

KILROY REALTY CORP  
Form 10-Q  
October 30, 2014

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 September 30, 2014

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

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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)

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 October 24, 2014, 83,956,738 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 September 30, 2014 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 September 30, 2014, the Company owned an approximate 97.9% common general partnership interest in the Operating Partnership. The remaining approximate 2.1% 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 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 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 and stockholders’ equity and partners’ capital are the main areas of difference between the consolidated financial statements of the Company and those of the Operating Partnership. The common limited partnership interests in the Operating Partnership are accounted for as partners’ capital in the Operating Partnership’s financial statements and, to the extent not held by the Company, as noncontrolling interests in the Company’s financial statements. The Operating Partnership’s financial statements reflect the noncontrolling interest in Kilroy Realty Finance Partnership, L.P., 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 interests 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 5, Secured and Unsecured Debt of the Operating Partnership;

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

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Note 7, Stockholders' Equity of the Company;

Note 8, Partners' Capital of the Operating Partnership;

Note 14, Net Income Available to Common Stockholders Per Share of the Company; and

Note 15, Net Income Available to Common Unitholders Per Unit of the Operating Partnership;

“Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

—Liquidity and Capital Resources of the Company;” and

—Liquidity and Capital Resources of the Operating Partnership.”

This report also includes separate sections under Part I, Item 4. Controls and Procedures and separate Exhibit 31 and Exhibit 32 certifications for each of the Company and the Operating Partnership to establish that the Chief Executive Officer and the Chief Financial Officer of each entity have made the requisite certifications and that the Company and Operating Partnership are compliant with Rule 13a-15 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 NINE MONTHS ENDED SEPTEMBER 30, 2014  
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## PART I – FINANCIAL INFORMATION

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

KILROY REALTY CORPORATION  
CONSOLIDATED BALANCE SHEETS

(Unaudited; in thousands, except share data)

	September 30, 2014	December 31, 2013
<b>ASSETS</b>		
<b>REAL ESTATE ASSETS:</b>		
Land and improvements (Note 2)	\$757,036	\$ 657,491
Buildings and improvements (Note 2)	3,882,015	3,590,699
Undeveloped land and construction in progress (Note 2)	1,112,046	1,016,757
Total real estate assets held for investment	5,751,097	5,264,947
Accumulated depreciation and amortization	(912,623	) (818,957
Total real estate assets held for investment, net (\$98,121 and \$234,532 of VIE, respectively, Note 1)	4,838,474	4,445,990
<b>REAL ESTATE ASSETS AND OTHER ASSETS HELD FOR SALE, NET</b> (Note 13)	49,815	213,100
<b>CASH AND CASH EQUIVALENTS</b>	200,431	35,377
<b>RESTRICTED CASH</b> (Notes 1 and 13)	17,487	49,780
<b>MARKETABLE SECURITIES</b> (Note 11)	12,076	10,008
<b>CURRENT RECEIVABLES, NET</b> (Note 4)	6,443	10,743
<b>DEFERRED RENT RECEIVABLES, NET</b> (Note 4)	139,910	127,123
<b>DEFERRED LEASING COSTS AND ACQUISITION-RELATED</b> <b>INTANGIBLE ASSETS, NET</b> (Notes 2 and 3)	183,057	186,622
<b>DEFERRED FINANCING COSTS, NET</b>	19,373	16,502
<b>PREPAID EXPENSES AND OTHER ASSETS, NET</b>	20,398	15,783
<b>TOTAL ASSETS</b>	<b>\$5,487,464</b>	<b>\$ 5,111,028</b>
<b>LIABILITIES AND EQUITY</b>		
<b>LIABILITIES:</b>		
Secured debt (Notes 5 and 11)	\$549,896	\$ 560,434
Exchangeable senior notes, net (Notes 5 and 11)	135,049	168,372
Unsecured debt, net (Notes 5 and 11)	1,743,962	1,431,132
Unsecured line of credit (Notes 5 and 11)	—	45,000
Accounts payable, accrued expenses and other liabilities	243,602	198,467
Accrued distributions (Note 16)	31,897	31,490
Deferred revenue and acquisition-related intangible liabilities, net (Notes 2 and 3)	114,504	101,286
Rents received in advance and tenant security deposits	45,086	44,240
Liabilities of real estate assets held for sale (Note 13)	3,099	14,447
Total liabilities	2,867,095	2,594,868
<b>COMMITMENTS AND CONTINGENCIES</b> (Note 10)		
<b>EQUITY:</b>		
Stockholders' Equity (Note 7):		
Preferred stock, \$.01 par value, 30,000,000 shares authorized:		
6.875% Series G Cumulative Redeemable Preferred stock, \$.01 par value, 4,600,000 shares authorized, 4,000,000 shares issued and outstanding (\$100,000 liquidation preference)	96,155	96,155

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6.375% Series H Cumulative Redeemable Preferred stock, \$.01 par value, 4,000,000 shares authorized, issued and outstanding (\$100,000 liquidation preference)	96,256	96,256
Common stock, \$.01 par value, 150,000,000 shares authorized, 83,388,220 and 82,153,944 shares issued and outstanding, respectively	834	822
Additional paid-in capital	2,530,282	2,478,975
Distributions in excess of earnings	(159,799	) (210,896
Total stockholders' equity	2,563,728	2,461,312
Noncontrolling Interests:		
Common units of the Operating Partnership (Note 6)	51,419	49,963
Noncontrolling interest in consolidated subsidiary (Notes 1 and 6)	5,222	4,885
Total noncontrolling interests	56,641	54,848
Total equity	2,620,369	2,516,160
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$5,487,464</b>	<b>\$ 5,111,028</b>

See accompanying notes to consolidated financial statements.



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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
<b>REVENUES</b>				
Rental income	\$ 115,221	\$ 103,354	\$ 338,911	\$ 303,573
Tenant reimbursements	11,346	9,583	33,399	28,350
Other property income (Note 12)	2,457	608	7,650	6,584
Total revenues	129,024	113,545	379,960	338,507
<b>EXPENSES</b>				
Property expenses	25,801	24,470	75,448	69,895
Real estate taxes	11,008	10,088	32,728	29,129
Provision for bad debts	58	101	58	196
Ground leases	771	929	2,306	2,665
General and administrative expenses	11,138	10,226	33,806	29,750
Acquisition-related expenses	431	568	1,268	1,387
Depreciation and amortization	50,032	45,804	148,647	138,652
Total expenses	99,239	92,186	294,261	271,674
<b>OTHER (EXPENSES) INCOME</b>				
Interest income and other net investment gains/(losses) (Note 11)	(9	) 673	587	1,084
Interest expense (Note 5)	(16,608	) (18,853	) (49,880	) (58,021
Total other (expenses) income	(16,617	) (18,180	) (49,293	) (56,937
<b>INCOME FROM CONTINUING OPERATIONS BEFORE GAIN ON SALE OF LAND</b>	13,168	3,179	36,406	9,896
Gain on sale of land (Note 13)	—	—	3,490	—
<b>INCOME FROM CONTINUING OPERATIONS DISCONTINUED OPERATIONS (Note 13)</b>	13,168	3,179	39,896	9,896
Income from discontinued operations	548	5,848	2,091	11,199
Gains on dispositions of discontinued operations	5,587	—	110,391	423
Total income from discontinued operations	6,135	5,848	112,482	11,622
<b>NET INCOME</b>	19,303	9,027	152,378	21,518
Net income attributable to noncontrolling common units of the Operating Partnership	(321	) (131	) (3,011	) (266
<b>NET INCOME ATTRIBUTABLE TO KILROY REALTY CORPORATION</b>	18,982	8,896	149,367	21,252
<b>PREFERRED DIVIDENDS</b>	(3,313	) (3,312	) (9,938	) (9,938
<b>NET INCOME AVAILABLE TO COMMON STOCKHOLDERS</b>	\$ 15,669	\$ 5,584	\$ 139,429	\$ 11,314
Income (loss) from continuing operations available to common stockholders per common share – basic (Note 14)	\$ 0.11	\$ 0.00	\$ 0.34	\$ (0.02
Income (loss) from continuing operations available to common stockholders per common share – diluted (Note 14)	\$ 0.11	\$ 0.00	\$ 0.33	\$ (0.02
Net income available to common stockholders per share – basic (Note 14)	\$ 0.18	\$ 0.07	\$ 1.67	\$ 0.13
Net income available to common stockholders per share – diluted (Note 14)	\$ 0.18	\$ 0.07	\$ 1.63	\$ 0.13

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Weighted average common shares outstanding – basic (Note 14)	83,161,323	76,768,893	82,525,033	75,750,822
Weighted average common shares outstanding – diluted (Note 14)	85,110,456	76,768,893	84,622,622	75,750,822
Dividends declared per common share	\$0.35	\$0.35	\$1.05	\$1.05

See accompanying notes to consolidated financial statements.

KILROY REALTY CORPORATION  
CONSOLIDATED STATEMENTS OF EQUITY

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

	Preferred Stock	Common Stock Number of Shares	Common Stock Common Stock	Additional Paid-in Capital	Distributions in Excess of Earnings	Total Stock- holders' Equity	Noncontrolling Interests	Total Equity
BALANCE AS OF DECEMBER 31, 2012	\$ 192,411	74,926,981	\$ 749	\$ 2,126,005	\$ (129,535 )	\$ 2,189,630	\$ 46,303	\$ 2,235,933
Net income					21,252	21,252	266	21,518
Issuance of common stock		7,215,838	72	349,879		349,951		349,951
Issuance of share-based compensation awards		—		1,075		1,075		1,075
Noncash amortization of share-based compensation				7,096		7,096		7,096
Repurchase of common stock and restricted stock units		(34,164 )		(1,803 )		(1,803 )		(1,803 )
Settlement of restricted stock units for shares of common stock		4,363		(10 )		(10 )		(10 )
Exercise of stock options, net		473		128		128		128
Adjustment for noncontrolling interest				(5,946 )		(5,946 )	5,946	—
Contribution by noncontrolling interest in consolidated subsidiary							4,885	4,885
Preferred dividends					(9,938 )	(9,938 )		(9,938 )
Dividends declared per common share and common unit (\$1.05 per share/unit)					(82,827 )	(82,827 )	(1,914 )	(84,741 )
BALANCE AS OF SEPTEMBER 30, 2013	\$ 192,411	82,113,491	\$ 821	\$ 2,476,424	\$ (201,048 )	\$ 2,468,608	\$ 55,486	\$ 2,524,094

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	Preferred Stock	Common Stock Number of Shares	Common Stock Common	Additional Paid-in Capital	Distributions in Excess of Earnings	Total Stock- holders' Equity	Noncontrolling Interests	Total Equity
BALANCE AS OF DECEMBER 31, 2013	\$ 192,411	82,153,944	\$ 822	\$ 2,478,975	\$ (210,896 )	\$ 2,461,312	\$ 54,848	\$ 2,516,160
Net income					149,367	149,367	3,011	152,378
Issuance of common stock (Note 7)		370,700	4	22,132		22,136		22,136
Issuance of share-based compensation awards		—		1,281		1,281		1,281
Noncash amortization of share-based compensation				10,345		10,345		10,345
Exercise of stock options (Note 9)		482,000	4	20,533		20,537		20,537
Repurchase of common stock, stock options and restricted stock units		(48,017 )		(2,861 )		(2,861 )		(2,861 )
Settlement of restricted stock units for shares of common stock		108,529		—		—		—
Common shares issued in connection with early exchange of 4.25%		431,270	4	219		223		223
Exchangeable Senior Notes (Note 5)								
Common shares received in connection with capped call option transactions (Note 5)		(111,206 )				—		—
Exchange of common units of the Operating Partnership		1,000		28		28	(28 )	—

Adjustment for noncontrolling interest	(370 )	(370 )	370	—
Contribution by noncontrolling interest in consolidated subsidiary			336	336
Preferred dividends	(9,938 )	(9,938 )		(9,938 )
Dividends declared per common share and common unit (\$1.05 per share/unit)	(88,332 )	(88,332 )	(1,896 )	(90,228 )
BALANCE AS OF SEPTEMBER 30, 2014	\$ 192,411	83,388,220	\$ 834	\$ 2,530,282
			\$(159,799)	\$ 2,563,728
			\$ 56,641	\$ 2,620,369

See accompanying notes to consolidated financial statements.

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

	Nine Months Ended September 30,	
	2014	2013
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 152,378	\$ 21,518
Adjustments to reconcile net income to net cash provided by operating activities (including discontinued operations):		
Depreciation and amortization of building and improvements and leasing costs	148,878	148,982
Increase in provision for bad debts	58	196
Depreciation of furniture, fixtures and equipment	1,731	1,363
Noncash amortization of share-based compensation awards	8,817	6,454
Noncash amortization of deferred financing costs and debt discounts and premiums	3,563	4,047
Noncash amortization of net below market rents (Note 3)	(6,216)	(6,015)
Gains on dispositions of discontinued operations (Note 13)	(110,391)	(423)
Gain on sale of land (Note 13)	(3,490)	—
Noncash amortization of deferred revenue related to tenant-funded tenant improvements	(7,695)	(7,585)
Straight-line rents	(15,245)	(18,188)
Net change in other operating assets	(795)	(6,435)
Net change in other operating liabilities	25,671	42,844
Insurance proceeds received for property damage	—	(448)
Net cash provided by operating activities	197,264	186,310
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Expenditures for acquisition of operating properties (Note 2)	(106,125)	(202,682)
Expenditures for operating properties	(93,977)	(83,991)
Expenditures for development and redevelopment properties and undeveloped land	(292,803)	(222,192)
Expenditures for acquisition of development and redevelopment properties (Note 2)	(97,727)	(13,269)
Net proceeds received from dispositions of operating properties and land (Note 13)	368,381	14,409
Insurance proceeds received from property damage	—	448
Decrease (increase) in acquisition-related deposits	1,000	(4,000)
Decrease in restricted cash (Notes 1 and 13)	32,293	229,613
Net cash used in investing activities	(188,958)	(281,664)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net proceeds from issuance of common stock (Note 7)	22,136	349,951
Borrowings on unsecured line of credit	365,000	10,000
Repayments on unsecured line of credit	(410,000)	(195,000)
Principal payments on secured debt	(7,315)	(91,298)
Proceeds from the issuance of unsecured debt (Note 5)	395,528	299,901
Repayments of unsecured debt (Note 5)	(83,000)	—
Repayments for early redemption of exchangeable senior notes (Note 5)	(37,092)	—
Financing costs	(8,043)	(3,975)
Repurchase of common stock and restricted stock units	(2,861)	(1,813)
Proceeds from exercise of stock options (Note 9)	20,537	128
Contributions from noncontrolling interests in consolidated subsidiary	336	—
Dividends and distributions paid to common stockholders and common unitholders	(88,540)	(82,152)
Dividends and distributions paid to preferred stockholders and preferred unitholders	(9,938)	(9,938)
Net cash provided by financing activities	156,748	275,804

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Net increase in cash and cash equivalents	165,054	180,450
Cash and cash equivalents, beginning of period	35,377	16,700
Cash and cash equivalents, end of period	\$200,431	\$197,150

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

	Nine Months Ended September 30,	
	2014	2013
<b>SUPPLEMENTAL CASH FLOWS INFORMATION:</b>		
Cash paid for interest, net of capitalized interest of \$33,533 and \$23,573 as of September 30, 2014 and 2013, respectively	\$42,633	\$47,107
<b>NONCASH INVESTING TRANSACTIONS:</b>		
Accrual for expenditures for operating properties and development and redevelopment properties	\$92,693	\$79,866
Tenant improvements funded directly by tenants	\$23,069	\$5,750
Assumption of other assets and liabilities in connection with operating and development property acquisitions, net	\$2,300	\$422
Contribution of land, net of related liabilities, by noncontrolling interest to consolidated subsidiary	\$—	\$4,885
Assumption of secured debt in connection with property acquisitions	\$—	\$95,496
<b>NONCASH FINANCING TRANSACTIONS:</b>		
Accrual of dividends and distributions payable to common stockholders and common unitholders	\$30,258	\$29,378
Accrual of dividends and distributions payable to preferred stockholders and preferred unitholders	\$1,656	\$1,692
Fair value of share-based compensation awards at equity classification date (Note 9)	\$18,111	\$10,347
Exchange of common units of the Operating Partnership into shares of the Company's common stock	\$28	\$—



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

(Unaudited; in thousands, except unit data)

	September 30, 2014	December 31, 2013
<b>ASSETS</b>		
<b>REAL ESTATE ASSETS:</b>		
Land and improvements (Note 2)	\$ 757,036	\$ 657,491
Buildings and improvements (Note 2)	3,882,015	3,590,699
Undeveloped land and construction in progress (Note 2)	1,112,046	1,016,757
Total real estate assets held for investment	5,751,097	5,264,947
Accumulated depreciation and amortization	(912,623	) (818,957
Total real estate assets held for investment, net (\$98,121 and \$234,532 of VIE, respectively, Note 1)	4,838,474	4,445,990
<b>REAL ESTATE ASSETS AND OTHER ASSETS HELD FOR SALE, NET (Note 13)</b>	<b>49,815</b>	<b>213,100</b>
<b>CASH AND CASH EQUIVALENTS</b>	<b>200,431</b>	<b>35,377</b>
<b>RESTRICTED CASH (Notes 1 and 13)</b>	<b>17,487</b>	<b>49,780</b>
<b>MARKETABLE SECURITIES (Note 11)</b>	<b>12,076</b>	<b>10,008</b>
<b>CURRENT RECEIVABLES, NET (Note 4)</b>	<b>6,443</b>	<b>10,743</b>
<b>DEFERRED RENT RECEIVABLES, NET (Note 4)</b>	<b>139,910</b>	<b>127,123</b>
<b>DEFERRED LEASING COSTS AND ACQUISITION-RELATED INTANGIBLE ASSETS, NET (Notes 2 and 3)</b>	<b>183,057</b>	<b>186,622</b>
<b>DEFERRED FINANCING COSTS, NET</b>	<b>19,373</b>	<b>16,502</b>
<b>PREPAID EXPENSES AND OTHER ASSETS, NET</b>	<b>20,398</b>	<b>15,783</b>
<b>TOTAL ASSETS</b>	<b>\$ 5,487,464</b>	<b>\$ 5,111,028</b>
<b>LIABILITIES AND CAPITAL</b>		
<b>LIABILITIES:</b>		
Secured debt (Notes 5 and 11)	\$ 549,896	\$ 560,434
Exchangeable senior notes, net (Notes 5 and 11)	135,049	168,372
Unsecured debt, net (Notes 5 and 11)	1,743,962	1,431,132
Unsecured line of credit (Notes 5 and 11)	—	45,000
Accounts payable, accrued expenses and other liabilities	243,602	198,467
Accrued distributions (Note 16)	31,897	31,490
Deferred revenue and acquisition-related intangible liabilities, net (Notes 2 and 3)	114,504	101,286
Rents received in advance and tenant security deposits	45,086	44,240
Liabilities of real estate assets held for sale (Note 13)	3,099	14,447
Total liabilities	2,867,095	2,594,868
<b>COMMITMENTS AND CONTINGENCIES (Note 10)</b>		
<b>CAPITAL:</b>		
Partners' Capital (Note 8):		
6.875% Series G Cumulative Redeemable Preferred units, 4,000,000 units issued and outstanding (\$100,000 liquidation preference)	96,155	96,155

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6.375% Series H Cumulative Redeemable Preferred units, 4,000,000 units issued and outstanding (\$100,000 liquidation preference)	96,256	96,256
Common units, 83,388,220 and 82,153,944 held by the general partner and 1,804,200 and 1,805,200 held by common limited partners issued and outstanding, respectively	2,419,033	2,315,361
Total partners' capital	2,611,444	2,507,772
Noncontrolling interests in consolidated subsidiaries (Notes 1 and 6)	8,925	8,388
Total capital	2,620,369	2,516,160
<b>TOTAL LIABILITIES AND CAPITAL</b>	<b>\$ 5,487,464</b>	<b>\$ 5,111,028</b>

See accompanying notes to consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
<b>REVENUES</b>				
Rental income	\$ 115,221	\$ 103,354	\$ 338,911	\$ 303,573
Tenant reimbursements	11,346	9,583	33,399	28,350
Other property income (Note 12)	2,457	608	7,650	6,584
Total revenues	129,024	113,545	379,960	338,507
<b>EXPENSES</b>				
Property expenses	25,801	24,470	75,448	69,895
Real estate taxes	11,008	10,088	32,728	29,129
Provision for bad debts	58	101	58	196
Ground leases	771	929	2,306	2,665
General and administrative expenses	11,138	10,226	33,806	29,750
Acquisition-related expenses	431	568	1,268	1,387
Depreciation and amortization	50,032	45,804	148,647	138,652
Total expenses	99,239	92,186	294,261	271,674
<b>OTHER (EXPENSES) INCOME</b>				
Interest income and other net investment gains/(losses) (Note 11)	(9	) 673	587	1,084
Interest expense (Note 5)	(16,608	) (18,853	) (49,880	) (58,021
Total other (expenses) income	(16,617	) (18,180	) (49,293	) (56,937
<b>INCOME FROM CONTINUING OPERATIONS BEFORE GAIN ON SALE OF LAND</b>	13,168	3,179	36,406	9,896
Gain on sale of land (Note 13)	—	—	3,490	—
<b>INCOME FROM CONTINUING OPERATIONS DISCONTINUED OPERATIONS (Note 13)</b>	13,168	3,179	39,896	9,896
Income from discontinued operations	548	5,848	2,091	11,199
Gains on dispositions of discontinued operations	5,587	—	110,391	423
Total income from discontinued operations	6,135	5,848	112,482	11,622
<b>NET INCOME</b>	19,303	9,027	152,378	21,518
Net income attributable to noncontrolling interests in consolidated subsidiaries	(59	) (47	) (201	) (178
<b>NET INCOME ATTRIBUTABLE TO KILROY REALTY, L.P.</b>	19,244	8,980	152,177	21,340
<b>PREFERRED DISTRIBUTIONS</b>	(3,313	) (3,312	) (9,938	) (9,938
<b>NET INCOME AVAILABLE TO COMMON UNITHOLDERS</b>	\$ 15,931	\$ 5,668	\$ 142,239	\$ 11,402
Income (loss) from continuing operations available to common unitholders per unit – basic (Note 15)	\$ 0.11	\$ 0.00	\$ 0.34	\$ (0.02)
Income (loss) from continuing operations available to common unitholders per unit – diluted (Note 15)	\$ 0.11	\$ 0.00	\$ 0.33	\$ (0.02)
Net income available to common unitholders per unit – basic (Note 15)	\$ 0.18	\$ 0.07	\$ 1.67	\$ 0.13
	\$ 0.18	\$ 0.07	\$ 1.63	\$ 0.13

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Net income available to common unitholders per unit – diluted

(Note 15)

Weighted average common units outstanding – basic (Note 15)	84,965,523	78,590,396	84,329,317	77,574,907
Weighted average common units outstanding – diluted (Note 15)	86,914,656	78,590,396	86,426,906	77,574,907
Dividends declared per common unit	\$0.35	\$0.35	\$1.05	\$1.05

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		Common Units	Total Partners' Capital	Noncontrolling Interests in Consolidated Subsidiaries	Total Capital
	Preferred Units	Number of Common Units				
BALANCE AS OF DECEMBER 31, 2012	\$ 192,411	76,753,484	\$ 2,040,243	\$ 2,232,654	\$ 3,279	\$ 2,235,933
Net income			21,340	21,340	178	21,518
Issuance of common units		7,210,838	349,951	349,951		349,951
Issuance of share-based compensation awards		—	1,075	1,075		1,075
Noncash amortization of share-based compensation			7,096	7,096		7,096
Repurchase of common units and restricted stock units		(34,164 )	(1,803 )	(1,803 )		(1,803 )
Settlement of restricted stock units		4,363	(10 )	(10 )		(10 )
Exercise of stock options, net		473	128	128		128
Contribution by noncontrolling interest in consolidated subsidiary				—	4,885	4,885
Preferred distributions			(9,938 )	(9,938 )		(9,938 )
Distributions declared per common unit (\$1.05 per unit)			(84,741 )	(84,741 )		(84,741 )
BALANCE AS OF SEPTEMBER 30, 2013	\$ 192,411	83,934,994	\$ 2,323,341	\$ 2,515,752	\$ 8,342	\$ 2,524,094

	Partners' Capital		Common Units	Total Partners' Capital	Noncontrolling Interests in Consolidated Subsidiaries	Total Capital
	Preferred Units	Number of Common Units				
BALANCE AS OF DECEMBER 31, 2013	\$ 192,411	83,959,144	\$ 2,315,361	\$ 2,507,772	\$ 8,388	\$ 2,516,160
Net income			152,177	152,177	201	152,378
Issuance of common units (Note 8)		370,700	22,136	22,136		22,136
Issuance of share-based compensation awards			1,281	1,281		1,281
Noncash amortization of share-based compensation			10,345	10,345		10,345
Exercise of stock options (Note 9)		482,000	20,537	20,537		20,537
Repurchase of common units, stock options and restricted stock units		(48,017 )	(2,861 )	(2,861 )		(2,861 )
Settlement of restricted stock units		108,529	—	—		—
Common units issued in connection with early exchange of 4.25%		431,270	223	223		223

Exchangeable Senior Notes (Note 5)						
Common units received in connection with capped call option transactions (Note 5)	(111,206 )		—			—
Contribution by noncontrolling interest in consolidated subsidiary			—	336		336
Preferred distributions	(9,938 )	(9,938 )				(9,938 )
Distributions declared per common unit (\$1.05 per unit)	(90,228 )	(90,228 )				(90,228 )
BALANCE AS OF SEPTEMBER 30, 2014	\$ 192,411	85,192,420	\$ 2,419,033	\$ 2,611,444	\$ 8,925	\$ 2,620,369

See accompanying notes to consolidated financial statements.

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

	Nine Months Ended September 30,	
	2014	2013
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 152,378	\$ 21,518
Adjustments to reconcile net income to net cash provided by operating activities (including discontinued operations):		
Depreciation and amortization of building and improvements and leasing costs	148,878	148,982
Increase in provision for bad debts	58	196
Depreciation of furniture, fixtures and equipment	1,731	1,363
Noncash amortization of share-based compensation awards	8,817	6,454
Noncash amortization of deferred financing costs and debt discounts and premiums	3,563	4,047
Noncash amortization of net below market rents (Note 3)	(6,216)	(6,015)
Gains on dispositions of discontinued operations (Note 13)	(110,391)	(423)
Gain on sale of land (Note 13)	(3,490)	—
Noncash amortization of deferred revenue related to tenant-funded tenant improvements	(7,695)	(7,585)
Straight-line rents	(15,245)	(18,188)
Net change in other operating assets	(795)	(6,435)
Net change in other operating liabilities	25,671	42,844
Insurance proceeds received for property damage	—	(448)
Net cash provided by operating activities	197,264	186,310
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Expenditures for acquisition of operating properties (Note 2)	(106,125)	(202,682)
Expenditures for operating properties	(93,977)	(83,991)
Expenditures for development and redevelopment properties and undeveloped land	(292,803)	(222,192)
Expenditures for acquisition of development and redevelopment properties (Note 2)	(97,727)	(13,269)
Net proceeds received from dispositions of operating properties and land (Note 13)	368,381	14,409
Insurance proceeds received for property damage	—	448
Decrease (increase) in acquisition-related deposits	1,000	(4,000)
Decrease in restricted cash (Notes 1 and 13)	32,293	229,613
Net cash used in investing activities	(188,958)	(281,664)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Net proceeds from issuance of common units (Note 8)	22,136	349,951
Borrowings on unsecured line of credit	365,000	10,000
Repayments on unsecured line of credit	(410,000)	(195,000)
Principal payments on secured debt	(7,315)	(91,298)
Proceeds from the issuance of unsecured debt (Note 5)	395,528	299,901
Repayments of unsecured debt (Note 5)	(83,000)	—
Repayments for early redemptions of exchangeable senior notes (Note 5)	(37,092)	—
Financing costs	(8,043)	(3,975)
Repurchase of common units and restricted stock units	(2,861)	(1,813)
Proceeds from exercise of stock options (Note 9)	20,537	128
Contributions from noncontrolling interests in consolidated subsidiary	336	—
Distributions paid to common unitholders	(88,540)	(82,152)
Distributions paid to preferred unitholders	(9,938)	(9,938)
Net cash provided by financing activities	156,748	275,804



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Net increase in cash and cash equivalents	165,054	180,450
Cash and cash equivalents, beginning of period	35,377	16,700
Cash and cash equivalents, end of period	\$200,431	\$197,150

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

	Nine Months Ended September 30,	
	2014	2013
<b>SUPPLEMENTAL CASH FLOWS INFORMATION:</b>		
Cash paid for interest, net of capitalized interest of \$33,533 and \$23,573 as of September 30, 2014 and 2013, respectively	\$42,633	\$47,107
<b>NONCASH INVESTING TRANSACTIONS:</b>		
Accrual for expenditures for operating properties and development and redevelopment properties	\$92,693	\$79,866
Tenant improvements funded directly by tenants	\$23,069	\$5,750
Assumption of other assets and liabilities in connection with operating and development property acquisitions, net	\$2,300	\$422
Contribution of land, net of related liabilities, by noncontrolling interest to consolidated subsidiary	\$—	\$4,885
Assumption of secured debt in connection with property acquisitions	\$—	\$95,496
<b>NONCASH FINANCING TRANSACTIONS:</b>		
Accrual of distributions payable to common unitholders	\$30,258	\$29,378
Accrual of distributions payable to preferred unitholders	\$1,656	\$1,692
Fair value of share-based compensation awards at equity classification date (Note 9)	\$18,111	\$10,347

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  
 Three and Nine Months Ended September 30, 2014 and 2013

1. Organization and Basis of Presentation

Organization

Kilroy Realty Corporation (the “Company”) is a self-administered real estate investment trust (“REIT”) active in premier office submarkets along the West Coast. We own, develop, acquire and manage real estate assets, consisting primarily of Class A properties in the coastal regions of Los Angeles, Orange County, San Diego County, the San Francisco Bay Area and greater Seattle, which we believe have strategic advantages and strong barriers to entry. Class A real estate encompasses attractive and efficient buildings of high quality that are attractive to tenants, are well-designed and constructed with above-average material, workmanship and finishes and are well-maintained and managed. We qualify as a REIT under the Internal Revenue Code of 1986, as amended (the “Code”). The Company’s common stock is publicly traded on the New York Stock Exchange (“NYSE”) under the ticker symbol “KRC.”

We own our interests in all of our real estate assets through Kilroy Realty, L.P. (the “Operating Partnership”) and Kilroy Realty Finance Partnership, L.P. (the “Finance Partnership”). We 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 office properties at September 30, 2014:

	Number of Buildings	Rentable Square Feet	Number of Tenants	Percentage Occupied	
Stabilized Office Properties	105	13,486,006	526	94.1	%

Our stabilized portfolio includes all of our properties with the exception of real estate assets held for sale, undeveloped land, development and redevelopment properties currently under construction or committed for construction, and “lease-up” properties. As of September 30, 2014, our stabilized portfolio of operating properties excluded two properties that were classified as held for sale as of that date. 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 “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. There were no operating properties in “lease-up” as of September 30, 2014. During the third quarter of 2014, we stabilized a development project in the Sunnyvale submarket of San Francisco, California consisting of three office buildings encompassing 587,429 square feet. As a result, this project is now included in our stabilized portfolio as of September 30, 2014.

As of September 30, 2014, the following properties were excluded from our stabilized portfolio:

	Number of Properties/Projects	Estimated Rentable Square Feet
Properties Held for Sale <sup>(1)</sup>	2	228,788
Development projects under construction <sup>(2)(3)</sup>	5	2,000,000

- (1) Includes two properties, one located in Orange, California and the other in the San Rafael submarket of San Francisco, California. For additional information see Note 13.
- (2) Estimated rentable square feet upon completion.
- (3) During the third quarter of 2014, we stabilized a development property in the Sunnyvale submarket of San Francisco, California consisting of three office buildings encompassing 587,429 square feet. As a result, this project is now included in our stabilized portfolio as of September 30, 2014.

As of September 30, 2014, all of our properties and development and redevelopment projects and all of our business was conducted in the state of California with the exception of thirteen office properties located in the state of Washington. All of our properties and development and redevelopment projects are 100% owned, excluding a development project owned by Redwood City Partners, LLC, a consolidated subsidiary (see Note 6).

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

As of September 30, 2014, the Company owned a 97.9% common general partnership interest in the Operating Partnership. The remaining 2.1% common limited partnership interest in the Operating Partnership as of September 30, 2014 was owned by non-affiliated investors and certain of our executive officers and directors (see Note 6). 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" (see Note 6).

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

#### Basis of Presentation

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

The accompanying interim financial statements have been prepared by management in accordance with accounting principles generally accepted in the United States of America ("GAAP") and in conjunction with the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures required for annual financial statements have been condensed or excluded pursuant to SEC rules and regulations. Accordingly, the interim financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the accompanying interim financial statements reflect all adjustments of a normal and recurring nature that are considered necessary for a fair presentation of the results for the interim periods presented. However, the results of operations for the interim periods are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. 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/A for the year ended December 31, 2013.

Certain amounts in the consolidated statements of operations for prior periods have been reclassified to reflect the activity of discontinued operations.

#### Variable Interest Entities

At September 30, 2014, the consolidated financial statements of the Company and the Operating Partnership included one variable interest entity ("VIE"), in which we were deemed to be the primary beneficiary. The VIE, Redwood City

Partners, LLC, was established in the second quarter of 2013 in connection with an undeveloped land acquisition. The impact of consolidating the VIE increased the Company's total assets, liabilities and noncontrolling interests by approximately \$98.5 million (of which \$98.1 million related to real estate held for investment on our consolidated balance sheet), approximately \$20.1 million and approximately \$5.2 million, respectively, as of September 30, 2014. As of December 31, 2013, the consolidated financial statements of the Company and the Operating Partnership included four VIEs, in which we were deemed to be the primary beneficiary. One of the VIEs was Redwood City Partners, LLC and the remaining three VIEs were established during the third and fourth quarter of 2013 to facilitate potential Section 1031 Exchanges. During the three months ended March 31, 2014, the Section 1031 Exchanges were successfully completed and the three VIEs were terminated. As a result, \$32.2 million of our restricted cash balance at December 31, 2013, which related to prior period disposition proceeds that were set aside to facilitate the Section 1031 Exchanges, was released from escrow. The impact of consolidating the VIEs increased the Company's total assets, liabilities and noncontrolling interests by approximately \$251.8 million (of which \$234.5 million related to real estate held for investment on our consolidated balance sheet), approximately \$12.1 million and approximately \$4.9 million, respectively, as of December 31, 2013.

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

Recent Accounting Pronouncements

On June 19, 2014, the Financial Accounting Standards Board (“FASB”) issued their final standard to amend the accounting guidance for stock compensation tied to performance targets (Accounting Standards Update (“ASU”) No. 2014-12). The issue is the result of a consensus of the FASB Emerging Issues Task Force (Issue No. 13-D). The standard requires that a performance target that could be achieved after the requisite service period be treated as a performance condition, and as a result, this type of performance condition may delay expense recognition until achievement of the performance target is probable. The ASU is effective for all entities for reporting periods (including interim periods) beginning after December 15, 2015, and early adoption is permitted. The Company will adopt the guidance effective January 1, 2016 and the guidance is not anticipated to have a material impact on our consolidated financial statements or notes to our consolidated financial statements.

On May 28, 2014, the FASB issued their final standard on revenue from contracts with customers. The guidance specifically notes that lease contracts with customers are a scope exception. The standard (ASU No. 2014-09) outlines a single comprehensive model for entities to use in accounting for revenues arising from contracts with customers. The ASU is effective for annual reporting periods (including interim periods), beginning after December 15, 2016, and early adoption is not permitted. The Company will adopt the guidance effective January 1, 2017 and is currently assessing the impact on our consolidated financial statements and notes to our consolidated financial statements.

On April 10, 2014, the FASB issued final guidance to change the criteria for reporting discontinued operations while enhancing disclosures in this area (ASU No. 2014-08). Under the new guidance, only disposals representing a strategic shift, such as a major line of business, a major geographical area or a major equity investment, should be presented as discontinued operations. The guidance will be applied prospectively to new disposals and new classifications of disposal groups as held for sale after the effective date. The guidance is effective for annual financial statements with fiscal years beginning on or after December 15, 2014 with early adoption permitted for disposals or classifications as held for sale which have not been reported in financial statements previously issued or available for issuance. The Company will adopt the guidance effective January 1, 2015 and the guidance is not anticipated to have a material impact on our consolidated financial statements and notes to our consolidated financial statements.



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

## 2. Acquisitions

### Operating Properties

During the nine months ended September 30, 2014, we acquired the one operating office property listed below, from an unrelated third party. The acquisition was funded with proceeds from 2013 and 2014 dispositions (see Note 13).

Property	Date of Acquisition	Number of Buildings	Rentable Square Feet	Occupancy as of September 30, 2014	Purchase Price (in millions)
401 Terry Avenue North, Seattle, WA	March 13, 2014	1	140,605	100.0%	\$106.1

The related assets, liabilities and results of operations of the acquired property 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 on the acquisition date:

	Total 2014 Acquisitions (in thousands)
<b>Assets</b>	
Land and improvements	\$22,500
Buildings and improvements <sup>(1)</sup>	77,046
Deferred leasing costs and acquisition-related intangible assets <sup>(2)</sup>	11,199
Total assets acquired	110,745
<b>Liabilities</b>	
Deferred revenue and acquisition-related intangible liabilities <sup>(3)</sup>	4,620
Total liabilities assumed	4,620
Net assets and liabilities acquired	\$106,125

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

Represents in-place leases of approximately \$9.3 million (with a weighted average amortization period of (2) seven years) and leasing commissions of approximately \$1.9 million (with a weighted average amortization period of seven years) at the time of the acquisition.

(3) Represents below-market leases of approximately \$4.6 million (with a weighted average amortization period of seven years).

### Development Project Sites

During the nine months ended September 30, 2014, we acquired one undeveloped land site listed below from an unrelated third party. The acquisition was funded with proceeds from the Company's at-the-market stock offering program (see Note 7) and disposition proceeds (see Note 13).

Project	Date of Acquisition	Type	Purchase Price (in millions)
Kilroy Mission Bay, San Francisco, CA <sup>(1)</sup>	May 23, 2014	Land	\$95.0

(1) In connection with this acquisition, we also assumed \$2.3 million in accrued liabilities which are not included in the purchase price above. As of September 30, 2014, 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 our consolidated balance sheets.

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

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

The following table summarizes our deferred leasing costs and acquisition-related intangible assets (acquired value of leasing costs, above-market operating leases, in-place leases and below-market ground lease obligation) and intangible liabilities (acquired value of below-market operating leases and above-market ground lease obligation) as of September 30, 2014 and December 31, 2013:

	September 30, 2014 (in thousands)	December 31, 2013
Deferred Leasing Costs and Acquisition-Related Intangible Assets, net:		
Deferred leasing costs	\$196,963	\$ 178,720
Accumulated amortization	(71,911)	(63,246)
Deferred leasing costs, net	125,052	115,474
Above-market operating leases	21,926	27,635
Accumulated amortization	(14,151)	(14,283)
Above-market operating leases, net	7,775	13,352
In-place leases	94,281	100,318
Accumulated amortization	(44,522)	(42,999)
In-place leases, net	49,759	57,319
Below-market ground lease obligation	490	490
Accumulated amortization	(19)	(13)
Below-market ground lease obligation, net	471	477
Total deferred leasing costs and acquisition-related intangible assets, net	\$183,057	\$ 186,622
Acquisition-Related Intangible Liabilities, net: <sup>(1)</sup>		
Below-market operating leases	\$69,533	\$ 69,385
Accumulated amortization	(31,288)	(25,706)
Below-market operating leases, net	38,245	43,679
Above-market ground lease obligation	6,320	6,320
Accumulated amortization	(298)	(223)
Above-market ground lease obligation, net	6,022	6,097
Total acquisition-related intangible liabilities, net	\$44,267	\$ 49,776

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

The following table sets forth amortization related to deferred leasing costs and acquisition-related intangibles, including amounts attributable to discontinued operations, for the three and nine months ended September 30, 2014 and 2013:

	Three Months Ended September		Nine Months Ended September	
	30, 2014	2013	30, 2014	2013
	(in thousands)			
Deferred leasing costs <sup>(1)</sup>	\$7,132	\$6,945	\$20,683	\$20,882
Above-market operating leases <sup>(2)</sup>	1,305	1,417	4,230	4,214
In-place leases <sup>(1)</sup>	5,169	7,677	17,090	22,546

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Below-market ground lease obligation <sup>(3)</sup>	2	2	6	6
Below-market operating leases <sup>(4)</sup>	(2,940	) (3,355	) (10,054	) (10,229
Above-market ground lease obligation <sup>(5)</sup>	(26	) (25	) (76	) (76
Total	\$10,642	\$12,661	\$31,879	\$37,343

- 
- The amortization of deferred leasing costs related to lease incentives is recorded to rental income and other
- (1) 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 above-market operating leases is recorded as a decrease to rental income in the consolidated statements of operations for the periods presented.
  - (3) The amortization of the below-market ground lease obligation is recorded as an increase to ground lease expense in the consolidated statements of operations for the periods presented.
  - (4) The amortization of below-market operating leases is recorded as an increase to rental income in the consolidated statements of operations for the periods presented.
  - (5) The amortization of the above-market ground lease obligation is recorded as a decrease to ground lease expense in the consolidated statements of operations for the periods presented.

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

The following table sets forth the estimated annual amortization expense related to deferred leasing costs and acquisition-related intangibles as of September 30, 2014 for future periods:

Year	Deferred Leasing Costs	Above-Market Operating Leases <sup>(1)</sup>	In-Place Leases	Below-Market Ground Lease Obligation <sup>(2)</sup>	Below-Market Operating Leases <sup>(3)</sup>	Above-Market Ground Lease Obligation <sup>(4)</sup>
	(in thousands)					
Remaining 2014	\$6,936	\$ 993	\$4,274	\$ 2	\$ (2,851 )	\$ (26 )
2015	24,851	2,530	13,131	8	(9,567 )	(101 )
2016	22,045	1,503	10,080	8	(7,847 )	(101 )
2017	19,163	1,241	8,440	8	(6,780 )	(101 )
2018	15,748	831	5,532	8	(5,177 )	(101 )
Thereafter	36,309	677	8,302	437	(6,023 )	(5,592 )
Total	\$125,052	\$ 7,775	\$49,759	\$ 471	\$ (38,245 )	\$ (6,022 )

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

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

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

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

#### 4. Receivables

##### Current Receivables, net

Current receivables, net is primarily comprised of contractual rents and other lease-related obligations due from tenants. The balance consisted of the following as of September 30, 2014 and December 31, 2013:

	September 30, 2014 <sup>(1)</sup>	December 31, 2013
	(in thousands)	
Current receivables	\$8,626	\$ 12,866
Allowance for uncollectible tenant receivables	(2,183 )	(2,123 )
Current receivables, net	\$6,443	\$ 10,743

(1) Excludes current receivables, net related to properties held for sale at September 30, 2014.

##### Deferred Rent Receivables, net

Deferred rent receivables, net consisted of the following as of September 30, 2014 and December 31, 2013:

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	September 30, 2014 <sup>(1)</sup>	December 31, 2013
	(in thousands)	
Deferred rent receivables	\$ 141,899	\$ 129,198
Allowance for deferred rent receivables	(1,989	) (2,075
Deferred rent receivables, net	\$ 139,910	\$ 127,123

(1) Excludes deferred rent receivables, net related to properties held for sale at September 30, 2014.

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

5. Secured and Unsecured Debt of the Operating Partnership

Secured Debt

The following table sets forth the composition of our secured debt as of September 30, 2014 and December 31, 2013:

Type of Debt	Annual Stated Interest Rate (1)	GAAP Effective Rate (1)(2)	Maturity Date	September 30, 2014 (3)	December 31, 2013 (3)
				(in thousands)	
Mortgage note payable	4.27%	4.27%	February 2018	\$131,363	\$133,117
Mortgage note payable (4)	4.48%	4.48%	July 2027	97,000	97,000
Mortgage note payable (4)	6.05%	3.50%	June 2019	90,065	92,502
Mortgage note payable	6.51%	6.51%	February 2017	66,907	67,663
Mortgage note payable (4)	5.23%	3.50%	January 2016	53,243	54,570
Mortgage note payable (4)	5.57%	3.25%	February 2016	40,611	41,654
Mortgage note payable (4)	5.09%	3.50%	August 2015	34,446	34,845
Mortgage note payable (4)	4.94%	4.00%	April 2015	26,629	27,641
Mortgage note payable	7.15%	7.15%	May 2017	7,185	8,972
Other	Various	Various	Various	2,447	2,470
Total				\$549,896	\$560,434

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

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

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

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

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

4.25% Exchangeable Senior Notes

The table below summarizes the balance and significant terms of the Company's 4.25% Exchangeable Notes due November 2014 (the "4.25% Exchangeable Notes") outstanding as of September 30, 2014 and December 31, 2013.

	4.25% Exchangeable Notes	
	September 30, 2014	December 31, 2013
	(in thousands)	
Principal amount	\$135,481	\$172,500
Unamortized discount	(432)	(4,128)
Net carrying amount of liability component	\$135,049	\$168,372

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Carrying amount of equity component <sup>(1)</sup>	\$15,578	\$19,835
Issuance date	November 2009	
Maturity date	November 2014	
Stated coupon rate <sup>(2)</sup>	4.25%	
Effective interest rate <sup>(3)</sup>	7.13%	
Exchange rate per \$1,000 principal value of the 4.25% Exchangeable Notes, as adjusted <sup>(3)</sup>	27.8307	
Exchange price, as adjusted <sup>(4)</sup>	\$35.93	
Number of shares on which the aggregate consideration to be delivered on conversion is determined <sup>(4)</sup>	3,770,531	4,800,796

The \$15.6 million carrying amount of the equity component at September 30, 2014 represents the proportionate (1) amount of the initial \$19.8 million carrying value of the equity component allocated to the remaining \$135.5 million outstanding principal balance of the 4.25% Exchangeable Notes at September 30, 2014.

(2) Interest on the 4.25% Exchangeable Notes is payable semi-annually in arrears on May 15<sup>th</sup> and November 15<sup>th</sup> 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 4.25% 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.



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 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

During the nine months ended September 30, 2014, the Company settled early exchanges of the 4.25% Exchangeable Notes with an aggregate principal amount of \$37.0 million. For these exchanges, the number of shares issued in excess of the exchange value was calculated on a proportionate basis for each day of a 30 trading-day observation following the exchange date. For the exchange settlements, the Company paid the noteholders a total of \$37.0 million in cash for the principal amount and issued to the noteholders a total of 431,270 shares of our common stock for the excess exchange value. As a result of the exchanges, the Company exercised the equivalent proportionate amount of its capped call options and, in connection received 111,206 shares of our common stock from the counterparties. This reduced the shares of common stock issued in connection with the exchanges to 320,064 shares.

Upon exchange of the balance of the 4.25% Exchangeable Notes at maturity, the holders will receive (i) cash up to the principal amount of the 4.25% Exchangeable Notes and (ii) to the extent the exchange value exceeds the principal amount of the 4.25% Exchangeable Notes, shares of the Company's common stock. Any shares of common stock delivered for settlement will be based on a daily exchange value calculated on a proportionate basis for each day of a 30 trading-day observation period.

The 4.25% Exchangeable Notes are exchangeable for shares of the Company's common stock prior to maturity only upon the occurrence of certain events. During the three and nine months ended September 30, 2014, the closing sale price per share of the common stock of the Company was more than 130% of the exchange price per share of the Company's common stock for at least 20 trading days in the specified period. As a result, for the three month period ended September 30, 2014, the 4.25% Exchangeable Notes were exchangeable at the exchange rate stated above and may be exchangeable thereafter, if one or more of the events were again to occur during future measurement periods.

In connection with the offering of the 4.25% Exchangeable Notes, we entered into capped call option transactions ("capped calls") to mitigate the dilutive impact of the potential exchange of the 4.25% Exchangeable Notes. The capped calls, as amended, are separate transactions entered into by us with the relevant financial institutions, are not part of the terms of the 4.25% Exchangeable Notes, and do not affect the holders' rights under the 4.25% Exchangeable Notes. The strike prices of the capped calls, which are subject to customary anti-dilution adjustments, correspond to the exchange prices of the applicable 4.25% Exchangeable Notes. The table below summarizes our capped call option positions for the 4.25% Exchangeable Notes as of September 30, 2014 and December 31, 2013.

	4.25% Exchangeable Notes	
	September 30, 2014	December 31, 2013
Referenced shares of common stock <sup>(1)</sup>	3,770,531	4,800,796
Exchange price, including effect of capped calls	\$42.81	\$ 42.81

(1) The referenced shares of common stock decreased during the nine months ended September 30, 2014 as a result of the settled exchanges of the 4.25% Exchangeable Notes totaling \$37.0 million.

The capped calls are expected to terminate upon the earlier of the maturity date of the 4.25% Exchangeable Notes or upon the date upon which the 4.25% Exchangeable Notes are no longer outstanding resulting from an exchange or repurchase by us. The initial cost of the capped calls were recorded as a reduction to additional paid-in capital.

For the three and nine months ended September 30, 2014 and 2013, the per share average trading price of the Company's common stock on the NYSE was higher than the \$35.93 exchange price for the 4.25% Exchangeable Notes, as presented below:

	Three Months Ended		Nine Months Ended September	
	September 30, 2014	2013	30, 2014	2013
Per share average trading price of the Company's common stock	\$62.06	\$51.57	\$59.27	\$52.42

The 4.25% Exchangeable Notes were exchangeable as of September 30, 2014 and September 30, 2013. If the 4.25% Exchangeable Notes outstanding as of those dates were exchanged, the approximate fair value of the shares upon exchange at September 30, 2014 and 2013, using the per share average trading price presented in the table above, would have been as follows:

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(in thousands)			
Approximate fair value of shares upon exchange	\$229,840	\$245,200	\$223,732	\$248,000
Principal amount of the 4.25% Exchangeable Notes	135,481	172,500	135,481	172,500
Approximate fair value in excess amount of principal amount	\$94,359	\$72,700	\$88,251	\$75,500

See Notes 14 and 15 for a discussion of the impact of the 4.25% Exchangeable Notes on our diluted earnings per share and unit calculations for the periods presented.

#### Interest Expense for the 4.25% Exchangeable Notes

The unamortized discount on the 4.25% Exchangeable Notes is accreted as additional interest expense from the date of issuance through the maturity date of the applicable Exchangeable Notes. The following table summarizes the total interest expense attributable to the 4.25% Exchangeable Notes based on the respective effective interest rates, before the effect of capitalized interest, for the three and nine months September 30, 2014 and 2013:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(in thousands)			
Contractual interest payments	\$1,439	\$1,833	\$4,908	\$5,498
Amortization of discount	1,004	1,116	3,337	3,291
Interest expense attributable to the 4.25% Exchangeable Notes	\$2,443	\$2,949	\$8,245	\$8,789

#### Unsecured Senior Notes

In July 2014, the Operating Partnership issued \$400.0 million aggregate principal amount of unsecured senior notes in a registered public offering. The outstanding balance of the unsecured senior notes is included in unsecured debt, net of the initial issuance discount of \$4.4 million, on our consolidated balance sheets. The unsecured senior notes, which are scheduled to mature on August 15, 2029, require semi-annual interest payments each February and August based on a stated annual interest rate of 4.250%. The Company used a portion of the net proceeds for general corporate purposes, including the repayment of borrowings under the Operating Partnership's revolving credit facility.

The following table summarizes the balance and significant terms of the registered unsecured senior notes issued by the Operating Partnership as of September 30, 2014 and December 31, 2013:

Issuance date	Maturity date	Stated coupon rate	Effective interest rate <sup>(1)</sup>	Principal Amount as of	
				September 30, 2014	December 31, 2013
(in thousands)					

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4.250% Unsecured Senior Notes <sup>(2)</sup> July 2014	August 2029	4.250%	4.350%	\$400,000	\$—
Unamortized discount				(4,422 )	—
Net carrying amount				\$395,578	\$—
3.800% Unsecured Senior Notes <sup>(3)</sup> January 2013	January 2023	3.800%	3.804%	\$300,000	\$300,000
Unamortized discount				(82 )	(90 )
Net carrying amount				\$299,918	\$299,910
4.800% Unsecured Senior Notes <sup>(4)</sup> July 2011	July 2018	4.800%	4.827%	\$325,000	\$325,000
Unamortized discount				(283 )	(339 )
Net carrying amount				\$324,717	\$324,661
6.625% Unsecured Senior Notes <sup>(5)</sup> May 2010	June 2020	6.625%	6.743%	\$250,000	\$250,000
Unamortized discount				(1,207 )	(1,367 )
Net carrying amount				\$248,793	\$248,633
5.000% Unsecured Senior Notes <sup>(6)</sup> November 2010	November 2015	5.000%	5.014%	\$325,000	\$325,000
Unamortized discount				(44 )	(73 )
Net carrying amount				\$324,956	\$324,927

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

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- (1) This represents the rate at which interest expense is recorded for financial reporting purposes, which reflects the amortization of initial issuance discounts, excluding debt issuance costs.
- (2) Interest on the 4.250% unsecured senior notes is payable semi-annually in arrears on February 15th and August 15th of each year.
- (3) Interest on the 3.800% unsecured senior notes is payable semi-annually in arrears on January 15th and July 15th of each year.
- (4) Interest on the 4.800% unsecured senior notes is payable semi-annually in arrears on January 15th and July 15th of each year.
- (5) Interest on the 6.625% unsecured senior notes is payable semi-annually in arrears on June 1st and December 1st of each year.
- (6) Interest on the 5.000% unsecured senior notes is payable semi-annually in arrears on May 3rd and November 3rd of each year.

In addition to the registered unsecured senior notes listed above, we also had outstanding Series B unsecured senior notes with an aggregate principal balance of \$83.0 million and effective interest rate of 6.45% as of December 31, 2013. We repaid the notes upon maturity in August 2014.

#### Unsecured Revolving Credit Facility and Term Loan Facility

In the second quarter of 2014, the Company amended the terms of our unsecured revolving credit facility and the Company's \$150.0 million term loan facility. The amendment increased the size of the Company's unsecured line of credit to \$600.0 million, extended the maturity to July 2019 on both the credit facility and term loan facility, reduced the annual interest rate on the unsecured revolving credit facility to LIBOR plus 1.250% and reduced the annual interest rate on the term loan facility to LIBOR plus 1.400%. The amendment did not affect the outstanding borrowings under the credit facility.

The following table summarizes the balance and terms of our unsecured revolving credit facility as of September 30, 2014 and December 31, 2013:

	September 30, 2014 (in thousands)	December 31, 2013	
Outstanding borrowings	\$—	\$45,000	
Remaining borrowing capacity	600,000	455,000	
Total borrowing capacity <sup>(1)</sup>	\$600,000	\$500,000	
Interest rate <sup>(2)(3)</sup>	—	% 1.62	%
Facility fee-annual rate <sup>(4)</sup>	0.250%	0.300%	
Maturity date	July 2019	April 2017	

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(1)