

KILROY REALTY CORP  
Form 10-Q  
October 29, 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 September 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 October 28, 2008, 33,086,957 shares of common stock, par value \$.01 per share, were outstanding.

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**KILROY REALTY CORPORATION**

**QUARTERLY REPORT FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2008**

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<i>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.</i>	

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

(in thousands, except share data)

	September 30, 2008 (unaudited)	December 31, 2007
<b>ASSETS</b>		
<b>REAL ESTATE ASSETS:</b>		
Land and improvements	\$ 334,634	\$ 324,779
Buildings and improvements	1,861,769	1,719,700
Undeveloped land and construction in progress	257,135	324,077
Total real estate held for investment	2,453,538	2,368,556
Accumulated depreciation and amortization	(514,712)	(463,932)
Total real estate assets, net	1,938,826	1,904,624
CASH AND CASH EQUIVALENTS	10,055	11,732
RESTRICTED CASH	1,503	546
MARKETABLE SECURITIES (Note 7)	2,243	707
CURRENT RECEIVABLES, NET	4,658	4,891
DEFERRED RENT RECEIVABLES, NET	64,444	67,283
NOTES RECEIVABLE	10,870	10,970
DEFERRED LEASING COSTS AND ACQUISITION-RELATED INTANGIBLES, NET	54,044	54,418
DEFERRED FINANCING COSTS, NET	6,731	8,492
PREPAID EXPENSES AND OTHER ASSETS, NET	6,124	5,057
<b>TOTAL ASSETS</b>	<b>\$ 2,099,498</b>	<b>\$ 2,068,720</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>LIABILITIES:</b>		
Secured debt (Note 2)	\$ 317,878	\$ 395,912
Exchangeable senior notes, net (Note 2)	456,780	456,090
Unsecured senior notes	144,000	144,000
Unsecured line of credit (Note 2)	237,000	111,000
Accounts payable, accrued expenses and other liabilities	58,938	58,249
Accrued distributions (Note 13)	21,422	20,610
Deferred revenue and acquisition-related liabilities (Note 3)	75,012	59,187
Rents received in advance and tenant security deposits	18,785	18,433
Total liabilities	1,329,815	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)	29,125	38,309
Total minority interests	102,763	111,947
<b>STOCKHOLDERS EQUITY (Notes 5 and 6):</b>		

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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, 1,500,000 shares authorized, none issued and outstanding		
7.80% Series E cumulative redeemable preferred stock, \$.01 par value, 1,610,000 shares authorized, issued and outstanding (\$40,250 liquidation preference)	38,425	38,425
7.50% Series F cumulative redeemable preferred stock, \$.01 par value, 3,450,000 shares authorized, issued and outstanding (\$86,250 liquidation preference)	83,157	83,157
Common stock, \$.01 par value, 150,000,000 shares authorized, 33,086,957 and 32,765,893 shares issued and outstanding, respectively	331	328
Additional paid-in capital	661,019	658,894
Distributions in excess of earnings	(116,012)	(87,512)
 Total stockholders' equity	 666,920	 693,292
 <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	 <b>\$ 2,099,498</b>	 <b>\$ 2,068,720</b>

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 September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
<b>REVENUES:</b>				
Rental income	\$ 64,546	\$ 58,596	\$ 188,337	\$ 167,547
Tenant reimbursements	7,269	6,392	23,148	18,002
Other property income	5,285	129	6,046	3,182
<b>Total revenues</b>	<b>77,100</b>	<b>65,117</b>	<b>217,531</b>	<b>188,731</b>
<b>EXPENSES:</b>				
Property expenses	12,824	11,481	36,185	32,051
Real estate taxes	5,827	5,182	16,149	14,402
Provision for bad debts (Note 9)	9	(111)	3,668	(310)
Ground leases	431	398	1,226	1,190
General and administrative expenses	9,627	8,719	28,050	27,227
Interest expense	9,727	9,009	28,888	26,737
Depreciation and amortization	20,661	18,334	62,063	52,556
<b>Total expenses</b>	<b>59,106</b>	<b>53,012</b>	<b>176,229</b>	<b>153,853</b>
<b>OTHER INCOME (LOSS):</b>				
Interest and other investment income (loss)	(149)	305	192	1,295
<b>INCOME FROM CONTINUING OPERATIONS BEFORE MINORITY INTERESTS</b>	<b>17,845</b>	<b>12,410</b>	<b>41,494</b>	<b>36,173</b>
<b>MINORITY INTERESTS:</b>				
Distributions on cumulative redeemable preferred units	(1,397)	(1,397)	(4,191)	(4,191)
Minority interest in earnings of Operating Partnership attributable to continuing operations	(870)	(557)	(1,882)	(1,601)
<b>Total minority interests</b>	<b>(2,267)</b>	<b>(1,954)</b>	<b>(6,073)</b>	<b>(5,792)</b>
<b>INCOME FROM CONTINUING OPERATIONS</b>	<b>15,578</b>	<b>10,456</b>	<b>35,421</b>	<b>30,381</b>
<b>DISCONTINUED OPERATIONS (Note 11):</b>				
Revenues from discontinued operations		2,804	199	7,897
Expenses from discontinued operations		(1,763)		(4,873)
Net gain on dispositions of discontinued operations			234	13,474
Minority interest in earnings of Operating Partnership attributable to discontinued operations		(67)	(27)	(1,072)
<b>Total income from discontinued operations</b>		<b>974</b>	<b>406</b>	<b>15,426</b>
<b>NET INCOME</b>	<b>15,578</b>	<b>11,430</b>	<b>35,827</b>	<b>45,807</b>
<b>PREFERRED DIVIDENDS</b>	<b>(2,402)</b>	<b>(2,402)</b>	<b>(7,206)</b>	<b>(7,206)</b>

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NET INCOME AVAILABLE FOR COMMON STOCKHOLDERS	\$ 13,176	\$ 9,028	\$ 28,621	\$ 38,601
Income from continuing operations per common share basic (Note 12)	\$ 0.41	\$ 0.25	\$ 0.87	\$ 0.71
Income from continuing operations per common share diluted (Note 12)	\$ 0.40	\$ 0.25	\$ 0.87	\$ 0.71
Net income per common share basic (Note 12)	\$ 0.41	\$ 0.28	\$ 0.88	\$ 1.19
Net income per common share diluted (Note 12)	\$ 0.40	\$ 0.28	\$ 0.88	\$ 1.19
Weighted average shares outstanding basic (Note 12)	32,338,796	32,373,228	32,381,993	32,364,457
Weighted average shares outstanding diluted (Note 12)	32,534,772	32,501,719	32,533,212	32,491,009
Dividends declared per common share	\$ 0.580	\$ 0.555	\$ 1.740	\$ 1.665

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)

	Preferred Stock	Common Stock Number of Shares	Common Stock	Additional Paid-in Capital	Distributions in Excess of Earnings	Total
BALANCE AT DECEMBER 31, 2007	\$ 121,582	32,765,893	\$ 328	\$ 658,894	\$ (87,512)	\$ 693,292
Net income					35,827	35,827
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				7,172		7,172
Exercise of stock options		1,000		21		21
Exchange of common units of the Operating Partnership (Note 4)		435,596	4	10,571		10,575
Adjustment for minority interest				(3,037)		(3,037)
Preferred dividends					(7,206)	(7,206)
Dividends declared per common share (\$1.74 per share)					(57,121)	(57,121)
BALANCE AT SEPTEMBER 30, 2008	\$ 121,582	33,086,957	\$ 331	\$ 661,019	\$ (116,012)	\$ 666,920

See accompanying notes to consolidated financial statements.



**Table of Contents****KILROY REALTY CORPORATION****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(unaudited, in thousands)

	Nine Months Ended September 30,	
	2008	2007
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 35,827	\$ 45,807
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	61,474	53,111
Increase (decrease) in provision for uncollectible tenant receivables	291	(310)
Increase in provision for uncollectible deferred rent receivables	3,377	
Distributions on cumulative redeemable preferred units	4,191	4,191
Minority interests in earnings of Operating Partnership	1,909	2,673
Depreciation of furniture, fixtures and equipment	589	642
Non-cash amortization of share-based compensation awards	11,372	11,117
Non-cash amortization of deferred financing costs and debt discount	2,347	2,028
Non-cash amortization of above/below market rents, net	(484)	(920)
Net gain on dispositions of operating properties (Note 11)	(234)	(13,474)
Non-cash amortization of deferred revenue related to tenant improvements (Note 3)	(8,907)	(2,752)
Insurance proceeds received for a property casualty loss	(531)	
Non-cash lease termination fee		(259)
Changes in assets and liabilities:		
Marketable securities	(1,536)	(455)
Current receivables	(58)	1,969
Deferred rent receivables	(538)	(4,884)
Deferred leasing costs	87	(1,304)
Prepaid expenses and other assets	(1,715)	(1,373)
Accounts payable, accrued expenses and other liabilities	3,727	13,045
Deferred revenue	3,902	7,129
Rents received in advance and tenant security deposits	352	758
 Net cash provided by operating activities	 115,442	 116,739
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Expenditures for operating properties	(19,373)	(31,868)
Expenditures for development and redevelopment properties	(56,175)	(154,421)
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
Proceeds from termination of profit participation agreement		4,848
Insurance proceeds received for a property casualty loss	531	
Decrease in escrow deposits		3,000
Increase in restricted cash	(957)	(868)
Receipt of principal payments on note receivable	100	94
Proceeds from sales of marketable securities		259
 Net cash used in investing activities	 (75,599)	 (189,659)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		

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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	126,000	(224,000)
Principal payments on secured debt	(80,815)	(60,915)
Repurchase of common stock (Note 5)	(14,770)	(2,631)
Financing costs	(694)	(5,616)
Proceeds from exercise of stock options	21	29
Dividends and distributions paid to common stockholders and common unitholders	(59,865)	(57,193)
Dividends and distributions paid to preferred stockholders and preferred unitholders	(11,397)	(11,397)
Net cash (used in) provided by financing activities	(41,520)	64,627
Net decrease in cash and cash equivalents	(1,677)	(8,293)
Cash and cash equivalents, beginning of period	11,732	11,948
Cash and cash equivalents, end of period	\$ 10,055	\$ 3,655

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

	<b>Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>		
Cash paid for interest, net of capitalized interest of \$12,272 and \$13,400 at September 30, 2008 and 2007, respectively	\$ 25,210	\$ 20,450
<b>NON-CASH INVESTING AND FINANCING TRANSACTIONS:</b>		
Tenant improvements funded directly by tenants to third parties	\$ 21,333	\$ 27,882
Accrual for expenditures for operating properties and development and redevelopment properties	\$ 6,232	\$ 12,015
Accrual of dividends and distributions payable to common stockholders and common unitholders	\$ 20,208	\$ 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)	\$ 10,054	\$ 23,633
Exchange of common units of the Operating Partnership into shares of the Company's common stock (Note 4)	\$ 10,575	\$ 1,837
Accrued costs for issuance of exchangeable senior notes		\$ 778
Non-cash receipt of marketable securities in connection with a lease termination		\$ 259

See accompanying notes to consolidated financial statements.

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**KILROY REALTY CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Three and Nine Months Ended September 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 September 30, 2008, the Company's stabilized portfolio of operating properties was comprised of 88 office buildings (the Office Properties ) and 43 industrial buildings (the Industrial Properties ), which encompassed an aggregate of approximately 8.3 million and 3.9 million rentable square feet, respectively. As of September 30, 2008, the Office Properties were approximately 89.5% leased to 296 tenants, and the Industrial Properties were approximately 93.4% leased to 64 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 September 30, 2008, the in-process development and redevelopment properties included one building that was under construction and three lease-up properties, which in aggregate will encompass approximately 358,000 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. In the third quarter of 2008, the Company added one development property and one redevelopment property to the Company's stabilized portfolio, which in aggregate encompass approximately 253,000 rentable square feet of new office space.

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 94.9% general partnership interest as of September 30, 2008. The remaining 5.1% common limited partnership interest in the Operating Partnership as of September 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.

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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 in 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 have a material impact 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 October 10, 2008, the Company adopted FASB Staff Position 157-3 *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* ( FSP FAS 157-3 ). FSP FAS 157-3 clarifies the application of SFAS 157 to financial instruments in an inactive market. The adoption of FSP FAS 157-3 did

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**KILROY REALTY CORPORATION**

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

not have a material impact on the Company's consolidated financial statements since the Company generally does not record its financial assets and liabilities at fair value.

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 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 at the date of issuance. 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 balance sheets 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 based upon 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.

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**KILROY REALTY CORPORATION**

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

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 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. EITF 07-5 will be effective for the first annual reporting period beginning after December 15, 2008, and early adoption is prohibited. 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.

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.

**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, subject to bank approval, up to an additional \$100 million under an accordion feature. As of September 30, 2008, the Company had borrowings of \$237 million outstanding under the Credit Facility and borrowing capacity of approximately \$313 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 (3.9% at September 30, 2008). The Credit Facility matures in April 2010 with a feature to extend the maturity for one year at the Company's option. 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 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.

**Table of Contents****KILROY REALTY CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)***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 September 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 September 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 nine months ended September 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 September 30,</b>		<b>Nine Months Ended September 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	\$ 13,912	\$ 13,590	\$ 42,152	\$ 41,169
Capitalized interest and loan cost amortization	(4,185)	(4,581)	(13,264)	(14,432)
Interest expense	\$ 9,727	\$ 9,009	\$ 28,888	\$ 26,737

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

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

	<b>September 30, 2008</b>	<b>December 31, 2007</b>
	<b>(in thousands)</b>	
Deferred revenue related to tenant-funded tenant improvements	\$ 72,081	\$ 55,779
Acquisition-related liabilities below-market leases	1,296	1,801
Other deferred revenue	1,635	1,607



Total	\$ 75,012	\$ 59,187
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**Table of Contents****KILROY REALTY CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Deferred revenue related to tenant-funded tenant improvements*

During the nine months ended September 30, 2008, the Company recorded an additional \$25.2 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 four 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 September 30, 2008 and 2007, \$5.1 million and \$1.3 million, respectively, of deferred revenue related to tenant-funded tenant improvements was amortized and recognized as rental income. During the nine months ended September 30, 2008 and 2007, \$8.9 million and \$2.8 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 September 30, 2008 for the remainder of 2008, the next five years and thereafter:

Year	(in thousands)
Remaining 2008	\$ 4,173
2009	8,582
2010	8,184
2011	7,823
2012	6,977
2013	6,749
Thereafter	29,593
Total	\$ 72,081

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

The Company owned a 94.9%, 93.7% and 93.5% common general partnership interest in the Operating Partnership as of September 30, 2008, December 31, 2007 and September 30, 2007, respectively. The remaining 5.1%, 6.3% and 6.5% common limited partnership interest as of September 30, 2008, December 31, 2007 and September 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 on a one-for-one basis. Whether satisfied in cash or 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 September 30, 2008 and December 31, 2007, the aggregate redemption value of the then-outstanding common limited partnership units of the Operating Partnership was \$85.2 million and \$119.2 million, respectively.

*Exchange of Common Limited Partnership Units*

During the nine months ended September 30, 2008, an aggregate 435,596 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.



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**KILROY REALTY CORPORATION**

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

**5. Stockholders Equity**

*Share Repurchases*

During the nine months ended September 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 and were funded through borrowings on the Company's Credit Facility. As of September 30, 2008, an aggregate of 988,025 shares remained eligible for repurchase under this share repurchase program. The Company did not repurchase any shares of its common stock during the three months ended September 30, 2008.

During the nine months ended September 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. There were no returns of shares of the Company's common stock by employees during the three months ended September 30, 2008.

*Rights Agreement*

In October 1998, the Company adopted a Rights Agreement. In connection therewith, common stockholders of record on October 15, 1998 received one preferred share purchase right for each share of the Company's outstanding common stock. The Rights Agreement expired in October 2008, and the Company reclassified and redesignated its Series B Junior Participating Preferred Stock as Preferred Stock.

**6. Share-Based Compensation**

*Share-Based Incentive Plan*

At September 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 September 30, 2008, there were 1,120,290 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 nine months ended September 30, 2008 and the 2007 program for the executive officers that was still in the performance period as of September 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 September 30, 2008, the Company was still in the performance period for the Development Performance Program (DPP), which was approved by the Executive Compensation Committee in 2007. The



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

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 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 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 fourth quarter 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 nine months ended September 30, 2008, is presented below:

	Shares	Weighted-Average Grant Date 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 September 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 nine months ended September 30, 2008 and 2007 was \$2.6 million and \$6.8 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 RSUs*

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

	Nonvested Restricted Stock Units	Vested Restricted Stock Units	Total Restricted Stock Units	Weighted- Average Grant Date Fair Value
Outstanding at January 1, 2008				\$
Granted	7,468		7,468	53.58
Issuance of dividend equivalents		94	94	46.05
Outstanding at September 30, 2008	7,468	94	7,562	\$ 53.49

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 \$4.4 million and \$3.9 million for the three months ended September 30, 2008 and 2007, respectively, and \$12.2 million and \$11.7 million for the nine months ended September 30, 2008 and 2007, respectively. 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 September 30, 2008 and 2007, respectively, and \$0.8 million and \$0.6 million were capitalized as part of real estate assets for the nine months ended September 30, 2008 and 2007, respectively. As of September 30, 2008, there was approximately \$12.1 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 September 30, 2008. The \$12.1 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 September 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. Fair Value Disclosures***Financial Instruments Recorded at Fair Value*

The assets held in connection with the Company's 2007 Deferred Compensation Plan are treated as trading securities for accounting purposes. These assets are measured at fair value on a recurring basis and are reported in marketable securities on the Company's consolidated balance sheet.

Description	Fair Value Measurement at September 30, 2008 (Level I Inputs) <sup>(1)</sup> (in thousands)
Marketable Securities	\$ 2,243

(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 September 30, 2008. The Company stopped recognizing revenue associated with this lease as of April 1, 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 Terminations**

In the second quarter of 2008, Favrilite, Inc. (Favrilite), 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. The Company held a \$3.6 million letter of credit and a \$0.3 million security deposit as credit support under the terms of the lease. 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 Favrilite lease that it estimated would not be recoverable after the application of the letter of credit proceeds and security deposit. In July 2008, the Company and Favrilite entered into an agreement to terminate the lease as of August 31, 2008. During the third quarter of 2008, the Company drew down the letter of credit and applied the \$3.9 million letter of credit proceeds and security deposit to July and August rent and the outstanding deferred rent receivable and accounts receivable balances.

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**KILROY REALTY CORPORATION**

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

During the three months ended September 30, 2008, the Company also recognized approximately \$2.7 million of non-cash rental revenue, which was primarily due to the acceleration of the amortization of the deferred revenue balance related to tenant-funded tenant improvements associated with the Favrille lease. At September 30, 2008, there was a \$16.9 million unamortized balance included in buildings and improvements on the Company's consolidated balance sheet related to the tenant improvements that remain in the two buildings previously leased to Favrille. The Company believes that these tenant improvements will have value to future tenants.

In July 2008, the Company entered into agreements with Intuit Inc. (Intuit), the Company's largest tenant at September 30, 2008 based on annual base rental revenues, 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 vacated approximately 95% of the premises in the third quarter of 2008 and is expected to vacate the remaining premises during the first quarter of 2009. The lease that was extended encompasses approximately 71,000 rentable square feet of office space and was scheduled to expire in August 2009.

In connection with the lease with Intuit that was terminated, the Company recognized a net lease termination fee of approximately \$4.9 million during the third quarter of 2008, which is included in other property income. The Company will recognize approximately \$0.2 million of additional other property income during the fourth quarter of 2008 through the first quarter of 2009, as Intuit will continue to occupy 5% of the space under the short-term 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 September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in thousands)			
<b>Office Properties:</b>				
Operating revenues <sup>(1)</sup>	\$ 68,848	\$ 57,560	\$ 192,632	\$ 165,916
Property and related expenses	17,224	15,472	52,649	43,079
Net Operating Income	51,624	42,088	139,983	122,837
<b>Industrial Properties:</b>				
Operating revenues <sup>(1)</sup>	8,252	7,557	24,899	22,815
Property and related expenses	1,867	1,478	4,579	4,254
Net Operating Income	6,385	6,079	20,320	18,561
<b>Total Reportable Segments:</b>				
Operating revenues <sup>(1)</sup>	77,100	65,117	217,531	188,731
Property and related expenses	19,091	16,950	57,228	47,333
Net Operating Income	58,009	48,167	160,303	141,398
<b>Reconciliation to Consolidated Net Income Available for Common Stockholders:</b>				
Total Net Operating Income for reportable segments	58,009	48,167	160,303	141,398
Unallocated other income:				
Interest and other investment income (loss)	(149)	305	192	1,295
Other unallocated expenses:				
General and administrative expenses	9,627	8,719	28,050	27,227
Interest expense	9,727	9,009	28,888	26,737
Depreciation and amortization	20,661	18,334	62,063	52,556
Income from continuing operations before minority interests	17,845	12,410	41,494	36,173
Minority interests attributable to continuing operations	(2,267)	(1,954)	(6,073)	(5,792)
Income from discontinued operations		974	406	15,426
Net income	15,578	11,430	35,827	45,807
Preferred dividends	(2,402)	(2,402)	(7,206)	(7,206)
Net income available for common stockholders	\$ 13,176	\$ 9,028	\$ 28,621	\$ 38,601

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

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

	Three Months Ended		Nine Months Ended	
	September 30, 2008	2007	September 30, 2008	2007
	(in thousands)			
<b>REVENUES:</b>				
Rental income	\$	\$ 1,963	\$	\$ 5,876
Tenant reimbursements		571		1,747
Other property income <sup>(1)</sup>		270	199	274
<b>Total revenues</b>		<b>2,804</b>	<b>199</b>	<b>7,897</b>
<b>EXPENSES:</b>				
Property expenses		832		2,573
Real estate taxes		381		764
Provision for bad debts				
Ground leases		113		339
Depreciation and amortization		437		1,197
<b>Total expenses</b>		<b>1,763</b>		<b>4,873</b>
Net gain on dispositions of discontinued operations <sup>(2)</sup>			234	13,474
Minority interest in earnings of Operating Partnership attributable to discontinued operations		(67)	(27)	(1,072)
<b>Total income from discontinued operations</b>	\$	\$ 974	\$ 406	\$ 15,426

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

(2) During the nine months ended September 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 nine months ended September 30, 2008 and 2007:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in thousands, except share and per share amounts)			
<b>Numerator:</b>				
Income from continuing operations	\$ 15,578	\$ 10,456	\$ 35,421	\$ 30,381
Preferred dividends	(2,402)	(2,402)	(7,206)	(7,206)
Income from continuing operations available for common stockholders	13,176	8,054	28,215	23,175
Discontinued operations		974	406	15,426
Net income available for common stockholders numerator for basic and diluted earnings per share	\$ 13,176	\$ 9,028	\$ 28,621	\$ 38,601
<b>Denominator:</b>				
Basic weighted average shares outstanding	32,338,796	32,373,228	32,381,993	32,364,457
Effect of dilutive securities nonvested shares of common stock, RSUs and stock options	195,976	128,491	151,219	126,552
Diluted weighted average shares and common share equivalents outstanding	32,534,772	32,501,719	32,533,212	32,491,009
<b>Basic earnings per share:</b>	&nbs			