
CEO ANNUAL
LETTER
2010

K I L R O Y

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To Our Shareholders

2010 was a year of significant accomplishments for KRC on many fronts, and particularly in terms of acquisitions, leasing and our balance sheet.

Having operated through multiple cycles for over 60 years, we saw signs toward the end of 2009 that there would be significant opportunities to create value through acquisitions during the latter half of the recession. We prepared ourselves by strengthening our balance sheet, bolstering our management team and acquiring extensive market knowledge. In early 2010, we took action and began pursuing office opportunities that allowed us to grow, both geographically and in size, at prices that were significantly below replacement cost.

In addition, as economic conditions stabilized, tenant demand increased along the West Coast, producing positive net absorption in most of our submarkets. Our leasing team took advantage of our quality properties and solid financial position to execute a significant number of new and renewing leases and increase our occupancy by 630 basis points during the year.

Our Leasing Gained Traction Throughout 2010...

This is evident in the numbers—we signed leases on two million square feet of space for the second year in a row, including 850,000 square feet in the fourth quarter alone. By year-end, we had reduced the number of unleased buildings in our stabilized portfolio from 22 to four.

Even more telling was the increasing number and quality of the prospective tenants with whom we spoke, and the renewed confidence with which they approached real estate decisions. As 2010 progressed, we saw growing interest for large blocks of space from corporate users in a broad range of industries, including healthcare, technology, life science, entertainment and defense. It became increasingly common for us to have multiple prospects looking at individual properties. And their top priorities had broadened from rental rates and contract terms to property location, quality and amenities.

If these trends persist, and we believe they will, we could see opportunities in 2011 to increase rental rates in some of our strongest markets and to consider disciplined, pre-leased development in others.



201 Third Street, San Francisco Bay Area

...Boosting Occupancy to Year-End 2008 Levels.

From a recession low of 82.8% at the end of 2009, occupancy in our stabilized portfolio steadily increased last year along with our leasing success. By year-end 2010, occupancy had improved to 89.1%, which is about where it was two years ago, and there is room for further improvement in 2011.

We began 2011 with our stabilized portfolio 92% leased, with outstanding letters of intent covering another 400,000 square feet of space, and with minimal lease expirations. Given that strong starting point and the increasing level of interest we are seeing from prospective tenants, we believe our stabilized occupancy will continue to move closer to our 10-year average of 94%.

Largely as a result of acquisitions and our higher average occupancy, our revenues in 2010 increased 8.1% to just under \$302 million. The recession-driven decline in our stabilized portfolio's net operating income was halted, with same-store NOI in the fourth quarter up 6.3% on a GAAP basis and 1.3% on a cash basis. Funds from operations were roughly flat for the year, at just under \$107 million. On a per share basis, FFO was down 21.1% to \$2.05 per share.

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MILLION SF
of signed leases
for the second
year in a row

89.1%

OCCUPANCY
at year-end, 2010;
roughly 6% higher
than the recession

92%

LEASED
stabilized portfolio
at 2011 beginning

8.1%

INCREASE
in revenue, to
\$302 Million in
2010

\$1.5

BILLION
raised in capital
from new equity
and debt offerings

Compelling Acquisitions Expanded Our Geographic Footprint Last Year...

Market dislocations often produce once-in-a-cycle opportunities to buy quality real estate assets at highly advantageous prices from over-leveraged owners seeking immediate liquidity. We saw this opportunity early and over the course of 2010, we invested roughly \$700 million in the purchase of ten office buildings, adding more than two million rentable square feet of space to our portfolio, increasing its value by nearly one third, and expanding its current annual net operating income by more than 20%.

Some of these acquisitions broadened our presence in areas of Southern California long familiar to KRC, including coastal San Diego and Orange Region. Others expanded the KRC franchise into attractive new markets, such as the rapidly growing South Financial District of downtown San Francisco and the technology-rich suburbs of eastern Seattle, home to Microsoft's headquarters campus.

While the details of each of these transactions are as unique as the properties themselves, a common theme runs throughout our current acquisition strategy. We are interested in top quality, well-located assets, those with strong near-term economics and those with a value-added component, and attractive, difficult to duplicate amenities that enhance their long-term value. We are entering 2011 with a strong pipeline of acquisition opportunities, having recently closed on an additional purchase in San Francisco, and we expect more buying activity as the new year progresses.

...And We Have Set the Table for Continued Growth in 2011.

Several competitive advantages drove our success in 2010—among them a rock-solid balance sheet and an experienced management team. We intend to deploy them in full force during what promises to be another active year for KRC in 2011.

We took several steps last year to broaden our sources of capital, improve our credit profile and enhance our overall financial strength and flexibility. We raised \$1.5 billion in capital from new equity and debt offerings, earned investment grade credit ratings for our public debt,



Key Center Bellevue, Pacific Northwest

extended our average weighted debt maturity by 2.5 years, and negotiated a new \$500 million bank line, most of which remains unused.

In early 2011, we added to our management line-up, bringing former Spieker Properties chief investment officer Eli Khouri on board to play a similar role at KRC. Eli joins what we believe is one of the most talented management teams operating in West Coast real estate markets today. We expect to leverage that talent across a growing portfolio throughout the coming year and beyond.

Looking forward, while we are cognizant of current global issues and how they may impact the economic environment, we are seeing meaningful improvement in our markets and multiple opportunities to expand our real estate enterprise. We have positioned ourselves to capitalize on these opportunities and are energized by the possibilities ahead of us. We remain committed to pursuing them in a thoughtful, disciplined manner, for the long-term benefit of our shareholders.

As always, we appreciate your continuing support.

Cordially,

A handwritten signature in black ink, appearing to read "John B. Kilroy".

John B. Kilroy, CEO

K I L R O Y