

KILROY REALTY CORP
Form 10-Q
July 27, 2011

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**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, 2011

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
(State or other jurisdiction of
incorporation or organization)**

**95-4598246
(I.R.S. Employer
Identification No.)**

Kilroy Realty, L.P.

**Delaware
(State or other jurisdiction of
incorporation or organization)**

**95-4612685
(I.R.S. Employer
Identification No.)**

12200 W. Olympic Boulevard, Suite 200, Los Angeles, California 90064

(Address of principal executive offices) (Zip Code)

(310) 481-8400

(Registrant's telephone number, including area code)

N/A

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Kilroy Realty Corporation Yes 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, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Kilroy Realty Corporation

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

Kilroy Realty, L.P.

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

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

Kilroy Realty Corporation Yes No

Kilroy Realty, L.P. Yes No

As of July 25, 2011, 58,464,412 shares of Kilroy Realty Corporation common stock, par value \$.01 per share, were outstanding.

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EXPLANATORY NOTE

This report combines the quarterly reports on Form 10-Q for the period ended June 30, 2011 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 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 terms the Company, we, our, and us refer to the Company or the Company and the Operating Partnership together, as the context requires.

The Company is a real estate investment trust, or REIT, and the general partner of the Operating Partnership. As of June 30, 2011, the Company owned an approximate 97.1% common general partnership interest in the Operating Partnership. The remaining approximate 2.9% 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 which are reflected in the disclosures in this Form 10-Q. We believe it is important to understand the differences between the Company and the Operating Partnership in the context of how the Company and the Operating Partnership operate as an interrelated, consolidated company. The Company is a REIT, whose only material asset is its ownership of partnership interests of the Operating Partnership. As a result, the Company does not conduct business itself, other than acting as the sole general partner of the Operating Partnership, issuing equity from time to time and guaranteeing certain debt of the Operating Partnership. The Company itself is not directly obligated under any indebtedness, but guarantees some of the debt of the Operating Partnership. The Operating Partnership owns substantially all of the assets of the Company either directly or through its subsidiaries, conducts the operations of the Company's business and is structured as a limited partnership with no publicly traded equity. Except for net proceeds from equity issuances by the Company, which the Company is required to contribute to the Operating Partnership in exchange for partnership units, the Operating Partnership generates the capital required by the Company's business through the Operating Partnership's operations, by the Operating Partnership's incurrence of indebtedness or through the issuance of partnership units.

Noncontrolling interests and stockholders' equity and partners' capital are the main areas of difference between the consolidated financial statements of the Company and those of the Operating Partnership. The common limited partnership interests in the Operating Partnership are accounted for as partners' capital in the Operating Partnership's financial statements and as noncontrolling interests in the Company's financial statements. The Operating Partnership's financial statements reflect the noncontrolling interest in Kilroy Realty Finance Partnership, L.P. This noncontrolling interest represents the Company's 1% indirect general partnership interest in Kilroy Realty Finance Partnership, L.P., which is directly held by Kilroy Realty Finance, Inc., a wholly-owned subsidiary of the Company. The differences between stockholders' equity, partners' capital and noncontrolling interests result from the differences in the equity issued at the Company and the Operating Partnership levels and in the Company's noncontrolling interest in Kilroy Realty Finance Partnership, L.P.

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

Combined reports better reflect how management and the analyst community view the business as a single operating unit;

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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

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Combined reports are more efficient for investors by reducing duplicative disclosure and providing a single document for their review.

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

consolidated financial statements;

the following notes to the consolidated financial statements:

Note 5, Secured and Unsecured Debt of the Operating Partnership;

Note 6, Noncontrolling Interests on the Company's Consolidated Financial Statements;

Note 7, Stockholders' Equity of the Company;

Note 8, Partners' Capital of the Operating Partnership;

Note 14, Net (Loss) Income Available to Common Stockholders per Share of the Company;

Note 15, Net (Loss) Income Available to Common Unitholders per Unit of the Operating Partnership;

Note 17, Pro Forma Results of the Company; and

Note 18, Pro Forma Results of the Operating Partnership.

This report also includes separate sections under Part I, Item 4. Controls and Procedures and separate Exhibit 31 and Exhibit 32 certifications for each of the Company and the Operating Partnership to establish that the Chief Executive Officer and the Chief Financial Officer of each entity have made the requisite certifications and that the Company and Operating Partnership are compliant with Rule 13a-15 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, 2011

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Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS OF KILROY REALTY CORPORATION****KILROY REALTY CORPORATION****CONSOLIDATED BALANCE SHEETS****(in thousands, except share data)**

	June 30, 2011 (unaudited)	December 31, 2010
<u>ASSETS</u>		
REAL ESTATE ASSETS:		
Land and improvements (Note 2)	\$ 528,082	\$ 491,333
Buildings and improvements (Note 2)	2,820,766	2,435,173
Undeveloped land and construction in progress	303,998	290,365
Total real estate held for investment	3,652,846	3,216,871
Accumulated depreciation and amortization	(720,864)	(672,429)
Total real estate assets, net	2,931,982	2,544,442
CASH AND CASH EQUIVALENTS	25,412	14,840
RESTRICTED CASH	1,349	1,461
MARKETABLE SECURITIES (Note 12)	5,654	4,902
CURRENT RECEIVABLES, NET (Note 4)	4,732	6,258
DEFERRED RENT RECEIVABLES, NET (Note 4)	97,958	89,052
DEFERRED LEASING COSTS AND ACQUISITION-RELATED INTANGIBLE ASSETS, NET (Notes 2 and 3)	153,231	131,066
DEFERRED FINANCING COSTS, NET (Note 5)	18,910	16,447
PREPAID EXPENSES AND OTHER ASSETS, NET	25,559	8,097
TOTAL ASSETS	\$ 3,264,787	\$ 2,816,565
<u>LIABILITIES, NONCONTROLLING INTEREST AND EQUITY</u>		
LIABILITIES:		
Secured debt, net (Notes 5 and 12)	\$ 475,820	\$ 313,009
Exchangeable senior notes, net (Notes 5 and 12)	303,374	299,964
Unsecured senior notes, net (Notes 5 and 12)	655,929	655,803
Unsecured line of credit (Notes 5 and 12)	245,000	159,000
Accounts payable, accrued expenses and other liabilities	66,664	68,525
Accrued distributions (Note 16)	22,563	20,385
Deferred revenue and acquisition-related intangible liabilities, net (Note 3)	90,149	79,322
Rents received in advance and tenant security deposits	28,117	29,189
Total liabilities	1,887,616	1,625,197

COMMITMENTS AND CONTINGENCIES (Note 11)

NONCONTROLLING INTEREST (Note 6):

7.45% Series A Cumulative Redeemable Preferred units of the Operating Partnership	73,638	73,638
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EQUITY:

Stockholders' Equity (Note 7):

Preferred stock, \$.01 par value, 30,000,000 shares authorized:

7.45% Series A Cumulative Redeemable Preferred stock, \$.01 par value, 1,500,000 shares authorized, none issued and outstanding		
7.80% Series E Cumulative Redeemable Preferred stock, \$.01 par value, 1,610,000 shares authorized, issued and outstanding (\$40,250 liquidation preference)	38,425	38,425
7.50% Series F Cumulative Redeemable Preferred stock, \$.01 par value, 3,450,000 shares authorized, issued and outstanding (\$86,250 liquidation preference)	83,157	83,157
Common stock, \$.01 par value, 150,000,000 shares authorized, 58,464,412 and 52,349,670 shares issued and outstanding, respectively	585	523
Additional paid-in capital	1,433,951	1,211,498
Distributions in excess of earnings	(285,916)	(247,252)
Total stockholders' equity	1,270,202	1,086,351
Noncontrolling interest:		
Common units of the Operating Partnership (Note 6)	33,331	31,379
Total equity	1,303,533	1,117,730
TOTAL LIABILITIES, NONCONTROLLING INTEREST AND EQUITY	\$ 3,264,787	\$ 2,816,565

See accompanying notes to consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended	
	2011	2010	June 30,	2010
			2011	2010
REVENUES:				
Rental income	\$ 83,452	\$ 65,038	\$ 163,742	\$ 125,694
Tenant reimbursements	7,510	6,483	13,932	12,201
Other property income	1,102	895	2,515	1,340
Total revenues	92,064	72,416	180,189	139,235
EXPENSES:				
Property expenses	17,583	14,543	35,272	26,563
Real estate taxes	8,413	6,482	16,582	12,518
Provision for bad debts	120	(12)	146	14
Ground leases (Note 11)	424	370	763	312
General and administrative expenses	7,440	6,728	14,000	13,823
Acquisition-related expenses	1,194	957	1,666	1,270
Depreciation and amortization	32,248	23,722	61,559	44,660
Total expenses	67,422	52,790	129,988	99,160
OTHER (EXPENSES) INCOME:				
Interest income and other net investment gains (losses) (Note 12)	58	(18)	242	366
Interest expense (Note 5)	(21,228)	(13,088)	(42,104)	(25,044)
Loss on early extinguishment of debt		(4,564)		(4,564)
Total other (expenses) income	(21,170)	(17,670)	(41,862)	(29,242)
NET INCOME	3,472	1,956	8,339	10,833
Net loss (income) attributable to noncontrolling common units of the Operating Partnership	10	60	(24)	(132)
NET INCOME ATTRIBUTABLE TO KILROY REALTY CORPORATION	3,482	2,016	8,315	10,701
PREFERRED DISTRIBUTIONS AND DIVIDENDS:				
Distributions to noncontrolling cumulative redeemable preferred units of the Operating Partnership	(1,397)	(1,397)	(2,794)	(2,794)
Preferred dividends	(2,402)	(2,402)	(4,804)	(4,804)
Total preferred distributions and dividends	(3,799)	(3,799)	(7,598)	(7,598)

NET (LOSS) INCOME AVAILABLE TO COMMON STOCKHOLDERS	\$	(317)	\$	(1,783)	\$	717	\$	3,103
Net (loss) income available to common stockholders per share-basic (Note 14)	\$	(0.01)	\$	(0.04)	\$	0.00	\$	0.05
Net (loss) income available to common stockholders per share-diluted (Note 14)	\$	(0.01)	\$	(0.04)	\$	0.00	\$	0.05
Weighted average common shares outstanding-basic (Note 14)		57,685,710		50,296,643		55,008,765		46,674,494
Weighted average common shares outstanding-diluted (Note 14)		57,685,710		50,296,643		55,384,729		46,677,850
Dividends declared per common share	\$	0.35	\$	0.35	\$	0.70	\$	0.70

See accompanying notes to consolidated financial statements.

Table of Contents**KILROY REALTY CORPORATION****CONSOLIDATED STATEMENTS OF EQUITY**
(unaudited, in thousands, except share and per share data)

			Common Stock			Total	Noncontrol- ling Interests Common Units of the	
	Preferred Stock	Number of Shares	Common Stock	Additional Paid-in Capital	Distributions in Excess of Earnings	Stock- holders Equity	Operating Partnership	Total Equity
BALANCE AS OF DECEMBER 31, 2009	\$ 121,582	43,148,762	\$ 431	\$ 913,657	\$ (180,722)	\$ 854,948	\$ 28,890	\$ 883,838
Net income					10,701	10,701	132	10,833
Issuance of common stock		9,200,000	92	299,755		299,847		299,847
Issuance of share-based compensation awards		3,239		1,660		1,660		1,660
Noncash amortization of share-based compensation				3,361		3,361		3,361
Exercise of stock options		4,000		83		83		83
Repurchase of common stock and restricted stock units		(59,782)		(2,121)		(2,121)		(2,121)
Allocation to the equity component of cash paid upon repurchase of 3.25%								
Exchangeable Notes				(2,694)		(2,694)		(2,694)
Adjustment for noncontrolling interest				(4,985)		(4,985)	4,985	
					(7,598)	(7,598)		(7,598)

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Preferred distributions and dividends								
Dividends declared per common share and common unit (\$0.70 per share/ unit)					(33,936)	(33,936)	(1,207)	(35,143)
BALANCE AS OF JUNE 30, 2010	\$ 121,582	52,296,219	\$ 523	\$ 1,208,716	\$ (211,555)	\$ 1,119,266	\$ 32,800	\$ 1,152,066
				Common Stock		Total	Noncontrol-ling Interests Common Units of the	
				Additional	Distributions in Excess of Earnings	Stock-holders Equity	Operating Partnership	Total Equity
	Preferred Stock	Number of Shares	Common Stock	Paid-in Capital				
BALANCE AS OF DECEMBER 31, 2010	\$ 121,582	52,349,670	\$ 523	\$ 1,211,498	\$ (247,252)	\$ 1,086,351	\$ 31,379	\$ 1,117,730
Net income					8,315	8,315	24	8,339
Issuance of common stock (Note 7)		6,037,500	61	220,954		221,015		221,015
Issuance of share-based compensation awards (Note 9)		68,727	1	2,155		2,156		2,156
Noncash amortization of share-based compensation				2,813		2,813		2,813
Exercise of stock options		15,000		395		395		395
Repurchase of common stock and restricted stock units (Note 9)		(11,485)		(732)		(732)		(732)
Exchange of common units of the		5,000		91		91	(91)	

Operating Partnership Adjustment for noncontrolling interest				(3,223)		(3,223)	3,223	
Preferred distributions and dividends				(7,598)		(7,598)		(7,598)
Dividends declared per common share and common unit (\$0.70 per share/ unit)				(39,381)		(39,381)	(1,204)	(40,585)
BALANCE AS OF JUNE 30, 2011								
	\$ 121,582	58,464,412	\$ 585	\$ 1,433,951	\$ (285,916)	\$ 1,270,202	\$ 33,331	\$ 1,303,533

See accompanying notes to consolidated financial statements.

Table of Contents**KILROY REALTY CORPORATION****CONSOLIDATED STATEMENTS OF CASH FLOWS****(unaudited, in thousands)**

	Six Months Ended June 30,	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 8,339	\$ 10,833
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of building and improvements and leasing costs	61,029	44,229
Increase in provision for bad debts	146	14
Depreciation of furniture, fixtures and equipment	530	431
Noncash amortization of share-based compensation awards	2,239	3,519
Noncash amortization of deferred financing costs and debt discounts and premiums	6,884	5,750
Noncash amortization of above/(below) market rents (Note 3)	1,398	32
Loss on early extinguishment of debt		4,564
Noncash amortization of deferred revenue related to tenant-funded tenant improvements	(4,668)	(4,775)
Changes in operating assets and liabilities:		
Marketable securities	(752)	(635)
Current receivables	1,380	483
Deferred rent receivables	(8,906)	(5,421)
Other deferred leasing costs	398	(2,594)
Prepaid expenses and other assets	(3,519)	(2,991)
Accounts payable, accrued expenses and other liabilities	(6,384)	(4,177)
Deferred revenue	(577)	507
Rents received in advance and tenant security deposits	(1,072)	7,619
Net cash provided by operating activities	56,465	57,388
CASH FLOWS FROM INVESTING ACTIVITIES:		
Expenditures for acquisition of operating properties (Note 2)	(378,554)	(373,574)
Expenditures for operating properties	(28,230)	(33,593)
Expenditures for development and redevelopment properties and undeveloped land	(12,347)	(8,113)
Net increase in escrow deposits	(16,500)	
Decrease in restricted cash	112	1,096
Receipt of principal payments on note receivable		76
Net cash used in investing activities	(435,519)	(414,108)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from issuance of common stock (Note 7)	221,015	299,847
Borrowings on unsecured line of credit	302,000	288,000
Repayments on unsecured line of credit	(216,000)	(235,000)
Principal payments on secured debt	(3,403)	(100,104)

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Repurchase of exchangeable senior notes		(151,097)
Proceeds from issuance of secured debt (Note 5)	135,000	71,000
Proceeds from issuance of unsecured debt		247,870
Financing costs	(5,201)	(4,643)
Decrease in loan deposits	2,027	1,420
Repurchase of common stock and restricted stock units	(732)	(2,121)
Proceeds from exercise of stock options	395	83
Dividends and distributions paid to common stockholders and common unitholders	(37,877)	(31,392)
Dividends and distributions paid to preferred stockholders and preferred unitholders	(7,598)	(7,598)
Net cash provided by financing activities	389,626	376,265
Net increase in cash and cash equivalents	10,572	19,545
Cash and cash equivalents, beginning of period	14,840	9,883
Cash and cash equivalents, end of period	\$ 25,412	\$ 29,428
SUPPLEMENTAL CASH FLOWS INFORMATION:		
Cash paid for interest, net of capitalized interest of \$3,327 and \$4,055 as of June 30, 2011 and 2010, respectively	\$ 34,568	\$ 18,634
NONCASH INVESTING TRANSACTIONS:		
Accrual for expenditures for operating properties and development and redevelopment properties	\$ 9,966	\$ 11,378
Tenant improvements funded directly by tenants to third parties	\$ 3,027	\$ 1,946
Assumption of secured debt with property acquisition (Notes 2 and 5)	\$ 30,042	\$ 51,079
Assumption of other liabilities with property acquisitions (Note 2)	\$ 4,438	\$ 6,369
NONCASH FINANCING TRANSACTIONS:		
Accrual of dividends and distributions payable to common stockholders and common unitholders	\$ 21,064	\$ 18,907
Accrual of dividends and distributions payable to preferred stockholders and preferred unitholders	\$ 1,909	\$ 1,909
Issuance of share-based compensation awards (Note 9)	\$ 7,216	\$ 5,418
Exchange of common units of the Operating Partnership into shares of the Company's common stock	\$ 91	\$

See accompanying notes to consolidated financial statements.

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(in thousands, except unit data)**

	June 30, 2011 (unaudited)	December 31, 2010
<u>ASSETS</u>		
REAL ESTATE ASSETS:		
Land and improvements (Note 2)	\$ 528,082	\$ 491,333
Buildings and improvements (Note 2)	2,820,766	2,435,173
Undeveloped land and construction in progress	303,998	290,365
Total real estate held for investment	3,652,846	3,216,871
Accumulated depreciation and amortization	(720,864)	(672,429)
Total real estate assets, net	2,931,982	2,544,442
CASH AND CASH EQUIVALENTS	25,412	14,840
RESTRICTED CASH	1,349	1,461
MARKETABLE SECURITIES (Note 12)	5,654	4,902
CURRENT RECEIVABLES, NET (Note 4)	4,732	6,258
DEFERRED RENT RECEIVABLES, NET (Note 4)	97,958	89,052
DEFERRED LEASING COSTS AND ACQUISITION-RELATED INTANGIBLE ASSETS, NET (Notes 2 and 3)	153,231	131,066
DEFERRED FINANCING COSTS, NET (Note 5)	18,910	16,447
PREPAID EXPENSES AND OTHER ASSETS, NET	25,559	8,097
TOTAL ASSETS	\$ 3,264,787	\$ 2,816,565
<u>LIABILITIES, NONCONTROLLING INTEREST AND CAPITAL</u>		
LIABILITIES:		
Secured debt, net (Notes 5 and 12)	\$ 475,820	\$ 313,009
Exchangeable senior notes, net (Notes 5 and 12)	303,374	299,964
Unsecured senior notes, net (Notes 5 and 12)	655,929	655,803
Unsecured line of credit (Notes 5 and 12)	245,000	159,000
Accounts payable, accrued expenses and other liabilities	66,664	68,525
Accrued distributions (Note 16)	22,563	20,385
Deferred revenue and acquisition-related intangible liabilities, net (Note 3)	90,149	79,322
Rents received in advance and tenant security deposits	28,117	29,189
Total liabilities	1,887,616	1,625,197

COMMITMENTS AND CONTINGENCIES (Note 11)

7.45% SERIES A CUMULATIVE REDEEMABLE PREFERRED UNITS	73,638	73,638
CAPITAL:		
Partners' Capital (Note 8):		
7.80% Series E Cumulative Redeemable Preferred units, 1,610,000 units issued and outstanding (\$40,250 liquidation preference)	38,425	38,425
7.50% Series F Cumulative Redeemable Preferred units, 3,450,000 units issued and outstanding (\$86,250 liquidation preference)	83,157	83,157
Common units, 58,464,412 and 52,349,670 held by the general partner and 1,718,131 and 1,723,131 held by common limited partners issued and outstanding, respectively	1,180,249	994,511
Total partners' capital	1,301,831	1,116,093
Noncontrolling interest in consolidated subsidiaries	1,702	1,637
Total capital	1,303,533	1,117,730
TOTAL LIABILITIES, NONCONTROLLING INTEREST AND CAPITAL	\$ 3,264,787	\$ 2,816,565

See accompanying notes to consolidated financial statements.

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

	Three Months Ended		Six Months Ended June 30,	
	June 30,		2011	2010
	2011	2010	2011	2010
REVENUES:				
Rental income	\$ 83,452	65,038	\$ 163,742	\$ 125,694
Tenant reimbursements	7,510	6,483	13,932	12,201
Other property income	1,102	895	2,515	1,340
Total revenues	92,064	72,416	180,189	139,235
EXPENSES:				
Property expenses	17,583	14,543	35,272	26,563
Real estate taxes	8,413	6,482	16,582	12,518
Provision for bad debts	120	(12)	146	14
Ground leases (Note 11)	424	370	763	312
General and administrative expenses	7,440	6,728	14,000	13,823
Acquisition-related expenses	1,194	957	1,666	1,270
Depreciation and amortization	32,248	23,722	61,559	44,660
Total expenses	67,422	52,790	129,988	99,160
OTHER (EXPENSES) INCOME:				
Interest income and other net investment gains (losses) (Note 12)	58	(18)	242	366
Interest expense (Note 5)	(21,228)	(13,088)	(42,104)	(25,044)
Loss on early extinguishment of debt		(4,564)		(4,564)
Total other (expenses) income	(21,170)	(17,670)	(41,862)	(29,242)
NET INCOME	3,472	1,956	8,339	10,833
Net income attributable to noncontrolling interests in consolidated subsidiaries	(32)	(51)	(65)	(96)
NET INCOME ATTRIBUTABLE TO KILROY REALTY, L.P.	3,440	1,905	8,274	10,737
PREFERRED DISTRIBUTIONS	(3,799)	(3,799)	(7,598)	(7,598)
NET (LOSS) INCOME AVAILABLE TO COMMON UNITHOLDERS	\$ (359)	\$ (1,894)	\$ 676	\$ 3,139

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Net (loss) income available to common unitholders per unit-basic (Note 15)	\$	(0.01)	\$	(0.04)	\$	0.00	\$	0.05
Net (loss) income available to common unitholders per unit-diluted (Note 15)	\$	(0.01)	\$	(0.04)	\$	0.00	\$	0.05
Weighted average common units outstanding-basic (Note 15)		59,407,687		52,019,774		56,731,316		48,397,625
Weighted average common units outstanding-diluted (Note 15)		59,407,687		52,019,774		57,107,280		48,400,981
Distributions declared per common unit	\$	0.35	\$	0.35	\$	0.70	\$	0.70

See accompanying notes to consolidated financial statements.

Issuance of common units (Note 8)						
Issuance of share-based compensation awards (Note 9)	68,727	2,156	2,156	2,156		2,156
Noncash amortization of share-based compensation		2,813	2,813	2,813		2,813
Exercise of stock options	15,000	395	395	395		395
Repurchase of common units and restricted stock units (Note 9)	(11,485)	(732)	(732)	(732)		(732)
Preferred distributions		(7,598)	(7,598)	(7,598)		(7,598)
Distributions declared per common unit (\$0.70 per unit)		(40,585)	(40,585)	(40,585)		(40,585)
BALANCE AS OF JUNE 30, 2011	\$ 121,582	60,182,543	\$ 1,180,249	\$ 1,301,831	\$ 1,702	\$ 1,303,533

See accompanying notes to consolidated financial statements.

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

	Six Months Ended	
	June 30,	
	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 8,339	\$ 10,833
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of building and improvements and leasing costs	61,029	44,229
Increase in provision for bad debts	146	14
Depreciation of furniture, fixtures and equipment	530	431
Noncash amortization of share-based compensation awards	2,239	3,519
Noncash amortization of deferred financing costs and debt discounts and premiums	6,884	5,750
Noncash amortization of above/(below) market rents (Note 3)	1,398	32
Loss on early extinguishment of debt		4,564
Noncash amortization of deferred revenue related to tenant-funded tenant improvements	(4,668)	(4,775)
Changes in operating assets and liabilities:		
Marketable securities	(752)	(635)
Current receivables	1,380	483
Deferred rent receivables	(8,906)	(5,421)
Other deferred leasing costs	398	(2,594)
Prepaid expenses and other assets	(3,519)	(2,991)
Accounts payable, accrued expenses and other liabilities	(6,384)	(4,177)
Deferred revenue	(577)	507
Rents received in advance and tenant security deposits	(1,072)	7,619
Net cash provided by operating activities	56,465	57,388
CASH FLOWS FROM INVESTING ACTIVITIES:		
Expenditures for acquisition of operating properties (Note 2)	(378,554)	(373,574)
Expenditures for operating properties	(28,230)	(33,593)
Expenditures for development and redevelopment properties and undeveloped land	(12,347)	(8,113)
Net increase in escrow deposits	(16,500)	
Decrease in restricted cash	112	1,096
Receipt of principal payments on note receivable		76
Net cash used in investing activities	(435,519)	(414,108)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from issuance of common units (Note 8)	221,015	299,847
Borrowings on unsecured line of credit	302,000	288,000
Repayments on unsecured line of credit	(216,000)	(235,000)
Principal payments on secured debt	(3,403)	(100,104)

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Repurchase of exchangeable senior notes		(151,097)
Proceeds from issuance of secured debt (Note 5)	135,000	71,000
Proceeds from issuance of unsecured debt		247,870
Financing costs	(5,201)	(4,643)
Decrease in loan deposits	2,027	1,420
Repurchase of common units and restricted stock units	(732)	(2,121)
Proceeds from exercise of stock options	395	83
Distributions paid to common unitholders	(37,877)	(31,392)
Distributions paid to preferred unitholders	(7,598)	(7,598)
Net cash provided by financing activities	389,626	376,265
Net increase in cash and cash equivalents	10,572	19,545
Cash and cash equivalents, beginning of period	14,840	9,883
Cash and cash equivalents, end of period	\$ 25,412	\$ 29,428
SUPPLEMENTAL CASH FLOWS INFORMATION:		
Cash paid for interest, net of capitalized interest of \$3,327 and \$4,055 as of June 30, 2011 and 2010, respectively	\$ 34,568	\$ 18,634
NONCASH INVESTING TRANSACTIONS:		
Accrual for expenditures for operating properties and development and redevelopment properties	\$ 9,966	\$ 11,378
Tenant improvements funded directly by tenants to third parties	\$ 3,027	\$ 1,946
Assumption of secured debt with property acquisitions (Notes 2 and 5)	\$ 30,042	\$ 51,079
Assumption of other liabilities with property acquisitions (Note 2)	\$ 4,438	\$ 6,369
NONCASH FINANCING TRANSACTIONS:		
Accrual of distributions payable to common unitholders	\$ 21,064	18,907
Accrual of distributions payable to preferred unitholders	\$ 1,909	\$ 1,909
Issuance of share-based compensation awards (Note 9)	\$ 7,216	\$ 5,418

See accompanying notes to consolidated financial statements.

Table of Contents**KILROY REALTY CORPORATION AND KILROY REALTY, L.P.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****Six Months Ended June 30, 2011 and 2010****(unaudited)****1. Organization and Basis of Presentation*****Organization***

Kilroy Realty Corporation (the *Company*) is a self-administered real estate investment trust (*REIT*) active in office and industrial submarkets along the West Coast. We own, develop, acquire and manage real estate assets, consisting primarily of Class A properties in the coastal regions of Los Angeles, Orange County, San Diego, greater Seattle and the San Francisco Bay Area, which we believe have strategic advantages and strong barriers to entry. We qualify as a REIT under the Internal Revenue Code of 1986, as amended (the *Code*). The *Company's* common stock is publicly traded on the New York Stock Exchange (*NYSE*) under the ticker symbol *KRC*.

We own our interests in all of our real estate assets through Kilroy Realty, L.P. (the *Operating Partnership*) and Kilroy Realty Finance Partnership, L.P. (the *Finance Partnership*). We conduct substantially all of our operations through the *Operating Partnership*. Unless stated otherwise or the context indicates otherwise, the term *Kilroy Realty Corporation* or the *Company* refers to Kilroy Realty Corporation and its consolidated subsidiaries and the term *Operating Partnership* refers to Kilroy Realty, L.P. and its consolidated subsidiaries. The terms *the Company*, *we*, *our*, and *us* refer to the *Company* or the *Company* and the *Operating Partnership* together, as the context requires. The descriptions of our business, employees, and properties apply to both the *Company* and the *Operating Partnership*.

The following table of office buildings (the *Office Properties*) and industrial buildings (the *Industrial Properties*) summarizes our stabilized portfolio of operating properties as of June 30, 2011. As of June 30, 2011, all of our properties and all of our business is currently conducted in the state of California with the exception of the operation of six office properties located in the state of Washington.

	Number of Buildings	Rentable Square Feet	Number of Tenants	Percentage Occupied
Office Properties ⁽¹⁾	107	11,465,821	416	87.9%
Industrial Properties	40	3,605,407	62	97.6%
Total Stabilized Portfolio	147	15,071,228	478	90.2%

(1) Includes eight office properties acquired during the six months ended June 30, 2011 for a total amount of \$413.0 million (see Note 2 for additional information).

Our stabilized portfolio excludes undeveloped land, development and redevelopment properties currently under construction or committed for construction, lease-up properties, and one property that we are in the process of

repositioning for residential use. As of June 30, 2011, we had one office redevelopment property encompassing approximately 300,000 rentable square feet under construction and we had one office redevelopment property encompassing approximately 98,000 rentable square feet which we removed from the stabilized portfolio since it was committed for redevelopment. We define "lease-up" properties as properties we recently developed or redeveloped that have not yet reached 95% occupancy and are within one year following cessation of major construction activities. We had no "lease-up" properties as of June 30, 2011.

As of June 30, 2011, the Company owned a 97.1% general partnership interest in the Operating Partnership. The remaining 2.9% common limited partnership interest in the Operating Partnership as of June 30, 2011 was owned by non-affiliated investors and certain of our directors and officers (see Note 6). Both the general and limited common partnership interests in the Operating Partnership are denominated in common units. The number of common units held by the Company is at all times equivalent to the number of outstanding shares of the Company's common stock, and the entitlements 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

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KILROY REALTY CORPORATION AND KILROY REALTY, L.P.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

rights as provided in the Operating Partnership's Fifth Amended and Restated Agreement of Limited Partnership (as amended, the Partnership Agreement) (see Note 6).

Kilroy Realty Finance, Inc., our wholly-owned subsidiary, is the sole general partner of the Finance Partnership and owns a 1.0% general partnership interest. The Operating Partnership owns the remaining 99.0% limited partnership interest. Kilroy Services, LLC (KSLLC), which is a wholly-owned subsidiary of the Operating Partnership, is the entity through which we conduct substantially all of our development activities. With the exception of the Operating Partnership, all of our subsidiaries, which include Kilroy Realty TRS, Inc., Kilroy Realty Management, L.P., Kilroy RB, LLC, Kilroy RB II, LLC, Kilroy Realty Northside Drive, LLC, and Kilroy Realty 303, LLC, are wholly-owned.

Basis of Presentation

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

The consolidated financial statements of the Company and the Operating Partnership also include variable interest entities (VIE) in which we are deemed to be the primary beneficiary. As of June 30, 2011, we had one bankruptcy-remote VIE, Kilroy Realty Northside Drive, LLC, which was formed in 2010 to hold three properties that secure the debt we assumed when we acquired the properties in 2010. The assets held by this entity are not available to satisfy the debts and other obligations of the Company or the Operating Partnership.

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, 2011. 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, 2010.

Change in Reportable Segments from Form 10-K for the year ended December 31, 2010

Our chief operating decision-makers internally evaluate the operating performance and financial results of our portfolio based on Net Operating Income for the following two segments of commercial real estate property: Office Properties and Industrial Properties. We define Net Operating Income as operating revenues (rental income, tenant reimbursements, and other property income) less operating expenses (property expenses, real estate taxes, provision for bad debts, and ground leases).

During the three and six months ended June 30, 2011, the amount of revenues and Net Operating Income generated by our Industrial Properties, in relation to our total consolidated operating portfolio revenues and Net Operating Income, had fallen below the required 10% quantitative reporting thresholds for the Industrial Properties to be considered a reportable segment under GAAP. Therefore, for the three and six months ended June 30, 2011,

Table of Contents**KILROY REALTY CORPORATION AND KILROY REALTY, L.P.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

our only reportable segment is our Office Properties segment. See Note 13 for a reconciliation of our Office Properties segment to our consolidated revenues, Net Operating Income, net income and consolidated assets.

2. Acquisitions

During the six months ended June 30, 2011, we acquired the eight office properties listed below from unrelated third parties. Unless otherwise noted, we funded these acquisitions principally with the net proceeds from the Company's public offering of common stock (see Note 7), and borrowings under the unsecured line of credit (see Note 5).

Property	Property Type	Date of Acquisition	Number of Buildings	Rentable Square Feet	Percentage Occupied as of June 30, 2011	Purchase Price (in millions)⁽¹⁾
250 Brannan Street San Francisco, CA 10210, 10220, and 10230 NE Points Drive; 3933 Lake Washington Boulevard NE Kirkland, WA ⁽²⁾	Office	January 28, 2011	1	90,742	76.7%	\$ 33.0
10770 Wateridge Circle San Diego, CA	Office	April 21, 2011	4	279,924	87.3%	100.1
601 108th Avenue N.E. Bellevue, WA	Office	May 12, 2011	1	174,310	97.5%	32.7
4040 Civic Center Drive San Rafael, CA	Office	June 3, 2011	1	488,470	89.8%	215.0
	Office	June 9, 2011	1	126,787	93.1%	32.2
Total			8	1,160,233		\$ 413.0

(1) Excludes acquisition-related costs.

(2) In connection with this acquisition, we assumed secured debt with an outstanding principal balance of \$30.0 million and a premium of \$1.0 million as a result of recording this debt at fair value on the acquisition date (see Note 5).

Table of Contents**KILROY REALTY CORPORATION AND KILROY REALTY, L.P.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

	601 108th Avenue N.E., Bellevue, WA⁽¹⁾	All Other Acquisitions⁽²⁾ (in thousands)	Total
<u>Assets</u>			
Land ⁽³⁾	\$	\$ 36,740	\$ 36,740
Buildings and improvements ⁽⁴⁾	214,095	143,545	357,640
Undeveloped land		2,560	2,560
Deferred leasing costs and acquisition-related intangible assets ⁽⁵⁾	13,790	17,500	31,290
Total assets acquired	227,885	200,345	428,230
<u>Liabilities</u>			
Deferred revenue and acquisition-related intangible liabilities ⁽⁶⁾	12,850	1,390	14,240
Secured debt ⁽⁷⁾		30,997	30,997
Accounts payable, accrued expenses and other liabilities	2,380	2,059	4,439
Total liabilities assumed	15,230	34,446	49,676
Net assets and liabilities acquired ⁽⁸⁾	\$ 212,655	\$ 165,899	\$ 378,554

(1) The purchase of 601 108th Avenue N.E., Bellevue, WA, represents the largest acquisition and 52.1% of the total aggregate purchase price of the properties acquired during the six months ended June 30, 2011.

(2) The purchase price of all other acquisitions completed during the six months ended June 30, 2011 were individually less than 5% and in aggregate less than 10% of the Company's total assets as of December 31, 2010.

(3) In connection with the acquisition of 601 108th Avenue N.E., Bellevue, WA,, we assumed the lessee obligations under a noncancellable ground lease that is scheduled to expire in November 2093 (see Notes 3 and 11).

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

(5)

Represents in-place leases (approximately \$18.9 million with a weighted average amortization period of 4.1 years), above-market leases (approximately \$6.6 million with a weighted average amortization period of 4.5 years), and unamortized leasing commissions (approximately \$5.7 million with a weighted average amortization period of 2.8 years).

- (6) Represents below-market leases (approximately \$9.0 million with a weighted average amortization period of 4.3 years) and an above-market ground lease obligation (approximately \$5.2 million with a weighted average amortization period of 82.5 years), under which we are the lessee.
- (7) Represents the mortgage loan, which includes an unamortized premium of approximately \$1.0 million, assumed in connection with the properties acquired in April 2011 (see Note 5).
- (8) Reflects the purchase price net of assumed secured debt and other lease-related obligations.

Table of Contents**KILROY REALTY CORPORATION AND KILROY REALTY, L.P.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****3. Deferred Leasing Costs and Acquisition-related Intangible Assets and Liabilities, net**

The following table summarizes our identified deferred leasing costs and acquisition-related intangible assets (acquired value of leasing costs, above-market leases, and in-place leases) and intangible liabilities (acquired value of below-market leases and above-market ground lease obligation) as of June 30, 2011 and December 31, 2010:

	June 30, 2011	December 31, 2010
	(in thousands)	
Deferred Leasing Costs and Acquisition-related Intangible Assets, net⁽¹⁾:		
Deferred leasing costs	\$ 131,098	\$ 128,980
Accumulated amortization	(43,921)	(45,869)
Deferred leasing costs, net	87,177	83,111
Above-market leases	27,922	21,321
Accumulated amortization	(4,747)	(2,163)
Above-market leases, net	23,175	19,158
In-place leases	50,915	36,964
Accumulated amortization	(8,036)	(8,167)
In-place leases, net	42,879	28,797
Total deferred leasing costs and acquisition-related intangible assets, net	\$ 153,231	\$ 131,066
Acquisition-related Intangible Liabilities, net⁽¹⁾⁽²⁾:		
Below-market leases	\$ 27,152	\$ 21,938
Accumulated amortization	(2,462)	(5,094)
Below-market leases, net	24,690	16,844
Above-market ground lease obligation	5,200	
Accumulated amortization	(5)	
Above-market ground lease obligation, net	5,195	
Total acquisition-related intangible liabilities, net	\$ 29,885	\$ 16,844

- (1) Balances and accumulated amortization amounts at June 30, 2011 reflect the write-off of the following fully amortized amounts at January 1, 2011: deferred leasing costs (approximately \$10.4 million), in-place leases (approximately \$5.0 million), and below-market leases (approximately \$3.8 million). Our accounting policy is to write-off the asset and corresponding accumulated amortization for fully amortized balances on January 1st of each fiscal year.
- (2) Included in deferred revenue and acquisition-related intangible liabilities, net in the consolidated balance sheets.

Table of Contents**KILROY REALTY CORPORATION AND KILROY REALTY, L.P.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table sets forth amortization related to deferred leasing costs and acquisition-related intangibles for the three and six months ended June 30, 2011 and 2010:

	Three Months Ended		Six Months Ended	
	June 30,	June 30,	June 30,	June 30,
	2011	2010	2011	2010
	(in thousands)			
Deferred leasing costs ⁽¹⁾	\$ 3,970	\$ 2,968	\$ 7,738	\$ 5,673
Net above-market leases ⁽²⁾	745	60	1,398	32
In-place leases ⁽¹⁾	2,686	267	4,859	285
Above-market ground lease obligation ⁽³⁾	5		5	
Total	\$ 7,406	\$ 3,295	\$ 14,000	\$ 5,990

- (1) The amortization of deferred leasing costs and in-place leases is recorded to depreciation and amortization expense in the consolidated statements of operations for the periods presented.
- (2) The amortization of net above-market leases is recorded as a decrease to rental income in the consolidated statements of operations for the periods presented.
- (3) The amortization of the above-market ground lease obligation is recorded as a decrease to ground lease expense in the consolidated statements of operations for the periods presented.

The following table sets forth the estimated annual amortization expense related to deferred leasing costs and acquisition-related intangibles as of June 30, 2011 for future periods:

Year Ending	Deferred Leasing Costs	Net Above-/(Below)-Market Leases⁽¹⁾	In-Place Leases	Above-Market Ground Lease Obligation
	(in thousands)			
Remaining 2011	\$ 8,946	\$ 706	\$ 6,165	\$ 32
2012	16,558	1,303	10,766	63
2013	14,751	1,062	8,682	63
2014	13,042	324	6,922	63
2015	9,859	(220)	3,991	63

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Thereafter	24,021	(4,690)	6,353	4,911
Total	\$ 87,177	\$ (1,515)	\$ 42,879	\$ 5,195

(1) Represents estimated annual net amortization related to above-/(below)-market leases. Amounts shown for 2011-2014 represent net above-market leases which will be recorded as a decrease to rental income in the consolidated statement of operations, and amounts shown for the periods 2015 and thereafter represent net below-market leases which will be recorded as an increase to rental income in the consolidated statement of operations.

Table of Contents**KILROY REALTY CORPORATION AND KILROY REALTY, L.P.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****4. Receivables***Current Receivables, net*

Current receivables, net is primarily comprised of contractual rents and other lease-related obligations due from tenants. The balance consisted of the following as of June 30, 2011 and December 31, 2010:

	June 30, 2011	December 31, 2010
	(in thousands)	
Current receivables	\$ 7,655	\$ 9,077
Allowance for uncollectible tenant receivables	(2,923)	(2,819)
Current receivables, net	\$ 4,732	\$ 6,258

Deferred Rent Receivables, net

Deferred rent receivables, net consisted of the following as of June 30, 2011 and December 31, 2010:

	June 30, 2011	December 31, 2010
	(in thousands)	
Deferred rent receivables	\$ 101,780	\$ 92,883
Allowance for deferred rent receivables	(3,822)	(3,831)
Deferred rent receivables, net	\$ 97,958	\$ 89,052

5. Secured and Unsecured Debt of the Operating Partnership*Secured Debt*

In January 2011, the Operating Partnership borrowed \$135.0 million under a mortgage loan that is scheduled to mature on February 1, 2018. The mortgage loan is secured by our 303 Second Street property in San Francisco, bears interest at an annual rate of 4.27%, and requires interest-only payments for the first two years with a 30-year amortization schedule thereafter. We used a portion of the proceeds to repay borrowings under the Operating Partnership's unsecured line of credit (the Credit Facility).

In April 2011, in connection with the acquisition of four office buildings in Kirkland, Washington, the Operating Partnership assumed a mortgage loan that is secured by the project. The assumed mortgage loan had a principal

balance of \$30.0 million at the acquisition date and is scheduled to mature on April 15, 2015. This mortgage loan was recorded at fair value on the date of the acquisition resulting in a premium of approximately \$1.0 million. This premium will be accreted on a straight-line basis, which approximates the effective interest method, as a reduction to interest expense from the acquisition date through the maturity date of the mortgage loan. The loan bears contractual interest at an annual rate of 4.94% and requires monthly principal and interest payments based on a 30-year amortization period.

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

Table of Contents**KILROY REALTY CORPORATION AND KILROY REALTY, L.P.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Exchangeable Senior Notes*

The following table summarizes the balance and significant terms of the Company's 3.25% Exchangeable Notes due 2012 (the 3.25% Exchangeable Notes) and 4.25% Exchangeable Notes due 2014 (the 4.25% Exchangeable Notes) and together with the 3.25% Exchangeable Notes, the Exchangeable Notes) outstanding as of June 30, 2011 and December 31, 2010:

	3.25% Exchangeable Notes		4.25% Exchangeable Notes	
	June 30, 2011	December 31, 2010	June 30, 2011	December 31, 2010
	(in thousands)			
Principal amount	\$ 148,000	\$ 148,000	\$ 172,500	\$ 172,500
Unamortized discount	(2,485)	(4,004)	(14,641)	(16,532)
Net carrying amount of liability component	\$ 145,515	\$ 143,996	\$ 157,859	\$ 155,968
Carrying amount of equity component		\$33,675		\$19,835
Maturity date		April 2012		November 2014
Stated coupon rate		3.25% ⁽¹⁾		4.25% ⁽²⁾
Effective interest rate ⁽³⁾		5.45%		7.13%
Exchange rate per \$1,000 principal value of the Exchangeable Notes, as adjusted ⁽⁴⁾		11.3636		27.8307
Exchange price, as adjusted ⁽⁴⁾		\$88.00		\$35.93
Number of shares on which the aggregate consideration to be delivered on conversion is determined ⁽⁴⁾		1,681,813		4,800,796

(1) Interest on the 3.25% Exchangeable Notes is payable semi-annually in arrears on April 15th and October 15th of each year.

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

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

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

Capped Call Transactions

In connection with the offerings of the Exchangeable Notes, we entered into capped call option transactions (capped calls) to mitigate the dilutive impact of the potential exchange of the Exchangeable Notes. The following table summarizes our capped call option positions as of both June 30, 2011 and December 31, 2010:

	3.25% Exchangeable Notes⁽¹⁾	4.25% Exchangeable Notes⁽²⁾
Referenced shares of common stock	1,121,201	4,800,796
Exchange price including effect of capped calls	\$102.72	\$42.81

(1) The capped calls mitigate the dilutive impact to us of the potential exchange of two-thirds of the 3.25% Exchangeable Notes into shares of common stock.

(2) The capped calls mitigate the dilutive impact to us of the potential exchange of all of the 4.25% Exchangeable Notes into shares of common stock.

For the three and six months ended June 30, 2011, the per share average trading price of the Company's common stock on the New York Stock Exchange (NYSE) was higher than the \$35.93 exchange price for the 4.25% Exchangeable Notes, as presented below:

	Three Months Ended June 30, 2011	Six Months Ended June 30, 2011
Average Trading Price of the Company's Stock	\$ 39.90	\$ 38.94

As a result, even though there would be no dilutive economic impact to our earnings until the Company's share price exceeded \$42.81, which is the exchange price after the impact of the capped calls, and even though the 4.25%

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Exchangeable Notes were not convertible as of June 30, 2011, we are required to include the dilutive impact of the 4.25% Exchangeable Notes based on the average share price in our diluted earnings per share and per unit calculations for the six months ended June 30, 2011 (see Notes 14 and 15). We are not required to include the the dilutive impact of the 4.25% Exchangeable Notes in our diluted earnings per share and per unit calculations for the three months ended June 30, 2011, since we had a net loss available to common stockholders and unitholders during this period and the effect would be anti-dilutive (see Notes 14 and 15). If the 4.25% Exchangeable Notes were able to be converted as of June 30, 2011, the approximate fair value of the shares upon conversion at that date would have been equal to approximately \$191.4 million, which would exceed the \$172.5 million principal amount of the 4.25% Exchangeable Notes by approximately \$18.9 million.

Interest Expense for the Exchangeable Notes

The unamortized discount on the Exchangeable Notes is accreted as additional interest expense from the date of issuance through the maturity date of the applicable Exchangeable Notes. The following table summarizes the total interest expense attributable to the Exchangeable Notes based on the effective interest rates set forth above, before the effect of capitalized interest, for the three and six months ended June 30, 2011 and 2010:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	(in thousands)			
Contractual interest payments	\$ 3,035	\$ 4,241	\$ 6,070	\$ 8,495
Amortization of discount	1,722	2,372	3,410	4,679
Interest expense attributable to the Exchangeable Notes	\$ 4,757	\$ 6,613	\$ 9,480	\$ 13,174

Unsecured Line of Credit

In June 2011, we amended the terms of our Credit Facility to extend the maturity date, and reduce the interest rate and facility fee. The following table summarizes the terms of our Credit Facility as of December 31, 2010 and as amended as of June 30, 2011:

	June 30, 2011	December 31, 2010
	(in thousands)	
Outstanding borrowings	\$ 245,000	\$ 159,000
Remaining borrowing capacity	255,000	341,000
Total borrowing capacity ⁽¹⁾	\$ 500,000	\$ 500,000
Interest rate ⁽²⁾	2.87%	2.99%

Facility fee-annual rate ⁽³⁾	0.350%	0.575%
Maturity date ⁽⁴⁾	August 2015	August 2013

- (1) We may elect to borrow, subject to lender approval, up to an additional \$200 million under an accordion feature under the terms of the Credit Facility.
- (2) The Credit Facility interest rate included interest at an annual rate of LIBOR plus 1.750% and 2.675% as of June 30, 2011 and December 31, 2010, respectively.
- (3) The facility fee is paid on a quarterly basis and is calculated based on the total borrowing capacity. In addition to the facility fee, we also incurred debt origination and legal costs of approximately \$5.0 million when we entered into the Credit Facility in 2010 and an additional \$3.3 million when we amended the Credit Facility in 2011. The unamortized balance of these costs will be amortized as additional interest expense over the extended term of the Credit Facility.
- (4) Under the terms of the Credit Facility, we may exercise an option to extend the maturity date by one year.

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

Table of Contents**KILROY REALTY CORPORATION AND KILROY REALTY, L.P.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Debt Covenants and Restrictions*

The Credit Facility, the unsecured senior notes, and certain other secured debt arrangements contain covenants and restrictions requiring us to meet certain financial ratios and reporting requirements. Some of the more restrictive financial covenants include a maximum ratio of total debt to total asset value, a minimum fixed-charge coverage ratio, a minimum unsecured debt ratio, and a minimum unencumbered asset pool debt service coverage ratio. Noncompliance with one or more of the covenants and restrictions could result in the full or partial principal balance of the associated debt becoming immediately due and payable. We believe we were in compliance with all of our debt covenants as of June 30, 2011.

Debt Maturities

The following table summarizes the stated debt maturities and scheduled amortization payments, excluding debt discounts and premiums, as of June 30, 2011:

Year Ending		(in thousands)
Remaining 2011	\$	72,262
2012		305,303
2013		6,373
2014		262,443
2015		602,382
Thereafter		450,028
Total	\$	1,698,791 ⁽¹⁾

(1) Includes gross principal balance of outstanding debt before impact of all debt discounts and premiums.

Capitalized Interest and Loan Fees

The following table sets forth our gross interest expense, including debt discount/premium and loan cost amortization, net of capitalized interest, for the three and six months ended June 30, 2011 and 2010. The capitalized amounts are a cost of development and redevelopment, and increase the carrying value of undeveloped land and construction in progress.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2011	2010	2011	2010
	(in thousands)			
Gross interest expense	\$ 23,293	\$ 15,897	\$ 46,148	\$ 30,437

Capitalized interest	(2,065)	(2,809)	(4,044)	(5,393)
Interest expense	\$ 21,228	\$ 13,088	\$ 42,104	\$ 25,044

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

7.45% Series A Cumulative Redeemable Preferred Units of the Operating Partnership

As of both June 30, 2011 and December 31, 2010, the Operating Partnership had outstanding 1,500,000 7.45% Series A Cumulative Redeemable Preferred Units representing preferred limited partnership interests in the Operating Partnership with a redemption value of \$50.00 per unit. There were no changes to this noncontrolling interest during the three and six months ended June 30, 2011 and 2010.

Common Units of the Operating Partnership

The Company owned a 97.1%, 96.8% and 96.7% common general partnership interest in the Operating Partnership as of June 30, 2011, December 31, 2010, and June 30, 2010, respectively. The remaining 2.9%, 3.2%

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KILROY REALTY CORPORATION AND KILROY REALTY, L.P.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

and 3.3% common limited partnership interest as of June 30, 2011, December 31, 2010 and June 30, 2010, respectively, was owned in the form of common units by non-affiliate investors and certain of our executive officers and directors. There were 1,718,131 and 1,723,131 common units outstanding held by these investors, executive officers and directors as of June 30, 2011 and December 31, 2010, respectively.

The noncontrolling common units may be redeemed by unitholders for cash. We, at our option, may satisfy the cash redemption obligation with shares of the Company's common stock on a one-for-one basis. Whether satisfied in cash or shares of the Company's common stock, the value for each noncontrolling common unit upon redemption is the amount equal to the average of the closing quoted price per share of the Company's common stock, par value \$.01 per share, as reported on the NYSE for the ten trading days immediately preceding the applicable redemption date. The aggregate value upon redemption of the then-outstanding noncontrolling common units was \$66.6 million and \$61.4 million as of June 30, 2011 and December 31, 2010, respectively. This redemption value does not necessarily represent the amount that would be distributed with respect to each 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 amount payable with respect to each share of the Company's common stock.

7. Stockholders' Equity of the Company

Issuance of Common Stock

In April 2011, the Company completed an underwritten public offering of 6,037,500 shares of its common stock. The net offering proceeds, after deducting underwriting discounts and commissions and offering expenses, were approximately \$221.0 million. We have used or, intend to use a portion of the net proceeds from the offering to fund acquisitions and for general corporate purposes.

8. Partners' Capital of the Operating Partnership

Issuance of Common Units

In April 2011, the Company completed an underwritten public offering of 6,037,500 shares of its common stock as discussed in Note 7. The net offering proceeds of approximately \$221.0 million were contributed by the Company to the Operating Partnership in exchange for 6,037,500 common units.

Common Units Outstanding

The Company owned 58,464,412, 52,349,670, and 52,296,219 common units representing a 97.1%, 96.8%, and 96.7% common general partnership interest in the Operating Partnership as of June 30, 2011, December 31, 2010, and June 30, 2010, respectively. The remaining 2.9%, 3.2%, and 3.3% common limited partnership interest as of June 30, 2011, December 31, 2010, and June 30, 2010, respectively, was owned by non-affiliate investors and certain of our executive officers and directors in the form of noncontrolling common units. There were 1,718,131, 1,723,131, and 1,723,131 common units outstanding held by these investors, executive officers and directors as of June 30, 2011, December 31, 2010, and June 30, 2010, respectively. For a further discussion of the noncontrolling common units as of June 30, 2011 and December 31, 2010, please refer to Note 6.

9. Share-Based Compensation

Stockholder Approved Equity Compensation Plans

As of June 30, 2011, we had one share-based incentive compensation plan, the Kilroy Realty 2006 Incentive Award Plan as amended (the 2006 Plan). As of June 30, 2011, 3,821,041 shares were available for grant under the 2006 Plan. The number of shares that remains available for grant is calculated using the weighted share counting provisions set forth in the 2006 Plan, which are based on the type of awards that are granted. The maximum number

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of shares available for grant subject to full value awards (which generally include equity awards other than options and stock appreciation rights) was 1,308,576 shares as of June 30, 2011.

Summary of Nonvested Shares

A summary of our nonvested shares activity from January 1, 2011 through June 30, 2011 is presented below:

Nonvested Shares	Shares	Weighted-Average Grant Date Fair Value Per Share
Outstanding at January 1, 2011	50,032	\$ 58.40
Granted	68,727	37.83
Vested ⁽¹⁾	(9,474)	56.76
Outstanding as of June 30, 2011	109,285	\$ 45.61

- (1) The total shares vested include 2,198 shares that were then tendered to satisfy minimum statutory tax withholding requirements related to the restricted shares that have vested in accordance with the terms of the 2006 Plan. We accept the return of shares at the current quoted market price of the Company's common stock to satisfy tax obligations.

A summary of our nonvested and vested shares activity for the six months ended June 30, 2011 and 2010 is presented below:

Six Months Ended June 30,	Shares Granted		Shares Vested	
	Non-Vested Shares	Weighted-Average Grant Date Fair Value	Vested Shares	Total Vest Date Fair Value⁽¹⁾ (in thousands)
	Issued	Per Share		
2011	68,727	\$ 37.83	(9,474)	\$ 370
2010	3,239	30.88	(16,358)	474

(1)

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

Summary of Restricted Stock Units

A summary of our restricted stock unit (RSU) activity from January 1, 2011 through June 30, 2011 is presented below:

	Nonvested RSUs			
		Weighted-Average		
		Grant Date		
		Fair Value		
	Amount	Per Share	Vested	Total RSUs
			RSUs	
Outstanding at January 1, 2011	125,754	\$ 29.88	588,068	713,822
Granted	107,673	37.94		107,673
Vested	(23,035)	30.57	23,035	
Issuance of dividend equivalents ⁽¹⁾			13,494	13,494
Canceled ⁽²⁾			(8,448)	(8,448)
Outstanding as of June 30, 2011	210,392	\$ 33.93	616,149	826,541

(1) RSUs issued as dividend equivalents are vested upon issuance.

(2) We accept the return of RSUs, at the current quoted market price of the Company's common stock, to satisfy minimum statutory tax-withholding requirements related to either RSUs that have vested or RSU dividend equivalents in accordance with the terms of the 2006 Plan.

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A summary of our RSU activity for the six months ended June 30, 2011 and 2010 is presented below:

	RSUs Granted		RSUs Vested	
	Non-Vested RSUs	Weighted-Average Grant Date Fair Value	Vested RSUs	Total Vest-Date Fair Value ⁽¹⁾ (in thousands)
Six Months Ended June 30,	Issued	Per Share		
2011	107,673	\$ 37.94	23,035	\$ 897
2010	159,606	30.24	23,564	740

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

Compensation Cost Recorded During the Period

The total compensation cost for all share-based compensation programs was \$1.4 million and \$2.2 million for the three months ended June 30, 2011 and 2010, respectively, and \$2.8 milli