SAUL CENTERS INC
Form 10-Q
August 04, 2014
Table of Contents

United States
Securities and Exchange Commission
Washington, D.C. 20549
FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934
For The Quarterly Period Ended June 30, 2014
Commission File Number 1-12254

SAUL CENTERS, INC.
(Exact name of registrant as specified in its charter)

Maryland	52-1833074
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

7501 Wisconsin Avenue, Bethesda, Maryland 20814
(Address of principal executive office) (Zip Code)
Registrant's telephone number, including area code (301) 986-6200

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

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES o NO x

Number of shares of common stock, par value $0.01 per share outstanding as of July 31, 2014: 20.8 million.

Table of Contents

SAUL CENTERS, INC.
Table of Contents

	Page
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements (Unaudited)	
(a) Consolidated Balance Sheets as of June 30, 2014 and December 31, 2013	4
(b) Consolidated Statements of Operations for the three and six months ended June 30, 2014 and 2013	5
(c) Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2014 and 2013	6
(d) Consolidated Statement of Stockholders' Equity for the six months ended June 30, 2014	7
(e) Consolidated Statements of Cash Flows for the six months ended June 30, 2014 and 2013	8
(f) Notes to Consolidated Financial Statements	9
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	
(a) Critical Accounting Policies	29
(b) Results of Operations:	
Same Property Revenue	31
Same Property Operating Income	32
Three months ended June 30, 2014 compared to three months ended June 30, 2013	32
Six months ended June 30, 2014 compared to six months ended June 30, 2013	33
(c) Liquidity and Capital Resources	34
Item 3. Quantitative and Qualitative Disclosures About Market Risk	42
Item 4. Controls and Procedures	42
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	43
Item 1A. Risk Factors	43
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	43
Item 3. Defaults Upon Senior Securities	43
Item 4. Mine Safety Disclosures	43
Item 5. Other Information	43
Item 6. Exhibits	44
Signatures	47

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments necessary for the fair presentation of the financial position and results of operations of Saul Centers, Inc. for the interim periods have been included. All such adjustments are of a normal recurring nature. These consolidated financial statements and the accompanying notes should be read in conjunction with the audited consolidated financial statements of Saul Centers, Inc. for the year ended December 31, 2013, which are included in its Annual Report on Form 10-K. The results of operations for interim periods are not necessarily indicative of results to be expected for the year.

Table of Contents

Saul Centers, Inc.

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share amounts)	June 30, 2014 (Unaudited)	December 31, 2013
Assets		
Real estate investments		
Land	$373,898	$354,967
Buildings and equipment	1,102,390	1,094,605
Construction in progress	16,259	9,867
	1,492,547	1,459,439
Accumulated depreciation	(380,608)	(364,663)
	1,111,939	1,094,776
Cash and cash equivalents	21,829	17,297
Accounts receivable and accrued income, net	44,114	43,884
Deferred leasing costs, net	26,693	26,052
Prepaid expenses, net	1,634	4,047
Deferred debt costs, net	10,564	9,675
Other assets	10,655	2,944
Total assets	$1,227,428	$1,198,675
Liabilities		
Notes payable	$820,145	$820,068
Revolving credit facility payable	—	—
Dividends and distributions payable	14,398	13,135
Accounts payable, accrued expenses and other liabilities	24,655	20,141
Deferred income	31,575	30,205
Total liabilities	890,773	883,549
Stockholders' equity		
Preferred stock, 1,000,000 shares authorized:		
Series A Cumulative Redeemable, 16,000 shares issued and outstanding	40,000	40,000
Series C Cumulative Redeemable, 56,000 shares issued and outstanding	140,000	140,000
Common stock, $0.01 par value, 40,000,000 shares authorized, 20,779,740 and 20,576,616 shares issued and outstanding, respectively	208	206
Additional paid-in capital	279,243	270,428
Accumulated deficit	(169,222)	(172,564)
Accumulated other comprehensive loss	(1,873)	(1,392)
Total Saul Centers, Inc. stockholders' equity	288,356	276,678
Noncontrolling interest	48,299	38,448
Total stockholders' equity	336,655	315,126
Total liabilities and stockholders' equity	$1,227,428	$1,198,675

The Notes to Financial Statements are an integral part of these statements.

Table of Contents
Saul Centers, Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

(Dollars in thousands, except per share amounts)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Revenue				
Base rent	$41,038	$39,553	$81,601	$79,293
Expense recoveries	7,825	7,463	16,614	15,077
Percentage rent	453	338	905	938
Other	2,970	1,455	6,113	2,687
Total revenue	52,286	48,809	105,233	97,995
Operating expenses				
Property operating expenses	6,138	6,041	13,723	11,990
Provision for credit losses	107	285	310	549
Real estate taxes	5,584	5,433	11,037	11,196
Interest expense and amortization of deferred debt costs	11,486	11,709	22,953	23,426
Depreciation and amortization of deferred leasing costs	10,309	12,472	20,489	28,824
General and administrative	4,023	3,925	8,703	7,329
Acquisition related costs	216	—	379	—
Predevelopment expenses	—	1,233	503	3,582
Total operating expenses	37,863	41,098	78,097	86,896
Operating income	14,423	7,711	27,136	11,099
Change in fair value of derivatives	(5)	51	(7)	61
Gain on sale of property	6,069	—	6,069	—
Net Income	20,487	7,762	33,198	11,160
Noncontrolling interest				
(Income) loss attributable to noncontrolling interests	(4,433)	(1,168)	(6,857)	418
Net income attributable to Saul Centers, Inc.	16,054	6,594	26,341	11,578
Preferred stock redemption	—	—	—	(5,228)
Preferred stock dividends	(3,207)	(3,207)	(6,413)	(7,571)
Net income (loss) attributable to common stockholders	$12,847	$3,387	$19,928	$(1,221)
Per share net income (loss) attributable to common stockholders				
Basic and diluted	$0.62	$0.17	$0.96	$(0.06)
Dividends declared per common share outstanding	$0.40	$0.36	$0.80	$0.72

The Notes to Financial Statements are an integral part of these statements.

Table of Contents
Saul Centers, Inc.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in thousands)	2014	2013	2014	2013
Net income	$20,487	$7,762	$33,198	$11,160
Other comprehensive income				
Change in unrealized loss on cash flow hedge	(420)	1,763	(647)	2,264
Total comprehensive income	20,067	9,525	32,551	13,424
Comprehensive income attributable to noncontrolling interests	(4,325)	(1,617)	(6,691)	(159)
Total comprehensive income attributable to Saul Centers, Inc.	15,742	7,908	25,860	13,265
Preferred stock redemption	—	—	—	(5,228)
Preferred stock dividends	(3,207)	(3,207)	(6,413)	(7,571)
Total comprehensive income attributable to common stockholders	$12,535	$4,701	$19,447	$466

The Notes to Financial Statements are an integral part of these statements.

Table of Contents
Saul Centers, Inc.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(Unaudited)

(Dollars in thousands, except per share amounts)	Preferred Stock	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive (Loss)	Total Saul Centers, Inc.	Noncontrolling Interest	Total
Balance, December 31, 2013	$180,000	$206	$270,428	$(172,564)	$(1,392)	$276,678	$38,448	$315,126
Issuance of 203,124 shares of common stock:								
99,800 shares pursuant to dividend reinvestment plan	—	1	4,447	—	—	4,448	—	4,448
103,324 shares due to exercise of employee stock options and issuance of directors' deferred stock	—	1	4,368	—	—	4,369	—	4,369
Issuance of 196,183 partnership units pursuant to dividend reinvestment plan	—	—	—	—	—	—	8,877	8,877
Net income	—	—	—	26,341	—	26,341	6,857	33,198
Change in unrealized loss on cash flow hedge	—	—	—	—	(481)	(481)	(166)	(647)
Preferred stock distributions:								
Series A	—	—	—	(800)	—	(800)	—	(800)
Series C	—	—	—	(2,406)	—	(2,406)	—	(2,406)
Common stock distributions	—	—	—	(8,275)	—	(8,275)	—	(8,275)
Distributions payable preferred stock:								
Series A, $50.00 per share	—	—	—	(800)	—	(800)	—	(800)
Series C, $42.97 per share	—	—	—	(2,406)	—	(2,406)	—	(2,406)
Distributions payable common stock ($0.40/share) and distributions payable partnership units ($0.40/unit)	—	—	—	(8,312)	—	(8,312)	(5,717)	(14,029)
Balance, June 30, 2014	$180,000	$208	$279,243	$(169,222)	$(1,873)	$288,356	$48,299	$336,655

The Notes to Financial Statements are an integral part of these statements.

Table of Contents
Saul Centers, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six months ended June 30,	
(Dollars in thousands)	2014	2013
Cash flows from operating activities:		
Net income	$33,198	$11,160
Adjustments to reconcile net income to net cash provided by operating activities:		
Change in fair value of derivatives	7	(61)
Gain on sale of property	(6,069)	—
Depreciation and amortization of deferred leasing costs	20,489	28,824
Amortization of deferred debt costs	614	625
Non cash compensation costs of stock grants and options	658	695
Provision for credit losses	310	549
(Increase) decrease in accounts receivable and accrued income	(218)	(844)
Additions to deferred leasing costs	(1,862)	(1,862)
(Increase) decrease in prepaid expenses	2,399	2,226
Increase in other assets	(7,711)	(1,886)
Increase in accounts payable, accrued expenses and other liabilities	4,309	(1,024)
Decrease in deferred income	(3,379)	(4,359)
Net cash provided by operating activities	42,745	34,043
Cash flows from investing activities:		
Acquisitions of real estate investments (1)	(8,545)	—
Additions to real estate investments	(7,002)	(7,322)
Additions to development and redevelopment projects	(6,343)	(4,054)
Proceeds from sale of property	6,679	—
Net cash used in investing activities	(15,211)	(11,376)
Cash flows from financing activities:		
Proceeds from notes payable (1)	—	83,600
Repayments on notes payable	(10,923)	(47,152)
Proceeds from revolving credit facility	11,000	123,000
Repayments on revolving credit facility	(11,000)	(161,000)
Additions to deferred debt costs	(1,303)	(1,254)
Proceeds from the issuance of:		
Common stock	8,159	12,683
Partnership units	8,877	—
Series C preferred stock	—	135,221
Preferred stock redemption payments:		
Series A preferred	—	(60,000)
Series B preferred	—	(79,328)
Preferred stock redemption costs	—	(9)
Distributions to:		
Series A preferred stockholders	(1,600)	(3,613)
Series B preferred stockholders	—	(3,253)
Series C preferred stockholders	(4,812)	(1,283)
Common stockholders	(15,683)	(14,489)
Noncontrolling interest	(5,717)	(4,978)
Net cash used in financing activities	(23,002)	(21,855)

Net increase in cash and cash equivalents	4,532	812
Cash and cash equivalents, beginning of period	17,297	12,133
Cash and cash equivalents, end of period	$21,829	$12,945

Supplemental discussion of non-cash investing and financing activities:

(1) The 2014 acquisition of real estate and proceeds from notes payable each exclude $11,000 in connection with the sale and leaseback of the Company's Olney property.

The Notes to Financial Statements are an integral part of these statements.

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

1. Organization, Formation and Structure

Saul Centers, Inc. ("Saul Centers") was incorporated under the Maryland General Corporation Law on June 10, 1993, and operates as a real estate investment trust (a "REIT") under the Internal Revenue Code of 1986, as amended (the "Code"). The Company is required to annually distribute at least 90% of its REIT taxable income (excluding net capital gains) to its stockholders and meet certain organizational and other requirements. Saul Centers has made and intends to continue to make regular quarterly distributions to its stockholders. Saul Centers, together with its wholly-owned subsidiaries and the limited partnerships of which Saul Centers or one of its subsidiaries is the sole general partner, are referred to collectively as the "Company." B. Francis Saul II serves as Chairman of the Board of Directors and Chief Executive Officer of Saul Centers.

Saul Centers was formed to continue and expand the shopping center business previously owned and conducted by the B. F. Saul Real Estate Investment Trust, the B. F. Saul Company and certain other affiliated entities, each of which is controlled by B. Francis Saul II and his family members (collectively, the "Saul Organization"). On August 26, 1993, members of the Saul Organization transferred to Saul Holdings Limited Partnership, a newly formed Maryland limited partnership (the "Operating Partnership"), and two newly formed subsidiary limited partnerships (the "Subsidiary Partnerships," and, collectively with the Operating Partnership, the "Partnerships"), shopping center and mixed-use properties and the management functions related to the transferred properties. Since its formation, the Company has developed and purchased additional properties.

The following table lists the properties acquired, in development and disposed since December 31, 2012.

Name of Property	Location	Type	Year of Acquisition/ Development/Disposition
Acquisitions			
1580 Rockville Pike	Rockville, MD	Shopping Center	2014
1582 Rockville Pike	Rockville, MD	Shopping Center	2014
Developments			
Park Van Ness	Washington, DC	Mixed-Use	2013
Dispositions			
Giant	Baltimore, MD	Shopping Center	2014

As of June 30, 2014, the Company's properties (the "Current Portfolio Properties") consisted of 49 operating shopping center properties (the "Shopping Centers"), six mixed-use properties which are comprised of office, retail and multi-family residential uses (the "Mixed-Use Properties") and three (non-operating) development properties.

2. Summary of Significant Accounting Policies

Nature of Operations

The Company, which conducts all of its activities through its subsidiaries, the Operating Partnership and Subsidiary Partnerships, engages in the ownership, operation, management, leasing, acquisition, renovation, expansion, development and financing of community and neighborhood shopping centers and mixed-use properties, primarily in the Washington, DC/Baltimore metropolitan area.

Because the properties are located primarily in the Washington, DC/Baltimore metropolitan area, the Company is subject to a concentration of credit risk related to these properties. A majority of the Shopping Centers are anchored by one or more major tenants. As of June 30, 2014, 31 of the Shopping Centers were anchored by a grocery store and offer primarily day-to-day necessities and services. Two tenants individually accounted for 2.5% or more of the Company's total revenue for the six months ended June 30, 2014. Excluding the results of the Giant Center, which was recently sold and at which Giant Food is a tenant, Giant Food, a tenant at nine Shopping Centers, and Safeway, a tenant at eight Shopping Centers, individually accounted for 4.6% and 2.5%, respectively, of the Company's total

revenue for the six months ended June 30, 2014.

Principles of Consolidation

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

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments necessary for the fair presentation of the financial position and results of operations of Saul Centers, Inc. for the interim periods have been included. All such adjustments are of a normal recurring nature. These consolidated financial statements and the accompanying notes should be read in conjunction with the audited consolidated financial statements of Saul Centers, Inc. for the year ended December 31, 2013, which are included in its Annual Report on Form 10-K. The results of operations for interim periods are not necessarily indicative of results to be expected for the year.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Accounts Receivable, Accrued Income and Allowance for Doubtful Accounts

Accounts receivable primarily represent amounts currently due from tenants in accordance with the terms of the respective leases. Receivables are reviewed monthly and reserves are established with a charge to current period operations when, in the opinion of management, collection of the receivable is doubtful. Accounts receivable in the accompanying financial statements are shown net of an allowance for doubtful accounts of approximately $0.4 million and $0.6 million at June 30, 2014 and December 31, 2013, respectively.

In addition to rents due currently, accounts receivable includes approximately $37.5 million and $37.2 million, at June 30, 2014 and December 31, 2013, respectively, net of allowance for doubtful accounts totaling $0.2 million and $0.5 million, respectively, representing minimum rental income accrued on a straight-line basis to be paid by tenants over the remaining term of their respective leases.

Assets Held for Sale

The Company considers properties to be assets held for sale when all of the following criteria are met:

- management commits to a plan to sell a property;
- it is unlikely that the disposal plan will be significantly modified or discontinued;
- the property is available for immediate sale in its present condition;
- actions required to complete the sale of the property have been initiated;
- sale of the property is probable and the Company expects the completed sale will occur within one year; and
- the property is actively being marketed for sale at a price that is reasonable given its current market value.

The Company must make a determination as to the point in time that it is probable that a sale will be consummated, which generally occurs when an executed sales contract has no contingencies and the prospective buyer has significant funds at risk to ensure performance. Upon designation as an asset held for sale, the Company records the carrying value of each property at the lower of its carrying value or its estimated fair value, less estimated costs to sell, and ceases depreciation. As of June 30, 2014, no properties were classified as held for sale.

Cash and Cash Equivalents

Cash and cash equivalents include short-term investments. Short-term investments include money market accounts and other investments which generally mature within three months, measured from the acquisition date, and/or are readily convertible to cash.

Construction In Progress

Construction in progress includes land, preconstruction and development costs of active projects. Preconstruction costs include legal, zoning and permitting costs and other project carrying costs incurred prior to the commencement of construction. Development costs include direct construction costs and indirect costs incurred subsequent to the start

of construction such as

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

architectural, engineering, construction management and carrying costs consisting of interest, real estate taxes and insurance. Construction in progress as of June 30, 2014 and December 31, 2013, is composed of the following:

(in thousands)	June 30, 2014	December 31, 2013
Park Van Ness	$13,845	$7,901
Other	2,414	1,966
Total	$16,259	$9,867

Deferred Debt Costs

Deferred debt costs consist of fees and costs incurred to obtain long-term financing, construction financing and the revolving line of credit. These fees and costs are being amortized on a straight-line basis over the terms of the respective loans or agreements, which approximates the effective interest method. Deferred debt costs totaled $10.6 million and $9.7 million, net of accumulated amortization of $5.2 million and $4.5 million, at June 30, 2014 and December 31, 2013, respectively.

Deferred Income

Deferred income consists of payments received from tenants prior to the time they are earned and recognized by the Company as revenue, including tenant prepayment of rent for future periods, real estate taxes when the taxing jurisdiction has a fiscal year differing from the calendar year, reimbursements specified in the lease agreement and tenant construction work provided by the Company. In addition, deferred income includes the fair value of certain below market leases.

Deferred Leasing Costs

Deferred leasing costs consist of commissions paid to third-party leasing agents, internal direct costs such as employee compensation and payroll-related fringe benefits directly related to time spent performing leasing-related activities for successful commercial leases and amounts attributed to in-place leases associated with acquired properties. Leasing related activities include evaluating the prospective tenant’s financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating lease terms, preparing lease documents and closing the transaction. Unamortized deferred costs are charged to expense if the applicable lease is terminated prior to expiration of the initial lease term. Deferred leasing costs are amortized over the term of the lease or remaining term of acquired leases. Collectively, deferred leasing costs totaled $26.7 million and $26.1 million, net of accumulated amortization of $19.1 million and $16.6 million, as of June 30, 2014 and December 31, 2013, respectively. Amortization expense, included in depreciation and amortization of deferred leasing costs in the consolidated statements of operations, totaled $2.6 million and $3.2 million for the six months ended June 30, 2014 and 2013, respectively.

Derivative Financial Instruments

The Company may, when appropriate, employ derivative instruments, such as interest-rate swaps, to mitigate the risk of interest rate fluctuations. The Company does not enter into derivative or other financial instruments for trading or speculative purposes. Derivative financial instruments are carried at fair value as either assets or liabilities on the consolidated balance sheets. For those derivative instruments that qualify and are designated as hedging instruments, the Company designates the hedging instrument, based upon the exposure being hedged, as a fair value hedge or a cash flow hedge. For those derivative instruments that qualify and are designated as hedging instruments, the effective portion of the gain or loss on the hedge instruments is reported as a component of accumulated other comprehensive income (loss) and recognized in earnings within the same line item associated with the forecasted transaction in the same period or periods during which the hedged transaction affects earnings. Any ineffective portion of the change in fair value of a derivative instrument is immediately recognized in earnings. For derivative instruments that do not qualify, or that qualify and are not designated, as hedging instruments, changes in fair value are immediately recognized in earnings.

Derivative financial instruments expose us to credit risk in the event of non-performance by the counterparties under the terms of the derivative instrument. The Company minimizes its credit risk on these transactions by dealing with

major, creditworthy financial institutions as determined by management, and therefore, it believes that the likelihood of realizing losses from counterparty non-performance is remote.

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

Income Taxes

The Company made an election to be treated, and intends to continue operating so as to qualify, as a REIT under the Code, commencing with its taxable year ended December 31, 1993. A REIT generally will not be subject to federal income taxation, provided that distributions to its stockholders equal or exceed its REIT taxable income and it complies with certain other requirements. Therefore, no provision has been made for federal income taxes in the accompanying consolidated financial statements.

Legal Contingencies

The Company is subject to various legal proceedings and claims that arise in the ordinary course of business, which are generally covered by insurance. While the resolution of these matters cannot be predicted with certainty, the Company believes the final outcome of such matters will not have a material adverse effect on its financial position or results of operations. Upon determination that a loss is probable to occur and can be reasonably estimated, 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.

Postemployment Benefits

From time to time, the Company may enter into an arrangement with an employee at the time of the employee's separation from service whereby the employee will receive certain payments in exchange for certain releases, covenants not to compete, or other promises. If no future services are required in order for the employee to receive the payments, the Company estimates the amount of payments to be made over the life of the arrangement and records that amount as an expense as of the date of the arrangement with a corresponding liability representing the amount to be paid in the future. During the six months ended June 30, 2014, the Company recorded as compensation expense $1.1 million of severance payments to be made in the future pursuant to a separation agreement entered into during March 2014.

Predevelopment Expenses

Predevelopment expenses represent certain costs incurred by the Company in connection with active development and redevelopment projects and include, for example, costs related to the early termination of tenant leases and demolition of existing structures.

Real Estate Investment Properties

The Company purchases real estate investment properties from time to time and records assets acquired and liabilities assumed, including land, buildings, and intangibles related to in-place leases and customer relationships, based on their fair values. The fair value of buildings generally is determined as if the buildings were vacant upon acquisition and subsequently leased at market rental rates and considers the present value of all cash flows expected to be generated by the property including an initial lease up period. From time to time the Company may purchase a property for future development purposes. The Company determines the fair value of above and below market intangibles associated with in-place leases by assessing the net effective rent and remaining term of the lease relative to market terms for similar leases at acquisition taking into consideration the remaining contractual lease period, renewal periods, and the likelihood of the tenant exercising its renewal options. The fair value of below market lease intangibles is recorded as deferred income and accreted as additional revenue over the remaining contractual lease period and any renewal option periods included in the valuation analysis. The fair value of above market lease intangibles is recorded as a deferred asset and amortized as a reduction of revenue over the remaining contractual lease term. The Company determines the fair value of at-market in-place leases considering the cost of acquiring similar leases, the foregone rents associated with the lease-up period and carrying costs associated with the lease-up period. Intangible assets associated with at-market in-place leases are amortized as additional expense over the remaining contractual lease term. To the extent customer relationship intangibles are present in an acquisition, the fair values of the intangibles are amortized over the lives of the customer relationships. The Company has never recorded a customer relationship intangible asset. Acquisition-related transaction costs are generally charged to expense as

incurred and reported as acquisition related costs in the consolidated statements of operations.

If there is an event or change in circumstance that indicates a potential impairment in the value of a real estate investment property, the Company prepares an analysis to determine whether the carrying value of the real estate investment property exceeds its estimated fair value. The Company considers both quantitative and qualitative factors including recurring operating losses, significant decreases in occupancy, and significant adverse changes in legal factors and business climate. If impairment indicators are present, the Company compares the projected cash flows of the property over its remaining useful life, on an

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

undiscounted basis, to the carrying value of that property. The Company assesses its undiscounted projected cash flows based upon estimated capitalization rates, historic operating results and market conditions that may affect the property. If the carrying value is greater than the undiscounted projected cash flows, the Company would recognize an impairment loss equivalent to an amount required to adjust the carrying amount to its then estimated fair value. The value of any property is sensitive to the actual results of any of the aforementioned estimated factors, either individually or taken as a whole. Should the actual results differ from management's projections, the valuation could be negatively or positively affected. The Company did not recognize an impairment loss on any of its real estate during the six months ended June 30, 2014 and 2013.

Interest, real estate taxes, development-related salary costs and other carrying costs are capitalized on projects under development and construction. Upon substantial completion of construction and the placement of the assets into service, rental income, real estate tax expense, property operating expenses (consisting of payroll, repairs and maintenance, utilities, insurance and other property related expenses) and depreciation are included in current operations and capitalization of interest ceases. Property operating expenses are charged to operations as incurred. Interest capitalized totaled $243,000 and $34,000 for the six months ended June 30, 2014 and 2013, respectively. Commercial development projects are considered substantially complete and available for occupancy upon completion of tenant improvements, but no later than one year from the cessation of major construction activity. Multi-family residential development projects are considered substantially complete and available for occupancy upon receipt of the certificate of occupancy from the appropriate licensing authority. 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 generally between 35 and 50 years for base buildings, or a shorter period if management determines that the building has a shorter useful life, and up to 20 years for certain other improvements that extend the useful lives. Leasehold improvement expenditures are capitalized when certain criteria are met, including when the Company supervises construction and will own the improvements. Tenant improvements are amortized, over the shorter of the lives of the related leases or the useful life of the improvements, using the straight-line method. Depreciation expense in the consolidated statements of operations totaled $17.9 million and $25.6 million for the six months ended June 30, 2014 and 2013, respectively. The $7.7 million decrease was primarily due to $8.0 million of additional depreciation expense recorded in 2013 on the building at Van Ness Square as a result of the reduction of its estimated remaining useful life to four months effective January 1, 2013. Repairs and maintenance expense totaled $6.5 million and $4.9 million for the six months ended June 30, 2014 and 2013, respectively, and is included in property operating expenses in the Consolidated Statements of Operations. An increase of $1.7 million in snow removal costs was the primary cause of increased property operating expenses.

Revenue Recognition

Rental and interest income are accrued as earned except when doubt exists as to collectability, in which case the accrual is discontinued. Recognition of 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 basis because of free rent periods or scheduled rent increases, income is recognized on a straight-line basis. Expense recoveries represent a portion of property operating expenses billed to tenants, including common area maintenance, real estate taxes and other recoverable costs, and are recognized in the period in which the expenses are incurred. Rental income based on a tenant's revenue ("percentage rent") is accrued when a tenant reports sales that exceed a breakpoint specified in the lease agreement.

Stock-based Employee Compensation, Stock Plan and Deferred Compensation Plan for Directors

The Company uses the fair value method to value and account for employee stock options. The fair value of options granted is determined at the time of each award using the Black-Scholes model, a widely used method for valuing stock-based employee compensation, and the following assumptions: (1) Expected Volatility determined using the most recent trading history of the Company's common stock (month-end closing prices) corresponding to the average

expected term of the options; (2) Average Expected Term of the options is based on prior exercise history, scheduled vesting and the expiration date; (3) Expected Dividend Yield determined by management after considering the Company's current and historic dividend yield rates, the Company's yield in relation to other retail REITs and the Company's market yield at the grant date; and (4) a Risk-free Interest Rate based upon the market yields of US Treasury obligations with maturities corresponding to the average expected term of the options at the grant date. The Company amortizes the value of options granted ratably over the vesting period and includes the amounts as compensation in general and administrative expenses.

The Company has a stock plan, which was originally approved in 2004, amended in 2008 and 2013 and which expires in 2023, for the purpose of attracting and retaining executive officers, directors and other key personnel (the "Stock Plan"). Pursuant to the Stock Plan, the Compensation Committee established a Deferred Compensation Plan for Directors for the benefit of its directors and their beneficiaries, which replaced a previous Deferred Compensation and Stock Plan for Directors.

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

A director may make an annual election to defer all or part of his or her director's fees and has the option to have the fees paid in cash, in shares of common stock or in a combination of cash and shares of common stock upon separation from the Board. If the director elects to have fees paid in stock, fees earned during a calendar quarter are aggregated and divided by the closing market price of the Company's common stock on the first trading day of the following quarter to determine the number of shares to be credited to the director. As of June 30, 2014, the director's deferred fee accounts comprise 227,233 shares.

The Compensation Committee has also approved an annual award of shares of the Company's common stock as additional compensation to each director serving on the Board of Directors as of the record date for the Annual Meeting of Stockholders. The shares are awarded as of each Annual Meeting of Stockholders, and their issuance may not be deferred.

Noncontrolling Interest

Saul Centers is the sole general partner of the Operating Partnership, owning a 74.3% common interest as of June 30, 2014. Noncontrolling interest in the Operating Partnership is comprised of limited partnership units owned by the Saul Organization. Noncontrolling interest reflected on the accompanying consolidated balance sheets is increased for earnings allocated to limited partnership interests and distributions reinvested in additional units, and is decreased for limited partner distributions. Noncontrolling interest reflected on the consolidated statements of operations represents earnings allocated to limited partnership interests.

Per Share Data

Per share data for net income (basic and diluted) is computed using weighted average shares of common stock. Convertible limited partnership units and employee stock options are the Company's potentially dilutive securities. For all periods presented, the convertible limited partnership units are non-dilutive. The following table sets forth, for the indicated periods, weighted averages of the number of common shares outstanding, basic and dilutive, the effect of dilutive options and the number of options which are not dilutive because the average price of the Company's common stock was less than the exercise prices. The treasury stock method was used to measure the effect of the dilution.

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2014	2013	2014	2013
Weighted average common shares outstanding-Basic	20,717	20,301	20,670	20,224
Effect of dilutive options	26	22	32	27
Weighted average common shares outstanding-Diluted	20,743	20,323	20,702	20,251
Non-dilutive options (1)	113	118	113	118

(1) The non-dilutive options were issued in 2007 and 2008.

Recently Issued Accounting Standards

In April 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-08, "Presentation of Financial Statements (Topic 205) and Property Plant and Equipment (Topic 360)" ("ASU 2014-08"). ASU 2014-08 changes the requirements for reporting discontinued operations such that disposals of components of an entity will be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations. ASU 2014-08 also requires additional disclosures about discontinued operations. ASU 2014-08 is effective for annual periods beginning after December 15, 2014, and interim periods within those years and early adoption is permitted. The Company retrospectively adopted ASU 2014-08 on April 15, 2014. The adoption of ASU 2014-08 did not have a material impact on the Company's financial condition or results of operations.

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers” (“ASU 2014-09”). ASU 2014-09 will replace most existing revenue recognition guidance and will require an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-09 is effective for annual periods beginning after December 15, 2016, and interim periods within those years and early adoption is not permitted. ASU 2014-09 must be applied retrospectively by either restating prior periods or by recognizing the cumulative effect as of the first date of application. We have not yet selected a transition method and are evaluating the impact that ASU 2014-09 will have on our consolidated financial statements and related disclosures.

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

Reclassifications

Certain reclassifications have been made to the prior year financial statements to conform to the presentation used for the six months ended June 30, 2014.

3. Real Estate Acquired and Sold

Kentlands Pad

In August 2013, the Company purchased for $4.3 million a retail pad with a 7,100 square foot restaurant located in Gaithersburg, Maryland, which is contiguous with and an expansion of the Company's other Kentlands assets, and incurred acquisition costs of $99,000.

Hunt Club Pad

In December 2013, the Company purchased for $0.8 million, including acquisition costs, a retail pad with a 5,500 square foot vacant building located in Apopka, Florida, which is contiguous with and an expansion of the Company's other Hunt Club asset.

1580 Rockville Pike

In January 2014, the Company purchased for $8.0 million a single-tenant retail property with a 12,100 square foot CVS Pharmacy located in Rockville, Maryland, which is contiguous with and an expansion of the Company's asset at 1500 Rockville Pike, and incurred acquisition costs of $163,000. Of the total purchase price, $4.3 million was allocated to a below market lease, which is included in deferred income on the accompanying consolidated balance sheet and is being accreted to income over the remaining life of the lease, or approximately 10 years. The impact on the Company's results of operations is not material. The acquisition was recorded as follows.

(in thousands)		
Land	$9,600	
Building	2,200	
In-place lease	513	
Below-market rents	(4,313	)
	$8,000	

1582 Rockville Pike and Olney Center

In April 2014, the Company purchased for $11.0 million a single-tenant retail property with a 40,700 square foot furniture store located at 1582 Rockville Pike in Rockville, Maryland, and concurrently sold to the seller, for $11.0 million, the 53,765 square foot Olney Center located in Olney, Maryland. 1582 Rockville Pike is contiguous with and an expansion of the Company’s assets at 1500 and 1580 Rockville Pike. In connection with the purchase, the Company incurred approximately $0.2 million of acquisition costs. The impact on the Company's results of operations is not material. The acquisition was recorded as follows.

(in thousands)		
Land	$9,742	
Building	828	
In-place lease	849	
Below-market rents	(419	)
	$11,000	

Simultaneously with the sale of the Olney Center, the Company entered into a lease of the property with the buyer and continues to operate, lease and manage the property. The lease term is 20 years and the Company has the option to purchase the property for $14.6 million at the end of the lease term. The purchaser has the right to sell the property to the Company at any time from and after April 2016 at a price equal to $11.0 million increased by 1.5% annually beginning January 1, 2015 and continuing each January thereafter. The Company has accounted for this transaction as a secured financing.

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

Giant Center
In April 2014, the Company sold for $7.5 million the 70,040 square foot Giant Center located in Milford Mill, Maryland and recognized a $6.1 million gain. As of March 31, 2014, the carrying amounts of the associated assets and liabilities were $0.5 million and $0.1 million, respectively. There was no debt on the property.

4. Noncontrolling Interest - Holders of Convertible Limited Partnership Units in the Operating Partnership
As of June 30, 2014, the Saul Organization holds a 25.7% limited partnership interest in the Operating Partnership represented by approximately 7.2 million convertible limited partnership units. These units are convertible into shares of Saul Centers' common stock, at the option of the unit holder, on a one-for-one basis provided that, in accordance with the Saul Centers, Inc. Articles of Incorporation, the rights may not be exercised at any time that the Saul Organization beneficially owns, directly or indirectly, in the aggregate more than 39.9% of the value of the outstanding common stock and preferred stock of Saul Centers (the "Equity Securities"). As of June 30, 2014, approximately 975,000 units were convertible into shares of Saul Centers common stock.
The impact of the Saul Organization's approximately 25.7% limited partnership interest in the Operating Partnership is reflected as Noncontrolling Interest in the accompanying consolidated financial statements. Fully converted partnership units and diluted weighted average shares outstanding for the three months ended June 30, 2014 and 2013, were approximately 27.9 million and 27.2 million, respectively, and for the six months ended June 30, 2014 and 2013, were approximately 27.8 million and 27.2 million, respectively.

5. Notes Payable, Revolving Credit Facility, Interest and Amortization of Deferred Debt Costs
The Company's outstanding debt totaled approximately $820.1 million at June 30, 2014, of which approximately $790.2 million was fixed-rate debt and approximately $29.9 million was variable rate debt. The carrying value of the properties collateralizing the notes payable totaled $901.0 million as of June 30, 2014.
During the three months ended June 30, 2014, the Company amended and restated its revolving credit facility. At June 30, 2014, the Company had a $275.0 million unsecured revolving credit facility, which can be used for working capital, property acquisitions, development projects or letters of credit. The revolving credit facility matures on June 23, 2018, and may be extended by the Company for one additional year subject to the Company's satisfaction of certain conditions. Saul Centers and certain consolidated subsidiaries of the Operating Partnership have guaranteed the payment obligations of the Operating Partnership under the revolving credit facility. Letters of credit may be issued under the revolving credit facility. On June 30, 2014, based on the value of the Company's unencumbered properties, approximately $274.4 million was available under the line, no borrowings were outstanding and approximately $628,000 was committed for letters of credit. The interest rate under the facility is variable and equals the sum of one-month LIBOR and a margin that is based on the Company's leverage ratio, and which can range from 145 basis points to 200 basis points. As of June 30, 2014, the margin was 145 basis points.
At June 30, 2014, the Company had a $71.6 million construction-to-permanent loan, with no amount outstanding, which is secured by and will be used to partially finance the construction of Park Van Ness.
Saul Centers is a guarantor of the revolving credit facility, of which the Operating Partnership is the borrower. The Operating Partnership is the guarantor of (a) a portion of each of the Northrock bank loan (approximately $7.5 million of the $14.7 million outstanding at June 30, 2014) and the Metro Pike Center bank loan (approximately $7.8 million of the $15.2 million outstanding at June 30, 2014) and (b) the $71.6 million Park Van Ness construction-to-permanent loan, which guarantee will be reduced and eventually eliminated subject to the achievement of certain leasing and cash flow levels. The fixed-rate notes payable are all non-recourse.
The Company accounts for the sale-leaseback of the Olney Center as a secured financing and, accordingly, the $11.0 million proceeds from the sale are included in notes payable. Monthly payments of approximately $60,400, which increase by 1.5% annually, are required under the lease and interest accrues at a fixed rate of 8.0%, which is the implicit rate under the lease. The purchaser has the right to sell the property to the Company at any time from and

after April 2016 at a price equal to $11.0 million increased by 1.5% annually beginning January 1, 2015 and continuing each January thereafter. The Company has an option to repurchase the property for $14.6 million when the lease expires in April 2034.

At December 31, 2013, the Company's outstanding debt totaled approximately $820.1 million, of which $789.9 million was fixed rate debt and $30.2 million was variable rate debt. No borrowings were outstanding on the Company's unsecured

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

revolving credit facility. The carrying value of the properties collateralizing the notes payable totaled $907.2 million as of December 31, 2013.

At June 30, 2014, the scheduled maturities of debt, including scheduled principal amortization, for years ending December 31, were as follows:

(In thousands)	Balloon Payments	Scheduled Principal Amortization	Total
July 1 through December 31, 2014	$—	$11,223	$11,223
2015	14,885	23,208	38,093
2016	28,879	23,496	52,375
2017	—	24,679	24,679
2018	27,748	24,821	52,569
2019	60,793	23,489	84,282
Thereafter	421,169	135,755	556,924
	$553,474	$266,671	$820,145

Interest expense and amortization of deferred debt costs for the three and six months ended June 30, 2014 and 2013, were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2014	2013	2014	2013
Interest incurred	$11,342	$11,429	$22,582	$22,835
Amortization of deferred debt costs	284	314	614	625
Capitalized interest	(140)	(34)	(243)	(34)
	$11,486	$11,709	$22,953	$23,426

6. Stockholders' Equity and Noncontrolling Interest

The consolidated statements of operations for the six months ended June 30, 2014 and 2013, reflect noncontrolling interest of $6.9 million and ($0.4 million), respectively, representing the Saul Organization's share of net income (loss) for each period.

In March 2013, the Company redeemed 60% of its then-outstanding 8% Series A Cumulative Redeemable Preferred Stock (the "Series A Stock") and all of its 9% Series B Cumulative Redeemable Preferred Stock. Costs associated with the redemptions were charged against accumulated deficit.

The Company has outstanding 1.6 million depositary shares, each representing 1/100th of a share of Series A Stock. The depositary shares are redeemable, in whole or in part at the Company's option, from time to time, at $25.00 per share. The depositary shares pay an annual dividend of $2.00 per share, equivalent to 8% of the $25.00 per share liquidation preference. The Series A preferred stock has no stated maturity, is not subject to any sinking fund or mandatory redemption and is not convertible into any other securities of the Company. Investors in the depositary shares 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.

On February 12, 2013, the Company sold, in an underwritten public offering, 5.6 million depositary shares, each representing 1/100th of a share of 6.875% Series C Cumulative Redeemable Preferred Stock, and received net cash proceeds of approximately $135.2 million. The depositary shares may be redeemed on or after February 12, 2018 at the Company's option, in whole or in part, at the $25.00 liquidation preference plus accrued but unpaid dividends. The depositary shares pay an annual dividend of $1.71875 per share, equivalent to 6.875% of the $25.00 liquidation preference. The first dividend was paid on April 15, 2013 and covered the period from February 12, 2013 through March 31, 2013. The Series C preferred stock has no stated maturity, is not subject to any sinking fund or mandatory

redemption and is not convertible into any other securities of the Company except in connection with certain changes of control or delisting events. Investors in the depositary shares

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

The Chairman and Chief Executive Officer, the President, the Executive Vice President - Chief Legal and Administrative Officer and the Senior Vice President-Chief Accounting Officer of the Company are also officers of various members of the Saul Organization and their management time is shared with the Saul Organization. Their annual compensation is fixed by the Compensation Committee of the Board of Directors, with the exception of the Senior Vice President-Chief Accounting 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 401K plan with entities in the Saul Organization which covers those full-time employees who meet the requirements as specified in the plan. Company contributions, which are included in general and administrative expense or property operating expenses in the consolidated statements of operations, at the discretionary amount of up to six percent of the employee’s cash compensation, subject to certain limits, were $191,600 and $189,000 for the six months ended June 30, 2014 and 2013, respectively. All amounts deferred by employees and the Company are fully vested.

The Company also participates in a multiemployer nonqualified deferred compensation plan with entities in the Saul Organization which covers those full-time employees who meet the requirements as specified in the plan. According to the plan, which can be modified or discontinued at any time, participating employees defer 2% of their compensation in excess of a specified amount. For the six months ended June 30, 2014 and 2013, the Company contributed $71,100 and $103,000, respectively, which is three times the amount deferred by employees and is included in general and administrative expense. All amounts deferred by employees and the Company are fully vested. The cumulative unfunded liability under this plan was $1.7 million and $1.6 million, at June 30, 2014 and December 31, 2013, 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 personnel. The method for determining the cost of the shared services is provided for in the Agreement and is based upon head count, estimates of usage or estimates of time incurred, as applicable. The terms of the Agreement and the payments made thereunder are deemed reasonable by management and are reviewed annually by the Audit Committee of the Board of Directors, which consists entirely of independent directors. Billings by the Saul Organization for the Company’s share of these ancillary costs and expenses for the six months ended June 30, 2014 and 2013, which included rental expense for the Company’s headquarters lease, totaled approximately $3.6 million and $3.2 million, respectively. The amounts are generally expensed as incurred and are primarily reported as general and administrative expenses in the consolidated financial statements. As of June 30, 2014 and December 31, 2013, accounts payable, accrued expenses and other liabilities included approximately $479,900 and $499,000, respectively, representing amounts due to the Saul Organization for the Company’s share of these ancillary costs and expenses.

The Company subleases its corporate headquarters space from a member of the Saul Organization. The lease commenced in March 2002, was extended in 2012 for five years, and provides for base rent increases of 3% per year, with payment of a pro-rata share of operating expenses over a base year amount. The Agreement requires each party to pay an allocation of total rental payments based on a percentage proportionate to the number of employees employed by each party. The Company’s rent expense was $414,000 and $428,000 for the six months ended June 30, 2014 and 2013, respectively, and is included in general and administrative expense.

The B. F. Saul Insurance Agency of Maryland, Inc., a subsidiary of the B. F. Saul Company and a member of the Saul Organization, is a general insurance agency that receives commissions and fees in connection with the Company’s

insurance program. Such commissions and fees amounted to $169,700 and $167,000 for the six months ended June 30, 2014 and 2013, respectively.

Effective as of September 4, 2012, the Company entered into a consulting agreement with B. F. Saul III, a former president of the Company, whereby Mr. Saul III will provide certain consulting services to the Company as an independent contractor and will be paid at a rate of $60,000 per month. The consulting agreement includes certain noncompete, nonsolicitation and nondisclosure covenants, and has a term of up to two years, although the consulting agreement is terminable by the Company at any time. For each of the six months ended June 30, 2014 and 2013, such consulting fees totaled $360,000.

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

8. Stock Option Plans

The Company has established two stock incentive plans, the 1993 plan and the 2004 plan, as amended, (together, the "Plans"). Under the Plans, options were granted at 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 options vest ratably over four years following the grant and are charged to expense using the straight-line method over the vesting period. Director options vest immediately and are charged to expense as of the date of grant.

The following table summarizes the amount and activity of each grant with outstanding unexercised options, the total value and variables used in the computation and the amount expensed and included in general and administrative expense in the Consolidated Statements of Operations for the six months ended June 30, 2014.

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

Stock options issued

	Directors								
Grant date	5/6/2005	5/1/2006	4/27/2007	4/25/2008	4/24/2009	5/7/2010	5/13/2011	5/4/2012	5/10/2
Total grant	30,000	30,000	30,000	30,000	32,500	32,500	32,500	35,000	35,00
Vested	30,000	30,000	30,000	30,000	32,500	32,500	32,500	35,000	35,00
Exercised	22,500	10,000	—	—	20,000	10,000	10,000	10,000	7,500
Forfeited	—	2,500	7,500	7,500	—	2,500	2,500	—	—
Exercisable at June 30, 2014	7,500	17,500	22,500	22,500	12,500	20,000	20,000	25,000	27,50
Remaining unexercised	7,500	17,500	22,500	22,500	12,500	20,000	20,000	25,000	27,50
Exercise price	$33.22	$40.35	$54.17	$50.15	$32.68	$38.76	$41.82	$39.29	$44.4
Volatility	0.198	0.206	0.225	0.237	0.344	0.369	0.358	0.348	0.333
Expected life (years)	10.0	9.0	8.0	7.0	6.0	5.0	5.0	5.0	5.0
Assumed yield	6.91%	5.93%	4.39%	4.09%	4.54%	4.23%	4.16%	4.61%	4.53
Risk-free rate	4.28%	5.11%	4.65%	3.49%	2.19%	2.17%	1.86%	0.78%	0.82
Total value at grant date	$71,100	$143,400	$285,300	$254,700	$222,950	$287,950	$297,375	$244,388	$262,
Expensed in previous years	71,100	143,400	285,300	254,700	222,950	287,950	297,375	244,388	262,9
Expensed in 2014	—	—	—	—	—	—	—	—	—
Future expense	—	—	—	—	—	—	—	—	—

	Officers						
Grant date	5/6/2005	4/27/2007	5/13/2011	5/4/2012	5/10/2013	5/9/2014	Subtotals
Total grant	132,500	135,000	162,500	242,500	202,500	170,000	1,045,000
Vested	118,750	67,500	105,625	56,250	50,625	—	398,750
Exercised	84,850	—	30,955	18,902	8,853	—	143,560
Forfeited	13,750	67,500	43,750	135,000	30,000	—	290,000
Exercisable at June 30, 2014	33,900	67,500	63,420	37,348	41,772	—	243,940
Remaining unexercised	33,900	67,500	87,795	88,598	163,647	170,000	611,440
Exercise price	$33.22	$54.17	$41.82	$39.29	$44.42	$47.03	
Volatility	0.207	0.233	0.330	0.315	0.304	0.306	

Expected life (years)	8.0	6.5	8.0	8.0	8.0	7.0	
Assumed yield	6.37 %	4.13 %	4.81 %	5.28 %	5.12 %	4.89 %	
Risk-free rate	4.15 %	4.61 %	2.75 %	1.49 %	1.49 %	2.17 %	
Gross value at grant date	$413,400	$1,339,200	$1,366,625	$1,518,050	$1,401,300	$1,397,400	$7,435,975
Estimated forfeitures	35,100	80,350	387,550	889,690	280,468	174,700	1,847,858
Expensed in previous years	378,300	1,258,850	692,088	261,807	209,027	—	2,800,072
Expensed in 2014	—	—	113,205	78,546	149,360	50,947	392,058
Future expense	—	—	173,782	288,007	762,445	1,171,753	2,395,987
Weighted average term of remaining future expense (in years)				3.1			

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

The table below summarizes the option activity for the six months ended June 30, 2014:

	Number of Shares	Weighted Average Exercise Price per share	Aggregate Intrinsic Value
Outstanding at January 1	753,625	$42.55	$4,529,206
Granted	200,000	47.03	314,000
Exercised	(99,685)	37.23	1,018,511
Expired/Forfeited	(37,500)	43.56	
Outstanding June 30	816,440	44.26	4,078,348
Exercisable June 30	448,940	43.87	2,659,611

The intrinsic value measures the price difference between the options’ exercise price and the closing share price quoted by the New York Stock Exchange as of the date of measurement. The intrinsic value for shares exercised during the period was calculated by using the closing share price on the date of exercise. At June 30, 2014, the closing share price of $48.60 was lower than the exercise price of the 90,000 and 22,500 outstanding options granted in 2007 and 2008, respectively, and, therefore, those options had no intrinsic value as of June 30, 2014. The weighted average remaining contractual life of the Company’s outstanding and exercisable options is 7.2 years and 5.7 years, respectively.

9. Fair Value of Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses are reasonable estimates of their fair value. The aggregate fair value of the notes payable with fixed-rate payment terms was determined using Level 3 data in a discounted cash flow approach, which is based upon management’s estimate of borrowing rates and loan terms currently available to the Company for fixed-rate financing and, assuming long-term interest rates of approximately 4.35% and 4.85%, would be approximately $852.0 million and $828.7 million, respectively, compared to the carrying value of $790.2 million and $789.9 million at June 30, 2014 and December 31, 2013, respectively. A change in any of the significant inputs may lead to a change in the Company’s fair value measurement of its debt.

The Company carries its interest rate swap at fair value. The Company has determined the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy with the exception of the impact of counter-party risk, which was determined using Level 3 inputs and is not significant. Derivative instruments are classified within Level 2 of the fair value hierarchy because their values are determined using third-party pricing models which contain inputs that are derived from observable market data. Where possible, the values produced by the pricing models are verified by market prices. Valuation models require a variety of inputs, including contractual terms, market prices, yield curves, credit spreads, measure of volatility, and correlations of such inputs. The swap agreement terminates on July 1, 2020. As of June 30, 2014, the fair value of the interest-rate swap was approximately $3.2 million and is included in “Accounts payable, accrued expenses and other liabilities” in the consolidated balance sheets. The decrease in value from inception of the swap is reflected in “Other Comprehensive Income” in the Consolidated Statements of Comprehensive Income. Amounts recognized in earnings are included in Changes in Fair Value of Derivatives in the Consolidated Statements of Operations.

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2014	2013	2014	2013
Change in fair value:				
Recognized in earnings	$(5)	$51	$(7)	$61
Recognized in other comprehensive income	(420)	1,763	(647)	2,264
	$(425)	$1,814	$(654)	$2,325

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

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 current portfolio properties.

11. Business Segments

The Company has two reportable business segments: Shopping Centers and Mixed-Use Properties. The accounting policies of the segments are the same as those described in the summary of significant accounting policies (see Note 2). The Company evaluates performance based upon income and cash flows from real estate of the combined properties in each segment. All of our properties within each segment generate similar types of revenues and expenses related to tenant rent, reimbursements and operating expenses. Although services are provided to a range of tenants, the types of services provided to them are similar within each segment. The properties in each portfolio have similar economic characteristics and the nature of the products and services provided to our tenants and the method to distribute such services are consistent throughout the portfolio. Certain reclassifications have been made to prior year information to conform to the 2014 presentation.

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

(Dollars in thousands)	Shopping Centers	Mixed-Use Properties	Corporate and Other	Consolidated Totals
Three months ended June 30, 2014				
Real estate rental operations:				
Revenue	$39,056	$13,210	$20	$52,286