Third Quarter, 1998	\$18 ³ / ₁₆	\$15 ³ / ₁₆
Second Quarter, 1998	\$18 ¹⁵ / ₁₆	\$17 ³ / ₁₆
First Quarter, 1998	\$18 ¹⁵ / ₁₆	\$17 ³ / ₈
Fourth Quarter, 1997	\$19 ³ / ₈	\$16 ¹ / ₄
Third Quarter, 1997	\$19 ¹ / ₈	\$16 ³ / ₁₆
Second Quarter, 1997	\$17 ¹ / ₄	\$15 ¹ / ₈
First Quarter, 1997	\$17 ³ / ₈	\$15 ¹ / ₂

The annual meeting of shareholders will be held at 11:00 a.m., local time, on April 23, 1999, at the Embassy Suites Chevy Chase Pavilion, 4300 Military Road, N.W., Washington, D.C. (at the intersection of Western and Wisconsin Avenues, adjacent to Friendship Heights Metro Stop on the Metro Red Line.)



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