

Saul Centers

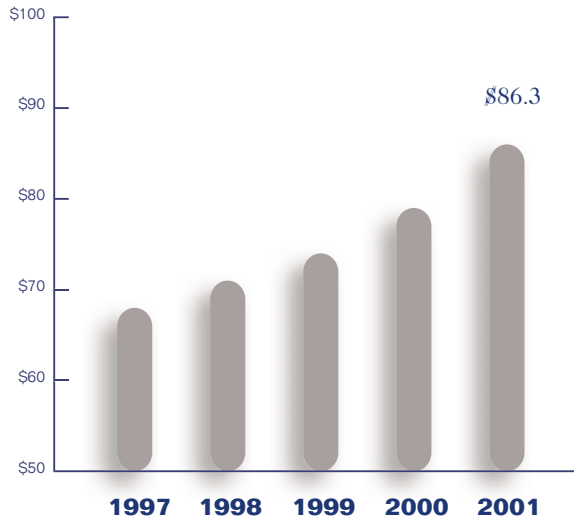


2001 **Annual Report** *to shareholders*

Historic Operating Performance

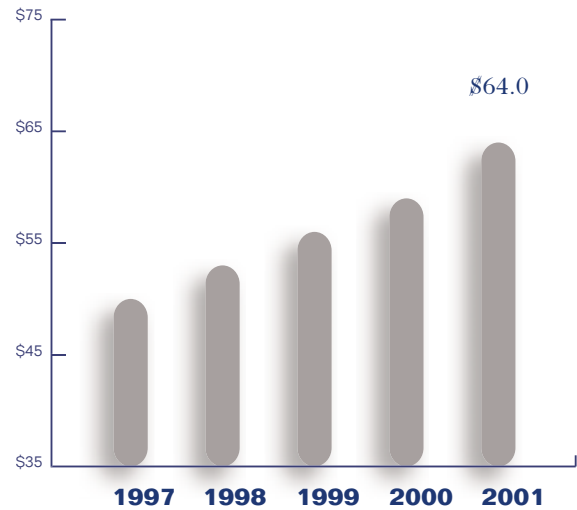
Total Revenues

\$ in millions



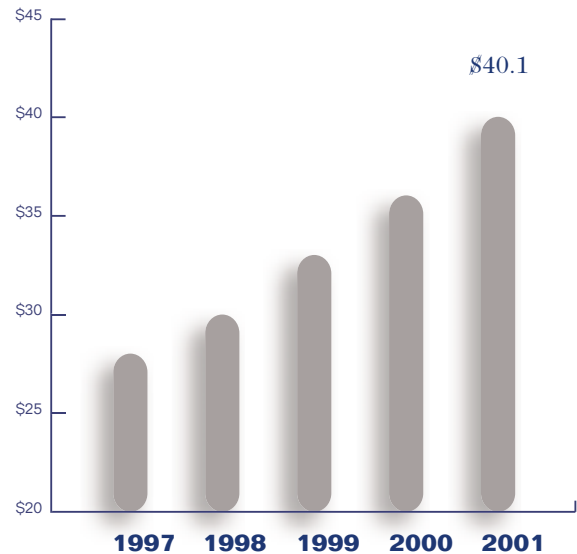
Property Operating Income


\$ in millions



Funds From Operations

\$ in millions



 Over 66% of our retail cash flow is produced by centers with grocery store anchors.



Saul Centers, Inc.

is a self-managed, self-administered equity real estate investment trust headquartered in Bethesda, Maryland. Saul Centers currently operates and manages a real estate portfolio of 33 community and neighborhood shopping center and office properties totaling approximately 6.1 million square feet of leasable area. Over 80% of our cash flow is generated from properties in the metropolitan Washington, DC/Baltimore area.

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



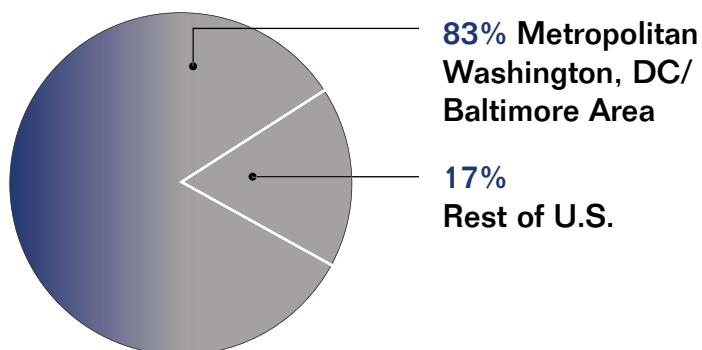
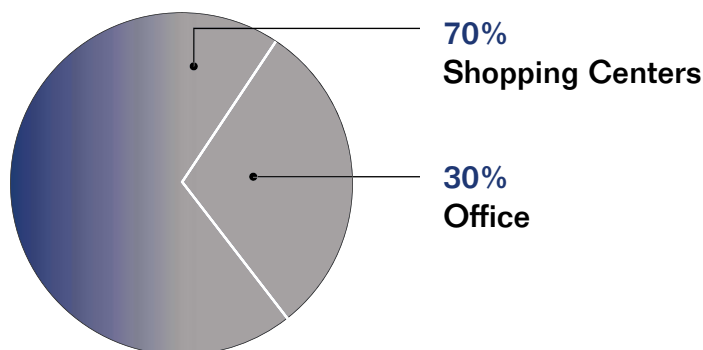
*Shares of
Saul Centers
are traded on
the New York
Stock Exchange
under the
symbol "BFS."*

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Portfolio Income

Based on Property Operating Income



Summary Financial Data:

| | Year ended December 31, | | | | |
|---|-------------------------|---------------|---------------|---------------|---------------|
| | 2001 | 2000 | 1999 | 1998 | 1997 |
| Total Revenues | \$ 86,308,000 | \$ 79,029,000 | \$ 73,791,000 | \$ 70,583,000 | \$ 67,717,000 |
| Funds From Operations (FFO) ^a | \$ 40,141,000 | \$ 35,648,000 | \$ 32,830,000 | \$ 29,768,000 | \$ 27,637,000 |
| Net Income | \$ 17,314,000 | \$ 14,045,000 | \$ 13,297,000 | \$ 9,129,000 | \$ 2,552,000 |
| Earnings before interest, taxes, depreciation & amortization (EBITDA) | \$ 65,627,000 | \$ 59,949,000 | \$ 56,397,000 | \$ 51,993,000 | \$ 42,085,000 |
| Average Shares and Units Outstanding | 19,382,720 | 18,795,571 | 18,147,954 | 17,233,047 | 16,690,417 |
| Average Shares Outstanding | 14,210,470 | 13,623,330 | 13,100,295 | 12,643,639 | 12,297,254 |
| FFO Per Share | \$ 2.07 | \$ 1.90 | \$ 1.81 | \$ 1.73 | \$ 1.66 |
| Net Income Per Share | \$ 1.22 | \$ 1.03 | \$ 1.01 | \$ 0.72 | \$ 0.21 |
| Interest Expense Coverage | 2.63 | 2.51 | 2.50 | 2.30 | 2.07 |

Property Data:

| | | | | | |
|-----------------------------|-----------|------------------|------------------|-----------|-----------|
| Number of Properties | 33 | 33 | 33 | 34 | 33 |
| Total Portfolio Square Feet | 6,159,000 | 6,143,000 | 6,108,000 | 5,901,000 | 5,821,000 |
| Shopping Center Square Feet | 4,956,000 | 4,941,000 | 4,936,000 | 5,187,000 | 5,150,000 |
| Office Square Feet | 1,203,000 | 1,202,000 | 1,172,000 | 714,000 | 671,000 |
| Average Percentage Leased | 93% | 93% ^b | 92% ^b | 90% | 90% |

^a Funds From Operations (FFO), presented on a fully converted basis and a widely accepted measure of operating performance for real estate investment trusts, is defined as net income before gains and losses from property sales, extraordinary items, and before real estate depreciation and amortization. All years are presented in conformance with the National Association of Real Estate Investment Trusts' current guidelines adopted October 27, 1999.

^b Excludes the Washington Square development property.



Since Saul Centers' formation in 1993, FFO per share has grown an annual average of 4.8% while net income per share has increased 14% annually.

Saul Centers

recorded another successful year of core operating performance with steady gains in leasing percentages and cash flow. As of December 31, 2001, the five year average annual total return from an investment in Saul Centers was in excess of 16%, which ranked in the top 10 of 151 public equity real estate investment trusts (REITs) according to statistics published by an industry trade association. Looking to the balance of 2002, the operation and management of tangible assets producing a steady income stream such as Washington, DC area neighborhood shopping centers and office buildings will, in our view, continue to be an especially attractive investment in these times of economic uncertainty.

MARKET OUTLOOK

2001 was a very turbulent year in many respects, with real estate markets generally experiencing rising vacancy levels, an excess capacity of sublease space, retail and technology tenant bankruptcies and leveling or declining rents. Unlike the excess supply of new speculative office space which created rising vacancy in the early 1990's, current vacancy increases and softening office markets have primarily been impacted by companies hesitating on major leasing

decisions in this time of uncertainty. However, similar to the early 1990's, the Washington, DC area is once again demonstrating that it is not as vulnerable to economic volatility as are other areas of the country. While not completely immune to these conditions, the Washington, DC/Baltimore metropolitan area, where Saul Centers produces over 83% of its cash flow, is one of the strongest real estate markets in the country.

The Washington, DC metropolitan area continues to produce steady total employment growth. Defense and national security spending is on the rise with the federal government and private defense contractors expanding their workforces. Biomedical research continues to fuel the growth of this region's life sciences industry. The service industry is growing in the areas of engineering and data processing. All of these economic forces point to continued increases in population, housing expansion and resulting retail sales growth and demand for office space in the region.

The Washington metropolitan area continues to enjoy one of the highest average household incomes in the country, at 40% above the nation's mean, and at year end 2001, office vacancy rates of 8% and retail vacancy rates approaching 6% were among the country's lowest. Buoyed by the stabilizing presence of the federal government, we believe the local real estate market is one of the top investment markets in the country.

FINANCIAL RESULTS

Funds From Operations (FFO) is a widely accepted measure of operating performance for REITs. FFO is defined as net income before gains and losses from property sales and real estate depreciation and amortization, and is presented on a fully converted basis (assuming all partnership units are converted to common shares). FFO increased 12.6% to \$40,141,000 in the year ended December 31, 2001 compared to \$35,648,000 for the 2000 year.



Southdale

Message to Our Shareholders

On a per share basis, FFO was \$2.07 per share for 2001, a 9.2% increase over the prior year. The 2001 results represented the seventh consecutive year of increased FFO since Saul Centers' first full year of operation as a public company in 1994, a compounded average annual growth rate of 4.8% in FFO per share during that period.

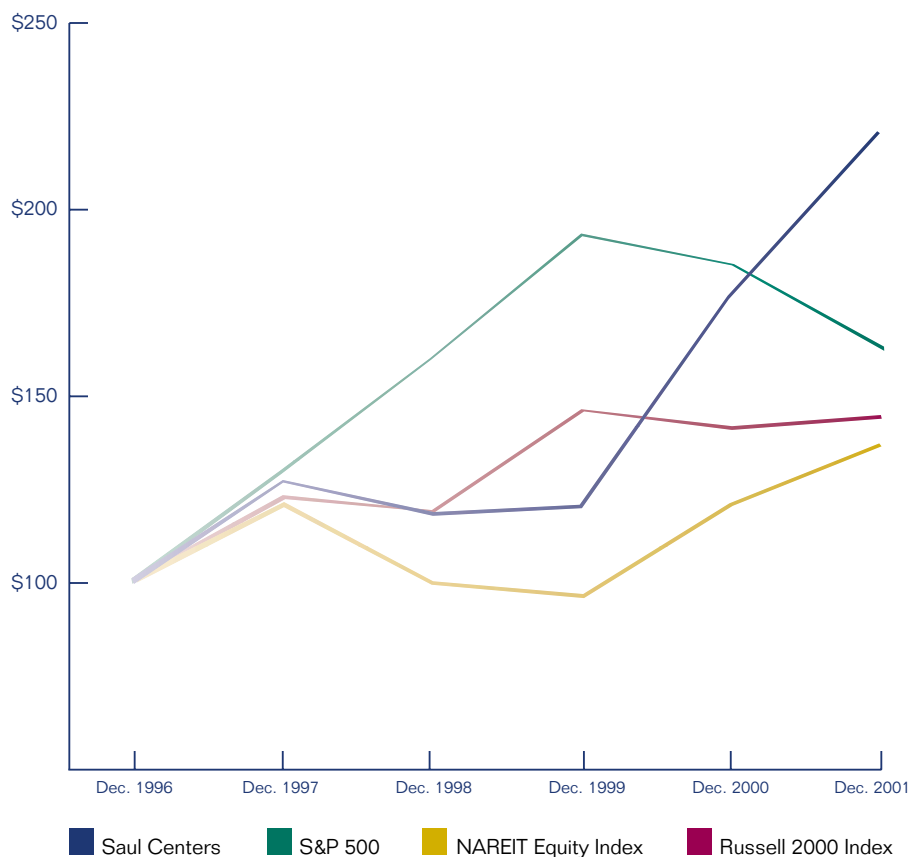
For the quarter ended December 31, 2001, FFO increased 11.2% to \$10,705,000, compared to \$9,626,000 for the 2000 quarter. The fourth quarter per share increase was 7.5% to \$.54 per share over the comparable 2000 quarter. Net income increased 23.3% to \$17,314,000, or \$1.22 per share, in 2001 compared to \$14,045,000, or \$1.03 per share, in the prior year. Over the past seven years net income has grown at a compounded annual rate of 14%.

CONSISTENT AND STABLE YIELD

Saul Centers continued to pay four quarterly dividends of \$.39 per share to shareholders. The annual dividend of \$1.56 per share equates to an FFO payout ratio of 75%. Steady cash flow growth over the past five years has produced increased free cash flow and dividend coverage, providing both strong dividend security as well as retained earnings for continued redevelopment and development investments.



The five year average annual total return from an investment in Saul Centers was in excess of 16%, which ranked in the top 10 of 151 public equity REITs.



TOTAL RETURN PROVEN OVER TIME

REITs have posted very attractive total returns, comprised of both dividend yield and price appreciation, during the past year. Saul Centers posted a 23% total return in 2001, versus an average 13.9% overall total return for the NAREIT Equity Index. Since public trading began in August 1993, the Company has produced a compounded annual total return of 11%. The year end 2001 dividend yield of 7.3% was approximately 2.3% over the 10-year Treasury and provides what we continue to believe is a very attractive income-oriented investment.

PORTFOLIO HIGHLIGHTS

◆ The Saul Centers' core shopping center and office portfolio produced another year of cash flow increases over prior year levels. Same property operating income increased a modest 1.3% compared to 3.3% growth a year earlier. The lower operating income growth was primarily caused by the transition time for 51,000 square feet of space at 601 Pennsylvania Avenue, while two new tenants were constructing tenant improvements in their offices, previously occupied by the Department of Justice. Total property cash flow growth increased by over 7% from 2000 levels, with the addition of a new phase of our Ashburn Village shopping center in Northern Virginia and the commencement of operations of the Washington Square office/retail development in Alexandria, Virginia.

Leasing percentages for the core portfolio averaged a strong 94.5% compared to 92.8% in 2000. This improvement was largely due to the Company's successful leasing at the redeveloped Crosstown Business Center. Overall, including the Company's new development properties, leasing percentages improved to 93.5% at year end 2001.

Property management effectively controlled operating expenses which produced a record gross margin of 76.2% in 2001. Over the past seven years, margins have improved from an initial 70% level, with compounded property expense increases held to a modest and efficient 2.5% annually.

RETAIL FOCUS

◆ The story of Saul Centers continues to be consistent with the strategy developed in the early 1990's. Whether during an

extended period of robust economic growth or during a downturn in business activity, the Company has remained committed to a strategy centering around core retail portfolio cash flow growth with selective development activity. The Washington, DC/Baltimore metropolitan area remains the focus of operations, with over 83% of the Company's cash flow produced in these markets. Consistency and regional geographical focus have been and remain our platforms for value creation and operating performance.

We have continued to place a primary emphasis on maintaining a diverse retail tenant base while minimizing exposure to any one tenant's credit. This factor is of critical nature during economic climates prone to increasing levels of retail failures and bankruptcies. Only one retail tenant, Giant Food, at 6.2% represented greater than 2.1% of total Company revenues in 2001.

◆ *Same store sales levels increased 2.8% over 2000 levels as consumers continue to seek lower priced and necessity goods offered at neighborhood shopping centers.*



Seven Corners

Additionally, leasing efforts focus on fixed minimum rent in lieu of percentage rent, which is rent contingent on a tenant's sales volume. By year end 2001, percentage rent was 2.4% of total revenues, compared to 2.7% in 2000. Diversity of the retail tenant base and an emphasis on the fixed component of rent are key ingredients of Saul Centers' secure cash flow stream.

8 While retailers have been announcing that in general their expansion and new store openings will continue throughout 2002, the trend appears to be expansion with much more caution and selectivity. Underperforming stores are being closed at a faster pace and vacancies generally have risen nationally. While not immune to economic slowdown, in-fill Washington, DC metropolitan retail submarkets have remained healthy. Within the shopping center portfolio, retail spaces with expiring leases were relet at

average rental rates 8% higher than expiring rents during 2001. Additionally, our asset management team placed a strong emphasis on tenant retention. Of over 450,000 square feet of retail lease expirations this past year, 70% of these tenants renewed their leases. This statistic alone is an indication of the appeal of our retail assets and their dominant locations.

We remain committed to the value which lies in the future of convenience and necessity-oriented grocery anchored strip retail, located in well populated areas. Over 66% of our retail cash flow is produced by centers with grocery store anchors. Overall sales per square foot for tenants reporting sales totaled \$277 per square foot during 2001. Same store sales levels increased 2.8% over 2000 levels indicating consumers continue to seek lower priced and necessity goods offered at neighborhood shopping centers.

OFFICE HIGHLIGHTS

With the commencement of operations at Washington Square, the office component of Saul Centers now totals over 1 million square feet and produces 30% of the portfolio's cash flow. Primarily all of this cash flow is generated from office properties in the greater Washington, DC metropolitan area. These office markets continue to be among the strongest in the country. The Washington region is characterized by a lack of in-fill, well-located ground and highly restrictive zoning laws, which together provide high barriers to entry for new competitive development.

The Company's premier office building is the high-rise 601 Pennsylvania Avenue located in the solid East End submarket of our nation's capital. Among major metropolitan areas, the Washington, DC office market enjoys the lowest vacancy rate in the country at approximately 8%.



601 Pennsylvania Avenue



Thruway




Avenel Business Park

The market has continued to prove its resilience to economic downturns. The presence of the federal government ensures the health and equilibrium in this market. Investment sales have attracted capital from all corners of the world, pushing prime Washington, DC building valuations to over \$400 per square foot during 2001. The year end 2002 expiration of Federal Trade Commission's 120,000 square foot lease at 601 Pennsylvania Avenue is the Company's only significant office lease expiring for the remainder of the year. Market rental rates are currently well above the 2001 rent, and leases are already being finalized for approximately 40% of this space.

Avenel Business Park is situated conveniently in the heart of the suburban Maryland I-270 biotech

corridor. Biomedical research continues to expand with a 2002 National Institutes of Health (NIH) budget increase of 16% recently approved by Congress. A diversified group of businesses centered around life science companies, research firms and the high profile biomedical research industry continue to demand office and laboratory facilities. Avenel is over 99% leased and renewal and rollover rental rates increased by over 35% on expiring leases during 2001. As biotech tenants currently account for only 30% of the park, significant unrealized value remains as existing tenant leases expire over the coming years.

DEVELOPMENT AND REDEVELOPMENT

 Saul Centers has been selectively involved in development and redevelopment opportunities. At the end of

2001, the leasing of Washington Square at Old Town, a new mixed-used office/retail development along North Washington Street in historic Old Town Alexandria, Virginia was nearing completion. This Class A project totals 235,000 square feet of leasable area and as of year end, approximately 70% of the space was leased. Cash flow from this successful development was approximately 60% of our annual 2001 FFO improvement.

In the summer of 2001, construction was substantially completed on a 28,000 square foot retail expansion to the Ashburn Village Shopping Center in Loudoun County, Virginia. This phase of the overall Ashburn development was 100% leased by year end. The high demand for space in this dominant neighborhood center resulted in our December 2001 commencement of construction of the final phase of retail shop space, totaling 25,000 square



In the summer of 2001, construction was substantially completed on a 28,000 square foot retail expansion to the Ashburn Village Shopping center in Loudoun County, Virginia.



Washington Square

feet. Approximately 25% of this phase is pre-leased, with several other leases currently under negotiation. Upon completion, scheduled for the summer of 2002, the Giant Food-anchored Ashburn Village will total over 200,000 square feet of prime retail space within a captive residential community of over 4,000 homes.

The conversion and redevelopment of a former Tulsa, Oklahoma shopping center to an office/warehouse facility named Crosstown Business Center has been successfully completed. This 197,000 square foot redevelopment is currently 91% leased to a diverse base of 12 tenants.

FINANCIAL HIGHLIGHTS

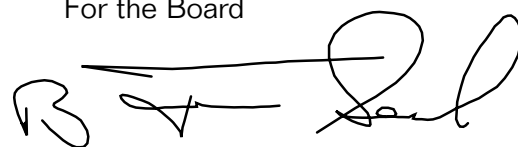
The Company completed several additional fixed rate debt transactions in 2001, as interest rates dropped to historical lows. Long term financings were closed totaling \$24 million at a weighted average interest rate of 7.38%. Proceeds were used to fund redevelopments and to reduce borrowings under the short term revolving line of credit. At year end, the Company had a total of \$50 million available to borrow under its \$70 million revolving line of credit, providing capacity to fund development and redevelopment activities over the coming years. Interest coverage improved to over 2.6 times, while floating rate debt was reduced to \$58 million, or 17% of total debt outstanding.

Only \$10 million of the \$293 million of long-term, fixed rate debt will mature between now and the end of 2011. Over the next 10 years, the Company is well positioned to access debt markets as an opportunity rather than out of necessity.

OUTLOOK FOR 2002

We expect demand for space in dominant neighborhood and community centers to remain solid. We also look for demand for quality Washington, DC area office space to improve as the economy strengthens. While cautious in this period of uncertainty, we remain confident that our quality assets and professional management team will continue to produce positive results as we look to the balance of 2002.

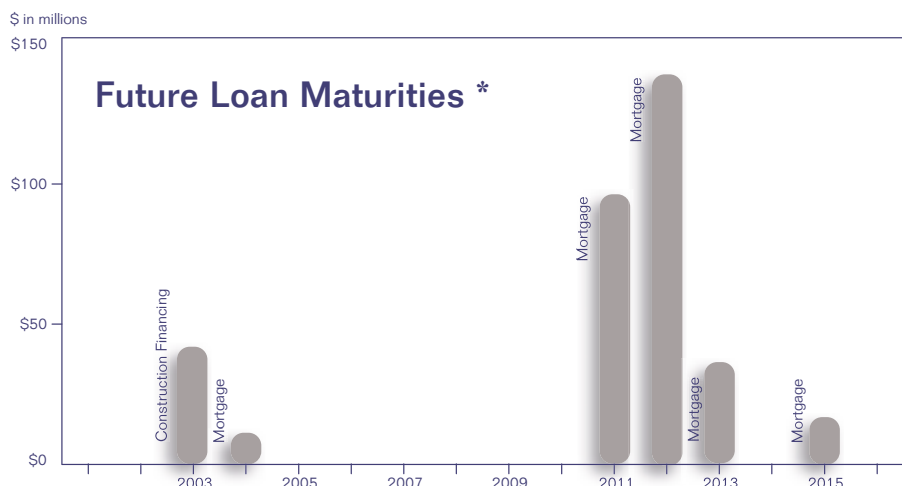
For the Board



B. Francis Saul II
February 28, 2002



Over 80% of secured debt matures after 2010.



* Excludes unsecured revolving line of credit. Total debt at year end 2001 was \$351.8 million.



Seven Corners



Saul Centers' properties are located primarily in the metropolitan Washington, DC/Baltimore area, representing 70% of the portfolio's gross leasable area.

Saul Centers' portfolio properties are located in Georgia, Kentucky, Maryland, New Jersey, Oklahoma, Virginia and Washington, DC.

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| SHOPPING CENTERS | Location of Property | Gross Leasable Square Feet |
|---------------------------------|------------------------|----------------------------|
| Ashburn Village I, II, III | Ashburn, VA | 185,537 |
| Ashburn Village IV ^a | Ashburn, VA | 25,000 |
| Beacon Center | Alexandria, VA | 352,915 |
| Belvedere | Baltimore, MD | 54,941 |
| Boulevard | Fairfax, VA | 56,350 |
| Clarendon | Arlington, VA | 6,940 |
| Clarendon Station | Arlington, VA | 4,868 |
| Flagship Center | Rockville, MD | 21,500 |
| French Market | Oklahoma City, OK | 245,629 |
| Germantown | Germantown, MD | 26,241 |
| Giant | Baltimore, MD | 70,040 |
| The Glen | Lake Ridge, VA | 112,639 |
| Great Eastern | District Heights, MD | 254,398 |
| Hampshire Langley | Langley Park, MD | 131,700 |
| Leesburg Pike | Baileys Crossroads, VA | 97,880 |
| Lexington Mall | Lexington, KY | 315,719 |
| Lumberton | Lumberton, NJ | 190,510 |
| Olney | Olney, MD | 53,765 |
| Ravenwood | Baltimore, MD | 87,750 |
| Seven Corners | Falls Church, VA | 560,998 |
| Shops at Fairfax | Fairfax, VA | 68,743 |
| Southdale | Glen Burnie, MD | 484,115 |

| SHOPPING CENTERS | Location of Property | Gross Leasable Square Feet |
|-------------------------------|----------------------|----------------------------|
| Southside Plaza | Richmond, VA | 340,691 |
| South Dekalb Plaza | Atlanta, GA | 162,793 |
| Thruway | Winston-Salem, NC | 344,880 |
| Village Center | Centreville, VA | 143,109 |
| West Park | Oklahoma City, OK | 76,610 |
| White Oak | Silver Spring, MD | 480,156 |
| SHOPPING CENTERS TOTAL | | 4,956,417 |

OFFICE PROPERTIES

| | | |
|--------------------------------|------------------|------------------|
| Avenel Business Park | Gaithersburg, MD | 388,620 |
| Crosstown Business Center | Tulsa, OK | 197,135 |
| 601 Pennsylvania Avenue | Washington, DC | 225,414 |
| Van Ness Square | Washington, DC | 156,493 |
| Washington Square | Alexandria, VA | 235,239 |
| OFFICE PROPERTIES TOTAL | | 1,202,901 |

| | |
|-----------------------------------|------------------|
| TOTAL PORTFOLIO PROPERTIES | 6,159,318 |
|-----------------------------------|------------------|

^a Phase IV consists of approximately 3.1 acres of land under development.

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, 2001 and 2000, and the related consolidated statements of operations, stockholders' equity (deficit) and cash flows for the years then ended. 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.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Saul Centers, Inc. and subsidiaries as of December 31, 2001 and 2000, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

Arthur Andersen LLP
Vienna, Virginia
February 13, 2002

| | December 31, | |
|---|-------------------|-------------------|
| (Dollars in thousands, except per share amounts) | 2001 | 2000 |
| Assets | | |
| Real estate investments | | |
| Land | \$ 67,710 | \$ 66,252 |
| Buildings and equipment | <u>385,936</u> | <u>325,609</u> |
| | 453,646 | 391,861 |
| Accumulated depreciation | <u>(136,928)</u> | <u>(124,180)</u> |
| | 316,718 | 267,681 |
| Construction in progress | 1,163 | 41,148 |
| Cash and cash equivalents | 1,805 | 1,772 |
| Accounts receivable and accrued income, net | 9,217 | 9,011 |
| Prepaid expenses | 12,514 | 9,485 |
| Deferred debt costs, net | 3,563 | 3,583 |
| Other assets | <u>1,423</u> | <u>1,770</u> |
| Total assets | <u>\$ 346,403</u> | <u>\$ 334,450</u> |
| Liabilities | | |
| Notes payable | \$ 351,820 | \$ 343,453 |
| Accounts payable, accrued expenses and other liabilities | 14,697 | 19,592 |
| Deferred income | <u>4,009</u> | <u>2,560</u> |
| Total liabilities | <u>370,526</u> | <u>365,605</u> |
| Minority interests | <u>--</u> | <u>--</u> |
| Shareholders' equity (deficit) | | |
| Common stock, \$0.01 par value, 30,000,000 shares authorized, 14,535,803 and 13,869,535 shares issued and outstanding, respectively | 145 | 139 |
| Additional paid-in capital | 64,564 | 52,594 |
| Accumulated deficit | <u>(88,832)</u> | <u>(83,888)</u> |
| Total stockholders' equity (deficit) | <u>(24,123)</u> | <u>(31,155)</u> |
| Total liabilities and stockholders' equity (deficit) | <u>\$ 346,403</u> | <u>\$ 334,450</u> |

The accompanying notes are an integral part of these statements.

Consolidated Statements of Operations

For the Year Ended December 31,

(Dollars in thousands, except per share amounts)

2001

2000

1999

Revenues

| | | | |
|--------------------|---------------|---------------|---------------|
| Base rent | \$ 69,662 | \$ 63,837 | \$ 59,200 |
| Expense recoveries | 11,456 | 11,129 | 10,176 |
| Percentage rent | 2,113 | 2,097 | 2,222 |
| Other | 3,077 | 1,966 | 2,193 |
| Total revenues | <u>86,308</u> | <u>79,029</u> | <u>73,791</u> |

Operating expenses

| | | | |
|-------------------------------------|---------------|---------------|---------------|
| Property operating expenses | 8,503 | 8,271 | 7,720 |
| Provision for credit losses | 617 | 467 | 295 |
| Real estate taxes | 7,226 | 6,451 | 6,207 |
| Interest expense | 24,920 | 23,843 | 22,568 |
| Amortization of deferred debt costs | 566 | 458 | 416 |
| Depreciation and amortization | 14,758 | 13,534 | 12,163 |
| General and administrative | 4,335 | 3,891 | 3,755 |
| Total operating expenses | <u>60,925</u> | <u>56,915</u> | <u>53,124</u> |

Operating income

| | | | |
|--------------------------|-----------|-----------|------------|
| Non-operating item | | | |
| Gain on sale of property | <u>--</u> | <u>--</u> | <u>553</u> |

Net income before minority interests

| | | |
|---------------|---------------|---------------|
| <u>25,383</u> | <u>22,114</u> | <u>21,220</u> |
|---------------|---------------|---------------|

Minority interests

| | | | |
|-------------------------------------|----------------|----------------|----------------|
| Minority share of income | (6,777) | (6,081) | (5,899) |
| Distributions in excess of earnings | <u>(1,292)</u> | <u>(1,988)</u> | <u>(2,024)</u> |
| Total minority interests | <u>(8,069)</u> | <u>(8,069)</u> | <u>(7,923)</u> |

Net income

| | | |
|------------------|------------------|------------------|
| <u>\$ 17,314</u> | <u>\$ 14,045</u> | <u>\$ 13,297</u> |
|------------------|------------------|------------------|

Per share (basic and dilutive)

| | | | |
|--------------------------------------|----------------|----------------|----------------|
| Net income before minority interests | <u>\$ 1.31</u> | <u>\$ 1.18</u> | <u>\$ 1.17</u> |
| Net income | <u>\$ 1.22</u> | <u>\$ 1.03</u> | <u>\$ 1.01</u> |

The accompanying notes are an integral part of these statements.

Consolidated Statements of Stockholders' Equity (Deficit)

(Dollars in thousands, except per share amounts)

| | Common Stock | Additional Paid-in Capital | Accumulated Deficit | Total |
|--|-----------------|----------------------------------|------------------------|--------------------|
| Stockholders' equity (deficit): | | | | |
| Balance, December 31, 1998 | \$ 129 | \$ 31,967 | \$ (69,380) | \$ (37,284) |
| Issuance of 497,767 shares of common stock | 4 | 7,158 | -- | 7,162 |
| Issuance of 373,546 convertible limited partnership units in the Operating Partnership | -- | 5,491 | -- | 5,491 |
| Net income | -- | -- | 13,297 | 13,297 |
| Distributions (\$1.17 per share) | -- | -- | (15,323) | (15,323) |
| Distributions payable (\$.39 per share) | -- | -- | (5,202) | (5,202) |
| Balance, December 31, 1999 | 133 | 44,616 | (76,608) | (31,859) |
| Issuance of 535,390 shares of common stock | 6 | 7,978 | -- | 7,984 |
| Net income | -- | -- | 14,045 | 14,045 |
| Distributions (\$1.17 per share) | -- | -- | (15,915) | (15,915) |
| Distributions payable (\$.39 per share) | -- | -- | (5,410) | (5,410) |
| Balance, December 31, 2000 | 139 | 52,594 | (83,888) | (31,155) |
| Issuance of 666,268 shares of common stock | 6 | 11,970 | -- | 11,976 |
| Net income | -- | -- | 17,314 | 17,314 |
| Distributions (\$1.17 per share) | -- | -- | (16,588) | (16,588) |
| Distributions payable (\$.39 per share) | -- | -- | (5,670) | (5,670) |
| Balance, December 31, 2001 | <u>\$ 145</u> | <u>\$ 64,564</u> | <u>\$ (88,832)</u> | <u>\$ (24,123)</u> |

The accompanying notes are an integral part of these statements.

Consolidated Statements of Cash Flows

(Dollars in thousands)

For the Year Ended December 31,
2001 2000 1999**Cash flows from operating activities:**

| | | | |
|---|---------------|---------------|---------------|
| Net income | \$ 17,314 | \$ 14,045 | \$ 13,297 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Minority interests | 8,069 | 8,069 | 7,923 |
| Gain on sale of property | -- | -- | (553) |
| Depreciation and amortization | 15,324 | 13,992 | 12,579 |
| Provision for credit losses | 617 | 467 | 295 |
| Increase in accounts receivable | (823) | (1,284) | (2,671) |
| Increase in prepaid expenses | (5,568) | (3,152) | (2,434) |
| Decrease (increase) in other assets | 347 | (252) | (360) |
| (Decrease) increase in accounts payable, accrued expenses and other liabilities | (4,895) | 1,201 | 3,535 |
| Increase (decrease) in deferred income | 1,449 | (305) | 26 |
| Other, net | -- | -- | 8 |
| Net cash provided by operating activities | <u>31,834</u> | <u>32,781</u> | <u>31,645</u> |

Cash flows from investing activities:

| | | | |
|---------------------------------------|-----------------|-----------------|-----------------|
| Net proceeds from sale of property | -- | -- | 1,718 |
| Additions to real estate investments | (13,055) | (18,233) | (11,587) |
| Additions to construction in progress | (8,745) | (25,193) | (27,051) |
| Net cash used in investing activities | <u>(21,800)</u> | <u>(43,426)</u> | <u>(36,920)</u> |

Cash flows from financing activities:

| | | | |
|--|-----------------|---------------|--------------|
| Proceeds from notes payable | 51,218 | 69,700 | 33,979 |
| Repayments on notes payable | (42,851) | (36,515) | (14,334) |
| Additions to deferred debt costs | (17) | (315) | (13) |
| Proceeds from the issuance of common stock and convertible limited partnership units in the Operating Partnership | 11,976 | 7,984 | 12,653 |
| Distributions to common stockholders and holders of convertible limited partnership units in the Operating Partnership | (30,327) | (29,394) | (28,448) |
| Net cash (used in) provided by financing activities | <u>(10,001)</u> | <u>11,460</u> | <u>3,837</u> |

| | | | |
|--|-----------------|-----------------|---------------|
| Net increase (decrease) in cash and cash equivalents | 33 | 815 | (1,438) |
| Cash and cash equivalents, beginning of year | 1,772 | 957 | 2,395 |
| Cash and cash equivalents, end of year | <u>\$ 1,805</u> | <u>\$ 1,772</u> | <u>\$ 957</u> |

Supplemental disclosure of cashflow information:

| | | | |
|---|-----------|-----------|-----------|
| Cash paid for interest, net of amount capitalized | \$ 24,419 | \$ 23,456 | \$ 22,698 |
|---|-----------|-----------|-----------|

The accompanying notes are an integral part of these statements.

1. ORGANIZATION, FORMATION, AND BASIS OF PRESENTATION

Organization

Saul Centers, Inc. ("Saul Centers") was incorporated under the Maryland General Corporation Law on June 10, 1993. 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") shopping center and office properties, and the management functions related to the transferred properties. Since its formation, the Company has purchased and developed additional properties. The Company is currently developing Ashburn Village IV, an in-line retail and retail pad expansion to the Company's Ashburn Village shopping center. The Company recently completed development of Ashburn Village III, Washington Square at Old Town and Crosstown Business Center. As of December 31, 2001, the Company's properties (the "Current Portfolio Properties") consisted of 27 operating shopping center properties and Ashburn Village IV (the "Shopping Centers") and 5 predominantly office operating properties (the "Office Properties"). To facilitate the placement of collateralized mortgage debt, the Company established Saul QRS, Inc. 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.

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 Washington DC/ Baltimore metropolitan area. Because the properties are located primarily in the Washington DC/Baltimore metropolitan area, the Company is subject to a concentration of credit risk related to these properties. A majority of the Shopping Centers are anchored by several major tenants. Seventeen of the Shopping Centers are anchored by a grocery store and offer primarily day-to-day necessities and services. As of December 31, 2001, no single Shopping Center accounted for more than 11.5% of the total Shopping Center gross leasable area. Only one retail tenant, Giant Food, at 6.2%, accounted for more than 2.1% of the Company's 2001 total revenues. No office tenant other than the United States Government, at 9.7%, accounted for more than 1.1% of 2001 total revenues.

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 accounting principles generally accepted in the United States 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 historic cost basis less depreciation. 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 accounting principles generally accepted in the United States, and accordingly, do not report the current value of the Company's real estate assets.

If there is an event or change in circumstance that indicates an impairment in the value of a real estate investment property, the Company's policy is to assess any impairment in value by making a comparison of the current and projected operating cash flows of the property over its remaining useful life, on an undiscounted basis, to the carrying amount of that property. If such carrying amount is in excess of the estimated projected operating cash flows of the property, the Company would recognize an impairment loss equivalent to an amount required to adjust the carrying amount to its estimated fair market value. The Company has not recognized an impairment loss in 2001, 2000 or 1999 on any of its real estate.

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, which includes contract services such as grounds maintenance, lot sweeping and snow removal, are charged to operations as incurred. Repairs and maintenance expense totaled \$2,913,000, \$3,144,000 and \$2,815,000, for calendar years 2001, 2000 and 1999, respectively, and is included in operating expenses in the accompanying consolidated financial statements. Interest expense capitalized totaled \$1,640,000, \$2,681,000 and \$934,000, for calendar years 2001, 2000 and 1999, 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. At this point the capitalization of interest and other costs ceases and the calculation of depreciation begins. 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.

Lease Acquisition Costs

Certain initial direct costs incurred by the Company in negotiating and consummating a successful lease are capitalized and amortized over the initial base term of the lease. These costs, net of accumulated amortization, are included in prepaid expenses and total \$10,419,000 and \$7,708,000 as of December 31, 2001 and 2000, respectively. Capitalized leasing costs are comprised of commissions paid to third party leasing agents as well as internal direct costs such as employee compensation and payroll related fringe benefits directly related to time spent performing leasing related activities. Such activities include evaluating the prospective tenant's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating lease terms, preparing lease documents and closing the transaction.

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, 2001 and 2000 are as follows:

| Construction in Progress | | |
|---------------------------------|-----------------|------------------|
| <i>(In thousands)</i> | December 31, | |
| | 2001 | 2000 |
| Ashburn Village IV | \$ 1,163 | \$ 692 |
| Ashburn Village III | -- | 1,413 |
| Washington Square | -- | 38,588 |
| Crosstown Business Center | -- | 455 |
| Balance | <u>\$ 1,163</u> | <u>\$ 41,148</u> |

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 include \$4,675,000 and \$3,053,000, at December 31, 2001 and 2000, 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 consolidated financial statements are shown net of an allowance for doubtful accounts of \$559,000 and \$563,000, at December 31, 2001 and 2000, respectively.

Allowance for Doubtful Accounts

| <i>(In thousands)</i> | For the Years Ended December 31, | |
|-----------------------------|-------------------------------------|---------------|
| | <u>2001</u> | <u>2000</u> |
| Beginning Balance | \$ 563 | \$ 594 |
| Provision for Credit Losses | 617 | 467 |
| Charge-offs | <u>(621)</u> | <u>(498)</u> |
| Ending Balance | <u>\$ 559</u> | <u>\$ 563</u> |

Deferred Debt Costs

Deferred debt costs consist of fees and costs incurred to obtain long-term financing, construction financing and the revolving line of credit. These fees and costs are being amortized over the terms of the respective loans or agreements. Deferred debt costs in the accompanying consolidated financial statements are shown net of accumulated amortization of \$1,968,000 and \$1,402,000, at December 31, 2001 and 2000, respectively.

Deferred Income

Deferred income consists of payments received from tenants prior to the time they are earned and recognized by the Company as revenue. These payments include prepayment of the following month's rent, prepayment of real estate taxes when the taxing jurisdiction has a fiscal year differing from the calendar year reimbursements specified in lease agreements and payments by tenants for tenant construction work provided by the Company.

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 accounting principles generally accepted in the United States. Expense recoveries represent a portion of property operating expenses billed to the tenants, including common area maintenance, real estate taxes and other recoverable costs. Expense recoveries are recognized in the period when the expenses are incurred. Rental income based on a tenant's revenues ("percentage rent") is accrued when a tenant reports sales that exceed 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 90% 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 consolidated financial statements. As of December 31, 2001 and 2000, the total tax basis of the Company's assets was \$375,210,000 and \$362,586,000, and the tax basis of the liabilities was \$362,464,000 and \$353,908,000, respectively.

Deferred Compensation and Stock Plan for Directors

Saul Centers has established a Deferred Compensation and Stock Plan for Directors (the "Plan") for the benefit of its directors and their beneficiaries. A director may elect to defer all or part of his or her director's fees and has the option to have the fees paid in cash, in shares of common stock or in a combination of cash and shares of common stock upon termination from the Board of Directors. If the director elects to have fees paid in stock, the number of shares allocated to the director is determined by the market price of the common stock on the day the fee is earned. As of December 31, 2001, 120,000 shares were authorized and registered for use under the Plan, and 112,000 shares had been credited to the directors' deferred fee accounts.

Beginning in 1999, pursuant to the Plan, 100 shares of the Company's common stock are awarded annually as additional compensation to each director serving on the Board of Directors as of the record date for the Annual Meeting of Stockholders. The shares are issued on the date of the Annual Meeting, their issuance may not be deferred and transfer of the shares is restricted for a period of twelve months following the date of issue.

Recent Accounting Pronouncements

Saul Centers, Inc. will adopt Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") 144, "Accounting for Impairment or Disposal of Long-Lived Assets," effective January 1, 2002. This Statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets. The Statement retains the requirements of SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" for long-lived assets to be held and used. SFAS 144 also supercedes the accounting and reporting provisions of APB Opinion No. 30 for segments of a business to be disposed of, but retains APB Opinion No. 30's requirement to report discontinued operations separately from continuing operations and extends that reporting to a component of an entity that either has been disposed of or is classified as held for sale. The adoption of SFAS 144 will not have a material impact on the Company's financial statements.

Cash and Cash Equivalents

Cash and cash equivalents includes cash and short-term investments with maturities of three months or less measured from the acquisition date.

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 outstanding of 19,382,715, 18,795,571 and 18,147,954, for the years ended December 31, 2001, 2000 and 1999, respectively. Per share data relating to net income after minority interests is computed on the basis of 14,210,474, 13,623,330 and 13,100,295, weighted average common shares for the years ended December 31, 2001, 2000 and 1999, respectively.

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

The Saul Organization has a 26.2% limited partnership interest, represented by 5,172,241 convertible limited partnership units, in the Operating Partnership, as of December 31, 2001. 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 29.9% of the outstanding equity securities of Saul Centers. The impact of the Saul Organization's 26.2% limited partnership interest in the Operating Partnership is reflected as minority interests in the accompanying consolidated financial statements.

4. NOTES PAYABLE

During 2001 the Company obtained three new mortgage loans totaling \$24,000,000 from an existing lender, secured by Van Ness Square and recent developments at Ashburn Village and Avenel Business Park. The loans require monthly payments of principal and interest based upon a weighted average 21.5 year amortization period and a fixed weighted average 7.38% interest rate. The Company also extended until January 2003, its \$42,000,000 construction loan used to finance the building of Washington Square at Old Town. Borrowings on the Company's \$70,000,000 unsecured line of credit totaled \$20,000,000 at December 31, 2001, leaving \$50,000,000 available for future use. The following is a summary of notes payable as of December 31, 2001:

Notes Payable

| <i>(In thousands)</i> | Principal Outstanding December 31, <u>2001</u> | Principal Outstanding December 31, <u>2000</u> | Interest <u>Rate *</u> | Scheduled <u>Maturity *</u> |
|-----------------------|---|---|---------------------------|--------------------------------|
| Fixed Rate Mortgages: | \$ 138,215 (a) | \$ 140,597 | 7.67 % | Oct. 2012 |
| | 95,716 (b) | 74,342 | 8.23 % | Dec. 2011 |
| | 35,583 (c) | 36,279 | 7.88 % | Jan. 2013 |
| | 13,936 (d) | 14,184 | 8.33 % | May 2015 |
| | 10,028 (e) | 10,227 | 6.88 % | May 2004 |
| Total Fixed Rate | 293,478 | 275,629 | 7.88 % | 10.4 Years |
| Variable Rate Loans: | | | | |
| Construction Loan | 38,342 (f) | 33,324 | 3.64 % | Jan. 2003 |
| Line of Credit | 20,000 (g) | 34,500 | 3.69 % | July 2003 |
| Total Variable Rate | 58,342 | 67,824 | 3.66 % | 1.2 Years |
| Total Notes Payable | \$ 351,820 | \$ 343,453 | 7.18 % | 8.9 Years |

*Interest rate and scheduled maturity data presented for December 31, 2001. Totals computed using weighted averages.

(a) The loan is collateralized by nine shopping centers and requires monthly principal and interest payments based upon a 25 year amortization schedule. Principal of \$2,382,000 was amortized during 2001.

(b) The loan is collateralized by Avenel Business Park, Van Ness Square, Ashburn Village, Leesburg Pike, Lumberton Plaza and Village Center. The loan was amended during 2001 to include new borrowings of \$24,000,000 at an average rate of 7.38%. The 8.23% blended interest rate is the weighted average of the initial loan rate and additional borrowings rates. Monthly principal and interest payments are based upon a weighted average 23 year amortization schedule. Principal of \$2,626,000 was amortized during 2001.

(c) The loan is collateralized by 601 Pennsylvania Avenue and requires monthly principal and interest payments based upon a 25 year amortization schedule. Principal of \$696,000 was amortized during 2001.

(d) The loan is collateralized by Shops at Fairfax and Boulevard shopping centers and requires monthly principal and interest payments based upon a 22 year amortization schedule. Principal of \$248,000 was amortized during 2001.

(e) The loan is collateralized by The Glen shopping center and requires monthly principal and interest payments based upon a 23 year amortization schedule. Principal of \$199,000 was amortized during 2001.

(f) The loan is a construction loan totaling \$42,000,000 and is collateralized by Washington Square. Interest expense is calculated based upon the 1, 2, 3 or 6 month LIBOR rate plus a spread of 1.45% to 1.9% (determined by certain leasing and/or construction benchmarks) or upon the bank's prime rate at the Company's option. The loan was extended until January 2003 upon payment in 2001 of a fee of 1/4% or \$105,000. The loan may be further extended for an additional one-year term with payment of a fee of 1/4% and the achievement of certain debt service and valuation tests, at the Company's option. The interest rate in effect on December 31, 2001 was based on a weighted average LIBOR of 1.94% and spread of 1.7%. The effective annual average interest rate, which considers debt cost amortization, was 6.15% for 2001.

(g) The loan is an unsecured revolving credit facility totaling \$70,000,000. Interest expense is calculated based upon the 1,2,3 or 6 month LIBOR rate plus a spread of 1.625% to 1.875% (determined by certain debt service coverage and leverage tests) or upon the bank's reference rate 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, 2001 was based on a weighted average LIBOR of 1.94% and spread of 1.75%. The effective annual average interest rate, which considers debt cost amortization and unused line fees, was 7.14% for 2001.

The December 31, 2001 and 2000, depreciation adjusted cost of properties collateralizing the mortgage notes payable totaled \$264,831,000 and \$218,415,000, respectively. Certain loans are subject to financial covenant tests, the most significant of which are debt service coverage and loan to

asset value requirements. The Company believes it is in compliance with all such covenants. Notes payable at December 31, 2001 and 2000, totaling \$242,168,000 and \$225,616,000, respectively, are guaranteed by members of The Saul Organization.

Notes to Consolidated Financial Statements

As of December 31, 2001, the scheduled maturities of all debt for years ended December 31, are as follows:

Debt Maturity Schedule

(In thousands)

| | |
|------------|-------------------|
| 2002 | \$ 6,293 |
| 2003 | 65,159 |
| 2004 | 16,631 |
| 2005 | 7,713 |
| 2006 | 8,359 |
| Thereafter | <u>247,665</u> |
| | <u>\$ 351,820</u> |

22 5. LEASE AGREEMENTS

Lease income includes primarily base rent arising from non-cancelable commercial leases. Base rent for the years ended December 31, 2001, 2000 and 1999, amounted to \$69,662,000, \$63,837,000 and \$59,200,000, respectively. Future base rent under noncancelable leases for years ended December 31, is as follows:

Future Base Rental Income

(In thousands)

| | |
|------------|-------------------|
| 2002 | \$ 65,331 |
| 2003 | 60,114 |
| 2004 | 54,675 |
| 2005 | 48,569 |
| 2006 | 41,640 |
| Thereafter | <u>253,310</u> |
| | <u>\$ 523,639</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. Expense recoveries for the years ended December 31, 2001, 2000 and 1999 amounted to \$11,456,000, \$11,129,000 and \$10,176,000, 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 \$2,113,000, \$2,097,000 and \$2,222,000, for the years ended December 31, 2001, 2000 and 1999, respectively.

6. LONG-TERM LEASE OBLIGATIONS

Certain properties are subject to noncancelable long-term leases which apply to land underlying the Shopping Centers. Certain of the leases provide for periodic adjustments of the base annual rent and require the payment of real estate taxes on the underlying land. The leases will expire between 2058 and 2068. Reflected in the accompanying consolidated financial statements is minimum ground rent expense of \$167,000, \$157,000 and \$154,000, for each of the years ended December 31, 2001, 2000 and 1999, respectively. The minimum future rental commitments under these ground leases are as follows:

Ground Lease Rental Commitments

(In thousands)

| | Annually 2002-2006 | Total Thereafter |
|---------------|-----------------------|---------------------|
| Beacon Center | \$ 53 | \$ 3,289 |
| Olney | 51 | 4,474 |
| Southdale | <u>60</u> | <u>3,665</u> |
| Total | <u>\$ 164</u> | <u>\$ 11,428</u> |

In addition to the above, 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, 2001 includes a charge for minority interests of \$8,069,000, consisting of \$6,777,000 related to The Saul Organization's share of the net income for the year and \$1,292,000 related to distributions to minority interests in excess of allocated net income for the year. The charge for the year ended December 31, 2000 of \$8,069,000 consists of \$6,081,000 related to The Saul Organization's share of the net income for the year and \$1,988,000 related to distributions to minority interests in excess of allocated net income for the year. The charge for the year ended December 31, 1999 of \$7,923,000 consists of \$5,899,000 related to The Saul Organization's share of net income for the year and \$2,024,000 related to distributions to minority interests in excess of allocated net income for the year.

8. RELATED PARTY TRANSACTIONS

In October 2000, the Company purchased Avenel VI, a 30,000 square foot office/flex property for \$4,200,000 based on an independent third party appraisal. The seller was a member of The Saul Organization.

In August 2000 and October 1999, the Company purchased land parcels of 7.11 and 6.47 acres, located within the 1,580 acre community of Ashburn Village in Loudoun County, Virginia, adjacent to its Ashburn Village neighborhood shopping center at a price of \$1,580,000 and \$1,438,000, respectively based on an independent third party appraisal. The land is being developed to expand the existing shopping center. The seller was a member of The Saul Organization.

Chevy Chase Bank, an affiliate of The Saul Organization, leases space in 13 of the Company's properties. Total rental income from Chevy Chase Bank amounted to \$1,330,000, \$1,223,000 and \$1,169,000, for the years ended December 31, 2001, 2000 and 1999, respectively.

The Chairman and Chief Executive Officer, the Vice Chairman and the 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.

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 are believed to be fair and are periodically reviewed by the Audit Committee of the Board of Directors. Included in general and administrative expense for the years ended December 31, 2001, 2000 and 1999, are charges totaling \$1,971,000, \$2,091,000 and \$1,798,000, related to shared services, of which \$2,010,000, \$2,056,000 and \$1,773,000, was paid during the years ended December 31, 2001, 2000 and 1999, 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 nonqualified 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, 2001, all 180,000 of the options were fully vested. No compensation expense has been recognized as a result of these grants.

10. NON-OPERATING ITEMS

Gain on Sale of Property

Gain on sale of property of \$553,000 in 1999 resulted from the District of Columbia's purchase of the Company's Park Road property as part of an assemblage of parcels for a neighborhood revitalization project. There were no property sales in 2001 or 2000.

11. FAIR VALUE OF FINANCIAL INSTRUMENTS

Statement of Financial Accounting Standards No. 107, "Disclosure about Fair Value of Financial Instruments," requires disclosure about the fair value of 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.

12. COMMITMENTS AND CONTINGENCIES

Neither the Company nor the Current Portfolio Properties are subject to any material litigation, nor, to management's knowledge, is any material litigation currently threatened against the Company, other than routine litigation and administrative proceedings arising in the ordinary course of business. Management believes that these items, individually or in the aggregate, will not have a material adverse impact on the Company or the Current Portfolio Properties.

The Company has contracted with a third party to purchase 24.0 acres of land zoned for retail development in Loudoun County, Virginia, for a purchase price of \$5.3 million. Closing is scheduled for March 2002.

13. DISTRIBUTIONS

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

Of the distributions paid during 2001, \$1.53 per share represented ordinary dividend income and \$0.03 per share represented return of capital to the shareholders. The following summarizes distributions paid during the years ended December 31, 2001, 2000 and 1999, including activity in the Plan:

| <i>(In thousands)</i> | Total Distributions to | | Dividend Reinvestment Plan | | |
|----------------------------------|------------------------|------------------------------------|----------------------------|-----------------|---------------------------|
| | Common Stockholders | Limited Partnership Unitholders | Common Stock Issued | Units Issued | Discounted Share Price |
| Distributions during 2001 | | | | | |
| October 31 | \$ 5,599 | \$ 2,018 | 176,319 | -- | \$ 18.62 |
| July 31 | 5,529 | 2,017 | 175,790 | -- | 18.04 |
| April 30 | 5,460 | 2,017 | 169,753 | -- | 17.95 |
| January 31 | 5,410 | 2,017 | 123,561 | -- | 17.07 |
| | <u>\$ 21,998</u> | <u>\$ 8,069</u> | <u>645,423</u> | <u>--</u> | |
| Distributions during 2000 | | | | | |
| October 31 | \$ 5,356 | \$ 2,018 | 133,435 | -- | \$ 14.85 |
| July 31 | 5,305 | 2,017 | 125,705 | -- | 15.34 |
| April 28 | 5,254 | 2,017 | 125,558 | -- | 14.97 |
| January 31 | 5,202 | 2,017 | 129,789 | -- | 14.43 |
| | <u>\$ 21,117</u> | <u>\$ 8,069</u> | <u>514,487</u> | <u>--</u> | |
| Distributions during 1999 | | | | | |
| October 29 | \$ 5,148 | \$ 2,017 | 130,753 | -- | \$ 13.76 |
| July 30 | 5,100 | 2,018 | 119,142 | 126,967 | 14.79 |
| April 30 | 5,075 | 1,967 | 111,990 | 119,877 | 15.28 |
| January 29 | 4,985 | 1,921 | 116,727 | 126,702 | 14.07 |
| | <u>\$ 20,308</u> | <u>\$ 7,923</u> | <u>478,612</u> | <u>373,546</u> | |

In December 2001, 2000 and 1999, the Board of Directors of the Company authorized a distribution of \$0.39 per share payable in January 2002, 2001 and 2000, to holders of record on January 17, 2002, January 17, 2001 and January 15, 2000, respectively. As a result, \$5,670,000, \$5,410,000 and \$5,202,000, was paid to common shareholders on January 31, 2002, January 31, 2001 and January 31, 2000, respectively. Also, \$2,017,000, \$2,017,000 and \$2,017,000, was paid to limited partnership unitholders on January 31, 2002, January 31, 2001 and January 31, 2000 (\$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 consolidated financial statements.

14. INTERIM RESULTS (UNAUDITED)

The following summary presents the results of operations of the Company for the quarterly periods of years 2001 and 2000.

(In thousands, except per share amounts)

| | Three Months Ended | | | |
|--------------------------------------|--------------------|-------------------|-------------------|-------------------|
| | <u>12/31/2001</u> | <u>09/30/2001</u> | <u>06/30/2001</u> | <u>03/31/2001</u> |
| Revenues | \$ 22,620 | \$ 21,533 | \$ 20,919 | \$ 21,236 |
| Net income before minority interests | 7,119 | 6,289 | 5,924 | 6,051 |
| Minority interests | (2,018) | (2,017) | (2,017) | (2,017) |
| Net income | <u>\$ 5,101</u> | <u>\$ 4,272</u> | <u>\$ 3,907</u> | <u>\$ 4,034</u> |
| Per Share Data: | | | | |
| Net income before minority interests | <u>\$ 0.36</u> | <u>\$ 0.32</u> | <u>\$ 0.31</u> | <u>\$ 0.32</u> |
| Net income | <u>\$ 0.35</u> | <u>\$ 0.30</u> | <u>\$ 0.28</u> | <u>\$ 0.29</u> |

| | Three Months Ended | | | |
|--------------------------------------|--------------------|-------------------|-------------------|-------------------|
| | <u>12/31/2000</u> | <u>09/30/2000</u> | <u>06/30/2000</u> | <u>03/31/2000</u> |
| Revenues | \$ 20,910 | \$ 19,724 | \$ 18,988 | \$ 19,407 |
| Net income before minority interests | 5,539 | 5,859 | 5,183 | 5,533 |
| Minority interests | (2,018) | (2,017) | (2,017) | (2,017) |
| Net income | <u>\$ 3,521</u> | <u>\$ 3,842</u> | <u>\$ 3,166</u> | <u>\$ 3,516</u> |
| Per Share Data: | | | | |
| Net income before minority interests | <u>\$ 0.29</u> | <u>\$ 0.31</u> | <u>\$ 0.28</u> | <u>\$ 0.30</u> |
| Net income | <u>\$ 0.25</u> | <u>\$ 0.28</u> | <u>\$ 0.24</u> | <u>\$ 0.26</u> |

| | Three Months Ended | | | |
|--|--------------------|-------------------|-------------------|-------------------|
| | <u>12/31/1999</u> | <u>09/30/1999</u> | <u>06/30/1999</u> | <u>03/31/1999</u> |
| Revenues | \$ 19,398 | \$ 18,409 | \$ 18,020 | \$ 17,964 |
| Net income before extraordinary item and minority interests | 6,103 | 5,145 | 4,931 | 5,041 |
| Minority interests | (2,017) | (2,018) | (1,967) | (1,921) |
| Net income | <u>\$ 4,086</u> | <u>\$ 3,127</u> | <u>\$ 2,964</u> | <u>\$ 3,120</u> |
| Per Share Data: | | | | |
| Net income before extraordinary item and minority interests | <u>\$ 0.33</u> | <u>\$ 0.28</u> | <u>\$ 0.27</u> | <u>\$ 0.28</u> |
| Net income | <u>\$ 0.31</u> | <u>\$ 0.24</u> | <u>\$ 0.23</u> | <u>\$ 0.24</u> |

15. 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.

| <i>(In thousands)</i> | <u>Shopping Centers</u> | <u>Office Properties</u> | <u>Corporate and Other</u> | <u>Consolidated Totals</u> |
|--|-----------------------------|------------------------------|--------------------------------|--------------------------------|
| 2001 | | | | |
| Real estate rental operations: | | | | |
| Revenues | \$ 58,714 | \$ 27,427 | \$ 167 | \$ 86,308 |
| Expenses | <u>(10,324)</u> | <u>(6,022)</u> | <u>--</u> | <u>(16,346)</u> |
| Income from real estate | 48,390 | 21,405 | 167 | (69,962) |
| Interest expense & amortization of debt costs | -- | -- | (25,486) | (25,486) |
| General and administrative | <u>--</u> | <u>--</u> | <u>(4,335)</u> | <u>(4,335)</u> |
| Subtotal | 48,390 | 21,405 | (29,654) | 40,141 |
| Depreciation and amortization | (9,751) | (5,007) | -- | (14,758) |
| Minority interests | -- | -- | (8,069) | (8,069) |
| Net income | <u>\$ 38,639</u> | <u>\$ 16,398</u> | <u>\$ (37,723)</u> | <u>\$ 17,314</u> |
| Capital investment | <u>\$ 8,220</u> | <u>\$ 13,580</u> | <u>\$ --</u> | <u>\$ 21,800</u> |
| Total assets | <u>\$192,762</u> | <u>\$ 124,529</u> | <u>\$ 29,112</u> | <u>\$ 346,403</u> |
| 2000 | | | | |
| Real estate rental operations: | | | | |
| Revenues | \$ 56,969 | \$ 21,837 | \$ 223 | \$ 79,029 |
| Expenses | <u>(10,252)</u> | <u>(4,937)</u> | <u>--</u> | <u>(15,189)</u> |
| Income from real estate | 46,717 | 16,900 | 223 | 63,840 |
| Interest expense & amortization of debt costs | -- | -- | (24,301) | (24,301) |
| General and administrative | <u>--</u> | <u>--</u> | <u>(3,891)</u> | <u>(3,891)</u> |
| Subtotal | 46,717 | 16,900 | (27,969) | 35,648 |
| Depreciation and amortization | (9,453) | (4,079) | (2) | (13,534) |
| Minority interests | -- | -- | (8,069) | (8,069) |
| Net income | <u>\$ 37,264</u> | <u>\$ 12,821</u> | <u>\$ (36,040)</u> | <u>\$ 14,045</u> |
| Capital investment | <u>\$ 14,886</u> | <u>\$ 28,540</u> | <u>\$ --</u> | <u>\$ 43,426</u> |
| Total assets | <u>\$185,518</u> | <u>\$ 117,497</u> | <u>\$ 31,435</u> | <u>\$ 334,450</u> |
| 1999 | | | | |
| Real estate rental operations: | | | | |
| Revenues | \$ 54,510 | \$ 19,183 | \$ 98 | \$ 73,791 |
| Expenses | <u>(9,604)</u> | <u>(4,618)</u> | <u>--</u> | <u>(14,222)</u> |
| Income from real estate | 44,906 | 14,565 | 98 | 59,569 |
| Interest expense & amortization of debt costs. | -- | -- | (22,984) | (22,984) |
| General and administrative | <u>--</u> | <u>--</u> | <u>(3,755)</u> | <u>(3,755)</u> |
| Subtotal | 44,906 | 14,565 | (26,641) | 32,830 |
| Depreciation and amortization | (8,414) | (3,749) | -- | (12,163) |
| Gain on property sale | 553 | -- | -- | 553 |
| Minority interests | -- | -- | (7,923) | (7,923) |
| Net income | <u>\$ 37,045</u> | <u>\$ 10,816</u> | <u>\$ (34,564)</u> | <u>\$ 13,297</u> |
| Capital investment | <u>\$ 16,939</u> | <u>\$ 21,699</u> | <u>\$ --</u> | <u>\$ 38,638</u> |
| Total assets | <u>\$186,769</u> | <u>\$ 90,185</u> | <u>\$ 22,711</u> | <u>\$ 299,665</u> |

General

The following discussion is based on the consolidated financial statements of the Company as of December 31, 2001 and for the year ended December 31, 2001. Prior year data is based on the Company's consolidated financial statements as of December 31, 2000 and 1999 and for the years ended December 31, 2000 and 1999.

Critical Accounting Policies

Our accounting policies are in conformity with generally accepted accounting principles in the United States ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to use judgment in the application of accounting policies, including making estimates and assumptions. These judgments affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the Company's financial statements and the reported amounts of revenue and expenses during the reporting periods. If our judgment or interpretation of the facts and circumstances relating to various transactions had been different, it is possible that different accounting policies would have been applied resulting in a different presentation of our financial statements. Below is a discussion of accounting policies which we consider critical in that they may require judgment in their application or require estimates about matters which are inherently uncertain. Additional discussion of accounting policies which we consider significant, including further discussion of the critical accounting policies described below, can be found in the notes to our Consolidated Financial Statements.

Valuation of Real Estate Investments

Real estate investment properties are stated at historic cost basis less depreciation. 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. Because these financial statements are prepared in conformity with accounting principles generally accepted in the United States, they do not report the current value of the Company's real estate assets.

If there is an event or change in circumstance that indicates an impairment in the value of a real estate investment property, the Company assesses an impairment in value by making a comparison of the current and projected operating cash flows of the property over its remaining useful life, on

an undiscounted basis, to the carrying amount of that property. If such carrying amount is greater than the estimated projected cash flows, the Company would recognize an impairment loss equivalent to an amount required to adjust the carrying amount to its estimated fair market value.

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.

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.

Lease Acquisition Costs

Certain initial direct costs incurred by the Company in negotiating and consummating a successful lease are capitalized and amortized over the initial base term of the lease. Capitalized leasing costs are comprised of commissions paid to third party leasing agents as well as internal direct costs such as employee compensation and payroll related fringe benefits directly related to time spent performing leasing related activities. Such activities include evaluating the prospective tenant's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating lease terms, preparing lease documents and closing the transaction.

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 scheduled rent increases, income is recognized on a straight-line basis throughout the initial term of the lease. Expense recoveries represent a portion of property operating expenses billed to the tenants, including common area maintenance, real estate taxes and other recoverable costs. Expense recoveries are recognized in the period

when the expenses are incurred. Rental income based on a tenant's revenues, known as percentage rent, is accrued when a tenant reports sales that exceed a specified breakpoint.

Legal Contingencies

The Company is subject to various legal proceedings and claims that arise in the ordinary course of business. These matters are generally covered by insurance. While the resolution of these matters cannot be predicted with certainty, we believe the final outcome of such matters will not have a material adverse effect on the Company's financial position or the results of operations. Once it has been determined that a loss is probable to occur, the estimated amount of the loss is recorded in the financial statements. Both the amount of the loss and the point at which its occurrence is considered probable can be difficult to determine.

Liquidity and Capital Resources

Cash and cash equivalents were \$1.8 million at December 31, 2001 and 2000. The Company's cash flow is affected by its operating, investing and financing activities, as described below.

Operating Activities

Cash provided by operating activities for the years ended December 31, 2001 and 2000 was \$31.8 million and \$32.8 million, respectively, and represents, in each year, cash received primarily from rental income, plus other income, less normal recurring general and administrative expenses and interest payments on debt outstanding.

Investing Activities

Cash used in investing activities for the years ended December 31, 2001 and 2000 was \$21.8 million and \$43.4 million, respectively, and primarily reflects the acquisition of properties and construction in progress, net of sales of properties, during those years.

Financing Activities

Cash used in financing activities for the year ended December 31, 2001 was \$10.0 million and cash provided by financing activities for the year ended December 31, 2000 was \$11.5 million. Cash used in financing activities for the year ended December 31, 2001 primarily reflects:

- \$51.2 million of proceeds received from notes payable incurred during the year; and
- \$12.0 million of proceeds received from the issuance of common stock and convertible limited partnership interests in the Operating Partnership issued under dividend reinvestment programs;

which was partially offset by:

- the repayment of borrowings on our notes payable totaling \$42.9 million; and
- distributions made to common stockholders and holders of convertible limited partnership units in the Operating Partnership during the year totaling \$30.3 million.

Cash provided by financing activities for the year ended December 31, 2000 primarily reflects:

- \$69.7 million of proceeds received from notes payable incurred during the year; and
- \$8.0 million of proceeds received from the issuance of common stock and convertible limited partnership interests in the Operating Partnership issued under dividend reinvestment programs.

The cash provided by financing activities was partially offset by:

- the repayment of borrowings on our notes payable totaling \$36.5 million;
- distributions made to common stockholders and holders of convertible limited partnership units in the Operating Partnership during the year totaling \$29.4 million; and
- additions to deferred debt expense of \$315,000.

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 90% (95% for the tax years beginning prior to January 1, 2001) of its "real estate investment trust taxable income," as defined in the Code. 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: i) redevelop certain of the Shopping Centers, ii) develop additional freestanding outparcels or expansions within certain of the Shopping Centers, iii) acquire existing neighborhood and community shopping centers and/or office properties, and iv) 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, proceeds from the operation of the Company's dividend reinvestment plan 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.

As of December 31, 2001, the scheduled maturities of all debt for years ended December 31, are as follows:

Debt Maturity Schedule

(In thousands)

| | |
|------------|-------------------|
| 2002 | \$ 6,293 |
| 2003 | 65,159 |
| 2004 | 16,631 |
| 2005 | 7,713 |
| 2006 | 8,359 |
| Thereafter | 247,665 |
| | <u>\$ 351,820</u> |

Management believes that the Company's current capital resources, including approximately \$50,000,000 of the Company's revolving line of credit, which was available for borrowing as of December 31, 2001, will be sufficient to meet its liquidity needs for the foreseeable future.

Dividend Reinvestment and Stock Purchase Plan

In December 1995, the Company established a Dividend Reinvestment and Stock Purchase Plan (the "Plan"), to allow its stockholders and holders of limited partnership interests an opportunity to buy additional shares of common stock by reinvesting all or a portion of their dividends or distributions. The Plan provides for investing in newly issued shares of common stock at a 3% discount from market price without payment of any brokerage commissions, service charges or other expenses. All expenses of the Plan are paid by the Company. The Company issued 645,420 and 514,487 shares under the Plan at a weighted average discounted price of \$17.99 and \$14.89 per share during the years ended December 31, 2001 and 2000, respectively.

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% of total asset value. The following is a summary of notes payable as of December 31, 2001 and 2000:

| Notes Payable | | | | |
|-----------------------|------------------------------------|-------------|---------------|-------------------|
| <i>(In thousands)</i> | Principal Outstanding December 31, | | Interest | Scheduled |
| | <u>2001</u> | <u>2000</u> | <u>Rate *</u> | <u>Maturity *</u> |
| Fixed Rate Mortgages: | \$ 138,215 (a) | \$ 140,597 | 7.67 % | Oct. 2012 |
| | 95,716 (b) | 74,342 | 8.23 % | Dec. 2011 |
| | 35,583 (c) | 36,279 | 7.88 % | Jan. 2013 |
| | 13,936 (d) | 14,184 | 8.33 % | May 2015 |
| | 10,028 (e) | 10,227 | 6.88 % | May 2004 |
| Total Fixed Rate | 293,478 | 275,629 | 7.88 % | 10.4 Years |
| Variable Rate Loans: | | | | |
| Construction Loan | 38,342 (f) | 33,324 | 3.64 % | Jan. 2003 |
| Line of Credit | 20,000 (g) | 34,500 | 3.69 % | July 2003 |
| Total Variable Rate | 58,342 | 67,824 | 3.66 % | 1.2 Years |
| Total Notes Payable | \$ 351,820 | \$ 343,453 | 7.18 % | 8.9 Years |

*Interest rate and scheduled maturity data presented for December 31, 2001. Totals computed using weighted averages.

(a) The loan is collateralized by nine shopping centers and requires monthly principal and interest payments based upon a 25 year amortization schedule. Principal of \$2,382,000 was amortized during 2001.

(b) The loan is collateralized by Avenel Business Park, Van Ness Square, Ashburn Village, Leesburg Pike, Lumberton Plaza and Village Center. The loan was amended during 2001 to include new borrowings of \$24,000,000 at an average rate of 7.38%. The 8.23% blended interest rate is the weighted average of the initial loan rate and additional borrowings rates. Monthly principal and interest payments are based upon a weighted average 23 year amortization schedule. Principal of \$2,626,000 was amortized during 2001.

(c) The loan is collateralized by 601 Pennsylvania Avenue and requires monthly principal and interest payments based upon a 25 year amortization schedule. Principal of \$696,000 was amortized during 2001.

(d) The loan is collateralized by Shops at Fairfax and Boulevard shopping centers and requires monthly principal and interest payments based upon a 22 year amortization schedule. Principal of \$248,000 was amortized during 2001.

(e) The loan is collateralized by The Glen shopping center and requires monthly principal and interest payments based upon a 23 year amortization schedule. Principal of \$199,000 was amortized during 2001.

(f) The loan is a construction loan totaling \$42,000,000 and is collateralized by Washington Square. Interest expense is calculated based upon the 1, 2, 3 or 6 month LIBOR rate plus a spread of 1.45% to 1.9% (determined by certain leasing and/or construction benchmarks) or upon the bank's prime rate at the Company's option. The loan was extended until January 2003 upon payment in 2001 of a fee of 1/4% or \$105,000. The loan may be further extended for an additional one-year term with payment of a fee of 1/4% and the achievement of certain debt service and valuation tests, at the Company's option. The interest rate in effect on December 31, 2001 was based on a weighted average LIBOR of 1.94% and spread of 1.7%. The effective annual average interest rate, which considers debt cost amortization, was 6.15% for 2001.

(g) The loan is an unsecured revolving credit facility totaling \$70,000,000. Interest expense is calculated based upon the 1,2,3 or 6 month LIBOR rate plus a spread of 1.625% to 1.875% (determined by certain debt service coverage and leverage tests) or upon the bank's reference rate 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, 2001 was based on a weighted average LIBOR of 1.94% and spread of 1.75%. The effective annual average interest rate, which considers debt cost amortization and unused line fees, was 7.14% for 2001.

The December 31, 2001 and 2000, depreciation adjusted cost of properties collateralizing the mortgage notes payable totaled \$264,831,000 and \$218,415,000, respectively. Certain loans are subject to financial covenant tests, the most significant of which are debt service coverage and loan to asset value requirements. The Company believes it is in compliance with all such covenants. Notes payable at December 31, 2001 and 2000, totaling \$242,168,000 and \$225,616,000, respectively, are guaranteed by members of The Saul Organization. The Company's interest expense coverage ratio increased to 2.63 during the past year, from 2.51 in 2000.

During 2001 the Company obtained three new mortgage loans totaling \$24,000,000 from an existing lender, secured by Van Ness Square and recent developments at Ashburn Village and Avenel Business Park. The loans require monthly payments of principal and interest based upon a weighted average 21.5 year amortization period and a fixed weighted average 7.38% interest rate.

Funds From Operations

In 2001, the Company reported Funds From Operations (FFO) of \$40,141,000 on a fully converted basis, representing a 12.6% increase over 2000 FFO of \$35,648,000. The following table presents a reconciliation from net income before minority interests to FFO:

| | For the Years Ended December 31, | | |
|--|----------------------------------|------------------|------------------|
| | 2001 | 2000 | 1999 |
| <i>(Amount in thousands)</i> | | | |
| Net income before minority interests | \$ 25,383 | \$ 22,114 | \$ 21,220 |
| Subtract: Gain on sale of property | -- | -- | (553) |
| Add: Depreciation and amortization of real property | <u>14,758</u> | <u>13,534</u> | <u>12,163</u> |
| Funds From Operations ¹ | <u>\$ 40,141</u> | <u>\$ 35,648</u> | <u>\$ 32,830</u> |
| Average Shares and Units Used to Compute FFO per Share | 19,383 | 18,796 | 18,148 |

¹ FFO, as defined by the National Association of Real Estate Investment Trusts, presented on a fully converted basis and a widely accepted measure of operating performance for real estate investment trusts, is defined as net income before gains or losses from property sales, extraordinary items, and before real estate depreciation and amortization. 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.

Redevelopments, 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 in 2001 at Washington Square, Ashburn Village, French Market and Crosstown Business Center.

During 2001, the Company continued the development of Washington Square at Old Town, a new Class A mixed-use office/retail complex along North Washington Street in historic Old Town Alexandria in Northern Virginia. The project totals 235,000 square feet of leasable area and is well located on a two-acre site along Alexandria's main street. The project consists of two identical buildings separated by a landscaped brick courtyard. Base building construction has been completed. The build-out of office tenant areas continues. As of February 22, 2002, the Company has signed leases on 69% of the 235,000 square feet of tenant space: the 46,000 square feet of street level retail space is 98% leased and the 189,000 square feet of office space is 62% leased.

During late 1999, the Company purchased land located within the 1,580 acre community of Ashburn Village in Loudoun County, Virginia, adjacent to its 108,000 square foot Ashburn Village neighborhood shopping center. The land was developed into Ashburn Village II, a 40,200 square foot in-line and pad expansion to the existing shopping center, containing 23,600 square feet of retail space and 16,600 square feet of professional office suites. Ashburn Village II commenced operations during the third quarter of 2000. In August 2000, the Company purchased an additional 7.1 acres of land adjacent to Ashburn Village II for \$1,579,000. During 2001, the Company completed the development of 4.0 acres of the land known as Ashburn Village III, consisting of a fully leased 28,000 square foot in-line and pad expansion to the retail area of the existing shopping center. The Company commenced construction on the remaining 3.1 acres known as Ashburn Village IV, during the fourth quarter of 2001. This phase will consist of an additional 25,000 square feet of retail space and will complete the development of Ashburn Village. Leases have been signed for 25% of this new shop space. Completion is scheduled for the summer of 2002.

Beginning in 1998, the Company executed a plan to redevelop its 213,000 square foot French Market shopping center, located in the northwest section of Oklahoma City, Oklahoma. The plan specified the retenting of a 103,000 square foot anchor tenant space and conversion of an outdated mini-mall to an anchor tenant use. The former Venture store space was re-demised and leased to Bed Bath and Beyond, Staples, Famous Footwear, BridesMart and Lakeshore Learning. The former enclosed mini-mall was leased to Burlington Coat Factory and during 2000, converted into a two-level 90,000 square foot super store, increasing the center's size to 247,000 square feet. The façade of the center was updated to complement the addition of the new tenants. The Company has recently completed construction of the final phase of the center's redevelopment after it obtained control of 20,000 square feet of space formerly operated as a grocery store. The Company re-demised the space to accommodate nine smaller tenant uses and updated the façade to complement the remainder of the center. As a result of the Company's efforts, approximately 94% of the center was leased as of December 31, 2001.

The conversion and redevelopment of the former Tulsa, Oklahoma shopping center to an office/warehouse facility named Crosstown Business Center continued throughout 2001. Twelve tenants lease 91% of the facility as of February 22, 2002.

The Company has contracted with a third party to purchase 24.0 acres of land zoned for retail development in Loudoun County, Virginia, for a purchase price of \$5.3 million. Closing is scheduled for March 2002.

Portfolio Leasing Status

At December 31, 2001, the portfolio consisted of 28 Shopping Centers and five predominantly Office Properties, all of which are located in seven states and the District of Columbia.

As of December 31, 2001, 93.5% of the Company's approximately 6,200,000 square feet of space was leased. On a same center basis (excluding Washington Square which was under development during 2001 and the prior year) 94.5% of the Company's approximately 5,900,000 square feet of operating leasable space was leased to tenants, as compared to 92.9% at December 31, 2000. The shopping center portfolio was 94.3% leased at December 31, 2001 compared to 94.1% at December 31, 2000. The Office Properties (excluding Washington Square) were 95.5% leased at December 31, 2001 compared to 86.8%

as of December 31, 2000. The overall improvement in year-end 2001 same center leasing percentage resulted primarily from the Company's successful leasing at Crosstown Business Center, which improved from 41% at year-end 2000 to 82% at year-end 2001.

Results of Operations

The following discussion compares the results of the Company for the year ended December 31, 2001 with the year ended December 31, 2000, and compares the year ended December 31, 2000 with the year ended December 31, 1999. This information should be read in conjunction with the accompanying consolidated financial statements and the notes related thereto.

Years Ended December 31, 2001 and 2000

Revenues for the year ended December 31, 2001 (the "2001 Year"), totaled \$86,308,000 compared to \$79,029,000 for the comparable period in 2000 (the "2000 Year"), an increase of \$7,279,000 (9.2%).

Base rent increased to \$69,662,000 in 2001 from \$63,837,000 in 2000, representing a \$5,825,000 (9.1%) increase. The increase in base rent resulted primarily from new leases in effect at recently developed and acquired properties: Ashburn Village II and III and a portion of Washington Square (approximately 100,000 square feet) during the 2001 Year.

Expense recoveries increased to \$11,456,000 in 2001 from \$11,129,000 in 2000, representing an increase of \$327,000 (2.9%).

Percentage rent was \$2,113,000 in 2001, compared to \$2,097,000 in 2000, representing an increase of \$16,000 (0.8%).

Other income, which consists primarily of parking income at three of the Office Properties, kiosk leasing, temporary leases and payments associated with early termination of leases, was \$3,077,000 in 2001, compared to \$1,966,000 in 2000, representing an increase of \$1,111,000 (56.5%). The increase in other income resulted from a \$442,000 increase in lease termination payments compared to the prior year, collection of \$363,000 from the estate of a former tenant in bankruptcy and a \$304,000 increase in parking rents primarily due to the commencement of operations at Washington Square.

Operating expenses, which consist mainly of repairs and maintenance, utilities, payroll and insurance expense, increased \$232,000 (2.8%) to \$8,503,000 in 2001 from \$8,271,000 in 2000.

The provision for credit losses was \$617,000 in 2001 compared to \$467,000 in 2000, representing an increase of \$150,000 (32.1%). The comparative credit loss increase resulted primarily from additions to credit loss reserves for three retail tenants and an office tenant in bankruptcy and unpaid rents in dispute with two retail tenants and an office tenant.

Real estate taxes were \$7,226,000 in 2001 compared to \$6,451,000 in 2000, representing an increase of \$775,000 (12.0%). Approximately half of the increase was attributable to development properties placed in service during the latter half of 2000 and during 2001. Approximately a quarter of the increase resulted from an assessment increase for the Company's Thruway shopping center.

Interest expense was \$24,920,000 in 2001 compared to \$23,843,000 in 2000, representing an increase of \$1,077,000 (4.5%). The increase in interest expense resulted from increased borrowings related to the development and acquisition of properties placed in service during 2001 and 2000.

Amortization of deferred debt costs was \$566,000 in 2001 compared to \$458,000 in 2000, an increase of \$108,000 (23.6%). The increase resulted from a full year of amortizing the costs of renewing and amending the Company's revolving line of credit facility in July 2000 and \$38 million of new long term debt put in place during 2000 and 2001.

Depreciation and amortization expense was \$14,758,000 in 2001 compared to \$13,534,000 in 2000, representing an increase of \$1,224,000 (9.0%). The increase resulted from increased amortization of leasing costs and depreciation of construction costs related to newly developed and acquired properties placed in service during 2001 and 2000.

General and administrative expense, which consists primarily of administrative payroll and other overhead expenses, was \$4,335,000 in 2001 compared to \$3,891,000 in 2000, representing an increase of \$444,000 (11.4%). Approximately half of the year over year increase resulted from additional payroll expenses and a quarter of the increase resulted from the write-off of abandoned acquisition costs.

Years Ended December 31, 2000 and 1999

Revenues for the year ended December 31, 2000 (the "2000 Year"), totaled \$79,029,000 compared to \$73,791,000 for the comparable period in 1999 (the "1999 Year"), an increase of \$5,238,000 (7.1%).

Base rent increased to \$63,837,000 in 2000 from \$59,200,000 in 1999, representing a \$4,637,000 (7.8%) increase. The increase in base rent resulted primarily from new leases in effect at recently redeveloped shopping centers (Shops At Fairfax/Boulevard, Thruway, French Market and Ashburn Village), a 4% percent average annual occupancy increase at Avenel Business Park, and a 60,000 square foot tenant paying higher rent while holding over beyond its scheduled lease expiration at 601 Pennsylvania Avenue. The increase in base rent was diminished in part by decreasing occupancy at Lexington Mall and the absence of rent from Park Road, sold in December 1999.

Expense recoveries increased to \$11,129,000 in 2000 from \$10,176,000 in 1999, representing an increase of \$953,000 (9.4%). Expense recovery income increased primarily as a result of substantial snow removal expenses during 2000 which were recovered from many of the Company's shopping center tenants and to a lesser extent, improved occupancy rates which allowed a greater percentage of operating expenses to be recovered from tenants.

Percentage rent was \$2,097,000 in 2000, compared to \$2,222,000 in 1999, representing a decrease of \$125,000 (5.6%). The decrease in percentage rent resulted primarily from the rollover of an anchor tenant lease into higher paying base rent in lieu of percentage rent at Giant shopping center.

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 \$1,966,000 in 2000, compared to \$2,193,000 in 1999, representing a decrease of \$227,000 (10.4%). The decrease in other income resulted from a \$252,000 reduction in lease termination payments compared to the prior year.

Operating expenses, which consist mainly of repairs and maintenance, utilities, payroll and insurance expense, increased \$551,000 (7.1%) to \$8,271,000 in 2000 from \$7,720,000 in 1999. The increase was primarily caused by higher snow removal expenses resulting from two severe snowstorms impacting the Mid-Atlantic region during January and February 2000, offset in part by cost savings

achieved by reducing maintenance and utility expenses attributable to the elimination of the interior mall area, replaced by Burlington Coat Factory's new super store, as a result of the Company's redevelopment of French Market.

The provision for credit losses was \$467,000 in 2000 compared to \$295,000 in 1999, representing an increase of \$172,000 (58.3%). The comparative credit loss increase resulted from unusually low credit loss activity in 1999, additions to credit loss reserves for two retail tenants in bankruptcy and rent in dispute with an office tenant.

Real estate taxes were \$6,451,000 in 2000 compared to \$6,207,000 in 1999, representing an increase of \$244,000 (3.9%).

Interest expense was \$23,843,000 in 2000 compared to \$22,568,000 in 1999, representing an increase of \$1,275,000 (5.6%). The increase in interest expense resulted from increased borrowings related to newly developed and acquired properties placed in service during 2000 and 1999, and to a lesser extent, the higher costs of borrowing in 2000 resulting from higher interest rates compared to 1999.

Amortization of deferred debt expense was \$458,000 in 2000 compared to \$416,000 in 1999, an increase of \$42,000 (10.1%). The increase resulted from the Company's new \$14,300,000 long term financing secured by the Shops at Fairfax and Boulevard shopping centers and the costs of renewing and amending the Company's revolving credit facility.

Depreciation and amortization expense was \$13,534,000 in 2000 compared to \$12,163,000 in 1999, representing an increase of \$1,371,000 (11.3%). The increase resulted from increased depreciation related to newly developed and acquired properties placed in service during 2000 and 1999.

General and administrative expense, which consists primarily of administrative payroll and other overhead expenses, was \$3,891,000 in 2000 compared to \$3,755,000 in 1999, representing an increase of \$136,000 (3.6%).

In 1999 the Company reported a gain on sale of property of \$553,000 resulting from the District of Columbia's purchase of the Company's Park Road property as part of an assemblage of parcels for a neighborhood revitalization project. There were no property sales in 2000.

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. The Plan's prospectus is available for review in the Shareholders Information section of the Company's web site.

To receive more information please call the plan administrator at 1-800-637-7549 and request to speak with a service representative or write:

U.S. Bank, N.A.
1555 N. RiverCenter Dr.,
Suite 301
Milwaukee, WI 53212

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, 2001 | \$22.00 | \$18.98 |
| Third Quarter, 2001 | \$19.87 | \$18.25 |
| Second Quarter, 2001 | \$19.30 | \$18.05 |
| First Quarter, 2001 | \$19.00 | \$17.60 |
| Fourth Quarter, 2000 | \$18.63 | \$15.31 |
| Third Quarter, 2000 | \$16.50 | \$15.63 |
| Second Quarter, 2000 | \$16.81 | \$15.38 |
| First Quarter, 2000 | \$16.31 | \$13.94 |

On February 22, 2002, the closing price was \$22.55.

There were approximately 500 holders of record as of that date.

DIRECTORS

B. Francis Saul II
Chairman & Chief
Executive Officer

B. Francis Saul III
Vice Chairman

Philip D. Caraci
President

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

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

General Paul X. Kelley
USMC (Ret.), Partner,
J.F. Lehman & Company

Charles R. Longworth
Chairman Emeritus, Colonial
Williamsburg Foundation

Patrick F. Noonan
Chairman, The
Conservation Fund

Mark Sullivan III
Attorney

The Honorable
James W. Symington
Partner, O'Connor & Hannan,
Attorneys at Law

John R. Whitmore
Senior Advisor to the
Bessemer Group, Inc.

EXECUTIVE OFFICERS

B. Francis Saul II
Chairman & Chief
Executive Officer

B. Francis Saul III
Vice Chairman

Philip D. Caraci
President

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

Christopher H. Netter
Senior Vice President, Leasing

John F. Collich
Senior Vice President,
Retail Development

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

COUNSEL

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Washington, DC 20037

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Vienna, Virginia 22182

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Symbol: BFS

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(800) 637-7549

INVESTOR RELATIONS

Saul Centers, Inc.
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Bethesda, MD 20814-6522
A copy of the Saul Centers, Inc.
annual report to the Securities
and Exchange Commission
on Form 10-K may be printed
from the Company's web site
or obtained at no cost to
stockholders by writing to
the above address or calling
(301) 986-6016.

HEADQUARTERS

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

*New corporate headquarters
commencing March 2002.*





*The Annual Meeting of
Shareholders will be held at
11:00 a.m., local time, on
April 26, 2002, at the Hyatt
Regency Bethesda, One Bethesda
Metro Center, Bethesda, MD
(at the south west corner of
the Wisconsin Avenue and Old
Georgetown Road intersection,
adjacent to the Bethesda Metro
Stop on the Metro Red Line.)*



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