

KILROY REALTY CORP
Form 10-Q
October 28, 2009
Table of Contents

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, 2009

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

Edgar Filing: KILROY REALTY CORP - Form 10-Q

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). 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 27, 2009, 43,148,762 shares of common stock, par value \$.01 per share, were outstanding.

Table of Contents

KILROY REALTY CORPORATION

QUARTERLY REPORT FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2009

TABLE OF CONTENTS

		Page
PART I FINANCIAL INFORMATION		
Item 1.	<u>FINANCIAL STATEMENTS</u>	3
	<u>Consolidated Balance Sheets as of September 30, 2009 (unaudited) and December 31, 2008</u>	3
	<u>Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2009 and 2008 (unaudited)</u>	4
	<u>Consolidated Statements of Equity for the Nine Months Ended September 30, 2009 and 2008 (unaudited)</u>	5
	<u>Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2009 and 2008 (unaudited)</u>	6
	<u>Notes to Consolidated Financial Statements</u>	8
Item 2.	<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	28
Item 3.	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	53
Item 4.	<u>CONTROLS AND PROCEDURES</u>	53
PART II OTHER INFORMATION		
Item 1.	<u>LEGAL PROCEEDINGS</u>	55
Item 1A.	<u>RISK FACTORS</u>	55
Item 2.	<u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	55
Item 3.	<u>DEFAULTS UPON SENIOR SECURITIES</u>	55
Item 4.	<u>SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS</u>	55
Item 5.	<u>OTHER INFORMATION</u>	55
Item 6.	<u>EXHIBITS</u>	56
	<u>SIGNATURES</u>	57
	<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, 2009 (unaudited)	December 31, 2008
<u>ASSETS</u>		
REAL ESTATE ASSETS:		
Land and improvements	\$ 335,932	\$ 336,874
Buildings and improvements	1,909,876	1,889,833
Undeveloped land and construction in progress	259,108	248,889
Total real estate held for investment	2,504,916	2,475,596
Accumulated depreciation and amortization	(587,968)	(532,769)
Total real estate assets, net	1,916,948	1,942,827
CASH AND CASH EQUIVALENTS	9,265	9,553
RESTRICTED CASH	2,936	672
MARKETABLE SECURITIES (Note 6)	3,229	1,888
CURRENT RECEIVABLES, NET	3,139	5,753
DEFERRED RENT RECEIVABLES, NET	72,623	67,144
NOTES RECEIVABLE	10,716	10,824
DEFERRED LEASING COSTS AND ACQUISITION-RELATED INTANGIBLES, NET	49,627	53,539
DEFERRED FINANCING COSTS, NET	4,393	5,883
PREPAID EXPENSES AND OTHER ASSETS, NET	6,126	4,835
TOTAL ASSETS	\$ 2,079,002	\$ 2,102,918
<u>LIABILITIES, NONCONTROLLING INTERESTS AND EQUITY</u>		
LIABILITIES:		
Secured debt (Notes 2 and 6)	\$ 296,788	\$ 316,456
Exchangeable senior notes, net (Notes 1, 2 and 6)	398,347	429,892
Unsecured senior notes (Note 6)	144,000	144,000
Unsecured line of credit (Notes 2 and 6)	126,000	252,000
Accounts payable, accrued expenses and other liabilities	42,565	55,066
Accrued distributions (Note 12)	17,133	21,421
Deferred revenue and acquisition-related liabilities	69,252	76,219
Rents received in advance and tenant security deposits	18,381	19,340
Total liabilities	1,112,466	1,314,394
COMMITMENTS AND CONTINGENCIES (NOTE 7)		
NONCONTROLLING INTEREST (Notes 1 and 3):		
7.45% Series A Cumulative Redeemable Preferred units of the Operating Partnership	73,638	73,638
EQUITY (Notes 1, 3 and 4):		
Stockholders' Equity:		
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	38,425	38,425

Edgar Filing: KILROY REALTY CORP - Form 10-Q

7.80% Series E Cumulative Redeemable Preferred stock, \$.01 par value, 1,610,000 shares authorized, issued and outstanding (\$40,250 liquidation preference)		
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, 43,148,762 and 33,086,148 shares issued and outstanding, respectively	431	331
Additional paid-in capital	904,043	700,122
Distributions in excess of earnings	(162,391)	(137,052)
Total stockholders' equity	863,665	684,983
Noncontrolling interest:		
Common units of the Operating Partnership	29,233	29,903
Total equity	892,898	714,886
TOTAL LIABILITIES, NONCONTROLLING INTERESTS AND EQUITY	\$ 2,079,002	\$ 2,102,918

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,	
	2009	2008	2009	2008
REVENUES:				
Rental income	\$ 61,297	\$ 64,405	\$ 186,959	\$ 187,914
Tenant reimbursements	6,843	7,256	21,898	23,111
Other property income (Note 8)	354	5,285	3,198	6,046
Total revenues	68,494	76,946	212,055	217,071
EXPENSES:				
Property expenses	12,699	12,822	37,611	36,180
Real estate taxes	5,988	5,816	18,260	16,115
Provision for bad debts	243	9	395	3,668
Ground leases	398	431	1,227	1,226
General and administrative expenses	7,662	9,627	22,023	28,050
Interest expense (Notes 1 and 2)	10,926	10,941	35,041	32,422
Depreciation and amortization	21,968	20,646	66,608	62,018
Total expenses	59,884	60,292	181,165	179,679
OTHER INCOME (LOSS):				
Interest income and other net investment gains (losses)	501	(149)	1,074	192
Gain on early extinguishment of debt (Note 2)	3,119		3,119	
Total other income (loss)	3,620	(149)	4,193	192
INCOME FROM CONTINUING OPERATIONS	12,230	16,505	35,083	37,584
DISCONTINUED OPERATIONS (Note 10):				
Revenues from discontinued operations		154		659
Expenses from discontinued operations		(28)	(224)	(84)
Net gain on dispositions of discontinued operations			2,485	234
Total income from discontinued operations		126	2,261	809
NET INCOME	12,230	16,631	37,344	38,393
Net income attributable to noncontrolling common units of the Operating Partnership	(320)	(795)	(1,144)	(1,688)
NET INCOME ATTRIBUTABLE TO KILROY REALTY CORPORATION	11,910	15,836	36,200	36,705
PREFERRED DISTRIBUTIONS AND DIVIDENDS:				
Distributions to noncontrolling cumulative redeemable preferred units of the Operating Partnership	(1,397)	(1,397)	(4,191)	(4,191)
Preferred dividends	(2,402)	(2,402)	(7,206)	(7,206)
Total preferred distributions and dividends	(3,799)	(3,799)	(11,397)	(11,397)
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS	\$ 8,111	\$ 12,037	\$ 24,803	\$ 25,308
Income from continuing operations available to common stockholders per common share basic (Notes 1 and 11)	\$ 0.17	\$ 0.36	\$ 0.58	\$ 0.75

Edgar Filing: KILROY REALTY CORP - Form 10-Q

Income from continuing operations available to common stockholders per common share diluted (Notes 1 and 11)	\$ 0.17	\$ 0.36	\$ 0.58	\$ 0.75
Net income available to common stockholders per share basic (Notes 1 and 11)	\$ 0.17	\$ 0.37	\$ 0.64	\$ 0.77
Net income available to common stockholders per share diluted (Notes 1 and 11)	\$ 0.17	\$ 0.37	\$ 0.64	\$ 0.77
Weighted average common shares outstanding basic (Notes 1 and 11)	42,934,796	32,338,796	37,279,250	32,381,993
Weighted average common shares outstanding diluted (Notes 1 and 11)	42,935,475	32,382,642	37,296,931	32,410,704
Dividends declared per common share	\$ 0.350	\$ 0.580	\$ 1.280	\$ 1.740

See accompanying notes to consolidated financial statements.

Table of Contents**KILROY REALTY CORPORATION****CONSOLIDATED STATEMENTS OF EQUITY**

(unaudited, in thousands, except share and per share data)

	Common Stock					Total Stock- holders Equity	Noncontrol- ling Interests Common Units of the Operating Partnership	Total Equity
	Preferred Stock	Number of Shares	Common Stock	Additional Paid-in Capital	Distributions in Excess of Earnings			
BALANCE AS OF DECEMBER 31, 2007 AS PREVIOUSLY REPORTED	\$ 121,582	32,765,893	\$ 328	\$ 658,894	\$ (87,512)	\$ 693,292	\$ 38,309	\$ 731,601
Cumulative change from adoption of new accounting principles (Note 1)				36,258	(3,050)	33,208	2,225	35,433
BALANCE AS OF DECEMBER 31, 2007 AS ADJUSTED	121,582	32,765,893	328	695,152	(90,562)	726,500	40,534	767,034
Net income					36,705	36,705	1,688	38,393
Repurchase of common stock		(299,777)	(3)	(14,767)		(14,770)		(14,770)
Issuance of share-based compensation awards		184,245	2	2,165		2,167		2,167
Noncash amortization of share-based compensation				7,172		7,172		7,172
Exercise of stock options		1,000		21		21		21
Exchange of common units of the Operating Partnership		435,596	4	10,560		10,564	(10,564)	
Adjustment for noncontrolling interest (Notes 1 and 3)				(2,640)		(2,640)	2,640	
Preferred distributions and dividends					(11,397)	(11,397)		(11,397)
Dividends declared per common share and common unit (\$1.74 per share/unit)					(57,121)	(57,121)	(3,555)	(60,676)
BALANCE AS OF SEPTEMBER 30, 2008	\$ 121,582	33,086,957	\$ 331	\$ 697,663	\$ (122,375)	\$ 697,201	\$ 30,743	\$ 727,944

	Common Stock					Total Stock- holders Equity	Noncontrol- ling Interests Common Units of the Operating Partnership	Total Equity
	Preferred Stock	Number of Shares	Common Stock	Additional Paid-in Capital	Distributions in Excess of Earnings			
BALANCE AS OF DECEMBER 31, 2008 AS ADJUSTED (NOTE 1)	\$ 121,582	33,086,148	\$ 331	\$ 700,122	\$ (137,052)	\$ 684,983	\$ 29,903	\$ 714,886
Net income					36,200	36,200	1,144	37,344
Issuance of common stock (Note 4)		10,062,500	100	191,566		191,666		191,666
Repurchase of common stock (Note 4)		(86,482)		(2,725)		(2,725)		(2,725)
Issuance of share-based compensation awards (Note 5)		55,998		7,535		7,535		7,535
Noncash amortization of share-based compensation				8,768		8,768		8,768
Exchange of common units of the Operating Partnership (Note 4)		30,598		516		516	(516)	
Adjustment for noncontrolling interest (Notes 1 and 3)				(925)		(925)	925	
				(814)		(814)		(814)

Edgar Filing: KILROY REALTY CORP - Form 10-Q

Repurchase of exchangeable senior notes equity component (Note 2)									
Preferred distributions and dividends					(11,397)	(11,397)			(11,397)
Dividends declared per common share and common unit (\$1.28 per share/unit)					(50,142)	(50,142)	(2,223)		(52,365)
BALANCE AS OF SEPTEMBER 30, 2009	\$ 121,582	43,148,762	\$ 431	\$ 904,043	\$ (162,391)	\$ 863,665	\$ 29,233		\$ 892,898

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,	
	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 37,344	\$ 38,393
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of building and improvements and leasing costs	66,018	61,474
Increase in provision for uncollectible tenant receivables	401	291
(Decrease) increase in provision for uncollectible deferred rent receivables	(6)	3,377
Depreciation of furniture, fixtures and equipment	615	589
Noncash amortization of share-based compensation awards	7,914	11,372
Noncash amortization of deferred financing costs and debt discount	7,543	5,881
Noncash amortization of above/below market rents, net	(349)	(484)
Net gain on dispositions of discontinued operations (Note 10)	(2,485)	(234)
Noncash amortization of deferred revenue related to tenant improvements	(7,431)	(8,907)
Gain on early extinguishment of debt (Note 2)	(3,119)	
Insurance proceeds received for a property casualty loss		(531)
Changes in assets and liabilities:		
Marketable securities	(1,341)	(1,536)
Current receivables	2,213	(58)
Deferred rent receivables	(5,473)	(538)
Deferred leasing costs	(450)	87
Prepaid expenses and other assets	(1,924)	(1,715)
Accounts payable, accrued expenses and other liabilities	135	3,727
Deferred revenue	(646)	3,902
Rents received in advance and tenant security deposits	(959)	352
 Net cash provided by operating activities	 98,000	 115,442
CASH FLOWS FROM INVESTING ACTIVITIES:		
Expenditures for operating properties	(25,047)	(19,373)
Expenditures for development and redevelopment properties	(15,129)	(56,175)
Net proceeds received from dispositions of operating properties (Note 10)	4,933	275
Insurance proceeds received for a property casualty loss		531
Increase in restricted cash	(2,264)	(957)
Receipt of principal payments on notes receivable	108	100
 Net cash used in investing activities	 (37,399)	 (75,599)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from issuance of common stock (Note 4)	191,666	
Borrowings on unsecured line of credit (Note 1)	102,000	148,500
Repayments on unsecured line of credit (Note 1)	(228,000)	(22,500)
Repurchase of exchangeable senior notes (Note 2)	(35,333)	
Principal payments on secured debt	(19,552)	(80,815)
Repurchase of common stock (Note 4)	(2,725)	(14,770)
Financing costs	(1,447)	(694)
Proceeds from exercise of stock options		21
Dividends and distributions paid to common stockholders and common unitholders	(56,101)	(59,865)

Edgar Filing: KILROY REALTY CORP - Form 10-Q

Dividends and distributions paid to preferred stockholders and preferred unitholders	(11,397)	(11,397)
Net cash used in financing activities	(60,889)	(41,520)
Net decrease in cash and cash equivalents	(288)	(1,677)
Cash and cash equivalents, beginning of period	9,553	11,732
Cash and cash equivalents, end of period	\$ 9,265	\$ 10,055