KILROY REALTY CORP
Form 10-Q
May 01, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2013
OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to
Commission File Number: 1-12675 (Kilroy Realty Corporation)
Commission File Number: 000-54005 (Kilroy Realty, L.P.)
KILROY REALTY CORPORATION
KILROY REALTY, L.P.
(Exact name of registrant as specified in its charter)

Kilroy Realty Corporation	Maryland (State or other jurisdiction of incorporation or organization)	95-4598246 (I.R.S. Employer Identification No.)
Kilroy Realty, L.P.	Delaware (State or other jurisdiction of incorporation or organization)	95-4612685 (I.R.S. Employer Identification No.)

12200 W. Olympic Boulevard, Suite 200, Los Angeles, California 90064
(Address of principal executive offices) (Zip Code)

(310) 481-8400
(Registrant's telephone number, including area code)

N/A
(Former name, former address and former fiscal year, if changed since last report)

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 requirements for the past 90 days.

Kilroy Realty Corporation Yes þ No o
Kilroy Realty, L. P. Yes þ 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).

Kilroy Realty Corporation Yes þ No o
Kilroy Realty, L.P. Yes þ 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 the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Kilroy Realty Corporation

Large accelerated filer þ Accelerated filer o Non-accelerated filer o Smaller reporting company o
(Do not check if a smaller reporting company)

Kilroy Realty, L.P.

Large accelerated filer o Accelerated filer o Non-accelerated filer þ Smaller reporting company o
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Kilroy Realty Corporation Yes o No þ

Kilroy Realty, L.P. Yes o No þ

As of April 30, 2013, 75,460,005 shares of Kilroy Realty Corporation common stock, par value $.01 per share, were outstanding.

EXPLANATORY NOTE

This report combines the quarterly reports on Form 10-Q for the period ended March 31, 2013 of Kilroy Realty Corporation and Kilroy Realty, L.P. Unless stated otherwise or the context otherwise requires, references to "Kilroy Realty Corporation" or the "Company," "we," "our," and "us" mean Kilroy Realty Corporation, a Maryland corporation, and its controlled and consolidated subsidiaries, and references to "Kilroy Realty, L.P." or the "Operating Partnership" mean Kilroy Realty, L.P., a Delaware limited partnership, and its controlled and consolidated subsidiaries.

The Company is a real estate investment trust, or REIT, and the general partner of the Operating Partnership. As of March 31, 2013, the Company owned an approximate 97.6% common general partnership interest in the Operating Partnership. The remaining approximate 2.4% common limited partnership interests are owned by non-affiliated investors and certain directors and executive officers of the Company. As the sole general partner of the Operating Partnership, the Company exercises exclusive and complete discretion over the Operating Partnership's day-to-day management and control and can cause it to enter into certain major transactions, including acquisitions, dispositions, and refinancings and cause changes in its line of business, capital structure, and distribution policies.

There are a few differences between the Company and the Operating Partnership, which are reflected in the disclosures in this Form 10-Q. We believe it is important to understand the differences between the Company and the Operating Partnership in the context of how the Company and the Operating Partnership operate as an interrelated, consolidated company. The Company is a REIT, the only material asset of which is the partnership interests it holds in the Operating Partnership. As a result, the Company does not conduct business itself, other than acting as the sole general partner of the Operating Partnership, issuing equity from time to time and guaranteeing certain debt of the Operating Partnership. The Company itself is not directly obligated under any indebtedness, but guarantees some of the debt of the Operating Partnership. The Operating Partnership owns substantially all of the assets of the Company either directly or through its subsidiaries, conducts the operations of the Company's business and is structured as a limited partnership with no publicly traded equity. Except for net proceeds from equity issuances by the Company, which the Company is required to contribute to the Operating Partnership in exchange for partnership units, the Operating Partnership generates the capital required by the Company's business through the Operating Partnership's operations, property dispositions, by the Operating Partnership's incurrence of indebtedness or through the issuance of partnership units.

Noncontrolling interests and stockholders' equity and partners' capital are the main areas of difference between the consolidated financial statements of the Company and those of the Operating Partnership. The common limited partnership interests in the Operating Partnership are accounted for as partners' capital in the Operating Partnership's financial statements and, to the extent not held by the Company, as noncontrolling interests in the Company's financial statements. The Operating Partnership's financial statements reflect the noncontrolling interest in Kilroy Realty Finance Partnership, L.P. This noncontrolling interest represents the Company's 1% indirect general partnership interest in Kilroy Realty Finance Partnership, L.P., which is directly held by Kilroy Realty Finance, Inc., a wholly-owned subsidiary of the Company. The differences between stockholders' equity, partners' capital and noncontrolling interests result from the differences in the equity issued by the Company and the Operating Partnership, and in the Company's noncontrolling interest in Kilroy Realty Finance Partnership, L.P.

We believe combining the quarterly reports on Form 10-Q of the Company and the Operating Partnership into this single report results in the following benefits:

- Combined reports better reflect how management and the analyst community view the business as a single operating unit;
- Combined reports enhance investors' understanding of the Company and the Operating Partnership by enabling them to view the business as a whole and in the same manner as management;
- Combined reports are more efficient for the Company and the Operating Partnership and result in savings in time, effort and expense; and
- Combined reports are more efficient for investors by reducing duplicative disclosure and providing a single document for their review.

To help investors understand the significant differences between the Company and the Operating Partnership, this report presents the following separate sections for each of the Company and the Operating Partnership:

- consolidated financial statements;
- the following notes to the consolidated financial statements:

Note 5, Secured and Unsecured Debt of the Operating Partnership;
Note 6, Noncontrolling Interests on the Company's Consolidated Financial Statements;
Note 7, Stockholders' Equity of the Company;

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Note 8, Partners' Capital of the Operating Partnership;
Note 12, Net (Loss) Income Available to Common Stockholders Per Share of the Company; and
Note 13, Net (Loss) Income Available to Common Unitholders Per Unit of the Operating Partnership;

- "Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources of the Company"; and
- "Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources of the Operating Partnership."

This report also includes separate sections under Part I, Item 4. Controls and Procedures and separate Exhibit 31 and Exhibit 32 certifications for each of the Company and the Operating Partnership to establish that the Chief Executive Officer and the Chief Financial Officer of each entity have made the requisite certifications and that the Company and Operating Partnership are compliant with Rule 13a-15 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and 18 U.S.C. §1350.

KILROY REALTY CORPORATION AND KILROY REALTY, L.P.
QUARTERLY REPORT FOR THE THREE MONTHS ENDED MARCH 31, 2013
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PART I-FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS OF KILROY REALTY CORPORATION
KILROY REALTY CORPORATION
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	March 31, 2013 (unaudited)	December 31, 2012
ASSETS		
REAL ESTATE ASSETS:		
Land and improvements (Note 2)	$637,854	$612,714
Buildings and improvements (Note 2)	3,631,057	3,335,026
Undeveloped land and construction in progress	747,679	809,654
Total real estate held for investment	5,016,590	4,757,394
Accumulated depreciation and amortization	(790,878)	(756,515)
Total real estate assets held for investment, net ($0 and $319,770 of VIE, Note 1)	4,225,712	4,000,879
CASH AND CASH EQUIVALENTS	135,676	16,700
RESTRICTED CASH	19,465	247,544
MARKETABLE SECURITIES (Note 11)	8,029	7,435
CURRENT RECEIVABLES, NET (Note 4)	10,666	9,220
DEFERRED RENT RECEIVABLES, NET (Note 4)	122,142	115,418
DEFERRED LEASING COSTS AND ACQUISITION-RELATED INTANGIBLE ASSETS, NET (Notes 2 and 3)	196,525	189,968
DEFERRED FINANCING COSTS, NET	20,501	18,971
PREPAID EXPENSES AND OTHER ASSETS, NET	16,571	9,949
TOTAL ASSETS	$4,755,287	$4,616,084
LIABILITIES AND EQUITY		
LIABILITIES:		
Secured debt (Notes 2, 5 and 11)	$570,676	$561,096
Exchangeable senior notes, net (Notes 5 and 11)	165,022	163,944
Unsecured debt, net (Notes 5 and 11)	1,430,880	1,130,895
Unsecured line of credit (Notes 5 and 11)	—	185,000
Accounts payable, accrued expenses and other liabilities	171,694	154,734
Accrued distributions (Note 14)	29,106	28,924
Deferred revenue and acquisition-related intangible liabilities, net (Notes 2 and 3)	118,118	117,904
Rents received in advance and tenant security deposits	37,251	37,654
Total liabilities	2,522,747	2,380,151
COMMITMENTS AND CONTINGENCIES (Note 10)		
EQUITY:		
Stockholders' Equity (Note 7):		
Preferred stock, $.01 par value, 30,000,000 shares authorized:		
6.875% Series G Cumulative Redeemable Preferred stock, $.01 par value, 4,600,000 shares authorized, 4,000,000 shares issued and outstanding ($100,000 liquidation preference)	96,155	96,155
6.375% Series H Cumulative Redeemable Preferred stock, $.01 par value, 4,000,000 shares authorized, issued and outstanding ($100,000 liquidation preference)	96,256	96,256
	753	749

Common stock, $.01 par value, 150,000,000 shares authorized, 75,349,705 and 74,926,981 shares issued and outstanding, respectively		
Additional paid-in capital	2,149,052	2,126,005
Distributions in excess of earnings	(157,211)	(129,535)
Total stockholders' equity	2,185,005	2,189,630
Noncontrolling interest:		
Common units of the Operating Partnership (Note 6)	47,535	46,303
Total equity	2,232,540	2,235,933
TOTAL LIABILITIES AND EQUITY	$4,755,287	$4,616,084

See accompanying notes to consolidated financial statements.

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KILROY REALTY CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited, in thousands, except share and per share data)

	Three Months Ended March 31,	
	2013	2012
REVENUES:		
Rental income	$107,380	$84,349
Tenant reimbursements	9,887	7,180
Other property income	230	868
Total revenues	117,497	92,397
EXPENSES:		
Property expenses	23,773	16,132
Real estate taxes	10,337	7,665
Provision for bad debts	95	2
Ground leases (Note 3)	847	807
General and administrative expenses	9,669	8,767
Acquisition-related expenses	655	1,528
Depreciation and amortization	50,391	34,652
Total expenses	95,767	69,553
OTHER (EXPENSES) INCOME:		
Interest income and other net investment gains (Note 11)	392	484
Interest expense (Note 5)	(19,734)	(21,163)
Total other (expenses) income	(19,342)	(20,679)
INCOME FROM CONTINUING OPERATIONS	2,388	2,165
DISCONTINUED OPERATIONS		
Income from discontinued operations	—	3,697
Net gain on dispositions of discontinued operations	—	72,809
Total income from discontinued operations	—	76,506
NET INCOME	2,388	78,671
Net loss (income) attributable to noncontrolling common units of the Operating Partnership	22	(1,795)
NET INCOME ATTRIBUTABLE TO KILROY REALTY CORPORATION	2,410	76,876
PREFERRED DISTRIBUTIONS AND DIVIDENDS:		
Distributions to noncontrolling cumulative redeemable preferred units of the Operating Partnership	—	(1,397)
Preferred dividends	(3,313)	(3,021)
Original issuance costs of redeemed preferred stock	—	(4,918)
Total preferred distributions and dividends	(3,313)	(9,336)
NET (LOSS) INCOME AVAILABLE TO COMMON STOCKHOLDERS	$(903)	$67,540
Loss from continuing operations available to common stockholders per common share - basic (Note 12)	$(0.02)	$(0.12)
Loss from continuing operations available to common stockholders per common share - diluted (Note 12)	$(0.02)	$(0.12)
Net (loss) income available to common stockholders per share - basic (Note 12)	$(0.02)	$1.06
Net (loss) income available to common stockholders per share - diluted (Note 12)	$(0.02)	$1.06
Weighted average common shares outstanding - basic (Note 12)	74,977,240	63,648,704
Weighted average common shares outstanding - diluted (Note 12)	74,977,240	63,648,704
Dividends declared per common share	$0.35	$0.35

See accompanying notes to consolidated financial statements.

KILROY REALTY CORPORATION
CONSOLIDATED STATEMENTS OF EQUITY
(unaudited, in thousands, except share and per share/unit data)

		Common Stock						
	Preferred Stock	Number of Shares	Common Stock	Additional Paid-in Capital	Distributions in Excess of Earnings	Total Stock-holders' Equity	Noncontrolling Interests - Common Units of the Operating Partnership	Total Equity
BALANCE AS OF DECEMBER 31, 2011	$121,582	58,819,717	$588	$1,448,997	$(277,450)	$1,293,717	$33,765	$1,327,482
Net income					76,876	76,876	1,795	78,671
Issuance of Series G Preferred stock	96,155					96,155		96,155
Series E and Series F Preferred stock, called for redemption	(121,582)				(4,918)	(126,500)		(126,500)
Issuance of common stock		9,487,500	95	381,968		382,063		382,063
Issuance of share-based compensation awards		59,938	—	294		294		294
Noncash amortization of share-based compensation				1,469		1,469		1,469
Repurchase of common stock and restricted stock units		(22,312)		(603)		(603)		(603)
Exercise of stock options		5,000		129		129		129
Adjustment for noncontrolling interest				(4,578)		(4,578)	4,578	—
Preferred dividends and distributions					(4,418)	(4,418)		(4,418)
Dividends declared per common share and common unit ($0.35 per share/unit)					(24,289)	(24,289)	(603)	(24,892)
BALANCE AS OF MARCH 31, 2012	$96,155	68,349,843	$683	$1,827,676	$(234,199)	$1,690,315	$39,535	$1,729,850

	Preferred Stock	Common Stock: Number of Shares	Common Stock: Common Stock	Additional Paid-in Capital	Distributions in Excess of Earnings	Total Stock-holders' Equity	Noncontrol-ling Interests - Common Units of the Operating Partnership	Total Equity
BALANCE AS OF DECEMBER 31, 2012	$192,411	74,926,981	$749	$2,126,005	$(129,535)	$2,189,630	$46,303	$2,235,933
Net income (loss)					2,410	2,410	(22)	2,388
Issuance of common stock (Note 7)		453,679	4	23,391		23,395		23,395
Issuance of share-based compensation awards (Note 9)		—		336		336		336
Noncash amortization of share-based compensation (Note 9)				2,422		2,422		2,422
Repurchase of common stock and restricted stock units (Note 9)		(33,534)		(1,199)		(1,199)		(1,199)
Settlement of restricted stock units for shares of common stock (Note 9)		2,579		(10)		(10)		(10)
Adjustment for noncontrolling interest				(1,893)		(1,893)	1,893	—
Preferred dividends and distributions					(3,313)	(3,313)		(3,313)
Dividends declared per common share and common unit ($0.35 per share/unit)					(26,773)	(26,773)	(639)	(27,412)
BALANCE AS OF MARCH 31, 2013	$192,411	75,349,705	$753	$2,149,052	$(157,211)	$2,185,005	$47,535	$2,232,540

See accompanying notes to consolidated financial statements.

KILROY REALTY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, in thousands)

	Three Months Ended March 31,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$2,388	$78,671
Adjustments to reconcile net income to net cash provided by operating activities (including discontinued operations):		
Depreciation and amortization of building and improvements and leasing costs	50,011	36,464
Increase in provision for bad debts	95	2
Depreciation of furniture, fixtures and equipment	380	288
Noncash amortization of share-based compensation awards	2,234	1,287
Noncash amortization of deferred financing costs and debt discounts and premiums	1,413	2,976
Noncash amortization of net below market rents (Note 3)	(2,047)	(525)
Net gain on dispositions of discontinued operations	—	(72,809)
Noncash amortization of deferred revenue related to tenant-funded tenant improvements	(2,442)	(2,261)
Straight-line rents	(6,724)	(5,487)
Net change in other operating assets	(7,390)	(3,869)
Net change in other operating liabilities	18,581	14,956
Insurance proceeds received for property damage	—	(951)
Net cash provided by operating activities	56,499	48,742
CASH FLOWS FROM INVESTING ACTIVITIES:		
Expenditures for acquisition of operating properties (Note 2)	(85,692)	(162,380)
Expenditures for operating properties	(25,571)	(17,307)
Expenditures for development and redevelopment properties and undeveloped land	(73,369)	(13,477)
Net proceeds received from dispositions of operating properties	—	100,765
Insurance proceeds received for property damage	—	951
Increase in acquisition-related deposits	—	(5,250)
Decrease (increase) in restricted cash (Note 1)	228,079	(386)
Net cash provided by (used in) investing activities	43,447	(97,084)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from issuance of Series G preferred stock	—	96,757
Net proceeds from issuance of common stock (Note 7)	23,395	382,063
Borrowings on unsecured line of credit	—	30,000
Repayments on unsecured line of credit	(185,000)	(212,000)
Principal payments on secured debt	(84,918)	(1,546)
Proceeds from the issuance of unsecured debt (Note 5)	299,901	150,000
Financing costs	(2,870)	(1,877)
Repurchase of common stock and restricted stock units (Note 9)	(1,209)	(603)
Proceeds from exercise of stock options	—	129
Dividends and distributions paid to common stockholders and common unitholders	(26,956)	(21,191)
Dividends and distributions paid to preferred stockholders and preferred unitholders	(3,313)	(3,799)
Net cash provided by financing activities	19,030	417,933
Net increase in cash and cash equivalents	118,976	369,591
Cash and cash equivalents, beginning of period	16,700	4,777
Cash and cash equivalents, end of period	$135,676	$374,368

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KILROY REALTY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS-(Continued)
(unaudited, in thousands)

	Three Months Ended March 31,	
	2013	2012
SUPPLEMENTAL CASH FLOWS INFORMATION:		
Cash paid for interest, net of capitalized interest of $7,175 and $3,251 as of March 31, 2013 and 2012, respectively	$11,303	$4,487
NONCASH INVESTING TRANSACTIONS:		
Accrual for expenditures for operating properties and development and redevelopment properties	$42,140	$5,421
Tenant improvements funded directly by tenants	$1,426	$95
Assumption of secured debt in connection with property acquisitions (Notes 2 and 5)	$95,496	$—
Assumption of other assets and liabilities in connection with operating and development property acquisitions, net (Note 2)	$422	$137
Net disposition proceeds held by a qualified intermediary in connection with Section 1031 exchange	$—	$42,395
NONCASH FINANCING TRANSACTIONS:		
Accrual of preferred stock issuance costs	$—	$602
Accrual of dividends and distributions payable to common stockholders and common unitholders	$27,011	$24,524
Accrual of dividends and distributions payable to preferred stockholders and preferred unitholders	$1,694	$2,431
Issuance of share-based compensation awards, net (Note 9)	$8,451	$29,989
Reclassification of preferred units called for redemption from equity to liabilities	$—	$126,500

See accompanying notes to consolidated financial statements.

ITEM 1: FINANCIAL STATEMENTS OF KILROY REALTY, L.P.

KILROY REALTY, L.P.
CONSOLIDATED BALANCE SHEETS
(in thousands, except unit data)

	March 31, 2013	December 31, 2012
	(unaudited)	
ASSETS		
REAL ESTATE ASSETS:		
Land and improvements (Note 2)	$637,854	$612,714
Buildings and improvements (Note 2)	3,631,057	3,335,026
Undeveloped land and construction in progress	747,679	809,654
Total real estate held for investment	5,016,590	4,757,394
Accumulated depreciation and amortization	(790,878)	(756,515)
Total real estate assets held for investment, net ($0 and $319,770 of VIE, Note 1)	4,225,712	4,000,879
CASH AND CASH EQUIVALENTS	135,676	16,700
RESTRICTED CASH	19,465	247,544
MARKETABLE SECURITIES (Note 11)	8,029	7,435
CURRENT RECEIVABLES, NET (Note 4)	10,666	9,220
DEFERRED RENT RECEIVABLES, NET (Note 4)	122,142	115,418
DEFERRED LEASING COSTS AND ACQUISITION-RELATED INTANGIBLE ASSETS, NET (Notes 2 and 3)	196,525	189,968
DEFERRED FINANCING COSTS, NET	20,501	18,971
PREPAID EXPENSES AND OTHER ASSETS, NET	16,571	9,949
TOTAL ASSETS	$4,755,287	$4,616,084
LIABILITIES AND CAPITAL		
LIABILITIES:		
Secured debt (Notes 2, 5 and 11)	$570,676	$561,096
Exchangeable senior notes, net (Notes 5 and 11)	165,022	163,944
Unsecured debt, net (Notes 5 and 11)	1,430,880	1,130,895
Unsecured line of credit (Notes 5 and 11)	—	185,000
Accounts payable, accrued expenses and other liabilities	171,694	154,734
Accrued distributions (Note 14)	29,106	28,924
Deferred revenue and acquisition-related intangible liabilities, net (Notes 2 and 3)	118,118	117,904
Rents received in advance and tenant security deposits	37,251	37,654
Total liabilities	2,522,747	2,380,151
COMMITMENTS AND CONTINGENCIES (Note 10)		
CAPITAL:		
Partners' Capital (Note 8):		
6.875% Series G Cumulative Redeemable Preferred units, 4,000,000 units issued and outstanding ($100,000 liquidation preference)	96,155	96,155
6.375% Series H Cumulative Redeemable Preferred units, 4,000,000 units issued and outstanding ($100,000 liquidation preference)	96,256	96,256
Common units, 75,349,705 and 74,926,981 held by the general partner and 1,826,503 and 1,826,503 held by common limited partners issued and outstanding, respectively	2,036,781	2,040,243
Total partners' capital	2,229,192	2,232,654
Noncontrolling interest in consolidated subsidiaries	3,348	3,279

Total capital	2,232,540	2,235,933
TOTAL LIABILITIES AND CAPITAL	$4,755,287	$4,616,084

See accompanying notes to consolidated financial statements.

KILROY REALTY, L.P.
CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited, in thousands, except unit and per unit data)

	Three Months Ended March 31, 2013	2012
REVENUES:		
Rental income	$107,380	84,349
Tenant reimbursements	9,887	7,180
Other property income	230	868
Total revenues	117,497	92,397
EXPENSES:		
Property expenses	23,773	16,132
Real estate taxes	10,337	7,665
Provision for bad debts	95	2
Ground leases (Note 3)	847	807
General and administrative expenses	9,669	8,767
Acquisition-related expenses	655	1,528
Depreciation and amortization	50,391	34,652
Total expenses	95,767	69,553
OTHER (EXPENSES) INCOME:		
Interest income and other net investment gains (Note 11)	392	484
Interest expense (Note 5)	(19,734)	(21,163)
Total other (expenses) income	(19,342)	(20,679)
INCOME FROM CONTINUING OPERATIONS	2,388	2,165
DISCONTINUED OPERATIONS		
Income from discontinued operations	—	3,697
Net gain on dispositions of discontinued operations	—	72,809
Total income from discontinued operations	—	76,506
NET INCOME	2,388	78,671
Net income attributable to noncontrolling interests in consolidated subsidiaries	(69)	(53)
NET INCOME ATTRIBUTABLE TO KILROY REALTY, L.P.	2,319	78,618
Preferred distributions	(3,313)	(4,418)
Original issuance costs of redeemed preferred units	—	(4,918)
Total preferred distributions	(3,313)	(9,336)
NET (LOSS) INCOME AVAILABLE TO COMMON UNITHOLDERS	$(994)	$69,282
Loss from continuing operations available to common unitholders per common unit - basic (Note 13)	$(0.02)	$(0.12)
Loss from continuing operations available to common unitholders per common unit - diluted (Note 13)	$(0.02)	$(0.12)
Net (loss) income available to common unitholders per unit - basic (Note 13)	$(0.02)	$1.05
Net (loss) income available to common unitholders per unit - diluted (Note 13)	$(0.02)	$1.05
Weighted average common units outstanding - basic (Note 13)	76,803,743	65,366,835
Weighted average common units outstanding - diluted (Note 13)	76,803,743	65,366,835
Dividends declared per common unit	$0.35	$0.35

See accompanying notes to consolidated financial statements.

KILROY REALTY, L.P.
CONSOLIDATED STATEMENTS OF CAPITAL
(unaudited, in thousands, except unit and per unit data)

	Partners' Capital Preferred Units	Number of Common Units	Common Units	Total Partners' Capital	Noncontrolling Interests in Consolidated Subsidiaries	Total Capital
BALANCE AS OF DECEMBER 31, 2011	$121,582	60,537,848	$1,203,259	$1,324,841	$2,641	$1,327,482
Net income			78,618	78,618	53	78,671
Issuance of Series G Preferred units	96,155			96,155		96,155
Redemption of Series E and Series F Preferred units, called for redemption	(121,582)		(4,918)	(126,500)		(126,500)
Issuance of common units		9,487,500	382,063	382,063		382,063
Issuance of share-based compensation awards		59,938	294	294		294
Noncash amortization of share-based compensation			1,469	1,469		1,469
Repurchase of common units and restricted stock units		(22,312)	(603)	(603)		(603)
Exercise of stock options		5,000	129	129		129
Preferred distributions			(4,418)	(4,418)		(4,418)
Distributions declared per common unit ($0.35 per unit)			(24,892)	(24,892)		(24,892)
BALANCE AS OF MARCH 31, 2012	$96,155	70,067,974	$1,631,001	$1,727,156	$2,694	$1,729,850

	Partners' Capital Preferred Units	Number of Common Units	Common Units	Total Partners' Capital	Noncontrolling Interests in Consolidated Subsidiaries	Total Capital
BALANCE AS OF DECEMBER 31, 2012	$192,411	76,753,484	$2,040,243	$2,232,654	$3,279	$2,235,933
Net income			2,319	2,319	69	2,388
Issuance of common units (Note 8)		453,679	23,395	23,395		23,395
Issuance of share-based compensation awards (Note 9)		—	336	336		336
Noncash amortization of share-based compensation (Note 9)			2,422	2,422		2,422
Repurchase of common units and restricted stock units (Note 9)		(33,534)	(1,199)	(1,199)		(1,199)
Settlement of restricted stock units (Note 9)		2,579	(10)	(10)		(10)
Preferred distributions			(3,313)	(3,313)		(3,313)
Distributions declared per common unit ($0.35 per unit)			(27,412)	(27,412)		(27,412)
	$192,411	77,176,208	$2,036,781	$2,229,192	$3,348	$2,232,540

BALANCE AS OF MARCH
31, 2013

See accompanying notes to consolidated financial statements.

KILROY REALTY, L.P.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, in thousands)

	Three Months Ended March 31,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$2,388	$78,671
Adjustments to reconcile net income to net cash provided by operating activities (including discontinued operations):		
Depreciation and amortization of building and improvements and leasing costs	50,011	36,464
Increase in provision for bad debts	95	2
Depreciation of furniture, fixtures and equipment	380	288
Noncash amortization of share-based compensation awards	2,234	1,287
Noncash amortization of deferred financing costs and debt discounts and premiums	1,413	2,976
Noncash amortization of net below market rents (Note 3)	(2,047)	(525)
Net gain on dispositions of discontinued operations	—	(72,809)
Noncash amortization of deferred revenue related to tenant-funded tenant improvements	(2,442)	(2,261)
Straight-line rents	(6,724)	(5,487)
Net change in other operating assets	(7,390)	(3,869)
Net change in other operating liabilities	18,581	14,956
Insurance proceeds received for property damage	—	(951)
Net cash provided by operating activities	56,499	48,742
CASH FLOWS FROM INVESTING ACTIVITIES:		
Expenditures for acquisition of operating properties (Note 2)	(85,692)	(162,380)
Expenditures for operating properties	(25,571)	(17,307)
Expenditures for development and redevelopment properties and undeveloped land	(73,369)	(13,477)
Net proceeds received from dispositions of operating properties	—	100,765
Insurance proceeds received for property damage	—	951
Increase in acquisition-related deposits	—	(5,250)
Decrease (increase) in restricted cash (Note 1)	228,079	(386)
Net cash provided by (used in) investing activities	43,447	(97,084)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from issuance of Series G preferred units	—	96,757
Net proceeds from issuance of common units (Note 8)	23,395	382,063
Borrowings on unsecured line of credit	—	30,000
Repayments on unsecured line of credit	(185,000)	(212,000)
Principal payments on secured debt	(84,918)	(1,546)
Proceeds from the issuance of unsecured debt (Note 5)	299,901	150,000
Financing costs	(2,870)	(1,877)
Repurchase of common units and restricted stock units (Note 9)	(1,209)	(603)
Proceeds from exercise of stock options	—	129
Distributions paid to common unitholders	(26,956)	(21,191)
Distributions paid to preferred unitholders	(3,313)	(3,799)
Net cash provided by financing activities	19,030	417,933
Net increase in cash and cash equivalents	118,976	369,591
Cash and cash equivalents, beginning of period	16,700	4,777
Cash and cash equivalents, end of period	$135,676	$374,368

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KILROY REALTY, L.P.
CONSOLIDATED STATEMENTS OF CASH FLOWS-(Continued)
(unaudited, in thousands)

	Three Months Ended March 31,	
	2013	2012
SUPPLEMENTAL CASH FLOWS INFORMATION:		
Cash paid for interest, net of capitalized interest of $7,175 and $3,251 as of March 31, 2013 and 2012, respectively	$11,303	$4,487
NONCASH INVESTING TRANSACTIONS:		
Accrual for expenditures for operating properties and development and redevelopment properties	$42,140	$5,421
Tenant improvements funded directly by tenants	$1,426	$95
Assumption of secured debt in connection with property acquisitions (Notes 2 and 5)	$95,496	$—
Assumption of other assets and liabilities in connection with operating and development property acquisitions, net (Note 2)	$422	$137
Net disposition proceeds held by a qualified intermediary in connection with Section 1031 exchange	$—	$42,395
NONCASH FINANCING TRANSACTIONS:		
Accrual of preferred unit issuance costs	$—	$602
Accrual of distributions payable to common unitholders	$27,011	$24,524
Accrual of distributions payable to preferred unitholders	$1,694	$2,431
Issuance of share-based compensation awards, net (Note 9)	$8,451	$29,989
Reclassification of preferred units called for redemption from equity to liabilities	$—	$126,500

See accompanying notes to consolidated financial statements.

KILROY REALTY CORPORATION AND KILROY REALTY, L.P.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Three Months Ended March 31, 2013 and 2012
(unaudited)

1. Organization and Basis of Presentation
Organization
Kilroy Realty Corporation (the "Company") is a self-administered real estate investment trust ("REIT") active in office submarkets along the West Coast. We own, develop, acquire and manage real estate assets, consisting primarily of Class A properties in the coastal regions of Los Angeles, Orange County, San Diego County, the San Francisco Bay Area and greater Seattle, which we believe have strategic advantages and strong barriers to entry. Class A real estate encompasses attractive and efficient buildings of high quality that are attractive to tenants, are well-designed and constructed with above-average material, workmanship and finishes and are well-maintained and managed. We qualify as a REIT under the Internal Revenue Code of 1986, as amended (the "Code"). The Company's common stock is publicly traded on the New York Stock Exchange ("NYSE") under the ticker symbol "KRC."
We own our interests in all of our real estate assets through Kilroy Realty, L.P. (the "Operating Partnership") and Kilroy Realty Finance Partnership, L.P. (the "Finance Partnership"). We conduct substantially all of our operations through the Operating Partnership. Unless stated otherwise or the context indicates otherwise, the terms "Kilroy Realty Corporation" or the "Company," "we," "our," and "us" refer to Kilroy Realty Corporation and its consolidated subsidiaries and the term "Operating Partnership" refers to Kilroy Realty, L.P. and its consolidated subsidiaries. The descriptions of our business, employees, and properties apply to both the Company and the Operating Partnership.
Our stabilized portfolio of operating properties was comprised of the following office properties at March 31, 2013:

	Number of Buildings	Rentable Square Feet	Number of Tenants	Percentage Occupied	
Office Properties	116	13,570,059	553	90.3	%

Our stabilized portfolio includes all of our properties with the exception of undeveloped land, development and redevelopment properties currently under construction or committed for construction, "lease-up" properties and properties held-for-sale. We define redevelopment properties as those projects for which we expect to spend significant development and construction costs on existing or acquired buildings pursuant to a formal plan, the intended result of which is a higher economic return on the property. We define "lease-up" properties as properties we recently developed or redeveloped that have not yet reached 95% occupancy and are within one year following cessation of major construction activities. As of March 31, 2013, the following properties were excluded from our stabilized portfolio:

	Number of Properties	Estimated Rentable Square Feet
Development properties under construction (1)	4	1,416,000
Lease-up properties	2	508,000

(1) Estimated rentable square feet upon completion.

As of March 31, 2013, all of our properties and development and redevelopment projects are owned and all of our business is
currently conducted in the state of California with the exception of eleven office properties located in the state of Washington.
As of March 31, 2013, the Company owned a 97.6% general partnership interest in the Operating Partnership. The remaining 2.4% common limited partnership interest in the Operating Partnership as of March 31, 2013 was owned by non-affiliated investors and certain of our directors and executive officers (see Note 6). Both the general and limited common partnership interests in the Operating Partnership are denominated in common units. The number of common

units held by the Company is at all times equivalent to the number of outstanding shares of the Company's common stock, and the rights of all the common units to quarterly distributions and payments in liquidation mirror those of the Company's common stockholders. The common limited partners have certain redemption rights as provided in the Operating Partnership's Seventh Amended and Restated Agreement of Limited Partnership (as amended, the "Partnership Agreement") (see Note 6).

Kilroy Realty Finance, Inc., which is a wholly-owned subsidiary of the Company, is the sole general partner of the Finance Partnership and owns a 1.0% general partnership interest. The Operating Partnership owns the remaining 99.0% limited partnership interest. Kilroy Services, LLC ("KSLLC"), which is a wholly-owned subsidiary of the Operating Partnership, is the entity through which we conduct substantially all of our development activities. With the exception of the Operating Partnership, all of our subsidiaries are wholly-owned.

Basis of Presentation

The consolidated financial statements of the Company include the consolidated financial position and results of operations of the Company, the Operating Partnership, the Finance Partnership, KSLLC, and all of our wholly-owned and controlled subsidiaries. The consolidated financial statements of the Operating Partnership include the consolidated financial position and results of operations of the Operating Partnership, the Finance Partnership, KSLLC, and all wholly-owned and controlled subsidiaries of the Operating Partnership. All intercompany balances and transactions have been eliminated in the consolidated financial statements.

The accompanying interim financial statements have been prepared by management in accordance with accounting principles generally accepted in the United States of America ("GAAP") and in conjunction with the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures required for annual financial statements have been condensed or excluded pursuant to SEC rules and regulations. Accordingly, the interim financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the accompanying interim financial statements reflect all adjustments of a normal and recurring nature that are considered necessary for a fair presentation of the results for the interim periods presented. However, the results of operations for the interim periods are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. The interim financial statements for the Company and the Operating Partnership should be read in conjunction with the audited consolidated financial statements and notes thereto included in our annual report on Form 10-K for the year ended December 31, 2012.

Consolidated Variable Interest Entities

As of December 31, 2012 the consolidated financial statements of the Company and the Operating Partnership included two variable interest entities ("VIE") in which we were deemed to be the primary beneficiary. The VIEs were established during 2012 to facilitate potential like-kind exchanges pursuant to Section 1031 of the Code to defer taxable gains on dispositions for federal and state income tax purposes. During the year ended December 31, 2012, one operating property and one development project were acquired in two separate transactions and transferred to the two special purpose VIEs to facilitate potential Section 1031 Exchanges. The impact of consolidating the VIEs increased the Company's total assets and liabilities by approximately $337.0 million and $111.1 million, respectively, at December 31, 2012. During the three months ended March 31, 2013, the Section 1031 Exchanges were completed and the VIEs were terminated. As a result, $228.1 million of restricted cash set aside to facilitate the Section 1031 Exchanges was released from escrow and the Company and the Operating Partnership did not have any VIEs at March 31, 2013.

2. Acquisitions

Operating Properties

During the three months ended March 31, 2013, we acquired the two operating office properties listed below from an unrelated third party. The acquisition was funded with a portion of the remaining proceeds from the sale of our industrial portfolio that was included in restricted cash at December 31, 2012 and the assumption of existing mortgage debt (see Note 5).

Property	Date of Acquisition	Number of Buildings	Rentable Square Feet	Occupancy as of March 31, 2013	Purchase Price (in millions)[1]
320 Westlake Ave. N. and 321 Terry Ave. N. [2] [3] Seattle, WA	January 16, 2013	2	320,398	100.0%	$ 170.0

Total	2	320,398	$ 170.0

(1) Excludes acquisition-related costs and includes assumed tenant improvements.
(2) We acquired these properties through a new special purpose entity wholly owned by the Finance Partnership.
(3) In connection with this acquisition, we assumed secured debt with an outstanding principal balance of $83.9 million that was recorded at fair value on the acquisition date, resulting in a premium of approximately $11.6 million (see Note 5).

KILROY REALTY CORPORATION AND KILROY REALTY, L.P.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The related assets, liabilities, and results of operations of the acquired properties are included in the consolidated financial statements as of the date of acquisition. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date:

	320 Westlake Ave. N. and 321 Terry Ave. N., Seattle, WA (in thousands)
Assets	
Land and improvements	$25,140
Buildings and improvements[(1)]	142,021
Deferred leasing costs and acquisition-related intangible assets[(2)]	16,019
Total assets acquired	183,180
Liabilities	
Deferred revenue and acquisition-related intangible liabilities[(3)]	1,570
Secured debt[(4)]	95,496
Accounts payable, accrued expenses and other liabilities	422
Total liabilities assumed	97,488
Net assets and liabilities acquired[(5)]	$85,692

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(1) Represents buildings, building improvements and tenant improvements.

(2) Represents in-place leases (approximately $13.0 million with a weighted average amortization period of 3.9 years), above-market leases (approximately $0.3 million with a weighted average amortization period of 4.6 years), and leasing commissions (approximately $2.7 million with a weighted average amortization period of 3.0 years).

(3) Represents below-market leases (approximately $1.6 million with a weighted average amortization period of 9.2 years).

(4) Represents the mortgage loan, which includes an unamortized premium of approximately $11.6 million at the date of acquisition, assumed in connection with the properties acquired in January 2013 (see Note 5).

(5) Reflects the purchase price net of assumed secured debt and other lease-related obligations.

KILROY REALTY CORPORATION AND KILROY REALTY, L.P.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

3. Deferred Leasing Costs and Acquisition-related Intangible Assets and Liabilities, net

The following table summarizes our deferred leasing costs and acquisition-related intangible assets (acquired value of leasing costs, above-market operating leases, in-place leases and below-market ground lease obligation) and intangible liabilities (acquired value of below-market operating leases and above-market ground lease obligation) as of March 31, 2013 and December 31, 2012:

	March 31, 2013	December 31, 2012
	(in thousands)	
Deferred Leasing Costs and Acquisition-related Intangible Assets, net[1]:		
Deferred leasing costs	$171,107	$168,087
Accumulated amortization	(62,265)	(61,443)
Deferred leasing costs, net	108,842	106,644
Above-market operating leases	27,627	27,977
Accumulated amortization	(13,010)	(12,180)
Above-market operating leases, net	14,617	15,797
In-place leases	103,778	101,061
Accumulated amortization	(31,195)	(34,019)
In-place leases, net	72,583	67,042
Below-market ground lease obligation	690	690
Accumulated amortization	(207)	(205)
Below-market ground lease obligation, net	483	485
Total deferred leasing costs and acquisition-related intangible assets, net	$196,525	$189,968
Acquisition-related Intangible Liabilities, net[1][2]:		
Below-market operating leases	$67,705	$70,486
Accumulated amortization	(16,690)	(17,555)
Below-market operating leases, net	51,015	52,931
Above-market ground lease obligation	6,320	6,320
Accumulated amortization	(147)	(122)
Above-market ground lease obligation, net	6,173	6,198
Total acquisition-related intangible liabilities, net	$57,188	$59,129

(1) Balances and accumulated amortization amounts at March 31, 2013 reflect the write-off of the following fully amortized amounts at January 1, 2013: deferred leasing costs (approximately $7.0 million), above-market leases (approximately $0.6 million), in-place leases (approximately $10.3 million), and below-market leases (approximately $4.4 million).

(2) Included in deferred revenue and acquisition-related intangible liabilities, net in the consolidated balance sheets.

The following table sets forth amortization related to deferred leasing costs and acquisition-related intangibles for the three months ended March 31, 2013 and 2012:

	Three Months Ended March 31, 2013	2012
	(in thousands)	
Deferred leasing costs [1]	$7,844	$4,498
Above-market operating leases [2]	1,438	1,371
In-place leases [1]	7,458	3,781
Below-market ground lease obligation [3]	2	50
Below-market operating leases [4]	(3,485)	(1,896)

Above-market ground lease obligation [5]	(25)	(16)
Total	$13,232	$7,788

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(1) The amortization of deferred leasing costs and in-place leases is recorded to depreciation and amortization expense in the consolidated statements of operations for the periods presented.

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KILROY REALTY CORPORATION AND KILROY REALTY, L.P.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

(2) The amortization of above-market operating leases is recorded as a decrease to rental income in the consolidated statements of operations for the periods presented.

(3) The amortization of the below-market ground lease obligation is recorded as an increase to ground lease expense in the consolidated statements of operations for the periods presented.

(4) The amortization of below−market operating leases is recorded as an increase to rental income in the consolidated statements of operations for the periods presented.

(5) The amortization of the above-market ground lease obligation is recorded as a decrease to ground lease expense in the consolidated statements of operations for the periods presented.

The following table sets forth the estimated annual amortization expense related to deferred leasing costs and acquisition−related intangibles as of March 31, 2013 for future periods:

Year	Deferred Leasing Costs	Above-Market Operating Leases[1]	In-Place Leases	Below-Market Ground Lease Obligation[2]	Below-Market Operating Leases[3]	Above-Market Ground Lease Obligation[4]
	(in thousands)					
Remaining 2013	$18,417	$ 3,939	$20,874	$ 6	$ (9,847)	$ (76)
2014	21,530	4,389	18,012	8	(11,512)	(101)
2015	17,558	2,586	11,729	8	(8,998)	(101)
2016	14,877	1,559	8,613	8	(6,814)	(101)
2017	12,311	1,225	6,818	8	(5,747)	(101)
Thereafter	24,149	919	6,537	445	(8,097)	(5,693)
Total	$108,842	$ 14,617	$72,583	$ 483	$ (51,015)	$ (6,173)

(1) Represents estimated annual amortization related to above-market operating leases. Amounts will be recorded as a decrease to rental income in the consolidated statements of operations.

(2) Represents estimated annual amortization related to below−market ground lease obligations. Amounts will be recorded as an increase to ground lease expense in the consolidated statements of operations.

(3) Represents estimated annual amortization related to below-market operating leases. Amounts will be recorded as an increase to rental income in the consolidated statements of operations.

(4) Represents estimated annual amortization related to above−market ground lease obligations. Amounts will be recorded as a decrease to ground lease expense in the consolidated statements of operations.

4. Receivables

Current Receivables, net

Current receivables, net is primarily comprised of contractual rents and other lease-related obligations due from tenants. The balance consisted of the following as of March 31, 2013 and December 31, 2012:

	March 31, 2013	December 31, 2012
	(in thousands)	
Current receivables	$13,192	$11,801
Allowance for uncollectible tenant receivables	(2,526)	(2,581)
Current receivables, net	$10,666	$9,220

Deferred Rent Receivables, net

Deferred rent receivables, net consisted of the following as of March 31, 2013 and December 31, 2012:

	March 31, 2013	December 31, 2012
	(in thousands)	

Deferred rent receivables	$124,269	$118,025
Allowance for deferred rent receivables	(2,127)	(2,607)
Deferred rent receivables, net	$122,142	$115,418

KILROY REALTY CORPORATION AND KILROY REALTY, L.P.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

5. Secured and Unsecured Debt of the Operating Partnership

Secured Debt

The following table sets forth the composition of our secured debt as of March 31, 2013 and December 31, 2012:

Type of Debt	Annual Stated Interest Rate (1)	GAAP Effective Rate (1)(2)	Maturity Date	March 31, 2013 (3)	December 31, 2012 (3)
				(in thousands)	
Mortgage note payable	4.27%	4.27%	February 2018	$134,815	$135,000
Mortgage note payable (4)	4.48%	4.48%	July 2027	97,000	97,000
Mortgage note payable (4)(5)	6.05%	3.50%	June 2019	94,896	—
Mortgage note payable (6)	6.37%	3.55%	April 2013	—	83,116
Mortgage note payable	6.51%	6.51%	February 2017	68,383	68,615
Mortgage note payable (4)	5.23%	3.50%	January 2016	55,863	56,302
Mortgage note payable (4)	5.57%	3.25%	February 2016	42,672	43,016
Mortgage note payable (4)	5.09%	3.50%	August 2015	35,245	35,379
Mortgage note payable (4)	4.94%	4.00%	April 2015	28,620	28,941
Mortgage note payable	7.15%	7.15%	May 2017	10,665	11,210
Public facility bonds (7)	Various	Various	Various	2,517	2,517
Total				$570,676	$561,096

(1) All interest rates presented are fixed-rate interest rates.

(2) This represents the rate at which interest expense is recorded for financial reporting purposes, which reflects the amortization of discounts/premiums, excluding debt issuance costs.

(3) Amounts reported include the amounts of unamortized debt premiums and discounts for the periods presented.

(4) The secured debt and the related properties that secure the debt are held in a special purpose entity and the properties are not available to satisfy the debts and other obligations of the Company or the Operating Partnership.

(5) In January 2013, in connection with the acquisition of two office buildings in Seattle, Washington, we assumed a mortgage loan that is secured by the project. The assumed mortgage had a principal balance of $83.9 million at the acquisition date and was recorded at fair value on the date of the acquisition resulting in a premium of approximately $11.6 million. The loan requires monthly principal and interest payments based on a 6.4 year amortization period.

(6) In January 2013, we repaid this loan prior to the stated maturity.

(7) The public facility bonds (the “Bonds”), the proceeds from which were used to finance infrastructure improvements on one of the Company’s undeveloped land parcels, were issued in February 2008 by the City of Carlsbad. The Bonds have annual maturities from September 1, 2013 through September 1, 2038, with interest rates ranging from 4.74% to 6.19%. Principal and interest payments for the Bonds will be charged through the assessment of special property taxes.

Although our mortgage loans are secured and non-recourse to the Company and the Operating Partnership, the Company
provides limited customary secured debt guarantees for items such as voluntary bankruptcy, fraud, misapplication of payments,

and environmental liabilities.

KILROY REALTY CORPORATION AND KILROY REALTY, L.P.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

4.25% Exchangeable Senior Notes

The table below summarizes the balance and significant terms of the Company's 4.25% Exchangeable Notes due November 2014 (the "4.25% Exchangeable Notes") outstanding as of March 31, 2013 and December 31, 2012.

	4.25% Exchangeable Notes	
	March 31, 2013	December 31, 2012
	(in thousands)	
Principal amount	$172,500	$172,500
Unamortized discount	(7,478)	(8,556)
Net carrying amount of liability component	$165,022	$163,944
Carrying amount of equity component	$19,835	
Issuance date	November 2009	
Maturity date	November 2014	
Stated coupon rate (1)	4.25%	
Effective interest rate (2)	7.13%	
Exchange rate per $1,000 principal value of the 4.25% Exchangeable Notes, as adjusted (3)	27.8307	
Exchange price, as adjusted (3)	$35.93	
Number of shares on which the aggregate consideration to be delivered on conversion is determined (3)	4,800,796	

(1) Interest on the 4.25% Exchangeable Notes is payable semi-annually in arrears on May 15th and November 15th of each year.

(2) The rate at which we record interest expense for financial reporting purposes, which reflects the amortization of the discounts on the 4.25% Exchangeable Notes. This rate represents our conventional debt borrowing rate at the date of issuance.

(3) The exchange rate, exchange price, and the number of shares to be delivered upon conversion are subject to adjustment under certain circumstances including increases in our common dividends.

The 4.25% Exchangeable Notes are exchangeable for shares of the Company's common stock prior to maturity only upon the occurrence of certain events. During the three months ended March 31, 2013, the closing sale price per share of the common stock of the Company was more than 130% of the exchange price per share of the Company’s common stock for at least 20 trading days in the specified period. As a result, for the three-month period ending June 30, 2013, the 4.25% Exchangeable Notes are exchangeable at the exchange rate stated above and may be exchangeable thereafter, if one or more of the events were again to occur during future measurement periods.

For the three months ended March 31, 2013 and 2012, the per share average trading price of the Company's common stock on the NYSE was higher than the $35.93 exchange price for the 4.25% Exchangeable Notes, as presented below:

	Three Months Ended March 31,	
	2013	2012
Per share average trading price of the Company's common stock	$51.14	$42.86

Although the 4.25% Exchangeable Notes were not convertible as of March 31, 2013 and 2012, if they were convertible, the approximate fair value of the shares upon conversion at these dates, using the per share average trading price presented in the table above, would have been as follows:

	March 31, 2013	March 31, 2012
	(in thousands)	
Approximate fair value of shares upon conversion	$247,300	$208,700
Principal amount of the 4.25% Exchangeable Notes	172,500	172,500

Approximate fair value in excess amount of principal amount	$74,800	$36,200

See Notes 12 and 13 for a discussion of the impact of the 4.25% Exchangeable Notes on our diluted earnings per share and unit calculations for the periods presented.

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Interest Expense for the Exchangeable Notes

The unamortized discount on the 4.25% Exchangeable Notes and the 3.25% Exchangeable Notes due April 2012 (the "3.25% Exchangeable Notes" and together with the 4.25% Exchangeable Notes, the "Exchangeable Notes") is accreted as additional interest expense from the date of issuance through the maturity date of the applicable Exchangeable Notes. The following table summarizes the total interest expense attributable to the 4.25% Exchangeable Notes and the 3.25% Exchangeable Notes which were repaid upon maturity in April 2012, based on the respective effective interest rates, before the effect of capitalized interest, for the three months ended March 31, 2013 and 2012:

	Three Months Ended March 31,	
	2013 [1]	2012
	(in thousands)	
Contractual interest payments	$1,833	$3,035
Amortization of discount	1,078	1,797
Interest expense attributable to the Exchangeable Notes	$2,911	$4,832

(1) The Company repaid the 3.25% Exchangeable Notes in April 2012. Interest payments and discount amortization for the three months ended March 31, 2013 are solely attributable to the 4.25% Exchangeable Notes.

Capped Call Transactions

In connection with the offering of the 4.25% Exchangeable Notes, we entered into capped call option transactions ("capped calls") to mitigate the dilutive impact of the potential conversion of the 4.25% Exchangeable Notes. The table below summarizes our capped call option positions for the 4.25% Exchangeable Notes as of both March 31, 2013 and December 31, 2012.

	4.25% Exchangeable Notes
Referenced shares of common stock	4,800,796
Exchange price including effect of capped calls	$42.81

Unsecured Senior Notes

In January 2013, the Operating Partnership issued unsecured senior notes in a public offering with an aggregate principal balance of $300.0 million, which is included in unsecured debt, net on our consolidated balance sheets. The unsecured senior notes, which are scheduled to mature on January 15, 2023, require semi-annual interest payments each January and July based on a stated annual interest rate of 3.80%. The unsecured senior notes are shown net of the initial issuance discount of $0.1 million on the consolidated balance sheets. The Company used a portion of the net proceeds for general corporate purposes, including the repayment of borrowings under the Operating Partnership's revolving credit facility.

Unsecured Revolving Credit Facility

The following table summarizes the balance and terms of our revolving credit facility as of March 31, 2013 and December 31, 2012, respectively:

	March 31, 2013		December 31, 2012	
	(in thousands)			
Outstanding borrowings	$—		$185,000	
Remaining borrowing capacity	500,000		315,000	
Total borrowing capacity[1]	$500,000		$500,000	
Interest rate[2]	—	%	1.66	%
Facility fee-annual rate[3]	0.300%			
Maturity date[4]	April 2017			

(1)

We may elect to borrow, subject to bank approval, up to an additional $200.0 million under an accordion feature under the terms of the revolving credit facility.

(2) The revolving credit facility interest rate was calculated based on an annual rate of LIBOR plus 1.450% as of both March 31, 2013 and December 31, 2012.

(3) The facility fee is paid on a quarterly basis and is calculated based on the total borrowing capacity. In addition to the facility fee, from 2010 to 2012 we incurred debt origination and legal costs totaling approximately $10.2 million that are currently being amortized through the maturity date of the revolving credit facility.

(4) Under the terms of the revolving credit facility, we may exercise an option to extend the maturity date by one year.

The Company intends to borrow amounts under the revolving credit facility from time to time for general corporate purposes, to fund potential acquisitions, to finance development and redevelopment expenditures, and to potentially repay long-term debt.

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Debt Covenants and Restrictions

The revolving credit facility, the term loan facility, the unsecured senior notes, and certain other secured debt arrangements contain covenants and restrictions requiring us to meet certain financial ratios and reporting requirements. Some of the more restrictive financial covenants include a maximum ratio of total debt to total asset value, a minimum fixed-charge coverage ratio, a minimum unsecured debt ratio, and a minimum unencumbered asset pool debt service coverage ratio. Noncompliance with one or more of the covenants and restrictions could result in the full or partial principal balance of the associated debt becoming immediately due and payable. We believe we were in compliance with all of our debt covenants as of March 31, 2013.

Debt Maturities

The following table summarizes the stated debt maturities and scheduled amortization payments, excluding debt discounts and premiums, as of March 31, 2013:

Year	(in thousands)	
Remaining 2013	7,016	
2014	265,346	
2015	395,104	
2016	249,431	
2017	71,748	
Thereafter	1,169,741	
Total	$2,158,386	(1)

(1) Includes gross principal balance of outstanding debt before impact of net unamortized premiums totaling approximately $8.2 million.

Capitalized Interest and Loan Fees

The following table sets forth gross interest expense reported in continuing operations, including debt discount/premium and loan cost amortization, net of capitalized interest, for the three months ended March 31, 2013 and 2012. The interest expense capitalized was recorded as a cost of development and redevelopment, and increased the carrying value of undeveloped land and construction in progress.

	Three Months Ended March 31,	
	2013	2012
	(in thousands)	
Gross interest expense	$27,466	$24,994
Capitalized interest	(7,732)	(3,831)
Interest expense	$19,734	$21,163

6. Noncontrolling Interests on the Company's Consolidated Financial Statements

Common Units of the Operating Partnership

The Company owned a 97.6%, 97.6% and 97.5% common general partnership interest in the Operating Partnership as of March 31, 2013, December 31, 2012, and March 31, 2012, respectively. The remaining 2.4%, 2.4% and 2.5% common limited partnership interest as of March 31, 2013, December 31, 2012 and March 31, 2012, respectively, was owned by non-affiliate investors and certain of our executive officers and directors in the form of noncontrolling common units. There were 1,826,503, 1,826,503 and 1,718,131 common units outstanding held by these investors, executive officers and directors as of March 31, 2013, December 31, 2012 and March 31, 2012, respectively.

The noncontrolling common units may be redeemed by unitholders for cash. We, at our option, may satisfy the cash redemption obligation with shares of the Company's common stock on a one-for-one basis. Whether satisfied in cash or shares of the Company's common stock, the value for each noncontrolling common unit upon redemption is the amount equal to the average of the closing quoted price per share of the Company's common stock, par value $.01 per share, as reported on the NYSE for the ten trading days immediately preceding the applicable balance sheet date. The aggregate value upon redemption of the then-outstanding noncontrolling common units was $95.9 million and $85.4 million as of March 31, 2013 and December 31, 2012, respectively. This redemption value does not necessarily represent the amount that would be distributed with respect to each noncontrolling common unit in the event of our termination or liquidation. In the event of our termination or liquidation, it is expected in most cases that each common unit would be entitled to a liquidating distribution equal to the liquidating distribution payable in respect of each share of the Company's common stock.

7. Stockholders' Equity of the Company

At-The-Market Stock Offering Program

Under our at-the-market stock offering program, which commenced in July 2011, we may offer and sell shares of our common stock having an aggregate gross sales price of up to $200.0 million from time to time in "at the market" offerings. During the three months ended March 31, 2013, we sold 453,679 shares of common stock under this program at a weighted average price of $52.65 per share, before selling commissions, for aggregate gross proceeds of approximately $23.9 million and net proceeds of approximately $23.4 million, after sales agent compensation. The proceeds from the sales were used to fund development and redevelopment expenditures and general corporate purposes. Since commencement of the program, we have sold 1,596,102 shares of common stock and, as of March 31, 2013, approximately $126.1 million remains available to be sold under this program. Actual future sales will depend upon a variety of factors including but not limited to market conditions, the trading price of the Company's common stock and our capital needs. We have no obligation to sell the remaining shares available for sale under this program.

8. Partners' Capital of the Operating Partnership

Issuance of Common Units

During the three months ended March 31, 2013, the Company utilized its at-the-market stock offering program to issue an aggregate of 453,679 shares of common stock as discussed in Note 7. The net offering proceeds of approximately $23.4 million were contributed by the Company to the Operating Partnership in exchange for 453,679 common units.

Common Units Outstanding

The Company owned 75,349,705, 74,926,981, and 68,349,843 common units representing a 97.6%, 97.6%, and 97.5% common general partnership interest in the Operating Partnership as of March 31, 2013, December 31, 2012, and March 31, 2012, respectively. The remaining 2.4%, 2.4%, and 2.5% common limited partnership interest as of March 31, 2013, December 31, 2012, and March 31, 2012, respectively, was owned by certain of our executive officers and directors and non-affiliate investors in the form of noncontrolling common units. There were 1,826,503, 1,826,503, and 1,718,131 common units outstanding held by these investors, officers and directors as of March 31, 2013, December 31, 2012, and March 31, 2012, respectively. For a further discussion of the noncontrolling common units as of March 31, 2013 and December 31, 2012, refer to Note 6.

9. Share-Based Compensation

Stockholder Approved Equity Compensation Plans

As of March 31, 2013, we maintained one share-based incentive compensation plan, the Kilroy Realty 2006 Incentive Award Plan as amended (the "2006 Plan"). As of March 31, 2013, 142,532 shares were available for grant under the 2006 Plan. The number of shares that remains available for grant is calculated using the weighted share counting provisions set forth in the 2006 Plan, which are based on the type of awards that are granted. The maximum number of shares available for grant subject to full value awards (which generally include equity awards other than options and stock appreciation rights) was 48,812 shares as of March 31, 2013.

Summary of Market-Measure Based RSUs

On March 30, 2012, the Executive Compensation Committee of the Company's Board of Directors granted 103,239 restricted stock units ("RSUs") to the Company's Chief Executive Officer. The RSUs granted vest in seven equal annual installments for each calendar year during 2012 through 2018 based on the achievement of certain absolute or relative total shareholder return goals measured annually or, if neither of the shareholder return hurdles are achieved for an applicable year during the performance period, those RSUs will remain eligible to vest in a subsequent year (ending in 2018) based on the achievement of a cumulative total shareholder return goal, as well as (in each case) continued employment through the applicable vesting date.

As of March 31, 2013, we had 88,491 unvested market-measure based RSUs outstanding.

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Summary of Time-Based RSUs

A summary of our time-based RSU activity from January 1, 2013 through March 31, 2013 is presented below:

	Nonvested RSUs		Vested RSUs	Total RSUs
	Amount	Weighted-Average Grant Date Fair Value Per Share		
Outstanding at January 1, 2013	279,102	$ 41.30	769,761	1,048,863
Granted	157,232	48.88	—	157,232
Vested	(64,778)	37.89	64,778	—
Settled [1]			(8,559)	(8,559)
Issuance of dividend equivalents [2]			6,864	6,864
Canceled [1][3]			(3,800)	(3,800)
Outstanding as of March 31, 2013	371,556	$ 45.11	829,044	1,200,600

(1) Represents vested RSUs that are settled in cash or shares of the Company's common stock.
(2) RSUs issued as dividend equivalents are vested upon issuance.
(3) We accept the return of RSUs, at the current quoted closing share price of the Company's common stock, to satisfy minimum statutory tax-withholding requirements related to either the issuance, vesting or settlement of RSUs in accordance with the terms of the 2006 Plan.

A summary of our time-based RSU activity for the three months ended March 31, 2013 and 2012 is presented below:

	RSUs Granted		RSUs Vested	
Three Months Ended March 31,	Non-Vested RSUs Issued	Weighted-Average Grant Date Fair Value Per Share	Vested RSUs	Total Vest-Date Fair Value [1] (in thousands)
2013	157,232	$ 48.88	(64,778)	$3,161
2012	196,033	44.29	(48,864)	1,961

(1) Total fair value of RSUs vested was calculated based on the quoted closing share price of the Company's common stock on the NYSE on the day of vesting.

On April 4, 2013, the terms of 61,327 time-based RSUs granted to certain officers of the Company in January 2013 were modified to include performance-based vesting requirements based on certain total shareholder return and FFO per share targets. The Company's closing stock price on the date of modification was $53.05. The compensation expense related to the modified RSUs will be recognized using the accelerated attribution expense method through the remainder of the five-year requisite service period.

Summary of Nonvested Shares

A summary of our nonvested shares activity from January 1, 2013 through March 31, 2013 is presented below:

Nonvested Shares	Shares	Weighted-Average Grant Date Fair Value Per Share
Outstanding at January 1, 2013	95,241	$ 40.42
Granted	—	—
Vested [1]	(47,291)	39.12
Outstanding as of March 31, 2013	47,950	$ 41.71

(1) The total shares vested include 20,880 shares that were tendered in accordance with the terms of the 2006 Plan to satisfy minimum statutory tax withholding requirements related to the restricted shares that have vested. We accept the return of shares at the current quoted closing share price of the Company's common stock to satisfy tax obligations.

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A summary of our nonvested and vested share activity for the three months ended March 31, 2013 and 2012 is presented below:

	Shares Granted		Shares Vested	
Three Months Ended March 31,	Non-Vested Shares Issued	Weighted-Average Grant Date Fair Value Per Share	Vested Shares	Total Fair Value at Vest Date[1] (in thousands)
2013	—	$ —	(47,291)	$2,290
2012	59,938	41.71	(33,104)	1,274

(1) Total fair value of shares vested was calculated based on the quoted closing share price of the Company's common stock on the NYSE on the date of vesting.

Summary of Stock Options

A summary of our stock option activity from January 1, 2013 through March 31, 2013 is presented below:

	Number of Options	Exercise Price	Remaining Contractual Term (years)
Outstanding at January 1, 2013	1,540,000	$42.61	
Granted	—	—	
Exercised	—	—	
Forfeited	(12,000)	42.61	
Outstanding at March 31, 2013 [1][2]	1,528,000	$42.61	8.9

(1) As of March 31, 2013, 308,000 of the outstanding stock options were exercisable.

(2) The total intrinsic value of options outstanding at March 31, 2013 was $15.0 million.

Share-based Compensation Cost Recorded During the Period

The total compensation cost for all share-based compensation programs was $2.4 million and $1.5 million for the three months ended March 31, 2013 and 2012, respectively. Of the total share-based compensation cost, $0.2 million and $0.2 million was capitalized as part of real estate assets for the three months ended March 31, 2013 and 2012, respectively. As of March 31, 2013, there was approximately $31.2 million of total unrecognized compensation cost related to nonvested incentive awards granted under share-based compensation arrangements that is expected to be recognized over a weighted-average period of 2.6 years. The remaining compensation cost related to these nonvested incentive awards had been recognized in periods prior to March 31, 2013.

10. Commitments and Contingencies

General

As of March 31, 2013, we had commitments of approximately $529.6 million for contracts and executed leases directly related to our operating and redevelopment properties. This amount includes the $27.5 million that we expect to pay before the end of 2013 upon the closing of the purchase of the land underlying the ground lease at 360 Third Street in San Francisco, CA. We exercised an option to acquire the land during the fourth quarter of 2012.

Environmental Matters

We follow the policy of monitoring our properties for the presence of hazardous or toxic substances. While there can be no assurance that a material environmental liability does not exist, we are not currently aware of any environmental liability with respect to the properties that would have a material adverse effect on our financial condition, results of operations, and cash flow. Further, we are not aware of any environmental liability or any unasserted claim or assessment with respect to an environmental liability that we believe would require additional disclosure or the recording of a loss contingency.

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11. Fair Value Measurements and Disclosures

Assets and Liabilities Reported at Fair Value

The only assets we record at fair value on our consolidated financial statements are the marketable securities related to our deferred compensation plan. The following table sets forth the fair value of our marketable securities as of March 31, 2013 and December 31, 2012:

Description	Fair Value (Level 1)[1]	
	March 31, 2013	December 31, 2012
	(in thousands)	
Marketable securities [2]	$8,029	$7,435

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(1) Based on quoted prices in active markets for identical securities.
(2) The marketable securities are held in a limited rabbi trust.

We report the change in the fair value of the marketable securities at the end of each accounting period in interest income and other net investment gains (losses) in the consolidated statements of operations. We adjust the related deferred compensation plan liability to fair value at the end of each accounting period based on the performance of the benchmark funds selected by each participant, which results in a corresponding increase or decrease to compensation cost for the period.

The following table sets forth the net gain (loss) on marketable securities recorded during the three months ended March 31, 2013 and 2012:

Description	Three Months Ended	
	March 31, 2013	March 31, 2012
	(in thousands)	
Net gain (loss) on marketable securities	$356	$435

Financial Instruments Disclosed at Fair Value

The following table sets forth the carrying value and the fair value of our other financial instruments as of March 31, 2013 and December 31, 2012:

	Carrying Value	Fair Value	Carrying Value	Fair Value
	March 31, 2013		December 31, 2012	
	(in thousands)			
Liabilities				