

KILROY REALTY CORP

Form 10-Q

July 26, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2018

OR

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 95-4598246
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

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

Kilroy Realty, L.P. Yes No

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 No

Kilroy Realty, L.P. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated

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filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Kilroy Realty Corporation

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

Emerging growth company

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.

Kilroy Realty, L.P.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

Emerging growth company

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).

Kilroy Realty Corporation Yes No

Kilroy Realty, L.P. Yes No

As of July 20, 2018, 100,559,903 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 June 30, 2018 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 June 30, 2018, the Company owned an approximate 98.0% common general partnership interest in the Operating Partnership. The remaining approximate 2.0% common limited partnership interests are owned by non-affiliated investors and certain directors and 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 that 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 generally 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 generally guarantees all 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 generally contributes to the Operating Partnership in exchange for units of partnership interest, the Operating Partnership generates the capital required by the Company’s business through the Operating Partnership’s operations, by the Operating Partnership’s incurrence of indebtedness or through the issuance of units of partnership interest.

Noncontrolling interests, 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., a Delaware limited partnership (the “Finance Partnership”). This noncontrolling interest represents the Company’s 1% indirect general partnership interest in the Finance Partnership, 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 interest result from the differences in the equity issued by the Company and the Operating Partnership, and in the Operating Partnership’s noncontrolling interest in the Finance Partnership.

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 6, Stockholders' Equity of the Company;

Note 8, Partners' Capital of the Operating Partnership;

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Note 13, Net Income Available to Common Stockholders Per Share of the Company;

Note 14, Net Income Available to Common Unitholders Per Unit of the Operating Partnership;

Note 15, Supplemental Cash Flow Information of the Company; and

Note 16, Supplemental Cash Flow Information 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

—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 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 or Rule 15d-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 AND SIX MONTHS ENDED JUNE 30, 2018
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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED) OF KILROY REALTY CORPORATION

KILROY REALTY CORPORATION
CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

| | June 30, 2018 (unaudited) | December 31, 2017 |
|--|---------------------------------|---------------------|
| ASSETS | | |
| REAL ESTATE ASSETS (Note 2): | | |
| Land and improvements | \$1,127,100 | \$ 1,076,172 |
| Buildings and improvements | 5,017,999 | 4,908,797 |
| Undeveloped land and construction in progress | 1,993,314 | 1,432,808 |
| Total real estate assets held for investment | 8,138,413 | 7,417,777 |
| Accumulated depreciation and amortization | (1,361,811) | (1,264,162) |
| Total real estate assets held for investment, net | 6,776,602 | 6,153,615 |
| CASH AND CASH EQUIVALENTS | 50,817 | 57,649 |
| RESTRICTED CASH | — | 9,149 |
| MARKETABLE SECURITIES (Note 11) | 22,519 | 20,674 |
| CURRENT RECEIVABLES, NET (Note 3) | 15,144 | 16,926 |
| DEFERRED RENT RECEIVABLES, NET (Note 3) | 256,558 | 246,391 |
| DEFERRED LEASING COSTS AND ACQUISITION-RELATED INTANGIBLE ASSETS, NET | 186,649 | 183,728 |
| PREPAID EXPENSES AND OTHER ASSETS, NET (Note 4) | 76,495 | 114,706 |
| TOTAL ASSETS | \$7,384,784 | \$ 6,802,838 |
| LIABILITIES AND EQUITY | | |
| LIABILITIES: | | |
| Secured debt, net (Notes 5 and 11) | \$338,189 | \$ 340,800 |
| Unsecured debt, net (Notes 5 and 11) | 2,156,521 | 2,006,263 |
| Unsecured line of credit (Notes 5 and 11) | 295,000 | — |
| Accounts payable, accrued expenses and other liabilities | 278,508 | 249,637 |
| Accrued dividends and distributions (Note 17) | 47,348 | 43,448 |
| Deferred revenue and acquisition-related intangible liabilities, net | 146,741 | 145,890 |
| Rents received in advance and tenant security deposits | 58,604 | 56,484 |
| Total liabilities | 3,320,911 | 2,842,522 |
| COMMITMENTS AND CONTINGENCIES (Note 10) | | |
| EQUITY: | | |
| Stockholders' Equity (Note 6): | | |
| Common stock, \$.01 par value, 150,000,000 shares authorized, 100,559,903 and 98,620,333 shares issued and outstanding, respectively | 1,006 | 986 |
| Additional paid-in capital | 3,951,289 | 3,822,492 |
| Distributions in excess of earnings | (149,368) | (122,685) |
| Total stockholders' equity | 3,802,927 | 3,700,793 |
| Noncontrolling Interests (Notes 1 and 7): | | |
| Common units of the Operating Partnership | 78,223 | 77,948 |
| Noncontrolling interests in consolidated property partnerships | 182,723 | 181,575 |
| Total noncontrolling interests | 260,946 | 259,523 |
| Total equity | 4,063,873 | 3,960,316 |

TOTAL LIABILITIES AND EQUITY

\$7,384,784 \$ 6,802,838

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 June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|------------|------------------------------|------------|
| | 2018 | 2017 | 2018 | 2017 |
| REVENUES | | | | |
| Rental income | \$ 164,515 | \$ 158,925 | \$ 327,386 | \$ 315,573 |
| Tenant reimbursements | 19,567 | 19,267 | 38,717 | 38,563 |
| Other property income | 2,990 | 2,406 | 3,791 | 5,770 |
| Total revenues | 187,072 | 180,598 | 369,894 | 359,906 |
| EXPENSES | | | | |
| Property expenses | 32,567 | 33,304 | 64,238 | 64,545 |
| Real estate taxes | 17,813 | 16,543 | 34,959 | 34,507 |
| Provision for bad debts (Note 12) | 5,641 | 409 | 5,376 | 1,707 |
| Ground leases | 1,586 | 1,547 | 3,147 | 3,189 |
| General and administrative expenses | 21,763 | 14,303 | 37,322 | 29,236 |
| Depreciation and amortization | 64,006 | 62,251 | 126,721 | 123,170 |
| Total expenses | 143,376 | 128,357 | 271,763 | 256,354 |
| OTHER (EXPENSES) INCOME | | | | |
| Interest income and other net investment gain/loss (Note 11) | 771 | 1,038 | 805 | 2,103 |
| Interest expense (Note 5) | (12,712) | (17,973) | (26,210) | (35,325) |
| Total other (expenses) income | (11,941) | (16,935) | (25,405) | (33,222) |
| INCOME FROM OPERATIONS BEFORE GAINS ON SALES OF REAL ESTATE | 31,755 | 35,306 | 72,726 | 70,330 |
| Gains on sales of depreciable operating properties | — | — | — | 2,257 |
| NET INCOME | 31,755 | 35,306 | 72,726 | 72,587 |
| Net income attributable to noncontrolling common units of the Operating Partnership | (566) | (616) | (1,317) | (1,239) |
| Net income attributable to noncontrolling interests in consolidated property partnerships | (3,640) | (3,242) | (7,614) | (6,375) |
| Total income attributable to noncontrolling interests | (4,206) | (3,858) | (8,931) | (7,614) |
| NET INCOME ATTRIBUTABLE TO KILROY REALTY CORPORATION | 27,549 | 31,448 | 63,795 | 64,973 |
| Preferred dividends | — | (1,615) | — | (4,966) |
| Original issuance costs of redeemed preferred stock and preferred units | — | — | — | (3,845) |
| Total preferred dividends | — | (1,615) | — | (8,811) |
| NET INCOME AVAILABLE TO COMMON STOCKHOLDERS | \$ 27,549 | \$ 29,833 | \$ 63,795 | \$ 56,162 |
| Net income available to common stockholders per share – basic (Note 13) | \$ 0.27 | \$ 0.30 | \$ 0.63 | \$ 0.56 |
| Net income available to common stockholders per share – diluted (Note 13) | \$ 0.27 | \$ 0.30 | \$ 0.63 | \$ 0.56 |
| Weighted average common shares outstanding – basic (Note 13) | 99,691,700 | 98,275,471 | 99,220,577 | 97,834,255 |
| Weighted average common shares outstanding – diluted (Note 13) | 100,150,850 | 98,827,378 | 99,687,682 | 98,427,345 |
| Dividends declared per common share | \$ 0.455 | \$ 0.425 | \$ 0.880 | \$ 0.800 |

See accompanying notes to consolidated financial statements.

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KILROY REALTY CORPORATION
CONSOLIDATED STATEMENTS OF EQUITY

(Unaudited; in thousands, except share and per share/unit data)

| | Preferred Stock | Number of Shares | Common Stock | Additional Paid-in Capital | Retained Earnings / (Distributions in Excess of Earnings) | Total Stock- holders' Equity | Noncontrolling Interests | Total Equity |
|---|--------------------|---------------------|-----------------|----------------------------------|---|---------------------------------------|-----------------------------|-----------------|
| BALANCE AS OF DECEMBER 31, 2016 | \$ 192,411 | 93,219,439 | \$ 932 | 3,457,649 | \$ (107,997) | \$ 3,542,995 | \$ 216,322 | \$ 3,759,317 |
| Net income | | | | | 64,973 | 64,973 | 7,614 | 72,587 |
| Redemption of Series G | (96,155) | | | | (3,845) | (100,000) | | (100,000) |
| Preferred stock Issuance of common stock | | 4,427,500 | 44 | 308,788 | | 308,832 | | 308,832 |
| Issuance of share-based compensation awards | | | | 4,691 | | 4,691 | | 4,691 |
| Non-cash amortization of share-based compensation | | | | 12,628 | | 12,628 | | 12,628 |
| Exercise of stock options | | 272,000 | 4 | 12,047 | | 12,051 | | 12,051 |
| Settlement of restricted stock units for shares of common stock | | 278,057 | 3 | (3) | | — | | — |
| Repurchase of common stock, stock options and restricted stock units | | (150,129) | (2) | (11,640) | | (11,642) | | (11,642) |
| Exchange of common units of the Operating Partnership | | 304,350 | 3 | 10,936 | | 10,939 | (10,939) | — |
| Contributions from noncontrolling interests in consolidated property partnerships | | | | | | — | 250 | 250 |
| Distributions to noncontrolling | | | | | | — | (8,651) | (8,651) |

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| | | | | | | | | |
|--|----------|------------|----------|-------------|--------------|-------------|-----------|-------------|
| interests in consolidated property partnerships | | | | | | | | |
| Adjustment for noncontrolling interest | | | (3,068) | | (3,068) | 3,068 | — | |
| Preferred dividends | | | | (4,966) | (4,966) | | (4,966) | |
| Dividends declared per common share and common unit (\$0.800 per share/unit) | | | | (80,964) | (80,964) | (1,662) | (82,626) | |
| BALANCE AS OF JUNE 30, 2017 | \$96,256 | 98,351,217 | \$984 | \$3,792,028 | \$(132,799) | \$3,756,469 | \$206,002 | \$3,962,471 |

| | Common Stock | | | Distributions in Excess of Earnings | Total Stock-holders' Equity | Noncontrolling Interests | Total Equity |
|---|------------------|--------------|----------------------------|-------------------------------------|-----------------------------|--------------------------|--------------|
| | Number of Shares | Common Stock | Additional Paid-in Capital | | | | |
| BALANCE AS OF DECEMBER 31, 2017 | 98,620,333 | \$986 | \$3,822,492 | \$(122,685) | \$3,700,793 | \$259,523 | \$3,960,316 |
| Net income | | | | 63,795 | 63,795 | 8,931 | 72,726 |
| Issuance of common stock (Note 7) | 1,719,195 | 17 | 124,130 | | 124,147 | | 124,147 |
| Issuance of share-based compensation awards | | | 2,453 | | 2,453 | | 2,453 |
| Non-cash amortization of share-based compensation | | | 16,597 | | 16,597 | | 16,597 |
| Exercise of stock options | 1,000 | — | 41 | | 41 | | 41 |
| Settlement of restricted stock units for shares of common stock | 405,067 | 4 | (4) | | — | | — |
| Repurchase of common stock, stock options and restricted stock units | (192,195) | (2) | (13,640) | | (13,642) | | (13,642) |
| Exchange of common units of the Operating Partnership | 6,503 | 1 | 244 | | 245 | (245) | — |
| Distributions to noncontrolling interests in consolidated property partnerships | | | | | — | (6,465) | (6,465) |
| Adjustment for noncontrolling interest | | | (1,024) | | (1,024) | 1,024 | — |
| | | | | (90,478) | (90,478) | (1,822) | (92,300) |

Dividends declared per
common share and
common unit (\$0.880 per
share/unit)

| | | | | | | | |
|--------------------------------|-------------|----------|--------------|--------------|--------------|------------|--------------|
| BALANCE AS OF JUNE 30, 2018 | 100,559,903 | \$ 1,006 | \$ 3,951,289 | \$(149,368) | \$ 3,802,927 | \$ 260,946 | \$ 4,063,873 |
|--------------------------------|-------------|----------|--------------|--------------|--------------|------------|--------------|

See accompanying notes to consolidated financial statements.

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KILROY REALTY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited; in thousands)

| | Six Months Ended June 30, | |
|--|------------------------------|------------|
| | 2018 | 2017 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$72,726 | \$72,587 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization of real estate assets and leasing costs | 124,633 | 120,734 |
| Depreciation of non-real estate furniture, fixtures and equipment | 2,088 | 2,436 |
| Increase in provision for bad debts (Note 12) | 5,376 | 1,707 |
| Non-cash amortization of share-based compensation awards | 12,267 | 8,966 |
| Non-cash amortization of deferred financing costs and debt discounts and premiums | 582 | 1,469 |
| Non-cash amortization of net below market rents | (5,481) | (3,603) |
| Gain on sale of depreciable operating properties | — | (2,257) |
| Non-cash amortization of deferred revenue related to tenant-funded tenant improvements | (8,869) | (8,243) |
| Straight-line rents | (10,566) | (15,537) |
| Net change in other operating assets | (5,513) | (7,418) |
| Net change in other operating liabilities | 1,600 | 7,575 |
| Net cash provided by operating activities | 188,843 | 178,416 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Expenditures for acquisition of undeveloped land (Note 2) | (311,299) | — |
| Expenditures for development properties and undeveloped land | (204,039) | (161,045) |
| Expenditures for acquisition of operating properties (Note 2) | (111,029) | — |
| Expenditures for operating properties | (74,079) | (40,738) |
| Net proceeds received from dispositions | — | 11,865 |
| Net decrease (increase) in acquisition-related deposits | 21,000 | (26,100) |
| Proceeds received from repayment of note receivable (Note 4) | 15,100 | — |
| Net cash used in investing activities | (664,346) | (216,018) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Borrowings on unsecured revolving credit facility (Note 5) | 505,000 | — |
| Repayments on unsecured revolving credit facility (Note 5) | (180,000) | — |
| Borrowings on unsecured debt (Note 5) | 120,000 | — |
| Principal payments on secured debt | (1,768) | (4,213) |
| Proceeds from the issuance of unsecured debt | — | 250,000 |
| Financing costs | (1,840) | (2,191) |
| Net proceeds from issuance of common stock | 124,147 | 308,832 |
| Redemption of Series G Preferred stock | — | (100,000) |
| Repurchase of common stock and restricted stock units | (13,642) | (11,642) |
| Proceeds from exercise of stock options | 41 | 12,051 |
| Distributions to noncontrolling interests in consolidated property partnerships | (6,485) | (8,651) |
| Contributions from noncontrolling interests in consolidated property partnerships | — | 250 |
| Dividends and distributions paid to common stockholders and common unitholders | (85,931) | (255,292) |
| Dividends and distributions paid to preferred stockholders and preferred unitholders | — | (5,806) |
| Net cash provided by financing activities | 459,522 | 183,338 |
| Net (decrease) increase in cash and cash equivalents and restricted cash | (15,981) | 145,736 |
| Cash and cash equivalents and restricted cash, beginning of period | 66,798 | 250,129 |
| Cash and cash equivalents and restricted cash, end of period | \$50,817 | \$395,865 |

See accompanying notes to consolidated financial statements.

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

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

| | June 30, 2018 (unaudited) | December 31, 2017 |
|--|---------------------------------|---------------------|
| ASSETS | | |
| REAL ESTATE ASSETS (Note 2): | | |
| Land and improvements | \$1,127,100 | \$ 1,076,172 |
| Buildings and improvements | 5,017,999 | 4,908,797 |
| Undeveloped land and construction in progress | 1,993,314 | 1,432,808 |
| Total real estate assets held for investment | 8,138,413 | 7,417,777 |
| Accumulated depreciation and amortization | (1,361,811) | (1,264,162) |
| Total real estate assets held for investment, net | 6,776,602 | 6,153,615 |
| CASH AND CASH EQUIVALENTS | 50,817 | 57,649 |
| RESTRICTED CASH | — | 9,149 |
| MARKETABLE SECURITIES (Note 11) | 22,519 | 20,674 |
| CURRENT RECEIVABLES, NET (Note 3) | 15,144 | 16,926 |
| DEFERRED RENT RECEIVABLES, NET (Note 3) | 256,558 | 246,391 |
| DEFERRED LEASING COSTS AND ACQUISITION-RELATED INTANGIBLE ASSETS, NET | 186,649 | 183,728 |
| PREPAID EXPENSES AND OTHER ASSETS, NET (Note 4) | 76,495 | 114,706 |
| TOTAL ASSETS | \$7,384,784 | \$ 6,802,838 |
| LIABILITIES AND CAPITAL | | |
| LIABILITIES: | | |
| Secured debt, net (Notes 5 and 11) | \$338,189 | \$ 340,800 |
| Unsecured debt, net (Notes 5 and 11) | 2,156,521 | 2,006,263 |
| Unsecured line of credit (Notes 5 and 11) | 295,000 | — |
| Accounts payable, accrued expenses and other liabilities | 278,508 | 249,637 |
| Accrued distributions (Note 17) | 47,348 | 43,448 |
| Deferred revenue and acquisition-related intangible liabilities, net | 146,741 | 145,890 |
| Rents received in advance and tenant security deposits | 58,604 | 56,484 |
| Total liabilities | 3,320,911 | 2,842,522 |
| COMMITMENTS AND CONTINGENCIES (Note 10) | | |
| CAPITAL: | | |
| Common units, 100,559,903 and 98,620,333 held by the general partner and 2,070,690 and 2,077,193 held by common limited partners issued and outstanding, respectively (Note 8) | 3,876,145 | 3,773,941 |
| Noncontrolling interests in consolidated property partnerships and subsidiaries (Note 1) | 187,728 | 186,375 |
| Total capital | 4,063,873 | 3,960,316 |
| TOTAL LIABILITIES AND CAPITAL | \$7,384,784 | \$ 6,802,838 |

See accompanying notes to consolidated financial statements.

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|------------------|------------------------------|------------------|
| | 2018 | 2017 | 2018 | 2017 |
| REVENUES | | | | |
| Rental income | \$ 164,515 | \$ 158,925 | \$ 327,386 | \$ 315,573 |
| Tenant reimbursements | 19,567 | 19,267 | 38,717 | 38,563 |
| Other property income | 2,990 | 2,406 | 3,791 | 5,770 |
| Total revenues | 187,072 | 180,598 | 369,894 | 359,906 |
| EXPENSES | | | | |
| Property expenses | 32,567 | 33,304 | 64,238 | 64,545 |
| Real estate taxes | 17,813 | 16,543 | 34,959 | 34,507 |
| Provision for bad debts (Note 12) | 5,641 | 409 | 5,376 | 1,707 |
| Ground leases | 1,586 | 1,547 | 3,147 | 3,189 |
| General and administrative expenses | 21,763 | 14,303 | 37,322 | 29,236 |
| Depreciation and amortization | 64,006 | 62,251 | 126,721 | 123,170 |
| Total expenses | 143,376 | 128,357 | 271,763 | 256,354 |
| OTHER (EXPENSES) INCOME | | | | |
| Interest income and other net investment gain/loss (Note 11) | 771 | 1,038 | 805 | 2,103 |
| Interest expense (Note 5) | (12,712) | (17,973) | (26,210) | (35,325) |
| Total other (expenses) income | (11,941) | (16,935) | (25,405) | (33,222) |
| INCOME FROM OPERATIONS BEFORE GAINS ON SALES OF REAL ESTATE | 31,755 | 35,306 | 72,726 | 70,330 |
| Gains on sales of depreciable operating properties | — | — | — | 2,257 |
| NET INCOME | 31,755 | 35,306 | 72,726 | 72,587 |
| Net income attributable to noncontrolling interests in consolidated property partnerships and subsidiaries | (3,740) | (3,335) | (7,818) | (6,562) |
| NET INCOME ATTRIBUTABLE TO KILROY REALTY, L.P. | 28,015 | 31,971 | 64,908 | 66,025 |
| Preferred distributions | — | (1,615) | — | (4,966) |
| Original issuance costs of redeemed preferred units | — | — | — | (3,845) |
| Total preferred distributions | — | (1,615) | — | (8,811) |
| NET INCOME AVAILABLE TO COMMON UNITHOLDERS | \$ 28,015 | \$ 30,356 | \$ 64,908 | \$ 57,214 |
| Net income available to common unitholders per unit – basic (Note 14) | \$ 0.27 | \$ 0.30 | \$ 0.63 | \$ 0.56 |
| Net income available to common unitholders per unit – diluted (Note 14) | \$ 0.27 | \$ 0.30 | \$ 0.63 | \$ 0.56 |
| Weighted average common units outstanding – basic (Note 14) | 101,762,390 | 100,352,664 | 101,291,549 | 100,024,000 |
| Weighted average common units outstanding – diluted (Note 14) | 102,221,546 | 100,904,571 | 101,758,654 | 100,617,090 |
| Dividends declared per common unit | \$ 0.455 | \$ 0.425 | \$ 0.880 | \$ 0.800 |

See accompanying notes to consolidated financial statements.

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

| | Partners' Capital | | | Total Partners' Capital | Noncontrolling Interests in Consolidated Property Partnerships and Subsidiaries | |
|---|--------------------|------------------------------|-----------------|-------------------------------|---|------------------|
| | Preferred Units | Number of Common Units | Common Units | | Property Partnerships and Subsidiaries | Total Capital |
| BALANCE AS OF DECEMBER 31, 2016 | \$ 192,411 | 95,600,982 | \$ 3,431,768 | \$ 3,624,179 | \$ 135,138 | \$ 3,759,317 |
| Net income | | | 66,025 | 66,025 | 6,562 | 72,587 |
| Redemption of Series G Preferred units | (96,155) | | (3,845) | (100,000) | | (100,000) |
| Issuance of common units | | 4,427,500 | 308,832 | 308,832 | | 308,832 |
| Issuance of share-based compensation awards | | | 4,691 | 4,691 | | 4,691 |
| Non-cash amortization of share-based compensation | | | 12,628 | 12,628 | | 12,628 |
| Exercise of stock options | | 272,000 | 12,051 | 12,051 | | 12,051 |
| Settlement of restricted stock units | | 278,057 | — | — | | — |
| Repurchase of common units, stock options and restricted stock units | | (150,129) | (11,642) | (11,642) | | (11,642) |
| Contributions from noncontrolling interests in consolidated property partnerships | | | | | 250 | 250 |
| Distributions to noncontrolling interests in consolidated property partnerships | | | | | (8,651) | (8,651) |
| Preferred distributions | | | (4,966) | (4,966) | | (4,966) |
| Distributions declared per common unit (\$0.800 per unit) | | | (82,626) | (82,626) | | (82,626) |
| BALANCE AS OF JUNE 30, 2017 | \$ 96,256 | 100,428,410 | \$ 3,732,916 | \$ 3,829,172 | \$ 133,299 | \$ 3,962,471 |

| | Partners' Capital | | Noncontrolling Interests in Consolidated Property Partnerships and Subsidiaries | |
|-----------------------------------|------------------------------|-----------------|---|------------------|
| | Number of Common Units | Common Units | Property Partnerships and Subsidiaries | Total Capital |
| BALANCE AS OF DECEMBER 31, 2017 | 100,697,526 | \$ 3,773,941 | \$ 186,375 | \$ 3,960,316 |
| Net income | | 64,908 | 7,818 | 72,726 |
| Issuance of common units (Note 8) | 1,719,195 | 124,147 | | 124,147 |

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| | | | | |
|---|-------------|--------------|------------|--------------|
| Issuance of share-based compensation awards | | 2,453 | | 2,453 |
| Non-cash amortization of share-based compensation | | 16,597 | | 16,597 |
| Exercise of stock options | 1,000 | 41 | | 41 |
| Settlement of restricted stock units | 405,067 | — | | — |
| Repurchase of common units, stock options and restricted stock units | (192,195 |) (13,642 |) | (13,642) |
| Distributions to noncontrolling interests in consolidated property partnerships | | | (6,465 |) (6,465) |
| Distributions declared per common unit (\$0.880 per unit) | | (92,300 |) | (92,300) |
| BALANCE AS OF JUNE 30, 2018 | 102,630,593 | \$ 3,876,145 | \$ 187,728 | \$ 4,063,873 |

See accompanying notes to consolidated financial statements.

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

| | Six Months Ended June 30, | |
|--|------------------------------|------------|
| | 2018 | 2017 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$72,726 | \$72,587 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization of real estate assets and leasing costs | 124,633 | 120,734 |
| Depreciation of non-real estate furniture, fixtures and equipment | 2,088 | 2,436 |
| Increase in provision for bad debts (Note 12) | 5,376 | 1,707 |
| Non-cash amortization of share-based compensation awards | 12,267 | 8,966 |
| Non-cash amortization of deferred financing costs and debt discounts and premiums | 582 | 1,469 |
| Non-cash amortization of net below market rents | (5,481) | (3,603) |
| Gain on sale of depreciable operating properties | — | (2,257) |
| Non-cash amortization of deferred revenue related to tenant-funded tenant improvements | (8,869) | (8,243) |
| Straight-line rents | (10,566) | (15,537) |
| Net change in other operating assets | (5,513) | (7,418) |
| Net change in other operating liabilities | 1,600 | 7,575 |
| Net cash provided by operating activities | 188,843 | 178,416 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Expenditures for acquisition of undeveloped land (Note 2) | (311,299) | — |
| Expenditures for development properties and undeveloped land | (204,039) | (161,045) |
| Expenditures for acquisition of operating properties (Note 2) | (111,029) | — |
| Expenditures for operating properties | (74,079) | (40,738) |
| Net proceeds received from dispositions | — | 11,865 |
| Net decrease (increase) in acquisition-related deposits | 21,000 | (26,100) |
| Proceeds received from repayment of note receivable (Note 4) | 15,100 | — |
| Net cash used in investing activities | (664,346) | (216,018) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Borrowings on unsecured revolving credit facility (Note 5) | 505,000 | — |
| Repayments on unsecured revolving credit facility (Note 5) | (180,000) | — |
| Borrowings on unsecured debt (Note 5) | 120,000 | — |
| Principal payments on secured debt | (1,768) | (4,213) |
| Proceeds from the issuance of unsecured debt | — | 250,000 |
| Financing costs | (1,840) | (2,191) |
| Net proceeds from issuance of common units | 124,147 | 308,832 |
| Redemption of Series G Preferred units | — | (100,000) |
| Repurchase of common units and restricted stock units | (13,642) | (11,642) |
| Proceeds from exercise of stock options | 41 | 12,051 |
| Distributions to noncontrolling interests in consolidated property partnerships | (6,485) | (8,651) |
| Contributions from noncontrolling interests in consolidated property partnerships | — | 250 |
| Distributions paid to common unitholders | (85,931) | (255,292) |
| Distributions paid to preferred unitholders | — | (5,806) |
| Net cash provided by financing activities | 459,522 | 183,338 |
| Net (decrease) increase in cash and cash equivalents and restricted cash | (15,981) | 145,736 |
| Cash and cash equivalents and restricted cash, beginning of period | 66,798 | 250,129 |
| Cash and cash equivalents and restricted cash, end of period | \$50,817 | \$395,865 |

See accompanying notes to consolidated financial statements.

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KILROY REALTY CORPORATION AND KILROY REALTY, L.P.
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization, Ownership and Basis of Presentation

Organization and Ownership

Kilroy Realty Corporation (the “Company”) is a self-administered real estate investment trust (“REIT”) active in premier office and mixed-use 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 Greater 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 generally 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 properties at June 30, 2018:

| | Number of Buildings | Rentable Square Feet (unaudited) | Number of Tenants | Percentage Occupied (unaudited) | Percentage Leased (unaudited) |
|------------------------------|---------------------|----------------------------------|-------------------|---------------------------------|-------------------------------|
| Stabilized Office Properties | 104 | 13,881,509 | 519 | 94.0 % | 96.8 % |

| | Number of Buildings | Number of Units | 2018 Average Occupancy (unaudited) |
|---------------------------------|---------------------|-----------------|------------------------------------|
| Stabilized Residential Property | 1 | 200 | 83.3 % |

Our stabilized portfolio includes all of our properties with the exception of development and redevelopment properties currently committed for construction, under construction, or in the tenant improvement phase, undeveloped land and real estate assets held for sale. We define redevelopment properties as those properties for which we expect to spend significant development and construction costs on the existing or acquired buildings pursuant to a formal plan, the intended result of which is a higher economic return on the property. We define properties in the tenant improvement phase as properties that we are developing or redeveloping where the project has reached cold shell condition and is ready for tenant improvements, which may require additional major base building construction before being placed in service. Projects in the tenant improvement phase are added to our stabilized portfolio once the project reaches the earlier of 95% occupancy or one year from the date of the cessation of major base building construction activities. Costs capitalized to construction in progress for development and redevelopment properties are transferred to land and improvements, buildings and improvements, and deferred leasing costs on our consolidated balance sheets at the historical cost of the property as the projects are placed in service.

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As of June 30, 2018, the following properties were excluded from our stabilized portfolio. We did not have any redevelopment properties or properties held for sale at June 30, 2018.

| | Number of Properties/Projects | Estimated Rentable Square Feet ⁽¹⁾ |
|---|----------------------------------|--|
| In-process development projects - tenant improvement ⁽²⁾ | 2 | 1,150,000 |
| In-process development projects - under construction ⁽³⁾ | 3 | 956,000 |

⁽¹⁾ Estimated rentable square feet upon completion.

⁽²⁾ Includes 86,000 square feet of Production, Distribution, and Repair (“PDR”) space at 100 Hooper.

⁽³⁾ In addition to the estimated office and PDR rentable square feet noted above, development projects under construction also include 120,000 square feet of retail space and 608 residential units.

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

Our stabilized portfolio also excludes our future development pipeline, which as of June 30, 2018 was comprised of seven potential development sites, representing approximately 80 gross acres of undeveloped land.

As of June 30, 2018, all of our properties and development projects were owned and all of our business was conducted in the state of California with the exception of twelve office properties and one development project under construction located in the state of Washington. All of our properties and development projects are 100% owned, excluding four office properties owned by three consolidated property partnerships, as well as an office project and a development site held by consolidated variable interest entities for future transactions intended to qualify as like-kind exchanges pursuant to Section 1031 of the Code (“Section 1031 Exchanges”).

Two of the three property partnerships, 100 First Street Member, LLC (“100 First LLC”) and 303 Second Street Member, LLC (“303 Second LLC”), each owned one office property in San Francisco, California through subsidiary REITs. As of June 30, 2018, the Company owned a 56% common equity interest in both 100 First LLC and 303 Second LLC. The third property partnership, Redwood City Partners, LLC (“Redwood LLC”) owned two office properties in Redwood City, California. As of June 30, 2018, the Company owned an approximate 93% common equity interest in Redwood LLC. The remaining interests in all three property partnerships were owned by unrelated third parties.

Ownership and 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, 303 Second LLC, 100 First LLC, Redwood LLC 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, 303 Second LLC, 100 First LLC, Redwood LLC and all of our wholly-owned and controlled subsidiaries. All intercompany balances and transactions have been eliminated in the consolidated financial statements.

As of June 30, 2018, the Company owned an approximate 98.0% common general partnership interest in the Operating Partnership. The remaining approximate 2.0% common limited partnership interest in the Operating Partnership as of June 30, 2018 was owned by non-affiliated investors and certain of our executive officers and directors. Both the general and limited common partnership interests in the Operating Partnership are denominated in common units. Generally, the number of common units held by the Company is 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.”

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% common general partnership interest in the Finance Partnership. The Operating Partnership owns the remaining 99.0% common limited partnership interest. With the exception of the Operating Partnership and our consolidated property partnerships, all of our subsidiaries are wholly-owned.

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, 2018. 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, 2017.

Variable Interest Entities

The Operating Partnership is a variable interest entity (“VIE”) that is consolidated by the Company as the primary beneficiary as the Operating Partnership is a limited partnership in which the common limited partners do not have substantive kick-out or participating rights. At June 30, 2018, the consolidated financial statements of the Company included six VIEs in addition to the Operating Partnership: 100 First LLC, 303 Second LLC, an entity established during the first quarter of 2018 to facilitate potential future Section 1031 Exchanges and three entities established during the second quarter of 2018 to facilitate potential future Section

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

1031 Exchanges. At June 30, 2018, the Operating Partnership was determined to be the primary beneficiary of these six VIEs since the Operating Partnership had the ability to control the activities that most significantly impact each of the VIE's economic performance. As of June 30, 2018, the six VIEs' total assets, liabilities and noncontrolling interests included on our consolidated balance sheet were approximately \$896.8 million (of which \$846.5 million related to real estate held for investment), approximately \$77.0 million and approximately \$176.5 million, respectively. Revenues, income and net assets generated by 100 First LLC and 303 Second LLC may only be used to settle their contractual obligations, which primarily consist of operating expenses, capital expenditures and required distributions.

At December 31, 2017, the consolidated financial statements of the Company and the Operating Partnership included two VIEs in which we were deemed to be the primary beneficiary: 100 First LLC and 303 Second LLC. At December 31, 2017, the impact of consolidating the VIEs increased the Company's total assets, liabilities and noncontrolling interests on our consolidated balance sheet by approximately \$426.5 million (of which \$382.1 million related to real estate held for investment), approximately \$27.3 million and approximately \$175.4 million, respectively.

Accounting Pronouncements Adopted January 1, 2018

Effective January 1, 2018, we adopted Financial Accounting Standards Board ("FASB") ASU No. 2014-09 "Revenue From Contracts with Customers (Topic 606)" ("ASU 2014-09") and the related FASB ASU Nos. 2016-12 and 2016-20, which provide practical expedients, technical corrections, and improvements for certain aspects of ASU 2014-09, on a modified retrospective basis. ASU 2014-09 establishes a single comprehensive model for entities to use in accounting for revenue from contracts with customers and supersedes most of the existing revenue recognition guidance.

We evaluated each of the Company's revenue streams to determine the sources of revenue that are impacted by ASU 2014-09 and concluded that two revenue streams, sales of real estate and revenue from our multi-tenant parking arrangements, fall within the scope of Topic 606. We evaluated the impact of the adoption of the guidance on the timing of gain recognition for our historical dispositions and concluded there was no significant impact to our consolidated financial statements given the straight forward nature of our historical disposition transactions. We also evaluated the impact of the guidance on the timing and pattern of revenue recognition for our multi-tenant parking arrangements and determined there was no significant impact to our consolidated financial statements. We generally provide parking for our multi-tenant properties based on the prevailing market rate per parking space, which adjusts based on prevailing market rates during the tenant's occupancy, and we recognize parking revenue as parking spaces are utilized by the tenant. Given the structure of these arrangements whereby the amount of parking revenue we recognize corresponds directly to the tenant's use, we were able to apply the practical expedient provided in Accounting Standards Codification ("ASC") 606-10-50-14(b) (the "right to invoice" practical expedient). As a result of applying this practical expedient, we are not required to disclose the transaction price allocated to future performance obligations for multi-tenant parking since we cannot predict or estimate the use of such parking spaces. During the three months ended June 30, 2018 and 2017, we recognized \$6.8 million and \$6.9 million, respectively, of parking revenue for arrangements that are within the scope of Topic 606, which is included in rental revenues on our consolidated statements of operations. During the six months ended June 30, 2018 and 2017, we recognized \$13.4 million and \$13.6 million, respectively, of parking revenue for arrangements that are within the scope of Topic 606, which is included in rental revenues on our consolidated statements of operations. We concluded that the adoption of Topic 606 did not have an impact on our consolidated financial statements or a material impact on the notes to our consolidated financial statements.

Effective January 1, 2018, we adopted FASB ASU No. 2017-09 "Compensation - Stock Compensation (Topic 718)" on a prospective basis. Under the guidance, an entity will not apply modification accounting to a share-based payment award if the award's fair value, vesting conditions, and classification as an equity or liability instrument remain the same immediately before and after the change. The adoption of this guidance did not have an impact on our

consolidated financial statements or notes to our consolidated financial statements.

Effective January 1, 2018, we adopted FASB ASU No. 2017-05 “Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20)” (“ASU 2017-05”) on a retrospective basis. This standard clarifies the scope of the original guidance within Subtopic 610-20 “Gains and Losses from the Derecognition of Nonfinancial Assets” that was issued in connection with ASU 2014-09 which provided guidance for recognizing gains and losses from the transfer of nonfinancial assets in transactions with noncustomers. Additionally, ASU 2017-05 adds guidance pertaining to the partial sales of real estate and clarifies that nonfinancial assets within the scope of ASC 610-20 may include nonfinancial assets transferred within a legal entity to a counterparty. For example, a parent may transfer control of nonfinancial assets by transferring ownership interests in a consolidated subsidiary. We evaluated the impact of the new amendments on our historical transactions and concluded that there was no impact. As such, the adoption of this guidance did not have an impact on our consolidated financial statements or notes to our consolidated financial statements.

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

Effective January 1, 2018, we adopted FASB ASU No. 2016-15 (“ASU 2016-15”) which provides guidance where there is diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows, on a retrospective basis. The adoption of this guidance did not have an impact on our consolidated financial statements or notes to our consolidated financial statements.

Effective January 1, 2018, we adopted FASB ASU No. 2016-01 (“ASU 2016-01”) which amends the accounting guidance on the classification and measurement of financial instruments and FASB ASU No. 2018-03 (“ASU 2018-03”) which provides technical corrections and improvements to ASU 2016-01, on a modified retrospective basis. The amendments require that all investments in equity securities, including other ownership interests, are reported at fair value with changes in fair value reported in net income. This requirement does not apply to investments that qualify for equity method accounting or to those that result in consolidation of the investee or for which the entity has elected the predictability exception to fair value measurement. Additionally, the amendments require that the portion of the total fair value change caused by a change in instrument-specific credit risk for financial liabilities for which the fair value option has been elected would be recognized in other comprehensive income. Any accumulated amount remaining in other comprehensive income is reclassified to earnings when the liability is extinguished. The adoption of this guidance did not have an impact on our consolidated financial statements or notes to our consolidated financial statements since our only financial instruments within the scope of ASU 2016-01 and 2018-03 are the marketable securities related to our deferred compensation plan which are classified as trading securities and marked to market at fair value through earnings each reporting period.

Accounting Pronouncements Effective January 1, 2019

ASU No. 2016-02 “Leases (Topic 842)”

On February 25, 2016, the FASB issued ASU No. 2016-02 “Leases (Topic 842)” (“ASU 2016-02”) to amend the accounting guidance for leases. The accounting applied by a lessor is largely unchanged under ASU 2016-02. However, the standard requires lessees to recognize lease assets and lease liabilities for leases classified as operating leases on the balance sheet. Lessees will recognize in the statement of financial position a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it will recognize lease expense for such leases generally on a straight-line basis over the lease term. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018. Early adoption is permitted. We continue to have a project team, led by senior accounting management, that is proactively working to analyze and evaluate the impact of the guidance on our consolidated financial statements.

In January 2018, the FASB released an exposure draft to amend ASU No. 2016-02 that would (1) simplify transition requirements for both lessees and lessors by adding an option that would permit an organization to apply the transition provisions of the new standard at its adoption date instead of at the earliest comparative period presented in its financial statements and (2) provide a practical expedient for lessors that would permit lessors to make an accounting policy election to not separate nonlease components from the associated lease components if certain criteria are met. In March 2018, the FASB finalized the changes with respect to optional transition relief and approved a practical expedient for lessors that would permit lessors to make an accounting policy election to not separate nonlease components from the associated lease components, by class of underlying asset, if the following two criteria are met: (1) the timing and pattern of transfer of the lease and nonlease components are the same and (2) the lease component would be classified as an operating lease if accounted for separately. For leases where we are the lessor, we currently believe that we will elect the optional transition relief and that we will meet the noted criteria to not be required to bifurcate and separately report nonlease components, such as common area maintenance revenue, for operating leases

on our consolidated statements of operations. As a result, we currently believe that leases where we are the lessor will be accounted for in a similar method to existing standards with the underlying leased asset being reported and recognized as a real estate asset. The FASB is expected to issue an Accounting Standards Update codifying these changes and we currently expect to adopt ASU 2016-02 using the practical expedients proposed in the standard and the changes approved by the FASB.

ASU 2016-02 also specifies that upon adoption, lessors will no longer be able to capitalize and amortize certain leasing related costs and instead will only be permitted to capitalize and amortize incremental direct leasing costs. As a result, we have concluded that upon the adoption of the standard, we will be required to expense as incurred certain leasing costs we are currently able to capitalize and amortize as deferred leasing costs under existing guidance. We continue to evaluate the impact of this change in the guidance and we currently expect this change will have a material impact to the Company's consolidated financial statements and results of operations upon adoption of the standard on January 1, 2019.

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

For leases where we are the lessee, specifically for our ground leases, we expect that the adoption of the standard will significantly change the accounting on our consolidated balance sheets since both existing ground leases and any future ground leases will be required to be recorded on the Company’s consolidated balance sheets as an obligation of the Company. We currently believe that existing ground leases executed before the January 1, 2019 adoption date will continue to be accounted for as operating leases and the new guidance will not have a material impact on our recognition of ground lease expense or our results of operations. However, we believe that we will be required to recognize a right of use asset and a lease liability on our consolidated balance sheets equal to the present value of the minimum lease payments required in accordance with each ground lease. As of June 30, 2018, our future undiscounted minimum rental payments under these leases totaled \$249.9 million, with several of the leases containing provisions for rental payments to fluctuate based on fair market value and operating income measurements with expirations through 2093. In addition, we currently believe that for new ground leases entered into after the adoption date of the new standard, such leases could be required to be accounted for as financing type leases, resulting in ground lease expense recorded using the effective interest method instead of on a straight-line basis over the term of the lease. This could have a significant impact on our results of operations if we enter into material new ground leases after the date of adoption since ground lease expense calculated using the effective interest method results in an increased amount of ground lease expense in the earlier years of a ground lease as compared to the current straight-line method.

Accounting Pronouncements Effective in 2020 and Beyond

ASU No. 2016-13 “Financial Instruments - Credit Losses (Topic 326)”

On June 16, 2016, the FASB issued ASU No. 2016-13 (“ASU 2016-13”) to amend the accounting for credit losses for certain financial instruments. Under the new guidance, an entity recognizes its estimate of expected credit losses as an allowance, which the FASB believes will result in more timely recognition of such losses. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company does not currently anticipate that the guidance will have a material impact on our consolidated financial statements or notes to our consolidated financial statements.

2. Acquisitions

Operating Property Acquisitions

During the six months ended June 30, 2018, we acquired the three operating properties listed below from an unrelated third party. The acquisition was funded with proceeds from the Company’s unsecured revolving credit facility and unsecured term loan facility.

| Property | Date of Acquisition | Number of Buildings | Rentable Square Feet (unaudited) ⁽¹⁾ | Purchase Price (in millions) |
|--|---------------------|---------------------|---|------------------------------|
| 345, 347 & 349 Oyster Point Boulevard, South San Francisco, CA | January 31, 2018 | 3 | 145,530 | \$ 111.0 |

(1) Excludes acquisition-related costs.

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 assets acquired and liabilities assumed as of the date of acquisition, excluding acquisition-related costs:

| | Total 2018 Operating Property Acquisitions |
|---|---|
| Assets | |
| Land and improvements | \$ 50,928 |
| Buildings and improvements ⁽¹⁾ | 59,123 |
| Deferred leasing costs and acquisition-related intangible assets ⁽²⁾ | 4,470 |
| Total assets acquired | \$ 114,521 |
| Liabilities | |
| Deferred revenue and acquisition-related intangible liabilities ⁽³⁾ | \$ 3,521 |
| Total liabilities assumed | 3,521 |
| Net assets and liabilities acquired | \$ 111,000 |

- (1) Represents buildings, building improvements and tenant improvements.
 (2) Represents in-place leases (approximately \$3.8 million with a weighted average amortization period of 2.6 years) and leasing commissions (approximately \$0.7 million with a weighted average amortization period of 3.5 years).
 (3) Represents below-market leases (approximately \$3.5 million with a weighted average amortization period of 9.8 years).

Development Project Acquisitions

During the six months ended June 30, 2018, we acquired the following development site, which is located adjacent to the three operating properties we acquired in January 2018, from an unrelated third party. The acquisition was funded with proceeds from the Company's unsecured revolving credit facility and the Company's at-the-market stock offering program.

| Project | Date of Acquisition | City/Submarket | Type | Purchase Price (in millions) (1) |
|---------------------|---------------------|---------------------|------|--|
| Kilroy Oyster Point | June 1, 2018 | South San Francisco | Land | \$ 308.2 |

Excludes acquisition-related costs. In connection with this acquisition, we also recorded \$40.6 million in accrued liabilities and environmental remediation liabilities, which are not included in the purchase price above. As of (1) June 30, 2018, the purchase price and assumed liabilities are included in undeveloped land and construction in progress and the assumed liabilities are included in accounts payable, accrued expenses and other liabilities on the Company's consolidated balance sheets.

3. Receivables

Current Receivables, net

Current receivables, net consisted of the following as of June 30, 2018 and December 31, 2017:

| | June 30, 2018 | December 31, 2017 |
|--|------------------|-------------------|
| | (in thousands) | |
| Current receivables | \$19,502 | \$ 19,235 |
| Allowance for uncollectible tenant receivables | (4,358) | (2,309) |
| Current receivables, net | \$15,144 | \$ 16,926 |

Deferred Rent Receivables, net

Deferred rent receivables, net consisted of the following as of June 30, 2018 and December 31, 2017:

| | June 30, 2018 | December 31, 2017 |
|---|------------------|-------------------|
| | (in thousands) | |
| Deferred rent receivables | \$260,152 | \$ 249,629 |
| Allowance for deferred rent receivables | (3,594) | (3,238) |
| Deferred rent receivables, net | \$256,558 | \$ 246,391 |

4. Prepaid Expenses and Other Assets, Net

Prepaid expenses and other assets, net consisted of the following at June 30, 2018 and December 31, 2017:

| | June 30, 2018 | December 31, 2017 |
|--|------------------|-------------------|
| | (in thousands) | |
| Furniture, fixtures and other long-lived assets, net | \$37,799 | \$ 39,686 |
| Notes receivable, net ⁽¹⁾ | 2,005 | 19,912 |
| Prepaid expenses & acquisition deposits | 36,691 | 55,108 |
| Total prepaid expenses and other assets, net | \$76,495 | \$ 114,706 |

During the six months ended June 30, 2018, a note receivable with a balance of \$15.1 million was repaid to the (1) Company. Notes receivable are shown net of a valuation allowance of approximately \$2.9 million as of June 30, 2018.

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5. Secured and Unsecured Debt of the Operating Partnership

The Company generally guarantees all of the Operating Partnership's unsecured debt obligations including the unsecured revolving credit facility, the unsecured term loan facility and all of the unsecured senior notes.

Unsecured Senior Notes - Private Placement

On May 11, 2018, the Operating Partnership entered into a Note Purchase Agreement (the "Note Purchase Agreement") in connection with the issuance and sale of \$50.0 million principal amount of the Operating Partnership's 4.30% Senior Notes, Series A, due July 18, 2026 (the "Series A Notes"), and \$200.0 million principal amount of the Operating Partnership's 4.35% Senior Notes, Series B, due October 18, 2026 (the "Series B Notes" and, together with the Series A Notes, the "Series A and B Notes"), pursuant to a private placement. As of June 30, 2018, there were no amounts issued or outstanding under the Series A and B Notes. In July 2018, the Company drew the full amount of the Series A Notes. The Series B Notes are required to be drawn by October 22, 2018. The Series A and B Notes mature on their respective due dates, unless earlier redeemed or prepaid pursuant to the terms of the Note Purchase Agreement. Interest on the Series A and B Notes is payable semi-annually in arrears on April 18 and October 18 of each year beginning April 18, 2019.

The Operating Partnership may, at its option and upon notice to the purchasers of the Series A and B Notes, prepay at any time all, or from time to time any part of the Series A and B Notes then outstanding (in an amount not less than 5% of the aggregate principal amount of the Series A and B Notes then outstanding in the case of a partial prepayment), at 100% of the principal amount so prepaid, plus the make-whole amount determined for the prepayment date with respect to such principal amount as set forth in the Note Purchase Agreement.

In connection with the issuance of the Series A and B Notes, the Company will enter into an agreement whereby it will guarantee the payment by the Operating Partnership of all amounts due with respect to the Series A and B Notes and the performance by the Operating Partnership of its obligations under the Note Purchase Agreement.

Unsecured Revolving Credit Facility and Term Loan Facility

The following table summarizes the balance and terms of our unsecured revolving credit facility as of June 30, 2018 and December 31, 2017:

| | June 30, 2018 | December 31, 2017 |
|---|------------------|-------------------|
| | (in thousands) | |
| Outstanding borrowings | \$295,000 | \$ — |
| Remaining borrowing capacity | 455,000 | 750,000 |
| Total borrowing capacity ⁽¹⁾ | \$750,000 | \$ 750,000 |
| Interest rate ⁽²⁾ | 3.10 | % 2.56 |
| Facility fee-annual rate ⁽³⁾ | 0.200% | |
| Maturity date | July 2022 | |

(1) We may elect to borrow, subject to bank approval and obtaining commitments for any additional borrowing capacity, up to an additional \$600.0 million under an accordion feature under the terms of the unsecured revolving

credit facility and unsecured term loan facility.

(2) Our unsecured revolving credit facility interest rate was calculated based on an annual rate of LIBOR plus 1.000% as of June 30, 2018 and December 31, 2017.

(3) Our facility fee is paid on a quarterly basis and is calculated based on the total borrowing capacity. In addition to the facility fee, we incurred debt origination and legal costs. As of June 30, 2018 and December 31, 2017, \$5.3 million and \$6.0 million of unamortized deferred financing costs, respectively, which are included in prepaid expenses and other assets, net on our consolidated balance sheets, remained to be amortized through the maturity date of our unsecured revolving credit facility.

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

During the first quarter of 2018, we borrowed the full \$150.0 million borrowing capacity of our unsecured term loan facility. In connection with the funding of the outstanding borrowings, we transferred \$30.0 million of outstanding borrowings under the unsecured revolving credit facility to the balance of our unsecured term loan facility. As a result, only \$120.0 million of cash proceeds were received from the funding of the unsecured term loan facility. The following table summarizes the balance and terms of our unsecured term loan facility as of June 30, 2018 and December 31, 2017:

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

| | June 30, 2018 | December 31, 2017 |
|---|------------------|-------------------|
| | (in thousands) | |
| Outstanding borrowings | \$ 150,000 | \$ — |
| Remaining borrowing capacity | — | 150,000 |
| Total borrowing capacity ⁽¹⁾ | \$ 150,000 | \$ 150,000 |
| Interest rate ⁽²⁾ | 3.17 | % 2.66 |
| Undrawn facility fee-annual rate ⁽³⁾ | 0.200% | |
| Maturity date | July 2022 | |

(1) As of June 30, 2018 and December 31, 2017, \$1.0 million and \$1.2 million of unamortized deferred financing costs, respectively, remained to be amortized through the maturity date of our unsecured term loan facility.

(2) Our unsecured term loan facility interest rate was calculated based on an annual rate of LIBOR plus 1.100% as of June 30, 2018 and December 31, 2017.

(3) Prior to borrowing the full capacity of our unsecured term loan facility, the undrawn facility fee was calculated based on any unused borrowing capacity and was paid on a quarterly basis.

Debt Covenants and Restrictions

The unsecured revolving credit facility, unsecured term loan facility, 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 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 June 30, 2018.

Debt Maturities

The following table summarizes the stated debt maturities and scheduled amortization payments of our issued and outstanding debt, excluding unamortized debt discounts, premiums and deferred financing costs, as of June 30, 2018:

| Year | (in thousands) |
|----------------------|----------------|
| Remaining 2018 | \$ 1,816 |
| 2019 | 76,309 |
| 2020 | 255,137 |
| 2021 | 5,342 |
| 2022 | 450,554 |
| Thereafter | 2,018,469 |
| Total ⁽¹⁾ | \$ 2,807,627 |

(1) Includes gross principal balance of outstanding debt before the effect of the following at June 30, 2018: \$13.7 million of unamortized deferred financing costs for the unsecured term loan facility, unsecured senior notes and secured debt, \$5.9 million of unamortized discounts for the unsecured senior notes and \$1.7 million of unamortized

premiums for the secured debt.

Capitalized Interest and Loan Fees

The following table sets forth gross interest expense, including debt discount/premium and deferred financing cost amortization, net of capitalized interest, for the three and six months ended June 30, 2018 and June 30, 2017. The interest expense capitalized was recorded as a cost of development and increased the carrying value of undeveloped land and construction in progress.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|-----------|------------------------------|-----------|
| | 2018 | 2017 | 2018 | 2017 |
| | (in thousands) | | | |
| Gross interest expense | \$28,523 | \$28,731 | \$55,603 | \$56,246 |
| Capitalized interest and deferred financing costs | (15,811) | (10,758) | (29,393) | (20,921) |
| Interest expense | \$12,712 | \$17,973 | \$26,210 | \$35,325 |

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6. Stockholders' Equity of the Company

At-The-Market Stock Offering Program

During the three months ended June 30, 2018, the Company completed its existing at-the-market stock offering program, under which we sold an aggregate of \$300.0 million in gross sales of shares. In June 2018, the Company commenced a new at-the-market stock offering program (the "2018 At-The-Market Program"), under which we may currently offer and sell shares of our common stock with an aggregate gross sales price of up to \$500.0 million. In connection with the 2018 At-The-Market-Program, the Company also entered into related forward purchase agreements whereby, at our discretion, we may sell shares of our common stock under the 2018 At-The-Market-Program under forward equity sales agreements. The use of a forward equity sales agreement would allow the Company to lock in a share price on the sale of shares of our common stock at the time the agreement is executed, but defer receiving the proceeds from the sale of shares until a later date. This also allows us to defer the potential dilutive impact of such offering of shares until such time as we settle the forward equity sales agreement.

Since commencement of our 2018 At-The-Market Program in June 2018, we have sold 349,466 shares of common stock through June 30, 2018, none of which were sold under forward equity sales agreements. Approximately \$473.4 million remains available to be sold under this program.

The following table sets forth information regarding sales of common stock under our at-the-market offering programs for the six months ended June 30, 2018:

| | Six Months Ended June 30, 2018 (in millions, except share and per share data) |
|--|---|
| Shares of common stock sold during the period | 1,719,195 |
| Weighted average price per common share | \$ 73.66 |
| Aggregate gross proceeds | \$ 126.6 |
| Aggregate net proceeds after selling commissions | \$ 125.1 |

The proceeds from sales were used to fund acquisitions, development expenditures and general corporate purposes. 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.

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

Common Units of the Operating Partnership

The Company owned an approximate 98.0%, 97.9%, and 97.9% common general partnership interest in the Operating Partnership as of June 30, 2018, December 31, 2017 and June 30, 2017, respectively. The remaining approximate 2.0%, 2.1%, and 2.1% common limited partnership interest as of June 30, 2018, December 31, 2017 and June 30, 2017, respectively, was owned by non-affiliated investors and certain of our executive officers and directors in the form of noncontrolling common units. There were 2,070,690, 2,077,193 and 2,077,193 common units outstanding held by these investors, executive officers and directors as of June 30, 2018, December 31, 2017 and June 30, 2017, respectively.

The noncontrolling common units may be redeemed by unitholders for cash. Except under certain circumstances, we, at our option, may satisfy the cash redemption obligation with shares of the Company's common stock on a one-for-one basis. If satisfied in cash, 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 redemption date. The aggregate value upon redemption of the then-outstanding noncontrolling common units was \$156.2 million and \$154.5 million as of June 30, 2018 and December 31, 2017, 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.

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8. Partners' Capital of the Operating Partnership

At-The-Market Stock Offering Program

During the six months ended June 30, 2018, the Company utilized its at-the-market stock offering programs to issue shares of common stock (see Note 6 "Stockholders' Equity of the Company" for additional information). The net offering proceeds were contributed by the Company to the Operating Partnership in exchange for common units for the six months ended June 30, 2018 as follows:

| | Six Months Ended June 30, 2018 (in millions, except share and per share data) |
|---|---|
| Shares of common stock contributed by the Company | 1,719,195 |
| Common units exchanged for share of common stock by the Company | 1,719,195 |
| Aggregate gross proceeds | \$ 126.6 |
| Aggregate net proceeds after selling commissions | \$ 125.1 |

Common Units Outstanding

The following table sets forth the number of common units held by the Company and the number of common units held by non-affiliated investors and certain of our executive officers and directors in the form of noncontrolling common units as well as the ownership interest held on each respective date:

| | June 30, 2018 | December 31, 2017 | June 30, 2017 | |
|--|---------------|-------------------|------------------|---|
| Company owned common units in the Operating Partnership | 100,559,903 | 98,620,333 | 98,351,217 | |
| Company owned general partnership interest | 98.0 | % 97.9 | % 97.9 | % |
| Noncontrolling common units of the Operating Partnership | 2,070,690 | 2,077,193 | 2,077,193 | |
| Ownership interest of noncontrolling interest | 2.0 | % 2.1 | % 2.1 | % |

For further discussion of the noncontrolling common units as of June 30, 2018 and December 31, 2017, refer to Note 7.

9. Share-Based Compensation

Stockholder Approved Equity Compensation Plans

As of June 30, 2018, we maintained one share-based incentive compensation plan, the Kilroy Realty 2006 Incentive Award Plan, as amended (the “2006 Plan”). As of June 30, 2018, approximately 1.8 million shares were available for grant under the 2006 Plan. The calculation of shares available for grant is presented after taking into account a reserve for a sufficient number of shares to cover the vesting and payment of 2006 Plan awards that were outstanding on that date, including performance-based vesting awards at (i) levels actually achieved for the performance or market conditions (as defined below) for which the performance period has been completed and (ii) at target levels for the performance or market conditions (as defined below) for awards still in a performance period.

2018 Share-Based Compensation Grants

In January and February 2018, the Executive Compensation Committee of the Company’s Board of Directors awarded 282,038 restricted stock units (“RSUs”) to certain officers of the Company under the 2006 Plan, which included 158,205 RSUs (at the target level of performance) that are subject to market and/or performance-based vesting requirements (the “2018 Performance-Based RSUs”) and 123,833 RSUs that are subject to time-based vesting requirements (the “2018 Time-Based RSUs”).

2018 Performance-Based RSU Grant

The 2018 Performance-Based RSUs are scheduled to vest at the end of a three-year period (consisting of calendar years 2018-2020). A target number of 2018 Performance-Based RSUs were awarded, and the final number of 2018 Performance-Based RSUs that vest (which may be more or less than the target number) will be based upon (1) the achievement of pre-set FFO per share goals for the year ending December 31, 2018 that applies to 100% of the Performance-Based RSUs awarded (the “FFO performance condition”) and (2) a performance measure that applies to 50% of the award based upon a measure of the Company’s

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average debt to EBITDA ratio for the three-year performance period (the “debt to EBITDA ratio performance condition”) and a market measure that applies to the other 50% of the award based upon the relative ranking of the Company’s total stockholder return for the three-year performance period compared to the total stockholder returns of an established comparison group of companies over the same period (the “market condition”). The 2018 Performance-Based RSUs are also subject to a three-year service vesting provision and are scheduled to cliff vest on the date the final vesting percentage is determined following the end of the three-year performance period under the awards. The number of 2018 Performance-Based RSUs ultimately earned could fluctuate from the target number of 2018 Performance-Based RSUs granted based upon the levels of achievement for the FFO performance condition, the debt to EBITDA ratio performance condition, the market condition, and the extent to which the service vesting condition is satisfied. The estimate of the number of 2018 Performance-Based RSUs earned is evaluated quarterly during the performance period based on our estimate for each of the performance conditions measured against the applicable goals. As of June 30, 2018, the number of 2018 Performance-Based RSUs estimated to be earned based on the Company’s estimate of the performance conditions measured against the applicable goals was 158,205, and the compensation cost recorded to date for this program was based on that estimate. Compensation expense for the 2018 Performance-Based RSU grant is recognized on a straight-line basis over the requisite service period for each participant, which is generally the three-year service period.

Each 2018 Performance-Based RSU represents the right, subject to the applicable vesting conditions, to receive one share of our common stock in the future. The determination of the grant date fair value of the portion of the 2018 Performance-Based RSU grants covered by the debt to EBITDA ratio performance condition was based on the \$66.46 share price on the grant date. The determination of the grant date fair value of the portion of the 2018 Performance-Based RSU grants covered by the market condition was calculated using a Monte Carlo simulation pricing model based on the assumptions in the table below, which resulted in a \$70.08 grant date fair value per share.

Fair Value Assumptions

| | |
|---------------------------------|-----------|
| Expected share price volatility | 20.00% |
| Risk-free interest rate | 2.37% |
| Expected life | 2.9 years |

The computation of expected volatility is based on a blend of the historical volatility of our shares of common stock over approximately 5.8 years, as that is expected to be most consistent with future volatility and equates to a time period twice as long as the approximate 2.9-year performance period of the RSUs, and implied volatility data based on the observed pricing of six month publicly-traded options on our shares of common stock. The risk-free interest rate is based on the yield curve on zero-coupon U.S. Treasury STRIP securities in effect at February 14, 2018. The expected life of the 2018 Performance-Based RSUs is equal to the remaining 2.9-year vesting period as of February 14, 2018.

The total grant date fair value of the 2018 Performance-Based RSU awards was \$10.8 million on the February 14, 2018 grant date of the awards. For the six months ended June 30, 2018, we recorded compensation expense based upon the grant date fair value per share for each component multiplied by the estimated number of RSUs to be earned as discussed above.

2018 Time-Based RSU Grant

The 2018 Time-Based RSUs are scheduled to vest in three equal annual installments beginning on January 5, 2019 through January 5, 2021. Compensation expense for the 2018 Time-Based RSUs is recognized on a straight-line basis over the requisite service period for each participant, which is generally the three-year service vesting period. Each

2018 Time-Based RSU represents the right to receive one share of our common stock in the future. The total grant date fair value of the 2018 Time-Based RSU awards was \$8.4 million, which was based on the \$70.37 and \$66.46 closing share prices of the Company's common stock on the NYSE on the January 29, 2018 and February 14, 2018, respectively, grant dates of the awards.

Share-Based Compensation Cost Recorded During the Period

The total compensation cost for all share-based compensation programs was \$11.5 million and \$6.5 million for the three months ended June 30, 2018 and 2017, respectively, and \$16.6 million and \$12.6 million for the six months ended June 30, 2018 and 2017, respectively. Of the total share-based compensation costs, \$2.8 million and \$1.6 million was capitalized as part of real estate assets and deferred leasing costs for the three months ended June 30, 2018 and 2017, respectively, and \$4.3 million and \$3.7 million for the six months ended June 30, 2018 and 2017, respectively. As of June 30, 2018, there was approximately \$30.2 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 1.8 years. The remaining compensation cost related to these nonvested incentive awards had been recognized in periods prior to June 30, 2018.

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10. Commitments and Contingencies

General

As of June 30, 2018, we had commitments of approximately \$833.2 million, excluding our ground lease commitments, for contracts and executed leases directly related to our operating properties and development projects.

Environmental Matters

We follow the policy of monitoring all of our properties, both acquisition and existing stabilized portfolio 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 our stabilized portfolio properties that would have a material adverse effect on our financial condition, results of operations and cash flow, or that we believe would require additional disclosure or the recording of a loss contingency.

As of June 30, 2018, we had accrued environmental remediation liabilities of approximately \$68.8 million recorded on our consolidated balance sheets in connection with certain of our in-process and future development projects. The accrued environmental remediation liabilities represent the costs we estimate we will incur when we commence development at various development acquisition sites. These estimates, which we developed with the assistance of third party experts, consist primarily of the removal of contaminated soil and other related costs since we are required to dispose of any existing contaminated soil when we develop new properties at these sites.

We record estimated environmental remediation obligations for acquired properties at the acquisition date when we are aware of such costs and when such costs are probable of being incurred and can be reasonably estimated. Estimated costs related to development environmental remediation liabilities are recorded as an increase to the cost of the development project. Actual costs are recorded as a decrease to the liability when incurred. These accruals are adjusted as an increase or decrease to the development project costs and as an increase or decrease to the accrued environmental remediation liability if we obtain further information or circumstances change. The environmental remediation obligation recorded at June 30, 2018 was not discounted to its present value since we expect to complete the remediation activities in the next one to five years in connection with development activities at the various sites. It is possible that we could incur additional environmental remediation costs in connection with these future development projects. However, given we are in the pre-development phase on these future development projects, potential additional environmental costs cannot be reasonably estimated at this time and certain changes in estimates could occur as the site conditions, final project timing, design elements, actual soil conditions and other aspects of the projects, which may depend upon municipal and other approvals beyond the control of the Company, are determined.

Other than the accrued environmental liabilities discussed above, we are not aware of any unasserted claims and assessments with respect to an environmental liability that we believe would require additional disclosure or the recording of an additional loss contingency.

11. Fair Value Measurements and Disclosures

Assets and Liabilities Reported at Fair Value

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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 June 30, 2018 and December 31, 2017:

| Description | Fair Value (Level 1) ⁽¹⁾ | |
|--------------------------------------|-------------------------------------|-------------------|
| | June 30, 2018 | December 31, 2017 |
| Marketable securities ⁽²⁾ | \$ 22,519 | \$ 20,674 |

(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 gain/loss in the consolidated statements of operations. We also adjust the related Deferred Compensation

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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 on marketable securities recorded during the three and six months ended June 30, 2018 and 2017:

| Description | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-----------------------------------|-----------------------------|-------|---------------------------|---------|
| | 2018 | 2017 | 2018 | 2017 |
| Net gain on marketable securities | \$422 | \$512 | \$18 | \$1,183 |

(in thousands)

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 June 30, 2018 and December 31, 2017:

| Liabilities | June 30, 2018 | | December 31, 2017 | |
|--------------------------|----------------|---------------------------|-------------------|---------------------------|
| | Carrying Value | Fair Value ⁽¹⁾ | Carrying Value | Fair Value ⁽¹⁾ |
| Secured debt, net | \$338,189 | \$336,860 | \$340,800 | \$346,858 |
| Unsecured debt, net | 2,156,521 | 2,145,159 | 2,006,263 | 2,077,199 |
| Unsecured line of credit | 295,000 | 295,333 | — | — |

(in thousands)

⁽¹⁾ Fair value calculated using Level II inputs, which are based on model-derived valuations in which significant inputs and significant value drivers are observable in active markets.

12. Other Significant Events

During the three and six months ended June 30, 2018, we recognized \$5.6 million and \$5.4 million of provision for bad debts, respectively. The provision for bad debts in 2018 is primarily due to a \$7.0 million increase in the provision for one tenant during the three months ended June 30, 2018, partially offset by a \$1.7 million and \$1.4 million decrease in the provision for bad debts for one lease due to the assignment of the lease to a credit tenant during the three and six months ended June 30, 2018, respectively.

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

13. Net Income Available to Common Stockholders Per Share of the Company

The following table reconciles the numerator and denominator in computing the Company's basic and diluted per-share computations for net income available to common stockholders for the three and six months ended June 30, 2018 and 2017:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--|------------|------------------------------|------------|
| | 2018 | 2017 | 2018 | 2017 |
| | (in thousands, except share and per share amounts) | | | |
| Numerator: | | | | |
| Net income attributable to Kilroy Realty Corporation | \$27,549 | \$31,448 | \$63,795 | \$64,973 |
| Total preferred dividends | — | (1,615) | — | (8,811) |
| Allocation to participating securities ⁽¹⁾ | (514) | (511) | (985) | (959) |
| Numerator for basic and diluted net income available to common stockholders | \$27,035 | \$29,322 | \$62,810 | \$55,203 |
| Denominator: | | | | |
| Basic weighted average vested shares outstanding | 99,691,700 | 98,275,471 | 99,220,577 | 97,834,255 |
| Effect of dilutive securities | 459,156 | 551,907 | 467,105 | 593,090 |
| Diluted weighted average vested shares and common share equivalents outstanding | 100,150,856 | 98,827,378 | 99,687,682 | 98,427,345 |
| Basic earnings per share: | | | | |
| Net income available to common stockholders per share | \$0.27 | \$0.30 | \$0.63 | \$0.56 |
| Diluted earnings per share: | | | | |
| Net income available to common stockholders per share | \$0.27 | \$0.30 | \$0.63 | \$0.56 |

(1) Participating securities include nonvested shares, certain time-based RSUs and vested market measure-based RSUs.

Share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are considered participating securities. The impact of potentially dilutive common shares, including stock options, RSUs and other securities are considered in our diluted earnings per share calculation for the three and six months ended June 30, 2018 and 2017. Certain market measure-based RSUs are not included in dilutive securities for the three and six months ended June 30, 2018 and 2017, as not all performance metrics had been met by the end of the applicable reporting periods.

See Note 9 "Share-Based Compensation" for additional information regarding share-based compensation.

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

14. Net Income Available to Common Unitholders Per Unit of the Operating Partnership

The following table reconciles the numerator and denominator in computing the Operating Partnership's basic and diluted per-unit computations for net income available to common unitholders for the three and six months ended June 30, 2018 and 2017:

| | Three Months Ended | | Six Months Ended | |
|---|--|-------------|------------------|-------------|
| | June 30, 2018 | 2017 | June 30, 2018 | 2017 |
| | (in thousands, except unit and per unit amounts) | | | |
| Numerator: | | | | |
| Net income attributable to Kilroy Realty, L.P. | \$28,015 | \$ 31,971 | \$64,908 | \$ 66,025 |
| Total preferred distributions | — | (1,615) | — | (8,811) |
| Allocation to participating securities ⁽¹⁾ | (514) | (511) | (985) | (959) |
| Numerator for basic and diluted net income available to common unitholders | \$27,501 | \$ 29,845 | \$63,923 | \$ 56,255 |
| Denominator: | | | | |
| Basic weighted average vested units outstanding | 101,762,390 | 100,352,664 | 101,291,549 | 100,024,000 |
| Effect of dilutive securities | 459,156 | 551,907 | 467,105 | 593,090 |
| Diluted weighted average vested units and common unit equivalents outstanding | 102,221,546 | 100,904,571 | 101,758,654 | 100,617,090 |
| Basic earnings per unit: | | | | |
| Net income available to common unitholders per unit | \$0.27 | \$ 0.30 | \$0.63 | \$ 0.56 |
| Diluted earnings per unit: | | | | |
| Net income available to common unitholders per unit | \$0.27 | \$ 0.30 | \$0.63 | \$ 0.56 |

(1) Participating securities include nonvested shares, certain time-based RSUs and vested market measure-based RSUs.

Share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are considered participating securities. The impact of potentially dilutive common units, including stock options, RSUs and other securities are considered in our diluted earnings per share calculation for the three and six months ended June 30, 2018 and 2017. Certain market measure-based RSUs are not included in dilutive securities for the three and six months ended June 30, 2018 and 2017, as not all performance metrics had been met by the end of the applicable reporting periods.

See Note 9 "Share-Based Compensation" for additional information regarding share-based compensation.

15. Supplemental Cash Flow Information of the Company

Supplemental cash flow information is included as follows (in thousands):

| | Six Months Ended June 30, | |
|---|------------------------------|----------|
| | 2018 | 2017 |
| SUPPLEMENTAL CASH FLOWS INFORMATION: | | |
| Cash paid for interest, net of capitalized interest of \$28,267 and \$20,219 as of June 30, 2018 and 2017, respectively | \$25,136 | \$30,977 |
| NON-CASH INVESTING TRANSACTIONS: | | |
| Accrual for expenditures for operating properties and development properties | \$80,198 | \$66,967 |
| Assumption of accrued liabilities in connection with acquisitions (Note 2) | \$40,624 | \$— |
| Tenant improvements funded directly by tenants | \$4,611 | \$9,221 |
| NON-CASH FINANCING TRANSACTIONS: | | |
| Accrual of dividends and distributions payable to common stockholders and common unitholders | \$47,348 | \$43,305 |
| Accrual of dividends and distributions payable to preferred stockholders and preferred unitholders | \$— | \$797 |
| Exchange of common units of the Operating Partnership into shares of the Company's common stock | \$245 | \$10,939 |

The following is a reconciliation of our cash and cash equivalents and restricted cash at the beginning and end of the six months ended June 30, 2018 and 2017.

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

| | Six Months Ended June 30, | |
|---|------------------------------|-----------|
| | 2018 | 2017 |
| RECONCILIATION OF CASH AND CASH EQUIVALENTS AND RESTRICTED CASH: | | |
| Cash and cash equivalents at beginning of period | \$57,649 | \$193,418 |
| Restricted cash at beginning of period | 9,149 | 56,711 |
| Cash and cash equivalents and restricted cash at beginning of period | \$66,798 | \$250,129 |
| Cash and cash equivalents at end of period | \$50,817 | \$387,616 |
| Restricted cash at end of period | — | 8,249 |
| Cash and cash equivalents and restricted cash at end of period | \$50,817 | \$395,865 |

16. Supplemental Cash Flow Information of the Operating Partnership:

Supplemental cash flow information is included as follows (in thousands):

| | Six Months Ended June 30, | |
|---|------------------------------|----------|
| | 2018 | 2017 |
| SUPPLEMENTAL CASH FLOWS INFORMATION: | | |
| Cash paid for interest, net of capitalized interest of \$28,267 and \$20,219 as of June 30, 2018 and 2017, respectively | \$25,136 | \$30,977 |
| NON-CASH INVESTING TRANSACTIONS: | | |
| Accrual for expenditures for operating properties and development properties | \$80,198 | \$66,967 |
| Assumption of accrued liabilities in connection with acquisitions (Note 2) | \$40,624 | \$— |
| Tenant improvements funded directly by tenants | \$4,611 | \$9,221 |
| NON-CASH FINANCING TRANSACTIONS: | | |
| Accrual of distributions payable to common unitholders | \$47,348 | \$43,305 |
| Accrual of distributions payable to preferred unitholders | \$— | \$797 |

The following is a reconciliation of our cash and cash equivalents and restricted cash at the beginning and end of the six months ended June 30, 2018 and 2017.

| | Six Months Ended June 30, | |
|---|------------------------------|-----------|
| | 2018 | 2017 |
| RECONCILIATION OF CASH AND CASH EQUIVALENTS AND RESTRICTED CASH: | | |
| Cash and cash equivalents at beginning of period | \$57,649 | \$193,418 |
| Restricted cash at beginning of period | 9,149 | 56,711 |
| Cash and cash equivalents and restricted cash at beginning of period | \$66,798 | \$250,129 |
| Cash and cash equivalents at end of period | \$50,817 | \$387,616 |
| Restricted cash at end of period | — | 8,249 |
| Cash and cash equivalents and restricted cash at end of period | \$50,817 | \$395,865 |

17. Subsequent Events

On July 18, 2018, aggregate dividends, distributions and dividend equivalents of \$47.3 million were paid to common stockholders, common unitholders and RSU holders of record on June 29, 2018.

On July 18, 2018, the Operating Partnership issued \$50.0 million principal amount of its 4.30% Senior Notes, Series A, due July 18, 2026 pursuant to the Note Purchase Agreement.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion relates to our consolidated financial statements and should be read in conjunction with the financial statements and notes thereto appearing elsewhere in this report. The results of operations discussion is combined for the Company and the Operating Partnership because there are no material differences in the results of operations between the two reporting entities.

Forward-Looking Statements

Statements contained in this “Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations” that are not historical facts may be forward-looking statements. Forward-looking statements include, among other things, statements or information concerning our plans, objectives, capital resources, portfolio performance, results of operations, projected future occupancy and rental rates, lease expirations, debt maturities, potential investments, strategies such as capital recycling, development and redevelopment activity, projected construction costs, projected construction commencement and completion dates, projected square footage of space that could be constructed on undeveloped land that we own, projected rentable square footage of or number of units in properties under construction or in the development pipeline, anticipated proceeds from capital recycling activity or other dispositions and anticipated dates of those activities or dispositions, resolution of our discussions with tenants on our internal watch list, projected increases in the value of properties, dispositions, future executive incentive compensation, pending, potential or proposed acquisitions, plans to grow our Net Operating Income and FFO, our ability to re-lease properties at or above current market rates, anticipated market conditions and demographics and other forward-looking financial data, as well as the discussion in “—Factors That May Influence Future Results of Operations,” “—Liquidity and Capital Resource of the Company,” and “—Liquidity and Capital Resources of the Operating Partnership.” Forward-looking statements can be identified by the use of words such as “believes,” “expects,” “projects,” “may,” “will,” “should,” “seeks,” “approximately,” “intends,” “plans,” “pro forma,” “estimates” or “anticipates” and the negative words and phrases and similar expressions that do not relate to historical matters. Forward-looking statements are based on our current expectations, beliefs and assumptions, and are not guarantees of future performance. Forward-looking statements are inherently subject to uncertainties, risks, changes in circumstances, trends and factors that are difficult to predict, many of which are outside of our control. Accordingly, actual performance, results and events may vary materially from those indicated in the forward-looking statements, and you should not rely on the forward-looking statements as predictions of future performance, results or events. Numerous factors could cause actual future performance, results and events to differ materially from those indicated in the forward-looking statements, including, among others: global market and general economic conditions and their effect on our liquidity and financial conditions and those of our tenants; adverse economic or real estate conditions generally, and specifically, in the States of California and Washington; risks associated with our investment in real estate assets, which are illiquid and with trends in the real estate industry; defaults on or non-renewal of leases by tenants; any significant downturn in tenants' businesses; our ability to re-lease property at or above current market rates; costs to comply with government regulations, including environmental remediation; the availability of cash for distribution and debt service and exposure to risk of default under debt obligations; increases in interest rates and our ability to manage interest rate exposure; the availability of financing on attractive terms or at all, which may adversely impact our future interest expense and our ability to pursue development, redevelopment and acquisition opportunities and refinance existing debt; a decline in real estate asset valuations, which may limit our ability to dispose of assets at attractive prices or obtain or maintain debt financing, and which may result in write offs or impairment charges; significant competition, which may decrease the occupancy and rental rates of properties; potential losses that may not be covered by insurance; the ability to successfully complete acquisitions and dispositions on announced terms; the ability to successfully operate acquired, developed and redeveloped properties; the ability to successfully complete development and redevelopment projects on schedule and within budgeted amounts; delays or refusals in obtaining all necessary zoning, land use and other required entitlements, governmental permits and authorizations for our development and redevelopment properties; increases in anticipated capital expenditures, tenant improvement and/or

leasing costs; defaults on leases for land on which some of our properties are located; adverse changes to, or implementations of, applicable laws, regulations or legislation, as well as business and consumer reactions to such changes; risks associated with joint venture investments, including our lack of sole decision-making authority, our reliance on co-venturers' financial condition and disputes between us and our co-venturers; environmental uncertainties and risks related to natural disasters; and our ability to maintain our status as a REIT. The factors included in this report are not exhaustive and additional factors could adversely affect our business and financial performance. For a discussion of additional factors that could materially adversely affect the Company's and the Operating Partnership's business and financial performance, see the discussion below as well as "Item 1A. Risk Factors," and in our "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's and the Operating Partnership's annual report on Form 10-K for the year ended December 31, 2017 and their respective other filings with the SEC. All forward-looking statements are based on information that was available and speak only as of the date on which they were made. We assume no obligation to update any forward-looking statement that becomes untrue because of

subsequent events, new information or otherwise, except to the extent we are required to do so in connection with our ongoing requirements under federal securities laws.

Overview and Background

We are a self-administered REIT active in premier office and mixed-use 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 Greater 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. We own our interests in all of our properties through the Operating Partnership and the Finance Partnership and generally conduct substantially all of our operations through the Operating Partnership. We owned an approximate 98.0%, 97.9%, and 97.9% general partnership interest in the Operating Partnership as of June 30, 2018, December 31, 2017 and June 30, 2017. All of our properties are held in fee except for the thirteen office buildings that are held subject to long-term ground leases for the land.

Factors That May Influence Future Results of Operations

Development Program

We believe that a portion of our long-term future growth will continue to come from the completion of our in-process development projects and, subject to market conditions, executing on our future development pipeline, including expanding entitlements. Over the past several years, we increased our focus on development opportunities and expanded our future development pipeline through targeted acquisitions of development opportunities on the West Coast. This includes the acquisition of a 39-acre development site in South San Francisco, California on June 1, 2018 for a cash purchase price of approximately \$308.2 million as discussed in “– Acquisitions” below.

We have a proactive planning process by which we continually evaluate the size, timing, costs and scope of our development program and, as necessary, scale activity to reflect the economic conditions and the real estate fundamentals that exist in our submarkets. We expect to execute on our development program with prudence and will be pursuing opportunities with attractive economic returns in strategic locations with proximity to public transportation or transportation access and retail amenities and in markets with strong fundamentals and visible demand. We plan to develop in phases and we generally favor starting projects with pre-leasing activity, as appropriate.

In-Process Development Projects - Tenant Improvement

During the three months ended June 30, 2018, the following two development projects were moved from the under construction phase to the tenant improvement phase:

100 Hooper, SOMA, San Francisco, California, which we acquired in July 2015 and commenced construction on in November 2016. This project encompasses approximately 314,000 square feet of office and approximately 86,000 square feet of production, distribution and repair (“PDR”) space configured in two buildings with a total estimated investment of approximately \$270.0 million. The office portion of the project is 100% pre-leased to Adobe Systems Inc. and the PDR space is 39% leased as of the date of this report. The lease with Adobe Systems Inc. will commence in phases beginning in the third quarter of 2018 through the second quarter of 2020 with cash rents commencing in the first quarter of 2019 through the second quarter of 2020. The project is expected to be stabilized in the second quarter of 2019.

•The Exchange on 16th, Mission Bay, San Francisco, California, which we acquired in May 2014 and commenced construction on in June 2015. This project will encompass approximately 750,000 gross rentable square feet consisting of 736,000 square feet of office space and 14,000 square feet of retail space at a total estimated investment

of \$570.0 million. The office space in the project is 100% pre-leased to Dropbox, Inc. The lease with Dropbox, Inc. will commence in phases beginning in the fourth quarter of 2018 through the fourth quarter of 2019 with cash rents commencing in the third quarter of 2019 through the first quarter of 2020. The estimated stabilization dates for Phase I, Phase II, and Phase III are the second quarter of 2019, the fourth quarter of 2019, and the third quarter of 2020, respectively.

In-Process Development Projects - Under Construction

As of June 30, 2018, we had three projects in our in-process development pipeline that were under construction.

Academy on Vine - Phase I (Office and Retail) in Hollywood, California, which we acquired in 2013 and commenced construction on in January 2018. Phase I of this mixed-use project includes the project's overall infrastructure and site work, approximately 306,000 square feet of office space and approximately 24,000 square feet of retail space for a total estimated investment of \$260.0 million. Construction is currently in progress and the cold shell is currently expected to be ready for tenant improvements in the first half of 2020.

333 Dexter, South Lake Union, Washington, which we acquired in February 2015 and commenced construction on in June 2017. This project encompasses approximately 650,000 gross rentable square feet of office space at a total estimated investment of \$380.0 million. Construction is currently in progress and the cold shell is currently estimated to be ready for tenant improvements in the second half of 2019.

One Paseo - Phases I & II (Retail and Residential), Del Mar Heights, San Diego, California, which we acquired in November 2007 and commenced construction on in December 2016. Phases I & II of this mixed-use project includes site work and related infrastructure for the entire project, as well as 608 residential units and approximately 96,000 square feet of retail space. The total estimated investment for these phases of the project is approximately \$465.0 million. The project is expected to be stabilized in phases beginning in the first quarter of 2019 for the retail space through the third quarter of 2020 for the residential units. The retail space of the project is currently 70% leased.

Future Development Pipeline

As of June 30, 2018, our future development pipeline included seven future projects located in the San Francisco Bay Area, Greater Los Angeles and San Diego County with an aggregate cost basis of approximately \$825.5 million at which we believe we could develop from 5.5 million rentable square feet to 6.5 million rentable square feet for a total estimated investment of \$5.0 billion to \$6.0 billion, depending on successfully obtaining entitlements and market conditions.

The following table sets forth information about our future development pipeline.

| Future Development Pipeline ⁽¹⁾ | Location | Approx. Developable Square Feet / Resi Units ⁽¹⁾ | Total Costs as of 6/30/2018 (\$ in millions) ⁽²⁾ |
|--|---------------|---|---|
| Greater Los Angeles | | | |
| Academy on Vine - Phase II (Residential) | Hollywood | 200 Resi Units | \$ 35.4 |
| San Diego County | | | |
| One Paseo - Phase III | Del Mar | 270,000 | 68.6 |
| 2100 Kettner | Little Italy | 175,000 | 23.8 |
| 9455 Towne Centre Drive | San Diego | 150,000 | 15.4 |
| Santa Fe Summit – Phases II and III | 56 Corridor | 600,000 | 80.8 |
| San Francisco Bay Area | | | |
| Kilroy Oyster Point ⁽³⁾ | San Francisco | 2,500,000 | 365.3 |
| Flower Mart | San Francisco | TBD | 236.2 |
| TOTAL: | | | \$ 825.5 |

The developable square feet and scope of projects could change materially from estimated data provided due to one (1) or more of the following: any significant changes in the economy, market conditions, our markets, tenant requirements and demands, construction costs, new supply, regulatory and entitlement processes or project design.

(2) Represents cash paid and costs incurred, including accrued liabilities in accordance with GAAP, as of June 30, 2018.

(3) The Company acquired this 39-acre site located in South San Francisco fully entitled for approximately 2.5 million square feet in the second quarter of 2018 for a purchase price of \$308.2 million. In addition to the purchase price, total costs as of June 30, 2018 include transaction costs, development spending, and accrued liabilities.

Fluctuations in our development activities could cause fluctuations in the average development asset balances qualifying for interest and other carrying cost and internal cost capitalization in future periods. During the three and six months ended June 30, 2018, we capitalized interest on in-process development projects and development pipeline projects with an average aggregate cost basis of approximately \$1.5 billion and \$1.4 billion, respectively, as it was determined these projects qualified for interest and other carrying cost capitalization under GAAP. During the three and six months ended June 30, 2017, we capitalized interest on in-process development projects and future development pipeline projects with an average aggregate cost basis of approximately \$1.0 billion, as it was determined these projects qualified for interest and other carrying cost capitalization under GAAP. For the three and six months ended June 30, 2018, we capitalized \$15.8 million and \$29.4 million, respectively, of interest to our qualifying development projects. For the three and six months ended June 30, 2017, we capitalized \$10.8 million and \$20.9 million, respectively, of interest to our qualifying development projects. For the three and six months ended June 30, 2018, we capitalized

\$6.9 million and \$13.3 million, respectively, of internal costs to our qualifying development projects. For the three and six months ended June 30, 2017, we capitalized \$5.1 million and \$10.8 million, respectively, of internal costs to our qualifying development projects.

Capital Recycling Program. We continuously evaluate opportunities for the potential disposition of properties and undeveloped land in our portfolio or the formation of strategic ventures with the intent of recycling the proceeds generated into capital used to fund new operating and development acquisitions, to finance development and redevelopment expenditures, to repay long-term debt and for other general corporate purposes. As part of this strategy, we attempt to enter into Section 1031 Exchanges and other tax deferred transaction structures, when possible, to defer some or all of the taxable gains on the sales, if any, for federal and state income tax purposes. See the “Liquidity and Capital Resources of the Operating Partnership – Liquidity Sources” section for further discussion of the program.

The timing of any potential future disposition or strategic venture transactions will depend on market conditions and other factors, including but not limited to our capital needs and our ability to defer some or all of the taxable gains on the sales. We cannot assure that we will dispose of any additional properties, enter into any additional strategic ventures, or that we will be able to identify and complete the acquisition of a suitable replacement property to effect a Section 1031 Exchange or be able to use other tax deferred structures in connection with our strategy.

Acquisitions. During the six months ended June 30, 2018, we acquired three office buildings in South San Francisco, California for a purchase price of \$111.0 million. In addition, we separately acquired a 39-acre development site adjacent to these office buildings for a cash purchase price of approximately \$308.2 million from an unrelated seller.

As part of our growth strategy, which is highly dependent on market conditions and business cycles, among other factors, we continue to evaluate strategic opportunities and remain a disciplined buyer of development and redevelopment opportunities as well as value-add or strategic operating properties. We continue to focus on growth opportunities in West Coast markets populated by knowledge and creative based tenants in a variety of industries, including technology, media, healthcare, life sciences, entertainment and professional services. Against the backdrop of market volatility, we expect to manage a strong balance sheet, execute on our development program and selectively evaluate opportunities that either add immediate Net Operating Income to our portfolio or play a strategic role in our future growth.

In connection with our growth strategy, we often have one or more potential acquisitions of properties and/or undeveloped land under consideration that are in varying stages of negotiation and due diligence review, or under contract, at any point in time. However, we cannot provide assurance that we will enter into any agreements to acquire those properties or undeveloped land or, if we do, that those will be completed. In addition, acquisitions are subject to various risks and uncertainties and we may be unable to complete an acquisition after making a nonrefundable deposit or incurring acquisition-related costs. As of June 30, 2018, we had \$15.0 million of acquisition deposits that were nonrefundable related to the future acquisition of an operating property with a purchase price of \$146.0 million that is currently expected to close by the end of 2018.

Incentive Compensation. Our Executive Compensation Committee determines compensation, including cash bonuses and equity incentives, for our executive officers. For 2018, the annual cash bonus program was structured to allow the Executive Compensation Committee to evaluate a variety of key quantitative and qualitative metrics at the end of the year and make a determination based on the Company’s and management’s overall performance. Our Executive Compensation Committee also grants equity incentive awards from time to time that include performance-based and/or market-measure based vesting requirements and/or time-based vesting requirements. As a result, accrued incentive compensation and compensation expense for future awards may be affected by our operating and development performance, financial results, stock price, performance against applicable performance-based vesting goals, market conditions, liquidity measures, and other factors. Consequently, we cannot predict the amounts that will be recorded in future periods related to such incentive compensation.

As of June 30, 2018, there was approximately \$30.2 million of total unrecognized compensation cost related to outstanding nonvested shares of restricted common stock and RSUs issued under share-based compensation arrangements. Those costs are expected to be recognized over a weighted-average period of 1.8 years. The \$30.2 million of unrecognized compensation cost does not reflect the future compensation cost for any potential share-based awards that may be issued subsequent to June 30, 2018. Share-based compensation expense for potential future awards could be affected by our operating and development performance, financial results, stock price, performance against applicable performance-based vesting goals, market conditions and other factors.

Information on Leases Commenced and Executed

Leasing Activity and Changes in Rental Rates. The amount of net rental income generated by our properties depends principally on our ability to maintain the occupancy rates of currently leased space and to lease currently available space, newly developed

or redeveloped properties, newly acquired properties with vacant space, and space available from unscheduled lease terminations. The amount of rental income we generate also depends on our ability to maintain or increase rental rates in our submarkets. Negative trends in one or more of these factors could adversely affect our rental income in future periods. The following tables set forth certain information regarding leasing activity for our stabilized portfolio during the three and six months ended June 30, 2018.

For Leases Commenced

| | 1st & 2nd Generation ⁽¹⁾⁽²⁾ | | | | Retention Rates ⁽⁴⁾ | 2nd Generation ⁽¹⁾⁽²⁾ | | | | Weighted Average Lease Term (in months) |
|----------------------------------|--|---------|-------------------------------------|---------|--------------------------------|----------------------------------|--------------------------|------------------------------------|--------------------------------------|---|
| | Number of Leases ⁽³⁾ | | Rentable Square Feet ⁽³⁾ | | | TI/LC Per Sq. Ft. ⁽⁵⁾ | TI/LC Per Sq. Ft. / Year | Changes in Rents ⁽⁶⁾⁽⁷⁾ | Changes in Cash Rents ⁽⁸⁾ | |
| | New | Renewal | New | Renewal | | | | | | |
| Three Months Ended June 30, 2018 | 26 | 16 | 279,976 | 570,265 | 62.9 % | \$52.29 | \$6.97 | 30.7 % | 16.9 % | 90 |
| Six Months Ended June 30, 2018 | 43 | 31 | 399,369 | 691,941 | 54.8 % | \$50.52 | \$7.22 | 30.4 % | 16.0 % | 84 |

For Leases Executed ⁽⁹⁾⁽¹⁰⁾

| | 1st & 2nd Generation ⁽¹⁾⁽²⁾ | | | | TI/LC per Sq. Ft. ⁽⁵⁾ | 2nd Generation ⁽¹⁾⁽²⁾ | | | | Weighted Average Lease Term (in months) |
|----------------------------------|--|---------|-------------------------------------|---------|----------------------------------|----------------------------------|------------------------------------|--------------------------------------|--|---|
| | Number of Leases ⁽³⁾ | | Rentable Square Feet ⁽³⁾ | | | TI/LC Per Sq. Ft. / Year | Changes in Rents ⁽⁶⁾⁽⁷⁾ | Changes in Cash Rents ⁽⁸⁾ | | |
| | New | Renewal | New | Renewal | | | | | | |
| Three Months Ended June 30, 2018 | 25 | 16 | 744,802 | 570,265 | \$52.82 | \$6.15 | 30.2 % | 9.8 % | | 103 |
| Six Months Ended June 30, 2018 | 45 | 31 | 924,498 | 691,941 | \$52.06 | \$6.37 | 29.9 % | 10.2 % | | 98 |

(1) Includes 100% of consolidated property partnerships.

First generation leasing includes space where we have made capital expenditures that result in additional revenue

(2) generated when the space is re-leased. Second generation leasing includes space where we have made capital expenditures to maintain the current market revenue stream.

(3) Represents leasing activity for leases that commenced or were signed during the period, including first and second generation space, net of month-to-month leases. Excludes leasing on new construction.

(4) Calculated as the percentage of space either renewed or expanded into by existing tenants or subtenants at lease expiration.

(5) Tenant improvements and leasing commissions per square foot excluding tenant-funded tenant improvements and certain tenant improvements used to fund base building improvements.

(6) Calculated as the change between GAAP rents for new/renewed leases and the expiring GAAP rents for the same space. Excludes leases for which the space was vacant longer than one year or vacant when the property was acquired.

(7) Excludes commenced and executed leases of approximately 115,291 and 33,383 rentable square feet, respectively, for the three months ended June 30, 2018, and 129,620 and 161,642 rentable square feet, respectively, for the six months ended June 30, 2018, for which the space was vacant longer than one year or being leased for the first time. Space vacant for more than one year is excluded from our change in rents calculations to provide a more meaningful market comparison.

(8) Calculated as the change between stated rents for new/renewed leases and the expiring stated rents for the same space. Excludes leases for which the space was vacant longer than one year or vacant when the property was

acquired.

For the three months ended June 30, 2018, 22 leases totaling 711,948 rentable square feet were signed but not (9) commenced as of June 30, 2018. For the six months ended June 30, 2018, 29 leases totaling 834,787 rentable square feet were signed but not commenced as of June 30, 2018.

(10) Excludes a 110,000 square foot lease executed at a property located San Francisco that the Company expects to acquire by the end of 2018.

As of June 30, 2018, we believe that the weighted average cash rental rates for our total stabilized portfolio are approximately 15% below the current average market rental rates, which includes a projection that the weighted average cash rental rates for our San Diego stabilized portfolio are approximately 5% above current market rental rates. Individual properties within any particular submarket presently may be leased either above, below, or at the current market rates within that submarket, and the average rental rates for individual submarkets may be above, below, or at the average cash rental rate of our portfolio.

Our rental rates and occupancy are impacted by general economic conditions, including the pace of regional economic growth and access to capital. Therefore, we cannot give any assurance that leases will be renewed or that available space will be re-leased at rental rates equal to or above the current market rates. Additionally, decreased demand and other negative trends or unforeseeable events that impair our ability to timely renew or re-lease space could have further negative effects on our future financial condition, results of operations, and cash flows.

Scheduled Lease Expirations. The following tables set forth certain information regarding our lease expirations for our stabilized portfolio for the remainder of 2018 and the next five years and by region for the remainder of 2018 and in 2019.

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Lease Expirations ⁽¹⁾

| Year of Lease Expiration | Number of Expiring Leases | Total Square Feet | % of Total Leased Sq. Ft. | Annualized Base Rent ⁽²⁾⁽³⁾ (in thousands) | % of Total Annualized Base Rent ⁽²⁾ | Annualized Base Rent per Sq. Ft. ⁽²⁾ |
|----------------------------------|---------------------------|-------------------|---------------------------|--|--|---|
| Remainder of 2018 ⁽⁴⁾ | 39 | 571,075 | 4.5 % | \$ 25,544 | 4.4 % | \$ 44.73 |
| 2019 ⁽⁴⁾ | 102 | 1,482,803 | 11.6 % | 61,047 | 10.6 % | \$ 41.17 |
| 2020 | 107 | 1,699,452 | 13.3 % | 68,889 | 12.0 % | \$ 40.54 |
| 2021 | 91 | 932,442 | 7.3 % | 40,075 | 7.0 % | \$ 42.98 |
| 2022 | 60 | 613,078 | 4.8 % | 25,890 | 4.5 % | \$ 42.23 |
| 2023 | 75 | 1,287,910 | 10.1 % | 67,068 | 11.6 % | \$ 52.08 |
| Total | 474 | 6,586,760 | 51.6 % | \$ 288,513 | 50.1 % | \$ 43.80 |

| Year ⁽⁴⁾ | Region | # of Expiring Leases | Total Square Feet | % of Total Leased Sq. Ft. | Annualized Base Rent ⁽²⁾⁽³⁾ | % of Total Annualized Base Rent ⁽²⁾ | Annualized Rent per Sq. Ft. ⁽²⁾ |
|---------------------|------------------------|----------------------|-------------------|---------------------------|--|--|--|
| 2018 | Greater Los Angeles | 24 | 86,092 | 0.7 % | \$ 3,734 | 0.6 % | \$ 43.37 |
| | Orange County | 1 | 1,090 | — % | 31 | — % | \$ 28.44 |
| | San Diego | 7 | 382,240 | 3.0 % | 17,024 | 3.0 % | \$ 44.54 |
| | San Francisco Bay Area | 4 | 72,041 | 0.6 % | 3,940 | 0.7 % | \$ 54.69 |
| | Greater Seattle | 3 | 29,612 | 0.2 % | 815 | 0.1 % | \$ 27.52 |
| | Total | 39 | 571,075 | 4.5 % | \$ 25,544 | 4.4 % | \$ 44.73 |
| 2019 | Greater Los Angeles | 45 | 324,890 | 2.6 % | \$ 10,745 | 1.8 % | \$ 33.07 |
| | Orange County | 6 | 77,875 | 0.6 % | 3,234 | 0.6 % | \$ 41.53 |
| | San Diego | 15 | 195,661 | 1.5 % | 7,209 | 1.3 % | \$ 36.84 |
| | San Francisco Bay Area | 20 | 689,340 | 5.4 % | 33,367 | 5.8 % | \$ 48.40 |
| | Greater Seattle | 16 | 195,037 | 1.5 % | 6,492 | 1.1 % | \$ 33.29 |
| | Total | 102 | 1,482,803 | 11.6 % | \$ 61,047 | 10.6 % | \$ 41.17 |

For leases that have been renewed early with existing tenants, the expiration date and annualized base rent information presented takes into consideration the renewed lease terms. Excludes leases not commenced as of June 30, 2018, space leased under month-to-month leases, storage leases, vacant space and future lease renewal options not executed as of June 30, 2018.

Annualized base rent includes the impact of straight-lining rent escalations and the amortization of free rent periods and excludes the impact of the following: amortization of deferred revenue related tenant-funded tenant improvements, amortization of above/below market rents, amortization for lease incentives due under existing leases and expense reimbursement revenue. Additionally, the underlying leases contain various expense structures including full service gross, modified gross and triple net. Percentages represent percentage of total portfolio annualized contractual base rental revenue. For additional information on tenant improvement and leasing commission costs incurred by the Company for the current reporting period, please see further discussion under the caption "Information on Leases Commenced and Executed."

⁽³⁾ Includes 100% of annualized base rent of consolidated property partnerships.

⁽⁴⁾ Adjusting for leases executed as of June 30, 2018 but not yet commenced, the remaining 2018 and 2019 expirations would be reduced by 191,833 square feet and 590,820 square feet, respectively.

In addition to the 0.8 million rentable square feet, or 6.0%, of currently available space in our stabilized portfolio, leases representing approximately 4.5% and 11.6% of the occupied square footage of our stabilized portfolio are scheduled to expire during the remainder of 2018 and in 2019, respectively. The leases scheduled to expire during the remainder of 2018 and in 2019 represent approximately 2.1 million rentable square feet or 15.0% of our total annualized base rental revenue. Individual properties within any particular submarket presently may be leased either above, below, or at the current quoted market rates within that submarket. Our ability to re-lease available space depends upon both general market conditions and the market conditions in the specific regions in which individual properties are located.

For the approximately 0.6 million rentable square feet or 4.4% of our total annualized base rental revenue scheduled to expire during the remainder of 2018, we believe that the weighted average cash rental rates for our overall portfolio are approximately at current average market rental rates, except in our San Francisco and San Diego submarkets where we currently believe these expiring leases are approximately 20% below market and 25% above market, respectively.

For the approximately 1.5 million rentable square feet or 10.6% of our total annualized base rental revenue scheduled to expire in 2019 we believe that the weighted average cash rental rates for our overall portfolio are approximately 20% below current average market rental rates, primarily due to our Los Angeles and San Francisco submarkets where we currently believe these expiring leases are approximately 20% below market and 35% below market, respectively.

Stabilized Portfolio Information

As of June 30, 2018, our stabilized portfolio was comprised of 104 office properties encompassing an aggregate of approximately 13.9 million rentable square feet and 200 residential units at our residential tower in Hollywood, California. Our stabilized portfolio includes all of our properties with the exception of development and redevelopment properties currently committed for construction, under construction, or in the tenant improvement phase, undeveloped land and real estate assets held for sale. We define redevelopment properties as those properties for which we expect to spend significant development and construction costs on the existing or acquired buildings pursuant to a formal plan, the intended result of which is a higher economic return on the property. We define properties in the tenant improvement phase as properties that we are developing or redeveloping where the project has reached cold shell condition and is ready for tenant improvements, which may require additional major base building construction before being placed in service. Projects in the tenant improvement phase are added to our stabilized portfolio once the project reaches the earlier of 95% occupancy or one year from the date of the cessation of major base building construction activities. Costs capitalized to construction in progress for development and redevelopment properties are transferred to land and improvements, buildings and improvements, and deferred leasing costs on our consolidated balance sheets as the historical cost of the property as the projects are placed in service.

We did not have any redevelopment or held for sale properties at June 30, 2018. Our stabilized portfolio also excludes our future development pipeline, which as of June 30, 2018 was comprised of seven potential development sites, representing approximately 80 gross acres of undeveloped land on which we believe we have the potential to develop from 5.5 million rentable square feet to 6.5 million rentable square feet, depending upon economic conditions.

As of June 30, 2018, the following properties were excluded from our stabilized portfolio:

| | Number of Properties/Projects | Estimated Rentable Square Feet ⁽¹⁾ |
|---|----------------------------------|--|
| In-process development projects - tenant improvement ⁽²⁾ | 2 | 1,150,000 |
| In-process development projects - under construction ⁽³⁾ | 3 | 956,000 |

(1) Estimated rentable square feet upon completion.

(2) Includes 86,000 square feet of Production, Distribution, and Repair (“PDR”) space at 100 Hooper.

(3) In addition to the estimated office and PDR rentable square feet noted above, development projects under construction also include 120,000 square feet of retail space and 608 residential units.

The following table reconciles the changes in the rentable square feet in our stabilized office portfolio of operating properties from June 30, 2017 to June 30, 2018:

| | Number of Buildings | Rentable Square Feet |
|--|------------------------|-------------------------|
| Total as of June 30, 2017 | 111 | 14,394,534 |
| Acquisitions | 3 | 145,530 |
| Dispositions | (10) | (675,143) |
| Remeasurement | — | 16,588 |
| Total as of June 30, 2018 ⁽¹⁾ | 104 | 13,881,509 |

(1) Includes four properties owned by consolidated property partnerships.

Occupancy Information

The following table sets forth certain information regarding our stabilized portfolio:

| Region | Number of Buildings | Rentable Square Feet | Occupancy at ⁽¹⁾ | | | |
|----------------------------|---------------------|----------------------|-----------------------------|-----------|------------|---|
| | | | 6/30/2018 | 3/31/2018 | 12/31/2017 | |
| Greater Los Angeles | 36 | 4,181,733 | 94.3% | 93.9% | 93.3% | % |
| Orange County | 1 | 271,556 | 89.6% | 89.6% | 86.6% | % |
| San Diego County | 21 | 2,044,781 | 98.5% | 98.0% | 97.4% | % |
| San Francisco Bay Area | 34 | 5,317,300 | 93.8% | 95.1% | 96.1% | % |
| Greater Seattle | 12 | 2,066,139 | 90.4% | 90.2% | 95.4% | % |
| Total Stabilized Portfolio | 104 | 13,881,509 | 94.0% | 94.3% | 95.2% | % |

| | Average Occupancy | | | |
|--------------------------------------|----------------------------------|-------|--------------------------------|-------|
| | Three Months Ended June 30, 2018 | | Six Months Ended June 30, 2017 | |
| Stabilized Portfolio ⁽¹⁾ | 94.6% | 94.2% | 94.7% | 94.2% |
| Same Store Portfolio ⁽²⁾ | 94.7% | 94.9% | 94.8% | 95.0% |
| Residential Portfolio ⁽³⁾ | 83.6% | 69.6% | 83.3% | 64.2% |

(1) Occupancy percentages reported are based on our stabilized office portfolio as of the end of the period presented.

Occupancy percentages reported are based on office properties owned and stabilized as of January 1, 2017 and still (2) owned and stabilized as of June 30, 2018 and exclude our residential tower. See discussion under “Results of Operations” for additional information.

(3) Our residential portfolio consists of our 200-unit residential tower located in Hollywood, California.

Significant Tenants

The following table sets forth information about our fifteen largest tenants based upon annualized base rental revenues, as defined below, as of June 30, 2018.

| Tenant Name | Region | Annualized Base Rental Revenue ⁽¹⁾⁽²⁾ | Rentable Square Feet | Percentage of Total Annualized Base Rental Revenue ⁽²⁾ | Percentage of Base Total Rentable Square Feet |
|-----------------------------|--|--|----------------------|---|---|
| LinkedIn Corporation | San Francisco Bay Area | \$ 28,344 | 663,239 | 4.9% | 4.8% |
| salesforce.com, inc. | San Francisco Bay Area / Greater Seattle | 23,836 | 456,867 | 4.1% | 3.3% |
| DIRECTV, LLC | Greater Los Angeles | 23,152 | 684,411 | 4.0% | 4.9% |
| Box, Inc. | San Francisco Bay Area | 22,441 | 371,792 | 3.9% | 2.7% |
| Riot Games, Inc. | Greater Los Angeles | 15,511 | 251,509 | 2.7% | 1.8% |
| Synopsys, Inc. | San Francisco Bay Area | 15,492 | 340,913 | 2.7% | 2.5% |
| Dropbox, Inc. | San Francisco Bay Area | 13,960 | 264,888 | 2.4% | 1.9% |
| Viacom International, Inc. | Greater Los Angeles | 13,718 | 211,343 | 2.4% | 1.5% |
| Bridgepoint Education, Inc. | San Diego County | 13,129 | 273,292 | 2.3% | 2.0% |
| AppDynamics, Inc. | San Francisco Bay Area | 10,792 | 147,288 | 1.9% | 1.1% |

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| | | | | | | | |
|--|---|------------|-----------|------|---|------|---|
| Concur Technologies | Greater Seattle | 10,643 | 288,322 | 1.9 | % | 2.1 | % |
| Capital One, N.A. | San Francisco Bay Area | 9,170 | 117,993 | 1.6 | % | 0.9 | % |
| AMN Healthcare, Inc. | San Diego County | 9,001 | 176,075 | 1.6 | % | 1.3 | % |
| Stanford University School of Medicine | San Francisco Bay Area | 8,461 | 128,688 | 1.5 | % | 0.9 | % |
| Adobe Systems, Inc. | San Francisco Bay Area / Greater Seattle | 7,586 | 204,757 | 1.3 | % | 1.5 | % |
| Total Top Fifteen Tenants | | \$ 225,236 | 4,581,377 | 39.2 | % | 33.2 | % |

(1) Includes 100% of annualized base rental revenues of consolidated property partnerships.

Annualized base rental revenue includes the impact of straight-lining rent escalations and the amortization of free rent periods and excludes the impact of the following: amortization of deferred revenue related tenant-funded

(2) tenant improvements, amortization of above/below market rents, amortization for lease incentives due under existing leases, and expense reimbursement revenue. Excludes month-to-month leases and vacant space as of June 30, 2018.

Results of Operations

Net Operating Income

Management internally evaluates the operating performance and financial results of our stabilized portfolio based on Net Operating Income. We define “Net Operating Income” as consolidated operating revenues (rental income, tenant reimbursements and other property income) less consolidated operating expenses (property expenses, real estate taxes, provision for bad debts and ground leases).

Net Operating Income is considered by management to be an important and appropriate supplemental performance measure to net income because we believe it helps both investors and management to understand the core operations of our properties excluding corporate and financing-related costs and non-cash depreciation and amortization. Net Operating Income is an unlevered operating performance metric of our properties and allows for a useful comparison of the operating performance of individual assets or groups of assets. This measure thereby provides an operating perspective not immediately apparent from GAAP income from operations or net income. In addition, Net Operating Income is considered by many in the real estate industry to be a useful starting point for determining the value of a real estate asset or group of assets. Other real estate companies may use different methodologies for calculating Net Operating Income, and accordingly, our presentation of Net Operating Income may not be comparable to other real estate companies. Because of the exclusion of the items shown in the reconciliation below, Net Operating Income should only be used as a supplemental measure of our financial performance and not as an alternative to GAAP income from operations or net income.

Management further evaluates Net Operating Income by evaluating the performance from the following property groups:

Same Store Properties – includes the consolidated results of all of the properties that were owned and included in our stabilized portfolio for two comparable reporting periods, i.e., owned and included in our stabilized portfolio as of January 1, 2017 and still owned and included in the stabilized portfolio as of June 30, 2018, including our residential tower in Hollywood, California;

Stabilized Development Properties – includes the results generated by the one office development project that was added to the stabilized portfolio in the first quarter of 2017;

Acquisition Properties – includes the results, from the dates of acquisition through the periods presented, for the three office buildings we acquired in January 2018; and

Dispositions and Other Properties – includes the results of the ten properties disposed of in the third quarter of 2017, the one property disposed of during the first quarter of 2017 and expenses for certain of our in-process and future development projects.

The following table sets forth certain information regarding the property groups within our stabilized office portfolio as of June 30, 2018:

| Group | # of Buildings | Rentable Square Feet |
|-----------------------------------|----------------|----------------------|
| Same Store Properties | 98 | 13,370,620 |
| Stabilized Development Properties | 3 | 365,359 |
| Acquisition Properties | 3 | 145,530 |
| Total Stabilized Office Portfolio | 104 | 13,881,509 |

Comparison of the Three Months Ended June 30, 2018 to the Three Months Ended June 30, 2017

The following table summarizes our Net Operating Income, as defined, for our total portfolio for the three months ended June 30, 2018 and 2017.

| | Three Months Ended | | Dollar Change | Percentage Change |
|--|--------------------|-----------|------------------|----------------------|
| | June 30, 2018 | 2017 | | |
| Reconciliation of Net Income Available to Common Stockholders to Net Operating Income, as defined: | | | | |
| Net Income Available to Common Stockholders | \$27,549 | \$29,833 | \$(2,284) | (7.7)% |
| Preferred dividends | — | 1,615 | (1,615) | (100.0)% |
| Net income attributable to Kilroy Realty Corporation | \$27,549 | \$31,448 | \$(3,899) | (12.4)% |
| Net income attributable to noncontrolling common units of the Operating Partnership | 566 | 616 | (50) | (8.1)% |
| Net income attributable to noncontrolling interests in consolidated property partnerships | 3,640 | 3,242 | 398 | 12.3% |
| Net income | \$31,755 | \$35,306 | \$(3,551) | (10.1)% |
| Unallocated expense (income): | | | | |
| General and administrative expenses | 21,763 | 14,303 | 7,460 | 52.2% |
| Depreciation and amortization | 64,006 | 62,251 | 1,755 | 2.8% |
| Interest income and other net investment gain/loss | (771) | (1,038) | 267 | (25.7)% |
| Interest expense | 12,712 | 17,973 | (5,261) | (29.3)% |
| Net Operating Income, as defined | \$129,465 | \$128,795 | \$670 | 0.5% |

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The following tables summarize our Net Operating Income, as defined, for our total portfolio for the three months ended June 30, 2018 and 2017.

| | Three Months Ended June 30, 2018 | | | | | 2017 | | | | |
|----------------------------------|----------------------------------|------------------------|------------------------|----------------------|------------|------------|------------------------|------------------------|----------------------|------------|
| | Same Store | Stabilized Development | Acquisition Properties | Dispositions & Other | Total | Same Store | Stabilized Development | Acquisition Properties | Dispositions & Other | Total |
| (in thousands) | | | | | | | | | | |
| Operating revenues: | | | | | | | | | | |
| Rental income | \$ 156,507 | \$ 6,330 | \$ 1,678 | \$ — | \$ 164,515 | \$ 149,891 | \$ 5,084 | \$ — | \$ 3,950 | \$ 158,925 |
| Tenant reimbursements | 19,160 | — | 345 | 62 | 19,567 | 18,717 | — | — | 550 | 19,267 |
| Other property income | 2,987 | — | — | 3 | 2,990 | 1,414 | 1 | — | 991 | 2,406 |
| Total | 178,654 | 6,330 | 2,023 | 65 | 187,072 | 170,022 | 5,085 | — | 5,491 | 180,598 |
| Property and related expenses: | | | | | | | | | | |
| Property expenses | 31,262 | 1,123 | 135 | 47 | 32,567 | 31,193 | 1,093 | — | 1,018 | 33,304 |
| Real estate taxes | 16,523 | 724 | 267 | 299 | 17,813 | 15,246 | 697 | — | 600 | 16,543 |
| Provision for bad debts | 5,641 | — | — | — | 5,641 | 451 | — | — | (42) | 409 |
| Ground leases | 1,586 | — | — | — | 1,586 | 1,547 | — | — | — | 1,547 |
| Total | 55,012 | 1,847 | 402 | 346 | 57,607 | 48,437 | 1,790 | — | 1,576 | 51,803 |
| Net Operating Income, as defined | \$ 123,642 | \$ 4,483 | \$ 1,621 | \$ (281) | \$ 129,465 | \$ 121,585 | \$ 3,295 | \$ — | \$ 3,915 | \$ 128,795 |

Three Months Ended June 30, 2018 as compared to the Three Months Ended June 30, 2017

| | Same Store | | Stabilized Development | | Acquisition Properties | | Dispositions & Other | | Total | |
|--------------------------------|---------------|----------------|------------------------|----------------|------------------------|----------------|----------------------|----------------|---------------|----------------|
| | Dollar Change | Percent Change | Dollar Change | Percent Change | Dollar Change | Percent Change | Dollar Change | Percent Change | Dollar Change | Percent Change |
| (\$ in thousands) | | | | | | | | | | |
| Operating revenues: | | | | | | | | | | |
| Rental income | \$6,616 | 4.4 % | \$1,246 | 24.5 % | \$1,678 | 100.0 % | \$(3,950) | (100.0)% | \$5,590 | 3.5 % |
| Tenant reimbursements | 443 | 2.4 % | — | — % | 345 | 100.0 % | (488) | (88.7)% | 300 | 1.6 % |
| Other property income | 1,573 | 111.2 % | (1) | (100.0)% | — | — % | (988) | (99.7)% | 584 | 24.3 % |
| Total | 8,632 | 5.1 % | 1,245 | 24.5 % | 2,023 | 100.0 % | (5,426) | (98.8)% | 6,474 | 3.6 % |
| Property and related expenses: | | | | | | | | | | |
| Property expenses | 69 | 0.2 % | 30 | 2.7 % | 135 | 100.0 % | (971) | (95.4)% | (737) | (2.2)% |
| Real estate taxes | 1,277 | 8.4 % | 27 | 3.9 % | 267 | 100.0 % | (301) | (50.2)% | 1,270 | 7.7 % |
| Provision for bad debts | 5,190 | 1,150.8% | — | — % | — | — % | 42 | 100.0 % | 5,232 | 1,279.2 % |
| Ground leases | 39 | 2.5 % | — | — % | — | — % | — | — % | 39 | 2.5 % |
| Total | 6,575 | 13.6 % | 57 | 3.2 % | 402 | 100.0 % | (1,230) | (78.0)% | 5,804 | 11.2 % |
| Net Operating Income, | \$2,057 | 1.7 % | \$1,188 | 36.1 % | \$1,621 | 100.0 % | \$(4,196) | (107.2)% | \$670 | 0.5 % |

as defined

Net Operating Income increased \$0.7 million, or 0.5%, for the three months ended June 30, 2018 as compared to the three months ended June 30, 2017 resulting from:

• An increase of \$2.1 million attributable to the Same Store Properties driven by the following activity:

• An increase in rental income of \$6.6 million primarily due to:

\$5.7 million increase from new leases and renewals at higher rates across all regions; and

\$1.1 million increase due to an increase in occupancy primarily at three properties, each in different submarkets;

• An increase in tenant reimbursements of \$0.4 million primarily due to higher supplemental property taxes partially offset by lower occupancy at certain properties;

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• An increase in other property income of \$1.6 million primarily due to early termination fee income from two tenants at two properties in 2018; offset by

• An increase in property and related expenses of \$6.6 million primarily due to the following:

\$5.2 million increase in the provision for bad debts primarily due to a \$7.0 million increase in the provision for one tenant (see further discussion below), partially offset by a \$1.7 million decrease in the provision for bad debts for one property due to the assignment of the lease to a credit tenant;

\$1.3 million increase in real estate taxes primarily due to \$1.0 million of higher supplemental taxes for a fully assessed development property completed in 2016, \$0.5 million from regular annual property tax increases, partially offset by \$0.2 million of supplemental adjustments, net of tax refunds received in 2017;

• An increase in Net Operating Income of \$1.2 million attributable to the Stabilized Development Properties;

• An increase in Net Operating Income of \$1.6 million attributable to the Acquisition Properties; and

• A decrease in Net Operating Income of \$4.2 million attributable to the Dispositions and Other Properties.

As noted above, during the three months ended June 30, 2018, we recorded a \$5.6 million provision for bad debts primarily due to a \$7.0 million increase in the provision for bad debts related to one tenant described below. We are currently in discussions with this tenant regarding its ability to meet its obligations under its lease and other obligations payable to us. As of June 30, 2018, our lease with this tenant represented approximately 1% of our total annualized base rental revenues. As of June 30, 2018, the range of possible loss related to this tenant was \$0 to \$13.9 million. Based on the status of our discussions with this tenant and consistent with our approach to monitoring the appropriateness of allowances with respect to tenants on our internal watch list, we have determined \$7.0 million to be the appropriate loss estimate to record for the three months ended June 30, 2018 and increased our allowances for uncollectible amounts with respect to this tenant from \$1.4 million to \$8.4 million as of June 30, 2018.

We cannot provide any assurance that we will resolve our discussions with the tenant described above on terms that are favorable to us, as to the timing of any such resolution or as to whether any of this tenant's lease or other obligations payable to us will be reduced or, possibly, extinguished as a result of those discussions. Moreover, we cannot provide any assurance that the resolution of our discussions with this tenant or our evaluation of other factors (including future increases in current tenant receivables and deferred rent receivables) will not result in us recording a further incremental provision for bad debts with respect to this tenant in the future.

Other Expenses and Income

General and Administrative Expenses

General and administrative expenses increased by approximately \$7.5 million, or 52.2%, for the three months ended June 30, 2018 compared to the three months ended June 30, 2017 primarily due to an increase in professional services fees and higher stock compensation amortization.

Depreciation and Amortization

Depreciation and amortization increased by approximately \$1.8 million, or 2.8%, for the three months ended June 30, 2018 compared to the three months ended June 30, 2017 primarily due to the following:

- An increase of \$2.1 million attributable to the Same Store Properties;
- An increase of \$0.3 million attributable to the Stabilized Development Properties;
- An increase of \$1.3 million attributable to the Acquisition Properties; partially offset by
- A decrease of \$1.9 million attributable to Dispositions & Other Properties.

Interest Expense

The following table sets forth our gross interest expense, including debt discounts/premiums and deferred financing cost amortization, and capitalized interest, including capitalized debt discounts/premiums and deferred financing cost amortization for the three months ended June 30, 2018 and 2017:

| | Three Months Ended June 30, | | Dollar Change | Percentage Change |
|---|--------------------------------|-----------|------------------|----------------------|
| | 2018 | 2017 | | |
| | (in thousands) | | | |
| Gross interest expense | \$28,523 | \$28,731 | \$(208) | (0.7)% |
| Capitalized interest and deferred financing costs | (15,811) | (10,758) | (5,053) | 47.0 % |
| Interest expense | \$12,712 | \$17,973 | \$(5,261) | (29.3)% |

Gross interest expense, before the effect of capitalized interest and deferred financing costs, decreased \$0.2 million, or 0.7%, for the three months ended June 30, 2018 as compared to the three months ended June 30, 2017 due to a decrease in our weighted average interest rate, partially offset by an increase in our average debt balances. Our weighted average interest rate, including loan fee amortization, was 4.2% and 4.4% for the three months ended June 30, 2018 and 2017, respectively.

Capitalized interest and deferred financing costs increased \$5.1 million, or 47.0%, for the three months ended June 30, 2018 compared to the three months ended June 30, 2017 primarily due to an increase in the average development asset balances qualifying for interest capitalization during the three months ended June 30, 2018. During the three months ended June 30, 2018 and 2017, we capitalized interest on in-process development projects and future development pipeline projects with an average aggregate cost basis of approximately \$1.5 billion and \$1.0 billion, respectively.

Net Income Attributable to Noncontrolling Interests in Consolidated Property Partnerships

Net income attributable to noncontrolling interests in consolidated property partnerships increased \$0.4 million or 12.3% for the three months ended June 30, 2018 compared to the three months ended June 30, 2017 primarily due to the inclusion of interest expense in 2017 for a mortgage note secured by one of the properties held by the property partnerships that was repaid in the fourth quarter of 2017. The amounts reported for the three months ended June 30, 2018 and 2017 are comprised of the noncontrolling interests' share of net income for 100 First Street Member, LLC ("100 First LLC"), 303 Second Street Member ("303 Second LLC") and Redwood City Partners, LLC ("Redwood LLC").

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Comparison of the Six Months Ended June 30, 2018 to the Six Months Ended June 30, 2017

The following table summarizes our Net Operating Income, as defined, for our total portfolio for the six months ended June 30, 2018 and 2017.

| | Six Months Ended June 30, | | Dollar Change | Percentage Change | |
|--|------------------------------|-----------|------------------|----------------------|---|
| | 2018 | 2017 | | | |
| (\$ in thousands) | | | | | |
| Reconciliation of Net Income Available to Common Stockholders to Net Operating Income, as defined: | | | | | |
| Net Income Available to Common Stockholders | \$63,795 | \$56,162 | \$7,633 | 13.6 | % |
| Preferred dividends | — | 4,966 | (4,966) | (100.0) | % |
| Original issuance costs of redeemed preferred stock and preferred units | — | 3,845 | (3,845) | (100.0) | % |
| Net income attributable to Kilroy Realty Corporation | \$63,795 | \$64,973 | \$(1,178) | (1.8) | % |
| Net income attributable to noncontrolling common units of the Operating Partnership | 1,317 | 1,239 | 78 | 6.3 | % |
| Net income attributable to noncontrolling interests in consolidated property partnerships | 7,614 | 6,375 | 1,239 | 19.4 | % |
| Net income | \$72,726 | \$72,587 | \$139 | 0.2 | % |
| Unallocated expense (income): | | | | | |
| General and administrative expenses | 37,322 | 29,236 | 8,086 | 27.7 | % |
| Acquisition-related expenses | — | — | — | — | % |
| Depreciation and amortization | 126,721 | 123,170 | 3,551 | 2.9 | % |
| Interest income and other net investment gains | (805) | (2,103) | 1,298 | (61.7) | % |
| Interest expense | 26,210 | 35,325 | (9,115) | (25.8) | % |
| Net (gain) loss on sale of land | — | (2,257) | 2,257 | (100.0) | % |
| Net Operating Income, as defined | \$262,174 | \$255,958 | \$6,216 | 2.4 | % |

The following tables summarize our Net Operating Income, as defined, for our total portfolio for the six months ended June 30, 2018 and 2017.

| | Six Months Ended June 30, 2018 | | | | | 2017 | | | | |
|--------------------------------|-----------------------------------|--------------------------------|--------------------------------|-----------------------------|-----------|---------------|--------------------------------|--------------------------------|-----------------------------|-----------|
| | Same Store | Stabilized Develop- ment | Acquisi- tion Properties | Disposi- tion & Other | Total | Same Store | Stabilized Develop- ment | Acquisi- tion Properties | Disposi- tion & Other | Total |
| (in thousands) | | | | | | | | | | |
| Operating revenues: | | | | | | | | | | |
| Rental income | \$311,862 | \$12,688 | \$2,836 | \$— | \$327,386 | \$297,796 | \$9,901 | \$— | \$7,876 | \$315,573 |
| Tenant reimbursements | 38,129 | 81 | 584 | (77) | 38,717 | 37,582 | — | — | 981 | 38,563 |
| Other property income | 3,788 | — | — | 3 | 3,791 | 4,697 | 8 | — | 1,065 | 5,770 |
| Total | 353,779 | 12,769 | 3,420 | (74) | 369,894 | 340,075 | 9,909 | — | 9,922 | 359,906 |
| Property and related expenses: | | | | | | | | | | |
| Property expenses | 61,612 | 2,298 | 251 | 77 | 64,238 | 60,855 | 1,865 | — | 1,825 | 64,545 |
| Real estate taxes | 32,594 | 1,453 | 443 | 469 | 34,959 | 31,936 | 1,395 | — | 1,176 | 34,507 |
| | 5,351 | — | — | 25 | 5,376 | 1,631 | — | — | 76 | 1,707 |

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| | | | | | | | | | | |
|----------------------------------|-----------|----------|----------|-----------|-----------|-----------|----------|----|-----------|-----------|
| Provision for bad debts | | | | | | | | | | |
| Ground leases | 3,147 | — | — | — | 3,147 | 3,189 | — | — | — | 3,189 |
| Total | 102,704 | 3,751 | 694 | 571 | 107,720 | 97,611 | 3,260 | — | 3,077 | 103,948 |
| Net Operating Income, as defined | \$251,075 | \$ 9,018 | \$ 2,726 | \$ (645) | \$262,174 | \$242,464 | \$ 6,649 | \$ | —\$ 6,845 | \$255,958 |

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Six Months Ended June 30, 2018 as compared to the Six Months Ended June 30, 2017

| | Same Store | | Stabilized Development | | Acquisition Properties | | Dispositions & Other | | Total | |
|--------------------------------|---------------|----------------|------------------------|----------------|------------------------|----------------|----------------------|----------------|---------------|----------------|
| | Dollar Change | Percent Change | Dollar Change | Percent Change | Dollar Change | Percent Change | Dollar Change | Percent Change | Dollar Change | Percent Change |
| (\$ in thousands) | | | | | | | | | | |
| Operating revenues: | | | | | | | | | | |
| Rental income | \$14,066 | 4.7 % | \$2,787 | 28.1 % | \$2,836 | 100.0 % | \$(7,876) | (100.0)% | \$11,813 | 3.7 % |
| Tenant reimbursements | 547 | 1.5 % | 81 | 100.0 % | 584 | 100.0 % | (1,058) | (107.8)% | 154 | 0.4 % |
| Other property income | (909) | (19.4)% | (8) | (100.0)% | — | 100.0 % | (1,062) | (99.7)% | (1,979) | (34.3)% |
| Total | 13,704 | 4.0 % | 2,860 | 28.9 % | 3,420 | 100.0 % | (9,996) | (100.7)% | 9,988 | 2.8 % |
| Property and related expenses: | | | | | | | | | | |
| Property expenses | | | | | | | | | | |