SAUL CENTERS INC
Form 10-Q
May 05, 2016
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 March 31, 2016
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 April 29, 2016: 21.1 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 March 31, 2016 and December 31, 2015	4
(b) Consolidated Statements of Operations for the three months ended March 31, 2016 and 2015	5
(c) Consolidated Statements of Comprehensive Income for the three months ended March 31, 2016 and 2015	6
(d) Consolidated Statement of Stockholders' Equity for the three months ended March 31, 2016	7
(e) Consolidated Statements of Cash Flows for the three months ended March 31, 2016 and 2015	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	25
(b) Results of Operations:	
Same Property Revenue	27
Same Property Operating Income	28
Three months ended March 31, 2016 compared to three months ended March 31, 2015	28
(c) Liquidity and Capital Resources	29
Item 3. Quantitative and Qualitative Disclosures About Market Risk	35
Item 4. Controls and Procedures	36
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	37
Item 1A. Risk Factors	37
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	37
Item 3. Defaults Upon Senior Securities	37
Item 4. Mine Safety Disclosures	37
Item 5. Other Information	37
Item 6. Exhibits	38
Signatures	41

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, 2015, 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)	March 31, 2016 (Unaudited)	December 31, 2015
Assets		
Real estate investments		
Land	$424,840	$424,837
Buildings and equipment	1,114,635	1,114,357
Construction in progress	92,698	83,516
	1,632,173	1,622,710
Accumulated depreciation	(431,463)	(425,370)
	1,200,710	1,197,340
Cash and cash equivalents	15,352	10,003
Accounts receivable and accrued income, net	48,593	51,076
Deferred leasing costs, net	26,815	26,919
Prepaid expenses, net	3,401	4,663
Other assets	6,764	5,407
Total assets	$1,301,635	$1,295,408
Liabilities		
Notes payable	$790,324	$796,169
Revolving credit facility payable	21,825	26,695
Construction loan payable	53,042	43,641
Dividends and distributions payable	16,570	15,380
Accounts payable, accrued expenses and other liabilities	30,893	27,687
Deferred income	30,959	32,109
Total liabilities	943,613	941,681
Stockholders’ equity		
Preferred stock, 1,000,000 shares authorized:		
Series C Cumulative Redeemable, 72,000 shares issued and outstanding	180,000	180,000
Common stock, $0.01 par value, 40,000,000 shares authorized, 21,335,346 and 21,266,239 shares issued and outstanding, respectively	213	213
Additional paid-in capital	308,574	305,008
Accumulated deficit	(180,264)	(180,091)
Accumulated other comprehensive loss	(2,313)	(1,802)
Total Saul Centers, Inc. stockholders’ equity	306,210	303,328
Noncontrolling interest	51,812	50,399
Total stockholders’ equity	358,022	353,727
Total liabilities and stockholders’ equity	$1,301,635	$1,295,408

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 March 31,	
	2016	2015
Revenue		
Base rent	$42,607	$41,479
Expense recoveries	9,558	8,732
Percentage rent	363	438
Other	4,398	1,439
Total revenue	56,926	52,088
Operating expenses		
Property operating expenses	7,995	7,616
Provision for credit losses	432	246
Real estate taxes	5,934	5,901
Interest expense and amortization of deferred debt costs	11,089	11,406
Depreciation and amortization of deferred leasing costs	11,035	10,440
General and administrative	4,060	3,771
Acquisition related costs	—	21
Total operating expenses	40,545	39,401
Operating income	16,381	12,687
Change in fair value of derivatives	(7)	(6)
Net Income	16,374	12,681
Noncontrolling interests		
Income attributable to noncontrolling interests	(3,426)	(2,474)
Net income attributable to Saul Centers, Inc.	12,948	10,207
Preferred stock dividends	(3,094)	(3,094)
Net income attributable to common stockholders	$9,854	$7,113
Per share net income attributable to common stockholders		
Basic and diluted	$0.46	$0.34
Dividends declared per common share outstanding	$0.47	$0.43

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 March 31,	
(Dollars in thousands)	2016	2015
Net income	$16,374	$12,681
Other comprehensive income		
Change in unrealized loss on cash flow hedge	(688)	(427)
Total comprehensive income	15,686	12,254
Comprehensive income attributable to noncontrolling interests	(3,249)	(2,364)
Total comprehensive income attributable to Saul Centers, Inc.	12,437	9,890
Preferred stock dividends	(3,094)	(3,094)
Total comprehensive income attributable to common stockholders	$9,343	$6,796

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, 2015	$180,000	$ 213	$305,008	$(180,091)	$ (1,802)	$303,328	$ 50,399	$353,727
Issuance of common stock:								
54,280 shares pursuant to dividend reinvestment plan	—	—	2,669	—	—	2,669	—	2,669
14,827 shares due to exercise of stock options and issuance of directors' deferred stock	—	—	897	—	—	897	—	897
Issuance of 32,769 partnership units pursuant to dividend reinvestment plan	—	—	—	—	—	—	1,613	1,613
Net income	—	—	—	12,948	—	12,948	3,426	16,374
Change in unrealized loss on cash flow hedge	—	—	—	—	(511)	(511)	(177)	(688)
Series C preferred stock distributions	—	—	—	—	—	—	—	—
Common stock distributions	—	—	—	—	—	—	—	—
Distributions payable on Series C preferred stock ($42.97/share)	—	—	—	(3,094)	—	(3,094)	—	(3,094)
Distributions payable common stock ($0.47/share) and distributions payable partnership units ($0.47/unit)	—	—	—	(10,027)	—	(10,027)	(3,449)	(13,476)
Balance, March 31, 2016	$180,000	$ 213	$308,574	$(180,264)	$ (2,313)	$306,210	$ 51,812	$358,022

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

-7-

Table of Contents
Saul Centers, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(Dollars in thousands)	Three months ended March 31, 2016	2015
Cash flows from operating activities:		
Net income	$16,374	$12,681
Adjustments to reconcile net income to net cash provided by operating activities:		
Change in fair value of derivatives	7	6
Depreciation and amortization of deferred leasing costs	11,035	10,440
Amortization of deferred debt costs	332	362
Non cash compensation costs of stock grants and options	293	256
Provision for credit losses	432	246
(Increase) decrease in accounts receivable and accrued income	2,051	(1,144)
Additions to deferred leasing costs	(1,468)	(1,169)
Decrease in prepaid expenses	1,262	587
Increase in other assets	(1,357)	(730)
Increase in accounts payable, accrued expenses and other liabilities	3,486	2,064
Decrease in deferred income	(1,150)	(406)
Net cash provided by operating activities	31,297	23,193
Cash flows from investing activities:		
Acquisitions of real estate investments	—	(893)
Additions to real estate investments	(4,150)	(2,712)
Additions to development and redevelopment projects	(9,658)	(7,019)
Net cash used in investing activities	(13,808)	(10,624)
Cash flows from financing activities:		
Proceeds from notes payable	—	30,000
Repayments on notes payable	(6,047)	(20,914)
Proceeds from revolving credit facility	6,000	4,000
Repayments on revolving credit facility	(11,000)	(21,000)
Proceeds from construction loan	9,377	3,377
Additions to deferred debt costs	24	(183)
Proceeds from the issuance of:		
Common stock	3,273	5,315
Partnership units	1,613	1,180
Distributions to:		
Series C preferred stockholders	(3,094)	(3,094)
Common stockholders	(9,145)	(8,379)
Noncontrolling interests	(3,141)	(2,879)
Net cash used in financing activities	(12,140)	(12,577)
Net increase (decrease) in cash and cash equivalents	5,349	(8)
Cash and cash equivalents, beginning of period	10,003	12,128
Cash and cash equivalents, end of period	$15,352	$12,120

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 significant properties acquired, in development and disposed since December 31, 2014.

Name of Property	Location	Type	Year of Acquisition/ Development/Disposition
Acquisitions			
726 N. Glebe Road	Arlington, VA	Shopping Center	2015
Developments			
Park Van Ness	Washington, DC	Mixed-Use	2013-2016

As of March 31, 2016, the Company’s properties (the “Current Portfolio Properties”) consisted of 50 operating shopping center properties (the “Shopping Centers”), six mixed-use properties, one of which was designated as held for sale, 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 March 31, 2016, 31 of the Shopping Centers were anchored by a grocery store and offer primarily day-to-day necessities and services. Three tenants individually accounted for 2.5% or more of the Company’s total revenue for the three months ended March 31, 2016. Giant Food, a tenant at nine Shopping Centers, Capital One, a tenant at 20 properties, and Albertson's/Safeway, a tenant at nine Shopping Centers, individually accounted for 4.2%, 2.7%, and 2.6%, respectively, of the Company's total revenue for the three months ended March 31, 2016.

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, 2015, 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 $1.4 million and $1.3 million at March 31, 2016 and December 31, 2015, respectively.

In addition to rents due currently, accounts receivable includes approximately $41.9 million and $41.4 million, at March 31, 2016 and December 31, 2015, respectively, net of allowance for doubtful accounts totaling $0.4 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 March 31, 2016, the Company has classified as held-for-sale one operating property, comprising 197,127 square feet of gross leasable area. The book value of this property, which is included in Other Assets, was $3.4 million, net of accumulated depreciation of $7.0 million, which does not exceed its estimated fair value, less costs to sell, and liabilities were $0.2 million. Fair value was determined based on a third party appraisal.

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.

-10-

Notes to Consolidated Financial Statements (Unaudited)

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 architectural, engineering, construction management and carrying costs consisting of interest, real estate taxes and insurance. Construction in progress as of March 31, 2016 and December 31, 2015, is composed of the following:

(in thousands)	March 31, 2016	December 31, 2015
Park Van Ness	$ 86,079	$ 77,245
Other	6,619	6,271
Total	$ 92,698	$ 83,516

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 $8.4 million and $8.7 million, net of accumulated amortization of $6.3 million and $6.2 million, at March 31, 2016 and December 31, 2015, respectively, and are reflected as a reduction of the related debt in the Consolidated Balance Sheets.

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 $26.8 million and $26.9 million, net of accumulated amortization of $27.7 million and $26.6 million, as of March 31, 2016 and December 31, 2015, respectively. Amortization expense, included in depreciation and amortization of deferred leasing costs in the consolidated statements of operations, totaled $1.6 million and $1.4 million for the three months ended March 31, 2016 and 2015, 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,

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

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

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.

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 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 three months ended March 31, 2016 and 2015.

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 $0.9 million and $0.3 million for the three months ended March 31, 2016 and 2015, 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 $9.5 million and $9.1 million for the three months ended March 31, 2016 and 2015, respectively. Repairs and maintenance expense totaled $4.3 million and $3.7 million for the three months ended March 31, 2016 and 2015, respectively, and is included in property operating expenses in the Consolidated Statements of Operations.

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. 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.

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

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 March 31, 2016, the director's deferred fee accounts comprise 239,553 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 Interests

Saul Centers is the sole general partner of the Operating Partnership, owning a 74.2% common interest as of March 31, 2016. Noncontrolling interests in the Operating Partnership is comprised of limited partnership units owned by the Saul Organization. Noncontrolling interests 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 interests 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.

	As of or for the three months ended March 31,	
(In thousands)	2016	2015
Weighted average common stock outstanding-Basic	21,306	21,018
Effect of dilutive options	31	119
Weighted average common stock outstanding-Diluted	21,337	21,137
Non-dilutive options	291	—
Years non-dilutive options were issued	2007 and 2015	

Recently Issued Accounting Standards

In May 2014, the FASB issued ASU No. 2014-09 and in April 2016, the FASB issued ASU 2016-10, both of which are titled, “Revenue from Contracts with Customers” (collectively “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, 2017, and interim periods within those years. Early adoption is permitted but not before annual periods beginning after December 15, 2016. 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.

In February 2015, the FASB issued ASU No. 2015-02, “Consolidation” ("ASU 2015-02"). ASU 2015-02 modifies existing consolidation guidance for reporting organizations that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. ASU 2015-02 is effective for annual periods beginning after December 15, 2015, and interim periods within those years. The adoption of ASU 2015-02 effective January 1, 2016, did not have a material impact on the Company’s consolidated financial statements or disclosures.

In April 2015, the FASB issued ASU No. 2015-03, “Interest - Imputation of Interest” (“ASU 2015-03”). ASU 2015-03 simplifies the presentation of debt issuance costs and will require an entity to deduct transaction costs from the carrying value of the related financial liability and not record those transaction costs as a separate asset. Recognition and measurement guidance for debt issuance costs are not affected by ASU 2015-03. ASU 2015-03 is effective for annual periods beginning after December 15, 2015, and interim periods within those years, and must be applied retrospectively by adjusting the balance sheet

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

of each individual period presented. The Company retrospectively adopted ASU 2015-03 effective January 1, 2016. As a result of the adoption of ASU 2015-03, the Company no longer reports its net deferred debt costs as an asset and instead reports those amounts as reduction of the carrying value of the associated debt.
In February 2016, the FASB issued ASU 2016-02, ‘‘Leases’’ (“ASU 2016-02”). ASU 2016-02 amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, interim periods within those years, and requires a modified retrospective transition approach for all leases existing at the date of initial application, with an option to use certain practical expedients for those existing leases. We are evaluating the impact that ASU 2016-02 will have on our consolidated financial statements and related disclosures.
In March 2016, the FASB issued ASU 2016-09, "Compensation-Stock Compensation" ("ASU 2016-09"). ASU 2016-09 simplifies the accounting for several aspects of share-based payments including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. ASU 2016-09 is effective for annual periods beginning after December 15, 2016 and interim periods within those years. The transition method varies based on the specific amendment. We are evaluating the impact that ASU 2016-09 will have on our consolidated financial statements and related disclosures.

Reclassifications

Certain reclassifications have been made to the prior year financial statements to conform to the presentation used for the three months ended March 31, 2016.

3. Real Estate Acquired and Sold

726 N. Glebe Road

In September 2015, the Company purchased for $4.0 million, 726 N. Glebe Road and incurred acquisition costs of $56,700. The property is contiguous with two other properties owned by the Company and is located in Arlington, Virginia.

Westview Pad

In February 2015, the Company purchased for $0.9 million, including acquisition costs, a 1.1 acre retail pad site in Frederick, Maryland, which is contiguous with and an expansion of the Company's other Westview asset.

Allocation of Purchase Price of Real Estate Acquired

The Company allocates the purchase price of real estate investment properties to various components, such as land, buildings and intangibles related to in-place leases and customer relationships, based on their fair values. See Note 2. Summary of Significant Accounting Policies-Real Estate Investment Properties.

4. Noncontrolling Interests - Holders of Convertible Limited Partnership Units in the Operating Partnership

As of March 31, 2016, the Saul Organization holds a 25.8% limited partnership interest in the Operating Partnership represented by approximately 7.3 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 March 31, 2016, approximately 1.0 million units were convertible into shares of Saul Centers common stock.
The impact of the Saul Organization’s approximately 25.8% limited partnership interest in the Operating Partnership is reflected as Noncontrolling Interests in the accompanying consolidated financial statements. Fully converted partnership units and diluted weighted average common stock outstanding for the three months ended March 31, 2016 and 2015, were approximately 28.7 million and 28.3 million, respectively.

5. Notes Payable, Revolving Credit Facility, Interest and Amortization of Deferred Debt Costs

The principal amount of the Company's outstanding debt totaled approximately $873.6 million at March 31, 2016, of which approximately $835.9 million was fixed-rate debt and approximately $37.7 million was variable rate debt, including

Table of Contents

Notes to Consolidated Financial Statements (Unaudited)

$23.0 million outstanding on the Company's unsecured revolving credit facility. The carrying value of the properties collateralizing the notes payable totaled approximately $852.2 million as of March 31, 2016.
At March 31, 2016, 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 March 31, 2016, based on the value of the Company’s unencumbered properties, approximately $251.6 million was available under the line, $23.0 million was outstanding and approximately $448,000 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 March 31, 2016, the margin was 145 basis points.
At March 31, 2016, the Company had a $71.6 million construction-to-permanent loan, with $54.6 million outstanding, which is secured by and 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 the Metro Pike Center bank loan (approximately $7.8 million of the $14.7 million outstanding at March 31, 2016) 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.
At December 31, 2015, the principal amount of the Company’s outstanding debt totaled approximately $875.2 million, of which $832.4 million was fixed rate debt and $42.8 million was variable rate debt, including $28.0 million outstanding on the Company’s unsecured revolving credit facility. The carrying value of the properties collateralizing the notes payable totaled $856.8 million as of December 31, 2015.
At March 31, 2016, 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
April 1 through December 31, 2016	$ —	$ 18,607	$18,607
2017	14,442	25,768	40,210
2018	50,748 (a)	25,902	76,650