SAUL CENTERS INC
Form 10-Q
November 01, 2018
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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 September 30, 2018
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 every Interactive Data File required to be submitted 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 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, smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 October 31, 2018: 22.6 million.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

CONSOLIDATED BALANCE SHEETS
(Unaudited)

(Dollars in thousands, except per share amounts)	September 30, 2018	December 31, 2017
Assets		
Real estate investments		
Land	$ 484,428	$ 450,256
Buildings and equipment	1,268,120	1,261,830
Construction in progress	161,625	91,114
	1,914,173	1,803,200
Accumulated depreciation	(516,568)	(488,166)
	1,397,605	1,315,034
Cash and cash equivalents	9,771	10,908
Accounts receivable and accrued income, net	55,541	54,057
Deferred leasing costs, net	28,057	27,255
Prepaid expenses, net	9,015	5,248
Other assets	6,149	9,950
Total assets	$ 1,506,138	$ 1,422,452
Liabilities		
Notes payable	$ 861,897	$ 897,888
Revolving credit facility payable	75,200	60,734
Term loan facility payable	74,568	—
Construction loan payable	1,247	—
Dividends and distributions payable	18,722	18,520
Accounts payable, accrued expenses and other liabilities	31,958	23,123
Deferred income	25,747	29,084
Total liabilities	1,089,339	1,029,349
Equity		
Preferred stock, 1,000,000 shares authorized:		
Series C Cumulative Redeemable, 42,000 and 72,000 shares issued and outstanding, respectively	105,000	180,000
Series D Cumulative Redeemable, 30,000 and 0 shares issued and outstanding, respectively	75,000	—
Common stock, $0.01 par value, 40,000,000 shares authorized, 22,512,320 and 22,123,128 shares issued and outstanding, respectively	225	221
Additional paid-in capital	373,036	352,590
Distributions in excess of accumulated earnings	(205,872)	(197,710)
Accumulated other comprehensive loss	(156)	(696)
Total Saul Centers, Inc. equity	347,233	334,405
Noncontrolling interest	69,566	58,698
Total equity	416,799	393,103
Total liabilities and equity	$ 1,506,138	$ 1,422,452

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

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Saul Centers, Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

(Dollars in thousands, except per share amounts)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Property revenue				
Base rent	$46,189	$45,385	$137,999	$135,436
Expense recoveries	9,209	9,447	26,582	26,378
Percentage rent	119	67	786	968
Other	1,494	1,329	4,263	7,797
Total property revenue	57,011	56,228	169,630	170,579
Property expenses				
Property operating expenses	6,910	7,418	20,766	20,543
Provision for credit losses	101	52	530	602
Real estate taxes	6,937	6,834	20,559	20,124
Total property expenses	13,948	14,304	41,855	41,269
Property operating income	43,063	41,924	127,775	129,310
Other revenue	48	9	218	31
Other expenses				
Interest expense and amortization of deferred debt costs	11,022	11,821	33,786	35,585
Depreciation and amortization of deferred leasing costs	11,256	11,363	33,956	34,396
General and administrative	4,141	4,363	13,208	13,178
Total other expenses	26,419	27,547	80,950	83,159
Operating income	16,692	14,386	47,043	46,182
Change in fair value of derivatives	10	(1)	(2)	(2)
Gain on sale of property	—	—	509	—
Net Income	16,702	14,385	47,550	46,180
Noncontrolling interests				
Income attributable to noncontrolling interests	(3,547)	(2,902)	(9,265)	(9,483)
Net income attributable to Saul Centers, Inc.	13,155	11,483	38,285	36,697
Extinguishment of issuance costs upon redemption of preferred shares	—	—	(2,328)	—
Preferred stock dividends	(2,953)	(3,093)	(9,309)	(9,281)
Net income available to common stockholders	$10,202	$8,390	$26,648	$27,416
Per share net income available to common stockholders				
Basic and diluted	$0.45	$0.38	$1.19	$1.25
Dividends declared per common share outstanding	$0.52	$0.51	$1.56	$1.53

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

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Saul Centers, Inc.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in thousands)	2018	2017	2018	2017
Net income	$16,702	$14,385	$47,550	$46,180
Other comprehensive income				
Change in unrealized loss on cash flow hedge	173	171	727	503
Total comprehensive income	16,875	14,556	48,277	46,683
Comprehensive income attributable to noncontrolling interests	(3,592)	(2,946)	(9,453)	(9,612)
Total comprehensive income attributable to Saul Centers, Inc.	13,283	11,610	38,824	37,071
Extinguishment of issuance costs upon redemption of preferred shares	—	—	(2,328)	—
Preferred stock dividends	(2,953)	(3,093)	(9,309)	(9,281)
Total comprehensive income available to common stockholders	$10,330	$8,517	$27,187	$27,790

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

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Saul Centers, Inc.

CONSOLIDATED STATEMENT OF EQUITY
(Unaudited)

(Dollars in thousands, except per share amounts)	Preferred Stock	Common Stock	Additional Paid-in Capital	Distributions in Excess of Accumulated Earnings	Accumulated Other Comprehensive (Loss)	Total Saul Centers, Inc.	Noncontrolling Interest	Total
Balance, December 31, 2017	$180,000	$ 221	$352,590	$(197,710)	$ (696)	$334,405	$ 58,698	$393,103
Issuance of 30,000 shares of Series D Cumulative preferred stock	75,000	—	(2,631)	—	—	72,369	—	72,369
Redemption of 30,000 shares of Series C Cumulative preferred stock	(75,000)	—	2,311	(2,328)	—	(75,017)	—	(75,017)
Issuance of common stock:								
356,452 shares pursuant to dividend reinvestment plan	—	4	18,139	—	—	18,143	—	18,143
32,740 shares due to exercise of employee stock options, director share grant and issuance of directors' deferred shares	—	—	2,627	—	—	2,627	—	2,627
Issuance of 270,246 partnership units	—	—	—	—	—	—	13,475	13,475
Net income	—	—	—	38,285	—	38,285	9,265	47,550
Change in unrealized loss on cash flow hedge	—	—	—	—	540	540	187	727
Preferred stock distributions:								
Series C	—	—	—	(4,340)	—	(4,340)	—	(4,340)
Series D	—	—	—	(2,016)	—	(2,016)	—	(2,016)
Common stock distributions	—	—	—	(23,135)	—	(23,135)	(7,997)	(31,132)
Distributions payable on Series C preferred stock ($42.97/share)	—	—	—	(1,805)	—	(1,805)	—	(1,805)
Distributions payable on Series D preferred stock ($38.28/share)	—	—	—	(1,148)	—	(1,148)	—	(1,148)
Distributions payable common stock ($0.52/share) and distributions payable	—	—	—	(11,675)	—	(11,675)	(4,062)	(15,737)

partnership units ($0.52/unit)								
Balance, September 30, 2018	$180,000	$ 225	$373,036	$(205,872)	$ (156)	$347,233	$ 69,566	$416,799

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

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Saul Centers, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine months ended September 30,	
(Dollars in thousands)	2018	2017
Cash flows from operating activities:		
Net income	$47,550	$46,180
Adjustments to reconcile net income to net cash provided by operating activities:		
Change in fair value of derivatives	2	2
Gain on sale of property	(509)	—
Depreciation and amortization of deferred leasing costs	33,956	34,396
Amortization of deferred debt costs	1,224	1,043
Compensation costs of stock grants and options	1,434	1,349
Provision for credit losses	530	602
Increase in accounts receivable and accrued income	(1,846)	(2,901)
Additions to deferred leasing costs	(4,195)	(3,654)
Increase in prepaid expenses	(3,767)	(3,947)
(Increase) decrease in other assets	1,171	(817)
Increase in accounts payable, accrued expenses and other liabilities	2,681	2,991
Decrease in deferred income	(3,358)	(801)
Net cash provided by operating activities	74,873	74,443
Cash flows from investing activities:		
Acquisitions of real estate investments (1)	(36,346)	(79,499)
Additions to real estate investments	(6,586)	(12,389)
Additions to development and redevelopment projects	(54,693)	(14,286)
Repayment of note receivable	1,326	—
Proceeds from sale of property (2)	—	6,688
Net cash used in investing activities	(96,299)	(99,486)
Cash flows from financing activities:		
Proceeds from notes payable	—	40,000
Repayments on notes payable	(36,577)	(20,303)
Proceeds from term loan facility	75,000	—
Proceeds from revolving credit facility	102,000	55,000
Repayments on revolving credit facility	(86,000)	(15,000)
Proceeds from construction loan	2,949	1,437
Additions to deferred debt costs	(2,493)	(2,069)
Proceeds from the issuance of:		
Common stock	19,336	15,303
Partnership units (1)	4,699	5,798
Series D preferred stock	72,369	—
Series C preferred stock redemption payment	(75,000)	—
Preferred stock redemption costs	(13)	—
Distributions to:		
Series C preferred stockholders	(7,433)	(9,281)
Series D preferred stockholders	(2,016)	—
Common stockholders	(34,613)	(33,350)
Noncontrolling interests	(11,919)	(11,429)
Net cash provided by financing activities	20,289	26,106

Net increase (decrease) in cash and cash equivalents	(1,137)	1,063
Cash and cash equivalents, beginning of period	10,908	8,322
Cash and cash equivalents, end of period	$9,771	$9,385
Supplemental disclosure of cash flow information:		
Cash paid for interest	$32,697	$34,394
Increase in accrued real estate investments and development costs	$6,880	$992

(1) The 2018 acquisition of real estate and proceeds from the issuance of partnership units each excludes $8,776 in connection with the acquisition of Ashbrook Marketplace in exchange for limited partnership units.
(2) Proceeds from sale of property excludes $1,275 of seller financing in connection with the sale of the Company's Great Eastern property.

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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 “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, 2016.

Name of Property	Location	Type	Year of Acquisition/ Development/Disposition
Acquisitions			
Burtonsville Town Square	Burtonsville, MD	Shopping Center	2017
7316 Wisconsin Avenue	Bethesda, MD	Mixed-Use	2018
Developments			
750 N. Glebe Road	Arlington, VA	Mixed-Use	2017 - 2018
Ashbrook Marketplace	Ashburn, VA	Shopping Center	2018
Dispositions			
Great Eastern	District Heights, MD	Shopping Center	2017

As of September 30, 2018, the Company’s properties (the “Current Portfolio Properties”) consisted of 49 shopping center properties (the “Shopping Centers”), seven mixed-use properties, which are comprised of office, retail and multi-family residential uses (the “Mixed-Use Properties”) and four (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 September 30, 2018, 32 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 nine months ended September 30, 2018. Giant Food, a tenant at ten Shopping Centers, and Capital One, a tenant at 18 properties, individually accounted for 4.8% and 2.7%, respectively, of the Company's total revenue for the nine months ended September 30, 2018.

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Notes to Consolidated Financial Statements (Unaudited)

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. Substantially all assets and liabilities of the Company as of September 30, 2018 and December 31, 2017, are comprised of the assets and liabilities of the Operating Partnership. The debt arrangements which are subject to recourse are described in Note 5. All significant intercompany balances and transactions have been eliminated in consolidation.

The Operating Partnership is a variable interest entity ("VIE") because the limited partners do not have substantive kick-out or participating rights. The Company is the primary beneficiary of the Operating Partnership because it has the power to direct its activities and the rights to absorb 74.1% of its net income. Because the Operating Partnership was previously consolidated into the financial statements of the Company, classification of it as a VIE had no impact on the consolidated financial statements of the Company.

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, 2017, 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 their 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 $0.6 million and $0.4 million at September 30, 2018 and December 31, 2017, respectively.

In addition to rents due currently, accounts receivable includes approximately $43.6 million and $44.1 million, at September 30, 2018 and December 31, 2017, respectively, net of allowance for doubtful accounts totaling $0.2 million and $0.2 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 September 30, 2018, the Company had no assets designated 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 architectural, engineering, construction management and carrying costs consisting of interest, real estate taxes and insurance. Construction in progress as of September 30, 2018 and December 31, 2017, is composed of the following:

(in thousands)	September 30, 2018	December 31, 2017
Glebe Road	$ 136,766	$ 83,462
Ashbrook Marketplace	10,016	—
Other	14,843	7,652
Total	$ 161,625	$ 91,114

Deferred Debt Costs

Deferred debt costs consist of fees and costs incurred to obtain long-term financing, construction financing and the credit facility. 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 $10.0 million and $6.9 million, net of accumulated amortization of $7.6 million and $8.2 million, at September 30, 2018 and December 31, 2017, respectively, and are reflected as a reduction of the related debt in the Consolidated Balance Sheets. At December 31, 2017, deferred debt costs totaling $1.8 million, related to the Glebe Road construction loan, which had no outstanding balance, are included in Other Assets 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 costs such as employee compensation and payroll-related fringe benefits directly related to time spent performing leasing-related activities for successful commercial leases, amounts attributed to in-place leases associated with acquired properties and lease inducement costs. 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 leasing 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 $28.1 million and $27.3 million, net of accumulated amortization of $36.1 million and $35.3 million, as of September 30, 2018 and December 31, 2017, respectively. Amortization expense, included in depreciation and amortization of deferred leasing

costs in the consolidated statements of operations, totaled $4.3 million and $4.1 million for the nine months ended September 30, 2018 and 2017, respectively.

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Notes to Consolidated Financial Statements (Unaudited)

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 in 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.
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 relative 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. Effective with the adoption of ASU 2017-01 in January 2017, acquisition-related transaction costs are generally capitalized to the basis of the acquired asset.

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 nine months ended September 30, 2018 and 2017.

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 $4.3 million and $2.5 million for the nine months ended September 30, 2018 and 2017, 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 $29.7 million and $30.3 million for the nine months ended September 30, 2018 and 2017, respectively. Repairs and maintenance expense totaled $8.7 million and $8.5 million for the nine months ended September 30, 2018 and 2017, respectively, and is included in property operating expenses in the Consolidated Statements of Operations.

Revenue Recognition

Rental and interest income are accrued as earned. 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 expense 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. 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. During the nine months ended September 30, 2018, 6,686 shares were credited to director's deferred fee accounts and 77,464 shares were issued. As of September 30, 2018, the director's deferred fee accounts comprise 113,040 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 74.1% common interest as of September 30, 2018. 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 attributable 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 attributable 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 September 30,		Nine months ended September 30,	
(In thousands)	2018	2017	2018	2017
Weighted average common stock outstanding-Basic	22,432	21,942	22,290	21,844
Effect of dilutive options	69	86	46	105
Weighted average common stock outstanding-Diluted	22,501	22,028	22,336	21,949
Non-dilutive options	443	—	508	—
Years non-dilutive options were issued	2016 and	—	2015, 2016	—

2017	and 2017

Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09 titled “Revenue from Contracts with Customers” and subsequently issued several related ASUs (collectively “ASU 2014-09”). ASU 2014-09 replaces most existing revenue recognition guidance and requires an entity to recognize the amount of revenue 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 and must be applied retrospectively by either restating prior periods or by recognizing the cumulative effect as of the date of first application. The Company adopted ASU 2014-09 effective January 1, 2018, using the modified retrospective approach. The adoption of ASU 2014-09 did not have an impact on the consolidated financial statements because the majority of the Company’s revenue consists of lease-related income from leasing arrangements, which is specifically excluded from ASU 2014-09. Other revenues, as a whole, are immaterial to total revenues. There was no change to previously reported amounts as a result of the adoption of ASU 2014-09.

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. Upon adoption of ASU 2016-02 effective January 1, 2019, we anticipate election of the practical expedient with respect to cost recoveries. We anticipate that the accounting for initial direct costs will impact the amount of those costs that are charged to expense and we continue to evaluate the impact on our consolidated financial statements and related disclosures.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments-Credit Losses" ("ASU 2016-13"). ASU 2016-13 replaces the incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of information to support credit loss estimates. ASU 2016-13 is effective for annual periods beginning after December 15, 2019, including interim periods within those years. We are evaluating the impact that ASU 2016-13 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 nine months ended September 30, 2018.

3. Real Estate Transactions

Acquisitions

Burtonsville Town Square

In January 2017, the Company purchased for $76.4 million, including acquisition costs, Burtonsville Town Square located in Burtonsville, Maryland. The purchase was funded by a new $40.0 million mortgage loan and the revolving credit facility.

Olney Shopping Center

In March 2017, the Company purchased for $3.1 million, including acquisition costs, the land underlying Olney Shopping Center. The land was previously leased by the Company with an annual rent of approximately $56,000. The purchase was funded by the revolving credit facility.

Ashbrook Marketplace

In May 2018, the Company acquired from the Trust, in exchange for 176,680 limited partnership units, approximately 13.7 acres of land located at the intersection of Ashburn Village Boulevard and Russell Branch Parkway in Loudoun County, Virginia. Based on the closing price of the Company's common stock, the land and the limited partnership units were recorded at a value of $8.8 million. Acquisition costs related to the transaction totaled approximately $0.2 million.

7316 Wisconsin Avenue

In September 2018, the Company purchased for $35.5 million, plus $0.7 million of acquisition costs, an office building and the underlying ground located at 7316 Wisconsin Avenue in Bethesda, Maryland. The property has mixed-use development potential of up to 325 apartment units and approximately 10,000 square feet of street level

retail pursuant to the recently approved Bethesda Downtown Plan. The purchase price was funded through the Company's revolving credit facility.

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 relative fair values or fair values. See Note 2. Summary of Significant Accounting Policies-Real Estate Investment Properties.

During 2017, the Company purchased one property, Burtonsville Town Square, at a cost of $76.4 million, including acquisition costs. Of the total acquisition cost, $28.4 million was allocated to land, $45.8 million was allocated to buildings, $2.2 million was allocated to in-place leases, $0.6 million was allocated to above-market leases, and $(0.6) million was allocated to below market rent, based on their relative fair values.

During 2018, the Company purchased one property, 7316 Wisconsin Avenue, at a cost of $36.2 million, including acquisition costs. Of the total acquisition cost, $34.2 million was allocated to land, $1.0 million was allocated to buildings, $0.9 million was allocated to in-place leases, and $0.1 million was allocated to above-market leases, based on their relative fair values.

Dispositions

Great Eastern Shopping Center

In September 2017, the Company sold for $8.5 million Great Eastern Shopping Center located in District Heights, Maryland. The Company provided $1.28 million second trust financing to the buyer, which bore interest at a fixed rate of 6%. In May 2018, the buyer repaid the loan in full and the Company recognized a $0.5 million gain that was previously deferred.

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

As of September 30, 2018, the Saul Organization holds a 25.9% limited partnership interest in the Operating Partnership represented by approximately 7.8 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 Company's 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 September 30, 2018, approximately 760,000 units were convertible into shares of Saul Centers common stock.

The impact of the Saul Organization's approximately 25.9% 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 September 30, 2018 and 2017, were approximately 30.3 million and 29.5 million, respectively, and for the nine months ended September 30, 2018 and 2017, were approximately 30.0 million and 29.4 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 $1.0 billion at September 30, 2018, of which approximately $870.9 million was fixed-rate debt and approximately $152.0 million was variable rate debt, including
$77.0 million outstanding under an unsecured revolving credit facility and $75.0 million outstanding under a term loan credit facility. The carrying value of the properties collateralizing the notes payable totaled approximately $965.6 million as of September 30, 2018.

On January 26, 2018, the Company replaced its credit facility. The new credit facility, which can be used for working capital, property acquisitions, development projects or letters of credit, totals $400.0 million, of which $325.0 million is a revolving credit facility and $75.0 million is a term loan. The revolving credit facility matures on January 26, 2022, and may be extended by the Company for one additional year, subject to satisfaction of certain conditions. The term loan matures on January 26, 2023, and may not be extended. In general, loan availability under the new credit facility is primarily determined by operating income from the Company's existing unencumbered properties. Interest accrues at a rate of LIBOR plus a spread of 135 basis points to 195 basis points under the revolving credit facility, and 130 basis points to 190 basis points under the term loan, each as determined by certain leverage tests. As of September 30, 2018, the applicable spread for borrowings is 135 basis points under the revolving credit facility and 130 basis points under the term loan. Saul Centers and certain consolidated subsidiaries of the Operating Partnership have guaranteed the payment obligations of the Operating Partnership under the new credit facility. Letters of credit

may be issued under the revolving credit facility. On September 30, 2018, based on the value of the Company’s unencumbered properties, approximately $161.1 million was available under the revolving credit facility, $77.0 million was outstanding and approximately $185,000 was committed for letters of credit.

On January 18, 2017, the Company closed on a 15-year, non-recourse $40.0 million mortgage loan secured by Burtonsville Town Square. The loan matures in 2032, bears interest at a fixed rate of 3.39%, requires monthly principal and interest payments of $197,900 based on a 25-year amortization schedule and requires a final payment of $20.3 million at maturity.

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On August 14, 2017, the Company closed on a $157.0 million construction-to-permanent loan, the proceeds of which will be used to partially fund the Glebe Road development project. The loan, which had an outstanding balance of $2.9 million at September 30, 2018, matures in 2035, bears interest at a fixed rate of 4.67%, requires interest only payments, which will be funded by the loan, until conversion to permanent. The conversion is expected in the fourth quarter of 2021, and thereafter, monthly principal and interest payments of $887,900 based on a 25-year amortization schedule will be required.

Effective September 1, 2017, the Company's construction-to-permanent loan secured by and used to partially finance the construction of Park Van Ness, converted to permanent financing. The loan matures in 2032, bears interest at a fixed rate of 4.88%, requires monthly principal and interest payments of $413,460 based on a 25-year amortization schedule and requires a final payment of $39.6 million at maturity.

On November 20, 2017, the Company closed on a 15-year, non-recourse $60.0 million mortgage loan secured by Washington Square. The loan matures in 2032, bears interest at a fixed rate of 3.75%, requires monthly principal and interest payments of $308,500 based on a 25-year amortization schedule and requires a final payment of $31.1 million. Proceeds were used to repay the remaining balance of $28.1 million on the existing mortgage and reduce the outstanding balance of the revolving credit facility.

Saul Centers is a guarantor of the credit facility, of which the Operating Partnership is the borrower. The Operating Partnership is the guarantor of (a) a portion of the Park Van Ness loan (approximately $10.0 million of the $70.1 million outstanding balance at September 30, 2018, which guarantee will be reduced to (i) $6.7 million on October 1, 2019, (ii) $3.3 million on October 1, 2020 and (iii) zero on October 1, 2021), and (b) a portion of the Kentlands Square II mortgage loan (approximately $9.2 million of the $35.6 million outstanding at September 30, 2018). All other notes payable are non-recourse.

At December 31, 2017, the principal amount of the Company’s outstanding debt totaled approximately $965.5 million, of which $890.4 million was fixed rate debt and $75.1 million was variable rate debt, including $61.0 million outstanding under an unsecured revolving credit facility. The carrying value of the properties collateralizing the notes payable totaled approximately $1.0 billion as of December 31, 2017.

At September 30, 2018, 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
October 1 through December 31, 2018	$—	$ 7,688	$7,688
2019	60,794	29,298	90,092
2020	61,163	26,772	87,935
2021	11,012	26,486	37,498
2022	113,502 (a)	26,990	140,492
2023	84,225	27,290	111,515
Thereafter	430,259	117,422	547,681
Principal amount	$760,955	$ 261,946	1,022,901
Unamortized deferred debt costs			9,989
Net			$1,012,912

(a) Includes $77.0 million outstanding under the revolving credit facility.

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Notes to Consolidated Financial Statements (Unaudited)

Interest expense and amortization of deferred debt costs for the three and nine months ended September 30, 2018 and 2017, were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2018	2017	2018	2017
Interest incurred	$12,361	$12,370	$36,863	$37,037
Amortization of deferred debt costs	377	351	1,224	1,043
Capitalized interest	(1,716)	(900)	(4,301)	(2,495)
	$11,022	$11,821	$33,786	$35,585

6. Equity

The consolidated statements of operations for the nine months ended September 30, 2018 and 2017, reflect noncontrolling interests of $9.3 million and $9.5 million, respectively, representing income attributable to the Saul Organization for each period.

On January 23, 2018, Saul Centers sold, in an underwritten public offering, 3.0 million depositary shares, each representing 1/100th of a share of 6.125% Series D Cumulative Redeemable Preferred Stock (the "Series D Stock"), providing net cash proceeds of approximately $72.6 million. The depositary shares may be redeemed at the Company's option, in whole or in part, on or after January 23, 2023, at the $25.00 liquidation preference, plus accrued but unpaid dividends to but not including the redemption date. The depositary shares pay an annual dividend of $1.53125 per share, equivalent to 6.125% of the $25.00 liquidation preference. The Series D 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 in 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. On February 22, 2018, the proceeds from the offering, together with cash on hand, were used to redeem 3.0 million depositary shares, each representing 1/100th of a share of the Company's 6.875% Series C Cumulative Redeemable Preferred Stock (the "Series C Stock"). Costs associated with the redemption were charged against Net income available to common stockholders.

At September 30, 2018, the Company had outstanding 4.2 million depositary shares, each representing 1/100th of a share of 6.875% Series C Stock. The depositary shares are redeemable 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 Series C 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 $264,900 and $270,600 for the nine months ended September 30, 2018 and 2017, respectively. All amounts contributed 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

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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 nine months ended September 30, 2018 and 2017, the Company credited to employee accounts $161,500 and $154,300, respectively, which is the sum of accrued earnings and three times the amount deferred by employees and is included in general and administrative expense. All amounts contributed by employees and credited by the Company are fully vested. The cumulative unfunded liability under this plan was $2.6 million and $2.4 million, at September 30, 2018 and December 31, 2017, 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 nine months ended September 30, 2018 and 2017, which included rental expense for the Company’s headquarters lease, totaled approximately $6.2 million and $5.4 million, net, respectively. The amounts are generally expensed as incurred and are primarily reported as general and administrative expenses in the Consolidated Statements of Operations. As of September 30, 2018 and December 31, 2017, accounts payable, accrued expenses and other liabilities included approximately $767,600 and $993,200, respectively, representing amounts due to the Saul Organization for the Company’s share of these ancillary costs and expenses.

The Company has entered into a shared third-party predevelopment cost agreement (the “Predevelopment Agreement”) with the Trust. The Predevelopment Agreement relates to the sharing of third-party predevelopment costs incurred in connection with the planning of the future redevelopment of certain adjacent real estate assets in the Twinbrook area of Rockville, Maryland. The costs will be shared on a pro rata basis based on the acreage owned by each entity and neither party is obligated to advance funds to the other.

In August 2016, the Company entered into an agreement to acquire from the Trust approximately 13.7 acres of land located at the intersection of Ashburn Village Boulevard and Russell Branch Parkway in Ashburn, Virginia. The transaction closed on May 9, 2018, and the Company issued 176,680 limited partnership units to the Trust. The Company intends to construct a shopping center and, upon stabilization, may be obligated to issue additional limited partnership units to the Trust.

The Company subleases its corporate headquarters space from a member of the Saul Organization. The lease commenced in March 2002, expires in 2022, 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 for its headquarters location was $590,000 and $578,200 for the nine months ended September 30, 2018 and 2017, 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 $251,800 and $173,800 for the nine months ended September 30, 2018 and 2017, respectively.

8. Stock Option Plans

In 2004, the Company has established a stock incentive plan (the "Plan"), as amended. Under the Plan, 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 nine months ended September 30, 2018.

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Notes to Consolidated Financial Statements (Unaudited)

	Directors									
Grant date	4/24/2009	5/7/2010	5/13/2011	5/4/2012	5/10/2013	5/9/2014	5/8/2015	5/6/2016	5/5/2017	5/11/
Total grant	32,500	32,500	32,500	35,000	35,000	30,000	35,000	32,500	27,500	27,50
Vested	32,500	32,500	32,500	35,000	35,000	30,000	35,000	32,500	27,500	27,50
Exercised	27,500	25,000	22,500	22,500	22,500	17,500	12,500	7,500	—	2,500
Forfeited	—	2,500	2,500	—	—	—	—	—	2,500	—
Exercisable at September 30, 2018	5,000	5,000	7,500	12,500	12,500	12,500	22,500	25,000	25,000	25,00
Remaining unexercised	5,000	5,000	7,500	12,500	12,500	12,500	22,500	25,000	25,000	25,00
Exercise price	$32.68	$38.76	$41.82	$39.29	$44.42	$47.03	$51.07	$57.74	$59.41	$49.4
Volatility	0.344	0.369	0.358	0.348	0.333	0.173	0.166	0.166	0.173	0.192
Expected life (years)	6.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Assumed yield	4.54%	4.23%	4.16%	4.61%	4.53%	4.48%	4.54%	3.75%	3.45%	3.70
Risk-free rate	2.19%	2.17%	1.86%	0.78%	0.82%	1.63%	1.50%	1.23%	1.89%	2.84
Total value at grant date	$222,950	$287,950	$297,375	$257,250	$278,250	$109,500	$125,300	$151,125	$165,550	$169