

KILROY REALTY CORP

Form 10-Q

July 26, 2018

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, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 1-12675 (Kilroy Realty Corporation)

Commission File Number: 000-54005 (Kilroy Realty, L.P.)

KILROY REALTY CORPORATION

KILROY REALTY, L.P.

(Exact name of registrant as specified in its charter)

Kilroy Realty Corporation Maryland 95-4598246  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

Kilroy Realty, L.P. Delaware 95-4612685  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

12200 W. Olympic Boulevard, Suite 200, Los Angeles, California 90064  
(Address of principal executive offices) (Zip Code)

(310) 481-8400  
(Registrant's telephone number, including area code)

N/A

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

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

Kilroy Realty Corporation Yes  No

Kilroy Realty, L.P. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Kilroy Realty Corporation Yes  No

Kilroy Realty, L.P. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated

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filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Kilroy Realty Corporation

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Kilroy Realty, L.P.

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Kilroy Realty Corporation Yes  No

Kilroy Realty, L.P. Yes  No

As of July 20, 2018, 100,559,903 shares of Kilroy Realty Corporation common stock, par value \$.01 per share, were outstanding.

## EXPLANATORY NOTE

This report combines the quarterly reports on Form 10-Q for the period ended June 30, 2018 of Kilroy Realty Corporation and Kilroy Realty, L.P. Unless stated otherwise or the context otherwise requires, references to “Kilroy Realty Corporation” or the “Company,” “we,” “our,” and “us” mean Kilroy Realty Corporation, a Maryland corporation, and its controlled and consolidated subsidiaries, and references to “Kilroy Realty, L.P.” or the “Operating Partnership” mean Kilroy Realty, L.P., a Delaware limited partnership and its controlled and consolidated subsidiaries.

The Company is a real estate investment trust, or REIT, and the general partner of the Operating Partnership. As of June 30, 2018, the Company owned an approximate 98.0% common general partnership interest in the Operating Partnership. The remaining approximate 2.0% common limited partnership interests are owned by non-affiliated investors and certain directors and officers of the Company. As the sole general partner of the Operating Partnership, the Company exercises exclusive and complete discretion over the Operating Partnership’s day-to-day management and control and can cause it to enter into certain major transactions, including acquisitions, dispositions, and refinancings and cause changes in its line of business, capital structure and distribution policies.

There are a few differences between the Company and the Operating Partnership that are reflected in the disclosures in this Form 10-Q. We believe it is important to understand the differences between the Company and the Operating Partnership in the context of how the Company and the Operating Partnership operate as an interrelated, consolidated company. The Company is a REIT, the only material asset of which is the partnership interests it holds in the Operating Partnership. As a result, the Company generally does not conduct business itself, other than acting as the sole general partner of the Operating Partnership, issuing equity from time to time and guaranteeing certain debt of the Operating Partnership. The Company itself is not directly obligated under any indebtedness, but generally guarantees all of the debt of the Operating Partnership. The Operating Partnership owns substantially all of the assets of the Company either directly or through its subsidiaries, conducts the operations of the Company’s business and is structured as a limited partnership with no publicly traded equity. Except for net proceeds from equity issuances by the Company, which the Company generally contributes to the Operating Partnership in exchange for units of partnership interest, the Operating Partnership generates the capital required by the Company’s business through the Operating Partnership’s operations, by the Operating Partnership’s incurrence of indebtedness or through the issuance of units of partnership interest.

Noncontrolling interests, stockholders’ equity and partners’ capital are the main areas of difference between the consolidated financial statements of the Company and those of the Operating Partnership. The common limited partnership interests in the Operating Partnership are accounted for as partners’ capital in the Operating Partnership’s financial statements and, to the extent not held by the Company, as noncontrolling interests in the Company’s financial statements. The Operating Partnership’s financial statements reflect the noncontrolling interest in Kilroy Realty Finance Partnership, L.P., a Delaware limited partnership (the “Finance Partnership”). This noncontrolling interest represents the Company’s 1% indirect general partnership interest in the Finance Partnership, which is directly held by Kilroy Realty Finance, Inc., a wholly owned subsidiary of the Company. The differences between stockholders’ equity, partners’ capital and noncontrolling interest result from the differences in the equity issued by the Company and the Operating Partnership, and in the Operating Partnership’s noncontrolling interest in the Finance Partnership.

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

- Combined reports better reflect how management and the analyst community view the business as a single operating unit;
- Combined reports enhance investors’ understanding of the Company and the Operating Partnership by enabling them to view the business as a whole and in the same manner as management;
- Combined reports are more efficient for the Company and the Operating Partnership and result in savings in time, effort and expense; and
- Combined reports are more efficient for investors by reducing duplicative disclosure and providing a single document for their review.

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

- consolidated financial statements;

the following notes to the consolidated financial statements:

Note 6, Stockholders' Equity of the Company;

Note 8, Partners' Capital of the Operating Partnership;

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Note 13, Net Income Available to Common Stockholders Per Share of the Company;

Note 14, Net Income Available to Common Unitholders Per Unit of the Operating Partnership;

Note 15, Supplemental Cash Flow Information of the Company; and

Note 16, Supplemental Cash Flow Information of the Operating Partnership;

•Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

—Liquidity and Capital Resources of the Company;” and

—Liquidity and Capital Resources of the Operating Partnership.”

This report also includes separate sections under Part I, Item 4. Controls and Procedures and separate Exhibit 31 and Exhibit 32 certifications for the Company and the Operating Partnership to establish that the Chief Executive Officer and the Chief Financial Officer of each entity have made the requisite certifications and that the Company and Operating Partnership are compliant with Rule 13a-15 or Rule 15d-15 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and 18 U.S.C. §1350.

KILROY REALTY CORPORATION AND KILROY REALTY, L.P.  
 QUARTERLY REPORT FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2018  
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## PART I – FINANCIAL INFORMATION

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

KILROY REALTY CORPORATION  
CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	June 30, 2018 (unaudited)	December 31, 2017
<b>ASSETS</b>		
<b>REAL ESTATE ASSETS (Note 2):</b>		
Land and improvements	\$1,127,100	\$ 1,076,172
Buildings and improvements	5,017,999	4,908,797
Undeveloped land and construction in progress	1,993,314	1,432,808
Total real estate assets held for investment	8,138,413	7,417,777
Accumulated depreciation and amortization	(1,361,811 )	(1,264,162 )
Total real estate assets held for investment, net	6,776,602	6,153,615
<b>CASH AND CASH EQUIVALENTS</b>	50,817	57,649
<b>RESTRICTED CASH</b>	—	9,149
<b>MARKETABLE SECURITIES (Note 11)</b>	22,519	20,674
<b>CURRENT RECEIVABLES, NET (Note 3)</b>	15,144	16,926
<b>DEFERRED RENT RECEIVABLES, NET (Note 3)</b>	256,558	246,391
<b>DEFERRED LEASING COSTS AND ACQUISITION-RELATED INTANGIBLE ASSETS, NET</b>	186,649	183,728
<b>PREPAID EXPENSES AND OTHER ASSETS, NET (Note 4)</b>	76,495	114,706
<b>TOTAL ASSETS</b>	<b>\$7,384,784</b>	<b>\$ 6,802,838</b>
<b>LIABILITIES AND EQUITY</b>		
<b>LIABILITIES:</b>		
Secured debt, net (Notes 5 and 11)	\$338,189	\$ 340,800
Unsecured debt, net (Notes 5 and 11)	2,156,521	2,006,263
Unsecured line of credit (Notes 5 and 11)	295,000	—
Accounts payable, accrued expenses and other liabilities	278,508	249,637
Accrued dividends and distributions (Note 17)	47,348	43,448
Deferred revenue and acquisition-related intangible liabilities, net	146,741	145,890
Rents received in advance and tenant security deposits	58,604	56,484
Total liabilities	3,320,911	2,842,522
<b>COMMITMENTS AND CONTINGENCIES (Note 10)</b>		
<b>EQUITY:</b>		
<b>Stockholders' Equity (Note 6):</b>		
Common stock, \$.01 par value, 150,000,000 shares authorized, 100,559,903 and 98,620,333 shares issued and outstanding, respectively	1,006	986
Additional paid-in capital	3,951,289	3,822,492
Distributions in excess of earnings	(149,368 )	(122,685 )
Total stockholders' equity	3,802,927	3,700,793
<b>Noncontrolling Interests (Notes 1 and 7):</b>		
Common units of the Operating Partnership	78,223	77,948
Noncontrolling interests in consolidated property partnerships	182,723	181,575
Total noncontrolling interests	260,946	259,523
Total equity	4,063,873	