DATA I/O CORP
Form DEF 14A
April 05, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934 (Amendment No.)

Filed by the Registrant x

Filed by a Party other than the Registrant o

Check the appropriate box:

o	Preliminary Proxy Statement
o	Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
x	Definitive Proxy Statement
o	Definitive Additional Materials
o	Soliciting Material Pursuant to § 240.14a-12

Data I/O Corporation
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x	No fee required	
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	1)	Title of each class of securities to which transaction applies:
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1) Amount Previously Paid:

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3) Filing Party:

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DATA I/O CORPORATION

NOTICE OF 2016

ANNUAL MEETING

and

PROXY STATEMENT

DATA I/O CORPORATION

April 4, 2016

To Our Shareholders:

You are cordially invited to attend the 2016 Annual Meeting of Data I/O Corporation, which will be held at Data I/O's headquarters at 6645 185th Ave NE, Suite 100, Redmond, Washington 98052 (Our new location). The meeting will begin at 9:00 a.m. Pacific Daylight Time on Tuesday, May 24, 2016.

Officers of Data I/O will be attending and will respond to questions after the meeting. Formal business will include the election of directors, ratification of the continued appointment of Grant Thornton LLP as Data I/O's independent auditors, and an advisory vote on executive compensation.

Please read the proxy materials carefully. Your vote is important. Data I/O appreciates you considering and acting on the proposals presented. We look forward to seeing you on May 24, 2016.

Sincerely,

Anthony Ambrose

President and Chief Executive Officer

DATA I/O CORPORATION

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS - May 24, 2016

To the Shareholders of Data I/O Corporation:

NOTICE IS HEREBY GIVEN that the Annual Meeting of Shareholders of Data I/O Corporation (the “Company” or “Data I/O”) will be held at 9:00 a.m. Pacific Daylight Time, on Tuesday, May 24, 2016, at Data I/O’s principal offices, 6645 185th Ave NE, Suite 100, Redmond, Washington 98052, for the following purposes:

(1) **Election of Directors:**

To elect five directors, each to serve until the next annual meeting of shareholders or until his or her successor is elected and qualified or until such director’s earlier death, resignation, or removal.

(2) **Ratification of Independent Auditors:**

To ratify the continued appointment of Grant Thornton LLP as Data I/O’s independent auditors for the calendar year ended December 31, 2016.

(3) **Say on Pay – Advisory Vote on Executive Compensation:**

To consider and vote on an advisory resolution on the compensation of our named executive officers.

(4) **Other Business:**

To consider and vote upon such other business as may properly come before the meeting or any adjournments or postponements thereof.

Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting To Be Held on May 24, 2016. The proxy statement and annual report to security holders are also available at

http://www.dataio.com/company/ investorrelations/annualmeeting.aspx.

The Board of Directors has fixed the close of business on March 24, 2016, as the Record Date for the determination of shareholders entitled to notice of, and to vote at, the 2016 Annual Meeting and any adjournment or postponement thereof.

By Order of the Board of Directors

/s/ Anthony Ambrose

Anthony Ambrose

President and Chief Executive Officer

Redmond, Washington

April 4, 2016

YOUR VOTE IS IMPORTANT

Whether or not you expect to attend the meeting in person, we urge you to sign, date and return the accompanying proxy card at your earliest convenience, or you may vote by the internet at http://www.investorvote.com/DAIO or by telephone at 1-800-652-8683, as provided in the instructions on the proxy card. This will ensure the presence of a quorum at the meeting. **Promptly returning a signed and dated proxy card, or voting by the internet or by telephone, will save Data I/O the extra expense of additional solicitation.** Your proxy is revocable at your request any time before it is voted. If you attend the meeting, you may vote in person if you wish, even if you have previously returned your proxy card. If you vote by mail, an addressed, postage-paid envelope is provided in order to make certain that your shares will be represented at the Annual Meeting.

DATA I/O CORPORATION

6645 185th Ave NE, Suite 100

Redmond, Washington 98052

PROXY STATEMENT

ANNUAL MEETING OF SHAREHOLDERS

May 24, 2016

INFORMATION REGARDING PROXY

This Proxy Statement and the accompanying form of proxy are furnished in connection with the solicitation of proxies by the Board of Directors ("Board of Directors") of Data I/O Corporation (the "Company" or "Data I/O") for use at the Annual Meeting of Shareholders to be held on Tuesday, May 24, 2016, at 9:00 a.m. Pacific Daylight Time at Data I/O's principal offices, 6645 185th Ave NE, Suite 100, Redmond, Washington 98052, and at any adjournment of the meeting (the "Annual Meeting"). Shareholders of record at the close of business on March 24, 2016 (the "Record Date") are entitled to notice of, and to vote at, the Annual Meeting. This Proxy Statement and a copy of Data I/O's 2015 Annual Report to Shareholders are being mailed to shareholders on or about April 13, 2016.

A proxy card is enclosed for your use. *You are requested on behalf of the Board of Directors to sign, date, and return the proxy card in the accompanying envelope*, which is postage-paid if mailed in the United States or Canada, or you may vote by the internet at http://www.investorvote.com/DAIO, or by telephone at 1-800-652-8683, as provided in the instructions on the proxy card. If you vote by the internet or by telephone, you do not need to mail back the proxy card.

A proxy in the accompanying form, which is properly signed, dated and returned and not revoked, will be voted in accordance with its instructions. To vote on the election of directors, check the appropriate box under Proposal 1 on your proxy card. You may (a) vote "FOR" all of the director nominees as a group, (b) "WITHOLD" authority to vote for all director nominees as a group, or (c) vote "FOR" all director nominees as a group except those nominees indicated to the contrary. To vote on Proposal 2 to ratify the continued appointment of Grant Thornton LLP as Data I/O's independent auditors for the calendar year ended December 31, 2016, check the appropriate box under Proposal 2 on

your proxy card. You may (a) vote "FOR" approval of the ratification of Grant Thornton LLP as Data I/O's independent auditors, (b) vote "AGAINST" approval of the ratification of Grant Thornton LLP as Data I/O's independent auditors, or (c) "ABSTAIN" from voting on the ratification of Grant Thornton LLP as Data I/O's independent auditors. To vote on Proposal 3, Say on Pay – Advisory Vote on Executive Compensation, you may vote (a) "FOR" the advisory resolution, (b) "AGAINST" the advisory resolution, or (c) "ABSTAIN" from voting on the advisory resolution on executive compensation.

Proxies which are returned to Data I/O without instructions will be voted as recommended by the Board of Directors. Any shareholder who returns a proxy may revoke it at any time prior to voting on any matter (without, however, affecting any vote taken prior to such revocation) by (i) delivering written notice of revocation to the Secretary of Data I/O at Data I/O's principal offices, (ii) executing and delivering to Data I/O another proxy dated as of a later date, or (iii) voting in person at the Annual Meeting.

VOTING SECURITIES AND PRINCIPAL HOLDERS

The only outstanding voting securities of Data I/O are shares of common stock (the "Common Stock"). As of the Record Date, there were 7,905,748 shares of Common Stock issued and outstanding, and each such share is entitled to one vote at the Annual Meeting. The presence in person or by proxy of holders of record of a majority of the outstanding shares of Common Stock is required for a quorum for transacting business at the Annual Meeting. Shares of Common Stock underlying abstentions will be considered present at the Annual Meeting for the purpose of calculating a quorum. Under Washington law and Data I/O's charter documents, if a quorum is present, the five nominees for election to the Board of Directors who receive the greatest number of affirmative votes cast at the Annual Meeting will be elected directors. Abstentions and broker non-votes will have no effect on the election of directors because they are not cast in favor of any particular candidate.

The proposal to ratify the continued appointment of Grant Thornton as Data I/O's independent auditors will be approved, if a quorum is present, if the number of votes cast in favor of the proposal exceeds the number of votes cast against the proposal. Abstentions and broker non-votes on the proposal will have no effect because approval of the proposal is based solely on the votes cast.

Say on Pay – The advisory vote on the compensation of Data I/O's named executive officers will be approved, if a quorum is present, if the number of votes cast in favor of the advisory resolution exceeds the number of votes cast against the advisory resolution. Abstentions and broker non-votes on the advisory resolution will have no effect because approval of the advisory resolution is based solely on the votes cast.

Proxies and ballots will be received and tabulated by Computershare Shareowner Services LLC, an independent business entity not affiliated with Data I/O.

Effect of Not Casting Your Vote

If you hold your shares in street name, it is critical that you instruct your broker or bank how to vote if you want it to count in Proposal 1, the election of directors; and Proposal 3, Say on Pay. Regulations no longer allow your bank or broker to vote your uninstructed shares in the election of directors on a discretionary basis. If you hold your shares in street name and you do not instruct your bank or broker how to vote in the Proposal 1, election of directors; and Proposal 3, Say on Pay, votes will not be cast on your behalf for these Proposals. Your bank or broker will, however, continue to have discretion to vote any uninstructed shares on Proposal 2, ratification of the appointment of Data I/O's independent auditors. If you are a shareholder of record and you do not cast your vote, votes will not be cast on your behalf on any of the items of business at the Annual Meeting.

The Common Stock is traded on The NASDAQ Capital Market under the symbol "DAIO". The last sale price for the Common Stock, as reported by The NASDAQ Capital Market on March 24, 2016, was $2.24 per share.

Principal Holders of Data I/O's Common Stock

The following table sets forth information for to all shareholders known by Data I/O to be the beneficial owners of more than five percent of its outstanding Common Stock as of March 25, 2016. Except as noted below, each person or entity has sole voting and investment powers with for the shares shown.

Name and Address	Amount and Nature of Beneficial Ownership		Percent of Shares Outstanding
Penbrook Management, LLC	521,390	(1)	6.6%

AnKap Partners, L.P.

AnKap, LLC

Robert S. Anderson, Ralph Kaplan

Barbara Burke DiCostanzo

Ward Anderson

880 Third Avenue, 16th Floor

New York, NY 10022

Mercury Fund XI, Ltd.	440,187	(2)	5.6%

Mercury Ventures III, Ltd.

Mercury Management, L.L.C.

Kevin C. Howe

501 Park Lane Drive,

McKinney, TX 75070

(1) The holding shown is as of December 31, 2015 as jointly reported by Penbrook Management, LLC; AnKap Partners, L.P.; AnKap, LLC; Robert S. Anderson; Ralph Kaplan; Barbara Burke DiCostanzo; and Ward Anderson, on the most recent (filed February 25, 2016) Schedule 13G filed pursuant to Rule 13d-1 under the Securities Exchange Act of 1934. The Schedule 13G indicates that Penbrook Management has sole dispositive power of 521,390 shares and disclaims beneficial ownership of them; AnKap Partners has sole voting power and dispositive power for 110,000 shares; AnKap, LLC has sole voting power and dispositive power for 110,000 shares and disclaims beneficial ownership of them; Robert S. Anderson has sole voting and dispositive power for 51,300 shares, shared voting power for 110,000 shares and shared dispositive power for 469,090 shares, with an aggregate amount of 520,390 shares, however disclaiming beneficial ownership of shares managed by Penbrook Management and AnKap Partners; Ralph Kaplan has shared voting power for 110,000 shares and shared dispositive power for 469,090 shares, with an aggregate amount of 469,090 shares, however disclaiming beneficial ownership of shares managed by Penbrook Management and AnKap Partners; Barbara Burke DiCostanzo has shared voting power for 110,000 share and shared dispositive power for 469,090 shares; with an aggregate amount of 469,090 shares, however disclaiming beneficial ownership of shares managed by Penbrook Management and AnKap Partners; and Ward Anderson has sole voting and dispositive power for 1,000 shares and shared voting power for 0 shares and shared dispositive power for 359,090 shares, with an aggregate amount of 360,090 shares, however disclaiming beneficial ownership of these shares managed by Penbrook Management.

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(2) The holding shown is as of December 31, 2015 as jointly reported by Mercury Fund XI, Ltd.; Mercury Ventures III, Ltd.; Mercury Management, L.L.C.; and Kevin C. Howe, on the most recent (filed January 20, 2016) Schedule 13G/A filed pursuant to Rule 13d-1under the Securities Exchange Act of 1934. The Schedule 13G/A indicates that Mr. Howe, manager, exercises voting and dispositive power of 440,187 shares on behalf of Mercury Management, the general partner of Mercury Ventures III, Ltd., which is the general partner of Mercury Fund XI, Ltd.

Directors' and Officers' Share Ownership

The following table indicates ownership of Data I/O's Common Stock by each director of Data I/O, each executive officer named in the compensation tables appearing later in this Proxy Statement, and by all directors and executive officers as a group, all as of March 25, 2016. Data I/O is not aware of any family relationships between any director, director nominee or executive officer of Data I/O.

Name	Amount and Nature of Beneficial Ownership		Percent of Shares Outstanding
Anthony Ambrose	251,305	(1)	3.2%
Joel S. Hatlen	264,812	(2)	3.3%
Rajeev Gulati	106,750	(3)	1.4%
Douglas W. Brown	58,200	(4)	(9)
Brian T. Crowley	40,454	(5)	(9)
Alan B. Howe	30,350	(6)	(9)
Mark J. Gallenberger	25,350	(7)	(9)
All current directors and executive officers as a group (7 persons)	777,221	(8)	9.8%

(1) Includes options to purchase 175,000 shares exercisable within 60 days.

(2) Includes options to purchase 90,000 shares exercisable within 60 days.

(3) Includes options to purchase 68,750 shares exercisable within 60 days.

(4) Includes options to purchase 27,500 shares exercisable within 60 days.

(5) Includes options to purchase 13,750 shares exercisable within 60 days.

(6) Includes options to purchase 11,250 shares exercisable within 60 days.

(7) Includes options to purchase 11,250 shares exercisable within 60 days.

(8) Includes options to purchase 397,500 shares exercisable within 60 days.

(9) Less than 1 percent each.

Data I/O is not aware of any arrangement the operation of which may at a subsequent date result in a change of control of Data I/O.

CORPORATE GOVERNANCE

Board Charters

The Board of Directors has adopted Corporate Governance and Nominating Committee, Audit Committee and Compensation Committee Charters. All our Charters are reviewed and updated periodically by our Board of Directors. All of our Charters were reviewed during 2015 and no changes were made. The current versions of our Charters are posted on the corporate governance page of our website at www.dataio.com/company/investorrelations/corporategovernance.aspx. All of these Charters are consistent with the applicable requirements of United States security laws and our NASDAQ listing standards.

Code of Ethics

Our Code of Ethics was reviewed by our Board of Directors during 2015 and no changes were made. The current version of our Code of Ethics is posted on the corporate governance page of our website at www.dataio.com/company/corporategovernance.axp. Data I/O's Code of Ethics apply to all directors, officers and employees of Data I/O, including the named executive officers. The key principles of the Code are to act legally, and with integrity in all work for Data I/O. We will post any amendments to our Code of Ethics on the corporate governance page of our website at www.dataio.com/company/investorrelations/corporategovernance.aspx. In the unlikely event that the Board of Directors approves any waiver to the Code of Ethics for our executive officers or directors, information concerning such waiver will also be posted on our website. In addition to posting information regarding amendments and waivers on our website, the same information will be included in a Current Report on Form 8-K within four business days following the date of the amendment or waiver, unless website posting of such amendments or waivers is permitted by the rules of The NASDAQ Stock Market LLC.

Risk Oversight

Our Board of Directors consists of four independent directors, and one non-independent director, our Chief Executive Officer. Risk oversight is generally handled by our entire Board of Directors, although certain risk oversight areas such as internal control and cyber risk are handled by our Audit Committee, and compensation is handled by our Compensation Committee, respectively.

Director Independence

Messrs. Crowley, Gallenberger, Howe and Brown are independent directors, as defined by applicable NASDAQ listing standards. Mr. Ambrose, our Chief Executive Officer, is not an independent director.

Leadership Structure

Our Chairman, Mr. Howe, is an independent director and Mr. Ambrose is our Chief Executive Officer, President and Director.

PROPOSAL 1: ELECTION OF DIRECTORS

At the 2015 Annual Meeting, the shareholders elected five directors to serve until the next Annual Meeting or until such director's successor has been qualified and elected or such director's earlier death, resignation or removal. For the 2016 Annual Meeting, the Board of Directors has approved the five nominees named below. All the nominees are currently members of the Board of Directors. Each of the nominees has indicated that they are willing and able to serve as directors. However, should one or more of the nominees not accept the nomination, or otherwise be unwilling or unable to serve, it is intended that the proxies will be voted for the election of a substitute nominee or nominees designated by the Board of Directors.

Recommendation: The Board of Directors recommends a vote FOR each of the director nominees.

Anthony Ambrose, age 54, was appointed a director of Data I/O effective October 25, 2012. He joined Data I/O October 25, 2012 and has served as President and Chief Executive Officer ("CEO"). Prior to Data I/O, Mr. Ambrose was Owner and Principal of Cedar Mill Partners, LLC, a strategy consulting firm since 2011. From 2007 to 2011, he was Vice President and General Manager at RadiSys Corporation, a leading provider of embedded wireless infrastructure solutions, where he led three product divisions and worldwide engineering. At RadiSys, he established the telecom platform business and grew it to over $125M in annual revenues. Until 2007, he was general manager and held several other progressively responsible positions at Intel Corporation, where he led development and marketing of standards based telecommunications platforms, and grew the industry standard server business to over $1B in revenues. He is a member of the EvergreenHealth Foundation Board of Trustees. Mr. Ambrose has a Bachelors of Science in Engineering from Princeton University.

Mr. Ambrose has extensive semiconductor and mobile broadband networks industry operating experience. He has significant executive experience in strategy development, business management, marketing, engineering and new product development. His role as our President and CEO gives him knowledge as well as unique insight into our challenges, opportunities and operations that the Board of Directors believes qualifies him to serve as a director of Data I/O.

Douglas W. Brown, age 60, was appointed a director of Data I/O effective April 1, 2011. Mr. Brown is currently Executive Chairman of All Star Directories, Inc., Seattle, Washington, a Web-based publisher of post-secondary online and career school directories which he joined as President in 2005 and served in that capacity until 2015. From 2003 to 2005, he provided governance and interim executive services, with engagements including Interim President and Board member, to venture-backed clients. From 1998 to 2003, he was a Board member of GoAhead Software and was appointed its President in 2001. From 1993 to 1999, he was a President of a Seattle-area manufacturing company which became a Division of Leggett & Platt in 1996. Prior to that time, he was the Chief Financial Officer (“CFO”) of Seattle Silicon, and Executive Vice President, Finance and Operations at Phamis. He started his career as a Certified Public Accountant at Arthur Young & Co, now Ernst & Young, in Seattle. Mr. Brown is a member of the Board of Directors of the Washington Technology Industry Association. Mr. Brown has a Bachelors degree in Business from University of Idaho.

Mr. Brown has extensive software, financial, CEO, CFO and board level experience that the Board of Directors believes qualifies him to serve as a director of Data I/O.

Brian T. Crowley, age 55, was appointed a director of Data I/O effective June 5, 2012. Mr. Crowley is currently Chief Operating Officer of Symbio, a global R&D and software engineering company. From April 2014 to July 2015, he served as Vice President of Engineering and Operations at Snupi Technologies, an Internet of Things startup. From July 2003 to September 2013, Mr. Crowley served as the President and CEO for BSquare Corporation (NASDAQ: BSQR) in Bellevue, Washington, the leading provider of embedded solutions, engineering services and production ready software products for the smart device market. Previously, he had served as Vice President, Product Development since joining BSquare in April 2002. From April 1999 to December 2001, Mr. Crowley was with DataChannel, a developer of enterprise portals where he held executive positions including Vice President of Engineering and Vice President of Marketing. From December 1997 to April 1999, he was Director of Development at Sequel Technology, a network solutions provider. From 1986 to December 1997, he held various positions at Applied Microsystems Corporation, including Vice President and General Manager of the Motorola products and quality assurance divisions. He serves on the Western Washington University Business School Deans Advisory Board. Mr. Crowley has a Bachelors of Science in Electrical Engineering from Arizona State University.

Mr. Crowley has experience as a CEO and public company director, as well as prior executive management experience in industries related to ours in product development, engineering, technology, and mergers and acquisitions that the Board of Directors believes qualifies him to serve as a director of Data I/O.

Mark J. Gallenberger, age 52, was appointed a director of Data I/O effective January 31, 2013. He is currently the Senior Vice President, Chief Financial Officer, Chief Operating Officer and Treasurer of Xcerra Corporation (formerly called LTX-Credence Corporation) (NASDAQ:XCRA), a global provider of test and handling capital equipment, interface products, test fixtures, and services to the semiconductor, industrial, and electronics manufacturing industries, which he joined in 2000. For the six years prior, he was Vice President/Senior Manager with Ernst &Young (Cap Gemini) in their consulting practice, establishing the Deals & Acquisitions Group. Previously, he held management and technical positions with Digital Equipment Corporation. He has a Masters of Business Administration from Northwestern University and a Bachelors of Science – Electrical Engineering from Rochester Institute of Technology.

Mr. Gallenberger has extensive semiconductor equipment industry, mergers & acquisition, capital markets, engineering technical, financial, and CFO experience that the Board of Directors believes qualifies him to serve as a director of Data I/O.

Alan B. Howe, age 54, was appointed a director of Data I/O effective January 31, 2013. He has served as the Co-founder and Managing Partner of Broadband Initiatives LLC, a boutique corporate advisory and consulting firm, since 2001. He served as Vice President of Strategic and Wireless Business Development for Covad Communications, Inc., a national broadband telecommunications company from May 2005 to October 2008. He served as CFO and Vice President of Corporate Development for Teletrac, Inc. from April 1995 to April 2001. Previously, he held various executive management positions for Sprint PCS, and Manufacturers Hanover Trust Company. He is currently a board member and Vice Chairman of Determine, Inc. (NASDAQ: DTRM) and has served on a number of private and public boards including in the past five years former reporting companies Qualstar, Ditech Networks, Inc., Altigen Communications, Inc., Proxim Wireless Corporation, and Crossroads Systems, Inc.. He has a Masters of Business Administration in Finance from Indiana University and a Bachelors of Science – Business Administration and Marketing from University of Illinois.

Mr. Howe has extensive wireless, business development, financial, CEO, CFO and board level and Chairman experience that the Board of Directors believes qualifies him to serve as a director of Data I/O.

THE BOARD OF DIRECTORS

Communications with the Board of Directors

Shareholders may communicate with the Board of Directors by sending an email or by sending a letter to Data I/O Corporation Board of Directors, c/o the Secretary, 6645 185th Ave NE, Suite 100, Redmond, WA 98052. The Secretary will receive the correspondence and forward it to the Chairman of the applicable Board of Directors Committee or to any individual director or directors to whom the communication is directed.

BOARD COMMITTEES

During the year ended December 31, 2015, there were six meetings of the Board of Directors. Each of the incumbent directors who was on the Board of Directors during 2015 attended at least 75% of the aggregate of the total number of meetings of the Board of Directors and the total number of meetings held by all committees of the Board of Directors on which he served during his term of service on the Board of Directors. Data I/O does not have a policy requiring members of the Board of Directors to attend the Annual Meeting, although we typically encourage our Board of Directors to attend. Mr. Brown and Mr. Ambrose attended our 2015 Annual Meeting in person and Mr. Crowley, Mr. Gallenberger, and Mr. Howe attended via telephone.

The Board of Directors had three standing Committees during 2015: the Corporate Governance and Nominating Committee, the Audit Committee, and the Compensation Committee. Each committee was comprised solely of independent directors during 2015, as defined by applicable NASDAQ listing standards including director independence generally as well as additional independence requirements for audit and compensation committees, and the Sarbanes-Oxley Act of 2002. The following table shows the composition of the Board Committees and Board Leadership structure during 2015 and through the date of this Proxy Statement.

Director	Audit Committee	Compensation Committee	Corporate Governance and Nominating Committee	Comments

M=member				
Doug Brown	M – Chair after 2015 Annual Meeting	M	M	Chairman of the Board through the 2015 Annual Meeting
Brian Crowley		M	Chair	
Alan Howe	M – Chair until 2015 Annual Meeting		M	Chairman of the Board since the 2015 Annual Meeting.
Mark Gallenberger	M	Chair	M	
Anthony Ambrose				President & CEO

Corporate Governance and Nominating Committee

The Corporate Governance and Nominating Committee, or "CGNC", develops, recommends to the Board of Directors, and monitors a set of corporate governance principles applicable to Data I/O. The CGNC seeks qualified candidates to serve on the Board of Directors, recommends them for the Board of Directors' consideration for election as directors at the Annual Meeting of Shareholders and proposes candidates to fill vacancies on the Board of Directors. The CGNC met one time in 2015. The CGNC continues to seek qualified candidates and recommends the director nominees to the Board of Directors. The CGNC identifies, evaluates, and recommends director nominees and Committee assignments which are described in greater detail below.

Audit Committee

The Audit Committee appoints, oversees, evaluates, and engages independent certified public accountants for the ensuing year and approves the compensation and other terms of such engagement; reviews the scope of the audit; periodically reviews Data I/O's program of internal control and audit functions; receives and reviews the reports of the independent accountants; and reviews the annual financial report to the directors and shareholders of Data I/O. Each member of the Audit Committee is an independent director, as defined by applicable NASDAQ listing standards and the Sarbanes-Oxley Act of 2002. During 2015 and through the date of this Proxy statement, all Audit Committee members are "audit committee financial experts" as defined by the applicable Securities and Exchange ("SEC") rules adopted pursuant to the Sarbanes-Oxley Act of 2002. The Audit Committee met five times during 2015. See the "Report of the Audit Committee" for additional information.

Compensation Committee

The Compensation Committee is composed entirely of independent directors, as defined by applicable NASDAQ listing standards for compensation committees. The Compensation Committee is responsible for setting and administering the policies which govern all of the compensation programs of Data I/O.

The Compensation Committee makes recommendations to the Board of Directors concerning the compensation of Data I/O's executive officers. The Compensation Committee administers Data I/O's long-term equity incentive plans. The Compensation Committee reviews all employee benefit programs and approves significant changes in major programs and all new programs. The Compensation Committee met two times during 2015.

As authorized by the Compensation Committee charter, the Compensation Committee may retain consultants or other advisors to assist in carrying out its responsibilities. No compensation consultants were engaged for 2015, however compensation surveys were purchased.

Consideration of Director Nominees

The Corporate Governance and Nominating Committee, has developed, and the Board has approved as part succession planning, Board Responsibilities and Director Recruitment Objectives, which further outline our directors roles and responsibilities and desired traits, characteristics, experience and criteria for selection. The Corporate Governance and Nominating Committee, or the independent members of the Board of Directors, as applicable, in evaluating and determining whether to recommend a person as a candidate for election as a director consider, in light of the Board Responsibilities and Director Recruitment Objectives, the relevant management and/or technology industry experience of potential director candidates (such as experience as chief executive, operations or financial officer, or similar positions); business development, mergers and acquisitions experience, public/corporate board experience, diversity, knowledge of Data I/O; educational experience; commitment to maximizing shareholder value; certain values such as integrity, accountability, judgment and adherence to high performance standards; independence pursuant to applicable guidelines; ability and willingness to undertake the required time commitment to Board functions; shareholder input; and an absence of conflicts of interest with Data I/O.

Director Diversity

The Corporate Governance and Nominating Committee also considers issues of diversity, such as diversity of gender, race and national origin, education, professional experience and differences in viewpoints and skills. The CGNC does not have a formal policy on Board diversity; however, the CGNC believes that it is important for Board members to represent diverse viewpoints. In considering candidates for the Board, the CGNC considers the entirety of each candidate's credentials in the context of these standards. With respect to evaluating the nomination of continuing directors for re-election, the individual's contributions to the Board are also considered.

Identifying Director Nominees; Consideration of Nominees of the Shareholders

The Corporate Governance and Nominating Committee may employ a variety of methods for identifying and evaluating nominees for director. The CGNC regularly assesses the size of the Board, the need for particular expertise on the Board, and whether any vacancies on the Board are expected due to retirement or otherwise. In the event that vacancies are anticipated, or otherwise arise, the CGNC considers various potential candidates for director which may come to the CGNC's attention through current Board members, professional search firms, shareholders, or other persons and evaluates these candidates in light of the Board Responsibilities and Director Recruitment Objectives. These candidates are evaluated at regular or special meetings of the CGNC, and may be considered at any point during the year.

The Corporate Governance and Nominating Committee will consider candidates recommended by shareholders, when the nominations are properly submitted, under the criteria summarized above in "Consideration of Director Nominees" and in accordance with the procedures described below in "Shareholder Nominations and Proposals for the 2017 Annual Meeting of Shareholders." Following verification of the shareholder status of persons proposing candidates, the CGNC makes an initial analysis of the qualifications of any candidate recommended by shareholders or others pursuant to the criteria summarized above to determine if the candidate is qualified for service on the Data I/O Board of Directors before deciding to undertake a complete evaluation of the candidate. If any materials are provided by a shareholder or professional search firm in connection with the nomination of a director candidate, such materials are forwarded to the CGNC as part of its review. Other than the verification of compliance with procedures and shareholder status, and the initial analysis performed by the CGNC, a potential candidate nominated by a shareholder is treated like any other potential candidate during the review process by the CGNC. For eligible shareholder nominees to be placed on the ballot for the 2016 Annual Meeting of Shareholders, shareholders were required to deliver nominations for proposed director nominees to Data I/O by February 18, 2016. While no formal candidate nominations were made by shareholders for election at the 2016 Annual Meeting, Mr. Howe and Mr. Gallenberger were initially identified by discussions with significant shareholders and the Board.

Certain Relationships and Related Transactions

Our Audit Committee is charged with monitoring and reviewing issues involving potential conflicts of interest, and reviewing and approving related party transactions as set forth in the Code of Ethics, which is posted on the corporate governance page of our website at www.dataio.com/company/investorrelations/corporategovernance.aspx. Under our Code of Ethics, our directors, officers and employees are expected to avoid conflicts of interest with Data I/O and are required to report any such conflicts of interest to our Chief Executive Officer or Chief Financial Officer, or to the Chair of our Audit Committee. Our Audit Committee reviews all such transactions and relationships by our directors and executive officers that come to its attention either through the director and officer questionnaires or otherwise, and considers whether to approve or take other appropriate action with respect to such transactions or relationships. During 2014 and 2015, no related party transactions that were significant or material occurred.

BOARD COMPENSATION

Employee directors (Anthony Ambrose) do not receive additional compensation for serving on the Board of Directors. During 2015, non-employee directors received a cash retainer of $7,750 for each quarter of service. Data I/O paid additional quarterly compensation to the non-employee directors who served as Chairman of the Board of Directors or as a Committee chair: $3,750 for Chairman of the Board of Directors; $2,500 for Chairman of the Audit Committee; $2,000 for Chairman of the Compensation Committee; and $2,000 for Chairman of the Corporate Governance and Nominating Committee. Fees are prorated based on time served for changes in directors and assignments.

In addition, each non-employee Board of Directors member as of May 21, 2015, was granted a restricted stock award for 3,700 shares of Data I/O stock. New non-employee members who join the Board of Directors are granted 15,000 nonqualified stock options as an initial grant. The stock options are granted under the provisions and terms of the Amended and Restated 2000 Stock Compensation Incentive Plan ("2000 Plan"). Data I/O also reimburses non-employee directors for actual travel and out-of-pocket expenses incurred in connection with service to Data I/O.

Each Data I/O non-employee member of the Board of Directors is required to achieve ownership of Data I/O stock at least equal to three times the annual director cash retainer fee based on Data I/O's then current share price. Non-employee directors have five years from their initial election or appointment to meet the ownership target requirement. Amounts that count toward meeting the target requirement include: shares owned; shared ownership (shares owned or held in trust by immediate family); and the gain amount from in-the-money vested options. If the stock ownership target requirement has not been met by any non-employee director, until such time as such director reaches the target requirement, he or she will be required to retain any Data I/O shares issued by Data I/O to such director (other than those disposed of to pay for the exercise and associated taxes on those shares). As of the Record

Date, none of the current non-employee directors have yet met the stock ownership target requirement, but they have from the current year up to two remaining years to meet the stock ownership target requirement.

The Chief Executive Officer ("CEO") is required to achieve ownership of Data I/O stock of at least two times the base pay of the CEO based on Data I/O's then current share price. The CEO has five years from appointment to meet the ownership target requirement. Amounts that count toward meeting the target requirement are the same as for the Board of Directors. If the stock ownership target requirement has not been met by the CEO, until such time as the CEO reaches the requirement amount, he or she will be required to retain any Data I/O shares issued by Data I/O (other than those disposed of to pay for the exercise and associated taxes on those shares). As of the Record Date the CEO has not yet met the stock ownership target requirement and has approximately one and a half years to meet the target requirement.

DIRECTOR COMPENSATION

The following table shows compensation paid by Data I/O to non-employee directors during 2015.

Name (a)	Fees Earned or Paid in Cash ($) (b)	Stock Awards ($) (c)	Option Awards ($) (d)	Non-Equity Incentive Plan Compensation ($) (e)	Nonqualified Deferred Compensation Earnings ($) (f)	All Other Compensation ($) (g)	Total ($) (h)
Douglas W. Brown (1)(2)	$42,950	$11,692	$0	$0	$0	$0	$54,462
Brian T. Crowley (1)(2)	$39,000	$11,692	$0	$0	$0	$0	$50,692
Alan B. Howe (1)(2)	$44,049	$11,692	$0	$0	$0	$0	$55,741
Mark J. Gallenberger (1)(2)	$39,000	$11,692	$0	$0	$0	$0	$50,692

(1) Each outside director elected at the annual meeting in 2015 was awarded 3,700 shares of restricted stock with a fair value of $11,692 on May 21, 2015 vesting in one year or the next annual meeting, if earlier.

(2) Each outside director had the following aggregate number of option awards outstanding at December 31, 2015: Brown, 27,500; Crowley, 15,000, Gallenberger 15,000 and Howe 15,000.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires Data I/O's directors, certain officers and persons who own more than ten percent (10%) of Data I/O's Common Stock ("Reporting Persons") to file with the SEC initial reports of ownership and reports of changes in ownership of Common Stock and other equity securities of Data I/O. Reporting Persons are required by SEC regulations to furnish Data I/O with copies of all Section 16(a) reports.

To Data I/O's knowledge, based solely on its review of copies of such reports furnished to Data I/O and representations that no other reports were required, all Section 16(a) filing requirements applicable to its Reporting Persons were complied with during 2015.

Report of the Audit Committee

The Audit Committee oversees Data I/O's financial reporting process on behalf of the Board of Directors. Management has the primary responsibility for the consolidated financial statements and the reporting process, including the systems of internal controls. Audit Committee members are not professional accountants, or auditors and their functions are not intended to duplicate or to certify the activities of management or the independent auditors. In fulfilling its oversight responsibilities, the Committee reviewed the audited consolidated financial statements in the Annual Report (Form 10-K) with management, including a discussion of the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments, and the clarity of disclosures in the financial statements.

The Committee reviewed with the independent auditors, who are responsible for expressing an opinion on the conformity of those audited consolidated financial statements with generally accepted accounting principles in the United States, their judgments as to the quality, not just the acceptability, of Data I/O's accounting principles and such other matters as are required to be discussed by PCAOB AU Section 380 with the Committee under generally accepted auditing standards. In addition, the Committee has discussed with the independent auditors the auditors' independence from management and Data I/O including the matters in the written disclosures and the letter provided by the independent auditors, as required by the applicable requirements of the Public Company Oversight Board for independent auditor communications with Audit Committees concerning independence, and considered the compatibility of non-audit services with the auditors' independence.

The Committee selects and engages Data I/O's independent auditors and discusses the overall scope and plans for their audits. The Committee meets with the independent auditors, with and without management present, to discuss the results of their examinations, their evaluations of Data I/O's internal controls, and the overall quality of Data I/O's financial reporting. The Committee held five meetings during 2015, of which four were attended by Data I/O's independent auditors.

In reliance on the reviews and discussions referred to above, the Committee recommended to the Board of Directors (and the Board has approved) that the audited consolidated financial statements be included in Data I/O's Annual Report (Form 10-K) for the year ended December 31, 2015 for filing with the Securities and Exchange Commission. The Committee has selected Grant Thornton LLP as Data I/O's auditors for the current year.

Respectfully submitted,

AUDIT COMMITTEE

Douglas W. Brown (Chair)

Mark Gallenberger

Alan B. Howe

April 4, 2016

PRINCIPAL ACCOUNTANT'S FEES AND SERVICES

Audit Fees: Aggregate fees billed by Grant Thornton LLP for professional services rendered for the audit of Data I/O's financial statements for each of the years ended December 31, 2015 and 2014 and for review of the financial statements included in each of Data I/O's quarterly reports on Form 10-Q during each of the years ended December 31, 2015 and 2014, were approximately $181,178 and $176,979, respectively.

Audit Related Fees: No aggregate fees were billed for the years ended December 31, 2015 and 2014 for assurance and subsidiary related services by Grant Thornton LLP that are reasonably related to the performance of the audit or review of Data I/O's financial statements that are not reported under the caption "Audit Fees" above, including accounting treatment consultations.

Tax Fees: No aggregate fees were billed for the years ended December 31, 2015 and 2014 for professional services rendered by Grant Thornton LLP for tax compliance, tax advice, tax examination support, and tax planning.

All Other Fees: No aggregate fees were billed for the years ended December 31, 2015 and 2014 for all other products and services provided by Grant Thornton LLP that are not otherwise disclosed above.

Policy on Pre-Approval by Audit Committee of Services Performed by Independent Auditors

The Audit Committee's policy is to pre-approve all audit and permissible non-audit services provided by the independent auditors. These services may include audit services, non-audit services, tax services and other services. Pre-approval is detailed as to the particular service or category of service and is subject to a specific engagement authorization.

During the year, circumstances may arise when it may become necessary to engage the independent auditors for additional services not contemplated in the original pre-approval. In those circumstances, the Audit Committee has delegated pre-approval authority to the Chair of the Audit Committee for those instances when pre-approval is needed prior to a scheduled Audit Committee meeting. These additional approvals should be reported at the next scheduled Audit Committee meeting.

For 2015, all services provided by the independent auditors were pre-approved.

EXECUTIVE COMPENSATION

Shareholder Vote

At our 2015 Annual Meeting of Shareholders, our shareholders approved, in an advisory vote, the compensation of our Named Executive Officers, as disclosed in the Executive Compensation discussion and analysis, the compensation tables and the related disclosures in our proxy statement. The proposal was approved by our shareholders with 99.21 percent of the votes cast voting "for" approval and 0.79 percent voting "against" approval. In light of the level of approval by our stockholders, the Compensation Committee considered the result of the vote and did not make changes to our compensation policies or practices specifically in response to the stockholder vote.

Elements of Our Company's Compensation Plan

Annual executive officer compensation consists of the following elements which are described in more detail below:

- Annual base salary;
- Management Incentive Compensation Plan or "MICP";
- Long-term equity incentives;
- Benefits; and
- Perquisites and other perceived benefits.

It is the Compensation Committee's policy to set total executive officer compensation at competitive levels based on compensation surveys with similar positions in similar sized company revenue ranges and at levels sufficient to attract and retain a strong motivated leadership team. Our philosophy for compensation of executive officers is based on the following two principles:

i. Executive base compensation levels should be established by comparison of job responsibility to similar positions in comparable companies and be adequate to retain highly-qualified personnel; and

ii. Variable compensation should be established to be comparably competitive and to provide incentive to improve performance and shareholder value.

- **Annual Base Salary.** The Compensation Committee establishes a base salary structure for each executive officer position. This structure defines the salary levels and the relationship of base salary to total cash compensation. The Compensation Committee reviews the salary structure periodically.

- **MICP.** The MICP offers each executive officer a performance-based opportunity to earn the variable component of annual cash compensation in an amount tied to a percentage of the executive officer's base salary. The Compensation Committee's philosophy in setting executive MICP percentages and the formulas for MICP payout is to pay above average total compensation for better than average historical or expected financial performance and below average compensation for lower than or average historical or expected financial performance. The percentages of base salary targeted for MICP payout ("the MICP Target") for specific executive officers for a given year are generally the same as the previous year, but can be changed by the Compensation Committee on an annual basis. The 2014 and 2015 MICP Target percentages for our executive officers were as follows: Mr. Ambrose 60% of base salary; Mr. Hatlen 40% until June 30, 2014 (45% prorated effective July 1, 2014) of base salary; and Mr. Gulati 45% of base salary of base salary. The MICP payout can range from 0% to 200% of each executive's MICP Target. If the

maximum target measures in the 2016 MICP Variable Compensation Matrix were achieved under the MICP measures, the Chief Executive Officer, Mr. Ambrose, would earn a cash bonus of 120% of his base salary; Mr. Gulati would earn 90% of his base salary; and Mr. Hatlen would earn 90% of his base salary.

The Compensation Committee determined that for 2014, 2015 and 2016 it was and will be critical to emphasize growth, profitability and cash preservation, as well as completion of key development and operational projects and corporate cost and spending objectives to deliver future new revenue and profitability. They have established two measures; one for Financial Performance ("FP") is based on achievement of various levels of operating income as percentage of revenue. See below for the Financial Performance Matrix. The second measure for Product and Spending Performance ("PSP") is based on the completion of key development and operational projects including product cost reductions, new customer targets and spending reduction objectives. The PSP is based upon an incentive compensation pool allocated among project development and operational goals typically related to delivery, cost, milestones, pilot customers, and releases, as well as spending goals related to certain product cost reduction targets and spending reduction targets. The achieved PSP result is prorated among participants based on their at target percentage incentive compensation. The PSP pool for 2015 was set, such that up to approximately 30% of target percentage incentive compensation could be achieved by this measure. For 2014, 2015 and 2016, the payout is a combination of the two (FP & PSP) measures.

The Compensation Committee believes that for 2014, 2015 and 2016, the applicable measures of key results for Data I/O have affected or will affect near-term and long-term shareholder value. A greater or lesser percentage of MICP Target is to be paid based on Data I/O's actual achievement of these measures with the payout target typically based on company financial plans as the Board determines appropriate. For 2014 the MICP payout was approximately 92% of target with payout achieved under the combined FP and PSP measure. For 2015 the MICP payout was approximately 88% of target with payout achieved under the combined FP and PSP measures. The Compensation Committee retains discretion to adjust the calculation of the two measures for changes outside normal business operations such as acquisitions or asset sales.

Data I/O Corporation 2014 & 2015 MICP Variable Compensation Matrix
Range of Payouts (actual results interpolated)

The 2014 and 2015 MICP Variable Compensation Matrix consists of two possible alternative measures. Project and Spending Performance (PSP) and Financial Performance (FP) with the payout based upon the combination of the two measures achieved.

Project and Spending Performance (PSP) An incentive compensation pool set to allow achievement of up to approximately the first 30% of target payout with points allocated among project development goals related to delivery, cost, milestones, pilot or new customers, and releases, as well as spending goals related to certain product cost reduction targets and spending reduction targets.

Financial Performance Matrix (FP)			Target Payout		Target 200% Payout
Operating Profit as a % of Revenue	0.0%	2.5%	5.0%	7.5%	10.0%
FP matrix payout as a % of Target	0%	50%	100%	150%	200%

- **Long-Term Equity Incentives.** The Compensation Committee approves grants under the Data I/O Corporation 2000 Plan ("the Plan"). This is Data I/O's only long-term incentive plan. The primary purpose of the Plan is to make a significant element of executive pay a reward for taking actions which maximize shareholder value over time. Generally, new options or stock awards are granted under the 2000 Plan, except the inducement grant of options and restricted stock to Mr. Ambrose and the inducement grant of options to Mr. Gulati, which were awarded on their employment under the terms of the 2000 Plan, but consisted of unregistered Data I/O shares as permitted for inducement grants.

Award Criteria

The Compensation Committee grants options or restricted stock unit awards based primarily on its perception of the executive's ability to affect future shareholder value and secondarily on the competitive conditions in the market for highly-qualified executives who typically command compensation packages which include a significant equity incentive. All restricted stock unit awards granted to our executive officers in 2014 and 2015 were based on these criteria.

Exercise Price

Historically, all options granted by Data I/O have been granted with an exercise price equal to the fair market value (an average of the day's high and low selling price) of Data I/O's Common Stock on the date of grant and, accordingly, will only have value if Data I/O's stock price increases. Options granted to employees are non-qualified.

Vesting and Exercise

Options granted to employees vest at a rate of 6.25% per quarter and have a six year term. Options granted to non-employee Directors are also non-qualified options and vest quarterly over a three year period. Restricted stock grants to employees vest annually over a 4 year period. Restricted stock grants to non-employee Directors vest in one year or on the next annual meeting date, if earlier. All grants are subject to acceleration of vesting in connection with certain events leading to a change in control of Data I/O or in the advent in a change in control or at any other time at the discretion of the Compensation Committee. All options granted to executive officers are issued in tandem with limited stock appreciation rights (“SARs”), which become exercisable only in the event of a change in control of Data I/O. See “Change in Control and other Termination Arrangements.”

Award Process

The timing of our typical grant/award is typically determined well in advance, with approval at a scheduled meeting of our Board of Directors or its Compensation Committee with the grant date generally to be effective on the date of our next Annual Meeting of Shareholders. The Annual Meeting of Shareholders does not coincide with any of our scheduled earning releases. We do not anticipate option grants or restricted stock awards at other dates, except for grants/awards to new employees based on their first date of employment or in specific circumstances approved by the Compensation Committee. The grant/award date is established when the Compensation Committee approves the grant/award and all key terms have been determined. If at the time of any planned grant/award date any member of our Board of Directors or Executive Officers is aware of material non-public information, the Company would not generally make the planned grant/award. In such an event, as soon as practical after material information is made public, the Compensation Committee would authorize the delayed grant/award.

- **Benefits.** Executive Officers of Data I/O are eligible for the same benefits as other Data I/O employees. Data I/O has no defined benefit pension programs. Data I/O has a 401(k) tax qualified retirement savings plan in which all U.S. based employees, including U.S. Executive Officers, are able to contribute the lesser of up to 100% of their annual salary or the limit prescribed by the IRS on a Roth or pre-tax basis. Data I/O will match up to 4% of pay contributed. Matching contributions in any year require employment on December 31, except in the case of retirement per the plan, and vest after three years of service credit.

- **Perquisites and Other Personal Benefits.** We believe perquisites are not conditioned upon performance, create divisions among employees, undermine morale, and are inconsistent with our compensation philosophy and policy of equitable treatment of all employees based upon their contribution to our business. No executive officer received perquisites valued at $10,000 or more in 2014 or 2015, except in connection with Mr. Gulati's hiring and relocation Mr. Gulati was provided temporary living and relocation expenses of $19,172 in 2014.

- **Individual Executive Officers' Performance.** The base salary of each executive officer is reviewed annually by the President and Chief Executive Officer. This is done on the basis of a review by the President and Chief Executive Officer, evaluating the executive's prior year performance against their individual job responsibilities and attainment of corporate objectives and Data I/O's financial performance. In developing executive compensation packages to recommend to the Compensation Committee, the President and Chief Executive Officer considers, in addition to each executive's prior year performance, the executive's long-term value to Data I/O, the executive's pay relative to that for comparable surveyed jobs, the executive's experience and ability relative to executives in similar positions, and the current year increases in executive compensation projected in industry surveys.

The Compensation Committee then reviews the President and Chief Executive Officer's recommendations for executive officers' total compensation and approves final decisions on pay for each executive officer based on the President and Chief Executive Officer's summary of the executive officers performance and on the other criteria and survey data described above. In this process, the Compensation Committee consults with Data I/O's President and Chief Executive Officer.

The base salary, total cash compensation, and long term equity incentive compensation for the President and CEO are reviewed annually by the Compensation Committee. This review includes a written evaluation of the CEO's performance for the previous year. The Compensation Committee meets annually without the President and Chief Executive Officer to evaluate his performance and to develop a recommendation for his compensation for the coming year. In addition to reviewing Data I/O's financial performance for the prior year, the Committee reviewed compensation surveys for chief executive officers and the President and Chief Executive Officer's individual performance, including development and execution of short- and long-term strategic objectives, Data I/O revenue growth and profitability, the achievement of which is expected to increase shareholder value.

The Compensation Committee determined the compensation package, including salary, bonus, MICP participation, stock option grants, restricted stock awards, and other benefits for Mr. Ambrose, President and Chief Executive Officer, based on the Committee's perception of his qualifications for the position and his ability to affect future shareholder value, as well as during the hiring process in 2012 based on compensation surveys, advice from Korn Ferry, and the competitive conditions in the market. No base pay adjustment was made in 2014 or 2015 for Mr. Ambrose.

Consideration of Risk in Compensation

The Compensation Committee believes that promoting the creation of long-term value discourages behavior that leads to excessive risk. The Compensation Committee believes that the following features of our compensation programs provide incentives for the creation of long-term shareholder value and encourage high achievement by our executive officers without encouraging inappropriate or unnecessary risks:

- Our long-term incentives in the form of stock options or restricted stock are at the discretion of the Compensation Committee and not formulaic.

- Stock options become exercisable over a four year period and remain exercisable for up to six years from the date of grant and restricted stock awards vest over a four year period, encouraging executives to look to long-term appreciation in equity values.

- We balance short and long-term decision-making with the annual cash incentive program and stock options and restricted stock that vest over four years.

- Because of the extent of the CEO and CFO's direct stock ownership, they could lose significant wealth if Data I/O were exposed to inappropriate or unnecessary risks which in turn affected our stock price.

- The metrics used in the MICP are measures the Committee believes drive shareholder value. Moreover, the Committee attempts to set ranges for these measures that encourage success without encouraging excessive risk taking to achieve short-term results.

- In addition, the overall MICP incentive compensation cannot exceed two times the MICP Target amount, no matter how much performance exceeds the measures established for the year.

Accounting and Tax Considerations of our Compensation Program

Options granted to employees are non-qualified options because of the more favorable tax treatment for Data I/O. We are required to value granted stock options under the fair value method and expense those amounts in the income statement over the stock option's remaining vesting period. Restricted stock is valued at its fair value on the award date and is expensed over its vesting period.

We have structured our compensation program to comply with Internal Revenue Code Sections 162(m) and 409A. Under Section 162(m) of the Internal Revenue Code, a limitation was placed on tax deductions of any publicly-held corporation for individual compensation to covered employees (generally the chief executive officer and the three other most highly compensated executive officers, other than the chief financial officer, whose compensation must be

disclosed pursuant to rules and regulations under the Securities Exchange Act of 1934) exceeding $1 million in any taxable year, unless the compensation is performance-based. The Compensation Committee is aware of this limitation and believes that no compensation to be paid by Data I/O in 2016 will exceed the $1 million limitation, except possibly related to a change of control example.

Change in Control and other Termination Arrangements

- **Change in Control Arrangements**. Data I/O has entered into agreements (the "Executive Agreements") with Messrs. Ambrose, Gulati and Hatlen which entitle them to receive payments if they are terminated without cause or resign with good reason within specified periods before or after the occurrence of certain events deemed to involve a change in control of Data I/O. Effective July 30, 2014, the Executive Agreements of Messrs. Ambrose, Gulati and Hatlen were amended and restated and the term of their Executive Agreements was extended with automatic renewal provisions. The Executive Agreements ensure appropriate incentives are in place for Messrs. Ambrose, Gulati and Hatlen to complete any change in control related transaction and transition, as well as comply with the provisions of Section 409A of the Internal Revenue Code. The Executive Agreements state that the resulting additional severance will be calculated under the Executive Agreements based on Data I/O's severance arrangements in place immediately preceding the date of a change in control (See: "Other Termination Arrangements" below for current severance policy). The Executive Agreements provide for continuation and vesting in Data I/O's matching 401(k) contributions through the date of termination after a change in control and include a reimbursement allowance of $20,000 for outplacement services. The Executive Agreements also have a transaction closing incentive of one half year's annual salary for Messrs. Ambrose, Gulati and Hatlen to encourage the consideration of all forms of strategic alternatives.

Data I/O's option grants and stock awards have been granted pursuant to the provisions of the 2000 Plan. The Change in Control provision applicable to the 2000 Plan is as follows:

<u>2000 Plan</u>

The 2000 Plan allows for the granting of "Awards", which include options, restricted stock and other awards made pursuant to the Plan. Subject to any different terms set forth in the award agreement, vesting of "qualifying" options and restricted stock awards may be affected by a Change in Control as described out in the table below. A "Change in Control" is defined to include (i) a merger or consolidation of the Company in which more than 50% of the voting power of the Company's outstanding stock after the transaction is owned by persons who are not shareholders immediately prior to such transaction, and (ii) the sale or transfer of all or substantially all of the Company's assets. A "Qualifying Award' is defined as an option or other Award that has been held for at least 180 days as of the Change of Control. "Qualifying Shares" means common stock issued pursuant to a Qualifying Award which are subject to the right of Data I/O to repurchase some or all of such shares at the original purchase price (if any) upon the holder's termination of services to Data I/O.

Treatment of Awards on a Change in Control	**Acceleration of Vesting**
The outstanding Awards do not remain outstanding or are not assumed by the surviving entity or replaced with comparable Awards.	Subject to certain limitations, the vesting of Qualifying Awards are accelerated in full. Restricted stock will vest and options will be exercisable in full prior to the effective date of the Change of Control.
The outstanding Awards remain outstanding after a Change of Control or are assumed by the surviving entity or replaced with comparable Awards.	Subject to certain limitations, the vesting of outstanding Qualifying Awards will be accelerated to the extent of 25% of the unvested portion thereof. The remaining 75% of the unvested portion will vest in accordance with the vesting schedule set forth in the applicable Award agreement.
The outstanding Awards remain outstanding after a Change of Control or are assumed by the surviving entity or replaced with comparable Awards, but the holder of a Qualifying Award is terminated involuntarily within 180 days of the Change of Control.	All Awards held by such person will be accelerated in full. Restricted stock will vest and options will be exercisable in full for a period of 90 days commencing on the effective date of the involuntary termination, or if shorter, the remaining term of the option.

In 1983, Data I/O adopted a SAR Plan which allows the Board of Directors to grant to each director, executive officer or holder of 10% or more of the stock of Data I/O a SAR with respect to certain options granted to these parties. A SAR has been granted in tandem with each option granted to an executive officer of Data I/O. SARs granted which have been held for at least six months are exercisable for a period of 20 days following the occurrence of either of the following events: (i) the close of business on the day that a tender or exchange offer by any person (with certain exceptions) is first published or sent or given if, upon consummation thereof, such person would be the beneficial owner of 30% or more of the shares of Common Stock then outstanding; or (ii) approval by the shareholders of Data I/O (or, if later, approval by the shareholders of a third party) of any merger, consolidation, reorganization or other transaction providing for the conversion or exchange of more than 50% of the outstanding shares of Data I/O's Common Stock into securities of a third party, or cash, or property, or a combination of any of the foregoing.

- **Other Termination Arrangements.** Data I/O has a severance policy for U.S. employees that provides for severance payouts for terminations without cause based upon years of service. The current formula, effective March 1, 2014, is 1 week pay for each year of service with a limit of six months' pay. For Mr. Hatlen, the prior standard formula applies, with pay and service years frozen at March 1, 2014, providing 1.5 weeks of pay for each year of service for those with 10 or more years of service. Mr. Ambrose, Mr. Hatlen and Mr. Gulati had at March 25, 2016 approximately 3, 24 and 3 years of service, respectively. Mr. Ambrose is entitled to a one year of base salary severance, except in the case of a change in control, as part of his employment arrangement. Mr. Gulati is entitled to a one-half year of base salary severance, except in the case of a change in control, as part of his employment arrangement. Data I/O does not have a formal policy regarding executive severance but has generally provided an amount it believes is consistent with severance typically provided for executives in similar positions and with similar periods of service.

Change in Control and Other Termination Arrangements

Termination without cause and Change in Control not applicable T

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Name The Company s outstanding debt totaled approximately $567,680,000 at September 30, 2008, of which approximately $552,579,000 was fixed rate and approximately $15,101,000 was variable rate construction loan debt. No balance was outstanding on the Company s variable rate, $150,000,00 unsecured revolving credit facility at September 30, 2008. The facility provides working capital and funds for acquisitions, certain developments an redevelopments, has a three-year term expiring on December 19, 2010 and provides for an additional one-year extension at the Company s option, to the Company s satisfaction of certain conditions. Until December 19, 2009, certain or all of the lenders may, upon request by the Company, incr the facility by $50,000,000. Letters of credit may be issued under the revolving credit facility. As of September 30, 2008, of the $150,000,000 avail for borrowing, approximately $177,000 was committed for letters of credit, and the resulting balance of approximately $149,823,000 was available borrow for working capital, operating property acquisitions or development projects. Interest rate pricing under the facility is primarily determined operating income from the Company s existing unencumbered properties and to a lesser extent, certain leverage tests. As of September 30, 2008, operating income from the unencumbered properties determined the interest rate for up to $100,000,000 of the line s available borrowings, with int expense to be calculated based upon the 1, 2, 3 or 6 month LIBOR plus a spread of 1.40% to 1.60% or upon the bank s reference rate, at the Comp option. The remaining $50,000,000 of the line s availability is determined based upon the Company s consolidated operating income after debt se On this portion of the facility, interest accrues at a rate of LIBOR plus a spread of 1.70% to 2.25%, determined by certain leverage tests, or upon the bank s reference rate plus a spread of 0.575%, at the Company s option.

Saul Centers is the guarantor of the revolving credit facility, of which the Operating Partnership is the borrower. The mortgage notes payable are all non-recourse debt, except for certain guarantees described below.

On February 29, 2008, the Company closed on a $7,500,000 increase to a fixed-rate mortgage secured by Shops at Fairfax and Boulevard shopping centers. The loan matures June 1, 2015 (same as the original financing), requires monthly interest only payments of $38,000, based upon a 6.08% interest rate, and requires a final principal payment of $7,500,000 at maturity. The Company has initially guaranteed $1,875,000 of this loan until th Boulevard redevelopment is completed and until certain debt service coverage tests are achieved.

On March 23, 2008, the Company closed on a $3,000,000 increase to a fixed-rate mortgage secured by Seabreeze Plaza. The loan matures May 1, 2 (same as the original financing), requires equal monthly principal and interest payments of $17,794, based upon a 5.90% interest rate and 30-year principal amortization, and requires a final principal payment of approximately $2,738,000 at maturity.

On March 28, 2008, the Company assumed a fully amortizing fixed-rate mortgage loan in the amount of approximately $10,349,000, secured by the acquisition property, Great Falls Center. The loan matures February 1, 2024 and requires equal monthly principal and interest payments of $83,113, based upon a 5.80% interest rate and 20-year principal amortization. Management determined the mortgage loan was fairly valued at acquisition be the terms of the loan were not materially different from current market terms.

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On March 31, 2008, the Company closed on a new 15-year, fixed-rate mortgage loan in the amount of $12,750,000, secured by the BJ s Wholesale center. The loan matures April 1, 2023, requires equal monthly principal and interest payments of $80,003, based upon a 6.43% interest rate and 30- principal amortization, and requires a final principal payment of approximately $9,255,000 at maturity.

In April 2008, the Company closed on a $10,825,000 additional financing secured by the Great Falls Center. Funding in the amount of $6,525,000 occurred on April 6, 2008, payable at an interest rate of 6.80%, interest only for the first year, after which amortization will commence on a 30-year amortization schedule, requiring monthly payments of principal and interest totaling $42,538. A final principal payment of approximately $1,274,00 will be due at maturity on February 1, 2024. The Company has initially guaranteed $2,000,000 of this loan, with the amount of any additional advan also be guaranteed until certain debt service coverage tests are achieved. The balance totaling $4,300,000 is a forward commitment to be funded pri March 31, 2009, subject to achieving certain re-leasing requirements.

In May 2008, the Company closed on a $21,822,000 secured construction loan, to fund the development of Northrock shopping center in Warrenton Virginia. Funding in the amount of approximately $6,495,000 occurred at closing. The loan accrues interest, payable at an interest rate of LIBOR pl 1.6%. The loan matures on May 1, 2011, with one 2-year extension option, exercisable at the Company s option subject to completion of improven and certain debt service coverage requirements. The loan is 100% guaranteed by the Company until such time as the construction is complete, at wh time the guarantee will be limited to 50% of the total principal outstanding. Approximately $10,604,000 is outstanding as of September 30, 2008.

Also in May 2008, the Company closed a $157,500,000 secured construction loan to finance the development of Clarendon Center, a mixed-use development adjacent to the Clarendon Metro station in Arlington, Virginia. The Company has guaranteed the loan, with the guarantee to be reduce subject to certain conditions related to pre-leasing, completion of construction and net operating income from the project. The loan accrues interest a interest rate of LIBOR plus 2.5% and matures on November 14, 2011, which term may be extended by the Company for two additional 9-month pe subject to the satisfaction of certain conditions. Approximately $4,497,000 was outstanding as of September 30, 2008.

At December 31, 2007, the Company s outstanding debt totaled approximately $532,726,000, of which approximately $524,726,000 was fixed rate $8,000,000 was variable rate debt outstanding on the Company s $150,000,000 unsecured revolving credit facility.

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At September 30, 2008, the scheduled maturities of all debt, including scheduled principal amortization, for years ending December 31, were as foll

Debt Maturity Schedule

(Dollars in thousands)	Balloon Payments	Scheduled Principal Amortization	To
October 1 through December 31, 2008	$	$ 4,313	$
2009		18,054	1
2010		19,413	1
2011	77,334(a)	20,852	9
2012	96,300	15,050	11
2013	39,440	9,269	4
Thereafter	201,628	66,027	26
	$ 414,702	$ 152,978	$ 56

(a) Includes the Clarendon Center and Northrock construction loan balances as of September 30, 2008, totaling $15,101.

Interest expense and amortization of deferred debt costs for the quarter ended September 30, 2008 and 2007, respectively were as follows:

Interest Expense and Amortization of Deferred Debt Costs

(Dollars in thousands)	Quarter ended September 30, 2008	2007	Nine months ended Septemb 2008	200
Interest incurred	$ 9,454	$ 8,928	$ 27,864	$ 26
Amortization of deferred debt costs	304	286	889	
Capitalized interest	(1,190)	(717)	(2,876)	(2
	$ 8,568	$ 8,497	$ 25,877	$ 25

6. Stockholders Equity and Minority Interests

The Consolidated Statements of Operations include a charge for minority interests of $1,743,000 and $2,332,000 for the three months ended September 30, 2008 and September 30, 2007, respectively, and include a charge of $5,837,000 and $6,618,000 for the nine months ended Septembe 2008 and September 30, 2007, respectively, representing The Saul Organization s limited partnership interest share of net income for each period.

On March 20, 2008, the Company filed a shelf registration statement (the Shelf Registration Statement) with the SEC relating to the future offeri to an aggregate of $140 million of preferred stock and depositary shares. On March 27, 2008, the Company sold 3,000,000 depositary shares, each representing 1/100th of a share of 9% Series B Cumulative Redeemable Preferred Stock, providing net cash proceeds of $72.1 million. The underwr exercised an over-allotment option, purchasing an additional 173,115 depositary shares providing additional net cash proceeds of $4.2 million.

The depositary shares may be redeemed, in whole or in part, at the $25.00 liquidation preference at the Company s option on or after March 15, 20
The depositary shares will pay an annual dividend of $2.25 per share, equivalent to 9% of the $25.00 liquidation preference. The first dividend will
paid on July 15, 2008 and will cover the period from March 27, 2008 through June 30, 2008. The Series B preferred stock has no stated maturity, is
subject to any sinking fund or mandatory redemption and is not convertible into any other securities of the Company. Investors in the depositary sha
generally have no voting rights, but will have limited voting rights if the Company fails to pay dividends for six or more quarters (whether or not declared or consecutive) and in certain other events.

7. Related Party Transactions

Chevy Chase Bank, an affiliate of The Saul Organization, leases space in 20 of the Company s properties. Total rental income from Chevy Chase E
amounted to approximately $2,558,000 and $2,144,000, for the nine months ended September 30, 2008 and 2007, respectively.

The Company utilizes Chevy Chase Bank for its various checking and short-term investment accounts. As of September 30, 2008, approximately $24,945,000 was held in deposit in these accounts.

The Chairman and Chief Executive Officer, the President, the Senior Vice President- General Counsel and the Vice President-Chief Accounting Of
of the Company are also officers of various members of The Saul Organization and their management time is shared with The Saul Organization. T
annual compensation is fixed by the Compensation Committee of the Board of Directors, with the exception of the Vice President-Chief Accountin
Officer whose share of annual compensation allocated to the Company is determined by the shared services agreement (described below).

The Company participates in a multiemployer profit sharing retirement plan with other entities within The Saul Organization which covers those full-time employees who meet the requirements as specified in the plan. Beginning January 1, 2002, only employer contributions are made to the pl
Each participant who is entitled to be credited with at least one hour of service on or after January 1, 2002, shall be 100% vested in his or her emplo
contribution account and no portion of such account shall be forfeitable. Employer contributions, at the discretionary amount of up to six percent of
employee s cash compensation, subject to certain limits, were $298,000 and $253,000, for the nine months ended September 30, 2008 and 2007, respectively. There are no past service costs associated with the plan since it is of the defined-contribution type.

The Company also participates in a multiemployer nonqualified deferred plan with entities in The Saul Organization which covers those full-time employees who meet the requirements as specified in the plan. The plan, which can be modified or discontinued at any time, requires participating employees to defer 2% of their compensation over a specified

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amount. The Company is required to contribute three times the amount deferred by employees. The Company s contribution totaled approximately $96,000 and $72,000, for the nine months ended September 30, 2008 and 2007, respectively. All amounts deferred by employees and the Company fully vested. The cumulative unfunded liability under this plan was approximately $954,000 and $857,000 at September 30, 2008 and December 31 2007, respectively, and is included in accounts payable, accrued expenses and other liabilities in the consolidated balance sheets.

The Company has entered into a shared services agreement (the Agreement) with The Saul Organization that provides for the sharing of certain personnel and ancillary functions such as computer hardware, software, and support services and certain direct and indirect administrative personne The method for determining the cost of the shared services is provided for in the Agreement and depending upon the service, is based upon head co estimates of usage or estimates of time incurred, as applicable. The terms of the Agreement and the payments made thereunder are deemed reasonal management and are reviewed annually by the Audit Committee of the Board of Directors, which consists entirely of independent directors. Billing The Saul Organization for the Company s share of these ancillary costs and expenses for the nine months ended September 30, 2008 and 2007, wh included rental expense for the Company s headquarters lease, totaled approximately $3,945,000 and $3,478,000, respectively. The amounts are ex when billed and are primarily reported as general and administrative expenses in these consolidated financial statements. As of September 30, 2008 December 31, 2007, accounts payable, accrued expenses and other liabilities included approximately $319,000 and $298,000, respectively, represen billings due to The Saul Organization for the Company s share of these ancillary costs and expenses.

The Company s corporate headquarters lease, which commenced in March 2002, is leased by a member of The Saul Organization. The 10-year lea provides for base rent escalated at 3% per year, with payment of a pro-rata share of operating expenses over a base year amount. Pursuant to the Agreement, the Company pays an allocation of total rental payments on a percentage proportionate to the number of employees employed by the Company and The Saul Organization. The Company s rent expense for the nine months ended September 30, 2008 and 2007 were approximately $661,000 and $651,000, respectively, and are included in general and administrative expense.

8. Non-Operating Items

Gain on Property Disposition

The gain on property disposition of approximately $205,000 during the nine months ended September 30, 2008 represents proceeds from an insurar settlement for HVAC units vandalized at the Company s West Park shopping center in Oklahoma City, Oklahoma. There were no property disposi during the nine months ended September 30, 2007.

9. Stock Option Plans

The Company has established two stock incentive plans, the 1993 plan and the 2004 plan (together, the Plans). Under the Plans, options were gra an exercise price not less than the market value of the common stock on the date of grant and expire ten years from the date of grant. Officer option ratably over four years following the grant and are expensed straight-line over the vesting period. Director options vest immediately and are expens of the date of grant.

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Note 9. Option detail

The following table summarizes the amount and activity of each grant, the total value and variables used in the computation and the amount expens
and included in general and administrative expense in the Consolidated Statements of Operations for the nine months ended September 30, 2008:

Stock options issued

	Officers					Directors					
Grant date	**05/23/2003**	**04/26/2004**	**05/06/2005**	**04/27/2007**	**Subtotals**	**04/26/2004**	**05/06/2005**	**05/01/2006**	**04/27/2007**	**04/25/2008**	**Subtotals**
Total grant	220,000	122,500	132,500	135,000	610,000	30,000	30,000	30,000	30,000	30,000	150,000
Vested	212,500	115,000	91,875	33,750	453,125	30,000	30,000	30,000	30,000	30,000	150,000
Exercised	96,422	28,750	6,250		131,422	6,200	2,500				8,700
Forfeited	7,500	7,500	11,250		26,250						
Exercisable at Sep 30, 2008	116,078	86,250	85,625	33,750	321,703	23,800	27,500	30,000	30,000	30,000	141,300
Remaining unexercised	116,078	86,250	115,000	135,000	452,328	23,800	27,500	30,000	30,000	30,000	141,300
Exercise price	$ 24.91	$ 25.78	$ 33.22	$ 54.17		$ 25.78	$ 33.22	$ 40.35	$ 54.17	$ 50.15	
Volatility	0.175	0.183	0.207	0.233		0.183	0.198	0.206	0.225	0.237	
Expected life (years)	7.0	7.0	8.0	6.5		5.0	10.0	9.0	8.0	7.0	
Assumed yield	7.00%	5.75%	6.37%	4.13%		5.75%	6.91%	5.93%	4.39%	4.09%	
Risk-free rate	4.00%	4.05%	4.15%	4.61%		3.57%	4.28%	5.11%	4.65%	3.49%	
Total value at grant date	$ 332,200	$ 292,775	$ 413,400	$ 1,258,848	$ 2,297,223	$ 66,600	$ 71,100	$ 143,400	$ 285,300	$ 254,700	$ 821,100
Expensed in previous years	320,875	254,450	256,108	209,808	1,041,241	66,600	71,100	143,400	285,300		566,400
Forfeited options	11,325	17,925	35,100		64,350						
Expensed during nine months ended Sep 30, 2008		20,400	68,733	236,040	325,173					254,700	254,700
Future expense		$	$ 53,459	$ 813,000	$ 866,459						
Weighted average term of future expense		2.5	years								

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The table below summarizes the option activity for the nine months ended September 30, 2008:

	Number of Shares	Wtd Avg Exercise Price/sh	Aggreg Intrinsic
Outstanding at January 1	586,753	$ 36.15	
Granted	30,000	50.15	
Exercised	23,125	26.02	
Expired/Forfeited			
Outstanding September 30	593,628	34.72	$ 8,47
Exercisable at September 30	463,003	30.56	7,96

The intrinsic value presented in the table above measures the price difference between the options exercise price and the closing share price quote the New York Stock Exchange as of the date of measurement. The date of exercise was the measurement date for shares exercised during the perioc September 30, 2008, the closing share price was $50.54 and was used for the calculation of aggregate intrinsic value of options outstanding and exercisable at that date. The options awarded in 2007 and 2008 had an exercise price in excess of the September 30, 2008 closing price and thus hav intrinsic value. The weighted average remaining contractual life of the Company s outstanding and exercisable options are 6.8 and 6.4 years, respe

10. 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 Cu Portfolio Properties.

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11. Business Segments

The Company has two reportable business segments: Shopping Centers and Office Properties. The accounting policies for the segments presented b
are the same as those described in the summary of significant accounting policies (see Note 2). The Company evaluates performance based upon ne
operating income for properties in each segment.

(Dollars in thousands)	Shopping Centers	Office Properties	Corporate and Other [1]	Consolid Tota
Quarter ended September 30, 2008				
Real estate rental operations:				
Revenue	$ 31,129	$ 9,628	$ 190	$ 40
Expenses	(6,980)	(2,857)		(9
Income from real estate	24,149	6,771	190	31
Interest expense & amortization of deferred debt costs			(8,568)	(8
General and administrative			(2,791)	(2
Subtotal	24,149	6,771	(11,169)	19
Depreciation and amortization of deferred leasing costs	(6,413)	(2,074)		(8
Minority interests			(1,743)	(1
Net income	$ 17,736	$ 4,697	$ (12,912)	$ 9
Capital investment	$ 12,675	33	5,822	$ 18
Total assets	$ 663,955	121,026	70,659	$ 855
Quarter ended September 30, 2007				
Real estate rental operations:				
Revenue	$ 28,377	$ 9,522	$ 115	$ 38
Expenses	(5,875)	(2,525)		(8
Income from real estate	22,502	6,997	115	29
Interest expense & amortization of deferred debt costs			(8,497)	(8
General and administrative			(2,636)	(2
Subtotal	22,502	6,997	(11,018)	18
Depreciation and amortization of deferred leasing costs	(4,509)	(2,016)		(6
Minority interests			(2,332)	(2
Net income	$ 17,993	$ 4,981	$ (13,350)	$ 9
Capital investment	$ 21,468	$ 273	$ 1,337	$ 23
Total assets	$ 564,002	$ 127,087	$ 33,934	$ 725

[1] Clarendon Center development included because a significant component will be residential.

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(Dollars in thousands)	Shopping Centers	Office Properties	Corporate and Other [(1)]	Consolic Tota
Nine months ended September 30, 2008				
Real estate rental operations:				
Revenue	$ 90,390	$ 28,883	$ 501	$ 119
Expenses	(19,935)	(8,127)		(28
Income from real estate	70,455	20,756	501	91
Interest expense & amortization of deferred debt costs			(25,877)	(25
General and administrative			(8,904)	(8
Subtotal	70,455	20,756	(34,280)	56
Depreciation and amortization of deferred leasing costs	(16,352)	(6,067)		(22
Gain on property disposition	205			
Minority interests			(5,837)	(5
Net income	$ 54,308	$ 14,689	$ (40,117)	$ 28
Capital investment	$ 86,935	344	14,671	$ 101
Total assets	$ 663,955	121,026	70,659	$ 855
Nine months ended September 30, 2007				
Real estate rental operations:				
Revenue	$ 83,118	$ 28,304	$ 353	$ 111
Expenses	(17,407)	(7,420)		(24
Income from real estate	65,711	20,884	353	86
Interest expense & amortization of deferred debt costs			(25,116)	(25
General and administrative			(8,314)	(8
Subtotal	65,711	20,884	(33,077)	53
Depreciation and amortization of deferred leasing costs	(13,348)	(6,128)		(19
Minority interests			(6,618)	(6
Net income	$ 52,363	$ 14,756	$ (39,695)	$ 27
Capital investment	$ 35,095	$ 1,100	$ 5,614	$ 41
Total assets	$ 564,002	$ 127,087	$ 33,934	$ 725

(1) Clarendon Center development included because a significant component will be residential.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

This section should be read in conjunction with the consolidated financial statements of the Company and the accompanying notes in Item 1. Fina Statements of this report and the more detailed information contained in our Form 10-K for the year ended December 31, 2007. Historical results a percentage relationships set forth in Item 1 and this section should not be taken as indicative of future operations of the Company. Capitalized terms but not otherwise defined in this section, have the meanings given to them in Item 1 of this Form 10-Q.

Forward-Looking Statements

This Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21 the Securities Exchange Act of 1934, as amended. These statements are generally characterized by terms such as believe , expect and may .

Although the Company believes that the expectations reflected in such forward-looking statements are based upon reasonable assumptions, the Company s actual results could differ materially from those given in the forward-looking statements as a result of changes in factors which include among others, the following:

risks related to the recent contraction of the domestic and global credit markets and their effect on discretionary spending;

risks that the Company s tenants will not pay rent;

risks related to the Company s reliance on shopping center anchor tenants and other significant tenants;

risks related to the Company s substantial relationships with members of The Saul Organization;

risks of financing, such as increases in interest rates, restrictions imposed by the Company s debt, the Company s ability to meet existing financial covenants and the Company s ability to consummate planned and additional financings on acceptable terms;

risks related to the Company s development activities;

risks that the Company s growth will be limited if the Company cannot obtain additional capital;

risks that planned and additional acquisitions or redevelopments may not be consummated, or if they are consummated, that they will n perform as expected;

risks generally incident to the ownership of real property, including adverse changes in economic conditions, changes in the investment climate for real estate, changes in real estate taxes and other operating expenses, adverse changes in governmental rules and fiscal polic the relative illiquidity of real estate and environmental risks;

risks related to the Company s status as a REIT for federal income tax purposes, such as the existence of complex regulations relating t Company s status as a REIT, the effect of future changes in REIT requirements as a result of new legislation and the adverse conseque the failure to qualify as a REIT; and

such other risks as described in Part I, Item 1A of our Form 10-K for the year ended December 31, 2007 and Part II, Item 1A of this For
10-Q.

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General

The following discussion is based primarily on the consolidated financial statements of the Company, as of September 30, 2008 and for the nine mo
period ended September 30, 2008.

Critical Accounting Policies

The Company s accounting policies are in conformity with U.S. GAAP. The preparation of financial statements in conformity with U.S. GAAP re
management to use judgment in the application of accounting policies, including making estimates and assumptions. These judgments affect the rep
amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the Company s financial statements and the report
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 cons
significant, including further discussion of the critical accounting policies described below, can be found in the notes to the Consolidated Financial
Statements.

Real Estate Investments

Real estate investment properties are stated at historic cost basis less depreciation. Management believes that these assets have generally appreciate
value and, accordingly, the aggregate current value exceeds their aggregate net book value and also exceeds the value of the Company s liabilities
reported in these financial statements. Because these financial statements are prepared in conformity with U.S. GAAP, they do not report the curren
value of the Company s real estate assets. The purchase price of real estate assets acquired is allocated between land, building and in-place acquire
leases based on the relative fair values of the components at the date of acquisition. Buildings are depreciated on a straight-line basis over their esti
useful lives of 35 to 50 years. Intangibles associated with acquired in-place leases are amortized over the remaining base lease terms.

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 a
impairment in value by making a comparison of the current and projected cash flows of the property over its remaining useful life, on an undiscoun
basis, to the carrying amount of that property. If such carrying amount is greater than the estimated projected cash flows, the Company would recog
an impairment loss equivalent to an amount required to adjust the carrying amount to its estimated fair market value.

When incurred, the Company capitalizes the cost of improvements that extend the useful life of property and equipment. All repair and maintenanc
expenditures are expensed. In addition, we capitalize leasehold improvements when certain criteria are met, including when we supervise constructi
and will own the improvement.

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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 opera

In the initial rental operations of development projects, a project is considered substantially complete and available for occupancy upon completion 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 35 to 50 years for base 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.

Deferred Leasing Costs

Certain initial direct costs incurred by the Company in negotiating and consummating successful leases are capitalized and amortized over the initia base term of the leases. Deferred leasing costs consist of commissions paid to third party leasing agents as well as internal direct costs such as empl compensation and payroll related fringe benefits directly related to time spent performing leasing related activities. Such activities include evaluatin prospective tenants financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating lease terms, preparing lease documents and closing transactions. In addition, deferred leasing costs include amounts attributed to in place leases associated with acquisition properties as determined pursuant to the application of SFAS No.141.

Revenue Recognition

Rental and interest income is accrued as earned except when doubt exists as to collectibility, in which case the accrual is discontinued. Recognition rental income commences when control of the space has been given to the tenant. When rental payments due under leases vary from a straight-line because of free rent periods or scheduled rent increases, income is recognized on a straight-line basis throughout the initial term of the lease. Expen recoveries represent a portion of property operating expenses billed to tenants, including common area maintenance, real estate taxes and other recoverable costs. Expense recoveries are recognized in the period when the expenses are incurred. Rental income based on a tenant s revenue, kno percentage rent, is accrued when a tenant reports sales that exceed a specified breakpoint.

Allowance for Doubtful Accounts - Current and Deferred Receivables

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

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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 b insurance. While the resolution of these matters cannot be predicted with certainty, the Company believes the final outcome of such matters will no have a material adverse effect on its financial position or the results of operations. Once it has been determined that a loss is probable to occur, the estimated amount of the loss is recorded in the financial statements. Both the amount of the loss and the point at which its occurrence is considered probable can be difficult to determine.

Results of Operations

Quarter ended September 30, 2008 compared to quarter ended September 30, 2007

Revenue

	Quarters ended September 30,		2008 to 2007 Cha	
(Dollars in thousands)	**2008**	**2007**	**$**	**%**
Base rent	$ 31,466	$ 30,064	$ 1,402	
Expense recoveries	7,652	6,638	1,014	1
Percentage rent	253	249	4	
Other	1,576	1,063	513	4
Total revenue	$ 40,947	$ 38,014	$ 2,933	

Note: *(Dollars in thousands)*

Base rent includes $234 and $499 for the quarters ended September 30, 2008 and 2007, respectively, to recognize base rent on a straight-line basis. addition, base rent includes $437 and $138, for the quarters ended September 30, 2008 and 2007, respectively, to recognize income from the amortization of in-place leases in accordance with SFAS No. 141.

Total revenue increased 7.7% in the quarter ended September 30, 2008 (2008 Quarter) compared to the corresponding prior year s quarter (20 The revenue increase for the 2008 Quarter resulted primarily from net rental income from the operations of a 2007 developed property and three 20 and one 2007 acquisition properties. The development property (Ashland Square) and the acquisition properties (Great Falls Center, BJ s Wholesa and Marketplace at Sea Colony in 2008 and Orchard Park in 2007) together defined as the Development and Acquisition Properties, contributed $1,457,000 of the revenue increase. Improved operating results at the core properties contributed the majority of the remaining quarter over quarter revenue growth. A discussion of the components of revenue follows.

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Base rent. The increase in base rent for the 2008 Quarter versus the 2007 Quarter was primarily attributable to leases in effect at the Development a
Acquisition Properties (88.2% or approximately $1,237,000). Rental rate growth in the core properties, particularly Leesburg Pike, Seven Corners,
Eastern Plaza and Southdale shopping centers provided the balance of the increase.

Expense recoveries. Expense recoveries represent a portion of property operating expenses billable to tenants, including common area maintenance,
estate taxes and other recoverable costs. The largest single contributor to the increase in expense recovery income resulted from operation of the
Development and Acquisition Properties (16.5% or approximately $167,000). Billings to tenants for their share of increased real estate tax expense
(39.7% or approximately $403,000) and property operating expenses (43.8% or approximately $444,000) throughout the core operating properties
accounted the balance of the increase.

Percentage rent. Percentage rent is rental revenue calculated on the portion of a tenant s sales revenue that exceeds a specified breakpoint. Percenta
rent for the 2008 Quarter was consistent with that of the 2007 Quarter.

Other revenue. Other revenue consists primarily of parking revenue at three of the Office Properties, temporary lease rental income, payments assoc
with early termination of leases and interest income from the investment of cash balances. The increase in other revenue for the 2008 Quarter result
primarily from increased lease termination fees (67.3% or approximately $345,000), interest income resulting from the investment of increased cash
balances (14.6% or approximately $75,000) and increased parking revenue primarily at 601 Pennsylvania Avenue (12.5% or approximately $64,000

Operating Expenses

(Dollars in thousands)	Quarters ended September 30, 2008	2007	2008 to 2007 Cha $	%
Property operating expenses	$ 5,360	$ 4,777	$ 583	1
Provision for credit losses	236	65	171	26
Real estate taxes	4,241	3,558	683	1
Interest expense and amortization of deferred debt	8,568	8,497	71	
Depreciation and amortization of leasing costs	8,487	6,525	1,962	3
General and administrative	2,791	2,636	155	
Total operating expenses	$ 29,683	$ 26,058	$ 3,625	1

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Increases in operating expenses resulted primarily from the operation and financing of the Development and Acquisition Properties and the asset retirements in conjunction with the redevelopment of Smallwood Village Center.

Property operating expenses. Property operating expenses consist of repairs and maintenance, utilities, payroll, insurance and other property related expenses. Expenses required to operate the Development and Acquisition Properties (19.7% or approximately $115,000) and increased repairs and maintenance at the core shopping centers (32.9% or approximately $192,000) and office properties (21.3% or approximately $124,000), produced t majority of the increase.

Provision for credit losses. The provision for credit losses represents the Company s estimation that amounts previously included in income and ov tenants may not be collectible. The increase in the 2008 Quarter versus the 2007 Quarter was primarily due to a credit loss provision established for rent dispute with a major tenant. The amount reported in each quarter represents six tenths of one percent (0.6%) or lower of total revenue for each quarter.

Real estate taxes. The increase in real estate taxes for the 2008 Quarter versus the 2007 Quarter was primarily due to a same property shopping cent increase of $469,000 (68.7% of total real estate tax increase), a 18.8% increase over the 2007 Quarter s amount, impacted largely by increased assessments at several of the Company s Northern Virginia shopping centers. The Office Properties, particularly Van Ness Square and 601 Pennsy Avenue contributed to the increase (19.5% or approximately $133,000) as well as the Development and Acquisition Properties (11.8% or approxim $81,000).

Interest expense and amortization of deferred debt. Interest expense increased in the 2008 Quarter versus the 2007 Quarter due to increased borrowi for the Development and Acquisition Properties offset in part by increased capitalized interest on development projects. Average outstanding borro increased approximately $38,024,000 (average fixed rate borrowings increased approximately $29,001,000 and average variable rate borrowings (construction loans) increased approximately $9,023,000). The new borrowing reduced the average interest rate by 0.11%. The combined impact of new borrowings, at a lower average rate, resulted in an approximately $527,000 increase in interest expense. Interest capitalized as a cost of constru and development projects increased during the 2008 Quarter compared to the 2007 Quarter decreased interest expense by approximately $473,000 ($1,190,000 versus $717,000) resulting primarily from construction activity at Clarendon Center, Northrock and Westview Village. Increased defer debt cost amortization increased interest expense by approximately $18,000 ($304,000 versus $286,000).

Depreciation and amortization of deferred leasing costs. The increase in depreciation and amortization of deferred leasing costs resulted primarily f asset retirements in conjunction with the redevelopment of Smallwood Village Center (56.7% or approximately $1,112,000) and the balance of the increase resulted from the Development and Acquisition Properties placed in service during the preceding twelve months.

General and administrative. General and administrative expenses consist of payroll, administrative and other overhead expenses. The majority of th general and administrative expense increase during the 2008 Quarter resulted from increased staff expenses of approximately $94,000. The balance the 2008 Quarter increase resulted from information technology expenses and New York Stock Exchange listing fees related to the Company s Ma 2008 preferred stock offering.

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Nine months ended September 30, 2008 compared to nine months ended September 30, 2007

Revenue

	Nine months ended September 30,		2008 to 2007 Cha	
(Dollars in thousands)	2008	2007	$	9
Base rent	$ 93,599	$ 88,616	$ 4,983	
Expense recoveries	21,730	19,518	2,212	1
Percentage rent	799	763	36	
Other	3,646	2,878	768	2
Total revenue	$ 119,774	$ 111,775	$ 7,999	

Note: *(Dollars in thousands)*

Base rent includes $845 and $1,315 for the nine months ended September 30, 2008 and 2007, respectively, to recognize base rent on a straight-line In addition, base rent includes $1,006 and $335, for the nine months ended September 30, 2008 and 2007, respectively, to recognize income from th amortization of in-place leases in accordance with SFAS No. 141.

Total revenue increased 7.2% in the nine month period ended September 30, 2008 (2008 Period) compared to the corresponding prior year s nin period (2007 Period). The revenue increase for the 2008 Period resulted primarily from net rental income from Development and Acquisition Pro (46.7% or approximately $3,736,000) and the lease-up of Lansdowne Town Center (18.0% or approximately $1,441,000). Improved operating resul the remaining properties and increased interest income contributed the balance of the period over period revenue growth. A discussion of the components of revenue follows.

Base rent. The increase in base rent for the 2008 Period versus the 2007 Period was primarily attributable to the Development and Acquisition Prop (65.3% or approximately $3,253,000) and the lease-up of Lansdowne Town Center (19.6% or approximately $977,000). Rental rate growth in the c properties, particularly Southdale, Seven Corners, Leesburg Pike and Beacon Center shopping centers provided the balance of the increase.

Expense recoveries. Expense recoveries represent a portion of property operating expenses billable to tenants, including common area maintenance, estate taxes and other recoverable costs. The largest single contributor to the increase in expense recovery income resulted from operation of the Development and Acquisition Properties (21.4% or approximately $473,000). Billings to tenants for their share of increased real estate tax expense (62.5% or approximately $1,382,000) and property operating expenses (16.1% or approximately $357,000) throughout the core operating properties accounted the balance of the increase.

Percentage rent. Percentage rent is rental revenue calculated on the portion of a tenant s sales revenue that exceeds a specified breakpoint. Percenta rent increased slightly for the 2008 Period compared to the prior year period.

Other revenue. Other revenue consists primarily of parking revenue at three of the Office Properties, temporary lease rental income, payments assoc with early termination of leases and interest income from the investment of cash balances. The increase in other revenue for the 2008 Period resulte primarily from increased lease termination fees (49.5% or approximately $380,000), increased parking revenue primarily at 601 Pennsylvania Aven (20.8% or approximately $160,000) and interest income resulting from the investment of increased cash balances (19.3% or approximately $148,00

Operating Expenses

	Nine months ended September 30,		2008 to 2007 Cha	
(Dollars in thousands)	**2008**	**2007**	**$**	**%**
Property operating expenses	$ 14,872	$ 13,925	$ 947	
Provision for credit losses	660	280	380	13
Real estate taxes	12,530	10,622	1,908	1
Interest expense and amortization of deferred debt	25,877	25,116	761	
Depreciation and amortization of leasing costs	22,419	19,476	2,943	1
General and administrative	8,904	8,314	590	
Total operating expenses	$ 85,262	$ 77,733	$ 7,529	

Increases in operating expenses resulted primarily from the operation and financing of the Development and Acquisition Properties and the asset retirements in conjunction with the redevelopment of Smallwood Village Center.

Property operating expenses. Property operating expenses consist of repairs and maintenance, utilities, payroll, insurance and other property related expenses. Increased core property utility expense (39.6% or approximately $375,000) and expenses required to operate the Development and Acqui Properties (28.3% or approximately $268,000) produced the majority of the increase.

Provision for credit losses. The provision for credit losses represents the Company s estimation that amounts previously included in income and ov tenants may not be collectible. The increase in the 2008 Period versus the 2007 Period was primarily due to a credit loss provision established for a dispute with a major tenant and a tenant who defaulted at Lansdowne Town Center.

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Real estate taxes. The increase in real estate taxes for the 2008 Period versus the 2007 Period was primarily due to a same property shopping center increase of $1,244,000 (65.2% of total real estate tax increase), a 16.9% increase over the 2007 Period s amount, impacted largely by increased assessments at several of the Company s Northern Virginia shopping centers. The Office Properties, particularly Van Ness Square and 601 Pennsyl Avenue, contributed toward the increase (20.1% or approximately $383,000) as well as the Development and Acquisition Properties (14.7% or approximately $281,000).

Interest expense and amortization of deferred debt. Interest expense increased in the 2008 Period versus the 2007 Period due to increased borrowing the Development and Acquisition Properties offset in part by increased capitalized interest on development projects. Average outstanding borrowin increased approximately $35,993,000 (average fixed rate borrowings increased approximately $43,776,000 while average variable rate borrowings revolving credit line and construction loans) decreased approximately $7,783,000). The new borrowing reduced the average interest rate by 0.14%. combined impact of the new borrowings, at a lower average rate, resulted in an approximately $1,248,000 increase in interest expense. Interest capitalized as a cost of construction and development projects increased during the 2008 Period compared to the 2007 Period decreased interest exp by approximately $535,000 ($2,876,000 versus $2,341,000) resulting primarily from construction activity at Clarendon Center, Northrock and West Village. Increased deferred debt cost amortization increased interest expense by approximately $49,000 ($889,000 versus $840,000).

Depreciation and amortization of deferred leasing costs. The increase in depreciation and amortization of deferred leasing costs resulted primarily f asset retirements in conjunction with the redevelopment of Smallwood Village Center (37.8% or approximately $1,112,000) and the balance of the increase resulted from the Development and Acquisition Properties placed in service during the preceding twelve months.

General and administrative. General and administrative expenses consist of payroll, administrative and other overhead expenses. General and administrative expenses increased for the 2008 Period compared to the 2007 Period due to increased staff expenses (87.5% or approximately $516,0 and real estate tax on land held for investment (25.1% or approximately $148,000), offset in part by reduced professional fees.

Gain on property disposition

The Company recognized a gain on property disposition of $205,000 in the 2008 Period. The gain represents proceeds from an insurance settlement HVAC units vandalized at the Company s West Park shopping center in Oklahoma City, Oklahoma. There were no property dispositions in the 20 Period.

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Liquidity and Capital Resources

Cash and cash equivalents were $25,137,000 and $7,043,000 at September 30, 2008 and 2007, respectively. The Company s cash flow is affected b operating, investing and financing activities, as described below.

(Dollars in thousands)	Nine Months Ended September 30, 2008	2007
Cash provided by operating activities	$ 57,309	$ 53,230
Cash used in investing activities	(101,745)	(41,809)
Cash provided by (used in) financing activities	63,808	(12,439)
Increase (decrease) in cash	$ 19,372	$ (1,018)

Operating Activities

Cash provided by operating activities represents cash received primarily from rental income, plus other income, less property operating expenses, n recurring general and administrative expenses and interest payments on debt outstanding.

Investing Activities

Cash used in investing activities includes property acquisitions, developments, redevelopments, tenant improvements and other property capital expenditures. Investing activities for the 2008 Period primarily reflect the acquisition of three operating properties (Great Falls Center, BJ s Whole Club and Marketplace at Sea Colony) and a land parcel (Northrock) and to a lesser extent development and construction costs of Clarendon Center, Northrock and Westview Village. Investing activities for the 2007 Period primarily reflect the development and construction costs associated with t lease-up of Lansdowne Town Center and the development of Clarendon Center. Tenant improvement and property capital expenditures totaled $6,998,000 and $5,963,000, for the 2008 and 2007 Periods, respectively.

Financing Activities

Cash provided by financing activities for the period ended September 30, 2008 primarily reflects:

Proceeds of $76,317,000, net of costs, received from the issuance of Series B preferred stock during the period;

Proceeds of $44,876,000 received from mortgage notes payable originated during the period;

Proceeds of $19,000,000 received from advances provided by the revolving credit facility during the period; and

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- Proceeds of $4,255,000 received from the issuance of common stock from options exercised and shares issued under the dividend reinvestment program.

which was partially offset by:

- the repayment of mortgage note payable borrowings totaling $12,271,000;
- repayments of $27,000,000 on the revolving credit facility;
- distributions to common stockholders during the period totaling $25,075,000;
- distributions to holders of convertible limited partnership units in the Operating Partnership during the period totaling $7,638,000;
- distributions made to preferred stockholders during the period totaling $7,883,000; and
- payments of $773,000 for financing costs of mortgage notes payable.

Cash used by financing activities for the period ended September 30, 2007 primarily reflects:

- the repayment of mortgage note payable borrowings totaling $10,839,000;
- repayments of $47,000,000 on the revolving credit facility;
- distributions to common stockholders during the period totaling $22,693,000;
- distributions to holders of convertible limited partnership units in the Operating Partnership during the period totaling $7,041,000;
- distributions made to preferred stockholders during the period totaling $6,000,000; and
- payments of $698,000 for financing costs of mortgage notes payable;

which was partially offset by:

- Proceeds of $52,000,000 received from mortgage notes payable originated during the period;
- Proceeds of $12,000,000 received from advances provided by the revolving credit facility during the period; and

Proceeds of $17,832,000 received from the issuance of common stock from the exercise of employee stock options and shares issued u
the dividend reinvestment program.

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Liquidity Requirements

Short-term liquidity requirements consist primarily of normal recurring operating expenses and capital expenditures, debt service requirements (including debt service relating to additional and replacement debt), distributions to common and preferred stockholders, distributions to unit holder amounts required for expansion and renovation of the Current Portfolio Properties and selective acquisition and development of additional propertie order to qualify as a REIT for federal income tax purposes, the Company must distribute to its stockholders at least 90% of its real estate investme taxable income, as defined in the Code. The Company expects to meet these short-term liquidity requirements (other than amounts required for additional property acquisitions and developments) through cash provided from operations and its existing line of credit. The Company anticipates t any additional property acquisitions and developments in the next 12 months will be funded with cash on hand and borrowing from construction financings, future long-term secured debt and the public or private issuance of common or preferred equity or units, each of which may be initially funded with our existing line of credit.

Long-term liquidity requirements consisted primarily of obligations under our long-term debt and dividends paid to our preferred shareholders. The Company anticipates that long-term liquidity requirements will also include amounts required for property acquisitions and developments. The Con expects to meet long-term liquidity requirements through cash provided from operations, long-term secured and unsecured borrowings, private or pu 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 intere in the Operating Partnership which can be converted into shares of Saul Centers common stock. The availability and terms of any such financing wi depend upon market and other conditions.

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As of September 30, 2008, the scheduled maturities, including scheduled principal amortization, of all debt for years ended December 31, are as fol

Debt Maturity Schedule

(Dollars in thousands)	**Balloon Payments**	**Scheduled Principal Amortization**	**To**
October 1 through December 31, 2008	$	$ 4,313	$
2009		18,054	1
2010		19,413	1
2011	77,334(a)	20,852	9
2012	96,300	15,050	11
2013	39,440	9,269	4
Thereafter	201,628	66,027	26
	$ 414,702	$ 152,978	$ 56

(a) Includes the Clarendon Center and Northrock construction loan balances as of September 30, 2008, totaling $15,101.

Management believes that the Company s capital resources, which at September 30, 2008 included cash balances of approximately $25,137,000 an borrowing availability of approximately $149,823,000 on its revolving line of credit, 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 common stockholders and of limited partnership interests an opportunity to buy additional shares of common stock by reinvesting all or a portion of their dividends or distribu 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 68,837 and 363,751 share under the Plan at a weighted average discounted price of $48.47 and $47.89 per share, during the nine month periods ended September 30, 2008 and 2007, respectively. The Company also credited 6,463 and 5,618 shares to directors pursuant to the reinvestment of dividends specified by the Direct Deferred Compensation Plan at a weighted average discounted price of $48.31 and $47.98 per share, during the nine month periods ended Septemb 2008 and 2007, respectively.

Capital Strategy and Financing Activity

As a general policy, the Company intends to maintain a ratio of its total debt to total asset value of 50% or less and to actively manage the Company leverage and debt expense on an ongoing basis in order to maintain prudent coverage of fixed charges. Asset value is the aggregate fair market valu the Current Portfolio Properties and any subsequently acquired properties as reasonably determined by management by reference to the properties aggregate cash flow. Given the Company s current debt level, it is management s belief that the ratio of the Company s debt to total asset value w 50% as of September 30, 2008.

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The organizational documents of the Company do not limit the absolute amount or percentage of indebtedness that it may incur. The Board of Direc may, from time to time, reevaluate the Company s debt capitalization policy in light of current economic conditions, relative costs of capital, mark values of the Company property portfolio, opportunities for acquisition, development or expansion, and such other factors as the Board of Directors deems relevant. The Board of Directors may modify the Company s debt capitalization policy based on such a reevaluation without shareholder ap and consequently, may increase or decrease the Company s debt to total asset ratio above or below 50% or may waive the policy for certain period time. The Company selectively continues to refinance or renegotiate the terms of its outstanding debt in order to achieve longer maturities, and obta generally more favorable loan terms, whenever management determines the financing environment is favorable.

The Company maintains a $150,000,000 unsecured revolving credit facility. The facility is intended to provide working capital and funds for acquisitions, certain developments and redevelopments. The credit facility has a three-year term expiring December 19, 2010 and provides for an additional one-year extension at the Company s option, subject to the Company s satisfaction of certain conditions. Until December 19, 2009, cert all of the lenders may, upon request by the Company, increase the facility by $50,000,000. Letters of credit may be issued under the facility. On September 30, 2008, of the $150,000,000 available for borrowing, approximately $177,000 was committed for letters of credit, and the resulting bal of approximately $149,823,000 was available to borrow for working capital, operating property acquisitions or development projects. Interest rate pricing under the facility is primarily determined by operating income from the Company s existing unencumbered properties and to a lesser extent certain leverage tests. As of September 30, 2008, operating income from the unencumbered properties determined the interest rate for up to $100,000,000 of the line s available borrowings, with interest expense to be calculated based upon the 1, 2, 3 or 6 month LIBOR plus a spread of 1 to 1.60% or upon the bank s reference rate, at the Company s option. The remaining $50,000,000 of the line s availability is determined based up Company s consolidated operating income after debt service. On this portion of the facility, interest accrues at a rate of LIBOR plus a spread of 1.7 2.25%, determined by certain leverage tests, or upon the bank s reference rate plus a spread of 0.575%, at the Company s option.

As of September 30, 2008, no borrowings were outstanding under the facility. The facility requires the Company and its subsidiaries to maintain cer financial covenants. As of September 30, 2008, the material covenants required the Company, on a consolidated basis, to:

- limit the amount of debt so as to maintain a gross asset value, as defined in the loan agreement, in excess of liabilities of at least $600 million plus 90% of the Company s future net equity proceeds;

- limit the amount of debt as a percentage of gross asset value, as defined in the loan agreement, to less than 60% (leverage ratio);

- limit the amount of debt so that interest coverage will exceed 2.5 to 1 on a trailing 12-full calendar month basis;

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limit the amount of debt so that interest, scheduled principal amortization and preferred dividend coverage exceeds 1.6 to 1; and

limit the amount of variable rate debt and debt with initial loan terms of less than five years to no more than 40% of total debt.

As of September 30, 2008, the Company was in compliance with all such covenants. Saul Centers is a guarantor of the revolving credit facility, of v the Operating Partnership is the borrower. Saul Centers is also the guarantor of the Northrock construction loan (approximately $10,604,000 outstan at September 30, 2008) and the Clarendon Center construction loan (approximately $4,497,000 outstanding at September 30, 2008). The fixed-rate payable are all non-recourse debt except for $1,875,000 of the increase to the Shops at Fairfax and Boulevard mortgage and $2,000,000 of the Grea Falls Center mortgage, both of which are guaranteed by Saul Centers.

On February 29, 2008, the Company closed on a $7,500,000 increase to a fixed-rate mortgage secured by Shops at Fairfax and Boulevard shopping centers. The loan matures June 1, 2015 (same as the original financing), requires monthly interest only payments of approximately $38,000, based u a 6.08% interest rate, and requires a final principal payment of $7,500,000 at maturity. The Company has initially guaranteed $1,875,000 of this loa until the Boulevard redevelopment is completed and until certain debt service coverage tests are achieved.

On March 23, 2008, the Company closed on a $3,000,000 increase to a fixed-rate mortgage secured by Seabreeze Plaza. The loan matures May 1, 2 (same as the original financing), requires equal monthly principal and interest payments of approximately $17,794, based upon a 5.90% interest rate 30-year principal amortization, and requires a final principal payment of approximately $2,738,000 at maturity.

On March 28, 2008, the Company assumed a fully amortizing fixed-rate mortgage loan in the amount of approximately $10,349,000, secured by the acquisition property, Great Falls Center. The loan matures February 1, 2024 and requires equal monthly principal and interest payments of approximately $83,113, based upon a 5.80% interest rate and 20-year principal amortization.

On March 31, 2008, the Company closed on a new 15-year, fixed-rate mortgage loan in the amount of $12,750,000, secured by the BJ s Wholesale center. The loan matures April 1, 2023, requires equal monthly principal and interest payments of approximately $80,003, based upon a 6.43% inter rate and 30-year principal amortization, and requires a final principal payment of approximately $9,255,000 at maturity.

In April 2008, the Company closed on a $10,825,000 additional financing secured by the Great Falls Center. Funding in the amount of $6,525,000 occurred on April 6, 2008, payable at an interest rate of 6.80%, interest only for the first year, after which amortization will commence on a 30-year amortization schedule, requiring monthly payments of principal and interest totaling approximately $42,538. A final principal payment of approxim $1,274,000 will be due at maturity on February 1, 2024. The Company has initially guaranteed $2,000,000 of this loan,

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with the amount of any additional advance to also be guaranteed until certain debt service coverage tests are achieved. The balance totaling $4,300,0
a forward commitment to be funded prior to March 31, 2009, subject to achieving certain re-leasing requirements.

In May 2008, the Company closed on a $21,822,000 secured construction loan, to fund the development of the 103,000 square foot Northrock shop
center in Warrenton, Virginia. Funding in the amount of approximately $6,495,000 occurred at closing. The loan accrues interest, payable at an inte
rate of LIBOR plus 1.6%. The loan matures on May 1, 2011, with one 2-year extension option, exercisable at the Company s option subject to completion of improvements and certain debt service coverage requirements. The loan is 100% guaranteed by the Company until such time as the construction is complete, at which time the guarantee will be limited to 50% of the total principal outstanding. Approximately $10,604,000 is outstanding as of September 30, 2008.

Also in May 2008, the Company closed a $157,500,000 secured construction loan to finance the development of Clarendon Center, a mixed-use development adjacent to the Clarendon Metro station in Arlington, Virginia. The Company has guaranteed the loan, with the guarantee to be reduce
subject to certain conditions related to pre-leasing, completion of construction and net operating income from the project. The loan accrues interest a
interest rate of LIBOR plus 2.5% and matures on November 14, 2011, which term may be extended by the Company for two additional 9-month pe
subject to the satisfaction of certain conditions. Approximately $4,497,000 was outstanding as of September 30, 2008.

Preferred Stock Issue

On March 20, 2008, the Company filed a shelf registration statement (the Shelf Registration Statement) with the SEC relating to the future offeri
to an aggregate of $140 million of preferred stock and depositary shares. On March 27, 2008, the Company sold 3,000,000 depositary shares, each representing 1/100th of a share of 9% Series B Cumulative Redeemable Preferred Stock, providing net cash proceeds of $72.1 million. The underwr
exercised an over-allotment option, purchasing an additional 173,115 depositary shares providing additional net cash proceeds of $4.2 million.

The depositary shares may be redeemed, in whole or in part, at the $25.00 liquidation preference at the Company s option on or after March 15, 20
The depositary shares will pay an annual dividend of $2.25 per share, equivalent to 9% of the $25.00 liquidation preference. The first dividend was
on July 15, 2008 and covered the period from March 27, 2008 through June 30, 2008. The Series B preferred stock has no stated maturity, is not sub
to any sinking fund or mandatory redemption and is not convertible into any other securities of the Company. Investors in the depositary shares gen
have no voting rights, but will have limited voting rights if the Company fails to pay dividends for six or more quarters (whether or not declared or consecutive) and in certain other events.

Net proceeds from the issuance of approximately $76.3 million were used to fully repay $22.0 million then outstanding under the Company s revol
credit facility and approximately $31.5 million was used to acquire three operating shopping center properties on March 28, 2008 ($61.1 million acquisition cost less financing proceeds of $29.6 million from loans secured by the acquisition properties). The remaining $22.8 million was investe
short-term certificates of deposit.

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Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements that are reasonably likely to have a current or future material effect on the Company s financi
condition, revenue or expenses, results of operations, liquidity, capital expenditures or capital resources.

Funds From Operations

For the quarter ended September 30, 2008, the Company reported Funds From Operations (FFO) [1] available to common shareholders of approxima
$15,966,000, representing a 3.1% decrease over the comparative 2007 quarter s FFO available to common shareholders. For the nine months ended
September 30, 2008, the Company reported FFO available to common shareholders of approximately $47,263,000, representing a 0.5% decrease ov
the comparative 2007 period s FFO available to common shareholders. The following table presents a reconciliation from net income to FFO avail
common stockholders for the periods indicated:

Funds From Operations Reconciliation

(Amounts in thousands)	**Quarter ended September 30,**		**Nine months ended Septemb**	
	2008	**2007**	**2008**	**2007**
Net income	$ 9,521	$ 9,624	$ 28,880	$ 27
Less: Gain on property disposition			(205)	
Add:				
Depreciation & amortization of real property	8,487	6,525	22,419	19
Minority interests	1,743	2,332	5,837	6
FFO	19,751	18,481	56,931	53
Subtract:				
Preferred stock dividends	(3,785)	(2,000)	(9,668)	(6
FFO available to common shareholders	$ 15,966	$ 16,481	$ 47,263	$ 47
Average shares & units used to compute FFO per share	23,407	23,247	23,387	23

(1) The National Association of Real Estate Investment Trusts (NAREIT) developed FFO as a relative non-GAAP financial measure of performa
of an equity REIT in order to recognize that income-producing real estate historically has not depreciated on the basis determined under GAA
FFO is defined by NAREIT as net income, computed in accordance with GAAP, plus minority interests, extraordinary items and real estate
depreciation and amortization, excluding gains or losses from property dispositions. FFO does not represent cash generated from operating
activities in accordance with GAAP and is not necessarily indicative of cash available to fund cash needs, which is disclosed in the Company
Consolidated Statements of Cash Flows for the applicable periods. There are no material legal or functional restrictions on the use of FFO. FF
should not be considered as an alternative to net income, its most directly comparable GAAP measure, as an indicator of the Company s oper
performance, or as an alternative to cash flows as a measure of liquidity. Management considers FFO a meaningful supplemental measure of
operating performance because it primarily excludes the assumption that the value of the real estate assets diminishes predictably over time (i
depreciation), which is contrary to what we believe occurs with our assets, and because industry analysts have accepted it as a performance
measure. FFO may not be comparable to similarly titled measures employed by other REITs.

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Acquisitions, Redevelopments and Renovations

Management anticipates that during the coming year the Company may: i) redevelop certain of the Current Portfolio Properties, ii) develop addition freestanding outparcels or expansions within certain of the Shopping Centers, iii) acquire existing neighborhood and community shopping centers a office properties, and iv) develop new shopping center or mixed-use commercial operating properties. Acquisition and development of properties ar undertaken only after careful analysis and review, and management s determination that such properties are expected to provide long-term earnings cash flow growth. During the balance of the year, any developments, expansions or acquisitions are expected to be funded with remaining net proce from the March 2008 preferred stock offering, bank borrowings from the Company s credit line, construction financing, proceeds from the operatio the Company s dividend reinvestment plan or other external capital resources available to the Company.

The Company has been selectively involved in acquisition, development, redevelopment and renovation activities. It continues to evaluate the acquisition of land parcels for retail and office development and acquisitions of operating properties for opportunities to enhance operating income a 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 Smallwood Village Center and Boulevard shopping centers. The following describes the acquisition, development, redevelopment and renovation activities of the Company in 2007 and the nine months ended September 30, 2008.

Broadlands Village

The Company purchased 24 acres of undeveloped land in the Broadlands section of the Dulles Technology Corridor of Loudoun County, Virginia i April 2002. Broadlands is a 1,500 acre planned community consisting of 3,500 residences, approximately half of which are constructed and currentl occupied. In October 2003, the Company completed construction of the first phase of the Broadlands Village shopping center. The 58,000 square fo Safeway supermarket opened in October 2003 with a pad building and many in-line small shops also opening in the fourth quarter of 2003. Constru of a 30,000 square foot second phase was substantially completed in 2004. The Company s total development costs of both phases, including the la acquisition, were approximately $22 million. During the second quarter of 2006, the Company substantially completed construction of a third phase this development, totaling approximately 22,000 square feet of shop space and two pad site locations. Development costs for this phase totaled approximately $7.1 million. The center was 97.5% leased and fully operational at September 30, 2008.

Ashland Square

On December 15, 2004, the Company acquired a 19.3 acre parcel of land in Manassas, Prince William County, Virginia for a purchase price of $6.3 million. The Company has plans to develop the parcel into a grocery-anchored neighborhood shopping center. The Company received site plan appr during the third quarter of 2006 to develop approximately 125,000 square feet of retail space. A site plan for an additional 35,000 square feet of commercial space is under review by Prince William County. During the fourth quarter of 2007, the Company completed preliminary site work consisting of clearing, grading and site utility construction. A ground lease has been executed with Chevy Chase Bank, which built a branch on a pa site. The bank branch opened for business October 2007. The balance of the center is being marketed to grocers and other retail businesses, with a development timetable yet to be finalized.

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New Market

On March 3, 2005, the Company acquired a 7.1 acre parcel of land located in New Market, Maryland for a purchase price of $500,000. On Septemb 2005, the Company acquired a 28.4 acre contiguous parcel for a purchase price of $1.5 million. Together, these parcels will accommodate a neighborhood shopping center development in excess of 120,000 square feet of leasable space. The Company had contracted to purchase one additi parcel with the intent to assemble additional acreage for further retail development near this I-70 interchange, east of Frederick, Maryland. During December 2007, the Company abandoned the acquisition of this final parcel and as of September 30, 2008, wrote-off to general and administrative expense all costs related to this parcel.

Lansdowne Town Center

During the first quarter of 2005, the Company received approval of a zoning submission to Loudoun County which allowed the development of a neighborhood shopping center named Lansdowne Town Center, within the Lansdowne Community in northern Virginia. On March 29, 2005, the Company finalized the acquisition of an additional 4.5 acres of land to bring the total acreage of the development parcel to 23.4 acres (including the acres acquired in 2002). The additional purchase price was approximately $1.0 million. In late 2006, the Company substantially completed construc of an approximately 189,000 square foot retail center. A lease was executed with Harris Teeter for a 55,000 square foot grocery store, which opened November 2006. Project costs totaled approximately $41.5 million. As of September 30, 2008, the project was fully operational and 98.4% leased.

Smallwood Village Center

On January 27, 2006, the Company acquired the 198,000 square foot Smallwood Village Center, located on 25 acres within the St. Charles planned community of Waldorf, Maryland. The center was acquired for a purchase price of $17.5 million subject to the assumption of an $11.3 million mort loan, and was 80.7% leased at September 30, 2008. The Company commenced construction during the first quarter of 2008 on a capital improveme project to improve access to the center, reconfigure portions of the center and upgrade the center s façade and common areas. The redeveloped cen total approximately 173,000 square feet. Substantial completion is projected in the fourth quarter of 2008. Project costs are expected to total approximately $6.8 million.

Clarendon Center

The Company owns an assemblage of land parcels (including its Clarendon and Clarendon Station operating properties) totaling approximately 1.5 adjacent to the Clarendon Metro Station in Arlington, Virginia. In June 2006, the Company obtained zoning approvals for a mixed-use developmen project to include up to approximately 45,000 square feet of retail space, 170,000 square feet of office space and 244 residential units. The total development costs are expected to be approximately $195.0 million, a portion of which will be funded with the $157.5 million construction loan tha Company closed in May 2008. Site excavation and utility construction is continuing on the southern block of the two parcels. Demolition of the nor block commenced in October 2008. The Company estimates substantial completion of shell construction in late 2010.

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Westview Village

In November 2007, the Company purchased a 10.4 acre site in the Westview development on Buckeystown Pike (MD Route 85) in Frederick, Mary
The purchase price was $5.0 million. Construction documents have been completed and site permits have been received for development of approximately 105,000 square feet of commercial space, including 60,000 square feet of retail shop space, 15,000 square feet of retail pads and 30,0
square feet of professional office space. The Company is currently marketing the space and has executed leases for 19,509 square feet, or 33% of th
retail shop space. The Company commenced construction in early 2008 and anticipates total construction and development costs, including land, to
approximately $26.5 million. Substantial completion of the building shell is scheduled for late 2008.

Great Eastern Plaza Land Parcel

On June 6, 2007, the Company acquired 8.0 acres of undeveloped land adjacent to its Great Eastern Plaza shopping center in District Heights, Mary
for a purchase price of $1.3 million. The Company is analyzing options to expand the existing shopping center onto this parcel at some future date.

Orchard Park

On July 19, 2007, the Company completed the acquisition of the 88,000 square foot Kroger-anchored Orchard Park shopping center located in Dunwoody, Georgia. The center is 92.5% leased as of September 30, 2008 and was acquired for a purchase price of $17.0 million.

Northrock

In January 2008, the Company acquired approximately 15.4 acres of undeveloped land in Warrenton, Virginia, located at the southwest corner of th
S. Route 29/211 and Fletcher Drive intersection. The Company has commenced building construction for Northrock shopping center, a neighborhoo
shopping center totaling approximately 103,000 square feet of leasable area. Approximately 62% of the project is pre-leased. The Harris Teeter supermarket chain has executed a lease for a 52,700 square foot grocery store to anchor the center. Additionally, the Company has executed a lease
Chevy Chase Bank for a pad building and has executed leases for 7,896 square feet of shop space. The land purchase price was $12.5 million, and t
Company anticipates total construction and development costs, including land, to be approximately $27.9 million. A portion of these total developm
costs will be funded with the $21.8 million construction loan the Company closed in May 2008. Construction substantial completion is anticipated f
the spring of 2009.

Great Falls Center

On March 28, 2008, the Company completed the acquisition of the Safeway-anchored Great Falls Center located in Great Falls, Virginia. The cente
94.9% leased at September 30, 2008 and was acquired for a purchase price of $36.6 million.

BJ s Wholesale Club

On March 28, 2008, the Company completed the acquisition of the single tenant property anchored by BJ s Wholesale Club, located in Alexandria,
Virginia. The center was 100% leased at September 30, 2008 and was acquired for a purchase price of $21.0 million.

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Marketplace at Sea Colony

On March 28, 2008, the Company completed the acquisition of Marketplace at Sea Colony, located in Bethany Beach, Delaware. The center was 10
leased at September 30, 2008 and was acquired for a purchase price of $3.0 million.

Boulevard

During the second quarter of 2008, permits were issued for the redevelopment of a portion of the Boulevard shopping center. A vacant pad building
totaling approximately 18,800 square feet and previously occupied by a furniture store has been demolished. The center s in-line shop space will be
expanded by approximately 8,000 square feet for small shop retail and a new pad building will replace the demolished structure. A ground lease has
executed with Chevy Chase Bank for the pad building, and a total of 4,650 square feet, or 58.4% of the small shop space is pre-leased to four tenant
The Company anticipates total construction and development costs to be approximately $2.8 million, with substantial completion anticipated in late
2008.

Portfolio Leasing Status

The following chart sets forth certain information regarding the operating portfolio for the periods ended September 30, 2008 and 2007, respectively

	Total Properties		Total Square Footage		Percent Leased	
As of September 30,	**Shopping Centers**	**Office**	**Shopping Centers**	**Office**	**Shopping Centers**	**Of**
2008	45	5	6,988,000	1,206,000	94.6%	9
2007	43	5	6,792,000	1,206,000	95.2%	9

The 2008 shopping center leasing percentage decreased primarily due to a 37,000 square foot leasing decrease at South Dekalb Plaza in Atlanta, Ge
and a 11,000 square foot decrease at Seabreeze Plaza in Palm Harbor, Florida. The office portfolio decrease occurred primarily at Avenel Business
where the percentage leased decreased from 96.9% in 2007 to 93.9% in 2008.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company is exposed to certain financial market risks, the most predominant being fluctuations in interest rates. Interest rate fluctuations are
monitored by management as an integral part of the Company s overall risk management program, which recognizes the unpredictability of financi
markets and seeks to reduce the potentially adverse effect on the Company s results of operations. The Company does not enter into financial instru
for trading purposes.

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The Company is exposed to interest rate fluctuations primarily as a result of any variable rate debt used to finance the Company s development and acquisition activities and for general corporate purposes. As of September 30, 2008, the Company had variable rate indebtedness totaling $15,101,0 Interest rate fluctuations will affect the Company s annual interest expense accrued on its variable rate debt. If the interest rate on the Company s v rate debt instruments outstanding at September 30, 2008 had been one percent higher, our annual interest expense accrued relating to these debt instruments would have increased by $151,010, based on those balances. Interest rate fluctuations will also affect the fair value of the Company s f rate debt instruments. As of September 30, 2008, the Company had fixed rate indebtedness totaling $552,579,000. If interest rates on the Company fixed rate debt instruments at September 30, 2008 had been one percent higher, the fair value of those debt instruments on that date would have decreased by approximately $26,716,000.

Item 4. Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclo in the Company s reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within th periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to the Company s management, inclu Chairman and Chief Executive Officer, its Senior Vice President-Chief Financial Officer, Secretary and Treasurer, and its Vice President-Chief Accounting Officer as appropriate, to allow timely decisions regarding required disclosure based closely on the definition of "disclosure controls an procedures" in Rule 13a-15(e) promulgated under the Exchange Act. In designing and evaluating the disclosure controls and procedures, manageme recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the des control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls an procedures.

The Company carried out an evaluation under the supervision and with the participation of the Company s management, including its Chairman an Chief Executive Officer, its Senior Vice President-Chief Financial Officer, Secretary and Treasurer, and its Vice President-Chief Accounting Office the effectiveness of the design and operation of the Company s disclosure controls and procedures as of September 30, 2008. Based on the foregoi Company s Chairman and Chief Executive Officer, its Senior Vice President-Chief Financial Officer, Secretary and Treasurer and its Vice President-Chief Accounting Officer concluded that the Company s disclosure controls and procedures were effective at the reasonable assurance le of September 30, 2008.

During the three months ended September 30, 2008, there were no changes in the Company s internal control over financial reporting that have ma affected, or are reasonably likely to materially affect, its internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 1A. Risk Factors

The global and domestic economies have recently experienced a significant contraction of credit markets and resulting slowdown in business and consumer spending. We believe that consumers have cut back their discretionary spending in response to credit constraints, unemployment, a reduc in home equity values, highly volatile fuel and other commodity prices, and general economic uncertainty.

Given these current conditions, the Company s business and results of operations could be adversely affected as follows:

Small business tenants and anchor retailers which lease space in the Company s properties, may experience a deterioration in their sale other revenue, or experience a constraint on the availability of credit necessary to fund operations, which in turn may adversely impact t tenants ability to pay contractual base rents and operating expense recoveries. Some tenants may terminate their occupancy due to an inability to operate profitably for an extended period of time, impacting the Company s ability to maintain occupancy levels.

Decreasing sales revenue by retail tenants could adversely impact the Company s receipt of percentage rents required to be paid by ten under certain leases,

Constraints on the availability of credit to office and retail tenants, necessary to purchase and install improvements, fixtures and equipm and fund start-up business expenses, could impact the Company s ability to procure new tenants for spaces currently vacant in existing operating properties or properties under development.

Other risk factors are presented in Item 1A. Risk Factors in the 2007 Annual Report of the Company on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

751 shares were acquired at a price of $46.78 per share, by B. Francis Saul II, the Company s Chairman of the Board and Chief Executive Officer, his spouse, through participation in the Company s Dividend Reinvestment and Stock Purchase Plan for the July 31, 2008 dividend distribution.

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Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

None

Item 6. Exhibits

3. (a) First Amended and Restated Articles of Incorporation of Saul Centers, Inc. filed with the Maryland Department of Assessments and Taxation on August 23, 1994 and filed as Exhibit 3.(a) of the 1993 Annual Report of the Company on Form 10-K are hereby incorporated by reference. Articles of Amendment to the First Amended and Restated Articles of Incorporation of Saul Centers, Inc., filed with the Maryland Department of Assessments and Taxation on May 28, 2004 and filed as Exhibit 3.(a) of the June 30, 2004 Quarterly Report of the Company is hereby incorporated by reference. Articles of Amendment to the First Amended and Restated Articles of Incorporation of Saul Centers, Inc., filed with the Maryland Department of Assessments and Taxation on May 26, 2006 and filed as Exhibit 3.(a) of the Company s Current Report on Form 8-K filed May 30, 2006 is hereby incorporated by reference.

(b) Amended and Restated Bylaws of Saul Centers, Inc. as in effect at and after August 24, 1993 and as of August 26, 1993 and filed as Exhibit 3.(b) of the 1993 Annual Report of the Company on Form 10-K are hereby incorporated by reference. Amendment No. 1 to Amended and Restate Bylaws of Saul Centers, Inc. adopted November 29, 2007 and filed as Exhibit 3(b) of the Company s Current Report on Form 8-K filed December 3, 2007 is hereby incorporated by reference.

(c) Articles Supplementary to First Amended and Restated Articles of Incorporation of the Company, dated October 30, 2003, filed as Exhibit 2 to the Company s Current Report on Form 8-A dated October 31, 2003, is hereby incorporated by reference.

(d) Articles Supplementary to First Amended and Restated Articles of Incorporation of the Company, as amended, dated March 26, 2008, filed as Exhibit 3.1 to the Company s Current Report on Form 8-K, filed March 27, 2008, is hereby incorporated by reference.

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4. (a) Deposit Agreement, dated November 5, 2003, among the Company, Continental Stock Transfer & Trust Company, as Depositary, and the holders of depositary receipts, each representing 1/100th of a share of 8% Series A Cumulative Redeemable Preferred Stock of Saul Centers, Inc. and filed as Exhibit 4 to the Registration Statement on Form 8-A on October 31, 2003 is hereby incorporated by reference.

   (b) Deposit Agreement, dated March 27, 2008, among the Company, Continental Stock Transfer & Trust Company, as Depositary, and the holders of depositary receipts, each representing 1/100th of a share of 9% Series B Cumulative Redeemable Preferred Stock of Saul Centers, Inc. and filed as Exhibit 4.1 to the Registration Statement on Form 8-A on March 27, 2008 is hereby incorporated by reference.

   (c) Form specimen of receipt representing the depositary shares, each representing 1/100th of a share of 8% Series A Cumulative Redeemable Preferred Stock of Saul Centers, Inc. and included as part of Exhibit 4 to the Registration Statement on Form 8-A on October 31, 2003 is hereby incorporated by reference.

   (d) Form specimen of receipt representing the depositary shares, each representing 1/100th of a share of 9% Series B Cumulative Redeemable Preferred Stock of Saul Centers, Inc. and included as part of Exhibit 4.2 to the Registration Statement on Form 8-A on March 27, 2008 is hereby incorporated by reference.

10. (a) First Amended and Restated Agreement of Limited Partnership of Saul Holdings Limited Partnership filed as Exhibit No. 10.1 to Registration Statement No. 33-64562 is hereby incorporated by reference. The First Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Holdings Limited Partnership, the Second Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Holdings Limited Partnership, and the Third Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Holdings Limited Partnership filed as Exhibit 10.(a) of the 1995 Annual Report of the Company on Form 10-K is hereby incorporated by reference. The Fourth Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Holdings Limited Partnership filed as Exhibit 10.(a) of the March 31, 1997 Quarterly Report of the Company is hereby incorporated by reference. The Fifth Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Holdings Limited Partnership filed as Exhibit 4.(c) to Registration Statement No. 333-41436, is hereby incorporated by reference. The Sixth Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Holdings Limited Partnership filed as Exhibit 10.(a) of

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the September 30, 2003 Quarterly Report of the Company on Form 10-Q is hereby incorporated by reference. The Seventh Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Holdings Limited Partnership filed as Exhibit 10.(a) of the December 31, 2003 Annual Report of the Company on Form 10-K is hereby incorporated by reference. The Eighth Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Holdings Limited Partnership filed as Exhibit 10.(a) of the December 31, 2007 Annual Report of the Company on Form 10-K is hereby incorporated by reference. The Ninth Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Holdings Limited Partnership filed as Exhibit 10.(a) of the March 31, 2008 Quarterly Report of the Company on Form 10-Q is hereby incorporated by reference. The Tenth Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Holdings Limited Partnership filed as Exhibit 10.(a) of the March 31, 2008 Quarterly Report of the Company on Form 10-Q is hereby incorporated by reference.

(b) First Amended and Restated Agreement of Limited Partnership of Saul Subsidiary I Limited Partnership and Amendment No. 1 thereto filed as Exhibit 10.2 to Registration Statement No. 33-64562 are hereby incorporated by reference. The Second Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Subsidiary I Limited Partnership, the Third Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Subsidiary I Limited Partnership and the Fourth Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Subsidiary I Limited Partnership as filed as Exhibit 10.(b) of the 1997 Annual Report of the Company on Form 10-K are hereby incorporated by reference.

(c) First Amended and Restated Agreement of Limited Partnership of Saul Subsidiary II Limited Partnership and Amendment No. 1 thereto filed as Exhibit 10.3 to Registration Statement No. 33-64562 are hereby incorporated by reference. The Second Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Subsidiary II Limited Partnership filed as Exhibit 10.(c) of the June 30, 2001 Quarterly Report of the Company is hereby incorporated by reference. The Third Amendment to the First Amended and Restated Agreement of Limited Partnership of Saul Subsidiary II Limited Partnership as filed as exhibit 10.(c) of the 2006 Annual Report of the Company on Form 10-K are hereby incorporated by reference.

(d) Property Conveyance Agreement filed as Exhibit 10.4 to Registration Statement No. 33-64562 is hereby incorporated by reference.

(e) Management Functions Conveyance Agreement filed as Exhibit 10.5 to Registration Statement No. 33-64562 is hereby incorporated by reference.

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(f) Registration Rights and Lock-Up Agreement filed as Exhibit 10.6 to Registration Statement No. 33-64562 is hereby incorporated by reference.

(g) Exclusivity and Right of First Refusal Agreement filed as Exhibit 10.7 to Registration Statement No. 33-64562 is hereby incorporated by reference.

(h) Agreement of Assumption dated as of August 26, 1993 executed by Saul Holdings Limited Partnership and filed as Exhibit 10.(i) of the 1993 Annual Report of the Company on Form 10-K is hereby incorporated by reference.

(i) Deferred Compensation Plan for Directors, dated as of April 23, 2004 and filed as Exhibit 10.(k) of the June 30, 2004 Quarterly Report of the Company is hereby incorporated by reference.

(j) Loan Agreement dated as of November 7, 1996 by and among Saul Holdings Limited Partnership, Saul Subsidiary II Limited Partnership and PFL Life Insurance Company, c/o AEGON USA Realty Advisors, Inc., filed as Exhibit 10.(t) of the March 31, 1997 Quarterly Report of the Company, is hereby incorporated by reference.

(k) Loan Agreement dated as of October 1, 1997 between Saul Subsidiary I Limited Partnership as Borrower and Nomura Asset Capital Corporation as Lender filed as Exhibit 10.(p) of the 1997 Annual Report of the Company on Form 10-K is hereby incorporated by reference.

(l) Revolving Credit Agreement, dated as of December 19, 2007, by and among Saul Holdings Limited Partnership as Borrower; U.S. Bank National Association, as Administrative Agent and Sole Lead Arranger; Wells Fargo Bank National Association, as Syndication Agent; and U.S. Bank National Association, Wells Fargo Bank National Association, Compass Bank, and Sovereign Bank, as Lenders, as filed as Exhibit 10.(n) of the December 31, 2007 Annual Report of the Company on Form 10-K, is hereby incorporated by reference.

(m) Guaranty, dated as of December 19, 2007, by and between Saul Centers, Inc., as Guarantor, and U.S. Bank National Association, as Administrative Agent and Sole Lead Arranger for itself and other financial institutions as Lenders, as filed as Exhibit 10.(o) of the December 31, 2007 Annual Report of the Company on Form 10-K, is hereby incorporated by reference.

(n) The Saul Centers, Inc. 2004 Stock Plan, as filed as Annex A to the Proxy Statement of the Company for its 2004 Annual Meeting of Stockholders, is hereby incorporated by reference. The Amendment to Saul Centers, Inc. 2004 Stock Plan, as filed as Annex A to the Proxy Statement of the Company for its 2008 Annual Meeting of Stockholders, is hereby incorporated by reference.

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(o) Form of Director Stock Option Agreements, as filed as Exhibit 10.(j) of the September 30, 2004 Quarterly Report of the Company, is hereby incorporated by reference.

(p) Form of Officer Stock Option Grant Agreements, as filed as Exhibit 10.(k) of the September 30, 2004 Quarterly Report of the Company, is hereby incorporated by reference.

(q) Construction Loan Agreement, dated as of May 14, 2008, by and among Saul Holdings Limited Partnership, U.S. Bank National Association, as agent, and the lenders party to or who become party to such agreement, as filed as Exhibit 10. (a) of the Company s Current Report on Form 8-K dated May 20, 2008, is hereby incorporated by reference.

(r) Shared Services Agreement, dated as of July 1, 2004, between B. F. Saul Company and Saul Centers, Inc., as filed as Exhibit 10. (a) of the Company s Current Report on Form 8-K dated October 3, 2008, is hereby incorporated by reference.

31. Rule 13a-14(a)/15d-14(a) Certifications of Chief Executive Officer and Chief Financial Officer (filed herewith)

32. Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer (filed herewith).

99. Schedule of Portfolio Properties

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	SAUL CENTERS, INC.
	(Registrant)
Date: November 7, 2008	/s/ B. Francis Saul III B. Francis Saul III, President
Date: November 7, 2008	/s/ Scott V. Schneider Scott V. Schneider Senior Vice President, Chief Financial Officer
	(principal financial officer)
Date: November 7, 2008	/s/ Kenneth D. Shoop Kenneth D. Shoop Vice President, Chief Accounting Officer
	(principal accounting officer)

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