
2002

Annual Report
to shareholders



Saul Centers

Saul Centers, Inc.

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 34 community and neighborhood shopping center and office properties totaling approximately 6.3 million square feet of leasable area. Over 82% 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.

PORTFOLIO COMPOSITION

Based on Property Operating Income



68.1% Shopping Centers

31.9% Office



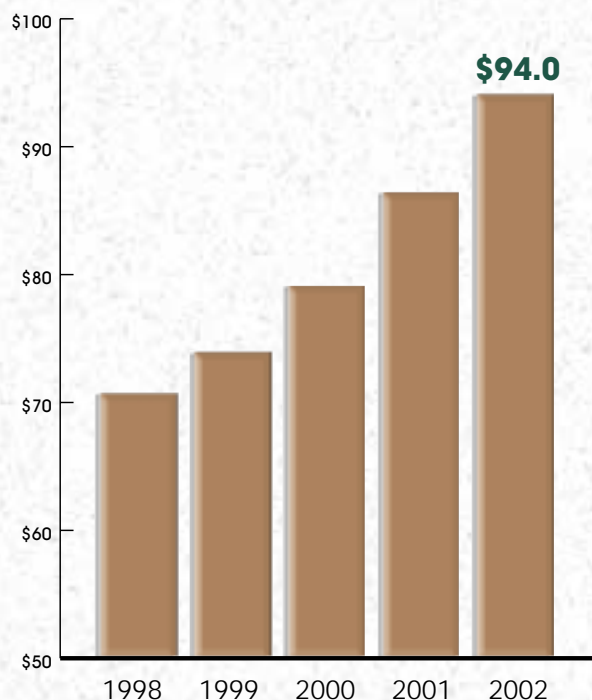
82.7% Metropolitan
Washington, DC/
Baltimore Area

17.3% Rest of U.S.

HISTORIC OPERATING PERFORMANCE

TOTAL REVENUES

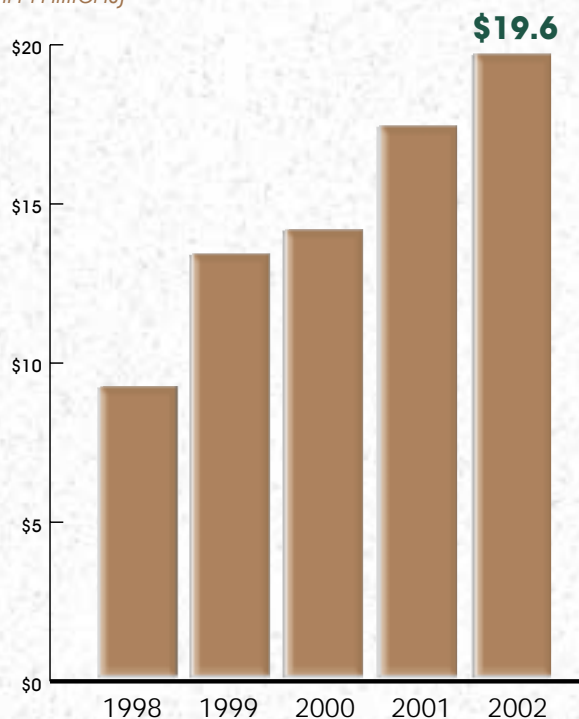
(in millions)



Over 81% of our retail cash flow is produced by centers with grocery store anchors.

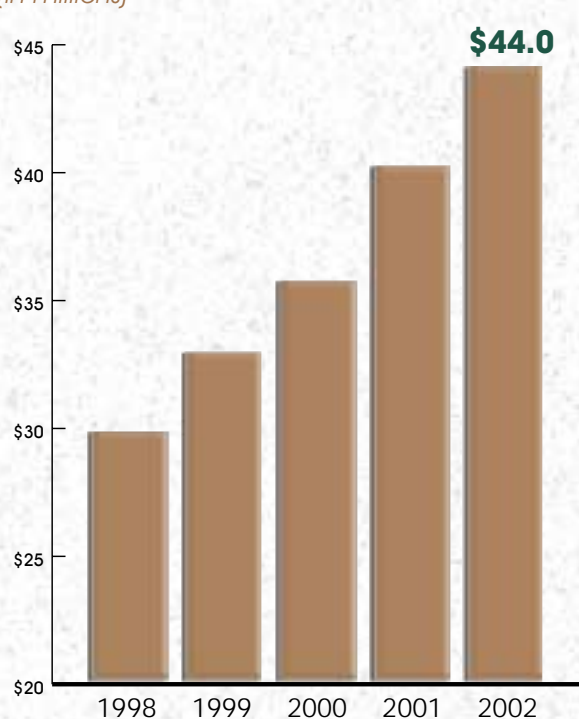
NET INCOME

(in millions)



FUNDS FROM OPERATIONS*

(in millions)



* Funds From Operations (FFO) is a non-GAAP financial measure. See page 34 for a definition of FFO and reconciliation to income before minority interests.

FINANCIAL HIGHLIGHTS

	Years ended December 31,				
	2002	2001	2000	1999	1998
Summary Financial Data					
Total Revenues	\$ 93,963,000	\$ 86,308,000	\$ 79,029,000	\$ 73,791,000	\$ 70,583,000
Net Income	\$ 19,566,000	\$ 17,314,000	\$ 14,045,000	\$ 13,297,000	\$ 9,129,000
FFO	\$ 44,031,000	\$ 40,141,000	\$ 35,648,000	\$ 32,830,000	\$ 29,718,000
Average Common Stock Outstanding	14,886,505	14,210,470	13,623,330	13,100,295	12,643,639
Average Shares and Units Outstanding	20,059,264	19,382,720	18,795,571	18,147,954	17,233,047
FFO Per Share (Diluted)	\$ 2.20	\$ 2.07	\$ 1.90	\$ 1.81	\$ 1.73
Net Income Per Share (Diluted)	\$ 1.31	\$ 1.22	\$ 1.03	\$ 1.01	\$ 0.72
Dividend as a Percentage of FFO	71%	75%	82%	86%	90%
Interest Expense Coverage ^a	2.78	2.63	2.51	2.47	2.33
Property Data					
Number of Properties	34 ^b	33	33	33	34
Total Portfolio Square Feet	6,272,000	6,159,000	6,143,000	6,108,000	5,901,000
Shopping Center Square Feet	5,069,000	4,956,000	4,941,000	4,936,000	5,187,000
Office Square Feet	1,203,000	1,203,000	1,202,000	1,172,000	714,000
Average Percentage Leased	94%	93%	93% ^c	92% ^c	90%

(a) Interest expense coverage is defined as operating income before interest expense, amortization of deferred debt expense, depreciation and amortization, divided by interest expense.

(b) Excludes Broadlands Village (under development) and Landsdowne and Clarendon Center land parcels.

(c) Excludes Washington Square, which was under development.



601 Pennsylvania Avenue



Seven Corners

MESSAGE TO OUR SHAREHOLDERS

While 2002 was another year of increasing cash flow growth for the Saul Centers operating portfolio, it was an even more successful year for site acquisitions. Three significant Northern Virginia acquisitions containing over 44 acres should produce sound growth prospects through the balance of this decade. Saul Centers has the zoning to develop over 600,000 square feet of retail and mixed-use space on these parcels.

2002 Development Site Acquisitions

*I*n March, we purchased 24 acres of undeveloped retail land in the Broadlands section of the Dulles Technology Corridor. The site is located adjacent to the Claiborne Parkway exit of the Dulles Greenway, in Loudoun County, Virginia. The Dulles Greenway is the "gateway to Loudoun County", a 14-mile extension of the Dulles Toll Road connecting Washington Dulles International Airport with historic Leesburg, Virginia. Broadlands is a 1,500 acre planned community consisting of 3,500 residences, over 2,000 of which are constructed. The land is zoned to accommodate approximately 225,000 square feet of neighborhood and community retail development.

The Company has signed a lease with and will build a 59,000 square foot supermarket for Safeway to anchor this development, to be known as Broadlands Village. Safeway is the second leading grocer in the metropolitan Washington, DC market and operates approximately 180 stores in the mid-Atlantic region. We have obtained building permits from Loudoun County for the 112,000 square foot initial phase of this center. Adjacent to Safeway, we will construct 42,000 square feet of small shops and lease four pad sites

totaling approximately 11,000 square feet of free-standing building users. Construction commenced in late-December 2002, and we expect to substantially complete this first phase of the center in the fall of 2003. A total of 65% of the space has been pre-leased and leasing interest remains strong for much of the remaining small shop space.

In December, the Company purchased approximately 19 acres of undeveloped land located within the Lansdowne community in Loudoun County, Virginia. The land is zoned to accommodate approximately 150,000 square feet of neighborhood and community retail development. The Broadlands and Lansdowne acquisitions expand the Company's Loudoun County investments, where we are also the owner and developer of the 210,000 square foot Ashburn Village neighborhood shopping center. Ashburn Village is a very successful



Broadlands Village rendering



Development acquisitions to fuel future growth

MESSAGE TO OUR SHAREHOLDERS

Giant Food anchored center which we developed and constructed in phases between 1994 and 2002; it is situated within a largely completed 5,000 home planned community.

In addition to the Broadlands and Landsdowne land parcels, Saul Centers purchased Clarendon Center, located in Arlington, Virginia. Clarendon Center is a 1.25 acre site with an existing and vacant 70,000 square foot office building with surface parking for 104 cars. It is located directly across the street from the Company's Clarendon and Clarendon Station properties, and adjacent to the Clarendon Metro rail station. The site is zoned for over 250,000 rentable square feet of commercial space. We plan to redevelop the site and have begun preparing conceptual plans and layouts for the county approval and permitting process.

The cash flow from buildings developed and constructed on these three sites should serve to enhance the financial performance of our existing 6.3 million square feet of commercial space. We remain committed to selectively enlarging and strengthening our metropolitan Washington area retail and office portfolio over the coming years.



Ashburn Village

2002 Financial Performance

This past year was yet another year of economic uncertainty, historically low interest rates, and a very challenging environment for commercial real estate nationwide. Our Washington metropolitan area focus and ownership of primarily in-fill community and neighborhood shopping centers and office properties again enabled us to enjoy another year of solid performance in 2002.

Total revenues for the year increased 8.9% to \$93,963,000 compared to \$86,308,000 for 2001. Operating income before gain on property disposition and minority interests increased 3.3% to \$26,210,000 compared to \$25,383,000 for 2001. After including gain on property sold and deducting minority interests the Company reported net income of \$19,566,000, or \$1.31 per share for 2002, a per share increase of 7.9% compared to net income of \$17,314,000, or \$1.22 per share for 2001 (fully diluted basis). The gain on sale of property reported during 2002 of \$1,426,000 represents final proceeds from the District of Columbia's condemnation and purchase of the Company's Park Road property. For the quarter ended December 31, 2002, revenues increased 8.3% to \$24,508,000 compared to \$22,620,000 for the comparable period in 2001. The Company reported net income of \$5,263,000 or \$.35 per share for the quarter ended December 31, 2002, compared to net income of \$5,101,000 or \$.35 per share for 2001 (fully diluted basis).



A year of solid performance

MESSAGE TO OUR SHAREHOLDERS

Funds From Operations (FFO) increased 9.7% to \$44,031,000 for the year ended December 31, 2002 compared to \$40,141,000 for 2001. For the quarter ended December 31, 2002, FFO increased 4.8% to \$11,221,000 compared to \$10,705,000 for the 2001 quarter. On a fully diluted per share basis, FFO was \$2.20 per share for 2002, a 6.0% increase over the prior year. For the quarter ended December 31, 2002, FFO per share increased 1.5% to \$.55 per share over the comparable 2001 quarter. Approximately twenty percent of the annual FFO improvement was derived from increased property operating income at our 235,000 square foot Washington Square development. FFO is presented on a fully converted basis and is a widely accepted non-GAAP financial measure of operating performance for REITs. FFO is defined as net income before extraordinary items, gains and losses on property sales and before real estate depreciation and amortization.

Investment Performance

During 2002, the Company paid four quarterly distributions of \$0.39 per share to shareholders, of which 93.5% was taxable as ordinary income and 6.5% represented return of capital. The total annual \$1.56 per share distribution equated to a 71% payout of the Company's 2002 FFO. Our stock began the year at a price of \$21.35 per share and ended 2002 at \$23.80 per share. When combining dividend yield and price appreciation, Saul Centers posted a 19.5% total return in 2002, versus an average 3.6% for the NAREIT Equity Index and an 18% total return for the shopping center sector. Retail-focused REITs outperformed the overall REIT industry total return average for the second straight year. The Company's five year annual average total return is 15.8%. Since public trading began in August 1993, Saul Centers has produced a compounded average annual total return of 11.8%. At year end 2002, the 6.6% dividend yield represents a spread of 2.6% over the benchmark 10 year Treasury yield, providing a very attractive risk-adjusted investment for yield oriented investors.

**The Company's
five year
annual average
total return
is 15.8%.**



Hampshire Langley



Seven Corners



Lumberton

A year that posted a 19.5% total return

MESSAGE TO OUR SHAREHOLDERS

Portfolio Highlights

The Saul Centers core operating portfolio produced another year of increased cash flow growth. Same property operating income for the total portfolio grew 6.6% for the year and 5.2% for the quarter ended December 31, 2002, compared to the same periods in 2001. The same property comparison excludes the development properties, Washington Square and Ashburn Village Phases III and IV, and the Company's September 2002 Kentlands Square acquisition. As of December 31, 2002, the total portfolio was 93.7% leased. Same property operating income in the shopping center portfolio increased 3.2% for the year and was unchanged in the fourth quarter compared to the same prior year periods. Same property office performance grew 16.6% for the year and 22.3% for the fourth quarter. The improvement in the office properties was inflated by the revenues generated from a major tenant paying higher rent under the terms of a short term holdover lease at 601 Pennsylvania Avenue, and to a lesser extent by higher lease termination fees and receipt of a payment from a former office tenant's bankruptcy estate.

Retail Highlights

Retail core operating trends have proven very resilient during this prolonged economic slowdown, as interest rates remain at historically low levels and consumers have generally continued to spend. The Washington DC/Baltimore metropolitan area remains the Company's area of focus, with approximately 83% of the retail cash flow from properties in



Kentlands Square acquisition

these markets. In general, grocery anchored retail tenants are experiencing increased competition from WalMart and Target entering their market areas. The expansion of these two retailers is pressuring already thin grocery margins and forcing more consolidation and store closings. Our Washington metropolitan area focus has greatly insulated the Company from these market pressures due to the lack of new development sites in our high density, in-fill locations. Additionally, twelve of the Company's 18 grocery anchored retail centers are anchored by one of the top three market share grocers in the trade area, also providing insulation from store closings as grocers exit non-core markets.

Grocery sales moderated within our portfolio to a 2% growth rate over the prior year, compared to 4% and 4.7% in the previous two years. Overall retail sales, on a same store basis, for tenants reporting sales totaled approximately \$265 per square foot during 2002. Same store sales levels decreased 3.2% compared to 2001 levels after averaging annual increases of over 3% for the previous two years. With less than 2% of the Company's revenue tied directly to tenant sales, the financial impact in percentage rent of this moderation in tenant sales is minimal. Our retailers, however, continue to show confidence despite an uncertain economic environment. Over 470,000 square feet of retail leases expired in 2002, with 65% of these tenants renewing their leases. During 2002, retail spaces were relet at average rental rates 10% higher than expiring rents for the 420,000 square feet of same store shopping center lease rollovers. The quality of our tenants was demonstrated by historically low levels of delinquencies and defaults within our portfolio throughout 2002.

The Company continues to pursue selective development and acquisition opportunities. During the third quarter of 2002, we completed construction of the final phase of the 210,000 square foot Ashburn Village shopping center in

Same property operating income grew 6.6%

MESSAGE TO OUR SHAREHOLDERS

Loudoun County. This phase consists of 25,000 square feet of retail space and two pad sites. Leases have been signed for over 21,000 square feet of this new space. The entire Ashburn Village shopping center is 98% leased.

Also during the third quarter, the Company acquired a 109,625 square foot neighborhood retail center located within the Kentlands development in Gaithersburg, Maryland. The property is anchored by a 102,250 square foot Lowe's home improvement store and is part of Kentlands Square, a shopping center exceeding 350,000 square feet of retail space. The Kentlands Square property is contained within



Washington Square lobby

the 352 acre Kentlands development, home to approximately 5,000 residents, living in 1,500 units.

Looking forward, we remain committed to the value which we see embedded in the future of our convenience and necessity-oriented strip retail centers, located in well populated service areas. Retail leases totaling 345,000 square feet, or 6.8% of our retail portfolio have expiration dates in 2003. Tenants leasing approximately 50% of these current year expirations have already renewed and extended their lease terms as of March 1, 2003.

Office Performance

The office/industrial component of the Saul Centers' 2002 property financial results comprised 32% of total property operating income. The Avenel Business Park and 601 Pennsylvania Avenue, together produced 65% of office operating income. The 388,000 square foot Avenel Business Park in Gaithersburg, Maryland was 98% leased at year end and continues to attract new businesses centered around life science and biomedical research. New tenants, leasing 38,000 square feet, joined the park in 2002 at rental rates averaging 17% higher than expiring rents.



Washington Square

During 2002, the Company nearly completed the leasing of its most significant development property, Washington Square. This development is a 235,000 square foot Class A mixed-use office/retail complex on North Washington Street in historic Old Town Alexandria, Virginia. Leases have been signed on 90% of the space.

Our premier high-rise office building is 601 Pennsylvania Avenue, located in the East End submarket of Washington, DC. Washington continues to remain one of the healthiest office submarkets in the country, with downtown vacancy rates, including sublet space, of 6.5% at year end. The market has continued to prove its resilience and stability during economic downturns. The year end 2002 expiration of

Washington remains one of the healthiest office markets in the U.S.

MESSAGE TO OUR SHAREHOLDERS

the Federal Trade Commission's 130,000 square foot lease at 601 Pennsylvania Avenue is the building's only expiring lease through year end 2003. The National Gallery of Art has just occupied and begun paying rent on 36,000 square feet of this space, while leases have also been signed for an additional 20,000 square feet. A significant portion of the remaining 74,000 square feet is under negotiation. While rental income will not be received until the second half of 2003 or later for the remaining unleased space, the steady leasing pace is reflective of the prime location and quality of this asset.

Including the 130,000 square feet of 601 Pennsylvania Avenue space, 206,000 square feet of office leases, or 17% of the total office portfolio, are scheduled to expire in 2003. A total of over 30% of this space has been leased as of March 1, 2003.

Capital Structure

This past year of heightened anxiety in the economy and the capital markets has resulted in a very favorable refinancing market due to the continuation of historically low long term interest rates. In January 2003, the Company completed a new \$42.5 million permanent financing of its Washington Square development. Proceeds from the new loan were used to repay the project's construction financing. The new loan matures in 15 years and has a very attractive 6.01% interest rate. With this new financing, Saul Centers' outstanding debt now totals \$382 million, with 88% of this debt

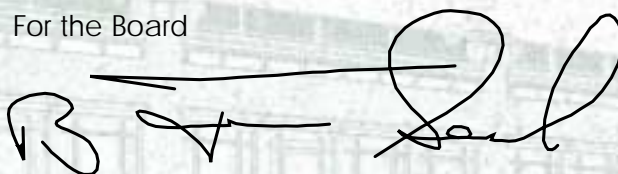
being fixed rate with an average 10-year life and weighted average 7.6% interest rate. Only \$17 million of this fixed rate debt matures prior to 2011.

During the summer of 2002, the Company renewed and expanded its revolving credit line. We closed a new \$125 million unsecured credit line to provide the Company working capital and funds for redevelopment and acquisitions. The line has a three-year term and working capital availability is currently \$34 million. An additional \$45 million is available for funding operating property acquisitions. Currently, commercial investment property is expensively priced, thus limiting the availability of economically attractive operating property acquisitions; however, we continue to pursue opportunities as they arise.

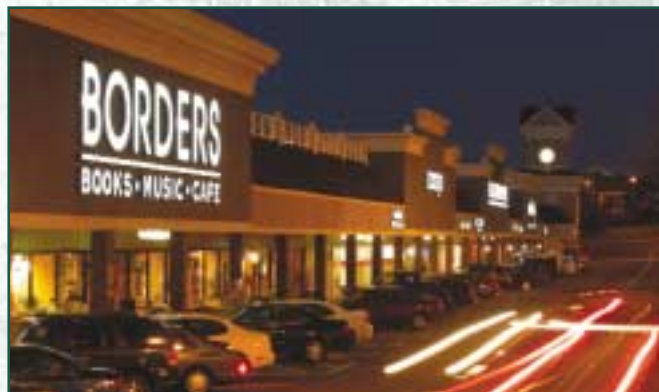
Outlook for 2003

In these times of uncertainty in the stock market, many investors have turned to real estate during the past few years to stabilize volatile portfolios with dividend paying REITs. With continued pressure on corporate earnings, lack of robust job growth and an uncertain economic recovery timeline, further improvement in real estate fundamentals remains in question. However, we remain confident in the long term cash flow growth potential of our portfolio and remain enthusiastically committed to our future development and redevelopment program. During the coming year, we look forward to building on our successes of 2002 and reacting to the continuing challenges of the retail and office marketplaces in order to create additional value for our shareholders.

For the Board



B. Francis Saul II
March 5, 2003



Thruway

A confident outlook for long-term growth

PORTFOLIO PROPERTIES



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.

SHOPPING CENTERS	Location of Property	Gross Leasable Square Feet
Ashburn Village I, II & III	Ashburn, VA	185,537
Ashburn Village IV	Ashburn, VA	25,200
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	244,724
Germantown	Germantown, MD	26,241
Giant	Baltimore, MD	70,040
The Glen	Lake Ridge, VA	112,639
Great Eastern	District Heights, MD	255,398
Hampshire Langley	Langley Park, MD	131,700
Kentlands Square	Gaithersburg, MD	109,922
Leesburg Pike	Baileys Crossroads, VA	97,880
Lexington Mall	Lexington, KY	315,719
Lumberton	Lumberton, NJ	192,510
Olney	Olney, MD	53,765
Ravenwood	Baltimore, MD	87,350
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	341,891
South Dekalb Plaza	Atlanta, GA	162,793
Thruway	Winston-Salem, NC	344,960
Village Center	Centreville, VA	143,100
West Park	Oklahoma City, OK	76,610
White Oak	Silver Spring, MD	480,156
SHOPPING CENTERS TOTAL		5,069,505

OFFICE PROPERTIES

Avenel Business Park	Gaithersburg, MD	388,620
Crosstown Business Center	Tulsa, OK	197,135
601 Pennsylvania Ave.	Washington, DC	225,414
Van Ness Square	Washington, DC	156,493
Washington Square	Alexandria, VA	234,775
OFFICE PROPERTIES TOTAL		1,202,437

TOTAL PORTFOLIO PROPERTIES	6,271,942
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The Company has purchased 24 acres of vacant land which is being developed as Broadlands Village, 19 acres of vacant land in the Lansdowne community in Loudoun County, Virginia and a 1.25 acre site in the Clarendon area of Arlington, Virginia, as future development and redevelopment properties.

REPORT OF INDEPENDENT AUDITORS

Board of Directors and Stockholders Saul Centers, Inc.

We have audited the accompanying consolidated balance sheet of Saul Centers, Inc. as of December 31, 2002, and the related consolidated statements of operations, stockholders' equity (deficit), and cash flows for the year 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 audit. The financial statements of Saul Centers, Inc. as of December 31, 2001 and for the years ended December 31, 2001 and 2000, were audited by other auditors who have ceased operations and whose report dated February 13, 2002, expressed an unqualified opinion on those statements.

We conducted our audit 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 audit provides a reasonable basis for our opinion.

In our opinion, the 2002 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Saul Centers, Inc. at December 31, 2002, and the consolidated results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States.

Ernst & Young LLP
McLean, Virginia
February 7, 2003

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

Board of Directors and Stockholders 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.

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

Note: As permitted by Rule 2-02(e) of Regulation S-X promulgated under the Securities Act of 1933, this is a copy of the audit report previously issued by Arthur Andersen LLP in connection with the filing of our Form 10-K for the fiscal year ended December 31, 2001. After reasonable efforts, we have been unable to have Arthur Andersen LLP reissue this audit report in connection with the filing of our Form 10-K for the fiscal year ended December 31, 2002.

CONSOLIDATED BALANCE SHEETS

SAUL CENTERS, INC.

	December 31,	
<i>(Dollars in thousands)</i>	2002	2001
Assets		
Real estate investments		
Land	\$ 90,469	\$ 67,710
Buildings and equipment	405,153	384,575
Construction in progress	8,292	2,524
	<u>503,914</u>	<u>454,809</u>
Accumulated depreciation	(150,286)	(136,928)
	<u>353,628</u>	<u>317,881</u>
Cash and cash equivalents	1,309	1,805
Accounts receivable and accrued income, net	12,505	9,217
Prepaid expenses	15,712	12,514
Deferred debt costs, net	4,125	3,563
Other assets	1,408	1,423
Total assets	<u><u>\$ 388,687</u></u>	<u><u>\$ 346,403</u></u>
Liabilities		
Notes payable	\$ 380,743	\$ 351,820
Accounts payable, accrued expenses and other liabilities	16,727	14,697
Deferred income	4,484	4,009
Total liabilities	<u>401,954</u>	<u>370,526</u>
Minority interests	<u>--</u>	<u>--</u>
Stockholders' equity (deficit)		
Common stock, \$0.01 par value, 30,000,000 shares authorized, 15,196,582 and 14,535,803 shares issued and outstanding, respectively	152	145
Additional paid-in capital	79,131	64,564
Accumulated deficit	(92,550)	(88,832)
Total stockholders' equity (deficit)	<u>(13,267)</u>	<u>(24,123)</u>
Total liabilities and stockholders' equity (deficit)	<u><u>\$ 388,687</u></u>	<u><u>\$ 346,403</u></u>

The accompanying notes are an integral part of these statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

SAUL CENTERS, INC.

*(Dollars in thousands,
except per share amounts)*

For the Year Ended December 31,

	2002	2001	2000
Revenue			
Base rent	\$ 75,699	\$ 69,662	\$ 63,837
Expense recoveries	12,680	11,456	11,129
Percentage rent	1,850	2,113	2,097
Other	3,734	3,077	1,966
Total revenue	<u>93,963</u>	<u>86,308</u>	<u>79,029</u>
Operating expenses			
Property operating expenses	10,115	8,503	8,271
Provision for credit losses	421	617	467
Real estate taxes	8,021	7,226	6,451
Interest expense	25,113	24,920	23,843
Amortization of deferred debt expense	725	566	458
Depreciation and amortization	17,821	14,758	13,534
General and administrative	5,537	4,335	3,891
Total operating expenses	<u>67,753</u>	<u>60,925</u>	<u>56,915</u>
Operating income	26,210	25,383	22,114
Non-operating item			
Gain on sale of property	1,426	--	--
Income before minority interests	<u>27,636</u>	<u>25,383</u>	<u>22,114</u>
Minority interests			
Minority share of income	(7,130)	(6,777)	(6,081)
Distributions in excess of earnings	(940)	(1,292)	(1,988)
Total minority interests	<u>(8,070)</u>	<u>(8,069)</u>	<u>(8,069)</u>
Net income	<u>\$ 19,566</u>	<u>\$ 17,314</u>	<u>\$ 14,045</u>
Per Share Amounts			
Net income (basic)	\$ 1.32	\$ 1.22	\$ 1.03
Net income (diluted)	<u>\$ 1.31</u>	<u>\$ 1.22</u>	<u>\$ 1.03</u>

The accompanying notes are an integral part of these statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)

SAUL CENTERS, INC.

<i>(Dollars in thousands, except per share amounts)</i>	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Total
Stockholders' equity (deficit)				
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	145	64,564	(88,832)	(24,123)
Issuance of 660,779 shares of common stock	7	14,567	--	14,574
Net income	--	--	19,566	19,566
Distributions (\$1.17 per share)	--	--	(17,360)	(17,360)
Distributions payable (\$.39 per share)	--	--	(5,924)	(5,924)
Balance, December 31, 2002	<u>\$ 152</u>	<u>\$ 79,131</u>	<u>\$ (92,550)</u>	<u>\$ (13,267)</u>

The accompanying notes are an integral part of these statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

SAUL CENTERS, INC.

<i>(Dollars in thousands)</i>	For the Year Ended December 31,		
	2002	2001	2000
Cash flows from operating activities			
Net income	\$ 19,566	\$ 17,314	\$ 14,045
Adjustments to reconcile net income to net cash provided by operating activities:			
Minority interests	8,070	8,069	8,069
Gain on sale of property	(1,426)	--	--
Depreciation and amortization	18,546	15,324	13,992
Provision for credit losses	421	617	467
Increase in accounts receivable	(2,283)	(823)	(1,284)
Increase in prepaid expenses	(7,661)	(5,568)	(3,152)
Decrease (increase) in other assets	15	347	(252)
Increase (decrease) in accounts payable, accrued expenses and other liabilities	1,776	(4,895)	1,201
Increase (decrease) in deferred income	475	1,449	(305)
Net cash provided by operating activities	<u>37,499</u>	<u>31,834</u>	<u>32,781</u>
Cash flows from investing activities			
Acquisitions of real estate investments	(28,871)	--	--
Additions to real estate investments	(14,466)	(13,055)	(18,233)
Additions to construction in progress	(5,768)	(8,745)	(25,193)
Net cash used in investing activities	<u>(49,105)</u>	<u>(21,800)</u>	<u>(43,426)</u>
Cash flows from financing activities			
Proceeds from notes payable	53,547	51,218	69,700
Repayments on notes payable	(24,624)	(42,851)	(36,515)
Additions to deferred debt expense	(1,287)	(17)	(315)
Proceeds from the issuance of common stock and convertible limited partnership units in the Operating Partnership	14,574	11,976	7,984
Distributions to common stockholders and holders of convertible limited partnership units in the Operating Partnership	(31,100)	(30,327)	(29,394)
Net cash provided by (used in) financing activities	<u>11,110</u>	<u>(10,001)</u>	<u>11,460</u>
Net (decrease) increase in cash and cash equivalents	(496)	33	815
Cash and cash equivalents, beginning of year	1,805	1,772	957
Cash and cash equivalents, end of year	<u>\$ 1,309</u>	<u>\$ 1,805</u>	<u>\$ 1,772</u>
Supplemental disclosures of cash flow information			
Cash paid for interest, net of amount capitalized	\$ 25,089	\$ 24,419	\$ 23,456

The accompanying notes are an integral part of these statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION, FORMATION, AND BASIS OF PRESENTATION

Organization

Saul Centers, Inc. ("Saul Centers") was incorporated under the Maryland General Corporation Law on June 10, 1993. Saul Centers operates as a real estate investment trust (a "REIT") under the Internal Revenue Code of 1986, as amended (the "Code"). Saul Centers generally will not be subject to federal income tax, provided it annually distributes at least 90% of its REIT taxable income to its stockholders and meets certain organizational and other requirements. Saul Centers has made and intends to continue to make regular quarterly distributions to its stockholders. Saul Centers, together with its wholly owned subsidiaries and the limited partnerships of which Saul Centers or one of its subsidiaries is the sole general partner, are referred to collectively as the "Company". B. Francis Saul II serves as Chairman of the Board of Directors and Chief Executive Officer of Saul Centers.

Formation and Structure of Company

Saul Centers was formed to continue and expand the shopping center business previously owned and conducted by the B.F. Saul Real Estate Investment Trust, the B.F. Saul Company, 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", and collectively with the Operating Partnership, the "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 Broadlands Village, a grocery anchored shopping center in Loudoun County. The Company recently completed development of Ashburn Village III and IV, in-line retail and retail pad expansions to the Ashburn Village shopping center; Washington Square at Old Town, a Class A mixed-use office/retail complex in Alexandria, Virginia; and Crosstown Business Center, an office/warehouse redevelopment located in Tulsa, Oklahoma. In June 2002 the Company purchased Clarendon Center for future redevelopment. In September 2002, the Company purchased 109,642 square feet of retail space known as Kentlands Square. In November 2002 the Company purchased a 19 acre parcel of land in the Lansdowne community in Loudoun County, Virginia. The Company plans to develop

the Lansdowne parcel into a grocery anchored neighborhood and community shopping center. As of December 31, 2002, the Company's properties (the "Current Portfolio Properties") consisted of 29 operating shopping center properties (the "Shopping Centers"), five predominantly office operating properties (the "Office Properties") and three development and/or redevelopment properties.

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

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, 2002, no single property accounted for more than 8.9% of the total gross leasable area. Only one retail tenant, Giant Food, at 5.7%, accounted

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

for more than 1.9% of the Company's 2002 total revenues. No office tenant other than the United States Government, at 8.4%, accounted for more than 1.4% of 2002 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 accumulated 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. Saul Centers adopted 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 Company has not recognized an impairment loss in 2002, 2001 or 2000 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 \$3,852,000, \$2,913,000 and \$3,144,000, for 2002, 2001 and 2000, respectively, and is included in operating expenses in the accompanying consolidated financial statements. Interest expense capitalized totaled \$548,000, \$1,640,000 and \$2,681,000, for 2002, 2001 and 2000, respectively.

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

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 are included in prepaid expenses and total \$12,140,000 and \$10,419,000, net of accumulated amortization of \$5,259,000 and \$4,465,000, as of December 31, 2002 and 2001, respectively. Capitalized leasing costs consist of commissions paid to third party leasing agents as well as internal direct costs such as employee compensation and payroll related fringe benefits directly related to time spent performing 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 transactions.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Construction in Progress

Construction in progress includes the land acquisition costs, predevelopment costs, and development costs of active projects. Predevelopment costs associated with these active projects include closing costs, legal, zoning and permitting costs and other project carrying costs incurred prior to the commencement of construction. Development costs include direct construction costs and indirect costs incurred subsequent to the start of construction such as architectural, engineering, construction management and carrying costs consisting of interest, real estate taxes and insurance. Construction in progress balances as of December 31, 2002 and 2001 are as follows:

Construction in Progress

(In thousands)

	December 31, 2002	2001
Broadlands Village	\$ 6,192	\$ --
Ashburn Village IV	--	1,163
Other	2,100	1,361
Balance	<u>\$ 8,292</u>	<u>\$ 2,524</u>

Accounts Receivable and Accrued Income

Accounts receivable primarily represent amounts currently due from tenants in accordance with the terms of the respective leases. Receivables are reviewed monthly and reserves are established with a charge to current period operations when, in the opinion of management, collection of the receivable is doubtful. Accounts receivable in the accompanying consolidated financial statements are shown net of an allowance for doubtful accounts of \$681,000 and \$559,000, at December 31, 2002 and 2001, respectively.

Allowance for Doubtful Accounts

(In thousands)

	For the Years Ended December 31, 2002	2001
Beginning Balance	\$ 559	\$ 563
Provision for Credit Losses	421	617
Charge-offs	(299)	(621)
Ending Balance	<u>\$ 681</u>	<u>\$ 559</u>

In addition to rents due currently, accounts receivable include \$6,262,000 and \$4,675,000, at December 31, 2002 and 2001, respectively, representing minimum rental income accrued on a straight-line basis to be paid by tenants over the remaining term of their respective leases. These amounts are presented after netting allowances of \$693,000 and \$676,000, respectively, for tenants whose rent payment history or financial condition casts doubt upon the tenant's ability to perform under its lease obligations.

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 totaled \$4,125,000 and \$3,563,000, and are presented net of accumulated amortization of \$2,693,000 and \$1,968,000, at December 31, 2002 and 2001, 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 the lease agreement and advance 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, 2002 and 2001, the total tax basis of the Company's assets was \$410,497,000 and \$377,704,000, and the tax basis of the liabilities was \$392,157,000 and \$362,464,000, 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, 2002, 170,000 shares were authorized and registered for use under the Plan, and 130,000 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

In November 2002, the Financial Accounting Standards Board ("FASB") issued Interpretation No. ("FIN") 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Direct Guarantees of Indebtedness of Others." FIN 45 outlines the disclosures to be made by a guarantor in its financial statements about its obligations under

certain guarantees. It states that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of its obligation. Saul Centers has guaranteed portions of its Partnership debt obligations, all of which are presented on the consolidated financial statements as mortgage notes payable. Saul Centers has guaranteed \$95,921,000 of the notes payable which are recourse loans made by the Operating Partnership as of December 31, 2002. The balance of the mortgage notes payable totaling \$284,822,000 are non-recourse, however, as is customary when obtaining long term non-recourse financing, Saul Centers has agreed to assume certain obligations should they arise specific to individual mortgages. No additional liabilities must be recognized as a result of the adoption of FIN 45 and the Company does not expect the adoption of FIN 45 to have a material impact on its financial condition or results of operations.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure," which amended SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 148 outlines alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. The Company has not made a voluntary change to the fair value based method. As a result, the adoption of SFAS No. 148 will not have an impact upon the consolidated financial statements.

In January 2003, the FASB issued FIN 46, "Consolidation of Variable Interest Entities," which changes the guidelines for consolidation of and disclosure related to unconsolidated entities, if those unconsolidated entities qualify as variable interest entities, as defined in FIN 46. The Company does not have any unconsolidated entities or variable interest entities and therefore the adoption of FIN 46 will not have an impact upon the consolidated 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Per Share Data

Per share data is calculated in accordance with SFAS No. 128, "Earnings Per Share." Per share data for net income (basic and diluted) is computed using weighted average shares of common stock. Convertible limited partnership units and employee stock options are the Company's potentially dilutive securities. For all periods presented, the convertible limited partnership units are anti-dilutive. The options are currently dilutive because the average share price of the Company's common stock exceeds the \$20.00 exercise price. The options were not dilutive during years previous to 2002. Five executive officers have been granted 180,000 stock options, 93,210 shares which remain unexercised as of December 31, 2002. The treasury share method was used to measure the effect of the dilution.

Basic and Diluted Shares Outstanding

(In thousands)

	December 31,		
	2002	2001	2000
Weighted average common shares outstanding – Basic	14,865	14,210	13,623
Effect of dilutive options	22	--	--
Weighted average common shares outstanding – Diluted	<u>14,887</u>	<u>14,210</u>	<u>13,623</u>
Average Share Price	\$ 22.90	*	*

* The option exercise price exceeded the average share price for these periods.

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

The Saul Organization has a 25.4% limited partnership interest, represented by 5,175,000 convertible limited partnership units, in the Operating Partnership, as of December 31, 2002. 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 beneficially owns, directly or indirectly, in the aggregate more than 24.9% of the outstanding equity securities of Saul Centers. The limited partnership units were not convertible as of December 31, 2002 because the Saul Organization owned in excess of 24.9% of the Company's equity securities. The impact of The Saul Organization's 25.4% limited partnership interest in the Operating Partnership is reflected as minority interests in the accompanying consolidated financial statements. Fully converted partnership units and diluted weighted average shares outstanding for the years ended December 31, 2002, 2001 and 2000, were 20,059,000, 19,383,000 and 18,796,000, respectively.

4. NOTES PAYABLE

During 2002 the Company closed a new \$125 million unsecured revolving credit facility to provide working capital and funds for redevelopments and acquisitions. The line has a three-year term and provides for an additional one-year extension at the Company's option. The new line is a \$55 million expansion of a prior revolver. The additional availability under the new facility will enable the Company to access capital for future purchases of operating properties as opportunities arise. At December 31, 2002, \$46,750,000 was outstanding under the line, with interest calculated using LIBOR plus 1.625%. Loan availability is determined by operating income from the Company's unencumbered properties, which as of December 31, 2002, allowed the Company to borrow an additional \$30,250,000 for general corporate use. An additional \$48 million is available for funding working capital and operating property acquisitions supported by the unencumbered properties' internal cash flow growth and operating income of future acquisitions. Also during 2002, the Company committed to replace its \$42,000,000 construction loan used to finance the building of Washington Square at Old Town with a \$42,500,000 permanent mortgage. The new permanent financing closed in January 2003, matures in 15 years and requires monthly principal and interest payments based upon a 27.5 year amortization period and 6.01% interest rate. In September 2002, the Company assumed a \$7,806,000 mortgage in conjunction with its acquisition of Kentlands Square shopping center. The following is a summary of notes payable as of December 31, 2002 and 2001:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Notes Payable

<i>(Dollars in thousands)</i>	Principal Outstanding December 31,		Interest	Scheduled
	2002	2001	Rate *	Maturity *
Fixed Rate Mortgages:	\$ 135,641 (a)	\$ 138,215	7.67 %	Oct 2012
	93,044 (b)	95,716	8.23 %	Dec 2011
	34,830 (c)	35,583	7.88 %	Jan 2013
	13,667 (d)	13,936	8.33 %	June 2015
	9,797 (e)	10,028	6.88 %	May 2004
	7,640 (f)	--	8.18 %	Feb 2004
Total Fixed Rate	294,619	293,478	7.89 %	9.2 Years
Variable Rate Loans:				
Construction Loan	39,374 (g)	38,342	2.89 %	Jan 2003
Line of Credit	46,750 (h)	20,000	3.09 %	Aug 2005
Total Variable Rate	86,124	58,342	3.00 %	1.5 Years
Total Notes Payable	\$ 380,743	\$ 351,820	6.78 %	7.4 Years

* Interest rate and scheduled maturity data presented as of December 31, 2002. Totals computed using weighted averages.

- (a) The loan is collateralized by nine shopping centers (Seven Corners, Thruway, White Oak, Hampshire Langley, Great Eastern, Southside Plaza, Belvedere, Giant and Ravenwood) and requires monthly principal and interest payments based upon a 25 year amortization schedule. Principal of \$2,574,000 was amortized during 2002.
- (b) The loan is collateralized by Avenel Business Park, Van Ness Square, Ashburn Village, Leesburg Pike, Lumberton Plaza and Village Center. The loan has been increased on three occasions since its inception in 1997. The 8.23% blended interest rate is the weighted average of the initial loan rate and additional borrowing rates. Monthly principal and interest payments are based upon a weighted average 23 year amortization schedule. Principal of \$2,672,000 was amortized during 2002.
- (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 \$753,000 was amortized during 2002.
- (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 \$269,000 was amortized during 2002.
- (e) The loan is collateralized by The Glen shopping center and a corporate guarantee. The loan requires monthly principal and interest payments based upon a 23 year amortization schedule. Principal of \$231,000 was amortized during 2002.
- (f) The loan is collateralized by Kentlands Square shopping center and requires monthly principal and interest payments based upon a 15 year amortization schedule. Principal of \$166,000 was amortized during 2002.
- (g) 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 repaid on January 9, 2003. The interest rate in effect on December 31, 2002 was based on a weighted average LIBOR of 1.44% and spread of 1.45%. The effective annual average interest rate, which considers debt cost amortization, was 3.69% for 2002.
- (h) The loan is an unsecured revolving credit facility totaling \$125,000,000. Loan availability is determined by operating income from the Company's unencumbered properties. An additional amount is available for funding qualified operating property acquisitions. 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, 2002 was based on a weighted average LIBOR of 1.391% and spread of 1.625% and a prime rate of 4.25%. The effective annual average interest rate, which considers debt cost amortization and unused line fees, was 4.84% for 2002.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The December 31, 2002 and 2001, depreciation adjusted cost of properties collateralizing the mortgage notes payable totaled \$280,051,000 and \$264,831,000, respectively. Certain loans are subject to financial covenant tests, the most significant of which are debt service coverage and loan to asset value requirements under the variable rate loans. The Company believes it is in compliance with all such covenants. Notes payable at December 31, 2002 and 2001, totaling \$266,392,000 and \$242,168,000, respectively, are guaranteed by members of The Saul Organization.

As of December 31, 2002, the scheduled maturities of all debt including scheduled principal amortization, for years ended December 31, are as follows:

Debt Maturity Schedule

(In thousands)

2003*	\$ 46,940
2004	23,988
2005	54,720
2006	8,635
2007	9,357
Thereafter	237,103
Total	<u>\$ 380,743</u>

* A total of \$39,374 of the 2003 maturities was refinanced in January 2003.

5. LEASE AGREEMENTS

Lease income includes primarily base rent arising from noncancelable commercial leases. Base rent for the years ended December 31, 2002, 2001 and 2000, amounted to \$75,699,000, \$69,662,000 and \$63,837,000, respectively. Future contractual payments under noncancelable leases for years ended December 31, is as follows:

Future Contractual Payments

(In thousands)

2003	\$ 70,701
2004	64,776
2005	58,094
2006	51,148
2007	44,966
Thereafter	244,364
Total	<u>\$ 534,049</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, 2002, 2001 and 2000 amounted to \$12,680,000, \$11,456,000 and \$11,129,000, 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 \$1,850,000, \$2,113,000 and \$2,097,000, for the years ended December 31, 2002, 2001 and 2000, 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 \$164,000, \$167,000 and \$157,000, for each of the years ended December 31, 2002, 2001 and 2000, respectively. The future minimum rental commitments under these ground leases are as follows:

Ground Lease Rental Commitments

(In thousands)

	Annually 2003-2007	Total Thereafter
Beacon Center	\$ 53	\$ 3,236
Olney	51	4,423
Southdale	60	3,605
Total	<u>\$ 164</u>	<u>\$11,264</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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.

The Company's corporate headquarters lease commenced in March 2002. The 10-year lease provides for an initial annual rental payment of \$513,000, escalated at 3% per year, with payment of a pro-rata share of operating expenses over a base year amount. Reflected in the accompanying financial statements is straight-lined rental expense of \$549,000 for the year ended December 31, 2002. The future minimum rental commitments under this lease are \$653,000 annually for the five years from 2003 through 2007, and \$2,722,000 thereafter. This lease expense is included in the shared services portion of general and administrative expense (see Note 8- Related Party Transactions).

7. STOCKHOLDERS' EQUITY AND MINORITY INTERESTS

The consolidated statement of operations for the year ended December 31, 2002 includes a charge for minority interests of \$8,070,000, consisting of \$7,130,000 related to The Saul Organization's share of the net income for the year and \$940,000 related to distributions to minority interests in excess of allocated net income for the year. The charge for the year ended December 31, 2001 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.

8. RELATED PARTY TRANSACTIONS

In October 2000, the Company purchased, through its Operating Partnership, 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, the Company purchased a land parcel of 7.11 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, based on an independent third party appraisal. The land was 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 \$1,368,000, \$1,330,000 and \$1,223,000, for the years ended December 31, 2002, 2001 and 2000, respectively.

An entity controlled by the son of Philip D. Caraci, the Company's President and director until March 2003 and current Vice Chairman, leased space in four of the Company's Shopping Centers during 2002. The total rental income was \$143,000 during the year ended December 31, 2002. The leases were assigned to unaffiliated third parties during the year and no further rental income will be received under these leases from the affiliated party during 2003. Additionally, a \$37,000 leasing commission payment was made to this affiliated party for procurement of a third party tenant lease at one of the Company's Shopping Centers.

The Chairman and Chief Executive Officer, the Vice Chairman, the President, and the Chief Accounting Officer of the Company are also affiliated with The Saul Organization but devote a substantial amount of time to the management of the Company. Their annual compensation is fixed by the Compensation Committee of the Board of Directors.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company shares with The Saul Organization on a pro-rata basis certain ancillary functions such as computer hardware, software and support services and certain direct and indirect administrative payroll based on management's estimate of usage or time incurred, as applicable. Also, The Saul Organization subleases office space to the Company for its corporate headquarters (see Note 6— Long-Term Lease Obligations for the terms of this lease). The terms of all such arrangements with The Saul Organization, including payments related thereto, are reviewed by the Audit Committee of the Board of Directors. Included in general and administrative expense for the years ended December 31, 2002, 2001 and 2000, are charges totaling \$2,574,000, \$1,971,000 and \$2,091,000, related to shared services, of which \$2,542,000, \$2,010,000 and \$2,056,000, were paid during the years ended December 31, 2002, 2001 and 2000, 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, all of which options were granted in 1993 and 1994. 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. During the year ended December 31, 2002, 86,790 options were exercised (49,900 incentive stock options and 36,890 nonqualified stock options). The remaining 93,210 unexercised option shares are fully vested and expire September 23, 2003. 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 \$1,426,000 in 2002 represents the final proceeds received upon appeal of 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 and 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 its 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, the fair value of the fixed rate notes payable is in excess of the \$294,619,000 carrying value. Management estimates that the fair value of these fixed rate notes payable, assuming current long term interest rates of approximately 6%, would be approximately \$329,000,000.

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 commissions, service charges or other expenses. All expenses of the Plan are paid by the Company. The Operating Partnership also maintains a similar dividend reinvestment plan that mirrors the Plan, which allows limited partnership interests the opportunity to buy additional limited partnership units.

During 2002, \$1.46 per share of the distributions paid represented ordinary dividend income and \$0.10 per share represented return of capital to the shareholders. The following summarizes distributions paid during the years ended December 31, 2002, 2001 and 2000, and includes activity in the Plan as well as limited partnership units issued from the reinvestment of unit distributions:

<i>(in thousands)</i>	Total Distributions to		Dividend Reinvestments		Discounted Share Price
	Common Stockholders	Limited Partnership Unitholders	Common Stock Issued	Units Issued	
Distributions during 2002					
October 31	\$ 5,839	\$ 2,019	136,107	3,110	\$ 23.18
July 31	5,785	2,017	135,603	--	22.94
April 30	5,736	2,017	119,772	--	22.94
January 31	5,670	2,017	165,390	--	20.39
	<u>\$ 23,030</u>	<u>\$ 8,070</u>	<u>556,872</u>	<u>3,110</u>	
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>	

In December 2002, 2001 and 2000, the Board of Directors of the Company authorized a distribution of \$0.39 per share payable in January 2003, 2002 and 2001, to holders of record on January 17, 2003, January 17, 2002 and January 15, 2001, respectively. As a result, \$5,924,000, \$5,670,000 and \$5,410,000, were paid to common shareholders on January 31, 2003, January 31, 2002 and January 31, 2001, respectively. Also, \$2,018,000, \$2,017,000 and \$2,017,000, were paid to limited partnership unitholders on January 31, 2003, January 31, 2002 and January 31, 2001 (\$0.39 per Operating Partnership unit), respectively. These amounts are reflected as a reduction of stockholders' equity in the case of common stock dividends and minority interests deductions in the case of limited partner distributions and are included in accounts payable in the accompanying consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

14. INTERIM RESULTS (UNAUDITED)

The following summary presents the results of operations of the Company for the quarterly periods of years 2002, 2001 and 2000.

(In thousands, except per share amounts)

	2002 Calendar Year			
	<u>1st Quarter</u>	<u>2nd Quarter</u>	<u>3rd Quarter</u>	<u>4th Quarter</u>
Revenues	\$ 23,191	\$ 22,793	\$ 23,471	\$ 24,508
Income before minority interests	8,352 (a)	6,499	5,503	7,282
Minority interests	(2,017)	(2,017)	(2,017)	(2,019)
Net income	<u>\$ 6,335</u>	<u>\$ 4,482</u>	<u>\$ 3,486</u>	<u>\$ 5,263</u>
Net income per share (basic & diluted)	<u>\$ 0.43</u>	<u>\$ 0.30</u>	<u>\$ 0.24</u>	<u>\$ 0.35</u>

(a) Includes \$1,426 gain on sale of Park Road property.

	2001 Calendar Year			
	<u>1st Quarter</u>	<u>2nd Quarter</u>	<u>3rd Quarter</u>	<u>4th Quarter</u>
Revenues	\$ 21,236	\$ 20,919	\$ 21,533	\$ 22,620
Income before minority interests	6,051	5,924	6,289	7,119
Minority interests	(2,017)	(2,017)	(2,017)	(2,018)
Net income	<u>\$ 4,034</u>	<u>\$ 3,907</u>	<u>\$ 4,272</u>	<u>\$ 5,101</u>
Net income per share (basic & diluted)	<u>\$ 0.29</u>	<u>\$ 0.28</u>	<u>\$ 0.30</u>	<u>\$ 0.35</u>

	2000 Calendar Year			
	<u>1st Quarter</u>	<u>2nd Quarter</u>	<u>3rd Quarter</u>	<u>4th Quarter</u>
Revenues	\$ 19,407	\$ 18,988	\$ 19,724	\$ 20,910
Income before minority interests	5,533	5,183	5,859	5,539
Minority interests	(2,017)	(2,017)	(2,017)	(2,018)
Net income	<u>\$ 3,516</u>	<u>\$ 3,166</u>	<u>\$ 3,842</u>	<u>\$ 3,521</u>
Net income per share (basic & diluted)	<u>\$ 0.26</u>	<u>\$ 0.24</u>	<u>\$ 0.28</u>	<u>\$ 0.25</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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.

(In thousands)

	Shopping Centers	Office Properties	Corporate and Other	Consolidated Totals
2002				
Real estate rental operations:				
Revenues	\$ 61,597	\$ 32,261	\$ 105	\$ 93,963
Expenses	(10,675)	(7,882)	--	(18,557)
Income from real estate	50,922	24,379	105	75,406
Interest expense & amortization of debt costs	--	--	(25,838)	(25,838)
General and administrative	--	--	(5,537)	(5,537)
Subtotal	50,922	24,379	(31,270)	44,031
Depreciation and amortization	(11,295)	(6,526)	--	(17,821)
Gain on property sale	1,426			1,426
Minority interests	--	--	(8,070)	(8,070)
Net income	<u>\$ 41,053</u>	<u>\$ 17,853</u>	<u>\$ (39,340)</u>	<u>\$ 19,566</u>
Capital investment	<u>\$ 31,769</u>	<u>\$ 17,336</u>	<u>\$ --</u>	<u>\$ 49,105</u>
Total assets	<u>\$ 215,692</u>	<u>\$ 135,836</u>	<u>\$ 37,159</u>	<u>\$ 388,687</u>
2001				
Real estate rental operations:				
Revenues	\$ 58,714	\$ 27,427	\$ 167	\$ 86,308
Expenses	(10,324)	(6,022)	--	(16,346)
Income from real estate	48,390	21,405	167	69,962
Interest expense & amortization of debt costs	--	--	(25,486)	(25,486)
General and administrative	--	--	(4,335)	(4,335)
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	(10,252)	(4,937)	--	(15,189)
Income from real estate	46,717	16,900	223	63,840
Interest expense & amortization of debt costs	--	--	(24,301)	(24,301)
General and administrative	--	--	(3,891)	(3,891)
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>

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General

The following discussion is based on the consolidated financial statements of the Company as of December 31, 2002 and for the year ended December 31, 2002. Prior year data is based on the Company's consolidated financial statements as of December 31, 2001 and 2000 and for the years ended December 31, 2001 and 2000.

Critical Accounting Policies

The Company's accounting policies are in conformity with accounting principles generally accepted 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 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 the financial statements. Below is a discussion of accounting policies which the Company considers 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 the Company considers significant, including further discussion of the critical accounting policies described below, can be found in the notes to the 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 GAAP, 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 consists 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 transactions.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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, the Company believes the final outcome of such matters will not have a material adverse effect on the 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 \$1,309,000 and \$1,805,000 at December 31, 2002 and 2001, respectively. The Company's principal demands for liquidity are expected to be distributions to its stockholders and unitholders, 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 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. 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, 2002 and 2001 was \$37,499,000 and \$31,834,000, respectively, and represents, in each year, cash received primarily from rental income, plus other income, less property operating expenses, normal recurring general and administrative expenses and interest payments on debt outstanding.

Investing Activities

Cash used in investing activities for the years ended December 31, 2002 and 2001 was \$49,105,000 and \$21,800,000, respectively, and primarily reflects the acquisition of properties (Broadlands Village and Lansdowne land parcels, Clarendon Center and Kentlands Square), tenant improvement activity, and construction in progress during those years.

Management anticipates that during the coming year the Company may: i) redevelop certain of the Current Portfolio Properties, 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 properties are expected to provide long-term earnings and cash flow growth. During the coming year, any developments, expansions or acquisitions are expected to be funded with 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Financing Activities

Cash provided by financing activities for the year ended December 31, 2002 was \$11,110,000 and cash used in financing activities for the year ended December 31, 2001 was \$10,001,000. Cash provided by financing activities for the year ended December 31, 2002 primarily reflects:

- \$53,547,000 of proceeds received from notes payable incurred during the year; and
- \$14,574,000 of proceeds received from the issuance of common stock under the dividend reinvestment program and from the exercise of stock options, and from the issuance of convertible limited partnership interests in the Operating Partnership;

which was partially offset by:

- the repayment of borrowings on our notes payable totaling \$24,624,000;
- distributions made to common stockholders and holders of convertible limited partnership units in the Operating Partnership during the year totaling \$31,100,000; and
- payments of \$1,287,000 for refinancing the Company's line of credit and extending the Washington Square construction loan.

Cash used in financing activities for the year ended December 31, 2001 primarily reflects:

- \$51,218,000 of proceeds received from notes payable incurred during the year; and
- \$11,976,000 of proceeds received from the issuance of common stock issued under dividend reinvestment program;

which was partially offset by:

- the repayment of borrowings on our notes payable totaling \$42,851,000; and
- distributions made to common stockholders and holders of convertible limited partnership units in the Operating Partnership during the year totaling \$30,327,000.

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, 2002, the scheduled maturities of all debt for years ended December 31, are as follows:

Debt Maturity Schedule

(In thousands)

2003*	\$	46,940
2004		23,988
2005		54,720
2006		8,635
2007		9,357
Thereafter		237,103
Total	\$	<u>380,743</u>

** A total of \$39,374 of the 2003 maturities was refinanced in January 2003.*

Management believes that the Company's capital resources, including approximately \$30,250,000 for general corporate use and \$45,000,000 for qualified future acquisitions provided by the Company's revolving line of credit, which was available for borrowing as of December 31, 2002, will be sufficient to meet its liquidity needs for the foreseeable future.

Dividend Reinvestments

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 556,872 and 645,423 shares under the Plan at a weighted average discounted price of \$22.24 and \$17.99 per share during the years ended December 31, 2002 and 2001, respectively.

Additionally, the Operating Partnership issued 3,110 limited partnership units under a dividend reinvestment plan mirroring the Plan at a weighted average discounted price of \$23.18 per unit during the year ended December 31, 2002.

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 fair market 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 fair market asset value. The following is a summary of notes payable as of December 31, 2002 and 2001:

<u>Notes Payable</u>				
<i>(Dollars in thousands)</i>	Principal Outstanding		Interest	Scheduled
	2002	2001	Rate *	Maturity *
Fixed Rate Mortgages:				
	\$ 135,641 (a)	\$ 138,215	7.67 %	Oct 2012
	93,044 (b)	95,716	8.23 %	Dec 2011
	34,830 (c)	35,583	7.88 %	Jan 2013
	13,667 (d)	13,936	8.33 %	June 2015
	9,797 (e)	10,028	6.88 %	May 2004
	7,640 (f)	--	8.18 %	Feb 2004
Total Fixed Rate	294,619	293,478	7.89 %	9.2 Years
Variable Rate Loans:				
Construction Loan	39,374 (g)	38,342	2.89 %	Jan 2003
Line of Credit	46,750 (h)	20,000	3.09 %	Aug 2005
Total Variable Rate	86,124	58,342	3.00 %	1.5 Years
Total Notes Payable	\$ 380,743	\$ 351,820	6.78 %	7.4 Years

**Interest rate and scheduled maturity data presented for December 31, 2002. Totals computed using weighted averages.*

- (a) The loan is collateralized by nine shopping centers (Seven Corners, Thruway, White Oak, Hampshire Langley, Great Eastern, Southside Plaza, Belvedere, Giant and Ravenwood) and requires monthly principal and interest payments based upon a 25 year amortization schedule. Principal of \$2,574,000 was amortized during 2002.
- (b) The loan is collateralized by Avenel Business Park, Van Ness Square, Ashburn Village, Leesburg Pike, Lumberton Plaza and Village Center. The loan has been increased on three occasions since its inception in 1997. 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 \$2,672,000 was amortized during 2002.
- (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 \$753,000 was amortized during 2002.
- (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 \$269,000 was amortized during 2002.
- (e) The loan is collateralized by The Glen shopping center and a corporate guarantee. The loan requires monthly principal and interest payments based upon a 23 year amortization schedule. Principal of \$231,000 was amortized during 2002.
- (f) The loan is collateralized by Kentlands Square shopping center and requires monthly principal and interest payments based upon a 15 year amortization schedule. Principal of \$166,000 was amortized during 2002.
- (g) 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 repaid on January 9, 2003. The interest rate in effect on December 31, 2002 was based on a weighted average LIBOR of 1.44% and spread of 1.45%. The effective annual average interest rate, which considers debt cost amortization, was 3.69% for 2002.
- (h) The loan is an unsecured revolving credit facility totaling \$125,000,000. Loan availability is determined by operating income from the Company's unencumbered properties. An additional amount is available for funding qualified operating property acquisitions. 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, 2002 was based on a weighted average LIBOR of 1.391% and spread of 1.625% and a prime rate of 4.25%. The effective annual average interest rate, which considers debt cost amortization and unused line fees, was 4.84% for 2002.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The December 31, 2002 and 2001, depreciation adjusted cost of properties collateralizing the mortgage notes payable totaled \$280,051,000 and \$264,831,000, respectively. Certain loans are subject to financial covenant tests, the most significant of which are debt service coverage and loan to asset value requirements under the variable rate loans. The Company believes it is in compliance with all such covenants. Notes payable at December 31, 2002 and 2001, totaling \$266,392,000 and \$242,168,000, respectively, are guaranteed by members of The Saul Organization. The Company's interest expense coverage ratio (calculated as operating income before interest expense, amortization of deferred debt expense and depreciation and amortization, divided by interest expense), increased to 2.78 during the past year, from 2.63 in 2001.

During 2002 the Company closed a new \$125 million unsecured revolving credit facility to provide working capital and funds for acquisitions. The line has a three-year term and provides for an additional one-year extension at the Company's option. The new line is a \$55 million expansion of a prior revolver. The additional availability under the new facility will

enable the Company to access capital for future purchases of operating properties as opportunities arise. As of December 31, 2002, \$46,750,000 was outstanding under the line, with interest calculated using LIBOR plus 1.625%. Loan availability is determined by operating income from the Company's unencumbered properties, which, as of December 31, 2002 allowed the Company to borrow an additional \$30,250,000 for general corporate use. An additional \$48 million is available for funding working capital and operating property acquisitions supported by the unencumbered properties' internal cash flow growth and operating income of future acquisitions. Also during 2002, the Company committed to replace its \$42,000,000 construction loan used to finance the building of Washington Square at Old Town with a \$42,500,000 permanent mortgage. The new permanent financing, closed in January 2003, matures in 15 years and requires monthly principal and interest payments based upon a 27.5 year amortization period and 6.01% interest rate. In September 2002, the Company assumed a \$7,806,000 mortgage in conjunction with its acquisition of Kentlands Square shopping center.

Funds From Operations

In 2002, the Company reported Funds From Operations (FFO) of \$44,031,000 on a fully converted basis, representing a 9.7% increase over 2001 FFO of \$40,141,000. The following table presents a reconciliation from income before minority interests to FFO:

<i>(In thousands)</i>	For the Years Ended December 31,				
	2002	2001	2000	1999	1998
Income before minority interests	\$ 27,636	\$ 25,383	\$ 22,114	\$ 21,220	\$ 16,369
Subtract: Gain on sale of property	(1,426)	-	-	(553)	--
Add:					
Cumulative effect of change in accounting method	--	--	--	--	771
Depreciation and amortization of real property	17,821	14,758	13,534	12,163	12,578
FFO ¹	<u>\$ 44,031</u>	<u>\$ 40,141</u>	<u>\$ 35,648</u>	<u>\$ 32,830</u>	<u>\$ 29,718</u>
Average Shares and Units Used to Compute FFO per Share	20,059	19,383	18,796	18,148	17,233

¹ FFO is a widely accepted non-GAAP financial measure of operating performance for REITs. FFO is presented on a fully converted basis, and is defined by the National Association of Real Estate Investment Trusts 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 GAAP 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Acquisitions, Redevelopments and Renovations

The Company has been selectively involved in acquisition, redevelopment and renovation activities. It continues to evaluate the acquisition of land parcels for retail and office development and acquisitions of operating properties for opportunities to enhance operating income and cash flow growth. The Company also continues to take advantage of redevelopment, renovation and expansion opportunities within the portfolio, as demonstrated by its recent activities at Washington Square and Ashburn Village.

In April 2002, the Company purchased 24 acres of undeveloped land in the Broadlands section of the Dulles Technology Corridor. The site is located adjacent to the Claiborne Parkway exit (Exit 5) of the Dulles Greenway, in Loudoun County, Virginia. The Dulles Greenway is the "gateway to Loudoun County," a 14-mile extension of the Dulles Toll Road, connecting Washington Dulles International Airport with historic Leesburg, Virginia. Broadlands is a 1,500 acre planned community consisting of 3,500 residences, approximately half of which are constructed and currently occupied. The land is zoned to accommodate approximately 225,000 square feet of neighborhood and community retail development. The Company has commenced the initial phase of construction totaling 112,000 square feet of retail space. Additionally, the Company has executed a grocery anchor lease with Safeway for a 59,000 square foot supermarket, and the first phase is 65% pre-leased.

In June 2002, the Company purchased Clarendon Center, located in Arlington, Virginia. Clarendon Center is a 1.25 acre site with an existing and primarily vacant 70,000 square foot office building with surface parking for 104 cars. It is located directly across the street from the Company's Clarendon and Clarendon Station properties. The Company is analyzing its options for a proposed redevelopment of the site.

In September 2002, the Company acquired a 109,625 square foot neighborhood retail center located within the Kentlands development in Gaithersburg, Maryland. The property, constructed in 1993, is anchored by a 102,250 square foot Lowe's home improvement store and is part of Kentlands Square, a shopping center exceeding

350,000 square feet of retail space. The Kentlands Square property is fully leased and includes an additional 6,000 square feet of retail development potential. The property was acquired for \$14.3 million, subject to the assumption of a \$7.8 million mortgage. The Kentlands Square shopping center is contained within the 352 acre Kentlands development, home to approximately 5,000 residents living in 1,500 units. The Kentlands community features a mix of upscale and colonial design townhouses, apartments, cottages and larger single family residences set along pedestrian friendly tree lined streets. Kentlands' neighborhoods include amenities such as green spaces, lakes and recreational, community and civic buildings.

In November 2002, the Company purchased approximately 19 acres of undeveloped land located within the Lansdowne community in Loudoun County, Virginia. The land is zoned to accommodate approximately 150,000 square feet of neighborhood and community retail development.

During 2002, 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 was completed in 2001 while the lease-up and build-out of the remaining office tenant areas occurred throughout 2002. As of February 21, 2003, 90% of the 235,000 square feet of tenant space was leased: the 46,000 square feet of street level retail space was 100% leased and the 189,000 square feet of office space was 85% leased.

During 2002, the Company completed construction of the final phase of its Ashburn Village shopping center. In 1994, Saul Centers purchased the original 12.7 acre parcel of vacant land located within the 1,580 acre community of Ashburn Village in Loudoun County, Virginia. The Company subsequently acquired an adjacent 6.6 acres in 1999 and 7.1 acres in 2000. The Company has successfully developed the site into an attractive 211,000 square foot neighborhood shopping center anchored by a 67,000 square foot Giant Food store.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The first phase of the development comprised of 108,000 square feet commenced operations in the fall of 1994. Ashburn Village phase II was a 49,000 square foot in-line and pad expansion which commenced operations during the third quarter of 2000. During the summer of 2001, the Company completed the development of Ashburn Village III, consisting of an additional 29,000 square feet of in-line and pad retail space. Ashburn Village phases I, II and III are 100% leased. The Company commenced construction on Ashburn Village IV, during the fourth quarter of 2001. This final phase consisting of 25,000 square feet of retail space was completed during the summer of 2002 and is 84% leased.

Portfolio Leasing Status

At December 31, 2002, the operating portfolio consisted of 29 Shopping Centers and five predominantly Office Properties, all of which are located in seven states and the District of Columbia.

As of December 31, 2002, 93.7% of the Company's approximately 6,300,000 square feet of space was leased compared to 93.5% at December 31, 2001. The shopping center portfolio was 93.9% leased at December 31, 2002 compared to 94.3% at December 31, 2001. The Office Properties were 92.9% leased at December 31, 2002 compared to 90.4% as of December 31, 2001. The slight improvement in the portfolio's leasing percentage resulted from increased leasing at the Ashburn Village and Washington Square developments, offset in part by decreased leasing at Lexington Mall and 601 Pennsylvania Avenue. The Company is intentionally not renewing leases at Lexington Mall in order to redevelop the shopping center and a major lease with a U.S. Government tenant expired at 601 Pennsylvania Avenue.

Results of Operations

The following discussion compares the results of the Company for the year ended December 31, 2002 with the year ended December 31, 2001, and compares the year ended December 31, 2001 with the year ended December 31, 2000. This information should be read in conjunction with the accompanying consolidated financial statements and the notes related thereto.

Years Ended December 31, 2002 and 2001

Revenues for the year ended December 31, 2002 ("2002") totaled \$93,963,000 compared to \$86,308,000 for the comparable year in 2001 ("2001"), an increase of \$7,655,000 (8.9%).

Base rent income was \$75,699,000 for 2002 compared to \$69,662,000 for 2001, representing an increase of \$6,037,000 (8.7%). Approximately 40% of the increase in base rent resulted from new leases in effect at recently developed and redeveloped properties: Washington Square, Ashburn Village III & IV, Crosstown Business Center and French Market. Approximately 30% of the increase resulted from a major tenant paying higher rent under the terms of a short-term lease extension at 601 Pennsylvania Avenue. The balance of the base rent increase resulted from releasing property space in the remaining Current Portfolio Properties at rental rates higher than expiring rents.

Expense recoveries were \$12,680,000 for 2002 compared to \$11,456,000 for the comparable 2001 period, representing an increase of \$1,224,000 (10.7%). The commencement of operations at the newly developed and redeveloped properties accounted for 45% of the increase in expense recovery income, while the balance of the increase in expense recoveries resulted from improved occupancy and increases in recoverable property tax expense.

Percentage rent was \$1,850,000 in 2002, compared to \$2,113,000 in 2001, a decrease of \$263,000 (12.4%). Approximately 40% of the percentage rent decrease occurred at Lexington Mall where the Company is positioning the mall for redevelopment and approximately 20% of the decrease occurred at French Market where a restaurant tenant reported lower sales revenue compared to the previous year.

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 \$3,734,000 in 2002, compared to \$3,077,000 in 2001, representing an increase of \$657,000 (21.4%). The increase in other income resulted primarily from a \$500,000 increase in lease termination payments compared to the prior year, approximately half of which was recognized at Washington Square, and a \$300,000 increase in parking income due to the lease-up of office space at Washington Square.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Operating expenses, consisting primarily of repairs and maintenance, utilities, payroll, insurance and other property related expenses, increased \$1,612,000 (19.0%) to \$10,115,000 in 2002 from \$8,503,000 in 2001. Approximately 40% of the property operating expense increase resulted from the commencement of operations at Washington Square and 25% of the increase resulted from snow removal expenses sustained as a result of two snow storms impacting many of the Company's properties in December 2002.

The provision for credit losses decreased \$196,000 (31.8%) to \$421,000 in 2002 from \$617,000 in the 2001 year. The credit loss provision in 2002 represented a return to historic levels, comparable to \$467,000 recorded in 2000. The credit loss provision in 2001 was elevated due primarily to three retail tenants and an office tenant in bankruptcy. In 2002, no significant tenants declared bankruptcy impairing the collectibility of rents receivable.

Real estate taxes increased \$795,000 (11.0%) to \$8,021,000 in 2002 from \$7,226,000 in 2001. Thirty-four percent of the increase in real estate tax expense in 2002 resulted from the commencement of operations at Washington Square, while approximately 36% resulted from increased taxes at the Company's two Washington, DC office properties.

Interest expense increased \$193,000 (0.8%) to \$25,113,000 for 2002 from \$24,920,000 reported for 2001. The minor variance resulted from the net of increased interest paid on permanent fixed rate financing for recently developed and redeveloped properties, offset by interest expense savings from lower interest rates on the Company's variable rate debt.

Amortization of deferred debt expense increased \$159,000 (28.1%) to \$725,000 for 2002 compared to \$566,000 for 2001. The increase resulted from the amortization of additional loan costs associated with extending the maturity of the Washington Square construction loan to January 2003 and costs associated with refinancing the Company's unsecured line of credit during the third quarter of 2002.

Depreciation and amortization expense increased \$3,063,000 (20.8%) from \$14,758,000 in 2001 to \$17,821,000 in 2002. Nearly half of the change or \$1,311,000, resulted from assets retired based upon a comprehensive review of real estate asset records and the Company's revision of the assets' estimated useful lives. The balance of the change reflects increased depreciation expense on developments and acquisitions placed in service during the past 12 months.

General and administrative expense, which consists of payroll, administrative and other overhead expenses, was \$5,537,000 for 2002, an increase of \$1,202,000 (27.7%) over 2001. Forty percent of the expense increase in 2002 compared to 2001 resulted from increased corporate office rent, 15% resulted from the write-off of abandoned property acquisition costs, 15% resulted from increased payroll and 10% resulted from increased legal expense.

The Company recognized a gain on the sale of real estate of \$1,426,000 in 2002. There were no property sale gains reported in 2001. In 1999, the District of Columbia condemned and purchased the Company's Park Road property as part of an assemblage of parcels for a neighborhood revitalization project. The Company disputed the original purchase price awarded by the District. The gain represents additional net proceeds the Company was awarded upon settlement of the dispute.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Years Ended December 31, 2001 and 2000

Revenues for the year ended December 31, 2001 ("2001"), totaled \$86,308,000 compared to \$79,029,000 for the comparable period in 2000 ("2000"), 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 2001.

Expense recoveries increased to \$11,456,000 in 2001 from \$10,129,000 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 shopping center 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 expense 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 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.

DIVIDEND REINVESTMENT PLAN

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

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

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

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, 2002	\$24.51	\$22.52
Third Quarter, 2002	\$25.40	\$21.91
Second Quarter, 2002	\$25.90	\$22.13
First Quarter, 2002	\$22.55	\$21.02
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
On February 21, 2003, the closing price was \$23.13.		
There were approximately 450 holders of record as of that date.		

CORPORATE INFORMATION

SAUL CENTERS, INC.

DIRECTORS

B. Francis Saul II
Chairman & Chief
Executive Officer

B. Francis Saul III
President

Philip D. Caraci
Vice Chairman

The Honorable
John E. Chapoton
Advisor to Brown Investment
Advisory & Trust

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

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

David B. Kay
Chief Financial Officer,
J.E. Robert Companies

General Paul X. Kelley
Chairman, American Battle
Monuments Commission

Charles R. Longworth
Chairman Emeritus, Colonial
Williamsburg Foundation

Patrick F. Noonan
Chairman, The
Conservation Fund

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
President

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

Bill D. Tzamaras
Chief Accounting Officer

Christopher H. Netter
Senior Vice President, Leasing

John F. Collich
Senior Vice President,
Retail Development

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

COUNSEL

Shaw Pittman LLP
Washington, DC 20037

INDEPENDENT AUDITORS

Ernst & Young LLP
McLean, Virginia 22102

WEB SITE

www.saulcenters.com

EXCHANGE LISTING

New York Stock Exchange
Symbol: BFS

TRANSFER AGENT

Continental Stock Transfer &
Trust Company
Attention: Saul Centers, Inc.
Dividend Reinvestment Plan
17 Battery Place
New York, NY 10004
(800) 509-5586

INVESTOR RELATIONS

Saul Centers, Inc.
7501 Wisconsin Ave.
Suite 1500
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

ANNUAL MEETING OF SHAREHOLDERS



**The Annual Meeting of
Shareholders will be held at
11:00 a.m., local time, on
April 25, 2003, 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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Phone: (301) 986-6200

Website: www.saulcenters.com