
CEO ANNUAL
LETTER

2012

K I L R O Y

“Over the past 24 months, through careful acquisitions, geographic expansion and talent recruitment, we have transformed KRC into the premier West Coast office landlord.”

To Our Shareholders

2011 was one of KRC’s strongest and most successful years since our IPO fifteen years ago.

We achieved new milestones in leasing, continued our expansion into high value West Coast markets, added to our management team, and accelerated our capital recycling program to help finance our growth while maintaining a strong and flexible balance sheet.

The results are evident in our rising occupancy numbers and improving financial results, and in the growing number of dynamic companies that have chosen to join the KRC tenant list.

But there’s a larger story here. Over the past 24 months, through careful acquisitions, geographic expansion and talent recruitment, we have transformed KRC into the premier West Coast office landlord. We now have offices in Seattle, San Francisco, Los Angeles, Orange County and San Diego. With a deeper management team, a growing footprint in high potential Seattle and San Francisco markets, and significant embedded earnings from the company’s redevelopment and development pipelines, we have assembled all the elements for a stronger, broader operating platform for KRC—one that can deliver significant growth and long-term value creation for our shareholders.

A Record Leasing Effort.

Our leasing program gained traction throughout 2011, culminating in the production of new or renewing leases on 1.3 million square feet of space across 48 transactions in the fourth quarter. With that strong finish, we completed nearly 2.6 million square feet of leasing for the year—the strongest annual leasing performance in our 15-year history as a public company.

Occupancy in our stabilized portfolio rose steadily last year, in step with our leasing success. At year-end 2011, occupancy reached 92.4%, up 960 basis points from a 2009 recession low of 82.8% and approaching our long term average of 94%.

Many of our recent leases underscore KRC’s growing stature in the marketplace as the go-to landlord for the flexible, tech-rich work spaces and the campus-style headquarters increasingly



DIRECTV, Greater Los Angeles

sought by today's innovation-driven companies. In transactions like those with DIRECTV, TD Ameritrade and PAC-12 Enterprises, KRC has established active collaborations with deeply engaged tenants to develop physical work environments that can advance their creativity and productivity. For these forward-looking enterprises, real estate has moved beyond simply a place to work to a strategic competitive advantage.

An Expanding West Coast Footprint.

Attractive acquisition opportunities remained an important feature of the commercial real estate landscape in 2011 and KRC was an active buyer. Across the year, we invested just under \$638 million in eight office projects, adding nearly two million square feet of space to our portfolio, primarily in the West Coast gateway cities of San Francisco and Seattle.

In San Francisco's South of Market district, epicenter for the city's exploding technology and media industries, KRC is now the largest landlord of Class A office space, with a portfolio totaling close to 2.1 million square feet. Further north, in the technology-rich suburbs of eastern Seattle, we've expanded our presence to just under 900,000 square feet of office space.

1.3

MILLION SF
of new or
renewing leases
across 48
transactions

92.4%

OCCUPANCY
at year-end, 2011

~\$638

MILLION
invested in eight
office projects

~2

MILLION SF
added office
space to portfolio

27%

CLIMB
of continuing
operations
revenues

The common thread in each of these transactions was a compelling, once-in-a-cycle opportunity to acquire a top quality, well-located asset below replacement cost. Typically, the asset came with a unique set of characteristics offering significant long-term appreciation potential. Woven together, our 2011 acquisitions are extending and deepening the KRC franchise in important West Coast markets in a deliberate and strategic manner. This broader footprint is creating new platforms for growth, diversifying our geographic exposure and increasing our earning power by region. (For more information on our 2011 acquisitions click [here](#).)

An Improving Financial Performance.

Our revenues from continuing operations climbed 27% last year, to \$367 million, fueled by an expanding office portfolio and higher average occupancy. Net operating income (NOI) generated by our stabilized portfolio also showed substantial improvement, with same-store NOI up 5.7% on a GAAP basis and 8.2% on a cash basis. Our cash same-store net operating income has now risen for six consecutive quarters.

Funds from operations (FFO) grew 28% in 2011, to \$136 million. On a per share basis, FFO was up 11.7%, to \$2.29 per share.

During the year, we accelerated a capital recycling program that is generating a substantial portion of the funds needed for our growth initiatives. Our strategy is to sell stable, fully mature assets commanding strong prices in today's markets and reinvest the proceeds in properties where we see better value-generating opportunities. We completed \$66 million of these dispositions in 2011 and another \$146 million in the first quarter of 2012. Since mid-2011, the program has generated approximately \$212 million of gross proceeds.

A Commitment to Sustainable Practices.

We share an interest with our tenants in work environments that optimize resource use, minimize environmental impact, and embody best practices in their operation and management. KRC is a leading proponent of the industry-driven Leadership in Energy and



303 Second Street, San Francisco Bay Area

Environmental Design (LEED) certification program for commercial real estate. KRC is the premier developer and operator of LEED properties in Southern California, and, with 25% of our office portfolio certified under LEED, we have emerged as a leader among public office REITs in LEED performance. Not only do we build all of our new developments with the goal of LEED Gold and major renovation projects with the goal of LEED Silver, but we are currently pursuing LEED Silver for over 600,000 square feet of existing office space.

Our efforts in this area were recently recognized by two influential standard-setters. The California Sustainability Alliance, an organization dedicated to fostering achievement of the state's ambitious climate, resource and environmental goals, selected KRC as the winner of its 2011 Sustainability Showcase Award in the commercial buildings category. The Building Owners and Managers Association International, a commercial real estate trade association, awarded KRC's 303 Second Street property in the SOMA submarket of San Francisco with its "BOMA 360" certification, a program that identifies commercial properties that exemplify the industry's best practices in building management and operations.

A Platform for Continued Growth.

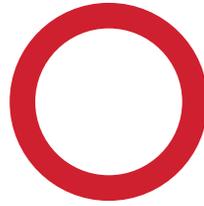
Over the past two years, in the tremendous macroeconomic uncertainty created by recession, KRC has leveraged its experience, financial strength and operating disciplines to build a larger, stronger real estate enterprise.



25%

LEED CERTIFIED

A quarter of our portfolio is LEED certified



100%

GOLD GOALS

All new developments were designed to be LEED Gold



**CALIFORNIA
SUSTAINABILITY
ALLIANCE**

2011 Sustainability Showcase Award

We have expanded our field of play to include important new West Coast markets. We have increased the size and the value of our property portfolio. We have deepened our bench, broadened our access to capital, achieved new records in leasing, and burnished our reputation as a landlord that can be counted on to deliver. And we have accomplished all this while maintaining a conservative approach to leverage and a strong balance sheet.

We believe there is much more to come. We see the potential to improve the performance of our existing portfolio through higher rents and occupancies. We will continue to evaluate potential existing building and redevelopment acquisition opportunities. And there is emerging tenant interest in new development. We are pursuing all of these opportunities in a thoughtful, disciplined manner, for the long-term to benefit of our shareholders.

As always, we appreciate your continuing support.

Cordially,

John B. Kilroy, CEO

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