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CEO ANNUAL  
LETTER

**2014**

**K I L R O Y**

*“We are creating a real estate enterprise that will set us further apart from our competitors while deepening our connections with the most innovative companies in the world. These relationships demonstrate the success we’ve achieved in developing the types of facilities and work environments that tenants want, which has created a virtuous cycle that will provide enduring shareholder value.”*

# To Our Shareholders

2013 was a year of focused execution for KRC. Operating across a larger playing field and leveraging a deeper talent bench, we tackled increasingly ambitious goals in leasing, development, acquisitions and capital recycling—and met or exceeded expectations in every case.

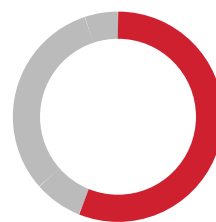
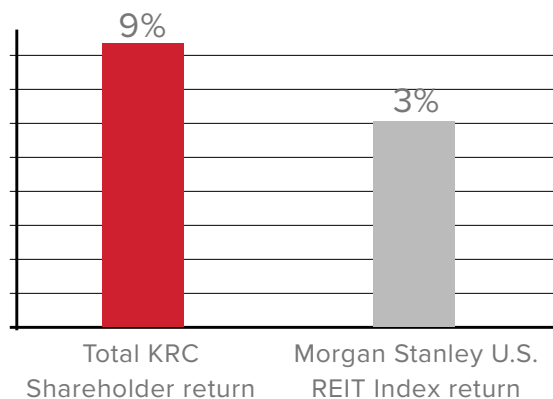
We delivered solid operating and financial results, expanded our opportunity pipeline up and down the West Coast, and positioned our enterprise to capitalize on improving real estate markets. Our success can be seen in our total shareholder return last year of 9% which beat the Morgan Stanley U.S. REIT Index return of 3%. Our three-year cumulative total shareholder return has been an impressive 52%.

And importantly, we continued to adapt our real estate assets for the dramatic and, in

our view, permanent changes reshaping the modern work environment. Our intense focus on geographic location, physical characteristics and operating sustainability is creating a portfolio that will set us further apart from our competitors while deepening our connections with the most innovative companies in the world.

## Another year of record leasing results.

We signed new or renewing leases on 2.3 million square feet of office space in 2013, including 732,000 square feet in the fourth quarter. That matched the record we set in 2012 and marked the sixth consecutive year that we have executed two million square feet in leasing. Further, we made significant progress reducing our future lease expirations.



**52%**

3-year cumulative total shareholder return



*331 Fairchild, San Francisco Bay Area*

Our consistently strong leasing performance over the last four years has increased the occupancy of our stabilized portfolio by more than a thousand basis points. At year-end 2013, our stabilized portfolio was 93.4% occupied and 95.1% leased.

And this momentum continued into the new year. Just six weeks after its ground-breaking, 333 Brannan Street, our LEED-platinum certified development project in the SOMA district of San Francisco, was fully leased to the online data storage innovator Dropbox. The property's location, expansive interiors and ceiling heights, and pioneering sustainability features were an immediate market hit and attracted significant interest from the tenant community.

## **Development playing an increasingly prominent role in our portfolio's evolution.**

Our cyclical shift toward development in early 2012 is now a driving force in our expanding presence in downtown San Francisco, the Silicon Valley, and the resurgent media and entertainment district in Hollywood. Ground-up development also allows us to create the unique product mixes, collaborative workspace interiors, highly efficient operating systems, and leading-edge sustainability features that

# 2.3

**MILLION SF**  
of new or  
renewed office  
space leases

# 6<sup>th</sup>

**CONSECUTIVE  
YEAR**

KRC has executed  
2M sf in leasing

# 93.4%

**OCCUPIED**  
portfolio by  
year-end 2013

# 95.1%

**LEASED**  
portfolio by  
year-end 2013

# 6

**PROJECTS**  
under  
construction,  
which encompass  
over 2.5M sf

are quickly becoming required attributes of Class A properties for the modern enterprise and its tech-savvy, environmentally conscious workforce.

During the fourth quarter, we delivered the first of four development projects commenced in 2012—a \$45 million, 88,000 square-foot corporate headquarters building for Audience Inc. in Mountain View, California. We also initiated construction on three additional projects during the year. We now have six projects under construction that encompass more than 2.5 million square feet and represent a total estimated investment of \$1.5 billion. We believe at prevailing market prices they will add more than \$700 million in net incremental value to our portfolio. With the recent execution of the Dropbox lease, four of the six projects are now fully leased.

## **Continued pursuit of opportunistic acquisitions in our core markets.**

We completed two such transactions in 2013, acquiring recently built, LEED-certified, Class A office campuses in highly desirable submarkets of San Diego and Seattle for a total cost of \$296 million. Both properties are fully leased and were immediately accretive to earnings.

## **Recycling capital through the sale of non-strategic assets.**

Last year, we negotiated the sale of 15 non-strategic properties totaling 1.2 million square feet of space for total proceeds of approximately \$352 million. The transactions closed in December and January 2014. Over the past two years, we've sold more than \$850 million of non-strategic and lower quality properties at favorable cap rates, recycling the capital into higher value, state-of-the-art development. This process allows us to maintain our financial strength and flexibility while upgrading the quality of our portfolio and building its value.



*Westlake Terry, Pacific Northwest*

## **Leading our industry toward a more sustainable future.**

With an in-house team dedicated to the sustainability of our properties, development and management practices, we are playing a leading role in the adoption and promotion of environmentally sound practices in commercial real estate.

At year-end, 40% of our stabilized portfolio was Leadership in Energy and Environmental Design (LEED) certified while 53% was ENERGY STAR certified. All our new development is designed to achieve LEED certification and we typically aim for the highest certification level. In San Francisco, for example, we are currently building the city's first two ground-up LEED Platinum office development projects. All these efforts now

rank KRC among the top three American office REITs in sustainable practices and properties, according to the most widely used global benchmark for sustainability performance.

## **Delivering solid financial results, including strong year-over-year growth in FFO.**

Funds from operations (FFO) grew 32% in 2013 to \$218.6 million and FFO per share increased 18% year over year. Our total revenues (including discontinued operations) climbed 15%, to just under \$498 million. Net operating income (NOI) generated by our stabilized portfolio also improved, with same-store NOI up 3.6% on a cash basis and 1.7% on a GAAP basis.

# 2013 Financials

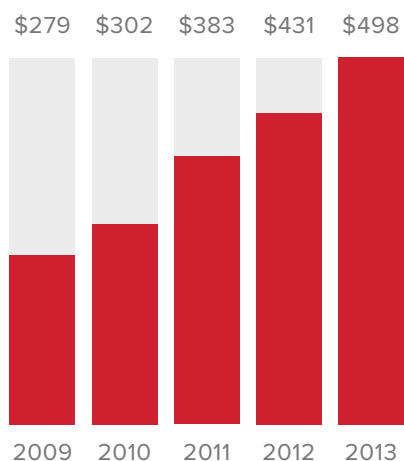
## Financial Data IN THOUSANDS EXCEPT PER SHARE DATA

|                             | 2013      | 2012      | 2011      | 2010      | 2009      |
|-----------------------------|-----------|-----------|-----------|-----------|-----------|
| Total Revenues*             | \$497,819 | \$431,473 | \$383,133 | \$301,980 | \$279,434 |
| Net Income                  | \$30,630  | \$249,826 | \$50,819  | \$4,512   | \$21,794  |
| Funds from Operations (FFO) | \$218,621 | \$165,455 | \$136,173 | \$106,639 | \$107,159 |
| FFO per Share               | \$2.66    | \$2.26    | \$2.29    | \$2.05    | \$2.60    |
| Dividends per Share         | \$1.40    | \$1.40    | \$1.40    | \$1.40    | \$1.63    |

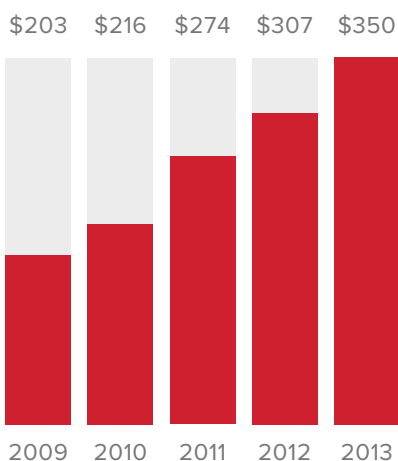
## Rentable Square Footage AT DECEMBER 31st

|                       | 2013       | 2012       | 2011       | 2010       | 2009      |
|-----------------------|------------|------------|------------|------------|-----------|
| Office Properties     | 12,736,099 | 13,249,780 | 11,421,112 | 10,395,208 | 8,708,466 |
| Industrial Properties | -----      | -----      | 3,413,354  | 3,602,896  | 3,654,463 |
| Occupancy             | 93%        | 93%        | 92%        | 89%        | 83%       |

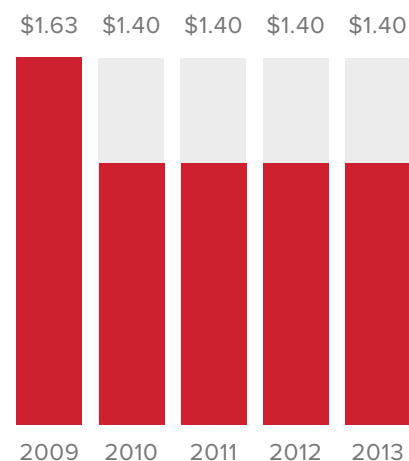
Total Revenues\*  
IN MILLIONS



Total Net Operating Income\*  
IN MILLIONS



Dividends Per Share



\*INCLUDES DISCONTINUED OPERATIONS

## **Commitment to a strong balance sheet year after year.**

During the year, we raised net proceeds of approximately \$649.9 million in the public equity and debt markets. Since the beginning of 2010, we have grown our enterprise value more than two and a half times and enhanced the quality of our portfolio significantly while at the same time reducing our leverage 580 bps. This is compelling evidence of our rigorous effort to uphold a strong and flexible balance sheet that will allow us to capitalize on growth opportunities through various market cycles. We ended 2013 with a debt to market capitalization of 33%, among the lowest ratios in our peer group.

## **Building a platform for continued growth and value creation.**

Moving into 2014, we remain focused on quality execution across all areas of our enterprise, in particular the timely delivery of our current development commitments and the continued transformation of our entire enterprise.

Leveraging the organizational strength, capacity and brand equity that we have already built at KRC from Seattle to San Diego, we are determined to expand our position as the West Coast's preeminent office landlord and enhance our enterprise value for the long term. The important work of improving our portfolio, strengthening our presence in the West Coast's top-performing markets, and building our pipeline of new opportunities will continue. It is very exciting and satisfying to see our carefully planned strategies succeed. And we believe there is much more to come.

We will continue to pursue opportunities in a thoughtful and disciplined manner, reshaping our portfolio to the standards of a 21st century workforce and creating long-term value for the benefit our shareholders.

As always, we appreciate your continuing support.

Cordially,

A handwritten signature in black ink, appearing to read "John B. Kilroy". The signature is fluid and cursive, with a large, stylized "K" and "R".

John B. Kilroy, CEO

**K I L R O Y**