

KILROY REALTY CORP  
Form 10-Q  
July 30, 2008  
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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, 2008

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**

(Exact name of registrant as specified in its charter)

Maryland  
(State or other jurisdiction of  
incorporation or organization)  
12200 W. Olympic Boulevard,  
Suite 200,

95-4598246  
(I.R.S. Employer  
Identification No.)  
90064

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**Los Angeles, California**  
(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. 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.

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of July 29, 2008, 32,652,346 shares of common stock, par value \$.01 per share, were outstanding.

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**KILROY REALTY CORPORATION**

**QUARTERLY REPORT FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2008**

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*Unless otherwise indicated or unless the context requires otherwise, all references in this report to we, us, our or the Company mean Kilroy Realty Corporation, including our consolidated subsidiaries.*

**Table of Contents****PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****KILROY REALTY CORPORATION****CONSOLIDATED BALANCE SHEETS**

(in thousands, except share data)

|                                                                                   | <b>June 30,<br/>2008<br/>(unaudited)</b> | <b>December 31,<br/>2007</b> |
|-----------------------------------------------------------------------------------|------------------------------------------|------------------------------|
| <b>ASSETS</b>                                                                     |                                          |                              |
| <b>REAL ESTATE ASSETS:</b>                                                        |                                          |                              |
| Land and improvements                                                             | \$ 324,779                               | \$ 324,779                   |
| Buildings and improvements                                                        | 1,739,874                                | 1,719,700                    |
| Undeveloped land and construction in progress                                     | 365,106                                  | 324,077                      |
| Total real estate held for investment                                             | 2,429,759                                | 2,368,556                    |
| Accumulated depreciation and amortization                                         | (497,697)                                | (463,932)                    |
| Total real estate assets, net                                                     | 1,932,062                                | 1,904,624                    |
| CASH AND CASH EQUIVALENTS                                                         | 4,367                                    | 11,732                       |
| RESTRICTED CASH                                                                   | 756                                      | 546                          |
| MARKETABLE SECURITIES (Note 7)                                                    | 2,406                                    | 707                          |
| CURRENT RECEIVABLES, NET                                                          | 3,843                                    | 4,891                        |
| DEFERRED RENT RECEIVABLES, NET                                                    | 66,554                                   | 67,283                       |
| NOTES RECEIVABLE                                                                  | 10,904                                   | 10,970                       |
| DEFERRED LEASING COSTS AND ACQUISITION-RELATED INTANGIBLES, NET                   | 52,282                                   | 54,418                       |
| DEFERRED FINANCING COSTS, NET                                                     | 7,341                                    | 8,492                        |
| PREPAID EXPENSES AND OTHER ASSETS, NET                                            | 7,210                                    | 5,057                        |
| <b>TOTAL ASSETS</b>                                                               | <b>\$ 2,087,725</b>                      | <b>\$ 2,068,720</b>          |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                       |                                          |                              |
| <b>LIABILITIES:</b>                                                               |                                          |                              |
| Secured debt (Note 2)                                                             | \$ 392,511                               | \$ 395,912                   |
| Exchangeable senior notes, net (Note 2)                                           | 456,550                                  | 456,090                      |
| Unsecured senior notes                                                            | 144,000                                  | 144,000                      |
| Unsecured line of credit (Note 2)                                                 | 159,000                                  | 111,000                      |
| Accounts payable, accrued expenses and other liabilities (Note 7)                 | 44,893                                   | 58,249                       |
| Accrued distributions (Note 13)                                                   | 21,422                                   | 20,610                       |
| Deferred revenue and acquisition-related liabilities (Note 3)                     | 75,421                                   | 59,187                       |
| Rents received in advance and tenant security deposits                            | 20,386                                   | 18,433                       |
| Total liabilities                                                                 | 1,314,183                                | 1,263,481                    |
| <b>COMMITMENTS AND CONTINGENCIES (NOTE 8)</b>                                     |                                          |                              |
| <b>MINORITY INTERESTS:</b>                                                        |                                          |                              |
| 7.45% Series A cumulative redeemable preferred units of the Operating Partnership | 73,638                                   | 73,638                       |
| Common units of the Operating Partnership (Note 4)                                | 36,608                                   | 38,309                       |
| Total minority interests                                                          | 110,246                                  | 111,947                      |

STOCKHOLDERS' EQUITY (Notes 5 and 6):

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|                                                                                                                                                                 |                  |                  |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------|------------------|
| Preferred stock, \$.01 par value, 30,000,000 shares authorized:                                                                                                 |                  |                  |
| 7.45% Series A cumulative redeemable preferred stock, \$.01 par value,<br>1,500,000 shares authorized, none issued and outstanding                              |                  |                  |
| Series B junior participating preferred stock, \$.01 par value,<br>400,000 shares authorized, none issued and outstanding                                       |                  |                  |
| 9.25% Series D cumulative redeemable preferred stock, \$.01 par value,<br>900,000 shares authorized, none issued and outstanding                                |                  |                  |
| 7.80% Series E cumulative redeemable preferred stock, \$.01 par value,<br>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,<br>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,<br>32,652,346 and 32,765,893 shares issued and outstanding, respectively                          | 327              | 328              |
| Additional paid-in capital                                                                                                                                      | 651,386          | 658,894          |
| Distributions in excess of earnings                                                                                                                             | (109,999)        | (87,512)         |
| <br>Total stockholders' equity                                                                                                                                  | <br>663,296      | <br>693,292      |
| <br>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY                                                                                                                  | <br>\$ 2,087,725 | <br>\$ 2,068,720 |

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<br>June 30, |                | Six Months Ended<br>June 30, |                |
|---------------------------------------------------------------------------------------------------|--------------------------------|----------------|------------------------------|----------------|
|                                                                                                   | 2008                           | 2007           | 2008                         | 2007           |
| <b>REVENUES:</b>                                                                                  |                                |                |                              |                |
| Rental income                                                                                     | \$ 61,486                      | \$ 54,518      | \$ 123,791                   | \$ 108,951     |
| Tenant reimbursements                                                                             | 7,686                          | 5,712          | 15,879                       | 11,610         |
| Other property income                                                                             | 457                            | 1,950          | 761                          | 3,053          |
| <b>Total revenues</b>                                                                             | <b>69,629</b>                  | <b>62,180</b>  | <b>140,431</b>               | <b>123,614</b> |
| <b>EXPENSES:</b>                                                                                  |                                |                |                              |                |
| Property expenses                                                                                 | 11,873                         | 10,604         | 23,361                       | 20,570         |
| Real estate taxes                                                                                 | 4,843                          | 4,668          | 10,322                       | 9,220          |
| Provision for bad debts (Note 9)                                                                  | 3,204                          | (26)           | 3,659                        | (199)          |
| Ground leases                                                                                     | 400                            | 389            | 795                          | 792            |
| General and administrative expenses                                                               | 9,187                          | 9,460          | 18,423                       | 18,508         |
| Interest expense                                                                                  | 9,448                          | 8,072          | 19,161                       | 17,728         |
| Depreciation and amortization                                                                     | 21,536                         | 17,378         | 41,402                       | 34,223         |
| <b>Total expenses</b>                                                                             | <b>60,491</b>                  | <b>50,545</b>  | <b>117,123</b>               | <b>100,842</b> |
| <b>OTHER INCOME:</b>                                                                              |                                |                |                              |                |
| Interest and other investment income                                                              | 184                            | 371            | 341                          | 990            |
| <b>INCOME FROM CONTINUING OPERATIONS BEFORE<br/>MINORITY INTERESTS</b>                            | <b>9,322</b>                   | <b>12,006</b>  | <b>23,649</b>                | <b>23,762</b>  |
| <b>MINORITY INTERESTS:</b>                                                                        |                                |                |                              |                |
| Distributions on cumulative redeemable preferred units                                            | (1,397)                        | (1,397)        | (2,794)                      | (2,794)        |
| Minority interest in earnings of Operating Partnership attributable<br>to continuing operations   | (348)                          | (531)          | (1,012)                      | (1,044)        |
| <b>Total minority interests</b>                                                                   | <b>(1,745)</b>                 | <b>(1,928)</b> | <b>(3,806)</b>               | <b>(3,838)</b> |
| <b>INCOME FROM CONTINUING OPERATIONS</b>                                                          | <b>7,577</b>                   | <b>10,078</b>  | <b>19,843</b>                | <b>19,924</b>  |
| <b>DISCONTINUED OPERATIONS (Note 11):</b>                                                         |                                |                |                              |                |
| Revenues from discontinued operations                                                             | 199                            | 2,450          | 199                          | 5,095          |
| Expenses from discontinued operations                                                             |                                | (1,509)        |                              | (3,112)        |
| Net gain on dispositions of discontinued operations                                               | 234                            | 4,848          | 234                          | 13,474         |
| Minority interest in earnings of Operating Partnership attributable<br>to discontinued operations | (27)                           | (375)          | (27)                         | (1,005)        |
| <b>Total income from discontinued operations</b>                                                  | <b>406</b>                     | <b>5,414</b>   | <b>406</b>                   | <b>14,452</b>  |
| <b>NET INCOME</b>                                                                                 | <b>7,983</b>                   | <b>15,492</b>  | <b>20,249</b>                | <b>34,376</b>  |
| <b>PREFERRED DIVIDENDS</b>                                                                        | <b>(2,402)</b>                 | <b>(2,402)</b> | <b>(4,804)</b>               | <b>(4,804)</b> |

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|                                                                      |    |            |    |            |    |            |    |            |
|----------------------------------------------------------------------|----|------------|----|------------|----|------------|----|------------|
| NET INCOME AVAILABLE FOR COMMON STOCKHOLDERS                         | \$ | 5,581      | \$ | 13,090     | \$ | 15,445     | \$ | 29,572     |
| Income from continuing operations per common share basic (Note 12)   | \$ | 0.16       | \$ | 0.23       | \$ | 0.47       | \$ | 0.47       |
| Income from continuing operations per common share diluted (Note 12) | \$ | 0.16       | \$ | 0.23       | \$ | 0.47       | \$ | 0.47       |
| Net income per common share basic (Note 12)                          | \$ | 0.17       | \$ | 0.40       | \$ | 0.48       | \$ | 0.91       |
| Net income per common share diluted (Note 12)                        | \$ | 0.17       | \$ | 0.40       | \$ | 0.48       | \$ | 0.91       |
| Weighted average shares outstanding basic (Note 12)                  |    | 32,351,044 |    | 32,371,183 |    | 32,403,829 |    | 32,359,999 |
| Weighted average shares outstanding diluted (Note 12)                |    | 32,509,817 |    | 32,486,171 |    | 32,532,424 |    | 32,485,566 |
| Dividends declared per common share                                  | \$ | 0.580      | \$ | 0.555      | \$ | 1.160      | \$ | 1.110      |

See accompanying notes to consolidated financial statements.

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

|                                                                | <b>Preferred<br/>Stock</b> | <b>Common Stock<br/>Number of<br/>Shares</b> | <b>Common<br/>Stock</b> | <b>Additional<br/>Paid-in<br/>Capital</b> | <b>Distributions<br/>in Excess of<br/>Earnings</b> | <b>Total</b> |
|----------------------------------------------------------------|----------------------------|----------------------------------------------|-------------------------|-------------------------------------------|----------------------------------------------------|--------------|
| BALANCE AT DECEMBER 31, 2007                                   | \$ 121,582                 | 32,765,893                                   | \$ 328                  | \$ 658,894                                | \$ (87,512)                                        | \$ 693,292   |
| Net income                                                     |                            |                                              |                         |                                           | 20,249                                             | 20,249       |
| Repurchase of common stock (Note 5)                            |                            | (299,777)                                    | (3)                     | (14,767)                                  |                                                    | (14,770)     |
| Issuance of nonvested shares of common stock (Note 6)          |                            | 184,245                                      | 2                       | 2,165                                     |                                                    | 2,167        |
| Non-cash amortization of share-based compensation              |                            |                                              |                         | 4,867                                     |                                                    | 4,867        |
| Exercise of stock options                                      |                            | 1,000                                        |                         | 21                                        |                                                    | 21           |
| Exchange of common units of the Operating Partnership (Note 5) |                            | 985                                          |                         | 28                                        |                                                    | 28           |
| Adjustment for minority interest                               |                            |                                              |                         | 178                                       |                                                    | 178          |
| Preferred dividends                                            |                            |                                              |                         |                                           | (4,804)                                            | (4,804)      |
| Dividends declared per common share (\$1.16 per share)         |                            |                                              |                         |                                           | (37,932)                                           | (37,932)     |
| BALANCE AT JUNE 30, 2008                                       | \$ 121,582                 | 32,652,346                                   | \$ 327                  | \$ 651,386                                | \$ (109,999)                                       | \$ 663,296   |

See accompanying notes to consolidated financial statements.



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

|                                                                                                                       | <b>Six Months Ended<br/>June 30,</b> |                  |
|-----------------------------------------------------------------------------------------------------------------------|--------------------------------------|------------------|
|                                                                                                                       | <b>2008</b>                          | <b>2007</b>      |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                                                          |                                      |                  |
| Net income                                                                                                            | \$ 20,249                            | \$ 34,376        |
| 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                                          | 41,010                               | 34,551           |
| Increase (decrease) in provision for uncollectible tenant receivables                                                 | 283                                  | (199)            |
| Increase in provision for uncollectible deferred rent receivables                                                     | 3,376                                |                  |
| Distributions on cumulative redeemable preferred units                                                                | 2,794                                | 2,794            |
| Minority interests in earnings of Operating Partnership                                                               | 1,039                                | 2,049            |
| Depreciation of furniture, fixtures and equipment                                                                     | 392                                  | 431              |
| Non-cash amortization of share-based compensation awards                                                              | 7,229                                | 7,387            |
| Non-cash amortization of deferred financing costs and debt discount                                                   | 1,587                                | 1,176            |
| Non-cash amortization of above/below market rents, net                                                                | (335)                                | (691)            |
| Net gain on dispositions of operating properties (Note 11)                                                            | (234)                                | (13,474)         |
| Non-cash amortization of deferred revenue related to tenant improvements (Note 3)                                     | (3,782)                              | (1,453)          |
| Insurance proceeds received for a property casualty loss                                                              | (531)                                |                  |
| Changes in assets and liabilities:                                                                                    |                                      |                  |
| Marketable securities                                                                                                 | (1,699)                              |                  |
| Current receivables                                                                                                   | 765                                  | 1,374            |
| Deferred rent receivables                                                                                             | (2,647)                              | (1,326)          |
| Deferred leasing costs                                                                                                | (669)                                | (968)            |
| Prepaid expenses and other assets                                                                                     | (2,595)                              | (1,663)          |
| Accounts payable, accrued expenses and other liabilities                                                              | (5,935)                              | 4,181            |
| Deferred revenue                                                                                                      | 1,870                                | 5,655            |
| Rents received in advance and tenant security deposits                                                                | 1,953                                | 417              |
| <b>Net cash provided by operating activities</b>                                                                      | <b>64,120</b>                        | <b>74,617</b>    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                                                          |                                      |                  |
| Expenditures for operating properties                                                                                 | (13,714)                             | (19,834)         |
| Expenditures for development and redevelopment properties                                                             | (37,726)                             | (109,134)        |
| Acquisition of redevelopment property and undeveloped land                                                            |                                      | (68,970)         |
| Proceeds received from 1031 exchange completion                                                                       |                                      | 43,794           |
| Net proceeds received from dispositions of operating properties (Note 11)                                             | 275                                  | 14,473           |
| Insurance proceeds received for a property casualty loss                                                              | 531                                  |                  |
| Proceeds from termination of profit participation agreement                                                           |                                      | 4,848            |
| Decrease in escrow deposits                                                                                           |                                      | 3,000            |
| Increase in restricted cash                                                                                           | (210)                                | (125)            |
| Receipt of principal payments on note receivable                                                                      | 66                                   | 62               |
| <b>Net cash used in investing activities</b>                                                                          | <b>(50,778)</b>                      | <b>(131,886)</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                                                          |                                      |                  |
| Proceeds from issuance of exchangeable senior notes, net of discount                                                  |                                      | 455,400          |
| Cost of capped call options on common stock                                                                           |                                      | (29,050)         |
| Net borrowings (repayments) on unsecured line of credit                                                               | 48,000                               | (258,000)        |

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|                                                                                      |          |           |
|--------------------------------------------------------------------------------------|----------|-----------|
| Principal payments on secured debt                                                   | (6,182)  | (58,581)  |
| Repurchase of common stock (Note 5)                                                  | (14,770) | (2,631)   |
| Financing costs                                                                      | (523)    | (5,289)   |
| Proceeds from exercise of stock options                                              | 21       |           |
| Dividends and distributions paid to common stockholders and common unitholders       | (39,655) | (37,796)  |
| Dividends and distributions paid to preferred stockholders and preferred unitholders | (7,598)  | (7,598)   |
| Net cash (used in) provided by financing activities                                  | (20,707) | 56,455    |
| Net decrease in cash and cash equivalents                                            | (7,365)  | (814)     |
| Cash and cash equivalents, beginning of period                                       | 11,732   | 11,948    |
| Cash and cash equivalents, end of period                                             | \$ 4,367 | \$ 11,134 |

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**KILROY REALTY CORPORATION**

**CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)**

(unaudited, in thousands)

|                                                                                                                    | <b>Six Months Ended<br/>June 30,</b> |             |
|--------------------------------------------------------------------------------------------------------------------|--------------------------------------|-------------|
|                                                                                                                    | <b>2008</b>                          | <b>2007</b> |
| <b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>                                                                         |                                      |             |
| Cash paid for interest, net of capitalized interest of \$8,388 and \$9,191 at June 30, 2008 and 2007, respectively | \$ 17,858                            | \$ 13,801   |
| <b>NON-CASH INVESTING AND FINANCING TRANSACTIONS:</b>                                                              |                                      |             |
| Tenant improvements funded directly by tenants to third parties                                                    | \$ 18,493                            | \$ 23,210   |
| Accrual for expenditures for operating properties and development and redevelopment properties                     | \$ 4,896                             | \$ 14,908   |
| Accrual of dividends and distributions payable to common stockholders and common unitholders                       | \$ 20,212                            | \$ 19,400   |
| Accrual of dividends and distributions payable to preferred stockholders and preferred unitholders                 | \$ 1,909                             | \$ 1,909    |
| Accrual of public facility bond obligation (Note 2)                                                                | \$ 2,781                             |             |
| Issuance of share-based compensation awards (Note 6)                                                               | \$ 10,050                            | \$ 23,633   |
| Exchange of common units of the Operating Partnership into shares of the Company's common stock                    | \$ 28                                | \$ 1,837    |
| Accrued costs for issuance of exchangeable senior notes                                                            |                                      | \$ 760      |

See accompanying notes to consolidated financial statements.

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**KILROY REALTY CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Three and Six Months Ended June 30, 2008 and 2007**

**(unaudited)**

**1. Organization and Basis of Presentation**

*Organization*

Kilroy Realty Corporation (the "Company") owns, operates, develops and acquires office and industrial real estate located in Southern California. The Company qualifies and operates as a self-administered real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended.

As of June 30, 2008, the Company's stabilized portfolio of operating properties was comprised of 86 office buildings (the "Office Properties") and 43 industrial buildings (the "Industrial Properties"), which encompassed an aggregate of approximately 8.1 million and 3.9 million rentable square feet, respectively. As of June 30, 2008, the Office Properties were approximately 93.8% leased to 304 tenants, and the Industrial Properties were approximately 90.7% leased to 62 tenants. All of the Company's properties are located in Southern California.

The Company's stabilized portfolio excludes development and redevelopment properties currently under construction and lease-up properties (collectively, the "in-process development and redevelopment properties"). The Company defines lease-up properties as properties recently developed or redeveloped by the Company that have not yet reached 95% occupancy and are within one year following cessation of major construction activities. As of June 30, 2008, the in-process development and redevelopment properties included three buildings that were under construction and three lease-up properties, which will encompass an aggregate of approximately 611,000 rentable square feet of new office space when completed. All of the in-process development and redevelopment properties are in the San Diego region of Southern California, except for one redevelopment property, which is in El Segundo, California.

The Company owns its interests in all of its Office Properties and Industrial Properties through Kilroy Realty, L.P. (the "Operating Partnership") and Kilroy Realty Finance Partnership, L.P. (the "Finance Partnership"). The Company conducts substantially all of its operations through the Operating Partnership, in which it owned a 93.7% general partnership interest as of June 30, 2008. The remaining 6.3% common limited partnership interest in the Operating Partnership as of June 30, 2008, was owned by certain of the Company's executive officers and directors, certain of their affiliates, and other outside investors (see Note 4). Kilroy Realty Finance, Inc., a wholly-owned subsidiary of the Company, is the sole general partner of the Finance Partnership and owns a 1.0% general partnership interest. The Operating Partnership owns the remaining 99.0% limited partnership interest. The Company conducts substantially all of its development activities through Kilroy Services, LLC ("KSLLC"), which is a wholly-owned subsidiary of the Operating Partnership. Unless otherwise indicated, all references to the Company include the Operating Partnership, the Finance Partnership, KSLLC and all wholly-owned subsidiaries of the Company. With the exception of the Operating Partnership, all of the Company's subsidiaries are wholly-owned.

*Basis of Presentation*

The consolidated financial statements of the Company include the consolidated financial position and results of operations of the Company, the Operating Partnership, the Finance Partnership, KSLLC and all wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in the consolidated financial statements. The Company also consolidates all variable interest entities ("VIEs") in which it is deemed to be the primary beneficiary in accordance with Financial Accounting Standards Board ("FASB") Interpretation No. 46R, *Consolidation of Variable Interest Entities*. The Company had no VIEs at June 30, 2008 or December 31, 2007.

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**KILROY REALTY CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The accompanying interim financial statements have been prepared by the Company's 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, 2008. These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2007.

*Accounting Pronouncements Adopted January 1, 2008*

Effective January 1, 2008, the Company adopted, on a prospective basis, Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ( SFAS 157 ), as amended by FASB Staff Position SFAS 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13* ( FSP FAS 157-1 ) and FASB Staff Position SFAS 157-2, *Effective Date of FASB Statement No. 157* ( FSP FAS 157-2 ). SFAS 157 defines fair value, establishes a framework for measuring fair value in GAAP and provides for expanded disclosure about fair value measurements. SFAS 157 applies prospectively to all other accounting pronouncements that require or permit fair value measurements. FSP FAS 157-1 amends SFAS 157 to exclude from the scope of SFAS 157 certain leasing transactions accounted for under Statement of Financial Accounting Standards No. 13, *Accounting for Leases*. FSP FAS 157-2 amends SFAS 157 to defer the effective date of SFAS 157 for all non-financial assets and non-financial liabilities except those that are recognized or disclosed at fair value in the financial statements on a recurring basis to fiscal years beginning after November 15, 2008.

The adoption of SFAS 157 did not have a material impact on the Company's consolidated financial statements. Management is currently evaluating the impact that SFAS 157 will have on its non-financial assets and non-financial liabilities since the application of SFAS 157 for such items was deferred to January 1, 2009. The Company currently believes that the application of SFAS 157 to its non-financial assets and non-financial liabilities will not be material to its consolidated financial statements. Assets and liabilities typically recorded at fair value on a non-recurring basis to which the Company has not yet applied SFAS 157 due to the deferral of SFAS 157 for such items include:

Non-financial assets and liabilities initially measured at fair value in an acquisition or business combination;

Long-lived assets measured at fair value due to an impairment assessment under Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*; and

Asset retirement obligations initially measured under Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations*.

Effective January 1, 2008, the Company adopted, on a prospective basis, Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS 159 ). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective of the guidance is to improve financial reporting by providing entities with the opportunity to mitigate

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**KILROY REALTY CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The adoption of SFAS 159 did not have a material impact on the Company's consolidated financial statements since the Company has not elected to apply the fair value option for any of its eligible financial instruments or other items.

*Recent Accounting Pronouncements to be Adopted in Future Reporting Periods*

In May 2008, the FASB issued FASB Staff Position APB 14-1 *Accounting for Convertible Debt Instruments That May Be Settled Upon Conversion (Including Partial Cash Settlement)* ( FSP APB 14-1 ). This new standard requires the initial proceeds from convertible debt that may be settled in cash to be bifurcated between a liability component and an equity component. The objective of the guidance is to require the liability and equity components of convertible debt to be separately accounted for in a manner such that the interest expense recorded on the convertible debt would not equal the contractual rate of interest on the convertible debt, but instead would be recorded at a rate that would reflect the issuer's conventional debt borrowing rate. This is accomplished through the creation of a discount on the debt that would be accreted using the effective interest method as additional non-cash interest expense over the period the debt is expected to remain outstanding. The provisions of FSP APB 14-1 will be applied retrospectively to all periods presented for fiscal years beginning after December 31, 2008. Management believes that FSP APB 14-1 will impact the accounting for the Company's 3.25% Exchangeable Senior Notes (the Notes ) and will have a material impact on the Company's consolidated financial statements and results of operations.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R) *Business Combinations* ( SFAS 141(R) ) and Statement of Financial Accounting Standards No. 160 *Noncontrolling Interests in Consolidated Financial Statements: An Amendment of ARB No. 51* ( SFAS 160 ). SFAS 141(R) requires an acquiring entity to recognize acquired assets and assumed liabilities in a transaction at fair value as of the acquisition date and changes the accounting treatment for certain items, including acquisition costs, which will be required to be expensed as incurred. SFAS 160 requires that noncontrolling interests be presented as a component of consolidated stockholders' equity and eliminates minority interest accounting such that the amount of net income attributable to the noncontrolling interests will be presented as part of consolidated net income on the consolidated statement of operations. SFAS 141(R) and SFAS 160 require concurrent adoption and are to be applied prospectively for the first annual reporting period beginning on or after December 15, 2008. Early adoption of either standard is prohibited. Management is currently evaluating the impact of these statements on the Company's consolidated financial statements.

In June 2008, the FASB issued FASB Staff Position EITF No. 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* ( FSP EITF 03-6-1 ). This new standard requires that nonvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents be treated as participating securities in the computation of earnings per share pursuant to the two-class method. The Company believes that FSP EITF 03-6-1 will require the Company to include the impact of its nonvested shares of common stock and restricted stock units in earnings per share using this more dilutive methodology. However, the Company currently believes that FSP EITF 03-6-1 will not have a material impact on the Company's consolidated financial statements and results of operations for the share-based payment programs currently in place. FSP EITF 03-6-1 will be applied retrospectively to all periods presented for fiscal years beginning after December 15, 2008.

In June 2008, the FASB ratified EITF Issue 07-5, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock* ( EITF 07-5 ). Paragraph 11(a) of Statement of Financial Accounting Standard No 133 *Accounting for Derivatives and Hedging Activities* ( SFAS 133 ) specifies that a contract that would otherwise meet the definition of a derivative but is both (a) indexed to the Company's own stock

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**KILROY REALTY CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

and (b) classified in stockholders' equity in the statement of financial position would not be considered a derivative financial instrument. EITF 07-5 provides a new two-step model to be applied in determining whether a financial instrument or an embedded feature is indexed to an issuer's own stock and thus able to qualify for the SFAS 133 paragraph 11(a) scope exception. Management is currently evaluating whether the adoption of EITF 07-5 will have an impact on the accounting for the Notes and related capped call option transactions. EITF 07-5 will be effective for the first annual reporting period beginning after December 15, 2008, and early adoption is prohibited.

In April 2008, the FASB issued FASB Staff Position 142-3, *Determination of the Useful Life of Intangible Assets* (FSP 142-3). FSP 142-3 is to be applied prospectively for fiscal years beginning after December 15, 2008. Management is currently evaluating the impact of FSP 142-3 on the Company's consolidated financial position, results of operations and cash flows but currently does not believe it will have a material impact on the Company's consolidated financial statements.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161). SFAS 161 is to be applied prospectively for the first annual reporting period beginning on or after November 15, 2008. The Company believes that the adoption of SFAS 161 will not have a material impact on the Company's financial statement disclosures since the Company does not currently have any derivative instruments.

In May 2008, the FASB issued Statement of Financial Accounting Standards No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS 162). This new standard identifies a hierarchical framework of accounting principles for the purpose of selecting the principles to be used in the preparation of financial statements of nongovernmental entities. The Company believes that the adoption of SFAS 162 will not have a material impact on the Company's consolidated financial position, results of operations and cash flows.

**2. Unsecured and Secured Debt**

*Unsecured Line of Credit*

The Company has a \$550 million unsecured line of credit (the Credit Facility), under which the Company may elect to borrow up to an additional \$100 million under an increase option. As of June 30, 2008, the Company had borrowings of \$159 million outstanding under the Credit Facility and borrowing capacity of approximately \$391 million. The Credit Facility bears interest at an annual rate between LIBOR plus 0.85% and LIBOR plus 1.35% depending upon the Company's leverage ratio at the time of borrowing (3.5% at June 30, 2008). The Credit Facility matures in April 2010 with an option to extend the maturity for one year. The fee for unused funds under the Credit Facility ranges from an annual rate of 0.15% to 0.20% depending on the Company's leverage ratio. The Company expects to use the Credit Facility to finance development and redevelopment expenditures, to fund potential acquisitions and for other general corporate uses.

*Exchangeable Senior Notes*

In March 2008, the exchange rate for the Notes was adjusted by 0.05% for the 4.5% increase in the Company's dividend per common share approved by the Company's Board of Directors in February 2008. This adjustment was made pursuant to the original terms of the Notes since the exchange rate for the Notes is subject to adjustment under certain circumstances, including increases in the Company's common dividends. The Notes had an initial exchange rate of 11.3580 common shares per \$1,000 principal amount of the Notes, which was equivalent to an exchange price of \$88.04 per common share and a conversion premium of approximately 20.0% based on a price of \$73.37 per share of the Company's common stock on March 27, 2007. The exchange rate was adjusted to 11.3636 common shares per \$1,000 principal amount of the Notes, which is equivalent to an

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exchange price of \$88.00 per common share and a conversion premium of approximately 19.94% based on a price of \$73.37 per share of the Company's common stock on March 27, 2007.

*Secured Debt*

In February 2008, the City of Carlsbad issued public facility bonds (the Bonds), the proceeds from which were used to finance infrastructure improvements on one of the Company's undeveloped land parcels. Of the Company's \$3.5 million maximum obligation under the Bonds, \$2.8 million was assessed to the Company and is reported as secured debt on the consolidated balance sheet at June 30, 2008 since the Company's obligation was fixed and determinable. Principal and interest payments for the Bonds will be charged to the Company through the assessment of special property taxes.

*Debt Covenants and Restrictions*

The Credit Facility, the unsecured senior notes and certain other secured debt arrangements contain covenants and restrictions requiring the Company to meet certain financial ratios and reporting requirements. Some of the more restrictive financial covenants include a maximum ratio of total debt to total assets, a maximum ratio of total secured debt to total assets, a fixed charge coverage ratio, a minimum consolidated tangible net worth and a limit of the ratio of development activities to total assets. In addition, one of the Company's loan covenants prohibits the Company from paying dividends in excess of 95% of funds from operations (FFO). 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. The Company was in compliance with all of its debt covenants at June 30, 2008.

*Capitalized Interest and Loan Fees*

The following table sets forth the Company's gross interest expense and loan cost amortization from continuing operations net of capitalized interest and loan cost amortization for the three and six months ended June 30, 2008 and 2007. The interest and loan cost amortization are capitalized as a cost of development and increase the carrying value of undeveloped land and construction in progress.

|                                                   | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|---------------------------------------------------|----------------------------------------|-------------|--------------------------------------|-------------|
|                                                   | <b>2008</b>                            | <b>2007</b> | <b>2008</b>                          | <b>2007</b> |
|                                                   | <b>(in thousands)</b>                  |             |                                      |             |
| Gross interest expense and loan cost amortization | \$ 14,030                              | \$ 13,166   | \$ 28,241                            | \$ 27,580   |
| Capitalized interest and loan cost amortization   | (4,582)                                | (5,094)     | (9,080)                              | (9,852)     |
| Interest expense                                  | \$ 9,448                               | \$ 8,072    | \$ 19,161                            | \$ 17,728   |

**3. Deferred Revenue and Acquisition-Related Liabilities**

Deferred revenue and acquisition-related liabilities consisted of the following at June 30, 2008 and December 31, 2007:

|                                                               | <b>June 30,<br/>2008</b> | <b>December 31,<br/>2007</b> |
|---------------------------------------------------------------|--------------------------|------------------------------|
|                                                               | <b>(in thousands)</b>    |                              |
| Deferred revenue related to tenant-funded tenant improvements | \$ 72,474                | \$ 55,779                    |
| Acquisition-related liabilities below-market leases           | 1,452                    | 1,801                        |



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|                        |           |           |
|------------------------|-----------|-----------|
| Other deferred revenue | 1,495     | 1,607     |
| Total                  | \$ 75,421 | \$ 59,187 |

**Table of Contents****KILROY REALTY CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Deferred revenue related to tenant-funded tenant improvements*

During the six months ended June 30, 2008, the Company recorded an additional \$20.5 million of deferred revenue related to tenant-funded tenant improvements. This amount primarily represents the cost of the tenant improvements paid for or reimbursed by the tenant in connection with three significant leases. The deferred revenue related to these tenant-funded tenant improvements will be amortized as additional rental income over the term of the related lease beginning upon the substantial completion of the respective properties.

During the three months ended June 30, 2008 and 2007, \$2.0 million and \$0.8 million, respectively, of deferred revenue related to tenant-funded tenant improvements was amortized and recognized as rental income. During the six months ended June 30, 2008 and 2007, \$3.8 million and \$1.5 million, respectively, of deferred revenue related to tenant-funded tenant improvements was amortized and recognized as rental income. The following is the estimated amortization of deferred revenue related to tenant-funded tenant improvements at June 30, 2008 for the remainder of 2008, the next five years and thereafter:

| <b>Year</b>    | <b>(in thousands)</b> |
|----------------|-----------------------|
| Remaining 2008 | \$ 4,130              |
| 2009           | 8,346                 |
| 2010           | 8,019                 |
| 2011           | 7,564                 |
| 2012           | 6,905                 |
| 2013           | 6,464                 |
| Thereafter     | 31,046                |
| <b>Total</b>   | <b>\$ 72,474</b>      |

**4. Minority Interests***Common Limited Partnership Unitholders*

The Company owned a 93.7%, 93.7% and 93.5% common general partnership interest in the Operating Partnership as of June 30, 2008, December 31, 2007 and June 30, 2007, respectively. The remaining 6.3%, 6.3% and 6.5% common limited partnership interest as of June 30, 2008, December 31, 2007 and June 30, 2007, respectively, was owned by certain of the Company's executive officers and directors, certain of their affiliates, and other outside investors in the form of common limited partnership units. The common limited partnership units may be redeemed by unitholders for cash. The Company may, at its option, satisfy the cash redemption obligation with shares of the Company's common stock. The redemption value for each common limited partnership unit of the Operating Partnership as of any balance sheet date 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 New York Stock Exchange ( NYSE ) for the ten trading days immediately preceding the respective balance sheet date. Accordingly, as of June 30, 2008 and December 31, 2007, the aggregate redemption value of the then-outstanding common limited partnership units of the Operating Partnership was \$107.7 million and \$119.2 million, respectively.

**5. Stockholders' Equity***Share Repurchases*

During the six months ended June 30, 2008, the Company repurchased 239,475 shares of its common stock in open market transactions for an aggregate price of approximately \$11.5 million, or \$48.23 per share. These repurchases were made pursuant to a share repurchase program approved by the Company's Board of Directors.



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**KILROY REALTY CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

and were funded through borrowings on the Company's Credit Facility. As of June 30, 2008, an aggregate of 988,025 shares remained eligible for repurchase under this share repurchase program.

During the six months ended June 30, 2008, the Company accepted the return, at the current quoted market price, of 60,302 shares of its common stock from certain key employees in accordance with the provisions of its incentive stock plan to satisfy minimum statutory tax-withholding requirements related to shares that vested during this period.

*Exchange of Common Limited Partnership Units*

During the six months ended June 30, 2008, an aggregate 985 common limited partnership units of the Operating Partnership were exchanged into shares of the Company's common stock. Neither the Company nor the Operating Partnership received any proceeds from the issuance of the common stock to the common limited partnership unitholders.

**6. Share-Based Compensation**

*Share-Based Incentive Plan*

At June 30, 2008, the Company had one share-based incentive compensation plan, the Kilroy Realty 2006 Incentive Award Plan (the "2006 Plan"), under which awards were available to be granted. At June 30, 2008, there were 1,118,206 shares and share-based awards available to be granted under the 2006 Plan. Under the Company's Stock Award Deferral Program, participants may defer receipt of awards of nonvested shares of common stock that may be granted under the 2006 Plan by electing to receive an equivalent number of restricted stock units ("RSUs") in lieu of such awards of nonvested shares of common stock.

The following summarizes the share-based compensation programs approved and the share-based awards granted during the six months ended June 30, 2008 and the 2007 program for the executive officers that was still in the performance period as of June 30, 2008.

*Executive Officer Share-Based Compensation Programs*

In January 2008, the Executive Compensation Committee approved the 2008 Annual Long-Term Incentive Program, which allows the executive officers to receive bonus compensation in the event certain specified corporate performance measures are achieved for the fiscal year ending December 31, 2008. It is anticipated that such awards will be paid in nonvested shares of common stock or, if available and at the applicable employee's option, in other equity-based instruments that, subject to vesting and other conditions, may become exchangeable on a one-for-one basis for shares of the Company's common stock or cash, at the election of the Company. The Company anticipates that any nonvested shares of common stock or other equity-based instruments earned under this program would be issued during the first quarter of 2009. Individual awards earned under the 2008 Annual Long-Term Incentive Program would vest in two equal installments on December 31, 2009 and December 31, 2010. Vesting will be based on continued employment through the applicable vesting dates.

As of June 30, 2008, the Company was still in the performance period for the Development Performance Program ("DPP"), which was approved by the Company's Executive Compensation Committee in 2007. The incentive award that may be earned under the DPP will be based on whether certain future specified development completion and leasing targets are achieved for development and redevelopment properties on which the Company commenced construction during 2007. During the DPP performance period, the Company records compensation expense at the end of each reporting period by evaluating the likelihood of achieving the specified

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targets and estimating the timeframe in which the targets could potentially be achieved and then recording compensation cost on the applicable portion of the estimated performance period that has elapsed before the end of the period. Performance is measured independently for the development completion and development leasing components of the DPP. If the development completion and development leasing targets individually are not achieved, no award would be earned under that component of the DPP. The Company currently estimates that any nonvested shares of common stock or other equity-based instruments that could potentially be earned under the development completion component of the DPP would be granted in the second half of 2008, and any nonvested shares of common stock or other equity-based instruments that could potentially be earned under the development leasing component of the DPP would be granted in the first half of 2009.

*Key Employee Share-Based Compensation Program*

In February 2008, the Executive Compensation Committee granted an aggregate of 82,303 nonvested shares of common stock to certain key employees. The total compensation cost for the grants of nonvested shares of common stock was calculated based on the quoted closing share price of the Company's common stock on the NYSE of \$49.21 on the grant date of February 5, 2008. These shares vest in equal annual installments on December 31st of each year over a five-year period.

*Non-employee Board Member Share-Based Compensation Program*

In May 2008, the Executive Compensation Committee granted an aggregate of 1,867 nonvested shares of common stock and 7,468 nonvested RSUs to non-employee board members as part of the board members' annual compensation in accordance with the Company's Board of Directors compensation program. The total compensation cost for these awards was calculated based on the quoted closing share price of the Company's common stock on the NYSE of \$53.58 on the grant date of May 15, 2008. These awards vest in equal annual installments on May 15th of each year over a two-year period.

*Summary of nonvested shares of common stock*

A summary of the status of the Company's nonvested shares of common stock as of January 1, 2008 and changes during the six months ended June 30, 2008, is presented below:

|                                         | Shares   | Weighted-Average<br>Grant-Date<br>Fair Value |
|-----------------------------------------|----------|----------------------------------------------|
| <b>Nonvested Shares of Common Stock</b> |          |                                              |
| Nonvested at January 1, 2008            | 237,833  | \$ 80.35                                     |
| Granted <sup>(1)</sup>                  | 184,245  | 52.38                                        |
| Vested                                  | (51,840) | 59.20                                        |
| Nonvested at June 30, 2008              | 370,238  | \$ 68.94                                     |

(1) Includes 100,075 nonvested shares of common stock awarded to the executive officers on December 31, 2007 under the 2007 Annual Long-Term Incentive Program, which were issued and outstanding on January 1, 2008.

The total fair value of shares that vested during the six months ended June 30, 2008 and 2007 was \$2.6 million and \$6.7 million, respectively, which was calculated based on the quoted closing share price of the Company's common stock on the NYSE on the applicable date of vesting.



**Table of Contents****KILROY REALTY CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Summary of nonvested RSUs*

A summary of the status of the Company's nonvested RSUs as of January 1, 2008 and changes during the six months ended June 30, 2008, is presented below:

| <b>Restricted Stock Units</b>              | <b>Restricted<br/>Stock Units</b> | <b>Weighted-<br/>Average<br/>Grant-Date<br/>Fair Value</b> |
|--------------------------------------------|-----------------------------------|------------------------------------------------------------|
| Outstanding at January 1, 2008             |                                   | \$                                                         |
| Granted                                    | 7,468                             | 53.58                                                      |
| Outstanding and nonvested at June 30, 2008 | 7,468                             | \$ 53.58                                                   |

Each RSU represents the right to receive one share of the Company's common stock in the future and will be subject to the same vesting conditions as would have applied to the award of nonvested shares of common stock in lieu of which such RSU is issued. RSUs carry with them the right to receive dividend equivalents that credit participants, upon the Company's payment of dividends with respect to the shares underlying the participant's RSUs, with additional, fully-vested RSUs equal to the value of the dividend paid in respect of such shares. Shares issued in settlement of RSUs will, to the extent vested, be distributed in a single lump sum distribution upon the earliest to occur of: (i) termination of the participant's employment or directorship; (ii) the occurrence of a change of control event; (iii) the date specified by the participant upon making the election, which must be at least two years after the start of the year in which the underlying award is earned; or (iv) the participant's death or disability.

*Compensation cost recorded during the period*

The total compensation cost for all share-based compensation programs was \$4.0 million and \$4.1 million for the three months ended June 30, 2008 and 2007, respectively, and \$7.8 million for both the six months ended June 30, 2008 and 2007. Of the total share-based compensation cost, \$0.3 million and \$0.2 million were capitalized as part of real estate assets for the three months ended June 30, 2008 and 2007, respectively, and \$0.5 million and \$0.4 million were capitalized as part of real estate assets for the six months ended June 30, 2008 and 2007, respectively. As of June 30, 2008, there was approximately \$14.4 million of total unrecognized compensation cost related to nonvested incentive awards granted under share-based compensation arrangements that is expected to be recognized over a weighted-average period of 1.7 years. The remaining compensation cost related to these nonvested incentive awards had been recognized in periods prior to June 30, 2008. The \$14.4 million of unrecognized compensation cost does not reflect the potential future compensation cost for the 2008 Annual Long-Term Incentive Program or the DPP discussed above since share-based awards have not been granted under these programs as of June 30, 2008. The compensation cost that will be recorded in future periods related to these programs will be based on the amounts ultimately earned under these programs.

**Table of Contents****KILROY REALTY CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****7. Financial Instruments Recorded at Fair Value**

The assets held in connection with the Company's 2007 Deferred Compensation Plan (the Plan) and the corresponding liability to the participants are measured at fair value on a recurring basis on the Company's consolidated balance sheet. The assets are treated as trading securities for accounting purposes and reported as marketable securities on the Company's consolidated balance sheet. The liability is adjusted to fair value at the end of each accounting period based on the performance of the benchmark funds selected by each participant in the Plan and reported in accounts payable, accrued expenses and other liabilities on the Company's consolidated balance sheet.

| <b>Description</b>                   | <b>Fair Value<br/>Measurement at<br/>June 30, 2008<br/>(Level I Inputs)<sup>(1)</sup><br/>(in thousands)</b> |
|--------------------------------------|--------------------------------------------------------------------------------------------------------------|
| <b>Assets:</b>                       |                                                                                                              |
| Marketable Securities                | \$ 2,406                                                                                                     |
| <b>Liabilities:</b>                  |                                                                                                              |
| Deferred Compensation Plan Liability | \$ (2,404)                                                                                                   |

(1) Based on quoted prices in active markets for identical securities.

**8. Commitments and Contingencies**

In March 2008, Newgen Results Corporation (Newgen) attempted to surrender the leased premises at one of the Company's Office Properties and ceased paying rent prior to the end of the lease term. Newgen signed the original lease for the property in 2000 and was subsequently acquired by Teletech Holdings Inc. (Teletech). The Company refused to accept a surrender of the premises and has initiated legal action against Teletech and Newgen for past due rent and future rent as it becomes due and owing. In the event there is ultimately an unfavorable result to the Company, the Company believes that there could potentially be a negative non-cash impact to the Company's results of operations ranging between \$0 and approximately \$3.5 million, primarily related to the deferred rent receivable balance for this tenant at June 30, 2008. The Company did not recognize any revenue associated with this lease during the three months ended June 30, 2008.

The Company leases the land at Kilroy Airport Center, Phase IV in Long Beach, California for future development opportunities. This land is adjacent to the Company's Office Properties at Kilroy Airport Center, Long Beach. The lease expires in July 2084, subject to the Company's option to terminate the lease early upon written notice to the landlord. This option to terminate was scheduled to expire in July 2008. However, in July 2008, the Company and the landlord agreed to extend this option until April 2009. Should the Company elect not to terminate the lease, the ground lease obligation will be subject to fair market rental adjustments in April 2009 and at scheduled dates thereafter.

**9. Significant Lease Termination**

In the second quarter of 2008, Favril, Inc. (Favril), the Company's seventh largest tenant at June 30, 2008 based on annualized base rental revenues, notified the Company of its intention to cease its business operations and to not pay any future rental payments under its lease beyond June 2008. In July 2008, the Company and Favril entered into an agreement to terminate the lease as of August 31, 2008. The Company drew \$3.6 million under a letter of credit and the \$0.3 million cash security deposit that were held as credit support under the terms of the lease, which will be applied to July and August rent and the deferred rent receivable balance related to the lease.



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**KILROY REALTY CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

At June 30, 2008, the Company increased its provision for bad debts by approximately \$3.1 million to reserve for the portion of the deferred rent receivable balance related to the Faville lease at June 30, 2008 that it estimated would not be recoverable after the application of all the remaining letter of credit proceeds as of the August 2008 lease termination date. In addition, the Company will recognize approximately \$2.7 million of additional non-cash rental revenue in the third quarter of 2008, primarily due to the acceleration of the amortization of the deferred revenue balance related to tenant-funded tenant improvements associated with the Faville lease.

**10. Segment Disclosure**

The Company's reportable segments consist of the two types of commercial real estate properties for which the Company's chief operating decision-makers internally evaluate operating performance and financial results: Office Properties and Industrial Properties. The Company also has certain corporate level activities including legal administration, accounting, finance and management information systems, which are not considered separate operating segments.

The Company evaluates the performance of its segments based upon net operating income. Net Operating Income is defined as operating revenues (rental income, tenant reimbursements and other property income) less property and related expenses (property expenses, real estate taxes, ground leases and provisions for bad debts) and excludes other non-property income and expenses, interest expense, depreciation and amortization and corporate general and administrative expenses. There is no intersegment activity.

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|                                                                                     | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |            |
|-------------------------------------------------------------------------------------|--------------------------------|-----------|------------------------------|------------|
|                                                                                     | 2008                           | 2007      | 2008                         | 2007       |
|                                                                                     | (in thousands)                 |           |                              |            |
| <b>Office Properties:</b>                                                           |                                |           |                              |            |
| Operating revenues <sup>(1)</sup>                                                   | \$ 61,309                      | \$ 54,577 | \$ 123,784                   | \$ 108,356 |
| Property and related expenses                                                       | 19,222                         | 14,145    | 35,423                       | 27,702     |
| Net Operating Income                                                                | 42,087                         | 40,432    | 88,361                       | 80,654     |
| <b>Industrial Properties:</b>                                                       |                                |           |                              |            |
| Operating revenues <sup>(1)</sup>                                                   | 8,320                          | 7,603     | 16,647                       | 15,258     |
| Property and related expenses                                                       | 1,098                          | 1,490     | 2,714                        | 2,681      |
| Net Operating Income                                                                | 7,222                          | 6,113     | 13,933                       | 12,577     |
| <b>Total Reportable Segments:</b>                                                   |                                |           |                              |            |
| Operating revenues <sup>(1)</sup>                                                   | 69,629                         | 62,180    | 140,431                      | 123,614    |
| Property and related expenses                                                       | 20,320                         | 15,635    | 38,137                       | 30,383     |
| Net Operating Income                                                                | 49,309                         | 46,545    | 102,294                      | 93,231     |
| <b>Reconciliation to Consolidated Net Income Available for Common Stockholders:</b> |                                |           |                              |            |
| Total Net Operating Income for reportable segments                                  | 49,309                         | 46,545    | 102,294                      | 93,231     |
| Unallocated other income:                                                           |                                |           |                              |            |
| Total other income                                                                  | 184                            | 371       | 341                          | 990        |
| Other unallocated expenses:                                                         |                                |           |                              |            |
| General and administrative expenses                                                 | 9,187                          | 9,460     | 18,423                       | 18,508     |
| Interest expense                                                                    | 9,448                          | 8,072     | 19,161                       | 17,728     |
| Depreciation and amortization                                                       | 21,536                         | 17,378    | 41,402                       | 34,223     |
| Income from continuing operations before minority interests                         | 9,322                          | 12,006    | 23,649                       | 23,762     |
| Minority interests attributable to continuing operations                            | (1,745)                        | (1,928)   | (3,806)                      | (3,838)    |
| Income from discontinued operations                                                 | 406                            | 5,414     | 406                          | 14,452     |
| Net income                                                                          | 7,983                          | 15,492    | 20,249                       | 34,376     |
| Preferred dividends                                                                 | (2,402)                        | (2,402)   | (4,804)                      | (4,804)    |
| Net income available for common stockholders                                        | \$ 5,581                       | \$ 13,090 | \$ 15,445                    | \$ 29,572  |

(1) All operating revenues are comprised of amounts received from third-party tenants.

**Table of Contents****KILROY REALTY CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****11. Discontinued Operations**

The following table summarizes the components that comprise income from discontinued operations for the three and six months ended June 30, 2008 and 2007.

|                                                                                                | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |           |
|------------------------------------------------------------------------------------------------|--------------------------------|----------|------------------------------|-----------|
|                                                                                                | 2008                           | 2007     | 2008                         | 2007      |
|                                                                                                | (in thousands)                 |          |                              |           |
| REVENUES:                                                                                      |                                |          |                              |           |
| Rental income                                                                                  | \$                             | \$ 1,937 | \$                           | \$ 3,914  |
| Tenant reimbursements                                                                          |                                | 512      |                              | 1,177     |
| Other property income <sup>(1)</sup>                                                           | 199                            | 1        | 199                          | 4         |
| Total revenues                                                                                 | 199                            | 2,450    | 199                          | 5,095     |
| EXPENSES:                                                                                      |                                |          |                              |           |
| Property expenses                                                                              |                                | 837      |                              | 1,743     |
| Real estate taxes                                                                              |                                | 192      |                              | 384       |
| Provision for bad debts                                                                        |                                |          |                              |           |
| Ground leases                                                                                  |                                | 113      |                              | 226       |
| Depreciation and amortization                                                                  |                                | 367      |                              | 759       |
| Total expenses                                                                                 |                                | 1,509    |                              | 3,112     |
| Net gain on dispositions of discontinued operations <sup>(2)</sup>                             | 234                            | 4,848    | 234                          | 13,474    |
| Minority interest in earnings of Operating Partnership attributable to discontinued operations | (27)                           | (375)    | (27)                         | (1,005)   |
| Total income from discontinued operations                                                      | \$ 406                         | \$ 5,414 | \$ 406                       | \$ 14,452 |

(1) Other property income for the three and six months ended June 30, 2008 represents the receipt of a cash bankruptcy settlement payment related to a property that was sold in 2005.

(2) During the three and six months ended June 30, 2008, the Company recognized an additional \$0.2 million net gain on the December 2007 disposition of Kilroy Airport Center Sea-Tac in connection with the resolution of a gain contingency related to the completion of certain capital improvements.

**Table of Contents****KILROY REALTY CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****12. Earnings Per Share**

The following table reconciles the numerator and denominator of the basic and diluted per-share computations for net income available for common stockholders for the three and six months ended June 30, 2008 and 2007:

|                                                                                                 | Three Months Ended<br>June 30,                        |            | Six Months Ended<br>June 30, |            |
|-------------------------------------------------------------------------------------------------|-------------------------------------------------------|------------|------------------------------|------------|
|                                                                                                 | 2008                                                  | 2007       | 2008                         | 2007       |
|                                                                                                 | (in thousands, except share<br>and per share amounts) |            |                              |            |
| <b>Numerator:</b>                                                                               |                                                       |            |                              |            |
| Income from continuing operations                                                               | \$ 7,577                                              | \$ 10,078  | \$ 19,843                    | \$ 19,924  |
| Preferred dividends                                                                             | (2,402)                                               | (2,402)    | (4,804)                      | (4,804)    |
| Income from continuing operations available for common stockholders                             | 5,175                                                 | 7,676      | 15,039                       | 15,120     |
| Discontinued operations                                                                         | 406                                                   | 5,414      | 406                          | 14,452     |
| Net income available for common stockholders numerator for basic and diluted earnings per share | \$ 5,581                                              | \$ 13,090  | \$ 15,445                    | \$ 29,572  |
| <b>Denominator:</b>                                                                             |                                                       |            |                              |            |
| Basic weighted average shares outstanding                                                       | 32,351,044                                            | 32,371,183 | 32,403,829                   | 32,359,999 |
| Effect of dilutive securities nonvested shares of common stock, RSUs and stock options          | 158,773                                               | 114,988    | 128,595                      | 125,567    |
| Diluted weighted average shares and common share equivalents outstanding                        | 32,509,817                                            | 32,486,171 | 32,532,424                   | 32,485,566 |
| <b>Basic earnings per share:</b>                                                                |                                                       |            |                              |            |
| Income from continuing operations available for common stockholders                             | \$ 0.16                                               | \$ 0.23    | \$ 0.47                      | \$ 0.47    |
| Discontinued operations                                                                         | 0.01                                                  | 0.17       | 0.01                         | 0.44       |
| Net income available for common stockholders                                                    | \$ 0.17                                               | \$ 0.40    | \$ 0.48                      | \$ 0.91    |
| <b>Diluted earnings per share:</b>                                                              |                                                       |            |                              |            |
| Income from continuing operations available for common stockholders                             | \$ 0.16                                               | \$ 0.23    | \$ 0.47                      | \$ 0.47    |
| Discontinued operations                                                                         | 0.01                                                  | 0.17       | 0.01                         | 0.44       |
| Net income available for common stockholders                                                    | \$ 0.17                                               | \$ 0.40    | \$ 0.48                      | \$ 0.91    |

At June 30, 2008 and 2007, the effect of 64,047 and 56,074 nonvested shares of common stock, respectively, were not included in the earnings per share calculation as their effect was antidilutive to income from continuing operations available for common stockholders. At June 30, 2008 and 2007, the effect of the assumed exchange of the Notes was not included in the earnings per share calculation as its effect was antidilutive to

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income from continuing operations available for common stockholders. At June 30, 2008 and 2007, the Company's employees and directors held no options to purchase shares of the Company's common stock that were antidilutive to income from continuing operations available for common stockholders.

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**KILROY REALTY CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**13. Subsequent Events**

On July 18, 2008, aggregate dividends and distributions of \$20.2 million were made to common stockholders and common unitholders of record on June 30, 2008.

In July 2008, the Company entered into a termination agreement with one of its significant tenants (see Note 9).

In July 2008, the Company entered into agreements with Intuit Inc. ( Intuit ), the Company's largest tenant based on annual base rental revenues at June 30, 2008, to early terminate one of its leases in 2008 and to extend another of its leases by one year to August 2010. The lease that was terminated encompassed approximately 90,000 rentable square feet of office space and was scheduled to expire in July 2014. Intuit had the option to early terminate this lease in 2010. Intuit will continue to occupy this space under a short-term lease and it is expected that it will vacate approximately 95% of the premises in either the third or fourth quarter of 2008 and the remaining premises during the first quarter of 2009. The lease that was extended encompasses approximately 71,000 rentable square feet of office space that was scheduled to expire in August 2009.

In connection with the lease that was terminated, the Company estimates it will recognize approximately \$4.6 million of other property income during the period from July 2008 through the first quarter of 2009, since Intuit will continue to occupy the space under the short-term lease. The estimated \$4.6 million net lease termination fee is comprised of a \$6.3 million lease termination payment from Intuit net of the deferred rent receivable and other balances recorded on the Company's consolidated balance sheet related to the lease at the lease termination date.

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

The following discussion relates to our consolidated financial statements and should be read in conjunction with the financial statements and notes thereto appearing elsewhere in this report. Statements contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations that are not historical facts may be forward-looking statements. Such statements are subject to certain risks and uncertainties, which could cause actual results to differ materially from those projected. Some of the information presented is forward-looking in nature, including information concerning projected future occupancy rates, rental rate increases, property development timing and investment amounts. Although the information is based on our current expectations, actual results could vary from expectations stated in this report. Numerous factors will affect our actual results, some of which are beyond our control. These include the timing and strength of regional economic growth, the strength of commercial and industrial real estate markets, market conditions affecting tenants, competitive market conditions, fluctuations in availability and cost of construction materials resulting from the effects of increased worldwide demand, increased labor costs, future interest rate levels, volatility in our stock price, and capital market conditions. You are cautioned not to place undue reliance on this information, which speaks only as of the date this report was filed. We assume no obligation to update publicly any forward-looking information, whether as a result of new information, future events or otherwise, except to the extent we are required to do so in connection with our ongoing requirements under federal securities laws to disclose material information. For a discussion of important risks related to our business, and related to investing in our securities, including risks that could cause actual results and events to differ materially from results and events referred to in the forward-looking information, see Item 1A Risk Factors in our annual report on Form 10-K for the fiscal year ended December 31, 2007 and the discussion under the captions Factors That May Influence Future Results of Operations and Liquidity and Capital Resources Factors That May Influence Future Sources of Capital and Liquidity below. In light of these risks, uncertainties and assumptions, the potential circumstances or events expressed or implied by the forward-looking statements in this report might not occur.

### **Overview and Background**

We own, operate and develop office and industrial real estate in Southern California. We operate as a self-administered REIT. We own our interests in all of our properties through the Operating Partnership and the Finance Partnership, and we conduct substantially all of our operations through the Operating Partnership. We owned a 93.7%, 93.7% and 93.5% general partnership interest in the Operating Partnership as of June 30, 2008, December 31, 2007 and June 30, 2007, respectively.

### **Factors That May Influence Future Results of Operations**

*Rental rates.* For leases that commenced during the three and six months ended June 30, 2008, the change in rental rate was an increase of 17.8% and 33.7%, respectively, on a GAAP basis and a decrease of 4.5% and an increase of 11.5%, respectively, on a cash basis. The change in rental rate on a cash basis is calculated as the change between the initial stated rent for a new or renewed lease and the ending stated rent for the expiring lease for the same space, whereas the change in rental rate on a GAAP basis compares the average rents over the term of the lease for each lease. Both calculations exclude leases for which the space was vacant longer than one year. The decrease in rental rates for the three months ended June 30, 2008 was primarily due to one new lease at an industrial property in Orange County. Excluding this lease, the change in rental rates on a GAAP basis would have been an increase of 21.2% and 38.8% for the three and six months ended June 30, 2008, respectively. The change in rental rates on a cash basis would have been an increase of 2.2% and 18.5% for the three and six months ended June 30, 2008, respectively. We believe that at June 30, 2008 the average cash rental rates for our properties were approximately 10% to 15% below the current average quoted market rates, although individual properties within any particular submarket presently may be leased either above, below or at the current quoted market rates within that submarket, and the average rental rates for individual submarkets may be above, below or at the average cash rental rate of our overall portfolio. We cannot give any assurance that leases will be renewed or that available space will be re-leased at rental rates equal to or above the current quoted market rates. Our occupancy and rental rates are impacted by general economic conditions, including the pace of regional

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economic growth and access to capital. An extended economic slowdown and tightening of the credit markets could have an adverse affect on our tenants and, as a result, on our future occupancy and rental rates.

*Asset Valuation.* General economic conditions and the resulting impact on market conditions or a downturn in tenants' businesses may adversely affect the value of our assets. Periods of economic slowdown or recession in the United States, declining demand for leased office or industrial properties and/or a decrease in market rental rates in our submarkets could have a negative impact on the value of our assets, including the value of our properties and related tenant improvements. If we were required under GAAP to write down the carrying value of any of our properties to the lower of cost or market due to impairment, or if as a result of an early lease termination we were required to remove and dispose of material amounts of tenant improvements that are not reusable to another tenant, our financial condition and results of operations could be negatively affected.

*Scheduled lease expirations.* In addition to the 859,100 rentable square feet, or 7.2%, of currently available space in our stabilized portfolio, leases representing approximately 4.8% and 13.5% of the leased square footage of our stabilized portfolio are scheduled to expire during the remainder of 2008 and in 2009, respectively. The leases scheduled to expire during the remainder of 2008 and in 2009 represent approximately 1.2 million rentable square feet of office space, or 13.3% of our total annualized base rental revenue, and 0.8 million rentable square feet of industrial space, or 2.5% of our total annualized base rental revenue, respectively. We believe that the average cash rental rates for leases scheduled to expire during the remainder of 2008 and in 2009 are approximately 10% to 15% below the current average quoted market rates, although individual properties within any particular submarket presently may be leased either above, below or at the current quoted market rates within that submarket, and the average rental rates for individual submarkets may be above, below or at the average cash rental rate of our overall portfolio. Our ability to re-lease available space depends upon the market conditions in the specific regions in which our properties are located.

*Sublease space.* Of our leased space as of June 30, 2008, approximately 213,300 rentable square feet, or 1.8%, of the rentable square footage in our stabilized portfolio, was available for sublease, compared to approximately 608,100 rentable square feet, or 5.1%, as of December 31, 2007. Of the 1.8% of available sublease space in our stabilized portfolio as of June 30, 2008, approximately 1.7% was vacant space, and the remaining 0.1% was occupied. Approximately 70%, 21% and 9% of the available sublease space as of June 30, 2008 is located in the San Diego, Orange County and Los Angeles regions, respectively. Of the approximately 213,300 rentable square feet available for sublease as of June 30, 2008, approximately 30,400 rentable square feet representing one lease that is scheduled to expire during the remainder of 2008, and approximately 46,100 rentable square feet representing five leases are scheduled to expire in 2009.

Negative trends or other unforeseeable events that impair our ability to renew or re-lease space and our ability to maintain or increase rental rates in our submarkets could have an adverse effect on our future financial condition, results of operations and cash flows.

*Rising Construction Costs.* As a result of increased worldwide demand, the availability of construction materials has become more limited, and the cost of such materials has increased significantly. However, the cost of skilled labor is moderating. A continued increase in the cost of construction materials, driven primarily by the volatility of the prices of underlying raw materials such as oil, cement and steel, and labor costs could adversely affect our expenditures for development and redevelopment costs and, consequently, our financial condition, results of operations and cash flows.

*City of San Diego.* Given the geographic concentration of our development program in San Diego County, our operating results may be affected by (i) the city of San Diego's current financial difficulties and ongoing investigations with respect to the city's finances, (ii) the city of San Diego's General Plan and Land Use update, (iii) the city of San Diego's zoning ordinance updates, (iv) the city of San Diego and other state agencies' future adoption of potential impact fees to address water supply infrastructure, climate change legislation and mandatory energy and sustainable building code requirements, and (v) recent storm water runoff regulations and other pending ordinances currently under consideration by the city, county and state water agencies and other agencies. Any of these factors may affect the city of San Diego's ability to finance capital projects and may



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impact real estate development, entitlements, costs of development and market conditions in this important submarket. As of the date this report was filed, we have not experienced any material adverse effects arising from these factors.

*Los Angeles Region.* In response to a recent court ruling, the State Water Resource Control Board has stopped processing enrollments under the statewide Construction General Storm Water Permit, which will halt virtually all new construction projects in the Los Angeles region that have not already obtained water permit coverage. This may impact our potential future development projects in this region. As of the date this report was filed, we have not experienced any material adverse effects arising from this factor.

*Incentive Compensation.* Our Executive Compensation Committee, which is currently comprised of three independent directors, determines compensation, including equity and cash incentive programs, for our executive officers. The programs approved by the Executive Compensation Committee have historically provided for equity and cash compensation to be earned by our executive officers based on certain performance measures, including financial, operating and development targets.

In the first quarter of 2008, our Executive Compensation Committee approved the 2008 Annual Bonus Program and the 2008 Annual Long-Term Incentive Program for executive management that will allow for executive management to receive bonus compensation for achieving certain specified corporate performance measures. The provisions of the 2008 programs were reported on Form 8-K filed with the SEC on January 31, 2008. As a result of the structure of these programs and other such programs that the Executive Compensation Committee may adopt in the future, accrued incentive compensation and compensation expense will be affected by our operating and development performance, financial results, the performance of our common stock and market conditions. Consequently, we cannot predict with certainty the amounts that will be recorded in future periods related to compensation programs.

*Share-Based Compensation.* As of June 30, 2008, there was \$14.4 million of total unrecognized compensation cost related to incentive awards granted under share-based compensation arrangements. That cost is expected to be recognized over a weighted-average period of 1.7 years. The \$14.4 million of unrecognized compensation cost does not reflect the potential future compensation cost for the 2008 Annual Long-Term Incentive Program or the DPP since share-based awards have not been granted under these programs as of June 30, 2008. The compensation cost that will be recorded in future periods related to these programs will be based on the amounts ultimately earned under these programs. (See Note 6 to our consolidated financial statements included with this report for additional information).

**Table of Contents****Significant Tenants**

The following table sets forth information about our fifteen largest tenants as of June 30, 2008, based upon annualized rental revenues at June 30, 2008.

| Tenant Name                        | Annualized Base Rental Revenues <sup>(1)</sup><br>(in thousands) | Percentage of Total Annualized Base Rental Revenues <sup>(1)</sup> | Initial Lease Date <sup>(2)</sup> | Lease Expiration Date  |
|------------------------------------|------------------------------------------------------------------|--------------------------------------------------------------------|-----------------------------------|------------------------|
| Intuit Inc.                        | \$ 17,374                                                        | 7.1%                                                               | November 1997                     | Various <sup>(3)</sup> |
| Cardinal Health, Inc.              | 9,256                                                            | 3.8                                                                | July 2007                         | August 2017            |
| AMN Healthcare                     | 8,341                                                            | 3.4                                                                | July 2003                         | July 2018              |
| DIRECTV Group, Inc. <sup>(4)</sup> | 8,037                                                            | 3.3                                                                | November 1996                     | July 2014              |
| The Boeing Company                 | 6,593                                                            | 2.7                                                                | August 1984                       | Various <sup>(5)</sup> |
| Fish & Richardson                  | 6,071                                                            | 2.5                                                                | October 2003                      | October 2018           |
| Favrille, Inc. <sup>(6)</sup>      | 5,588                                                            | 2.3                                                                | March 2003                        | June 2025              |
| Epson America, Inc.                | 5,538                                                            | 2.3                                                                | October 1999                      | October 2019           |
| Scripps Health <sup>(7)</sup>      | 5,199                                                            | 2.1                                                                | July 2004                         | June 2021              |
| Accredited Home Lenders, Inc.      | 5,164                                                            | 2.1                                                                | December 2005                     | May 2016               |
| Verenium Corporation               | 5,158                                                            | 2.1                                                                | November 2000                     | Various <sup>(8)</sup> |
| Hewlett-Packard Company            | 4,348                                                            | 1.8                                                                | October 1999                      | April 2012             |
| Fair Isaac Corporation             | 4,006                                                            | 1.6                                                                | August 2003                       | July 2010              |
| Avnet, Inc.                        | 3,768                                                            | 1.5                                                                | March 2003                        | February 2013          |
| Epicor Software Corporation        | 3,509                                                            | 1.4                                                                | September 1999                    | August 2009            |
| Total                              | \$ 97,950                                                        | 40.0%                                                              |                                   |                        |

(1) Based upon annualized contractual base rental revenue, which is calculated on a straight-line basis in accordance with GAAP, for leases for which rental revenue is being recognized by us as of June 30, 2008.

(2) Represents the date of the first relationship between the tenant and us or our predecessor.

(3) In July 2008, we executed agreements with Intuit to early terminate one of its leases and extend another lease by one year (see Note 13 to our consolidated financial statements included with this report for additional information). Prior to these agreements, the Intuit leases of 71,000, 90,238 and 465,812 rentable square feet had been scheduled to expire in August 2009, July 2014 and August 2017, respectively. Subsequent to the execution of these agreements, the Intuit leases of 90,238, 71,000 and 465,812 rentable square feet will expire in August 2008, August 2010 and August 2017, respectively. We estimate that annualized base rental revenues from Intuit will decrease by approximately \$2.2 million as a result of these agreements.

(4) In July 2008, we executed a lease amendment with DIRECTV Group, Inc. for an additional 24,500 rentable square feet at 2240 E. Imperial Highway in El Segundo, CA. This lease will increase the annualized base rental revenue from DIRECTV Group, Inc. by approximately \$0.5 million, and is expected to commence in the fourth quarter of 2008.

(5) The Boeing Company leases of 113,242, 286,151 and 65,447 rentable square feet expire in March 2009, July 2010 and October 2010, respectively.

(6) As of June 30, 2008, Favrille leased an aggregate of 128,580 rentable square feet in two buildings in Sorrento Mesa, CA. In July 2008, we entered into an early lease termination agreement with Favrille under which the lease will terminate on August 31, 2008.

(7) Scripps Health has preleased an additional office building encompassing approximately 146,200 rentable square feet that we are developing at 15004 Innovation Drive in San Diego, CA. The tenant is expected to begin occupying the building in the third quarter of 2008.

(8) The Verenium Corporation leases of 76,246 and 60,662 rentable square feet expire in November 2015 and March 2017, respectively.

**Table of Contents****Stabilized Portfolio Information*****Building and Occupancy Information***

The following table sets forth certain information regarding our stabilized portfolio at June 30, 2008, which was comprised of the Office Properties and the Industrial Properties. Our stabilized portfolio of operating properties consists of all our properties, except for properties we recently developed or redeveloped that have not yet reached 95.0% occupancy and are within one year following cessation of major construction activity (lease-up properties), properties classified as held for sale and properties currently under construction.

**Occupancy by Segment Type**

| Region                        | Number of Buildings | Square Feet Total | Occupancy |
|-------------------------------|---------------------|-------------------|-----------|
| <b>Office Properties:</b>     |                     |                   |           |
| Los Angeles County            | 24                  | 2,899,075         | 96.0%     |
| Orange County                 | 5                   | 277,340           | 72.0      |
| San Diego County              | 52                  | 4,565,824         | 93.8      |
| Other                         | 5                   | 346,439           | 93.8      |
|                               | 86                  | 8,088,678         | 93.8      |
| <b>Industrial Properties:</b> |                     |                   |           |
| Los Angeles County            | 1                   | 192,053           | 100.0     |
| Orange County                 | 42                  | 3,684,068         | 90.3      |
|                               | 43                  | 3,876,121         | 90.7      |
| Total portfolio               | 129                 | 11,964,799        | 92.8%     |

As of the date this report was filed, Office Properties and Industrial Properties represented approximately 88.5% and 11.5%, respectively, of our annualized base rental revenue. For the three months ended June 30, 2008, average occupancy in our stabilized portfolio was 92.9% compared to 92.8% for the three months ended June 30, 2007. For the six months ended June 30, 2008, average occupancy in our stabilized portfolio was 93.7% compared to 93.5% for the six months ended June 30, 2007. As of June 30, 2008, we had approximately 859,100 rentable square feet of vacant space in our stabilized portfolio compared to approximately 850,400 rentable square feet as of June 30, 2007.

The following table reconciles the changes in the rentable square feet in our stabilized portfolio of operating properties from June 30, 2007 to June 30, 2008. Rentable square footage in our portfolio of stabilized properties increased by an aggregate of approximately 0.3 million rentable square feet, or 2.2%, to 12.0 million rentable square feet at June 30, 2008, as a result of the activity noted below.

|                                                 | Office Properties   |                      | Industrial Properties |                      | Total               |                      |
|-------------------------------------------------|---------------------|----------------------|-----------------------|----------------------|---------------------|----------------------|
|                                                 | Number of Buildings | Rentable Square Feet | Number of Buildings   | Rentable Square Feet | Number of Buildings | Rentable Square Feet |
| Total at June 30, 2007                          | 84                  | 7,835,040            | 43                    | 3,869,969            | 127                 | 11,705,009           |
| Properties added from the Development Portfolio | 5                   | 783,812              |                       |                      | 5                   | 783,812              |
| Dispositions <sup>(1)</sup>                     | (3)                 | (532,430)            |                       |                      | (3)                 | (532,430)            |
| Remeasurement                                   |                     | 2,256                |                       | 6,152                |                     | 8,408                |
| Total at June 30, 2008                          | 86                  | 8,088,678            | 43                    | 3,876,121            | 129                 | 11,964,799           |

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- (1) In accordance with Financial Accounting Standards No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets* ( SFAS 144 ) the operating results and gains (losses) on property sales of real estate assets sold are included in discontinued operations in the consolidated statement of operations.

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### ***Current Regional Information***

*Los Angeles County.* Our Los Angeles stabilized office portfolio of 2.9 million rentable square feet was 96.0% occupied with approximately 116,400 vacant rentable square feet as of June 30, 2008, compared to 96.1% occupied with approximately 112,100 vacant rentable square feet as of December 31, 2007. As of the date this report was filed, leases representing an aggregate of approximately 124,300 and 346,900 rentable square feet are scheduled to expire during the remainder of 2008 and in 2009, respectively, in this region. The aggregate rentable square feet scheduled to expire during the remainder of 2008 and in 2009 represents approximately 16.2% of the total occupied rentable square feet in this region as of the date this report was filed and 5.6% of our annualized base rental revenues for our total stabilized portfolio.

*San Diego County.* Our San Diego stabilized office portfolio was 93.8% occupied with approximately 284,800 vacant rentable square feet as of June 30, 2008, compared to 91.4% occupied with approximately 393,400 vacant rentable square feet as of December 31, 2007. Included in the 93.8% occupancy percentage as of June 30, 2008 was one of our San Diego Office Properties encompassing approximately 102,900 rentable square feet, where Teletech and Newgen ceased paying rent and attempted to surrender the leased premises to the Company. We did not record any rental revenue for this property during the three months ended June 30, 2008 (see Note 8 to our consolidated financial statements included with this report for additional information). In addition, in July 2008 we entered into an agreement with Favril to terminate an approximately 128,600 square foot San Diego office lease effective August 31, 2008 (see Note 9 to our consolidated financial statements included with this report for additional information). Including the impact of these two leases, occupancy for our San Diego Office Properties would be approximately 88.7% as of the date this report was filed. We are beginning to see other modest increases in vacancy in certain San Diego submarkets.

As of the date this report was filed, leases representing an aggregate of approximately 326,300 and 217,900 rentable square feet are scheduled to expire during the remainder of 2008 and in 2009, respectively, in this region. The aggregate rentable square feet scheduled to expire during the remainder of 2008 and in 2009 represents approximately 12.7% of the total occupied rentable square feet in this region as of the date this report was filed and 6.2% of our annualized base rental revenues for our total stabilized portfolio. We continue development and redevelopment of office properties in San Diego County, and we will continue to seek economically attractive development opportunities in this region depending upon market conditions. See additional information regarding our development and redevelopment properties under the caption Development and Redevelopment Programs.

*Orange County.* As of June 30, 2008, our Orange County stabilized industrial portfolio was 90.3% occupied with approximately 358,700 vacant rentable square feet, compared to 94.4% occupied with approximately 207,000 vacant rentable square feet as of December 31, 2007. The decrease in Orange County stabilized industrial portfolio occupancy is primarily attributable to one building representing approximately 153,300 rentable square feet. The building was leased to one tenant in bankruptcy that rejected the lease in bankruptcy court during the quarter ended June 30, 2008. Also included in our Orange County industrial portfolio is one vacant building encompassing approximately 157,500 rentable square feet. We are in the process of re-entitling this property for residential use. If successful, we will evaluate the strategic options for the property, including the potential disposition of the asset.

Our Orange County stabilized office portfolio of approximately 277,300 rentable square feet was 72.0% occupied with approximately 77,700 vacant rentable square feet as of June 30, 2008, compared to 99.1% occupied with approximately 2,600 vacant rentable square feet as of December 31, 2007. The decrease in occupancy is primarily attributable to a lease that expired during the second quarter of 2008, which represents approximately 54,300 rentable square feet. As of the date this report was filed, leases representing an aggregate of approximately 75,400 and 900,500 rentable square feet were scheduled to expire during the remainder of 2008 and in 2009, respectively, in this region. The aggregate rentable square feet scheduled to expire during the remainder of 2008 and in 2009 represents approximately 28.3% of the total occupied rentable square feet in this region as of the date this report was filed and 3.8% of the annualized base rental revenues for our total stabilized portfolio.

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### Results of Operations

Management internally evaluates the operating performance and financial results of our portfolio based on net operating income for the following segments of commercial real estate property: Office Properties and Industrial Properties. We define net operating income as operating revenues from continuing operations (rental income, tenant reimbursements and other property income) less operating expenses from continuing operations (property expenses, real estate taxes, provision for bad debts and ground leases). The net operating income segment information presented within this section consists of the same net operating income segment information disclosed in Note 10 to our consolidated financial statements in accordance with Statement of Financial Accounting Standards No. 131 Disclosures about Segments of an Enterprise and Related Information.

#### Comparison of the Three Months Ended June 30, 2008 to the Three Months Ended June 30, 2007

The following table reconciles our net operating income by segment to our net income available for common stockholders for the three months ended June 30, 2008 and 2007.

|                                                                        | 2008      | Three Months Ended<br>June 30,<br>2007<br>(in thousands) | Dollar<br>Change | Percentage<br>Change |
|------------------------------------------------------------------------|-----------|----------------------------------------------------------|------------------|----------------------|
| <b>Net operating income, as defined:</b>                               |           |                                                          |                  |                      |
| Office Properties                                                      | \$ 42,087 | \$ 40,432                                                | \$ 1,655         | 4.1%                 |
| Industrial Properties                                                  | 7,222     | 6,113                                                    | 1,109            | 18.1                 |
| Total portfolio                                                        | 49,309    | 46,545                                                   | 2,764            | 5.9                  |
| <b>Reconciliation to Net Income Available for Common Stockholders:</b> |           |                                                          |                  |                      |
| Net operating income, as defined for reportable segments               | 49,309    | 46,545                                                   | 2,764            | 5.9                  |
| Other expenses:                                                        |           |                                                          |                  |                      |
| General and administrative expenses                                    | 9,187     | 9,460                                                    | (273)            | (2.9)                |
| Interest expense                                                       | 9,448     | 8,072                                                    | 1,376            | 17.0                 |
| Depreciation and amortization                                          | 21,536    | 17,378                                                   | 4,158            | 23.9                 |
| Total other income                                                     | 184       | 371                                                      | (187)            | (50.4)               |
| Income from continuing operations before minority interests            | 9,322     | 12,006                                                   | (2,684)          | (22.4)               |
| Minority interests attributable to continuing operations               | (1,745)   | (1,928)                                                  | 183              | (9.5)                |
| Income from discontinued operations                                    | 406       | 5,414                                                    | (5,008)          | (92.5)               |
| Net income                                                             | 7,983     | 15,492                                                   | (7,509)          | (48.5)               |
| Preferred dividends                                                    | (2,402)   | (2,402)                                                  |                  | 0.0                  |
| Net income available for common stockholders                           | \$ 5,581  | \$ 13,090                                                | \$ (7,509)       | (57.4)%              |

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### Rental Operations

We evaluate the operations of our portfolio based on operating property type. The following tables compare the net operating income for the Office Properties and for the Industrial Properties for the three months ended June 30, 2008 and 2007.

#### Office Properties

|                                | Total Office Portfolio                 |                  |                 |                   | Core Office Portfolio <sup>(1)</sup> |                  |                   |                   |
|--------------------------------|----------------------------------------|------------------|-----------------|-------------------|--------------------------------------|------------------|-------------------|-------------------|
|                                | 2008                                   | 2007             | Dollar Change   | Percentage Change | 2008                                 | 2007             | Dollar Change     | Percentage Change |
|                                | (in thousands, except percentage data) |                  |                 |                   |                                      |                  |                   |                   |
| Operating revenues:            |                                        |                  |                 |                   |                                      |                  |                   |                   |
| Rental income                  | \$ 54,340                              | \$ 47,795        | \$ 6,545        | 13.7%             | \$ 47,609                            | \$ 47,674        | \$ (65)           | (0.1)             |
| Tenant reimbursements          | 6,641                                  | 4,883            | 1,758           | 36.0              | 5,502                                | 4,883            | 619               | 12.7              |
| Other property income          | 328                                    | 1,899            | (1,571)         | (82.7)            | 324                                  | 1,899            | (1,575)           | (82.9)            |
| <b>Total</b>                   | <b>61,309</b>                          | <b>54,577</b>    | <b>6,732</b>    | <b>12.3</b>       | <b>53,435</b>                        | <b>54,456</b>    | <b>(1,021)</b>    | <b>(1.9)</b>      |
| Property and related expenses: |                                        |                  |                 |                   |                                      |                  |                   |                   |
| Property expenses              | 11,564                                 | 9,847            | 1,717           | 17.4              | 11,179                               | 9,768            | 1,411             | 14.4              |
| Real estate taxes              | 4,151                                  | 4,002            | 149             | 3.7               | 3,699                                | 3,995            | (296)             | (7.4)             |
| Provision for bad debts        | 3,107                                  | (93)             | 3,200           | 3,440.9           | 3,107                                | (93)             | 3,200             | 3,440.9           |
| Ground leases                  | 400                                    | 389              | 11              | 2.8               | 399                                  | 388              | 11                | 2.8               |
| <b>Total</b>                   | <b>19,222</b>                          | <b>14,145</b>    | <b>5,077</b>    | <b>35.9</b>       | <b>18,384</b>                        | <b>14,058</b>    | <b>4,326</b>      | <b>30.8</b>       |
| <b>Net operating income</b>    | <b>\$ 42,087</b>                       | <b>\$ 40,432</b> | <b>\$ 1,655</b> | <b>4.1%</b>       | <b>\$ 35,051</b>                     | <b>\$ 40,398</b> | <b>\$ (5,347)</b> | <b>(13.2)%</b>    |

(1) Office Properties owned and stabilized at January 1, 2007 and still owned and stabilized at June 30, 2008.

#### Operating Revenues

Total revenues from Office Properties increased \$6.7 million, or 12.3%, to \$61.3 million for the three months ended June 30, 2008, compared to \$54.6 million for the three months ended June 30, 2007.

#### Rental Income

Rental income from Office Properties increased \$6.5 million, or 13.7%, to \$54.3 million for the three months ended June 30, 2008, compared to \$47.8 million for the three months ended June 30, 2007, due to the following:

An increase of \$6.0 million generated by the five office development properties that were added to the stabilized portfolio in the third quarter of 2007 (the 2007 Office Development Properties );

An increase of \$0.6 million generated by a property that was taken out of service in June 2006 and placed into lease-up in the third quarter of 2007 and a project consisting of two buildings that was acquired for redevelopment in the first quarter of 2007 and placed into lease-up in the fourth quarter of 2007 (the 2007 Office Redevelopment Properties ); and

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An offsetting decrease of \$0.1 million attributable to the Office Properties owned and stabilized at January 1, 2007 and still owned and stabilized at June 30, 2008 (the Core Office Portfolio ).



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### **Tenant Reimbursements**

Tenant reimbursements from Office Properties increased \$1.8 million, or 36.0%, to \$6.6 million for the three months ended June 30, 2008, compared to \$4.8 million for the three months ended June 30, 2007, due to the following:

An increase of \$1.0 million generated by the 2007 Office Development Properties;

An increase of \$0.2 million generated by the 2007 Office Redevelopment Properties; and

An increase of \$0.6 million generated by the Core Office Portfolio due to an increase in reimbursable property expenses as discussed below.

### **Other Property Income**

Other property income from Office Properties decreased \$1.6 million, or 82.7%, to \$0.3 million for the three months ended June 30, 2008, compared to \$1.9 million for the three months ended June 30, 2007, due to a \$1.7 million net lease termination fee from an early lease termination at one of our Office Properties in San Diego included in other property income for the three months ended June 30, 2007. Other property income for both periods consisted primarily of lease termination fees and other miscellaneous income within the Core Office Portfolio.

### **Property and Related Expenses**

Total expenses from Office Properties increased \$5.1 million, or 35.9%, to \$19.2 million for the three months ended June 30, 2008, compared to \$14.1 million for the three months ended June 30, 2007.

### **Property Expenses**

Property expenses from Office Properties increased \$1.7 million, or 17.4%, to \$11.6 million for the three months ended June 30, 2008, compared to \$9.9 million for the three months ended June 30, 2007, due to the following:

An increase of \$1.4 million generated by the Core Office Portfolio, due to the following:

A \$0.9 million increase attributable to general increases in certain recurring operating costs such as utilities, janitorial and other service-related costs; and

A \$0.5 million increase attributable to higher repairs and maintenance expenses; and

An increase of \$0.3 million attributable to the 2007 Office Development Properties and the 2007 Office Redevelopment Properties.

### **Real Estate Taxes**

Real estate taxes from Office Properties increased \$0.1 million, or 3.7%, to \$4.1 million for the three months ended June 30, 2008, compared to \$4.0 million for the three months ended June 30, 2007, due to the following:

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An increase of \$0.4 million attributable to the 2007 Office Development Properties; and

An offsetting decrease of \$0.3 million attributable to the Core Office Portfolio, primarily due to the reversal of accruals for estimated supplemental tax assessments related to recently constructed tenant improvements, at which the enrolled value was lower than anticipated.

**Table of Contents****Provision for Bad Debts**

The provision for bad debts from Office Properties increased \$3.2 million for the three months ended June 30, 2008, compared to the three months ended June 30, 2007, primarily due to an increase of \$3.1 million attributable to increasing the provision for bad debts for the deferred rent receivable balance related to the Faville lease. (See Note 9 to our consolidated financial statements included with this report for additional information.) We evaluate our reserve levels on a quarterly basis.

**Net Operating Income**

As a result of the items discussed above, net operating income from Office Properties increased \$1.7 million, or 4.1%, to \$42.1 million for the three months ended June 30, 2008, compared to \$40.4 million for the three months ended June 30, 2007, primarily due to the following:

An increase of \$6.3 million generated by 2007 Office Development Properties;

An increase of \$0.7 million generated by 2007 Office Redevelopment Properties; and

An offsetting decrease of \$5.3 million attributable to the Core Office Portfolio, primarily due to the following:

A decrease of \$1.6 million in other property income primarily attributable to a lease termination fee received during the three months ended June 30, 2007; and

An increase of \$3.2 million in the provision for bad debts during the three months ended June 30, 2008 primarily related to Faville as discussed above.

**Industrial Properties**

|                                       | <b>Total Industrial Portfolio<sup>(1)</sup></b> |                 |                          |                              |
|---------------------------------------|-------------------------------------------------|-----------------|--------------------------|------------------------------|
|                                       | <b>2008</b>                                     | <b>2007</b>     | <b>Dollar<br/>Change</b> | <b>Percentage<br/>Change</b> |
|                                       | <b>(in thousands, except percentage data)</b>   |                 |                          |                              |
| <b>Operating revenues:</b>            |                                                 |                 |                          |                              |
| Rental income                         | \$ 7,146                                        | \$ 6,723        | \$ 423                   | 6.3%                         |
| Tenant reimbursements                 | 1,045                                           | 829             | 216                      | 26.1                         |
| Other property income                 | 129                                             | 51              | 78                       | 152.9                        |
| <b>Total</b>                          | <b>8,320</b>                                    | <b>7,603</b>    | <b>717</b>               | <b>9.4</b>                   |
| <b>Property and related expenses:</b> |                                                 |                 |                          |                              |
| Property expenses                     | 309                                             | 757             | (448)                    | (59.2)                       |
| Real estate taxes                     | 692                                             | 666             | 26                       | 3.9                          |
| Provision for bad debts               | 97                                              | 67              | 30                       | 44.8                         |
| <b>Total</b>                          | <b>1,098</b>                                    | <b>1,490</b>    | <b>(392)</b>             | <b>(26.3)</b>                |
| <b>Net operating income</b>           | <b>\$ 7,222</b>                                 | <b>\$ 6,113</b> | <b>\$ 1,109</b>          | <b>18.1%</b>                 |

(1)

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The Total Industrial Portfolio is the same as our Core Industrial Portfolio at June 30, 2008, which represents properties owned and stabilized at January 1, 2007 and still owned and stabilized at June 30, 2008.

### **Operating Revenues**

Total revenues from Industrial Properties increased \$0.7 million, or 9.4%, to \$8.3 million for the three months ended June 30, 2008, compared to \$7.6 million for the three months ended June 30, 2007.

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### **Rental Income**

Rental income from Industrial Properties increased \$0.4 million, or 6.3%, to \$7.1 million for the three months ended June 30, 2008, compared to \$6.7 million for the three months ended June 30, 2007. This increase was primarily attributable to an increase in rental rates in connection with new leases at two of our Orange County Industrial Properties. Average occupancy remained consistent at 90.8% for the three months ended June 30, 2008, compared the same period in 2007.

### **Tenant Reimbursements**

Tenant reimbursements from Industrial Properties increased \$0.2 million, or 26.1%, to \$1.0 million for the three months ended June 30, 2008, compared to \$0.8 million for the three months ended June 30, 2007. The increase in tenant reimbursements was primarily attributable to new leases at the two Orange County Industrial Properties discussed above and an increase in reimbursable operating expenses.

### **Property and Related Expenses**

Total expenses from Industrial Properties decreased \$0.4 million, or 26.3%, to \$1.1 million for the three months ended June 30, 2008, compared to \$1.5 million for the three months ended June 30, 2007.

### **Property Expenses**

Property expenses from Industrial Properties decreased \$0.4 million, or 59.2%, to \$0.3 million for the three months ended June 30, 2008, compared to \$0.7 million for the three months ended June 30, 2007. This decrease was attributable to a \$0.5 million credit recorded in June 2008 for insurance proceeds received in connection with a casualty loss at one of our Industrial Properties in 2006.

### **Net Operating Income**

Net operating income from Industrial Properties increased \$1.1 million, or 18.1%, to \$7.2 million for the three months ended June 30, 2008, compared to \$6.1 million for the three months ended June 30, 2007, primarily due to the following:

An increase in rental rates at two of our Orange County Industrial Properties; and

The receipt of \$0.5 million of insurance proceeds, as discussed above.

### **Other Income and Expenses**

#### *Interest Expense*

The following table sets forth our gross interest expense and loan cost amortization from continuing operations net of capitalized interest and loan cost amortization for the three months ended June 30, 2008 and 2007.

|                                                   | <b>Three Months Ended<br/>June 30,</b> |             | <b>Dollar</b> | <b>Percentage</b> |
|---------------------------------------------------|----------------------------------------|-------------|---------------|-------------------|
|                                                   | <b>2008</b>                            | <b>2007</b> | <b>Change</b> | <b>Change</b>     |
|                                                   | <b>(\$ in thousands)</b>               |             |               |                   |
| Gross interest expense and loan cost amortization | \$ 14,030                              | \$ 13,166   | \$ 864        | 6.6%              |
| Capitalized interest and loan cost amortization   | (4,582)                                | (5,094)     | 512           | 10.1              |
| Interest expense                                  | \$ 9,448                               | \$ 8,072    | \$ 1,376      | 17.0%             |



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Gross interest and loan cost amortization before the effect of capitalized interest and loan cost amortization increased \$0.9 million, or 6.6%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007 due to the following:

An increase in our average debt balance associated with our development activities and the repurchase of shares of our common stock during the three months ended June 30, 2008 compared to the three months ended June 30, 2007; and

An offsetting decrease in our weighted-average interest rate from approximately 5.3% for the three months ended June 30, 2007 to approximately 4.8% for the three months ended June 30, 2008.

Capitalized interest and loan cost amortization decreased \$0.5 million, or 10.1%, for the three months ended June 30, 2008 compared to the three months ended June 30, 2007 due to a decrease in our weighted-average interest rate as noted above, which caused a corresponding decrease in the capitalization rate applied to development asset balances qualifying for interest capitalization.

### *Depreciation and Amortization Expense*

Depreciation and amortization expense increased \$4.2 million, or 23.9%, to \$21.5 million for the three months ended June 30, 2008 compared to \$17.3 million for the three months ended June 30, 2007. This increase was primarily attributable to:

An increase of \$2.3 million from the 2007 Office Development Properties;

An increase of \$1.4 million from the Core Office Portfolio, which was due primarily to changes in the estimated useful lives for certain unamortized leasing commissions;

An increase of \$0.3 million from the 2007 Office Redevelopment Properties; and

An increase of \$0.2 million from the Industrial Properties.

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### Comparison of the Six Months Ended June 30, 2008 to the Six Months Ended June 30, 2007

The following table reconciles our net operating income by segment to our net income available for common stockholders for the six months ended June 30, 2008 and 2007.

|                                                                        | Six Months Ended<br>June 30,<br>2008 | 2007<br>(in thousands) | Dollar<br>Change | Percentage<br>Change |
|------------------------------------------------------------------------|--------------------------------------|------------------------|------------------|----------------------|
| <b>Net operating income, as defined:</b>                               |                                      |                        |                  |                      |
| Office Properties                                                      | \$ 88,361                            | \$ 80,654              | \$ 7,707         | 9.6%                 |
| Industrial Properties                                                  | 13,933                               | 12,577                 | 1,356            | 10.8                 |
| Total portfolio                                                        | 102,294                              | 93,231                 | 9,063            | 9.7                  |
| <b>Reconciliation to Net Income Available for Common Stockholders:</b> |                                      |                        |                  |                      |
| Net operating income, as defined for reportable segments               | 102,294                              | 93,231                 | 9,063            | 9.7                  |
| <b>Other expenses:</b>                                                 |                                      |                        |                  |                      |
| General and administrative expenses                                    | 18,423                               | 18,508                 | (85)             | (0.5)                |
| Interest expense                                                       | 19,161                               | 17,728                 | 1,433            | 8.1                  |
| Depreciation and amortization                                          | 41,402                               | 34,223                 | 7,179            | 21.0                 |
| Total other income                                                     | 341                                  | 990                    | (649)            | (65.6)               |
| Income from continuing operations before minority interests            | 23,649                               | 23,762                 | (113)            | (0.5)                |
| Minority interests attributable to continuing operations               | (3,806)                              | (3,838)                | 32               | 0.8                  |
| Income from discontinued operations                                    | 406                                  | 14,452                 | (14,046)         | (97.2)               |
| Net income                                                             | 20,249                               | 34,376                 | (14,127)         | (41.1)               |
| Preferred dividends                                                    | (4,804)                              | (4,804)                |                  | 0.0                  |
| Net income available for common stockholders                           | \$ 15,445                            | \$ 29,572              | \$ (14,127)      | (47.8)%              |



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### Rental Operations

We evaluate the operations of our portfolio based on operating property type. The following tables compare the net operating income for the Office Properties and for the Industrial Properties for the six months ended June 30, 2008 and 2007.

#### Office Properties

|                                | Total Office Portfolio                 |                  |                 |                   | Core Office Portfolio <sup>(1)</sup> |                  |                   |                   |
|--------------------------------|----------------------------------------|------------------|-----------------|-------------------|--------------------------------------|------------------|-------------------|-------------------|
|                                | 2008                                   | 2007             | Dollar Change   | Percentage Change | 2008                                 | 2007             | Dollar Change     | Percentage Change |
|                                | (in thousands, except percentage data) |                  |                 |                   |                                      |                  |                   |                   |
| Operating revenues:            |                                        |                  |                 |                   |                                      |                  |                   |                   |
| Rental income                  | \$ 109,330                             | \$ 95,462        | \$ 13,868       | 14.5%             | \$ 95,973                            | \$ 95,231        | \$ 742            | 0.8%              |
| Tenant reimbursements          | 13,827                                 | 9,898            | 3,929           | 39.7              | 11,193                               | 9,883            | 1,310             | 13.3              |
| Other property income          | 627                                    | 2,996            | (2,369)         | (79.1)            | 622                                  | 2,996            | (2,374)           | (79.2)            |
| <b>Total</b>                   | <b>123,784</b>                         | <b>108,356</b>   | <b>15,428</b>   | <b>14.2</b>       | <b>107,788</b>                       | <b>108,110</b>   | <b>(322)</b>      | <b>(0.3)</b>      |
| Property and related expenses: |                                        |                  |                 |                   |                                      |                  |                   |                   |
| Property expenses              | 22,169                                 | 19,243           | 2,926           | 15.2              | 21,398                               | 19,157           | 2,241             | 11.7              |
| Real estate taxes              | 8,937                                  | 7,888            | 1,049           | 13.3              | 7,683                                | 7,873            | (190)             | (2.4)             |
| Provision for bad debts        | 3,522                                  | (221)            | 3,743           | 1,693.7           | 3,522                                | (221)            | 3,743             | 1,693.7           |
| Ground leases                  | 795                                    | 792              | 3               | 0.4               | 792                                  | 790              | 2                 | 0.3               |
| <b>Total</b>                   | <b>35,423</b>                          | <b>27,702</b>    | <b>7,721</b>    | <b>27.9</b>       | <b>33,395</b>                        | <b>27,599</b>    | <b>5,796</b>      | <b>21.0</b>       |
| <b>Net operating income</b>    | <b>\$ 88,361</b>                       | <b>\$ 80,654</b> | <b>\$ 7,707</b> | <b>9.6%</b>       | <b>\$ 74,393</b>                     | <b>\$ 80,511</b> | <b>\$ (6,118)</b> | <b>(7.6)%</b>     |

(1) Office Properties owned and stabilized at January 1, 2007 and still owned and stabilized at June 30, 2008.

#### Operating Revenues

Total revenues from Office Properties increased \$15.4 million, or 14.2%, to \$123.8 million for the six months ended June 30, 2008, compared to \$108.4 million for the six months ended June 30, 2007.

#### Rental Income

Rental income from Office Properties increased \$13.9 million, or 14.5%, to \$109.3 million for the six months ended June 30, 2008, compared to \$95.4 million for the six months ended June 30, 2007, due to the following:

An increase of \$11.9 million generated by the 2007 Office Development Properties;

An increase of \$1.3 million generated by the 2007 Office Redevelopment Properties.

An increase of \$0.7 million generated by Core Office Properties, due to the following:

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A net increase of \$0.3 million primarily attributable to the following changes in occupancy:

An increase of \$2.0 million in our Los Angeles office portfolio primarily due to an increase in average occupancy of 3.0% in the Los Angeles office portfolio to 96.1% for the six months ended June 30, 2008, from 93.1% for the six months ended June 30, 2007;

An offsetting decrease of \$1.4 million in rental income from our San Diego office portfolio primarily due to a decrease in average occupancy of 4.2% in the San Diego office portfolio to 91.9% for the six months ended June 30, 2008, from 96.1% for the six months ended June 30, 2007. The decrease in average occupancy is primarily attributable to three vacant buildings representing approximately 243,900 rentable square feet; and

An offsetting decrease of \$0.3 million in our Orange County office portfolio.

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An increase of \$0.9 million generated from the amortization of deferred revenue related to tenant-funded tenant improvements; and

An offsetting decrease of \$0.5 million in parking income primarily attributable to one lease in our Los Angeles Core Office Portfolio.

### **Tenant Reimbursements**

Tenant reimbursements from Office Properties increased \$3.9 million, or 39.7%, to \$13.8 million for the six months ended June 30, 2008, compared to \$9.9 million for the six months ended June 30, 2007, due to the following:

An increase of \$2.1 million generated by the 2007 Office Development Properties;

An increase of \$1.3 million generated by the Core Office Portfolio due to an increase in reimbursable property expenses as discussed below; and

An increase of \$0.5 million generated by the 2007 Office Redevelopment Properties.

### **Other Property Income**

Other property income from Office Properties decreased \$2.4 million, or 79.1%, to \$0.6 million for the six months ended June 30, 2008, compared to \$3.0 million for the six months ended June 30, 2007, primarily due to \$2.8 million in net lease termination fees from two early lease terminations at two of our Office Properties in San Diego included in other property income for the six months ended June 30, 2007. Other property income for both periods consisted primarily of lease termination fees and other miscellaneous income within the Core Office Portfolio.

### **Property and Related Expenses**

Total expenses from Office Properties increased \$7.7 million, or 27.9%, to \$35.4 million for the six months ended June 30, 2008, compared to \$27.7 million for the six months ended June 30, 2007.

### **Property Expenses**

Property expenses from Office Properties increased \$2.9 million, or 15.2%, to \$22.1 million for the six months ended June 30, 2008, compared to \$19.2 million for the six months ended June 30, 2007, due to the following:

An increase of \$2.2 million generated by the Core Office Portfolio, due to the following:

An increase of \$1.6 million attributable to general increases in certain recurring operating costs such as utilities, janitorial and other service-related costs; and

An increase of \$0.6 million attributable to higher repairs and maintenance expenses;

An increase of \$0.5 million generated by the 2007 Office Development Properties; and

An increase of \$0.2 million generated by the 2007 Office Redevelopment Properties.

### **Real Estate Taxes**

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Real estate taxes from Office Properties increased \$1.0 million, or 13.3%, to \$8.9 million for the six months ended June 30, 2008, compared to \$7.9 million for the six months ended June 30, 2007, due to the following:

An increase of \$1.1 million attributable to the 2007 Office Development Properties;

An increase of \$0.1 million attributable to the 2007 Office Redevelopment Properties; and

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An offsetting decrease of \$0.2 million attributable to the Core Office Portfolio, primarily due to the reversal of accruals for estimated supplemental tax assessments related to recently constructed tenant improvements, at which the enrolled value was lower than anticipated.

### Provision for Bad Debts

The provision for bad debts from Office Properties increased \$3.7 million for the six months ended June 30, 2008, compared to the six months ended June 30, 2007, primarily due to the following:

An increase of \$3.1 million due to increasing the provision for bad debts for the deferred rent receivable balance related to the Faville lease. (See Note 9 to our consolidated financial statements included with this report for additional information);

An increase of \$0.6 million primarily due to changes in our estimates of collectibility of receivables from certain other watchlist tenants.

We evaluate our reserve levels on a quarterly basis.

### Net Operating Income

As a result of the items discussed above, net operating income from Office Properties increased \$7.7 million, or 9.6%, to \$88.4 million for the six months ended June 30, 2008, compared to \$80.7 million for the six months ended June 30, 2007, due to the following:

An increase of \$12.3 million generated 2007 Office Development Properties;

An increase of \$1.5 million generated by 2007 Office Redevelopment Properties; and

An offsetting decrease of \$6.1 million attributable to the Core Office Portfolio primarily due to the following:

A decrease of \$2.4 million in other property income during the six months ended June 30, 2008 as discussed above; and

An increase of \$3.7 million in the provision for bad debts during the six months ended June 30, 2008 as discussed above.

### Industrial Properties

|                       | Total Industrial Portfolio <sup>(1)</sup> |           |               |                   |
|-----------------------|-------------------------------------------|-----------|---------------|-------------------|
|                       | 2008                                      | 2007      | Dollar Change | Percentage Change |
|                       | (in thousands, except percentage data)    |           |               |                   |
| Operating revenues:   |                                           |           |               |                   |
| Rental income         | \$ 14,461                                 | \$ 13,489 | \$ 972        | 7.2%              |
| Tenant reimbursements | 2,052                                     | 1,712     | 340           | 19.9              |
| Other property income | 134                                       | 57        | 77            | 135.1             |
| Total                 | 16,647                                    | 15,258    | 1,389         | 9.1               |

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### Property and related expenses:

|                         |           |           |          |        |
|-------------------------|-----------|-----------|----------|--------|
| Property expenses       | 1,192     | 1,327     | (135)    | (10.2) |
| Real estate taxes       | 1,385     | 1,332     | 53       | 4.0    |
| Provision for bad debts | 137       | 22        | 115      | 522.7  |
| Total                   | 2,714     | 2,681     | 33       | 1.2    |
| Net operating income    | \$ 13,933 | \$ 12,577 | \$ 1,356 | 10.8%  |

- (1) The Total Industrial Portfolio is the same as our Core Industrial Portfolio at June 30, 2008, which represents properties owned and stabilized at January 1, 2007 and still owned and stabilized at June 30, 2008.

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### **Operating Revenues**

Total revenues from Industrial Properties increased \$1.4 million, or 9.1%, to \$16.7 million for the six months ended June 30, 2008, compared to \$15.3 million for the six months ended June 30, 2007.

### **Rental Income**

Rental income from Industrial Properties increased \$1.0 million, or 7.2%, to \$14.5 million for the six months ended June 30, 2008, compared to \$13.5 million for the six months ended June 30, 2007. This increase was primarily attributable to an increase in rental rates in connection with new leases at two of our Orange County Industrial Properties and an increase in occupancy. Average occupancy increased 1.4% to 92.7% for the six months ended June 30, 2008, compared to 91.3% for the six months ended June 30, 2007.

### **Tenant Reimbursements**

Tenant reimbursements from Industrial Properties increased \$0.3 million, or 19.9%, to \$2.0 million for the six months ended June 30, 2008, compared to \$1.7 million for the six months ended June 30, 2007. The increase in tenant reimbursements was primarily attributable to an increase in repairs and maintenance and other service-related costs.

### **Property and Related Expenses**

Total expenses from Industrial Properties remained consistent at approximately \$2.7 million for the six months ended June 30, 2008, compared to the same period in June 30, 2007.

### **Property Expenses**

Property expenses from Industrial Properties decreased \$0.1 million, or 10.2%, to \$1.2 million for the six months ended June 30, 2008, compared to \$1.3 million for the six months ended June 30, 2007, due to the following:

A decrease of \$0.5 million attributable to a credit recorded in June 2008 for insurance proceeds received in connection with a casualty loss at one of our Industrial Properties in 2006.

An offsetting increase of \$0.4 million for the six months ended June 30, 2008 compared to the same period in 2007 primarily due to the following:

An increase of \$0.2 million in repairs and maintenance and other service-related costs; and

An increase of \$0.2 million primarily due to non-reimbursable legal fees.

### **Provision for Bad Debts**

The provision for bad debts from Industrial Properties increased by \$0.1 million, or 522.7%, for the six months ended June 30, 2008, compared to the six months ended June 30, 2007, primarily due to changes in our estimates of the collectibility of receivables from certain watchlist tenants. We evaluate our reserve levels on a quarterly basis.

### **Net Operating Income**

Net operating income from Industrial Properties increased \$1.4 million, or 10.8%, to \$13.9 million for the six months ended June 30, 2008, compared to \$12.5 million for the six months ended June 30, 2007, primarily due to an increase in occupancy in the Core Industrial Portfolio as discussed above.





**Table of Contents****Other Income and Expenses***Interest Expense*

The following table sets forth our gross interest expense and loan cost amortization from continuing operations net of capitalized interest and loan cost amortization for the six months ended June 30, 2008 and 2007.

|                                                   | Six Months Ended<br>June 30, |           | Dollar   | Percentage |
|---------------------------------------------------|------------------------------|-----------|----------|------------|
|                                                   | 2008                         | 2007      | Change   | Change     |
|                                                   | (\$ in thousands)            |           |          |            |
| Gross interest expense and loan cost amortization | \$ 28,241                    | \$ 27,580 | \$ 661   | 2.4%       |
| Capitalized interest and loan cost amortization   | (9,080)                      | (9,852)   | 772      | 7.8        |
| Interest expense                                  | \$ 19,161                    | \$ 17,728 | \$ 1,433 | 8.1%       |

Gross interest and loan cost amortization before the effect of capitalized interest and loan cost amortization increased \$0.7 million, or 2.4%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007, due to the following:

An increase in our average debt balance associated with our development activities and the repurchase of shares of our common stock during the six months ended June 30, 2008 compared to the six months ended June 30, 2007; and

An offsetting decrease in our weighted-average interest rate from approximately 5.8% for the six months ended June 30, 2007 to approximately 4.9% for the six months ended June 30, 2008.

Capitalized interest and loan cost amortization decreased \$0.8 million, or 7.8%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007, due to the following:

A decrease in our weighted-average interest rate as noted above, which caused a corresponding decrease in the capitalization rate applied to development asset balances qualifying for interest capitalization; and

An offsetting increase attributable to higher average development asset balances qualifying for interest capitalization during the six months ended June 30, 2008 compared to the six months ended June 30, 2007.

*Depreciation and Amortization Expense*

Depreciation and amortization expense increased \$7.2 million, or 21.0%, to \$41.4 million for the six months ended June 30, 2008 compared to \$34.2 million for the six months ended June 30, 2007, due to the following:

An increase of \$4.5 million from the 2007 Office Development Properties;

An increase of \$2.2 million from the Core Office Portfolio and the Industrial Properties due to asset additions and changes in the estimated useful lives for certain unamortized leasing commissions; and

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An increase of \$0.5 million from the 2007 Office Redevelopment Properties.

### *Other Income*

Total other income decreased approximately \$0.6 million, or 65.6%, for the six months ended June 30, 2008 compared to the six months ended June 30, 2007, due to the following:

A decrease of \$0.3 million due to lower cash balances and lower interest rates during the six months ended June 30, 2008 compared to the six months ended June 30, 2007;

A decrease of \$0.2 million due to interest earned in January 2007 on the funds held at a qualified intermediary for an exchange of real property pursuant to Section 1031 of the Internal Revenue Code (a Section 1031 Exchange ). In January 2007, we used these funds to partially fund two acquisitions to complete a Section 1031 Exchange; and

A decrease of \$0.1 million due to the fair value adjustment on our marketable securities held in connection with our deferred compensation plan during the six months ended June 30, 2008. We did not hold any marketable securities during the six months ended June 30, 2007.

**Table of Contents****Lease Information****Lease Expirations by Segment Type<sup>(1)</sup>**

| <b>Year of Lease Expiration</b> | <b>Number of<br/>Expiring<br/>Leases</b> | <b>Net Rentable<br/>Area Subject<br/>to Expiring<br/>Leases<br/>(Sq. Ft.)</b> | <b>Percentage of<br/>Leased<br/>Square Feet<br/>Represented by<br/>Expiring<br/>Leases</b> | <b>Annualized Base<br/>Rental<br/>Revenue<br/>Under<br/>Expiring<br/>Leases<br/>(000s)<sup>(2)</sup></b> |
|---------------------------------|------------------------------------------|-------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------|
| <b>Office Properties:</b>       |                                          |                                                                               |                                                                                            |                                                                                                          |
| Remaining 2008                  | 28                                       | 462,597                                                                       | 6.2%                                                                                       | \$ 13,537                                                                                                |
| 2009                            | 66                                       | 693,545                                                                       | 9.2                                                                                        | 17,756                                                                                                   |
| 2010                            | 73                                       | 1,317,642                                                                     | 17.6                                                                                       | 32,129                                                                                                   |
| 2011                            | 49                                       | 507,180                                                                       | 6.8                                                                                        | 10,431                                                                                                   |
| 2012                            | 39                                       | 529,481                                                                       | 7.1                                                                                        | 14,738                                                                                                   |
| 2013                            | 33                                       | 526,575                                                                       | 7.0                                                                                        | 12,965                                                                                                   |
| Total Office                    | 288                                      | 4,037,020                                                                     | 53.9                                                                                       | 101,556                                                                                                  |
| <b>Industrial Properties:</b>   |                                          |                                                                               |                                                                                            |                                                                                                          |
| Remaining 2008                  | 2                                        | 63,424                                                                        | 1.8                                                                                        | 725                                                                                                      |
| 2009                            | 14                                       | 786,203                                                                       | 22.8                                                                                       | 5,268                                                                                                    |
| 2010                            | 15                                       | 413,485                                                                       | 12.0                                                                                       | 3,250                                                                                                    |
| 2011                            | 12                                       | 345,634                                                                       | 10.0                                                                                       | 3,217                                                                                                    |
| 2012                            | 10                                       | 591,672                                                                       | 17.1                                                                                       | 4,112                                                                                                    |
| 2013                            | 3                                        | 295,369                                                                       | 8.6                                                                                        | 2,181                                                                                                    |
| Total Industrial                | 56                                       | 2,495,787                                                                     | 72.3                                                                                       | 18,753                                                                                                   |
| Total                           | 344                                      | 6,532,807                                                                     | 59.6%                                                                                      | \$ 120,309                                                                                               |

(1) The information presented reflects leasing activity through the date of this filing. For leases that have been renewed early or space that has been released to a new tenant, the expiration date and annualized base rental revenue information presented takes into consideration the renewed or released lease terms.

Excludes space leased under month-to-month leases and vacant space at June 30, 2008.

(2) Reflects annualized contractual base rental revenue calculated on a straight-line basis.

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### Leasing Activity by Segment Type

For the three months ended June 30, 2008

|                       | Number of Leases <sup>(1)</sup> |         | Rentable Square Feet <sup>(1)</sup> |         | Changes in Rents <sup>(2)</sup> | Changes in Cash Rents <sup>(3)</sup> | Retention Rates <sup>(4)</sup> | Weighted Average Lease Term (in months) |
|-----------------------|---------------------------------|---------|-------------------------------------|---------|---------------------------------|--------------------------------------|--------------------------------|-----------------------------------------|
|                       | New                             | Renewal | New                                 | Renewal |                                 |                                      |                                |                                         |
| Office Properties     | 7                               | 4       | 32,643                              | 43,431  | 21.3%                           | 4.2%                                 | 29.1%                          | 53                                      |
| Industrial Properties |                                 | 4       |                                     | 362,777 | 16.5                            | (8.8)                                | 98.6                           | 57                                      |
| Total portfolio       | 7                               | 8       | 32,643                              | 406,208 | 17.8%                           | (4.5)%                               | 78.8%                          | 56                                      |

### Leasing Activity by Segment Type

For the six months ended June 30, 2008

|                       | Number of Leases <sup>(1)</sup> |         | Rentable Square Feet <sup>(1)</sup> |         | Changes in Rents <sup>(2)</sup> | Changes in Cash Rents <sup>(3)</sup> | Retention Rates <sup>(4)</sup> | Weighted Average Lease Term (in months) |
|-----------------------|---------------------------------|---------|-------------------------------------|---------|---------------------------------|--------------------------------------|--------------------------------|-----------------------------------------|
|                       | New                             | Renewal | New                                 | Renewal |                                 |                                      |                                |                                         |
| Office Properties     | 14                              | 14      | 139,485                             | 85,321  | 48.7%                           | 29.9%                                | 41.4%                          | 62                                      |
| Industrial Properties | 3                               | 7       | 164,727                             | 425,187 | 20.7                            | (3.3)                                | 72.0                           | 57                                      |
| Total portfolio       | 17                              | 21      | 304,212                             | 510,508 | 33.7%                           | 11.5%                                | 64.1%                          | 58                                      |

- (1) Represents leasing activity for leases commencing during the period shown, including first and second generation space, net of month-to-month leases. Excludes leasing on new construction.
- (2) Calculated as the change between GAAP rents for new/renewed leases and the expiring GAAP rents for the same space. Excludes leases for which the space was vacant longer than one year.
- (3) Calculated as the change between stated rents for new/renewed leases and the expiring stated rents for the same space. Excludes leases for which the space was vacant longer than one year.
- (4) Calculated as the percentage of space either renewed or expanded into by existing tenants or subtenants at lease expiration.

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### **Development and Redevelopment Programs**

We believe that a portion of our future potential growth will continue to come from our development pipeline. We continue to seek and obtain development opportunities throughout Southern California and specifically in our core markets. We have made significant progress in expanding our development program through targeted acquisitions of redevelopment opportunities and undeveloped land.

In February 2008, we executed two lease agreements with Bridgepoint Education, Inc. ( Bridgepoint ) totaling approximately 289,700 rentable square feet. In the third quarter of 2008, Bridgepoint will lease 100% of the approximately 147,500 rentable square feet at Kilroy Sabre Springs Phase III, which is currently under construction. In the third quarter of 2009, Bridgepoint will expand its occupancy at 13500 Evening Creek Drive from approximately 119,800 rentable square feet at June 30, 2008 to approximately 142,200 rentable square feet. Both leases are scheduled to expire in June 2018. Bridgepoint is currently projected to become our third largest tenant in the third quarter of 2008 and to become our second largest tenant in the third quarter of 2009, based on its percentage of our projected total annualized base rental revenues.

We believe that another possible source of potential future growth is redevelopment opportunities within our existing portfolio or targeted acquisitions. Redevelopment efforts can achieve similar returns to new development with reduced entitlement risk and shorter construction periods. Depending on market conditions, we will continue to pursue future redevelopment opportunities in our strategic submarkets where there is limited land for development.

We have a proactive planning process by which we continually evaluate the size, timing, costs and scope of our development and redevelopment programs and, as necessary, scale activity to reflect the economic conditions and the real estate fundamentals that exist in our strategic submarkets. However, we may be unable to lease committed development or redevelopment properties at expected rental rates or within projected timeframes or complete development or redevelopment properties on schedule or within budgeted amounts, which could adversely affect our financial condition, results of operations and cash flows.

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The following tables set forth certain information regarding our office development and redevelopment properties in-process as of June 30, 2008.

### Development Properties

| Property Name / Submarket / City      | Actual/<br>Estimated<br>Completion<br>Date | Estimated<br>Stabilization<br>Date <sup>(1)</sup> | Rentable<br>Square<br>Feet Upon<br>Completion | Total<br>Estimated<br>Investment <sup>(2)(3)</sup><br>(\$ in millions) | Total<br>Costs as of<br>June 30,<br>2008 <sup>(3)(4)</sup> | Percentage<br>Leased |
|---------------------------------------|--------------------------------------------|---------------------------------------------------|-----------------------------------------------|------------------------------------------------------------------------|------------------------------------------------------------|----------------------|
| <b>Property In Lease-up</b>           |                                            |                                                   |                                               |                                                                        |                                                            |                      |
| Sorrento Gateway-Lot 3                |                                            |                                                   |                                               |                                                                        |                                                            |                      |
| Sorrento Mesa                         |                                            |                                                   |                                               |                                                                        |                                                            |                      |
| San Diego, CA                         | 4th Qtr 2007                               | 4th Qtr 2008                                      | 55,500                                        | \$ 22.0                                                                | \$ 15.7                                                    | 0%                   |
| <b>Properties Under Construction</b>  |                                            |                                                   |                                               |                                                                        |                                                            |                      |
| Kilroy Sabre Springs Phase III        |                                            |                                                   |                                               |                                                                        |                                                            |                      |
| I-15 Corridor                         |                                            |                                                   |                                               |                                                                        |                                                            |                      |
| San Diego, CA                         | 3rd Qtr 2008                               | 3rd Qtr 2008                                      | 147,533                                       | 65.5                                                                   | 51.6                                                       | 100% <sup>(5)</sup>  |
| ICC 15004 Innovation Drive            |                                            |                                                   |                                               |                                                                        |                                                            |                      |
| I-15 Corridor                         |                                            |                                                   |                                               |                                                                        |                                                            |                      |
| San Diego, CA                         | 3rd Qtr 2008                               | 3rd Qtr 2008                                      | 146,156                                       | 50.0                                                                   | 47.3                                                       | 100% <sup>(6)</sup>  |
| Sorrento Gateway-Lot 1 <sup>(7)</sup> |                                            |                                                   |                                               |                                                                        |                                                            |                      |
| Sorrento Mesa                         |                                            |                                                   |                                               |                                                                        |                                                            |                      |
| San Diego, CA                         | 4th Qtr 2008                               | 4th Qtr 2009                                      | 50,925                                        | 22.5                                                                   | 12.1                                                       | 0%                   |
| <b>Total</b>                          |                                            |                                                   | 400,114                                       | \$ 160.0                                                               | \$ 126.7                                                   | 73%                  |

(1) Based on management's estimation of the earlier of stabilized occupancy (95.0%) or one year from the date of substantial completion.

(2) Represents total projected development costs at June 30, 2008.

(3) Amounts exclude tenant-funded tenant improvements.

(4) Represents cash paid and costs incurred as of June 30, 2008.

(5) This building was leased to Bridgepoint in February 2008. See additional information regarding Bridgepoint above.

(6) This building was leased to Scripps Health in July 2006.

(7) We are developing this property for medical office use.

### Redevelopment Properties

| Property Name /<br>Submarket /City | Actual<br>Completion<br>Date | Estimated<br>Stabilization<br>Date <sup>(1)</sup> | Rentable<br>Square<br>Feet Upon<br>Completion | Existing<br>Invest-<br>ment <sup>(2)</sup> | Estimated<br>Redevelop-<br>ment<br>Costs | Total<br>Estimated<br>Investment <sup>(3)</sup><br>(\$ in millions) | Total Costs<br>as of<br>June 30,<br>2008 <sup>(3)(4)</sup> | Percentage<br>Leased |
|------------------------------------|------------------------------|---------------------------------------------------|-----------------------------------------------|--------------------------------------------|------------------------------------------|---------------------------------------------------------------------|------------------------------------------------------------|----------------------|
| <b>Properties In Lease-up</b>      |                              |                                                   |                                               |                                            |                                          |                                                                     |                                                            |                      |

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2240 E. Imperial Highway

Kilroy Airport Center

|                         | 3rd Qtr<br>2007 | 3rd Qtr<br>2008 |         |        |         |         |         |  |                     |
|-------------------------|-----------------|-----------------|---------|--------|---------|---------|---------|--|---------------------|
| El Segundo, CA          |                 |                 | 107,041 | \$ 5.0 | \$ 16.7 | \$ 21.7 | \$ 18.9 |  | 100% <sup>(5)</sup> |
| Sabre Springs Corporate |                 |                 |         |        |         |         |         |  |                     |

Center I-15 Corridor

|               | 4th Qtr<br>2007 | 4th Qtr<br>2008 |         |      |      |      |      |  |     |
|---------------|-----------------|-----------------|---------|------|------|------|------|--|-----|
| San Diego, CA |                 |                 | 103,900 | 24.7 | 10.4 | 35.1 | 30.7 |  | 19% |

|              |  |  |         |         |         |         |         |  |     |
|--------------|--|--|---------|---------|---------|---------|---------|--|-----|
| <b>Total</b> |  |  | 210,941 | \$ 29.7 | \$ 27.1 | \$ 56.8 | \$ 49.6 |  | 60% |
|--------------|--|--|---------|---------|---------|---------|---------|--|-----|

- (1) Based on management's estimation of the earlier of stabilized occupancy (95.0%) or one year from the date of substantial completion.
- (2) Represents the depreciated carrying value at the commencement of redevelopment for the space being redeveloped.
- (3) Amounts exclude tenant-funded tenant improvements.
- (4) Represents cash paid and costs incurred as of June 30, 2008, including the existing investment at commencement of redevelopment. See footnote (2) above.
- (5) In July 2008, we executed a lease amendment with DIRECTV Group, Inc. for the remaining 24,500 rentable square feet of this property.

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### **Liquidity and Capital Resources**

#### *Current Sources of Capital and Liquidity*

We seek to create and maintain a capital structure that allows for financial flexibility and diversification of capital resources. Our primary source of liquidity to fund distributions, debt service, leasing costs and maintenance-related capital expenditures is net cash from operations. We believe that we will have sufficient capital resources to satisfy our liquidity needs over the next twelve-month period. Our primary sources of liquidity to fund development and redevelopment costs, potential undeveloped land and property acquisitions, temporary working capital and unanticipated cash needs are the Credit Facility, proceeds received from our property disposition program, construction loans and the public or private issuance of debt or equity securities. As of June 30, 2008, our total debt as a percentage of total market capitalization was 38.6%, and our total debt and liquidation value of our preferred equity as a percentage of total market capitalization was 45.3%.

As of June 30, 2008, we had borrowings of \$159 million outstanding under the Credit Facility and borrowing capacity of approximately \$391 million. The Credit Facility bears interest at an annual rate between LIBOR plus 0.85% and LIBOR plus 1.35%, depending upon our leverage ratio at the time of borrowing (3.48% at June 30, 2008). We expect to use the Credit Facility to finance development and redevelopment expenditures, to fund potential acquisitions and for other general corporate uses.

#### *Factors That May Influence Future Sources of Capital and Liquidity*

One of our fixed-rate mortgage notes payable had a principal balance of \$72.6 million at June 30, 2008 and is scheduled to mature in August 2008. We currently plan to repay this mortgage note by borrowing from the Credit Facility.

During the six months ended June 30, 2008, we repurchased 239,475 shares of our common stock in open market transactions for an aggregate price of approximately \$11.5 million, or \$48.23 per share. These repurchases were made pursuant to a share repurchase program approved by our Board of Directors and were funded through borrowings on our Credit Facility. As of June 30, 2008, an aggregate of 988,025 shares remained eligible for repurchase under this share repurchase program. We may opt to repurchase additional shares of our common stock in the future depending upon market conditions.

We have the ability to repurchase the Notes in open market transactions. We may opt to repurchase the Notes in the future depending upon market conditions and our financial position.

Our Credit Facility, unsecured senior notes and certain other secured debt agreements contain covenants and restrictions requiring us to meet certain financial ratios and reporting requirements. Some of the more restrictive covenants include a maximum ratio of total debt to total assets, a maximum ratio of total secured debt to total assets, a fixed charge coverage ratio, a minimum consolidated tangible net worth, a limit of the ratio of development activities to total assets and a maximum ratio of dividend payments to FFO. Non-compliance with one or more of the covenants or restrictions could result in the full or partial principal balance of the associated debt becoming immediately due and payable. We were in compliance with all our debt covenants at June 30, 2008.



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### Debt Composition

The composition of our aggregate debt balances at June 30, 2008 and December 31, 2007 was as follows:

|                                               | Percentage of Total Debt |                   | Weighted Average Interest Rate |                   |
|-----------------------------------------------|--------------------------|-------------------|--------------------------------|-------------------|
|                                               | June 30, 2008            | December 31, 2007 | June 30, 2008                  | December 31, 2007 |
| Secured vs. unsecured:                        |                          |                   |                                |                   |
| Secured                                       | 34.0%                    | 35.6%             | 5.6%                           | 5.9%              |
| Unsecured                                     | 66.0                     | 64.4              | 3.8                            | 4.2               |
| Fixed rate vs. variable rate:                 |                          |                   |                                |                   |
| Fixed rate                                    | 83.2                     | 86.8              | 4.6                            | 4.7               |
| Variable rate                                 | 16.8                     | 13.2              | 3.4                            | 5.9               |
| Total debt/interest rate                      |                          |                   | 4.4                            | 4.8               |
| Total debt/interest rate including loan costs |                          |                   | 4.8                            | 5.2               |

The following is our total capitalization at June 30, 2008:

|                                                                      | Shares/Units at June 30, 2008 | Aggregate Principal Amount or \$ Value Equivalent (\$ in thousands) | % of Total Capitalization |
|----------------------------------------------------------------------|-------------------------------|---------------------------------------------------------------------|---------------------------|
| <b>Debt:</b>                                                         |                               |                                                                     |                           |
| Secured debt                                                         |                               | \$ 392,511                                                          | 13.1%                     |
| Exchangeable senior notes <sup>(1)</sup>                             |                               | 460,000                                                             | 15.4                      |
| Unsecured senior notes                                               |                               | 144,000                                                             | 4.8                       |
| Credit Facility                                                      |                               | 159,000                                                             | 5.3                       |
| Total debt                                                           |                               | \$ 1,155,511                                                        | 38.6                      |
| <b>Equity:</b>                                                       |                               |                                                                     |                           |
| 7.450% Series A cumulative redeemable preferred units <sup>(2)</sup> | 1,500,000                     | \$ 75,000                                                           | 2.5                       |
| 7.800% Series E cumulative redeemable preferred stock <sup>(3)</sup> | 1,610,000                     | 40,250                                                              | 1.3                       |
| 7.500% Series F cumulative redeemable preferred stock <sup>(3)</sup> | 3,450,000                     | 86,250                                                              | 2.9                       |
| Common limited partnership units outstanding <sup>(4)</sup>          | 2,188,340                     | 102,918                                                             | 3.4                       |
| Common shares outstanding <sup>(4)</sup>                             | 32,652,346                    | 1,535,640                                                           | 51.3                      |
| Total equity                                                         |                               | \$ 1,840,058                                                        | 61.4                      |
| <b>Total Capitalization</b>                                          |                               | \$ 2,995,569                                                        | 100.0%                    |

(1) Represents gross aggregate principal amount before the effect of the unamortized discount of approximately \$3.4 million at June 30, 2008.

(2) Value based on \$50.00 per share liquidation preference.

(3) Value based on \$25.00 per share liquidation preference.

(4) Value based on the closing price per share of our common stock of \$47.03 at June 30, 2008.

### Off-Balance Sheet Arrangements

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As of June 30, 2008 and as of the date this report was filed, we do not have any off-balance sheet transactions, arrangements or obligations, including contingent obligations.

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### Historical Cash Flows

The principal sources of funding for our future development, redevelopment, acquisitions, share repurchases and capital expenditures are cash flow from operating activities, the Credit Facility, secured and unsecured debt financing and proceeds from potential dispositions. The following is a summary of the sources and uses of cash for the six months ended June 30, 2008, compared to the six months ended June 30, 2007.

|                                                     | 2008      | 2007      | Six months ended June 30,<br>Dollar<br>Change<br>(\$in thousands) | Percentage<br>Change |
|-----------------------------------------------------|-----------|-----------|-------------------------------------------------------------------|----------------------|
| Net cash provided by operating activities           | \$ 64,120 | \$ 74,617 | \$ (10,497)                                                       | (14.1)%              |
| Net cash used in investing activities               | (50,778)  | (131,886) | 81,108                                                            | (61.5)               |
| Net cash (used in) provided by financing activities | (20,707)  | 56,455    | (77,162)                                                          | (136.7)              |

#### Operating Activities

Our net cash provided by operating activities decreased by \$10.5 million, or 14.1%, to \$64.1 million for the six months ended June 30, 2008, compared to \$74.6 million for the six months ended June 30, 2007, due to the following:

A decrease of \$4.6 million in cash received from tenants for reimbursement of tenant-funded tenant improvements during the six months ended June 30, 2008 compared to the six months ended June 30, 2007;

An increase of \$4.1 million in cash paid for interest during the six months ended June 30, 2008 compared to the six months ended June 30, 2007 due to a change in the composition of the Company's debt structure and the timing of interest payments as a result of the issuance of the Notes in April 2007;

An increase of \$3.6 million in cash incentive compensation paid during the six months ended June 30, 2008 compared to the six months ended June 30, 2007; and

An offsetting increase of \$1.8 million primarily attributable to an increase in cash flow from property operations for the six months ended June 30, 2008 compared to the six months ended June 30, 2007.

#### Investing Activities

Net cash used in investing activities decreased by \$81.1 million, or 61.5%, to \$50.8 million for the six months ended June 30, 2008, compared to \$131.9 million for the six months ended June 30, 2007 due to the following:

A decrease of \$71.4 million in development expenditures for the six months ended June 30, 2008 compared to the six months ended June 30, 2007;

A decrease of \$6.1 million in capital expenditures for operating properties for the six months ended June 30, 2008 compared to the six months ended June 30, 2007; and

A decrease of \$2.6 million in net expenditures for property acquisitions and dispositions during the six months ended June 30, 2007.



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*Financing Activities*

Net cash used in financing activities fluctuated by \$77.2 million, or 136.7%, to \$20.7 million for the six months ended June 30, 2008, compared to \$56.5 million provided by financing activities for the six months ended June 30, 2007, due to the following:

An increase of \$11.5 million in cash paid to repurchase shares of our common stock for the six months ended June 30, 2008 compared to June 30, 2007 (see Note 5 to our consolidated financial statements included with this report for additional information). We did not repurchase any shares of our common stock during the six months ended June 30, 2007;

A decrease of \$63.2 million in net proceeds received from debt financings during the six months ended June 30, 2008 as compared to six months ended June 30, 2007; and

An increase of \$1.9 million in our dividends and distributions paid to common stockholders and common unitholders for the six months ended June 30, 2008 compared to the six months ended June 30, 2007 due primarily to a 4.5% increase in our dividends per common share during the first quarter of 2008.

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### Non-GAAP Supplemental Financial Measure: Funds From Operations

We calculate FFO in accordance with the White Paper on FFO approved by the Board of Governors of NAREIT. The White Paper defines FFO as net income or loss calculated in accordance with GAAP, excluding extraordinary items, as defined by GAAP, and gains and losses from sales of depreciable operating property, plus real estate-related depreciation and amortization (excluding amortization of deferred financing costs and depreciation of non-real estate assets), and after adjustment for unconsolidated partnerships and joint ventures.

We believe that FFO is a useful supplemental measure of our operating performance. The exclusion from FFO of gains and losses from the sale of operating real estate assets allows investors and analysts to readily identify the operating results of the assets that form the core of our activity and assists in comparing those operating results between periods. Also, because FFO is generally recognized as the industry standard for reporting the operations of REITs, it facilitates comparisons of operating performance to other REITs. However, other REITs may use different methodologies to calculate FFO, and accordingly, our FFO may not be comparable to all other REITs.

Implicit in historical cost accounting for real estate assets in accordance with GAAP is the assumption that the value of real estate assets diminishes predictably over time. Since real estate values have historically risen or fallen with market conditions, many industry investors and analysts have considered presentations of operating results for real estate companies using historical cost accounting to be insufficient by themselves. Because FFO excludes depreciation and amortization of real estate assets, we believe that FFO along with the required GAAP presentations provides a more complete measurement of our performance relative to our competitors and a more appropriate basis on which to make decisions involving operating, financing and investing activities than the required GAAP presentations alone would provide.

However, FFO should not be viewed as an alternative measure of our operating performance since it does not reflect either depreciation and amortization costs or the level of capital expenditures and leasing costs necessary to maintain the operating performance of our properties, which are significant economic costs and could materially impact our results from operations.

The following table presents our FFO for the three and six months ended June 30, 2008 and 2007:

|                                                        | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|--------------------------------------------------------|--------------------------------|-----------|------------------------------|-----------|
|                                                        | 2008                           | 2007      | 2008                         | 2007      |
|                                                        | (in thousands)                 |           |                              |           |
| Net income available for common stockholders           | \$ 5,581                       | \$ 13,090 | \$ 15,445                    | \$ 29,572 |
| Adjustments:                                           |                                |           |                              |           |
| Minority interest in earnings of Operating Partnership | 375                            | 906       | 1,039                        | 2,049     |
| Depreciation and amortization of real estate assets    | 21,339                         | 17,526    | 41,010                       | 34,551    |
| Net gain on dispositions of operating properties       | (234)                          | (4,848)   | (234)                        | (13,474)  |
| Funds From Operations <sup>(1)</sup>                   | \$ 27,061                      | \$ 26,674 | \$ 57,260                    | \$ 52,698 |

(1) Reported amounts are attributable to our common stockholders and common unitholders of the Operating Partnership.

**Table of Contents****ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The primary market risk we face is interest rate risk. We mitigate this risk by maintaining prudent amounts of leverage, minimizing interest expense while continuously evaluating all available debt and equity resources and following established risk management policies and procedures that may include the periodic use of derivative instruments. As of June 30, 2008 and 2007, we did not have any derivative instruments.

Information about our changes in interest rate risk exposures from December 31, 2007 to June 30, 2008 is incorporated herein by reference from Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources.

**Tabular Presentation of Market Risk**

The tabular presentation below provides information about our interest rate sensitive financial instruments at June 30, 2008 and December 31, 2007. All of our interest rate sensitive financial instruments are held for purposes other than trading purposes. The table below presents principal cash flows and related weighted average interest rates, excluding loan cost amortization, by contractual maturity dates at June 30, 2008. The table also presents comparative summarized information for financial instruments held at December 31, 2007. The interest rates on our variable-rate debt are indexed to LIBOR plus spreads of 0.75% to 0.95% at both June 31, 2008 and December 31, 2007.

**Interest Rate Risk Analysis Tabular Presentation**

(dollars in millions)

|                                      | Remaining |         | Maturity Date |         |          |            | June 30,<br>2008 |               | December 31,<br>2007 |               |
|--------------------------------------|-----------|---------|---------------|---------|----------|------------|------------------|---------------|----------------------|---------------|
|                                      | 2008      | 2009    | 2010          | 2011    | 2012     | Thereafter | Total            | Fair<br>Value | Total                | Fair<br>Value |
| <b>Liabilities:</b>                  |           |         |               |         |          |            |                  |               |                      |               |
| Unsecured debt:                      |           |         |               |         |          |            |                  |               |                      |               |
| Credit Facility                      |           |         | \$ 159.0      |         |          |            | \$ 159.0         | \$ 158.1      | \$ 111.0             | \$ 110.2      |
| Variable-rate index                  |           |         | LIBOR         |         |          |            | LIBOR            |               | LIBOR                |               |
| Notes                                |           |         |               |         | \$ 460.0 |            | \$ 460.0         | \$ 380.8      | \$ 460.0             | \$ 399.4      |
| Fixed interest rate                  |           |         |               |         | 3.25%    |            | 3.25%            |               | 3.25%                |               |
| Other fixed-rate                     |           |         | \$ 61.0       |         |          | \$ 83.0    | \$ 144.0         | \$ 126.3      | \$ 144.0             | \$ 145.3      |
| Weighted average fixed interest rate |           |         | 5.72%         |         |          | 6.45%      | 6.14%            |               | 6.14%                |               |
| Secured debt:                        |           |         |               |         |          |            |                  |               |                      |               |
| Variable-rate                        |           |         | \$ 35.5       |         |          |            | \$ 35.5          | \$ 34.8       | \$ 35.5              | \$ 35.6       |
| Variable-rate index                  |           |         | LIBOR         |         |          |            | LIBOR            |               | LIBOR                |               |
| Fixed-rate                           | \$ 76.7   | \$ 81.6 | \$ 6.5        | \$ 75.0 | \$ 103.4 | \$ 13.8    | \$ 357.0         | \$ 340.0      | \$ 360.4             | \$ 369.0      |
| Weighted average fixed interest rate | 3.96%     | 7.16%   | 6.63%         | 6.69%   | 5.42%    | 6.91%      | 5.85%            |               | 5.86%                |               |

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**ITEM 4. CONTROLS AND PROCEDURES**

We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) or Rule 15d-15(e) under the Securities Exchange Act of 1934, as amended) that are designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934, as amended, is processed, recorded, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by SEC Rule 13a-15(b), we carried out an evaluation, under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the disclosure controls and procedures as of June 30, 2008, the end of the period covered by this report.

Based on the foregoing, the Chief Executive Officer and Chief Financial Officer concluded, as of that time, that our disclosure controls and procedures were effective at the reasonable assurance level.

There have been no significant changes that occurred during the quarter covered by this report in our internal control over financial reporting identified in connection with the evaluation referenced above that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



**Table of Contents****PART II OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

We are not a defendant in, and our properties are not subject to, any legal proceedings that, if determined adversely to us, would have a material adverse effect upon our financial condition, results of operations or cash flows.

**ITEM 1A. RISK FACTORS** There have been no material changes to the risk factors included in our annual report on Form 10-K for the fiscal year ended December 31, 2007.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

| Period  |                | (a)<br>Total number of<br>shares (or units)<br>purchased | (b)<br>Average price paid<br>per share (or<br>unit) | (c)<br>Total number of<br>shares (or units)<br>purchased as part of<br>publicly announced<br>plans or programs | (d)<br>Maximum number (or<br>approximate dollar<br>value) of shares (or<br>units) that may yet be<br>purchased under the<br>plans or programs |
|---------|----------------|----------------------------------------------------------|-----------------------------------------------------|----------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------|
| April 1 | April 30, 2008 | 3,523 <sup>(1)</sup>                                     | \$ 49.11                                            |                                                                                                                |                                                                                                                                               |
| May 1   | May 31, 2008   |                                                          |                                                     |                                                                                                                |                                                                                                                                               |
| June 1  | June 30, 2008  | 79,818 <sup>(2)</sup>                                    | 49.61                                               | 79,818                                                                                                         | 988,025                                                                                                                                       |
| Total   |                | 83,341                                                   | \$ 49.59                                            | 79,818                                                                                                         | 988,025                                                                                                                                       |

(1) In April 2008, a total of 3,523 shares were tendered to satisfy minimum statutory tax withholding obligations related to the vesting of restricted shares.

(2) In June 2008, we repurchased 79,818 shares of our common stock in open market transactions for an aggregate price of approximately \$4.0 million, or \$49.61 per share.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES** None

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

At the annual meeting of our stockholders on May 20, 2008, our stockholders elected John B. Kilroy, Sr. for a term expiring in 2011 (27,247,347 votes for and 742,780 votes withheld), Edward F. Brennan for a term expiring in 2011 (26,066,438 votes for and 1,923,689 votes withheld), and Scott S. Ingraham for a term expiring in 2010 (27,287,452 votes for and 702,675 votes withheld) as directors of the Company. The stockholders also voted on a stockholder proposal relating to the declassification of our board of directors (23,166,473 votes for, 1,839,710 votes against, 24,019 abstentions, and 2,959,925 broker non-votes).

**ITEM 5. OTHER INFORMATION** None

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### **ITEM 6. EXHIBITS**

| <b>Exhibit<br/>Number</b> | <b>Description</b>                                                                                                                                            |
|---------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3(i).1                    | Articles of Amendment and Restatement of the Registrant <sup>(1)</sup>                                                                                        |
| 3(i).2                    | Articles Supplementary of the Registrant designating its 7.45% Series A Cumulative Redeemable Preferred Stock <sup>(2)</sup>                                  |
| 3(i).3                    | Articles Supplementary of the Registrant designating its Series B Junior Participating Preferred Stock <sup>(3)</sup>                                         |
| 3(i).4                    | Articles Supplementary of the Registrant designating 780,000 shares of its 9.250% Series D Cumulative Redeemable Preferred Stock <sup>(4)</sup>               |
| 3(i).5                    | Articles Supplementary of the Registrant designating an additional 120,000 shares of its 9.250% Series D Cumulative Redeemable Preferred Stock <sup>(5)</sup> |
| 3(i).6                    | Articles Supplementary of the Registrant designating its 7.80% Series E Cumulative Redeemable Preferred Stock <sup>(6)</sup>                                  |
| 3(i).7                    | Articles Supplementary of the Registrant designating its 7.50% Series F Redeemable Preferred Stock <sup>(7)</sup>                                             |
| 3(ii).1                   | Amended and Restated Bylaws of the Registrant <sup>(1)</sup>                                                                                                  |
| 3(ii).2                   | Amendment No. 1 to Amended and Restated Bylaws of the Registrant <sup>(8)</sup>                                                                               |
| 31.1*                     | Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer                                                                                             |
| 31.2*                     | Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer                                                                                             |
| 32.1*                     | Section 1350 Certification of Chief Executive Officer                                                                                                         |
| 32.2*                     | Section 1350 Certification of Chief Financial Officer                                                                                                         |

\* Filed herewith

(1) Previously filed as an exhibit to the Registration Statement on Amendment No. 3 to Form S-11 (No. 333-15553).

(2) Previously filed as an exhibit on Form 10-K for the year ended December 31, 2003.

(3) Previously filed as an exhibit to the Registration Statement on Amendment No. 1 to Form S-3 (No. 333-72229).

(4) Previously filed as an exhibit on Form 10-K for the year ended December 31, 1999.

(5) Previously filed as an exhibit to the Registration Statement on Form S-3 (No. 333-34638).

(6) Previously filed as an exhibit on Form 8-A as filed with the Securities and Exchange Commission on October 24, 2003.

(7) Previously filed as an exhibit on Form 8-A as filed with the Securities and Exchange Commission on December 6, 2004.

(8) Previously filed as an exhibit on Form 8-K as filed with the Securities and Exchange Commission on May 18, 2007.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on July 29, 2008.

KILROY REALTY CORPORATION

By: /s/ JOHN B. KILROY, JR.  
**John B. Kilroy, Jr.**

*President and Chief Executive Officer*

*(Principal Executive Officer)*

By: /s/ RICHARD E. MORAN JR.  
**Richard E. Moran Jr.**

*Executive Vice President and Chief Financial Officer*

*(Principal Financial Officer)*

By: /s/ HEIDI R. ROTH  
**Heidi R. Roth**

*Senior Vice President and Controller*

*(Principal Accounting Officer)*