KILROY REALTY CORP
Form 10-K/A
November 08, 2005
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 3

FORM 10-K/A

(MARK ONE)

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

For the fiscal year ended December 31, 2004

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	**95-4598246**
(State or other jurisdiction	**(I.R.S. Employer**

of incorporation or organization)	Identification Number)
12200 W. Olympic Boulevard, Suite 200 **Los Angeles, California** **(Address of principal executive offices)**	**90064** **(Zip Code)**

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $.01 par value	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: None

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 x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes x No ¨

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant was approximately $968,361,059 based on the closing price on the New York Stock Exchange for such shares on June 30, 2004.

As of February 28, 2005, 28,742,839 shares of common stock, par value $.01 per share, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company s Proxy Statement with respect to its 2005 Annual Meeting of Stockholders to be filed not later than 120 days after the end of the registrant s fiscal year are incorporated by reference into Part III hereof.

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EXPLANATORY NOTE

This Amendment No. 3 on Form 10-K/A (the Amended Filing) of Kilroy Realty Corporation (the Company) of the Form 10-K for the fiscal year ended December 31, 2004 (as amended by Amendments No. 1 and No. 2 on Form 10-K/A, the Original Filing), is being filed to restate the Company s consolidated financial statements to mark six interest rate swap and two interest rate cap agreements the Company entered into in 2000 and 2002 to market and to recognize the impact of this mark to market adjustment in the income statement for each period, rather than through other comprehensive income. Prior to entering into these agreements, the Company engaged an independent consulting firm specializing in derivatives to advise the Company with respect to derivatives and hedging matters. The Company consulted closely with the independent derivatives specialist during its preparation of the formal designation of the instruments to ensure that each of the instruments qualified for hedge accounting treatment under Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133) and the related accounting guidance. Although both the Company and the independent derivatives specialist believed the designation documentation met the requirements under SFAS 133 at the time the derivative transactions were entered into, the Company has subsequently determined that the designation documentation does not meet the technical requirements under SFAS 133 to qualify for hedge accounting treatment. As a result, the Company is required to restate prior period financial statements to mark all of these instruments to market and to recognize the impact of this mark to market adjustment in the statement of operations for each period, rather than through other comprehensive income.

In addition, based on a recent review of the Company s accounting treatment for tenant improvements reimbursed by the tenant, the Company is also restating its financial statements to record a capital asset and related depreciation for leasehold improvements constructed by the Company that are reimbursed by tenants, with a corresponding liability for deferred revenue, which will be amortized into rental revenue over the lives of the related leases. In connection with the restatement, certain other immaterial adjustments have been recorded.

The Company previously filed Amendment No. 2 on Form 10-K/A to restate the Company s income from continuing operations per common share included within its consolidated statements of operations for the years ended December 31, 2004 and 2003, and the notes related thereto, to correctly reflect the impact of preferred stock dividends in the calculation of income from continuing operations per common share in accordance with Statement of Financial Accounting Standards No. 128, Earnings per Share, so that income from continuing operations per share is presented net of preferred dividends paid and accrued. Amendment No. 2 was also filed to restate the consolidated statements of cash flows for the years ended December 31, 2004, 2003 and 2002 to correct the classification of two items in the consolidated statements of cash flows.

For a more detailed description of the restatements, see Note 27 to the accompanying consolidated financial statements contained in this Amended Filing. In connection with the restatements, the Company reevaluated the effectiveness of its controls and procedures and, accordingly, includes revised disclosure in this Amended Filing under Part II, Item 9A Controls and Procedures.

The Company is concurrently filing amendments to its Quarterly Reports on Form 10-Q/A for the quarters ended March 31, 2005 and June 30, 2005 also to restate the Company s consolidated financial statements to mark the interest rate swap and interest rate cap agreements the Company entered into in 2000 and 2002 to market and to recognize the impact of this mark to market adjustment in the statement of operations for each period, rather than through other comprehensive income, as well as to record a capital asset and related depreciation for leasehold improvements constructed by the Company that are reimbursed by tenants with a corresponding liability for deferred revenue, which will be amortized into rental revenue over the lives of the related leases. The decision to further restate the Company s consolidated financial statements was previously announced in our Current Reports on Form 8-K filed with the Securities and Exchange Commission on October 25, 2005 and October 31, 2005.

The Company has also updated its historical financial statements and the accompanying selected financial data in this Form 10-K/A for discontinued operations that have resulted from the disposition of five operating

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properties during the nine months ended September 30, 2005. The other concurrently filed amendments referenced above reflect a similar update.

To reflect the restatement of the Company s consolidated financial statements described above and the update for discontinued operations, the Company is also re-issuing Part II, Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) and Part II, Item 7A Quantitative and Qualitative Disclosures about Market Risk that accompanied the financial statements in the Original Filing.

This Form 10-K/A does not reflect events occurring after the filing of the Original Filing or modify or update disclosures, including the exhibits to the Original Filing, affected by subsequent events except in connection with the foregoing.

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PART II

ITEM 6. SELECTED FINANCIAL DATA

Kilroy Realty Corporation Consolidated

(in thousands, except per share, square footage and occupancy data)

	Year Ended December 31,				
	2004	2003	2002	2001	2000
	(As Restated, see Note 27 to the Company s consolidated financial statements)				
Statements of Operations Data:					
Rental income	$ 196,191	$ 177,346	$ 173,931	$ 169,420	$ 148,156
Tenant reimbursements	21,156	19,665	20,854	20,016	17,365
Other property income	1,202	23,998	2,672	6,268	711
Total revenues	218,549	221,009	197,457	195,704	166,232
Property expenses	34,010	30,910	28,007	27,109	20,220
Real estate taxes	16,344	15,061	14,440	13,776	12,941
Provision for bad debts	886	1,503	6,712	3,609	1,663
Ground leases	1,401	1,296	1,354	1,507	1,643
General and administrative expenses	34,021	20,095	12,902	11,692	10,535
Interest expense	33,994	30,515	30,629	37,854	38,460
Depreciation and amortization	58,620	55,471	57,750	50,381	38,245
Total expenses	179,276	154,851	151,794	145,928	123,707
Net settlement payments on interest rate swaps	(2,893)	(3,218)	(6,819)	(6,454)	
Gain (loss) on derivative	3,099	704	(244)	(5,553)	
Interest and other income	521	196	513	1,030	1,878
Interest income from related party					2,724
Equity in earnings from unconsolidated real estate					191
Total other income (expense)	727	(2,318)	(6,550)	(10,977)	4,793
Income from continuing operations before net gain on dispositions and minority interests	40,000	63,840	39,113	38,799	47,318
Net gain on dispositions of operating properties			896	4,714	11,256
Income from continuing operations before minority interests	40,000	63,840	40,009	43,513	58,574
Minority interests:					
Distributions on Cumulative Redeemable Preferred units	(9,579)	(13,163)	(13,500)	(13,500)	(13,500)
Original issuance costs of redeemed preferred units	(1,200)	(945)			
Minority interest in earnings of Operating Partnership attributable to continuing operations	(3,218)	(6,533)	(3,714)	(2,613)	(5,576)
Recognition of previously reserved Development LLC preferred return			3,908		
Minority interest in earnings of Development LLCs			(1,024)	(3,701)	(421)
Total minority interests	(13,997)	(20,641)	(14,330)	(19,814)	(19,497)

Income from continuing operations	26,003	43,199	25,679	23,699	39,077
Discontinued operations:					
Revenues from discontinued operations	7,134	10,231	17,706	18,748	18,717
Expenses from discontinued operations	(3,929)	(5,901)	(9,677)	(9,519)	(10,076)
Net gain on dispositions of discontinued operations	6,148	3,642	6,570		
Impairment loss on property held for sale	(726)				
Minority interest in earnings of Operating Partnership attributable to discontinued operations	(1,089)	(1,055)	(1,844)	(968)	(1,078)
Total income from discontinued operations	7,538	6,917	12,755	8,261	7,563
Net income before cumulative effect of change in accounting principle	33,541	50,116	38,434	31,960	46,640
Cumulative effect of change in accounting principle				(1,392)	
Net income	33,541	50,116	38,434	30,568	46,640
Preferred dividends	(3,553)	(349)			
Net income available for common stockholders	$ 29,988	$ 49,767	$ 38,434	$ 30,568	$ 46,640
Share Data:					
Weighted average shares outstanding basic	28,244	27,527	27,450	27,167	26,599
Weighted average shares outstanding diluted	28,422	27,738	27,722	27,373	26,755
Income from continuing operations per common share basic	$ 0.79	$ 1.56	$ 0.94	$ 0.87	$ 1.47
Income from continuing operations per common share diluted	$ 0.79	$ 1.54	$ 0.93	$ 0.87	$ 1.46
Net income per common share basic	$ 1.06	$ 1.81	$ 1.40	$ 1.13	$ 1.75
Net income per common share diluted	$ 1.06	$ 1.79	$ 1.39	$ 1.12	$ 1.74
Dividends declared per common share	$ 1.98	$ 1.98	$ 1.98	$ 1.92	$ 1.80

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	Kilroy Realty Corporation Consolidated				
	December 31,				
	2004	2003	2002	2001	2000
	(As Restated, see Note 27)				
Balance Sheet Data:					
Total real estate held for investment, before accumulated depreciation and amortization	$ 1,863,230	$ 1,735,796	$ 1,691,667	$ 1,604,180	$ 1,501,625
Total assets	1,609,024	1,516,428	1,507,710	1,457,346	1,459,086
Total debt	801,441	761,048	762,037	714,587	723,688
Total liabilities	929,348	849,683	853,580	802,798	791,354
Total minority interests	133,129	183,712	219,948	217,182	226,682
Total stockholders equity	546,547	483,033	434,182	437,366	441,050
Other Data:					
Funds From Operations(1)	$ 87,643	$ 110,758	$ 96,908	$ 84,288	$ 83,955
Cash flows from:					
Operating activities	120,513	124,399	122,409	129,391	89,378
Investing activities	(123,271)	(67,463)	(78,487)	(53,614)	(148,276)
Financing activities	(2,281)	(62,821)	(44,632)	(76,890)	50,382
Office Properties:					
Rentable square footage	7,674,424	7,316,187	7,447,605	7,225,448	6,624,423
Occupancy	94.0%	87.6%	91.1%	93.9%	96.2%
Industrial Properties:					
Rentable square footage	4,602,605	4,878,603	4,880,963	5,085,945	5,807,555
Occupancy	95.5%	94.5%	97.7%	98.5%	97.8%

(1) Management believes that Funds From Operations (FFO) is a useful supplemental measure of the Company s operating performance. The Company computes FFO in accordance with the White Paper on FFO approved by the Board of Governors of the National Association of Real Estate Investment Trusts (NAREIT). The White Paper defines FFO as net income or loss computed in accordance with generally accepted accounting principles (GAAP), excluding extraordinary items, as defined by GAAP, and gains and losses from sales of depreciable operating property, plus real estate related depreciation and amortization (excluding amortization of deferred financing costs and depreciation of non-real estate assets), and after adjustment for unconsolidated partnerships and joint ventures. Other REITs may use different methodologies for calculating FFO, and accordingly, the Company s FFO may not be comparable to other REITs.

Because FFO excludes depreciation and amortization, gains and losses from property dispositions and extraordinary items, it provides a performance measure that, when compared year over year, reflects the impact to operations from trends in occupancy rates, rental rates, operating costs, development activities, general and administrative expenses and interest costs, providing a perspective not immediately apparent from net income. In addition, management believes that FFO provides useful information to the investment community about the Company s financial performance when compared to other REITs since FFO is generally recognized as the industry standard for reporting the operations of REITs.

However, FFO should not be viewed as an alternative measure of the Company s operating performance since it does not reflect either depreciation and amortization costs or the level of capital expenditures and leasing costs necessary to maintain the operating performance of the Company s properties, which are significant economic costs and could materially impact the Company s results of operations.

Non-cash adjustments to arrive at FFO were as follows: in all periods, minority interest in earnings of the operating partnership, depreciation and amortization and net gain (loss) from dispositions of operating properties; in 2001 and 2000, non-cash amortization of restricted stock grants; and in 2001, cumulative effect of change in accounting principle. For additional information, see Non-GAAP Supplemental Financial Measure: Funds From Operations including a reconciliation of the Company s GAAP net income available to common stockholders to FFO for the years ended December 31, 2004, 2003, 2002, 2001 and 2000.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion relates to the consolidated financial statements of the Company and should be read in conjunction with the financial statements and notes thereto appearing elsewhere in this report. Statements contained in this Management s Discussion and Analysis of Financial Condition and Results of Operations that are not historical facts may be forward-looking statements. Such statements are subject to certain risks and uncertainties, which could cause actual results to differ materially from those projected. Some of the enclosed information presented is forward-looking in nature, including information concerning development timing and investment amounts. Although the information is based on the Company s current expectations, actual results could vary from expectations stated here. Numerous factors will affect the Company s actual results, some of which are beyond its control. These include the timing and strength of regional economic growth, the strength of commercial and industrial real estate markets, competitive market conditions, future interest rate levels and capital market conditions. You are cautioned not to place undue reliance on this information, which speaks only as of the date of this report. The Company assumes no obligation to update publicly any forward-looking information, whether as a result of new information, future events or otherwise except to the extent the Company is required to do so in connection with its ongoing requirements under Federal securities laws to disclose material information. For a discussion of important risks related to the Company s business, and an investment in its securities, including risks that could cause actual results and events to differ materially from results and events referred to in the forward-looking information, see the discussion under the caption Business Risks in Item 1 Business and under the captions Factors That May Influence Future Results of Operations and Liquidity and Capital Resources Factors That May Influence Future Sources of Capital and Liquidity below. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this report might not occur.

Impact of Restatements and Reclassifications

Management s Discussion and Analysis of Financial Condition and Results of Operations has been updated to reflect the restatements of the consolidated financial statements and the reclassifications for discontinued operations. For a more detailed description of the restatements and reclassifications, see Notes 27 and 28 to the accompanying consolidated financial statements included in this Form 10-K/A.

Overview and Background

Kilroy Realty Corporation (the Company) owns, operates, and develops office and industrial real estate, primarily in Southern California. The Company operates as a self-administered real estate investment trust (REIT). The Company owns its interests in all of its properties through Kilroy Realty, L.P. (the Operating Partnership) and Kilroy Realty Finance Partnership, L.P. (the Finance Partnership) and conducts substantially all of its operations through the Operating Partnership. The Company owned an 87.7% and 87.2% general partnership interest in the Operating Partnership as of December 31, 2004 and 2003, respectively.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the reporting periods. Certain accounting policies are considered to be critical accounting estimates, as they require management to make assumptions about matters that are highly uncertain at the time the estimate is made and changes in the accounting estimate are reasonably likely to occur from period to period. Management believes the following critical accounting policies reflect the Company s more significant judgments and estimates used in the preparation of the consolidated financial statements. For a summary of all the Company s significant accounting policies see note 2 to the Company s consolidated financial statements included elsewhere in this report.

Property Acquisitions In accordance with Statement of Financial Accounting Standards No. 141, *Business Combinations* (SFAS 141), the Company allocates the purchase price of acquired properties to land, buildings and improvements and identified tangible and intangible assets and liabilities associated with in-place leases (including tenant improvements, unamortized leasing commissions, value of above and below-market leases, acquired in-place lease values, and tenant relationships, if any) based on their respective estimated fair values. The fair value of the tangible assets of the acquired properties considers the value of the properties as if vacant as of the acquisition date. Management must make significant assumptions in determining the value of assets and liabilities acquired. Using different assumptions in the allocation of the purchase cost of the acquired properties would affect the timing of recognition of the related revenue and expenses.

Amounts allocated to land are derived from comparable sales of land within the same region. Amounts allocated to buildings and improvements, tenant improvements and unamortized leasing commissions are based on current market replacement costs and other market rate information.

The amount allocated to acquired in-place leases is determined based on management s assessment of current market conditions and the estimated lease-up periods for the respective spaces. The amount allocated to acquired in-place leases is included in deferred leasing costs and other related intangible assets in the balance sheet and amortized as an increase to amortization expense over the remaining non-cancelable term of the respective leases.

The value allocable to the above or below market component of an acquired in-place lease is determined based upon the present value (using a discount rate which reflects the risks associated with the acquired leases) of the difference between (i) the contractual rents to be paid pursuant to the lease over its remaining term, and (ii) management s estimate of the rents that would be paid using fair market rental rates over the remaining term of the lease. The amounts allocated to above or below market leases are included in other assets or other liabilities in the balance sheet and are amortized on a straight-line basis as an increase or reduction of rental income over the remaining non-cancelable term of the respective leases.

Revenue recognition. In accordance with Statement of Financial Accounting Standards No. 13, Accounting for Leases, minimum annual rental revenue is recognized in rental revenues on a straight-line basis over the term of the related lease. In addition, the Company records a capital asset when reimbursements are received from tenants for leasehold improvements constructed by the Company, with the offsetting side of this accounting entry recorded to deferred revenue. The deferred revenue is amortized as additional rental revenue over the life of the related lease. Tenant reimbursement revenue, which is comprised of additional amounts recoverable from tenants for common area maintenance expenses and certain other recoverable expenses is recognized as revenue in the period in which the related expenses are incurred.

Allowances for uncollectible current tenant receivables and deferred rent receivables. Tenant receivables and unbilled deferred rent receivables are carried net of the allowances for uncollectible tenant receivables and unbilled deferred rent. Management s determination of the adequacy of these allowances requires significant judgments and estimates.

Current tenant receivables consist primarily of amounts due for contractual lease payments, reimbursements of common area maintenance expenses, property taxes and other expenses recoverable from tenants. Management s determination of the adequacy of the allowance for uncollectible current tenant receivables is performed using a methodology that incorporates both a specific identification and aging analysis and includes an overall evaluation of the Company s historical loss trends and the current economic and business environment. The specific identification methodology relies on factors such as the age and nature of the receivables, the payment history and financial condition of the tenant, the Company s assessment of the tenant s ability to meet its lease obligations, and the status of negotiations of any disputes with the tenant. The Company s allowance also includes a reserve based on historical loss trends not associated with any specific tenant. This reserve as well as the Company s specific identification reserve is reevaluated quarterly based on economic conditions and the current business environment.

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Deferred rent receivables represent the amount that the cumulative straight-line rental income recorded to date exceeds cash rents billed to date under the lease agreement. Given the longer-term nature of these types of receivables, management s determination of the adequacy of the allowance for deferred rent receivables is based primarily on historical loss experience. Management evaluates the allowance for deferred rent receivables using a specific identification methodology for the Company s significant tenants assessing the tenants financial condition and their ability to meet their lease obligations. In addition, the allowance includes a reserve based upon the Company s historical experience and current and anticipated future economic conditions that is not associated with any specific tenant.

Management s estimate for the required allowances is reevaluated quarterly as economic and market conditions and the creditworthiness of the Company s tenants change. During the fourth quarter of 2003 and the year ended December 31, 2004, the Company s accounts receivable aging and collection of outstanding tenant receivables improved, and as a result, the Company decreased its provision for bad debt. No assurance can be given that this trend will continue in 2005. For the years ended December 31, 2004, 2003 and 2002 the Company recorded a provision for bad debts and deferred rent of approximately 0.4%, 0.8%, and 3.4% of recurring revenue. Of the provision of 3.4% recorded for the year ended December 31, 2002, approximately 1.8% related specifically to reserves recorded for receivables from Peregrine Systems, Inc. (Peregrine). Peregrine, the Company s second largest tenant at December 31, 2002, had filed for bankruptcy in September 2002. The Company s reserve levels will fluctuate based on the economy and/or if the Company experiences an increased or decreased incidence of bad debts. If the Company experiences increased levels of bad debt expense or if the Company experiences write-offs in excess of its allowances, the Company s financial position, revenues and results of operations would be adversely affected.

Evaluation of asset impairment. Operating properties are carried at the lower of historical cost less accumulated depreciation or estimated fair value. Properties held for sale are reported at the lower of the carrying value or the fair value less estimated cost to sell. The Company evaluates an operating property for potential impairment whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. In the event that these periodic assessments reflect that the carrying amount of a property exceeds the sum of the undiscounted cash flows (excluding interest) that are expected to result from the use and eventual disposition of the property, the Company would recognize an impairment loss to the extent the carrying amount exceeded the estimated fair value of the property. The estimation of expected future net cash flows and the estimation of a property s fair value are inherently uncertain and rely on subjective assumptions dependent upon future and current market conditions and events that affect the ultimate value of the property. It requires management to make assumptions related to future rental rates, tenant allowances, operating expenditures, property taxes, capital improvements, occupancy levels, and the estimated proceeds generated from the future sale of the property. The Company s estimate of future cash flows are subject to revision if management s assessment of market conditions or intent to hold the property changes.

In the first quarter 2004, the Company reclassified one of its office properties as held for sale and recorded a $0.7 million impairment loss to reflect the property on the balance sheet at its estimated fair market value less selling costs. The Company subsequently sold the property in May 2004. The Company did not record any impairment losses during the years ended December 31, 2003 or 2002. If the Company determines it is necessary to recognize a material impairment loss the Company s financial position, and results of operations may be adversely affected.

Depreciable lives of leasing costs. The Company incurs certain capital costs in connection with leasing its properties. These leasing costs primarily include lease commissions and tenant improvements. Leasing costs are amortized on the straight-line method over the shorter of the estimated useful life of the asset or the estimated remaining term of the associated lease, ranging from one to 15 years. Management reevaluates the remaining useful life of these costs as the creditworthiness of the Company s tenants and economic and market conditions change. If management determines that the estimated remaining life of the respective lease has changed, the Company adjusts the amortization period and, accordingly, the depreciation expense recorded each period may

fluctuate. If the Company experiences increased levels of amortization or depreciation expense due to decreases in the estimated useful lives of leasing costs, the Company s financial position, and results of operations may be adversely affected.

Factors That May Influence Future Results of Operations

Rental income. The amount of net rental income generated by the Company s Properties depends principally on its ability to maintain the occupancy rates of currently leased space and to lease currently available space, newly developed or redeveloped properties and space available from unscheduled lease terminations. The amount of rental income generated by the Company also depends on its ability to maintain or increase rental rates in its submarkets. Negative trends in one or more of these factors could adversely affect the Company s rental income in future periods.

Rental rates. For leases that commenced during the year ended December 31, 2004, the change in rental rate was a decrease of 6.9% on a GAAP basis, and a decrease of 9.2% on a cash basis. The change in rental rate on a cash basis is calculated as the change between the initial stated rent for a new or renewed lease and the ending stated rent for the expiring lease for the same space, whereas the change in rental rate on a GAAP basis compares the average rents over the term of the lease for each lease. Both calculations exclude leases for which the space was vacant longer than one year. The decrease in rental rates on a GAAP basis was primarily due to two leases the Company renewed during 2004. The first was a renewal with The Boeing Company which was signed during the second quarter of 2004 with a decrease in rental rate of 25% on both a GAAP and cash basis. See additional discussion of The Boeing Company under Recent information regarding significant tenants. The second lease was with DirecTV and was signed during the fourth quarter of 2004 with a decrease in rental rate of 15% on a GAAP basis. Although the renewals with The Boeing Company and DirecTV resulted in a reduction in rental rates, both leases were extended by three years. Excluding these two leases, the change in rental rates on a GAAP basis would have been an increase of 7.3% for the year ended December 31, 2004. The change in rental rates on a cash basis would have been a decrease of 4.0%. Management believes that the average rental rates for its Properties are approximately at the current average quoted market rates, although individual Properties within any particular submarket presently may be leased above or below the current quoted market rates within that submarket. The Company cannot give any assurance that leases will be renewed or that available space will be re-leased at rental rates equal to or above the current quoted market rates.

Scheduled lease expirations. In addition to the 667,800 square feet of currently available space in the Company s stabilized portfolio, leases representing approximately 11.4% and 10.3% of the leased square footage of the Company s stabilized portfolio are scheduled to expire during 2005 and 2006, respectively. The leases scheduled to expire in 2005 and the leases scheduled to expire in 2006 represent approximately 1.3 million square feet of office space, or 13.2% of the Company s total annualized base rent, and 1.2 million square feet of industrial space, or 4.8% of the Company s total annualized base rent, respectively. The Company has either renewed or re-leased approximately 626,400, or 48%, of the net rentable square feet scheduled to expire in 2005 as of the date of this report. Management believes that the average rental rates for leases scheduled to expire during 2005 are approximately at the current average quoted market rates. The Company s ability to release available space depends upon the market conditions in the specific submarkets in which the Properties are located.

Submarket Information

Los Angeles County. There have been modest signs of improvement in market conditions in the overall Los Angeles County region during the last year and a half based on third-party reports of positive absorption and decreased levels of direct vacancy as well as an increased level of interest in leasing opportunities at the Company s properties. Most notable have been the improvements seen in the West Los Angeles and Long Beach submarkets. Conversely, the El Segundo submarket remains the Company s most significant leasing challenge as management continues to see only mild signs of improvement in this region. At December 31, 2004, the Company s Los Angeles stabilized office portfolio was 91% occupied with approximately 257,100 vacant

rentable square feet as compared to 83% occupied with approximately 563,200 vacant rentable square feet at December 31, 2003. As of December 31, 2004, leases representing an aggregate of approximately 134,300 and 367,500 rentable square feet are scheduled to expire during 2005 and 2006, respectively, in this region.

The Los Angeles stabilized portfolio includes two office buildings that were developed by the Company, encompassing approximately 284,300 rentable square feet. These buildings were previously in the lease-up phase and were added to the stabilized portfolio during 2003, since one year had passed following substantial completion. One of the buildings is located in West Los Angeles. This building encompasses approximately 151,000 rentable square feet and was 69% occupied as of December 31, 2004. As of December 31, 2004, the Company had executed leases for 95% of the rentable square feet at this building compared to 61% as of December 31, 2003.

The other stabilized office building is located in a two-building complex in the El Segundo submarket. This building encompasses approximately 133,300 rentable square feet and was approximately 37% occupied as of December 31, 2004. The Company had executed leases or letters of intent for 56% of the rentable square feet at this building as of December 31, 2004, compared to 31% as of December 31, 2003. Within the same complex in El Segundo, the Company had one office redevelopment project encompassing approximately 241,600 rentable square feet. This project was in the lease-up phase and was 19% leased as of December 31, 2004.

San Diego County. San Diego County remains the strongest market in Southern California real estate based on reports of positive absorption, increased rental rates and growing tenant demand. As of December 31, 2004, the Company s San Diego stabilized office portfolio was 97% occupied with approximately 102,300 vacant rentable square feet. This includes one office development project, encompassing approximately 208,500 rentable square feet, that was previously in the lease-up phase and added to the stabilized portfolio during the third quarter of 2004. As of December 31, 2004, this building was 100% occupied. In January 2004, the Company completed the redevelopment of one office building encompassing approximately 68,000 rentable square feet. The Company also commenced construction on the third phase of a development project in July 2004, which will encompass an aggregate of approximately 103,000 rentable square feet. These development and redevelopment projects were not leased as of December 31, 2004. Further, leases representing an aggregate of approximately 274,800 and 210,200 rentable square feet were scheduled to expire during 2005 and 2006, respectively, in this region. Of the 274,800 rentable square feet scheduled to expire in 2005, approximately 72,600, or 26%, has either been renewed or re-leased as of the date of this report. See additional information regarding the Company s development projects under the caption Development and redevelopment programs below.

Orange County. As of December 31, 2004, the Company s Orange County properties were 99% occupied with approximately 35,200 vacant rentable square feet. As of December 31, 2004, leases representing an aggregate of approximately 620,400 and 399,400 rentable square feet were scheduled to expire during 2005 and 2006, respectively, in this region. Of the 620,400 rentable square feet scheduled to expire in 2005, approximately 383,300, or 55% has either been renewed or re-leased as of the date of this report.

Sublease space. Of the Company s leased space at December 31, 2004, approximately 435,200 rentable square feet, or 3.5%, of the square footage in the Company s stabilized portfolio was available for sublease, as compared to 760,200 rentable square feet, or 6.2% at December 31, 2003. Of the 3.5% of available sublease space in the Company s stabilized portfolio as of December 31, 2004, approximately 3.0% was vacant space and the remaining 0.5% was occupied. Of the approximately 435,200 rentable square feet available for sublease at December 31, 2004, approximately 48,500 and 2,500 rentable square feet represents leases scheduled to expire during 2005 and 2006, respectively.

Negative trends or other events that impair the Company s ability to renew or release space and its ability to maintain or increase rental rates in its submarkets could have an adverse effect on the Company s future financial condition, results of operations and cash flows.

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Recent information regarding significant tenants The Boeing Company. As of December 31, 2004, the Company s largest tenant, The Boeing Company, leased an aggregate of approximately 831,300 rentable square feet of office space under seven separate leases, representing approximately 6.2% of the Company s total annual base rental revenues. In April 2004, the Boeing Company renewed one lease for a building located in El Segundo, encompassing approximately 286,200 rentable square feet, which was scheduled to expire in July 2004. Under the terms of the amended lease, the rental rate decreased 25% on a cash and GAAP basis and the lease is now scheduled to expire in July 2007. One lease encompassing approximately 211,100 rental square feet is scheduled to expire in December 2007; however, under the terms of the lease, The Boeing Company has the right to terminate this lease on December 31, 2006. The other five leases are scheduled to expire at various dates between August 2005 and March 2009. See discussion regarding the Company s third largest office tenant, Direct TV, Inc., under Rental rates.

Development and redevelopment programs. Management believes that a portion of the Company s potential growth over the next several years will continue to come from its development pipeline. During 2003 and 2002, the Company scaled back its development activity as result of the economic environment and its impact on the Company s ability to lease projects within budgeted timeframes. However, as San Diego County remains the strongest market in Southern California, the Company commenced construction in July 2004 on the third phase of its Innovation Corporate Center, which is located in the San Diego County I-15 Corridor submarket. The first two phases of the development project are 100% leased and encompass an aggregate of approximately 289,000 rentable square feet. The third phase will include two office buildings and will encompass an aggregate of approximately 103,000 rentable square feet and has a total estimated investment of approximately $23.0 million. The Company does not have any lease commitments for these buildings as of the date of this report. However, tenant demand in this submarket is currently strong, and management believes the prospects of leasing the project are also strong.

The Company also owns approximately 56.8 acres of undeveloped land upon which the Company currently expects to develop an aggregate of approximately 1.2 million rentable square feet of office space within the next three to five years. All of the Company s undeveloped land is located in San Diego County. See additional information regarding the Company s development portfolio under the caption Development and Redevelopment in this report.

Management believes that another source of the Company s potential growth over the next several years will come from redevelopment opportunities within its existing portfolio. Redevelopment efforts can achieve similar returns to new development with reduced entitlement risk and shorter construction periods. The Company s redevelopment portfolio includes one life science conversion project in North San Diego County and another project in which the Company performed extensive interior refurbishments at an office building in El Segundo that had been occupied by a single tenant for approximately 30 years. These projects, which encompass approximately 309,600 rentable square feet, were completed in 2004 and are expected to be added to the stabilized portfolio in the first and third quarters of 2005. As of December 31, 2004, the property in El Segundo was 19% leased and the property in North San Diego County had not been leased. See additional information regarding the Company s in-process redevelopment portfolio under the caption Development and Redevelopment in this report. Depending on market conditions, the Company will continue to pursue future redevelopment opportunities in its strategic submarkets where no land available for development exists.

The Company has a proactive planning process by which it continually evaluates the size, timing and scope of its development and redevelopment programs and, as necessary, scales activity to reflect the economic conditions and the real estate fundamentals that exist in the Company s strategic submarkets. However, the Company may be unable to lease committed development or redevelopment properties at expected rental rates or within projected timeframes or complete projects on schedule or within budgeted amounts, which could adversely affect the Company s financial condition, results of operations and cash flows.

Other Factors. The Company s operating results are and may continue to be affected by uncertainties and problems associated with the deregulation of the utility industry in California since 94.6% of the total rentable square footage of the Company s stabilized portfolio is located in California. Energy deregulation has resulted in

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higher utility costs in some areas of the state and intermittent service interruptions. In addition, primarily as a result of the events of September 11, 2001, the Company s annual insurance costs increased across its portfolio by approximately 14% during 2002, approximately 11% during 2003 and approximately 12% during 2004. As of the date of this report, the Company had not experienced any material negative effects arising from either of these issues.

Incentive Compensation. The Company has long-term incentive compensation programs that provide for cash and stock compensation to be earned by the Company s senior officers if the Company attains certain performance measures that are based on annualized shareholder returns on an absolute and a relative basis as well as certain other financial, operating and development targets. As a result, accrued incentive compensation in future periods is affected by the closing price per share of the Company s common stock at the end of each quarter. Future increases or decreases in the price per share of the Company s common stock and the resultant cumulative annualized shareholder return calculations will cause an increase or decrease to general and administrative expenses and a corresponding decrease or increase to net income available to common shareholders. Under the absolute component of a special long-term plan for the Company s executive officers, every $1 change in the Company s stock price equates to an approximate $1.7 million change in the total amount payable at the end of the three-year term of the plan (see Note 15 to the Company s consolidated financial statements for further discussion about the program). Management cannot predict the amounts that will be ultimately recorded in future periods related to these programs since they are significantly influenced by the Company s stock price and market conditions.

Results of Operations

As of December 31, 2004, the Company s stabilized portfolio was comprised of 84 office properties (the Office Properties) encompassing an aggregate of approximately 7.7 million rentable square feet, and 49 industrial properties (the Industrial Properties, and together with the Office Properties, the Properties), encompassing an aggregate of approximately 4.6 million rentable square feet. The Company s stabilized portfolio of operating properties consists of all the Company s Properties, and excludes properties recently developed or redeveloped by the Company that have not yet reached 95.0% occupancy and are within one year following substantial completion (lease-up properties) and projects currently under construction.

As of December 31, 2004, the Office and Industrial Properties represented approximately 84% and 16%, respectively, of the Company s annualized base rent. For the year ended December 31, 2004, average occupancy in the Company s stabilized portfolio was 92% compared to 91% for the year ended December 31, 2003. As of December 31, 2004, the Company had approximately 667,810 square feet of vacant space in its stabilized portfolio compared to 1,177,458 square feet as of December 31, 2003.

The following table reconciles the changes in the rentable square feet in the Company s stabilized portfolio of operating properties from December 31, 2003 to December 31, 2004. Rentable square footage in the Company s portfolio of stabilized properties increased by an aggregate of approximately 0.1 million rentable square feet, or 0.7%, to 12.3 million rentable square feet at December 31, 2004, as a result of the activity noted below.

	Office Properties		Industrial Properties		Total	
	Number of Buildings	Rentable Square Feet	Number of Buildings	Rentable Square Feet	Number of Buildings	Rentable Square Feet
Total at December 31, 2003	82	7,316,187	50	4,878,603	132	12,194,790

Acquisitions	2	281,830			2	281,830
Properties added from the Development Portfolio	1	208,464			1	208,464
Dispositions(1)	(1)	(125,020)	(1)	(277,037)	(2)	(402,057)
Remeasurement		(7,037)		1,039		(5,998)
Total at December 31, 2004(2)	84	7,674,424	49	4,602,605	133	12,277,029

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(1) In accordance with Financial Accounting Standards No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144) the operating results and gains or (losses) on property sales of real estate assets sold are included in discontinued operations in the consolidated statement of operations.

(2) Includes three office buildings and two industrial building the Company sold as of September 30, 2005, which encompassed approximately 419,000 rentable square feet.

Management internally evaluates the operating performance and financial results of its portfolio based on Net Operating Income for the following segments of commercial real estate property: Office Properties and Industrial Properties. The Company defines Net Operating Income as operating revenues from continuing operations (rental income, tenant reimbursements and other property income) less property and related expenses from continuing operations (property expenses, real estate taxes, provision for bad debts and ground leases). The Net Operating Income segment information presented within this Management s Discussion and Analysis consists of the same Net Operating Income segment information disclosed in Note 20 of the Company s consolidated financial statements in accordance with Statement of Financial Accounting Standards No. 131 Disclosures about Segments of an Enterprise and Related Information.

Year Ended December 31, 2004 Compared to Year Ended December 31, 2003

The following table reconciles the Company s Net Operating Income by segment to the Company s net income available to common stockholders for the years ended December 31, 2004 and 2003.

	Year Ended December 31,			
	2004	**2003**	**Dollar Change**	**Percentage Change**
		(in thousands)		
Net Operating Income, as defined				
Office Properties	$ 136,279	$ 141,393	$ (5,114)	(3.6)%
Industrial Properties	29,629	30,846	(1,217)	(3.9)
Total portfolio	165,908	172,239	(6,331)	(3.7)
Reconciliation to Net Income Available to Common Stockholders:				
Net Operating Income, as defined for reportable segments	165,908	172,239	(6,331)	(3.7)
Other expenses:				
General and administrative expenses	34,021	20,095	13,926	69.3
Interest expense	33,994	30,515	3,479	11.4
Depreciation and amortization	58,620	55,471	3,149	5.7
Total other income (expense)	727	(2,318)	3,045	(131.4)
Income from continuing operations before minority interests	40,000	63,840	(23,840)	(37.3)
Minority interests attributable to continuing operations	(13,997)	(20,641)	6,644	(32.2)
Income from discontinued operations	7,538	6,917	621	9.0
Net income	33,541	50,116	(16,575)	(33.1)
Preferred dividends	(3,553)	(349)	(3,204)	918.1
Net Income available to common stockholders	$ 29,988	$ 49,767	$ (19,779)	(39.7)%

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Rental Operations

Management evaluates the operations of its portfolio based on operating property type. The following tables compare the net operating income for the Office Properties and for the Industrial Properties for the years ended December 31, 2004 and 2003.

Office Properties

	Total Office Portfolio				Core Office Portfolio(1)			
	2004	2003	Dollar Change	Percentage Change	2004	2003	Dollar Change	Percentage Change
				(in thousands)				
Operating revenues:								
Rental income	$ 164,600	$ 145,226	$ 19,374	13.3%	$ 142,972	$ 133,326	$ 9,646	7.2%
Tenant reimbursements	17,626	16,194	1,432	8.8	16,714	15,577	1,137	7.3
Other property income	1,189	23,849	(22,660)	(95.0)	1,160	19,580	(18,420)	(94.1)
Total	183,415	185,269	(1,854)	(1.0)	160,846	168,483	(7,637)	(4.5)
Property and related expenses:								
Property expenses	31,439	28,888	2,551	8.8	27,806	27,067	739	2.7
Real estate taxes	13,482	12,448	1,034	8.3	11,459	11,524	(65)	(0.6)
Provision for bad debts	814	1,244	(430)	(34.6)	512	1,491	(979)	(65.7)
Ground leases	1,401	1,296	105	8.1	1,329	1,282	47	3.7
Total	47,136	43,876	3,260	7.4	41,106	41,364	(258)	(0.6)
Net Operating Income	$ 136,279	$ 141,393	$ (5,114)	(3.6)%	$ 119,740	$ 127,119	$ (7,379)	(5.8)%

(1) Office properties owned and stabilized at January 1, 2003 and still owned and stabilized at September 30, 2005.

Total revenues from Office Properties decreased $1.9 million, or 1.0%, to $183.4 million for the year ended December 31, 2004 compared to $185.3 million for the year ended December 31, 2003. Rental income from Office Properties increased $19.4 million, or 13.3%, to $164.6 million for the year ended December 31, 2004 compared to $145.2 million for the year ended December 31, 2003. Rental income generated by the Core Office Portfolio increased $9.6 million, or 7.2%, for the year ended December 31, 2004 compared to the year ended December 31, 2003. This increase is primarily due to an increase in occupancy in this portfolio. Average occupancy in the Core Office Portfolio increased 3.9% to 93.6% for the year ended December 31, 2004 compared to 89.7% for the same period in 2003. The remaining $9.8 million increase for the Office Properties was attributable to rental income generated by the office properties developed by the Company in 2003 and 2004 (the Office Development Properties).

Tenant reimbursements from Office Properties increased $1.4 million, or 8.8%, to $17.6 million for the year ended December 31, 2004 compared to $16.2 million for the year ended December 31, 2003. Tenant reimbursements generated by the Core Office Portfolio increased $1.1 million, or 7.3%, for the year ended December 31, 2004 compared to the year ended December 31, 2003. This increase is primarily attributable to the increase in occupancy in this Portfolio, as noted above. The remaining increase in tenant reimbursements is attributable to an increase of $0.5 million in the Office Development Properties partially offset by a decrease of $0.2 million attributable to the office properties that were

taken out of service and moved from the Company s stabilized portfolio to the redevelopment portfolio during the first quarter of 2003 and the second quarter of 2004 (the Office Redevelopment Properties).

Other property income from Office Properties decreased approximately $22.7 million to $1.2 million for the year ended December 31, 2004 compared to $23.9 million for the year ended December 31, 2003. Other property income for the year ended December 31, 2003 included an $18.0 million lease termination fee related to a settlement with Peregrine Systems Inc. In accordance with the settlement agreement approved by the bankruptcy court, the Company received an initial payment of $18.3 million from Peregrine in 2003 and $750,000 in 2004. The Company is scheduled to receive three additional payments of approximately $750,000 each to be paid

annually over the next three years. The future payments were recorded at their net present value which was approximately $2.6 million as of the date of the settlement. The lease termination fee of $18.0 represents the $18.3 million payment plus the $2.6 million net present value of the future payments, offset by $2.9 million in receivables and other costs and obligations associated with the leases. The future payments were reserved for financial reporting purposes at December 31, 2003 through the provision for bad debts. Other property income for the year ended December 31, 2003 also included a $4.3 million lease termination fee resulting from the early termination of leases at a building in San Diego, California. Other property income for the year ended December 31, 2004 included $1.9 million of other income related to a lease termination in 2001. The $1.9 million had previously been reserved for financial reporting purposes until certain contingencies associated with the lease termination had been resolved. This income was partially offset by a $1.8 million charge related to the settlement of outstanding litigation. The remaining balance in other property income for the year ended December 31, 2004 is mainly comprised of lease termination fees.

Total expenses from Office Properties increased $3.2 million, or 7.4%, to $47.1 million for the year ended December 31, 2004 compared to $43.9 million for the year ended December 31, 2003. Property expenses from Office Properties increased $2.5 million, or 8.8%, to $31.4 million for the year ended December 31, 2004 compared to $28.9 million for the year ended December 31, 2003. An increase of $0.7 million, or 2.7%, was generated by the Core Office Portfolio. This increase was primarily attributable to an increase in property management expenses, utilities and janitorial and other contract services due to the increase in occupancy. The remaining $1.8 million increase in property expenses is attributable to the Office Development Properties due to an increase in variable operating expenses related to the increase in occupancy in this portfolio. Real estate taxes increased $1.0 million, or 8.3%, to $13.5 million for the year ended December 31, 2004 as compared to $12.5 million for the same period in 2003. Real estate taxes for the Core Office Portfolio remained consistent at approximately $11.5 million during the year ended December 31, 2004 compared to the year ended December 31, 2003. The increase in property taxes was attributable to a $0.9 million increase in the Office Development Properties and a $0.1 million increase in the Office Redevelopment Properties. The provision for bad debts decreased $0.4 million, or 34.6%, for the year ended December 31, 2004 compared to the year ended December 31, 2003. The decrease was primarily due to a change in the provision related to the Company s leases with Peregrine and a general improvement in the Company s accounts receivable aging. The Company evaluates its reserve levels on a quarterly basis. Ground lease expense increased $0.1 million, or 8.1%, for the year ended December 31, 2004 compared to the same period in 2003.

Net Operating Income from Office Properties decreased $5.1 million, or 3.6%, to $136.3 million for the year ended December 31, 2004 compared to $141.4 million for the year ended December 31, 2003. Of this decrease, $7.4 million was attributable to the Core Office Portfolio and $5.2 million was attributable to the Office Redevelopment Properties, which was partially offset by an increase of $7.5 million attributable to the Office Development Properties. The overall decrease in Net Operating Income is primarily due to the significant lease termination fees received during 2003 related to the Peregrine settlement and another early lease termination.

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Industrial Properties

	Total Industrial Portfolio(1)			
	2004	2003	Dollar Change	Percentage Change
	(in thousands)			
Operating revenues:				
Rental income	$ 31,591	$ 32,120	$ (529)	(1.6)%
Tenant reimbursements	3,530	3,471	59	1.7
Other property income	13	149	(136)	(91.3)
Total	35,134	35,740	(606)	(1.7)
Property and related expenses:				
Property expenses	2,571	2,022	549	27.2
Real estate taxes	2,862	2,613	249	9.5
Provision for bad debts	72	259	(187)	(72.2)
Total	5,505	4,894	611	12.5
Net Operating Income	$ 29,629	$ 30,846	$ (1,217)	(3.9)%

(1) The Total Industrial Portfolio is equivalent to the Company s Core Industrial Portfolio at December 31, 2004, which represents properties owned and stabilized at January 1, 2003 and still owned and stabilized at September 30, 2005.

Total revenues from Industrial Properties decreased $0.6 million, or 1.7%, to $35.1 million for the year ended December 31, 2004 compared to $35.7 million for the year ended December 31, 2003. Rental income from Industrial Properties decreased $0.5 million, or 1.6%, to $31.6 million for the year ended December 31, 2004 compared to $32.1 million for the year ended December 31, 2003. This decrease was primarily due to a decline in occupancy in the Industrial Portfolio. Average occupancy in the Industrial Portfolio decreased 1.8% to 94.4% for the year ended December 31, 2004 compared to 96.2% for the year ended December 31, 2003.

Tenant reimbursements from Industrial Properties remained consistent at approximately $3.5 million during the year ended December 31, 2004 compared to the year ended December 31, 2003. Other property income from Industrial Properties decreased $0.1 million, or 91.3%, for the year ended December 31, 2004 compared to the same period in 2003. Other property income primarily includes amounts recorded in connection with lease terminations.

Total expenses from Industrial Properties increased $0.6 million, or 12.5%, to $5.5 million for the year ended December 31, 2004 compared to $4.9 million for the year ended December 31, 2003. Property expenses from Industrial Properties increased by $0.6 million, or 27.2%, to $2.6 million for the year ended December 31, 2004 compared to $2.0 million for the year ended December 31, 2003. This increase was primarily attributable to an increase in repairs and maintenance costs for the year ended December 31, 2004 compared to the same period in 2003. Real estate taxes for the Industrial Properties increased $0.2 million, or 9.5%, for the year ended December 31, 2004 compared to the year ended December 31, 2003. This increase was primarily due to refunds received during the year ended December 31, 2003 for real estate taxes that were successfully appealed by the Company. The provision for bad debts decreased $0.2 million, or 72.2%, for the year ended December 31, 2004 compared to the year ended December 31, 2003. During the year ended December 31, 2004 the Company s reserve requirement decreased due to

the collection of previously reserved receivables. The Company evaluates its reserve levels on a quarterly basis.

Net Operating Income from Industrial Properties decreased $1.2 million, or 3.9%, to $29.6 million for the year ended December 31, 2004 compared to $30.8 million for the year ended December 31, 2003.

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Non-Property Related Income and Expenses

General and administrative expenses increased $13.9 million, or 69.3%, to $34.0 million for the year ended December 31, 2004 compared to $20.1 million for the year ended December 31, 2003. The increase is primarily due to a $13.3 million increase in accrued incentive compensation and was driven by a special long-term incentive plan for the Company s executive officers for which the amount payable under the plan is based on the Company s absolute and relative shareholder returns (see Note 15 to the Company s consolidated financial statements for further discussion about the program). Compensation expense under this program is accounted for using variable plan accounting. The Company estimates the amount to be paid based on the Company s quoted closing stock price at the end of each period, and records compensation expense equal to that portion of the total compensation applicable to the portion of the performance period that has elapsed through the end of the period. The closing price per share for the Company s common stock as of December 31, 2004 was $42.75 as compared to $32.75 as of December 31, 2003. The amounts recorded in future periods related to this plan will increase or decrease as the Company s quoted price per share of the Company s common stock at the end of each period increases or decreases.

Net interest expense increased $3.5 million, or 11.4%, to $34.0 million for the year ended December 31, 2004 compared to $30.5 million for the year ended December 31, 2003. Gross interest and loan fee expense, before the effect of capitalized interest and loan fees, increased $0.5 million, or 1.2% to $41.2 million for the year ended December 31, 2004 from $41.2 million for the year ended December 31, 2003. Total capitalized interest and loan fees decreased $3.0 million, or 28.0% to $7.7 million for the year ended December 31, 2004 from $10.7 million for the year ended December 31, 2003, primarily due to lower average balances eligible for capitalization during the year ended December 31, 2004 as compared to December 31, 2003.

Depreciation and amortization increased $3.1 million, or 5.7%, to $58.6 million for the year ended December 31, 2004 compared to $55.5 million for the year ended December 31, 2003. An increase of $3.1 million was attributable to the Office Development Properties, and an increase of $0.6 million was attributable to the Core Office Portfolio which was partially offset by a decrease of $0.6 million related to the Office Redevelopment Properties taken out of service in 2003.

Other income and expense changed $3.0 million, or 131.4%, to $0.7 million of income for the year ended December 31, 2004 compared to $2.3 million of expense for the year ended December 31, 2003. The increasing income was primarily due to a $2.3 million increase in value of the Company s derivative instruments as a result of increasing interest rates. The increase in income was also due to a $0.3 million increase in interest and other income. This increase was primarily due to a $0.1 million net realized gain from the sale of stock that the Company received in satisfaction of a creditors claim under a lease that was terminated early. Additionally, during the year ended December 31, 2004, the Company recorded $0.1 million in non-recurring interest earned in connection with the reimbursement of prior year supplemental property taxes.

Income from Continuing Operations

Income from continuing operations before minority interests decreased $23.8 million, or 37.3%, to $40.0 million for the year ended December 31, 2004 compared to $63.8 million for the year ended December 31, 2003. The decrease was primarily due to the decrease in Net Operating Income from the Office Properties due to the 2003 Peregrine settlement and due to the increase in general and administrative expenses.

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Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

The following table reconciles the Company s Net Operating Income by segment to the Company s net income available to common stockholders for the years ended December 31, 2003 and 2002.

	Year Ended December 31,			
	2003	2002	Dollar Change	Percentage Change
	(dollars in thousands)			
Net Operating Income, as defined				
Office Properties	$ 141,393	$ 117,241	$ 24,152	20.6%
Industrial Properties	30,846	29,703	1,143	3.8
Total portfolio	172,239	146,944	25,295	17.2
Reconciliation to Net Income Available to Common Stockholders:				
Net Operating Income, as defined for reportable segments	172,239	146,944	25,295	17.2
Other expenses:				
General and administrative expenses	20,095	12,902	7,193	55.8
Interest expense	30,515	30,629	(114)	(0.4)
Depreciation and amortization	55,471	57,750	(2,279)	(3.9)
Total other income (expense)	(2,318)	(6,550)	4,232	(64.6)
Income from continuing operations before net gain on dispositions and minority interests	63,840	39,113	24,727	63.2
Net gain on disposition of operating properties(1)		896	(896)	(100.0)
Income from continuing operations before minority interests	63,840	40,009	23,831	59.6
Minority interests	(20,641)	(14,330)	(6,311)	44.0
Income from discontinued operations	6,917	12,755	(5,838)	(45.8)
Net income	50,116	38,434	11,682	30.4
Preferred dividends	(349)		(349)	(100.0)
Net Income available to common stockholders	$ 49,767	$ 38,434	$ 11,333	29.5%

(1) In accordance with SFAS 144 Accounting for the Impairment or Disposal of Long-Lived Assets, the net income and the net gain on disposition of properties sold subsequent to December 31, 2001 are reflected in the consolidated statements of operations as discontinued operations for all periods presented. The net gain on dispositions of operating properties for the year ended December 31, 2002 relates to the disposition of an office property the Company sold in the fourth quarter of 2001. This additional gain had previously been reserved for financial reporting purposes until certain associated litigation was resolved in the second quarter of 2002.

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Rental Operations

Management evaluates the operations of its portfolio based on operating property type. The following tables compare the Net Operating Income from continuing operations, for the Office Properties and for the Industrial Properties for the years ended December 31, 2003 and 2002.

Office Properties

	Total Office Portfolio				Core Office Portfolio(1)			
	2003	2002	Dollar Change	Percentage Change	2003	2002	Dollar Change	Percentage Change
	(dollars in thousands)							
Operating revenues:								
Rental income	145,226	141,740	3,486	2.5%	123,731	126,877	(3,146)	(2.5)%
Tenant reimbursements	16,194	17,359	(1,165)	(6.7)	14,616	14,602	14	0.1
Other property income	23,849	2,583	21,266	823.3	19,581	2,477	17,104	690.5
Total	185,269	161,682	23,587	14.6	157,928	143,956	13,972	9.7
Property and related expenses:								
Property expenses	28,888	25,615	3,273	12.8	26,487	23,102	3,385	14.7
Real estate taxes	12,448	11,727	721	6.1	10,588	10,475	113	1.1
Provision for bad debts	1,244	5,745	(4,501)	(78.3)	142	5,485	(5,343)	(97.4)
Ground leases	1,296	1,354	(58)	(4.3)	1,282	1,334	(52)	(3.9)
Total	43,876	44,441	(565)	(1.3)	38,499	40,396	(1,897)	(4.7)
Net Operating Income	141,393	117,241	24,152	20.6%	119,429	103,560	15,869	15.3%

(1) Stabilized office properties owned at January 1, 2002 and still owned and stabilized at September 30, 2005.

Total revenues from Office Properties increased $23.6 million, or 14.6%, to $185.3 million for the year ended December 31, 2003 compared to $161.7 million for the year ended December 31, 2002. Rental income from Office Properties increased $3.5 million, or 2.5%, to $145.2 million for the year ended December 31, 2003 compared to $141.7 million for the year ended December 31, 2002. This increase was primarily attributable to an increase of $10.8 million in rental income generated by the office properties developed and redeveloped by the Company in 2003 and 2002 (the Office Development Properties), offset by a decrease of $3.1 million, or 2.5% related to the Core Office Portfolio, and a decrease of $4.2 million in rental income attributable to the office properties that were taken out of service and moved from the Company s stabilized portfolio to the redevelopment portfolio during 2003 (Office Redevelopment Properties). The decrease in the Core Office Portfolio was primarily attributable to a decline in occupancy in this portfolio. Average occupancy in the Core Office Portfolio declined 1.3% to 89.4% for the year ended December 31, 2003 as compared to 90.7% for the year ended December 31, 2002.

Tenant reimbursements from Office Properties decreased $1.2 million, or 6.7%, to $16.2 million for the year ended December 31, 2003 compared to $17.4 million for the year ended December 31, 2002. A decrease of $1.4 million attributable to the Office Redevelopment Properties was partially offset by an increase of $0.2 million attributable to the Office Development Properties. Tenant reimbursements generated by the Core Office Portfolio remained consistent at $14.6 million for the year ended December 31, 2003 compared to the same period in 2002. Other property income from Office Properties increased $21.3 million, or 823.3%, to $23.9 million for the year ended December 31, 2003 compared to $2.6 million for the year ended December 31, 2002. Other property income for the year ended December 31, 2003, included an $18.0 million lease termination fee related to a

settlement with Peregrine Systems, Inc. In accordance with the settlement agreement approved by the bankruptcy court, the Company received a payment of $18.3 million in 2003 and was scheduled to receive four additional payments of approximately $750,000 each to be paid annually over the next four years. The future payments were recorded at their net present value which was approximately $2.6 million. The lease termination fee of $18.0 represents the $18.3 million payment plus the $2.6 million net present value of the future payments, offset by $2.9 million in receivables and other costs and obligations associated with the leases. The future payments were reserved for financial reporting purposes at December 31, 2003 through the provision for bad debts. Also during the year ended December 31, 2003, the Company recognized a $4.3 million net lease termination fee resulting from the early termination of leases at a building in San Diego. The remaining amounts in other property income from Office Properties for both periods consisted primarily of lease termination fees, management fees and tenant late charges.

Total expenses for Office Properties decreased $0.6 million, or 1.3%, to $43.9 million for the year ended December 31, 2003 compared to $44.5 million for the year ended December 31, 2002. Property expenses from Office Properties increased $3.3 million, or 12.8%, to $28.9 million for the year ended December 31, 2003 compared to $25.6 million for the year ended December 31, 2002. This increase was primarily attributable to higher repairs and maintenance in the Core Office Portfolio, which was due to non-recurring expenditures at one complex of buildings. Real estate taxes increased $0.7 million, or 6.1%, to $12.4 million for the year ended December 31, 2003 as compared to $11.7 million for the year ended December 31, 2002. Real estate taxes for the Core Office Portfolio increased $0.1 million, or 1.1%, for the year ended December 31, 2003 compared to the same period in 2002. Of the remaining increase of $0.6 million in real estate taxes, an increase of $1.2 million attributable to the Office Development Properties was partially offset by a decrease of $0.6, million attributable to the Office Redevelopment Properties. The provision for bad debts decreased $4.5 million, or 78.3%, for the year ended December 31, 2003 as compared to the year ended December 31, 2002. The decrease was primarily due to a change in the provision related to the Company s leases with Peregrine. For the year ended December 31, 2003, the Company recorded a provision of approximately $2.6 million related to the future settlement payments to be received from Peregrine, and reversed a provision for bad debts and unbilled deferred rents receivable of approximately $3.1 million related to the Company s leases with Peregrine as a result of the settlement with Peregrine in July 2003. During 2002, the Company recorded a provision for bad debts and unbilled deferred rents receivable of approximately $3.8 million specifically related to receivables from Peregrine. The remaining decrease is due to an improvement in the Company s accounts receivable aging and collections of outstanding tenant receivables during 2003. The Company evaluates its reserve for unbilled deferred rent and tenant receivables on a quarterly basis. Ground lease expense decreased $0.1 million, or 4.3%, for the year ended December 31, 2003 compared to the same period in 2002.

Net Operating Income from Office Properties increased $24.2 million, or 20.6%, to $141.4 million for the year ended December 31, 2003 compared to $117.2 million for the year ended December 31, 2002. An increase of $15.9 million was attributable to the Core Office Portfolio which was primarily due to the Peregrine lease termination fee. The remaining increase of $8.3 million was primarily attributable to the Office Development Properties.

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Industrial Properties

	Total Industrial Portfolio				Core Industrial Portfolio(1)			
	2003	2002	Dollar Change	Percentage Change	2003	2002	Dollar Change	Percentage Change
				(dollars in thousands)				
Operating revenues:								
Rental income	$ 32,120	$ 32,191	$ (71)	(0.2)%	$ 31,487	$ 31,896	$ (409)	(1.3)%
Tenant reimbursements	3,471	3,495	(24)	(0.7)	3,440	3,465	(25)	(0.7)
Other property income	149	89	60	67.4	149	89	60	67.4
Total	35,740	35,775	(35)	(0.1)	35,076	35,450	(374)	(1.1)
Property and related expenses:								
Property expenses	2,022	2,392	(370)	(15.5)	1,998	2,392	(394)	(16.5)
Real estate taxes	2,613	2,713	(100)	(3.7)	2,533	2,677	(144)	(5.4)
Provision for bad debts	259	967	(708)	(73.2)	236	964	(728)	(75.5)
Total	4,894	6,072	(1,178)	(19.4)	4,767	6,033	(1,266)	(21.0)
Net Operating Income	$ 30,846	$ 29,703	$ 1,143	3.8%	$ 30,309	$ 29,417	$ 892	3.0%

(1) Stabilized industrial properties owned at January 1, 2002 and still owned at September 30, 2005.

Total revenues from Industrial Properties remained consistent at approximately $35.7 million during the year ended December 31, 2003 compared to the year ended December 31, 2002. Rental income from Industrial Properties decreased $0.1 million, or 0.2%, to $32.1 million for the year ended December 31, 2003 compared to $32.2 million for the year ended December 31, 2002. Rental income generated by the Core Industrial Portfolio decreased $0.4 million, or 1.3%, for the year ended December 31, 2003 as compared to the year ended December 31, 2002. This decrease was primarily attributable to a decrease in occupancy in this portfolio. Average occupancy decreased 1.3% to 96.2% for the year ended December 31, 2003 compared to 97.5% for the year ended December 31, 2002. The net decrease in rental income from the Core Industrial Portfolio was partially offset by an increase of $0.3 million from the one property acquired during 2002 (Industrial Acquisition).

Tenant reimbursements from Industrial Properties remained consistent at approximately $3.5 million during the year ended December 31, 2003 compared to the year ended December 31, 2002. Other property income from Industrial Properties increased $0.1 million for the year ended December 31, 2003 which was attributable to lease termination fees in the Core Industrial Portfolio. Other income for both periods is primarily comprised of lease termination fees and tenant late charges.

Total expenses from Industrial Properties decreased $1.2 million, or 19.4%, to $4.9 million for the year ended December 31, 2003 compared to $6.1 million for the year ended December 31, 2002. Property expenses from Industrial Properties decreased $0.4 million, or 15.5%, for the year ended December 31, 2003 compared to the year ended December 31, 2002. This decrease was primarily attributable to lower repairs and maintenance costs in the Core Industrial Portfolio for the year ended December 31, 2003 compared to the same period in 2002. Real estate taxes decreased $0.1 million, or 3.7%, for the year ended December 31, 2003 compared to the year ended December 31, 2002. This decrease was attributable to the refunds received for real estate taxes successfully appealed by the Company in 2003 at buildings in the Core Industrial Portfolio. The provision for bad debts decreased $0.7 million, or 73.2%, for the year ended December 31, 2003 compared to the same period in 2002. During the year ended December 31, 2003, the Company decreased its reserve for bad debts and unbilled deferred rent specifically related

to the Company s watchlist tenants due to improvement in the collection of tenant receivables. The Company evaluates its reserve levels on a quarterly basis.

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Net Operating Income, from Industrial Properties increased $1.1 million, or 3.8%, for the year ended December 31, 2003 compared to the year ended December 31, 2002. Net operating income for the Core Industrial Portfolio increased $0.9 million, or 3.0%, for the year ended December 31, 2003 compared to the same period in 2002 and an increase of $0.2 million was generated by the Industrial Acquisition.

Non-Property Related Income and Expenses

General and administrative expenses increased $7.2 million, or 55.8%, to $20.1 million for the year ended December 31, 2003 compared to $12.9 million for the year ended December 31, 2002. This increase was primarily due to a $7.1 million increase in accrued incentive compensation and was driven by a special long-term incentive plan for the Company s executive officers for which the amount payable under the plan is based on the Company s absolute and relative shareholder returns. (See note 15 to the Company s consolidated financial statements for further discussion about the program.) Compensation expense under this program is accounted for using variable plan accounting. The Company estimates the amount to be paid based on the Company s quoted closing stock price at the end of each period, and records compensation expense equal to that portion of the total compensation applicable to the portion of the performance period that has elapsed through the end of the period. The closing price per share for the Company s common stock as of December 31, 2003 was $32.75 as compared to the initial stock price of $21.19 at plan inception. The amounts recorded in future periods related to this plan will increase or decrease as the Company s quoted price per share of the Company s common stock at the end of the period increases or decreases.

The increase in general and administrative expenses was also due to higher legal, reporting and public company costs incurred in connection with compliance with new requirements imposed by the Sarbanes-Oxley Act of 2002 and the New York Stock Exchange. The increases in general and administrative expenses were partially offset by the reversal of a $0.5 million reserve in connection with the Peregrine settlement agreement. The Company had initially recorded this reserve in the second quarter of 2002 for costs the Company paid for the fifth and final building that was to be leased to Peregrine. This building was surrendered to the Company in June 2002.

Net interest expense decreased $0.1 million, or 0.4%, to $30.5 million for the year ended December 31, 2003 compared to $30.6 million for the year ended December 31, 2002. Gross interest and loan fee expense, before the effect of capitalized interest and loan fees, decreased $1.4 million, or 3.1%, to $41.2 million for the year ended December 31, 2003 from $42.6 million for the year ended December 31, 2002, due to an overall decrease in the Company s weighted average annual borrowing rates. Throughout 2002, the Company s weighted average interest rate decreased from 6.8% at December 31, 2001 to 5.3% at December 31, 2002. In contrast, the Company s weighted average interest rate remained relatively consistent throughout 2003. The Company s weighted average interest rate was 5.3% at both January 1, 2003 and December 31, 2003. Total capitalized interest and loan fees decreased $1.2 million, or 10.3% to $10.7 million for the year ended December 31, 2003 from $11.9 million for the year ended December 31, 2002, primarily due to lower average balances eligible for capitalization during the year ended December 31, 2003 as compared to December 31, 2002.

Depreciation and amortization decreased $2.3 million, or 3.9%, to $55.5 million for the year ended December 31, 2003 compared to $57.8 million for the year ended December 31, 2002. During the year ended December 31, 2002 the Company recorded accelerated depreciation and amortization charges of approximately $5.3 million for previously capitalized leasing costs related to the Company s leases with Peregrine. The Company did not record a similar charge in 2003. This decrease was partially offset by an increase attributable to the development properties completed and stabilized since December 31, 2002.

Other income and expense changed $4.2 million, or 64.6%, to $2.3 million of expense for the year ended December 31, 2003 compared to $6.6 million of expense for the year ended December 31, 2002. The decreasing expense was primarily due to a $3.6 million decrease in cash settlement payments on interest rate swaps as a result of a change in the composition of the Company s derivative instruments. The Company had two interest rate swap agreements, each with a notional amount of $150 million, with fixed swap rates of 6.948% and 5.48%

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that expired in February 2002 and November 2002, respectively. The Company entered into new swap agreements, which had an aggregate notional amount of $100 million, in October and December 2002 to replace these swaps which had a weighted average fixed swap rate of 2.78%. The replacement swaps expire in 2005 and 2006.

Income from Continuing Operations

Income from continuing operations before net gains on dispositions and minority interests increased $24.7 million, or 63.2%, to $63.8 million for the year ended December 31, 2003 compared to $39.1 million for the year ended December 31, 2002. The increase was primarily due to the increase in Net Operating Income from the Office Properties of $24.1 million.

Building and Lease Information

The following tables set forth certain information regarding the Company s Office and Industrial Properties at December 31, 2004:

Occupancy by Segment Type

Region	Number of Buildings	Square Feet Total	Occupancy
Office Properties:			
Los Angeles	26	2,872,925	91.1%
Orange County	7	387,327	97.4
San Diego	43	3,535,212	97.1
Other	8	878,960	89.7
	84	7,674,424	94.0
Industrial Properties:			
Los Angeles	4	388,805	53.0
Orange County	43	3,918,383	99.4
Other	2	295,417	100.0
	49	4,602,605	95.5
Total portfolio	133	12,277,029	94.6%

Leasing Activity by Segment Type

For the year ended December 31, 2004

	Number of Leases(1)		Rentable Square Feet					
	New	Renewal	New(1)	Renewal	Changes in Rents(2)	Changes in Cash Rents(3)	Retention Rates(4)	Weighted Average Lease Term (in months)
Office Properties	66	36	630,505	728,802	(7.9)%	(9.4)%	87.0%	70
Industrial Properties	6	11	186,474	356,083	0.6%	(8.4)%	73.5%	50
Total portfolio	72	47	816,979	1,084,885	(6.9)%	(9.2)%	82.0%	64

(1) Represents leasing activity for leases commencing during the period shown, including first and second generation space, net of month-to-month leases. Excludes leasing on new construction.

(2) Calculated as the change between GAAP rents for new/renewed leases and the expiring GAAP rents for the same space. Excludes leases for which the space was vacant longer than one year.

(3) Calculated as the change between stated rents for new/renewed leases and the expiring stated rents for the same space. Excludes leases for which the space was vacant longer than one year. The change in cash rents for two of the leases was calculated using the leases stabilized stated rent. The starting rents for these two leases were discounted for the first six months.

(4) Calculated as the percentage of space either renewed or expanded into by existing tenants at lease expiration.

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Liquidity and Capital Resources

Current Sources of Capital and Liquidity

The Company seeks to create and maintain a capital structure that allows for financial flexibility and diversification of capital resources. The Company s primary source of liquidity to fund distributions, debt service, leasing costs and capital expenditures is net cash from operations. The Company s primary sources of liquidity to fund development and redevelopment costs, potential undeveloped land and property acquisitions, temporary working capital and unanticipated cash needs are the Company s $425 million unsecured revolving line of credit, proceeds received from the Company s disposition program and construction loans. As of December 31, 2004 and 2003, the Company s total debt as a percentage of total market capitalization was 33.5% and 38.5%, respectively. As of December 31, 2004 and 2003 the Company s total debt plus preferred equity as a percentage of total market capitalization was 41.9% and 46.6%, respectively.

As of December 31, 2004, the Company had borrowings of $167 million outstanding under its unsecured revolving line of credit (the Credit Facility) and availability of $258 million. The Credit Facility bears interest at an annual rate between LIBOR plus 1.00% and LIBOR plus 1.70% (3.50% at December 31, 2004), depending upon the Company s leverage ratio at the time of borrowing, and matures in October 2007 with the option to extend the maturity for one year. The fee for unused funds ranges from an annual rate of 0.20% to 0.30% depending on the Company s leverage ratio. The Company expects to use the Credit Facility to finance development and redevelopment expenditures, to fund potential acquisitions and for other general corporate uses.

The Company also has the ability to issue up to an additional $187 million of equity securities under a currently effective shelf registration statement.

Factors That May Influence Future Sources of Capital and Liquidity

The Company s Credit Facility, unsecured senior notes, and certain other secured debt agreements contain covenants and restrictions requiring the Company to meet certain financial ratios and reporting requirements. Some of the more restrictive covenants include a maximum total debt to total assets ratio, a maximum total secured debt to total assets ratio, minimum debt service coverage and fixed charge coverage ratios, a minimum consolidated tangible net worth and a limit of development activities as compared to total assets. Non-compliance with one or more of the covenants and restrictions could result in the full or partial principal balance of the associated debt becoming immediately due and payable. The Company was in compliance with all its debt covenants at December 31, 2004.

The composition of the Company s aggregate debt balances at December 31, 2004 and 2003 were as follows:

	Percentage of Total Debt		Weighted Average Interest Rate	
	December 31, 2004	December 31, 2003	December 31, 2004	December 31, 2003

Secured vs. unsecured:				
Secured	61.2%	69.1%	5.7%	5.8%
Unsecured	38.8	30.9	5.2	4.2
Fixed-rate vs. variable rate:				
Fixed rate(1)(2)(3)(4)	90.4(6)	72.6	5.7	6.3
Variable rate(5)	9.6%	27.4%	3.5	2.8
Total debt			5.5	5.3
Total debt including loan fees			6.1%	5.9%

(1) Although the Company s derivative instruments do not qualify for hedge accounting since the original designation memos did not meet the technical requirements of SFAS 133, the Company s derivatives are intended to manage the Company s exposure to interest rate risk.

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The Company does not enter into derivatives for speculative purposes. Since the Company believes the derivatives are highly effective in offsetting the variable rate cash flows of its debt from an economic perspective, the effect of these derivative instruments are taken into account in evaluating the overall composition of the fixed versus floating nature of the Company s debt instruments on the table above.

(2) At December 31, 2004 and 2003, the Company had an interest-rate swap agreement, which expired in January 2005, to fix LIBOR on $50 million of its variable rate debt at 4.46%.

(3) At December 31, 2004 and 2003, the Company had an interest-rate swap agreement, which expires in November 2005, to fix LIBOR on $50 million of its variable rate debt at 2.57%.

(4) At December 31, 2004 and 2003, the Company had two interest-rate swap agreements, which expire in December 2006, to fix LIBOR on $50 million of its variable rate debt at 2.98%.

(5) At December 31, 2003, the Company had interest-rate cap agreements to cap LIBOR on $100 million of its variable rate debt at 4.25%. These agreements were terminated in June 2004.

(6) Excluding the $50 million interest-rate swap agreement that expired in January 2005, the Company s fixed-rate debt as a percentage of total debt was 84.2% at December 31, 2004.

The percentage of fixed rate debt to total debt at December 31, 2003 does not take into consideration the portion of variable-rate debt capped by the Company s interest-rate cap agreements. Including the effects of the interest-rate cap agreements, the Company had fixed or capped approximately 85.7% of its total outstanding debt at December 31, 2003. The Company did not have any outstanding interest-rate cap agreements as of December 31, 2004.

At December 31, 2004, 28.3% of the Company s total debt, before the effect of derivative instruments, required interest payments based on LIBOR rates. During 2004, one-month LIBOR increased from 1.12% at January 2, 2004 to 2.40% at December 31, 2004. Although the interest payments on 90.4% of the Company s debt are either fixed, or economically hedged through the employment of interest-rate swap agreements at December 31, 2004, the remaining 9.6% of the Company s debt is exposed to fluctuations of the one-month LIBOR rate. In addition, one of the Company s interest rate swap agreements expired in January 2005. This agreement had a $50 million notional amount and after its expiration, the Company s fixed rate debt as a percentage of total debt would have been 84.2% at December 31, 2004. The Company cannot provide assurance that it will be able to replace its interest-rate swap agreements as they expire and, therefore, the Company could be exposed to rising interest rates in the future.

The following table lists the derivative financial instruments held by the Company as of December 31, 2004 and 2003:

Type of Instrument	Rate	Expiration Date	Notional Amount of Outstanding Instruments at December 31, 2004	2003
			(000 s)	
Cap	4.25%	1/2005(1)	$	$ 50,000
Cap	4.25%	1/2005(1)		50,000
Swap	4.46%	1/2005	50,000	50,000

Swap	2.57%	11/2005	50,000	50,000
Swap	2.98%	12/2006	25,000	25,000
Swap	2.98%	12/2006	25,000	25,000
			$ 150,000	$ 250,000

(1) The interest-rate cap agreements were terminated in June 2004.

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Following is the Company s total market capitalization as of December 31, 2004:

	Shares/Units at December 31, 2004	Aggregate Principal Amount or $ Value Equivalent	% of Total Market Capitalization
		(000 s)	
Debt:			
Secured debt		$ 490,441	20.5%
Unsecured senior notes		144,000	6.0
Unsecured line of credit		167,000	7.0
Total debt		$ 801,441	33.5
Equity:			
7.450% Series A Cumulative Redeemable Preferred Units(1)	1,500,000	$ 75,000	3.1
7.800% Series E Cumulative Redeemable Preferred Stock(2)	1,610,000	40,250	1.7
7.500% Series F Cumulative Redeemable Preferred Stock(2)	3,450,000	86,250	3.6
Common Units Outstanding(3)	3,989,142	170,536	7.1
Common Shares Outstanding(3)	28,548,597	1,220,453	51.0
Total equity		$ 1,592,489	66.5
Total Market Capitalization		$ 2,393,930	100.0%

(1) Value based on $50.00 per share liquidation preference.

(2) Value based on $25.00 per share liquidation preference.

(3) Value based on closing share price of $42.75 at December 31, 2004.

Contractual Obligations

The following table provides information with respect to the maturities and scheduled principal repayments of the Company s secured debt, unsecured senior notes and Credit Facility and scheduled interest payments of the Company s fixed-rate debt and interest-rate swap agreements at December 31, 2004 and provides information about the minimum commitments due in connection with the Company s ground lease obligations and capital commitments at December 31, 2004. The table does not reflect available maturity extension options.

	Payment Due by Period				
	Less than 1 Year	1 3 Years (2006-2007)	3 5 Years (2008-2009)	More than 5 Years	Total

	(2005)			(After 2009)	
			(in thousands)		
Principal payments secured debt	$ 49,233	$ 42,734	$ 195,701	$ 202,773	$ 490,441
Principal payments Credit Facility(1)		167,000			167,000
Principal payments unsecured senior notes				144,000	144,000
Interest payments fixed-rate debt(2)	34,580	64,954	52,789	62,692	215,015
Interest payments interest rate swaps(2)(3)	2,743	1,444			4,187
Ground lease obligations(4)	1,606	3,218	3,207	75,073	83,104
Capital commitments(5)	13,601				13,601
Total	$ 101,763	$ 279,350	$ 251,697	$ 484,538	$ 1,117,348

(1) The Credit Facility has a one-year extension option.

(2) As of December 31, 2004, 90.4% of the Company s debt was contractually fixed or constructively fixed through interest-rate swap agreements. The information in the table above reflects the Company s projected interest rate obligations for these fixed-rate payments

based on the contractual interest rates, interest payment dates and scheduled maturity dates. The remaining 9.6% of the Company s debt bears interest at variable rates and the variable interest rate payments are based on LIBOR plus a spread that ranges from 1.00% to 1.70%. In addition, one of the Company s interest rate swap agreements expired in January 2005. This agreement had a $50 million notional amount and after its expiration, the Company s fixed-rate debt as a percentage of total debt would have been 84.2% at December 31, 2004. The interest payments on the Company s variable-rate debt have not been reported in the table above because management cannot reasonably determine the future interest obligations on its variable-rate debt as management cannot predict what LIBOR rates will be in the future. As of December 31, 2004, one-month LIBOR was 2.40%. See additional information regarding the Company s debt and derivative instruments under Item 7A: Quantitative and Qualitative Disclosures about Market Risk.

(3) Represents the scheduled interest payments for the Company s total outstanding interest-rate swap agreements as of December 31, 2004, based on the contractual interest rates, interest payment dates and maturity dates. The interest payments are reported at the gross amount and do not reflect the variable payment to be received from the counterparty and the offsetting variable interest to be paid on the associated debt. The Company employs derivative instruments to minimize the variability that changes in interest rates could have on its future cash flows and does not hold interest-rate swaps for speculative purposes. These instruments effectively convert a portion of the Company s variable-rate debt to fixed-rate debt. The Company had interest-rate swap agreements with a total notional amount of $150 million as of December 31, 2004.

(4) The Company has noncancelable ground lease obligations for the SeaTac Office Center in Seattle, Washington expiring in December 2032, with an option to extend the lease for an additional 30 years; and Kilroy Airport Center in Long Beach, California with a lease period for Phases I, II, III and IV expiring in July 2084.

(5) Amounts represent commitments under signed leases and contracts for operating properties, excluding amounts for leasehold improvements that are reimbursed by tenants. See further discussion of projected amounts the Company estimates it could spend on development projects under the caption Capital Commitments below.

Capital Commitments

As of December 31, 2004, the Company had two development projects and two redevelopment projects that were either in lease-up or under construction. These projects have a total estimated investment of approximately $111 million. The Company has incurred an aggregate of approximately $77 million on these projects as of December 31, 2004, and currently projects it could, but is not committed to, spend approximately $30 million of the remaining $34 million of presently budgeted development costs during 2005, depending on leasing activity. In addition, the Company had one development project and one redevelopment project that were added to the Company s stabilized portfolio of operating properties in 2003, which had not yet reached stabilized occupancy as of December 31, 2004. Depending on leasing activity, the Company currently projects it could spend approximately $5 million for these projects during 2005. The Company also estimates it could spend an additional $40 million on other development projects in 2005, depending upon market conditions. See additional information regarding the Company s in-process development and redevelopment portfolio under the caption Development and Redevelopment Programs in this report.

As of December 31, 2004, the Company had executed leases that committed the Company to approximately $13 million in unpaid leasing costs and tenant improvements and the Company had contracts outstanding for approximately $1 million in capital improvements at December 31, 2004. In addition, for 2005, the Company plans to spend approximately $16 million to $18 million in capital improvements, tenant improvements, and leasing costs for properties within the Company s stabilized portfolio, depending on leasing activity. Capital expenditures may fluctuate in any given period subject to the nature, extent and timing of improvements required to maintain the Company s properties. Tenant improvements and leasing costs may also fluctuate in any given period depending upon factors such as the type of property, the term of the lease, the type of lease, the involvement of external leasing agents and overall market conditions.

Other Liquidity Needs

The Company is required to distribute 90% of its REIT taxable income (excluding capital gains) on an annual basis in order to qualify as a REIT for federal income tax purposes. Accordingly, the Company intends to continue to make, but has not contractually bound itself to make, regular

quarterly distributions to common stockholders and common unitholders from cash flow from operating activities. All such distributions are at the discretion of the Board of Directors. The Company may be required to use borrowings under the Credit Facility, if necessary, to meet REIT distribution requirements and maintain its REIT status. The Company has historically

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distributed amounts in excess of its taxable income resulting in a return of capital to its stockholders, and currently has the ability to not increase its distributions to meet its REIT requirements for 2005. The Company considers market factors and Company performance in addition to REIT requirements in determining its distribution levels. Amounts accumulated for distribution to stockholders are invested primarily in interest-bearing accounts and short-term interest-bearing securities, which are consistent with the Company s intention to maintain its qualification as a REIT. Such investments may include, for example, obligations of the Government National Mortgage Association, other governmental agency securities, certificates of deposit and interest-bearing bank deposits. On January 18, 2005, the Company paid a regular quarterly cash dividend of $0.495 per common share to stockholders of record on December 31, 2004. This dividend is equivalent to an annual rate of $1.98 per share. In addition, the Company is required to make quarterly distributions to its Series A Preferred Unitholders and Series E and Series F Preferred Stockholders, which in aggregate total approximately $15 million of annualized preferred dividends and distributions.

The Company s Board of Directors has approved a share repurchase program, pursuant to which the Company is authorized to repurchase up to an aggregate of four million shares of its outstanding common stock. An aggregate of 1,227,500 shares currently remain eligible for repurchase under this program. The Company may opt to repurchase shares of its common stock in the future depending upon market conditions. The Company did not repurchase shares of common stock under this program during the year ended December 31, 2004.

The Company believes that it will have sufficient capital resources to satisfy its liquidity needs over the next twelve-month period. The Company expects to meet its short-term liquidity needs, which may include principal repayments of its debt obligations, capital expenditures and distributions to common and preferred stockholders and unitholders, through retained cash flow from operations and borrowings under the Credit Facility.

The Company expects to meet its long-term liquidity requirements, which may include property and undeveloped land acquisitions and additional future development and redevelopment activity, through retained cash flow, borrowings under the Credit Facility, additional long-term secured and unsecured borrowings, proceeds from the disposition of non-strategic assets, issuance of common or preferred units of the Operating Partnership, and the potential issuance of debt or equity securities of the Company. The Company does not intend to reserve funds to retire existing debt upon maturity. The Company presently expects to refinance such debt at maturity or retire such debt through the issuance of equity securities, as market conditions permit.

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Historical Recurring Capital Expenditures, Tenant Improvements and Leasing Costs

The following tables set forth the capital expenditures, tenant improvements and leasing costs, excluding expenditures that are recoverable from tenants, for renewed and re-tenanted space within the Company s stabilized portfolio for the three years ended December 31, 2004 on a per square foot basis.

	Year Ended December 31,		
	2004	2003	2002
Office Properties:			
Capital Expenditures:			
Capital expenditures per square foot	$ 0.43	$ 0.48	$ 0.06
Tenant Improvement and Leasing Costs(1):			
Replacement tenant square feet	352,208	736,638	296,484
Tenant improvements per square foot leased	$ 21.01	$ 16.21	$ 6.85
Leasing commissions per square foot leased	$ 7.38	$ 7.31	$ 7.43
Total per square foot	$ 28.39	$ 23.52	$ 14.28
Renewal tenant square feet	728,802	276,689	244,366
Tenant improvements per square foot leased	$ 9.71	$ 2.77	$ 4.69
Leasing commissions per square foot leased	$ 4.67	$ 5.19	$ 2.20
Total per square foot	$ 14.38	$ 7.96	$ 6.89
Total per square foot per year	$ 7.33	$ 6.09	$ 3.71
Average lease term (in years)	5.8	5.2	5.7
Industrial Properties:			
Capital Expenditures:			
Capital expenditures per square foot	$ 0.04	$ 0.02	$ 0.12
Tenant Improvement and Leasing Costs(1):			
Replacement tenant square feet	186,474	142,460	388,883
Tenant improvements per square foot leased	$ 9.22	$ 5.35	$ 4.61
Leasing commissions per square foot leased	$ 2.54	$ 1.83	$ 1.95
Total per square foot	$ 11.77	$ 7.18	$ 6.56
Renewal tenant square feet	356,083	234,699	180,555
Tenant improvements per square foot leased	$ 1.15	$ 0.21	$ 1.11
Leasing commissions per square foot leased	$ 0.38	$ 0.05	$ 0.72
Total per square foot	$ 1.53	$ 0.26	$ 1.83
Total per square foot per year	$ 3.19	$ 1.62	$ 1.27
Average lease term (in years)	4.2	4.6	6.6

(1) Includes only tenants with lease terms of 12 months or longer. Excludes leases for amenity, parking, retail and month-to-month tenants.

Capital expenditures may fluctuate in any given period subject to the nature, extent, and timing of improvements required to be made to the Properties. The Company anticipates this level of capital expenditures will continue during 2005 for various improvements at other properties. The Company believes that all of its Office and Industrial Properties are well maintained and do not require significant capital improvements.

Tenant improvements and leasing costs may also fluctuate in any given year depending upon factors such as the property, the term of the lease, the type of lease, the involvement of external leasing agents and overall market conditions. During 2004, as dictated by market demand, the Company leased space within some of its more challenging markets at an increased tenant improvement and leasing cost per square foot. The Company anticipates that this trend will continue in 2005.

Off-Balance Sheet Arrangements

As of December 31, 2004, the Company does not have any off-balance sheet transactions, arrangements or obligations, including contingent obligations.

Historical Cash Flows

The principal sources of funding for development, redevelopment, acquisitions and capital expenditures are cash flow from operating activities, the Credit Facility, secured and unsecured debt financing and proceeds from the Company s dispositions. The Company s net cash provided by operating activities decreased $3.9 million, or 3.2% to $120.5 million for the year ended December 31, 2004 compared to $124.4 million for the year ended December 31, 2003. The decrease is primarily attributable to a lease termination fee payment of $18.3 million received in connection with the Peregrine settlement agreement in the third quarter of 2003. This decrease is partially offset by an increase in average occupancy. For the year ended December 31, 2004, average occupancy was 92.3% as compared to 91.2% for the year ended December 31, 2003.

Net cash used in investing activities increased $55.8 million, or 82.6% to $123.3 million for the year ended December 31, 2004 as compared to $67.5 million for the year ended December 31, 2003. The increase is primarily attributable to the Company s acquisition of an office property and undeveloped land in December 2004 for a net cash payment of approximately $95.5 million. The increase was partially offset by a decrease in development spending. The Company scaled back its development activity during the last two years as a result of the economic environment and the related impact on leasing. In July 2004, the Company commenced construction on the third phase of a development project that will include two office buildings. As a result, development spending is likely to increase during 2005. See additional information regarding the Company s development programs and anticipated development spending under the captions Factors That May Influence Future Results of Operations Development and redevelopment programs and Capital Commitments.

Net cash used in financing activities decreased $60.5 million, or 96.4% to $2.3 million for the year ended December 31, 2004 compared to $62.8 million for the year ended December 31, 2003. The decrease was primarily attributable to a $72.4 million increase in net borrowing activity and capital raised from the issuance of preferred stock in 2004 as compared to 2003. The increase in borrowing activity was mainly due to the Company s property acquisition during the fourth quarter of 2004.

Non-GAAP Supplemental Financial Measure: Funds From Operations

Management believes that FFO is a useful supplemental measure of the Company s operating performance. The Company computes FFO in accordance with the White Paper on FFO approved by the Board of Governors NAREIT. The White Paper defines FFO as net income or loss computed in accordance with GAAP, excluding extraordinary items, as defined by GAAP, and gains and losses from sales of depreciable operating property, plus real estate related depreciation and amortization (excluding amortization of deferred financing costs and depreciation of non-real estate assets), and after adjustment for unconsolidated partnerships and joint ventures. Other REITs may use different methodologies for calculating FFO, and accordingly, the Company s FFO may not be comparable to other REITs.

Because FFO excludes depreciation and amortization, gains and losses from property dispositions and extraordinary items, it provides a performance measure that, when compared year over year, reflects the impact to operations from trends in occupancy rates, rental rates, operating costs, development activities, general and administrative expenses and interest costs, providing a perspective not immediately apparent from net income. In addition, management believes that FFO provides useful information to the investment community about the Company s financial performance when compared to other REITs since FFO is generally recognized as the industry standard for reporting the operations of REITs.

However, FFO should not be viewed as an alternative measure of the Company s operating performance since it does not reflect either depreciation and amortization costs or the level of capital expenditures and leasing costs necessary to maintain the operating performance of the Company s properties, which are significant economic costs and could materially impact the Company s results from operations.

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The following table presents the Company s Funds from Operations, for the years ended December 31, 2004, 2003, 2002, 2001 and 2000:

	Year ended December 31,				
	2004	2003	2002	2001	2000
			(in thousands)		
Net income available for common stockholders	$ 29,988	$ 49,767	$ 38,434	$ 30,568	$ 46,640
Adjustments:					
Minority interest in earnings of Operating Partnership	4,307	7,588	5,558	3,581	6,654
Depreciation and amortization of real estate assets	59,496	57,045	60,382	51,271	40,665
Net (gain) loss on dispositions of operating properties	(6,148)	(3,642)	(7,466)	(4,714)	(11,256)
Cumulative effect on change in accounting principle				1,392	
Non-cash amortization of restricted stock grants(1)				2,190	1,252
Funds From Operations(2)	$ 87,643	$ 110,758	$ 96,908	$ 84,288	$ 83,955

(1) Commencing January 1, 2002 non-cash amortization of restricted stock grants is not added back to calculate FFO.

(2) Reported amounts are attributable to common stockholders and common unitholders.

Inflation

The majority of the Company s leases require tenants to pay most operating expenses, including real estate taxes, utilities, insurance, and increases in common area maintenance expenses. The effect of such provisions is to reduce the Company s exposure to increases in costs and operating expenses resulting from inflation.

New Accounting Pronouncements

In April 2004, the Financial Accounting Standards Board (FASB) issued FASB Staff Position FAS 129-1, Disclosure Requirements under FASB Statement No. 129, Disclosure of Information about Capital Structure, Relating to Contingently Convertible Financial Instruments (FASP FAS 129-1). FSP FAS 129-1 provides guidance on disclosures of contingently convertible financial instruments, including those containing contingent conversion requirements that have not been met and are not otherwise required to be included in the calculation of diluted earnings per share. The statement was effective immediately, and applies to all existing and newly created securities. The adoption of this statement did not have a material effect on the Company s results of operations or financial condition.

In December 2004, the FASB issued Statement 123 (revised), Share-Based Payment (FAS 123(R)). FAS 123 (R) requires that all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. The new standard will be effective in the first reporting period ending after June 15, 2005. The adoption of this statement is not expected to have a material effect on the Company s results of operations or financial condition.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The primary market risk faced by the Company is interest rate risk. The Company mitigates this risk by maintaining prudent amounts of leverage, minimizing interest expense while continuously evaluating all available debt and equity resources and following established risk management policies and procedures which include the periodic use of derivatives. The Company s primary strategy in entering into derivative contracts is to minimize the variability that changes in interest rates could have on its future cash flows. The Company generally employs derivative instruments that effectively convert a portion of its variable rate debt to fixed rate debt. Although the Company s derivative instruments do not qualify for hedge accounting since the original

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designation memos did not meet the technical requirements of SFAS 133, the Company s derivatives are intended to manage the Company s exposure to interest rate risk. The Company believes the derivatives are highly effective in offsetting the variable rate cash flows of its debt from an economic perspective. The Company does not enter into derivative instruments for speculative purposes.

Information about the Company s changes in interest rate risk exposures from December 31, 2003 to December 31, 2004 is incorporated herein by reference from Item 7: Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources.

Tabular Presentation of Market Risk

The tabular presentation below provides information about the Company s interest rate sensitive financial and derivative instruments at December 31, 2004 and 2003. All of the Company s interest rate sensitive financial and derivative instruments are held for purposes other than trading. For debt obligations, the table presents principal cash flows and related weighted average interest rates or the interest rate index by contractual maturity dates. The interest rate spreads on the Company s variable-rate debt were LIBOR plus 1.10% at December 31, 2004 and ranged from LIBOR plus 1.40% to LIBOR plus 1.85% at December 31, 2003. For the interest rate cap and swap agreements, the table presents the aggregate notional amount and weighted average interest rates or strike rates by contractual maturity date. The notional amounts are used solely to calculate the contractual cash flow to be received under the contract and do not reflect outstanding principal balances at December 31, 2004 and 2003. The table also presents comparative summarized information for financial and derivative instruments held at December 31, 2003.

Interest Rate Risk Analysis Tabular Presentation

(dollars in millions)

	Maturity Date						December 31, 2004		December 31, 2003	
	2005	**2006**	**2007**	**2008**	**2009**	**Thereafter**	**Total**	**Fair Value**	**Total**	**Fair Value**
Liabilities:										
Unsecured debt:										
Variable-rate			$ 167.0				$ 167.0	$ 167.0	$ 235.0	$ 235.0
Variable-rate index			LIBOR				LIBOR		LIBOR	
Fixed-rate						$ 144.0	$ 144.0	$ 154.1		
Average interest rate						6.14%	6.14%			
Secured debt:										
Variable-rate	$ 29.0				$ 31.0		$ 60.0	$ 60.0	$ 123.8	$ 123.8
Variable-rate index	LIBOR				LIBOR		LIBOR		LIBOR	
Fixed-rate	$ 20.2	$ 10.5	$ 32.2	$ 83.1	$ 81.6	$ 202.8	$ 430.4	$ 445.1	$ 402.2	$ 414.1
Average interest rate	7.51%	6.54%	6.62%	4.18%	7.16%	6.12%	6.05%		6.72%	
Interest-Rate Derivatives:										
Interest-rate swap agreements:										
Notional amount	$ 100.0	$ 50.0					$ 150.0	$ 0.4	$ 150.0	$ (2.7)
Fixed pay interest rate	3.52%	2.98%					3.34%		3.34%	

Floating receive rate index	LIBOR	LIBOR		
Interest-rate cap agreements:				
Notional amount			$ 100.0	$
Cap rate			4.25%	
Forward rate index			LIBOR	

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

See the index included at Item 15. Exhibits, Financial Statement Schedules.

ITEM 9A. CONTROLS AND PROCEDURES

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in its reports under the Securities Exchange Act of 1934 is processed, recorded, summarized and reported within the time periods specified in the SEC s rules and forms and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any system of controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Subsequent to the filing of the original Form 10-K for the fiscal year ended December 31, 2004, management discovered an error in the computation of income from continuing operations per common share included within the consolidated statements of operations and determined that the error required the restatement of per share amounts for income from continuing operations, basic and diluted, for the fiscal years ended December 31, 2004 and 2003. The Company incorrectly calculated the per share results of income from continuing operations, basic and diluted, by not deducting the impact of dividends paid and accrued to its preferred stockholders. In accordance with Statement of Financial Accounting Standards No. 128, Earnings per Share, the Company should have presented income from continuing operations per share net of preferred dividends paid and accrued to its preferred stockholders. Also subsequent to the filing of the original Form 10-K for the year ended December 31, 2004, the Company s management concluded that it had been incorrectly classifying two items on the consolidated statements of cash flows. First, distributions to cumulative redeemable preferred unitholders were included in the Company s consolidated statements of cash flows as an operating activity when, in accordance with Statement of Financial Accounting Standards No. 95 Statement of Cash Flows, distributions paid to cumulative redeemable preferred unitholders should have been classified as a financing activity. Second, capital expenditures for operating properties, development and redevelopment projects and undeveloped land were reflected on an accrual basis of accounting rather than the cash paid for such expenditures in investing activities in the consolidated statements of cash flows. The adjustment to reflect these expenditures on a cash basis in investing activities for each period is offset by an adjustment for the same amount in cash flows from operating activities to appropriately reflect the associated increases and decreases in accounts payable, accrued expenses and other liabilities.

Subsequent to the filing of a Form 10-K/A for the fiscal year ended December 31, 2004, filed to reflect the above-described restatements (collectively, the August Restatement), the Company concluded that a further restatement was necessary because it determined that its hedge designation memos do not meet the technical requirements to qualify for hedge accounting treatment in accordance with Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133). During 2000 and 2002, the Company entered into six interest rate swap and two interest rate cap agreements. Prior to entering into these agreements, the Company engaged an independent consulting firm specializing in derivatives to advise the Company with respect to derivatives and hedging matters. The Company consulted closely with the independent derivatives specialist during its preparation of the formal designation of the instruments to ensure that each of the instruments qualified for hedge accounting treatment under SFAS 133 and the related accounting guidance. Although both the Company and the independent derivatives specialist believed the designation documentation met the requirements under SFAS 133 at the time the derivative transactions were entered into, the Company has subsequently determined that the designation documentation does not meet the technical requirements under SFAS 133 to qualify for hedge accounting treatment. As a result, the Company is restating the financial statements of the Company for the fiscal years ended December 31, 2002, 2003 and 2004, previously issued by the Company and filed with the SEC on Form 10-K (as amended), and for the related interim periods, to mark all of these instruments to market and to recognize the impact of this mark to market adjustment in the statement of operations for each period, rather than through other comprehensive income.

The August Restatement caused management to conclude that the Company had a material weakness in its internal control over financial reporting because the controls over the initial analysis of the accounting guidance did not identify the impact of significant new corporate transactions on a per share disclosure required on the consolidated statements of operations, or the appropriate classification of two specific items on the consolidated statements of cash flows. In connection with the Company s conclusion that a further restatement is necessary to address a required change in the Company s accounting for derivative instruments and hedging activities, management subsequently reassessed the Company s internal control over financial reporting. Management determined that, although there were no deficiencies in the design of the controls in place with respect to the Company s derivative and hedging activities, the Company had a further material weakness in its internal control over financial reporting because the controls over reevaluating the accounting treatment for its derivative instruments based on the formal designation documentation in place did not operate effectively to identify improvements to the documentation that were deemed necessary to ensure qualification for hedge accounting treatment under SFAS 133 and related accounting guidance.

As required by SEC Rule 13a-15(b), the Company carried out an evaluation, under the supervision and with the participation of management including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the disclosure controls and procedures as of the end of the period covered by this report, which included consideration of the restatements. Based on the finding of the material weaknesses described above, the Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures were not effective as of the end of the period covered by this report.

In light of this conclusion, the Company performed additional technical review and analysis procedures to ensure its consolidated financial statements are prepared in accordance with generally accepted accounting principles. Accordingly, management believes that the financial statements included in this report fairly present in all material respects our financial condition, results of operations and cash flows for the periods presented.

Changes in Internal Control Over Financial Reporting

Management had previously concluded that the Company s disclosure controls and procedures were effective as of December 31, 2004 and reported that there was no change in the Company s internal control over financial reporting that occurred during the quarter ended December 31, 2004 that materially affected, or was reasonably likely to materially affect, the internal control over financial reporting. However, in connection with the August Restatement of the Company s consolidated financial statements for the fiscal years ended December 31, 2004, 2003 and 2002, as fully described in Note 27 of this Annual Report on Form 10-K/A for the fiscal year ended December 31, 2004, management determined that the material weakness described above that led to the August Restatement existed as of December 31, 2004 and has, as a result, effected changes to the Company s internal control over financial reporting subsequent to the period covered by this report. The Company implemented procedures to more formally document and review the technical analysis of all relevant accounting literature that is performed to evaluate the accounting treatment and presentation and disclosure requirements for significant and/or non-routine transactions. This review is now performed both when a transaction is completed for the first time and when a similar repeat transaction is completed, if it is significant. Management believes these enhanced procedures provide additional internal control over financial reporting and improve the ability of management to identify any potential accounting implications prior to and during the comprehensive review of the Company s consolidated financial statements. In addition, the Company implemented a more comprehensive review of the consolidated statements of cash flows. Management believes these changes remediated the material weakness that led to the August Restatement.

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In connection with the Company s conclusion that a further restatement is necessary to address a required change in the Company s accounting for derivative instruments and hedging activities, management reassessed the Company s internal control over financial reporting. As a result of this reassessment, management determined that, although there were no deficiencies in the design of the controls in place with respect to the Company s derivative and hedging activities, the Company had a further material weakness in its internal control over financial reporting because the controls over reevaluating the accounting treatment for its derivative instruments based on the formal designation documentation in place did not operate effectively to identify improvements to the documentation that were deemed necessary to ensure qualification for hedge accounting treatment under SFAS 133 and related accounting guidance. Accordingly, the Company has implemented procedures requiring, in the event that the Company has derivative transactions that it believes qualify for hedge accounting, close consultation with the Company s independent derivatives specialist during its initial preparation of the formal designation of the instruments to ensure that each of the derivative instruments qualifies for hedge accounting treatment, consistent with the Company s past practice. In addition, the Company will communicate with its independent derivatives specialist on a quarterly basis going forward from the time a derivative instrument qualifies for hedge accounting to review the Company s designation documentation to ensure that the instrument continues to qualify for hedge accounting. Management believes these changes remediate the material weakness that led to the further restatement to mark the interest rate cap and interest rate swap agreements to market and to recognize the impact of this mark to market adjustment in the statement of operations for each period.

Management s Report on Internal Control Over Financial Reporting (as restated November 7, 2005)

Internal control over financial reporting is a process designed by, or under the supervision of, the Chief Executive Officer and Chief Financial Officer and effected by the board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the consolidated financial statements.

In management s report dated March 1, 2005, management concluded that the Company s internal control over financial reporting was effective as of December 31, 2004. In August 2005 management revised their assessment due to the identification of a material weakness, described in the following paragraph, which resulted in the August Restatement (defined above). Management further reassessed the Company s internal control over financial reporting in November 2005, as discussed below.

Management is responsible for establishing and maintaining adequate internal control over financial reporting. The Company s internal control over financial reporting is supported by written policies and procedures and by an appropriate segregation of responsibilities and duties. The Company has used the criteria set forth in the *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission to assess its internal control over financial reporting, considering the restatement of per share amounts for income from continuing operations, basic and diluted, and the restatement of the consolidated statements of cash flows described above. Based on the foregoing, in August 2005 management concluded that the Company s internal control over financial reporting was not effective as of December 31, 2004, because the controls over the initial analysis of the accounting guidance did not identify the impact of significant new corporate transactions on a per share disclosure required on the consolidated statements of operations or the appropriate classification of two specific items on the consolidated statements of cash flows. Specifically, the Company did not identify the impact of the issuance of preferred stock and the resultant

payment of preferred dividends on the calculation of income from continuing operations per share included within its consolidated statements of operations. As a result of this material weakness, the Company incorrectly calculated the per share results of income from continuing operations, basic and diluted, by not deducting the impact of dividends paid and accrued to its preferred stockholders. In accordance with Statement of Financial Accounting Standards No. 128, Earnings per Share, the Company should have reduced the amount of income from continuing operations per share by the amount of preferred dividends paid and accrued to its preferred stockholders. In addition, the Company incorrectly classified two items on the consolidated statements of cash flows. First, the distributions to cumulative redeemable preferred unitholders were included in the Company s consolidated statements of cash flows as an operating activity when, in accordance with Statement of Financial Accounting Standards No. 95 Statement of Cash Flows, distributions paid to cumulative redeemable preferred unitholders should have been classified as a financing activity. Second, the capital expenditures for operating properties, development and redevelopment projects and undeveloped land were reflected on an accrual basis of accounting rather than cash paid for such expenditures in investing activities in the consolidated statements of cash flows. The adjustment to reflect these expenditures on a cash basis in investing activities for each period is offset by an adjustment for the same amount in cash flows from operating activities to appropriately reflect the associated increases and decreases in accounts payable, accrued expenses and other liabilities.

Subsequently, in November 2005 in connection with the Company s conclusion that a further restatement is necessary to address a required change in the Company s accounting for derivative instruments and hedging activities, management reassessed the Company s internal control over financial reporting. As a result of this reassessment, management determined that, although there were no deficiencies in the design of the controls in place with respect to the Company s derivative and hedging activities, the Company had a further material weakness in its internal control over financial reporting because the controls over the formal designation of its derivative and hedging instruments did not operate effectively to identify improvements to the documentation that were deemed necessary to ensure qualification for hedge accounting treatment under SFAS 133 and related accounting guidance.

In light of this subsequently identified material weakness and the material weakness associated with the August Restatement, management has confirmed its August 2005 assessment that the Company s internal control over financial reporting was not effective as of December 31, 2004.

Deloitte & Touche LLP, the Company s independent registered public accounting firm, has audited the Company s financial statements and has issued a report on management s restated assessment of internal control over financial reporting.

November 7, 2005

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Kilroy Realty Corporation:

We have audited management s restated assessment, included within this Form 10-K/A of Kilroy Realty Corporation for the year ended December 31, 2004 at Item 9A under the heading Management s Report on Internal Control over Financial Reporting (as restated November 4, 2005) , that Kilroy Realty Corporation (the Company) did not maintain effective internal control over financial reporting as of December 31, 2004, because of the effect of the material weaknesses identified in management s restated assessment based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed by, or under the supervision of, the company s principal executive and principal financial officers, or persons performing similar functions, and effected by the company s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our report dated March 1, 2005, we expressed an unqualified opinion on management s assessment that the Company maintained effective internal control over financial reporting and an unqualified opinion on the effectiveness of internal control over financial reporting. As described in the following paragraph, the Company subsequently identified material misstatements in its 2004 annual financial statements and 2004 interim financial statements, which caused such financial statements to be restated in August 2005. Additionally, as described below, subsequent to the August restatement, the Company identified material misstatements in its 2004 annual financial statements and 2004 interim financial statements, which caused such financial statements to be restated in November 2005. Management subsequently revised its assessment due to the identification of a material weakness, described in the following paragraph, which resulted in the August 2005 financial statement restatements and reconfirmed its assessment due to the identification of a second material weakness, described below, which resulted in the November 2005 financial statement restatements. Accordingly, our opinion on the

effectiveness of the Company s internal control over financial reporting as of December 31, 2004 expressed herein is different from that expressed in our initial report dated March 1, 2005.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weaknesses have been identified and included in management s restated assessment:

The Company s controls over the initial analysis of accounting guidance did not identify the impact of significant new corporate transactions on a per share disclosure required on the consolidated statements of operations and the appropriate classification of distributions to cumulative redeemable preferred unitholders and a portion of the expenditures for operating properties, development and redevelopment projects and undeveloped land in the consolidated statements of cash flows.

The Company s controls over the formal designation of its derivative and hedging instruments did not operate effectively to identify improvements to the documentation that were deemed necessary to ensure qualification for hedge accounting treatment. The impact of the mark to market adjustment of these instruments should have been recognized in the statement of operations for each period, rather than through other comprehensive income.

These material weaknesses resulted in the restatements of the Company s previously issued annual financial statements as described more fully in Note 27 to the consolidated financial statements. These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the consolidated financial statements and financial statement schedule as of and for the year ended December 31, 2004 (as restated), of the Company and this report does not affect our report on such restated financial statements.

In our opinion, management s restated assessment that the Company did not maintain effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2004, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2004 and the related consolidated statements of operations, stockholders equity, and cash flows for the year ended December 31, 2004 (as restated) and the related financial statement schedule as of and for the year ended December 31, 2004 of the Company and our report dated March 1, 2005 (August 15, 2005 as to the effects of the restatements described in Note 27 (related to income from continuing operations per common share and cash flow classifications) and discontinued operations described in Note 28, and November 7, 2005 as to the effects of the restatements described in Note 27 (related to derivative instruments and leasehold improvements paid by tenants.)) expressed an unqualified opinion on those consolidated financial statements and financial statement schedule and included an explanatory paragraph relating to the restatements described in Note 27.

/s/ DELOITTE & TOUCHE LLP

Los Angeles, California

March 1, 2005

(August 15, 2005, as to the effects of the material weakness related to income from continuing operations per common share and cash flow classifications and November 7, 2005 as to the effects of the material weakness related to derivative instruments described in Management s Report on Internal Control Over Financial Reporting (as restated November 7, 2005))

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PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a)(1) and (2) *Financial Statements and Schedules*

The following consolidated financial information is included as a separate section of this annual report on Form 10-K:

Report of Independent Registered Public Accounting Firm	F-2
Consolidated Balance Sheets as of December 31, 2004 (As Restated, see Note 27) and 2003 (As Restated, see Note 27)	F-3
Consolidated Statements of Operations for the Years ended December 31, 2004 (As Restated, see Note 27), 2003 (As Restated, see Note 27) and 2002 (As Restated, see Note 27)	F-4
Consolidated Statements of Stockholders Equity for the Years ended December 31, 2004 (As Restated, see Note 27), 2003 (As Restated, see Note 27) and 2002 (As Restated, see Note 27)	F-5
Consolidated Statements of Cash Flows for the Years ended December 31, 2004 (As Restated, see Note 27), 2003 (As Restated, see Note 27) and 2002 (As Restated, see Note 27)	F-6
Notes to Consolidated Financial Statements	F-7
Schedule II Valuation and Qualifying Accounts	F-49

All other schedules are omitted since the required information is not present in amounts sufficient to require submission of the schedule or because the information required is included in the financial statements and notes thereto.

(3) *Exhibits*

Exhibit Number	Description
3(i).1	Articles of Amendment and Restatement of the Registrant (1)
3(i).2	Articles Supplementary of the Registrant designating its 7.45% Series A Cumulative Redeemable Preferred Stock (2)
3(i).3	Articles Supplementary of the Registrant designating its Series B Junior Participating Preferred Stock (3)
3(i).4	Articles Supplementary of the Registrant designating its 9.250% Series D Cumulative Redeemable Preferred Stock (4)(5)
3(i).5	Articles Supplementary of the Registrant designating an additional 120,000 shares of its 9.250% Series D Cumulative Redeemable Preferred Stock (4)
3(i).6	Articles Supplementary of the Registrant designating its 7.80% Series E Cumulative Redeemable Preferred Stock (6)
3(i).7	Articles Supplementary of the Registrant designating its 7.50% Series F Cumulative Redeemable Preferred Stock (7)
3(ii).1	Amended and Restated Bylaws of the Registrant (1)

4.1	Form of Certificate for Common Stock of the Registrant (1)
4.2	Registration Rights Agreement dated January 31, 1997(1)
4.3	Registration Rights Agreement dated February 6, 1998 (8)
4.4	Second Amended and Restated Registration Rights Agreement dated as of March 5, 2004 (2)
4.5	Registration Rights Agreement dated as of October 31, 1997 (9)

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Exhibit Number	Description
4.6	Rights Agreement dated as of October 2, 1998 between Kilroy Realty Corporation and ChaseMellon Shareholder Services, L.L.C., as Rights Agent, which includes the form of Articles Supplementary of the Series B Junior Participating Preferred Stock of Kilroy Realty Corporation as Exhibit A, the form of Right Certificate as Exhibit B and the Summary of Rights to Purchase Preferred Shares as Exhibit C (10)
4.7	Registration Rights Agreement dated as of October 6, 2000 (11)
4.8	The Company is party to agreements in connection with long-term debt obligations, none of which individually exceeds ten percent of the total assets of the Company on a consolidated basis. Pursuant to Item 601(b)(4)(iii)(A) of Regulation S-K, the Company agrees to furnish copies of these agreements to the Commission upon request
4.9	Note and Guarantee Agreement dated August 4, 2004 by and between Kilroy Realty, L.P. and Kilroy Realty Corporation and the purchasers whose names appear in the acceptance form at the end of the Note and Guarantee Agreement (12)
4.10	Form of 5.72% Series A Guaranteed Senior Note due 2010 (12)
4.11	Form of 6.45% Series B Guaranteed Senior Note due 2014 (12)
10.1	Fifth Amended and Restated Agreement of Limited Partnership of Kilroy Realty, L.P. dated as of March 5, 2004 (2)
10.2	First Amendment to Fifth Amended and Restated Agreement of Limited Partnership of Kilroy Realty, L.P., dated as of December 7, 2004 (13)
10.3	Omnibus Agreement dated as of October 30, 1996 by and among Kilroy Realty, L.P. and the parties named therein (1)
10.4	Supplemental Representations, Warranties and Indemnity Agreement by and among Kilroy Realty, L.P. and the parties named therein (1)
10.5	Pledge Agreement by and among Kilroy Realty, L.P., John B. Kilroy, Sr., John B. Kilroy, Jr. and Kilroy Industries (1)
10.6	1997 Stock Option and Incentive Plan of the Registrant and Kilroy Realty, L.P. (1)
10.7	Form of Indemnity Agreement of the Registrant and Kilroy Realty, L.P. with certain officers and directors (1)
10.8	Lease Agreement dated January 24, 1989 by and between Kilroy Long Beach Associates and the City of Long Beach for Kilroy Long Beach Phase I (14)
10.9	First Amendment to Lease Agreement dated December 28, 1990 by and between Kilroy Long Beach Associates and the City of Long Beach for Kilroy Long Beach Phase I (14)
10.10	Lease Agreement dated July 17, 1985 by and between Kilroy Long Beach Associates and the City of Long Beach for Kilroy Long Beach Phase III (15)
10.11	Lease Agreement dated April 21, 1988 by and between Kilroy Long Beach Associates and the Board of Water Commissioners of the City of Long Beach, acting for and on behalf of the City of Long Beach, for Long Beach Phase IV (15)
10.12	Lease Agreement dated December 30, 1988 by and between Kilroy Long Beach Associates and the City of Long Beach for Kilroy Long Beach Phase II (15)
10.13	First Amendment to Lease dated January 24 1989 by and between Kilroy Long Beach Associates and the City of Long Beach for Kilroy Long Beach Phase III (15)
10.14	Second Amendment to Lease Agreement dated December 28, 1990 by and between Kilroy Long Beach Associates and the City of Long Beach for Kilroy Long Beach Phase III (15)
10.15	First Amendment to Lease Agreement dated December 28, 1990 by and between Kilroy Long Beach Associates and the City of Long Beach for Kilroy Long Beach Phase II (15)

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Exhibit Number	Description
10.16	Third Amendment to Lease Agreement dated October 10, 1994 by and between Kilroy Long Beach Associates and the City of Long Beach for Kilroy Long Beach Phase III (15)
10.17	Development Agreement by and between Kilroy Long Beach Associates and the City of Long Beach (15)
10.18	Amendment No. 1 to Development Agreement by and between Kilroy Long Beach Associates an the City of Long Beach (15)
10.19	Ground Lease by and between Frederick Boysen and Ted Boysen and Kilroy Industries dated May 15, 1969 for SeaTac Office Center (14)
10.20	Amendment No. 1 to Ground Lease and Grant of Easement dated April 27, 1973 among Frederick Boysen and Dorothy Boysen, Ted Boysen and Rose Boysen and Sea/Tac Properties (14)
10.21	Amendment No. 2 to Ground Lease and Grant of Easement dated May 17, 1977 among Frederick Boysen and Dorothy Boysen, Ted Boysen and Rose Boysen and Sea/Tac Properties (14)
10.22	Airspace lease dated July 10, 1980 by and among the Washington State Department of Transportation, as lessor, and Sea/Tac Properties, Ltd. and Kilroy Industries, as lessee (14)
10.23	Memorandum of Lease dated April 1, 1980 by and among Bow Lake, Inc., as lessor, and Kilroy Industries and Sea/Tac Properties, Ltd., as lessees for Sea/Tac Office Center (14)
10.24	Amendment No. 1 to Ground Lease dated September 17, 1990 between Bow Lake, Inc., as lessor, and Sea/Tac Properties, Ltd., as lessee (14)
10.25	Amendment No. 2 to Ground Lease dated March 21, 1991 between Bow Lake, Inc., as lessor, and Sea/Tac Properties, Ltd., as lessee (14)
10.26	Property Management Agreement between Kilroy Realty Finance Partnership, L.P. and Kilroy Realty, L.P. (16)
10.27	Form of Environmental Indemnity Agreement (16)
10.28	Option Agreement by and between Kilroy Realty, L.P. and Kilroy Airport Imperial Co. (17)
10.29	Option Agreement by and between Kilroy Realty, L.P. and Kilroy Calabasas Associates (17)
10.30	Employment Agreement between the Registrant and John B. Kilroy, Jr. (17)
10.31	Amended and Restated Employment Agreement between the Registrant and Richard E. Moran Jr. (17)
10.32	Employment Agreement between the Registrant and Jeffrey C. Hawken (18)
10.33	Noncompetition Agreement by and between the Registrant and John B. Kilroy, Sr. (1)
10.34	Noncompetition Agreement by and between the Registrant and John B. Kilroy, Jr. (1)
10.35	License Agreement by and among the Registrant and the other persons named therein (17)
10.36	Purchase and Sale Agreement and Joint Escrow Instructions dated April 30, 1997 by and between Mission Land Company, Mission-Vacaville, L.P. and Kilroy Realty, L.P. (18)
10.37	Agreement of Purchase and Sale and Joint Escrow Instructions dated April 30, 1997 by and between Camarillo Partners and Kilroy Realty, L.P. (18)
10.38	Purchase and Sale Agreement and Escrow Instructions dated May 5, 1997 by and between Kilroy Realty L.P. and Pullman Carnegie Associates (19)
10.39	Amendment to Purchase and Sale Agreement and Escrow Instructions dated June 27, 1997 by and between Pullman Carnegie Associates and Kilroy Realty, L.P. (20)
10.40	Purchase and Sale Agreement, Contribution Agreement and Joint Escrow Instructions dated May 12, 1997 by and between Shidler West Acquisition Company, LLC and Kilroy Realty, L.P. (20)

Exhibit Number	Description
10.41	First Amendment to Purchase and Sale Agreement, Contribution Agreement and Joint Escrow Instructions dated June 6, 1997 by and between Shidler West Acquisition Company, L.L.C. and Kilroy Realty, L.P. (20)
10.42	Second Amendment to Purchase and Sale Agreement, Contribution Agreement and Joint Escrow Instructions dated June 12, 1997 by and between Shidler West Acquisition Company, LLC and Kilroy Realty, L.P. (20)
10.43	Agreement of Purchase and Sale and Joint Escrow Instructions dated June 12, 1997 by and between Mazda Motor of America, Inc. and Kilroy Realty, L.P. (19)
10.44	First Amendment to Agreement of Purchase and Sale and Joint Escrow Instructions dated June 30, 1997 by and between Mazda Motor of America, Inc. and Kilroy Realty, L.P. (19)
10.45	Agreement for Purchase and Sale of 2100 Colorado Avenue, Santa Monica, California dated June 16, 1997 by and between Santa Monica Number Seven Associates L.P. and Kilroy Realty, L.P. (19)
10.46	Purchase and Sale Agreement and Joint Escrow Instructions dated July 10, 1997 by and between Kilroy Realty, L.P. and Mission Square Partners (21)
10.47	First Amendment to Purchase and Sale Agreement and Joint Escrow Instructions dated July 10, 1997 by and between Kilroy Realty, L.P. and Mission Square Partners dated August 22, 1997 (21)
10.48	Second Amendment to the Purchase and Sale Agreement and Joint Escrow Instructions dated July 10, 1997 by and between Kilroy Realty, L.P. and Mission Square Partners dated September 5, 1997 (21)
10.49	Third Amendment to the Purchase and Sale Agreement and Joint Escrow Instructions dated July 10, 1997 by and between Kilroy Realty, L.P. and Mission Square Partners dated September 19, 1997 (21)
10.50	Fourth Amendment to the Purchase and Sale Agreement and Joint Escrow Instructions dated July 10, 1997 by and between Kilroy Realty, L.P. and Mission Square Partners dated September 22, 1997 (21)
10.51	Fifth Amendment to the Purchase and Sale Agreement and Joint Escrow Instructions dated July 10, 1997 by and between Kilroy Realty, L.P. and Mission Square Partners dated September 23, 1997 (21)
10.52	Sixth Amendment to the Purchase and Sale Agreement and Joint Escrow Instructions dated July 10, 1998 by and between Kilroy Realty, L.P. and Mission Square Partners dated September 25, 1997 (21)
10.53	Seventh Amendment to the Purchase and Sale Agreement and Joint Escrow Instructions dated July 10, 1997 by and between Kilroy Realty, L.P. and Mission Square Partners dated September 29, 1997 (21)
10.54	Eighth Amendment to the Purchase and Sale Agreement and Joint Escrow Instructions dated July 10, 1997 by and between Kilroy Realty, L.P. and Mission Square Partners dated October 2, 1997 (21)
10.55	Ninth Amendment to the Purchase and Sale Agreement and Joint Escrow Instructions dated July 10, 1997 by and between Kilroy Realty, L.P. and Mission Square Partners dated October 24, 1997 (21)
10.56	Contribution Agreement dated October 21, 1997 by and between Kilroy Realty, L.P. and Kilroy Realty Corporation and The Allen Group and the Allens (22)
10.57	Purchase and Sale Agreement and Escrow Instructions dated December 11, 1997 by and between Kilroy Realty, L.P. and Swede-Cal Properties, Inc., Viking Investors of Southern California and Viking Investors of Southern California II (23)
10.58	Amendment to the Contribution Agreement dated October 14, 1998 by and between Kilroy Realty, L.P. and Kilroy Realty Corporation and The Allen Group and the Allens dated October 21, 1997 (24)

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Exhibit Number	Description
10.59	Employment Agreement between the Registrant and Tyler H. Rose (25)
10.60	Secured Promissory Notes and Deeds of Trusts Aggregating $80.0 Million Payable to Metropolitan Life Insurance Company dated January 10, 2002 (25)
10.61	Secured Promissory Notes and Deeds of Trust Aggregating $115 million payable to Teachers Insurance and Annuity Association of America (26)
10.62	Fourth Amended and Restated Revolving Credit Agreement dated October 22, 2004 (27)
10.63	Fourth Amended and Restated Guaranty of Payment dated October 22, 2004 (27)
12.1*	Statement of Computations of Consolidated Ratio of Earnings to Combined Fixed Charges and Preferred Dividends and Distributions
21.1	List of Subsidiaries of the Registrant (2)
23.1*	Consent of Deloitte & Touche LLP
24.1	Power of Attorney (included in the signature page of the Form 10-K filed with the Securities and Exchange Commission on March 2, 2005)
31.1*	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31.2*	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32.1*	Section 1350 Certification of Chief Executive Officer
32.2*	Section 1350 Certification of Chief Financial Officer

* Filed herewith

Management contract or compensatory plan or arrangement.

(1) Previously filed as an exhibit to the Registration Statement on Amendment No. 3 to Form S-11 (No. 333-15553).

(2) Previously filed as an exhibit on Form 10-K for the year ended December 31, 2003.

(3) Previously filed as an exhibit to the Registration Statement on Amendment No. 1 to Form S-3 (No. 333-72229).

(4) Previously filed as an exhibit on Form 10-K for the year ended December 31, 1999.

(5) Previously filed as an exhibit to the Registration Statement on Form S-3 (No. 333-34638).

(6) Previously filed an exhibit on Form 8-A as filed with the Securities and Exchange Commission on October 24, 2003.

(7) Previously filed as an exhibit on Form 8-A (No. 001-12675) as filed with the Securities and Exchange Commission on December 6, 2004.

(8) Previously filed as an exhibit on Form 8-K as filed with the Securities and Exchange Commission on February 11, 1998.

(9) Previously filed as an exhibit on Form 8-K/A as filed with the Securities and Exchange Commission on December 19, 1997.

(10) Previously filed as an exhibit on Form 8-K as filed with the Securities and Exchange Commission on October 8, 1998.

(11) Previously filed as an exhibit on Form 10-K for the year ended December 31, 2000.

(12) Previously filed as an exhibit on Form 8-K filed with the Securities and Exchange Commission on August 11, 2004.

(13) Previously filed as an exhibit on Form 8-K as filed with the Securities and Exchange Commission on December 9, 2004.

(14) Previously filed as an exhibit to the Registration Statement on Amendment No. 2 to Form S-11 (No. 333-15553).

(15) Previously filed as an exhibit to the Registration Statement on Form S-11 (No. 333-15553).

(16) Previously filed as an exhibit to the Registration Statement on Amendment No. 5 to Form S-11 (No. 333-15553).

(17) Previously filed as an exhibit to the Registration Statement on Amendment No. 4 to Form S-11 (No. 333-15553).

(18) Previously filed as an exhibit on Form 8-K as filed with the Securities and Exchange Commission on June 6, 1997.

(19) Previously filed as an exhibit on Form 8-K as filed with the Securities and Exchange Commission on July 15, 1997.

(20) Previously filed as an exhibit on Form 8-K as filed with the Securities and Exchange Commission on July 3, 1997.

(21) Previously filed as an exhibit on Form 10-Q for the quarter ended September 30, 1997.

(22) Previously filed as an exhibit on Form 8-K as filed with the Securities and Exchange Commission on November 21, 1997.

(23) Previously filed as an exhibit on Form 8-K as filed with the Securities and Exchange Commission on December 29, 1997.

(24) Previously filed as an exhibit on Form 10-Q for the quarter ended September 30, 1998.

(25) Previously filed as an exhibit on Form 10-K for the year ended December 31, 2001.

(26) Previously filed as an exhibit on Form 10-Q for the quarter ended March 31, 2004.

(27) Previously filed as an exhibit on Form 8-K filed with the Securities and Exchange Commission on October 22, 2004.

(b) *Reports on Form 8-K*

The Company filed a Current Report on Form 8-K dated October 25, 2004, under Item 2.02, in connection with its third quarter 2004 earnings release and attached to such report its third quarter 2004 Supplemental Financial Report.

The Company filed a Current Report on Form 8-K dated October 22, 2004, under Items 1.01 and 9.01, in connection with the renewal of its $425 million unsecured revolving credit facility.

The Company filed a Current Report on Form 8-K dated December 8, 2004, under Items 8.01 and 9.01, in connection with the issuance of 3,450,000 shares of its 7.50% Series F Cumulative Redeemable Preferred Stock.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on November 7, 2005.

KILROY REALTY CORPORATION

By: /s/ HEIDI R. ROTH

Heidi R. Roth

Senior Vice President and Controller

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Name	Title	Date
/s/ * John B. Kilroy, Sr.	Chairman of the Board	November 7, 2005
/s/ JOHN B. KILROY, JR. John B. Kilroy, Jr.	President, Chief Executive Officer and Director (Principal Executive Officer)	November 7, 2005
/s/ RICHARD E. MORAN JR. Richard E. Moran Jr.	Executive Vice President and Chief Financial Officer (Principal Financial Officer)	November 7, 2005
/s/ HEIDI R. ROTH Heidi R. Roth	Senior Vice President and Controller (Principal Accounting Officer)	November 7, 2005
/s/ * Edward F. Brennan, Ph.D.	Director	November 7, 2005
/s/ * John R. D Eathe	Director	November 7, 2005
/s/ * William P. Dickey	Director	November 7, 2005
/s/ * Matthew J. Hart	Director	November 7, 2005

/s/ *	Director	November 7, 2005
Dale F. Kinsella		

*By: /s/ RICHARD E. MORAN JR.

Richard E. Moran Jr.

Attorney-in-Fact

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KILROY REALTY CORPORATION

CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2004 AND 2003

AND FOR THE THREE YEARS ENDED DECEMBER 31, 2004

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Kilroy Realty Corporation:

We have audited the accompanying consolidated balance sheets of Kilroy Realty Corporation (the Company) as of December 31, 2004 and 2003, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2004. Our audits also included the financial statement schedule listed in the index at Item 15. These financial statements and the financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2004 and 2003, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects, the information set forth therein.

As discussed in Note 27, the Company has restated its consolidated balance sheets as of December 31, 2004 and 2003, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2004.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company s internal control over financial reporting as of December 31, 2004, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 1, 2005 (August 15, 2005 as to the effects of the material weakness related to income from continuing operations per common share and cash flow classifications and November 7, 2005 as to the effects of the material weakness related to derivative instruments described in Management s Report on Internal Control Over Financial Reporting (as restated November 7, 2005)) expressed an unqualified opinion on management s assessment of the effectiveness of the Company s internal control over financial reporting and an adverse opinion on the effectiveness of the Company s internal control over financial reporting because of the material weaknesses.

DELOITTE & TOUCHE LLP

Los Angeles, California

March 1, 2005 (August 15, 2005 as to the effects of the restatements described in Note 27 (related to income from continuing operations per common share and cash flow classifications) and discontinued operations described in Note 28, and November 7, 2005 as to the effects of the restatements described in Note 27 (related to derivative instruments and leasehold improvements paid by tenants.))

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KILROY REALTY CORPORATION

CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	December 31,	
	2004	2003
	(As Restated, see Note 27)	
ASSETS		
REAL ESTATE ASSETS (Notes 3, 4, 20 and 26):		
Land and improvements	$ 304,033	$ 289,730
Buildings and improvements, net	1,465,285	1,317,050
Undeveloped land and construction in progress, net	93,912	129,016
Total real estate held for investment	1,863,230	1,735,796
Accumulated depreciation and amortization	(372,656)	(326,479)
Total real estate assets, net	1,490,574	1,409,317
CASH AND CASH EQUIVALENTS	4,853	9,892
RESTRICTED CASH	332	8,558
CURRENT RECEIVABLES, NET (Note 5)	4,843	4,919
DEFERRED RENT RECEIVABLES, NET (Note 6)	46,816	36,804
DEFERRED LEASING COSTS AND OTHER RELATED INTANGIBLES, NET (Notes 7 and 8)	50,711	36,041
DEFERRED FINANCING COSTS, NET (Notes 9 and 11)	5,849	3,657
PREPAID EXPENSES AND OTHER ASSETS	5,046	7,240
TOTAL ASSETS	$ 1,609,024	$ 1,516,428
LIABILITIES AND STOCKHOLDERS EQUITY		
LIABILITIES:		
Secured debt (Note 10)	$ 490,441	$ 526,048
Unsecured senior notes (Note 10)	144,000	
Unsecured line of credit (Note 10)	167,000	235,000
Accounts payable, accrued expenses and other liabilities (Note 11)	73,005	41,147
Accrued distributions (Note 13)	16,923	16,369
Rents received in advance, tenant security deposits and deferred revenue	37,979	31,119
Total liabilities	929,348	849,683
COMMITMENTS AND CONTINGENCIES (Note 16)		
MINORITY INTERESTS (Note 12):		
7.45% (8.075% as of December 31, 2003) Series A Cumulative Redeemable Preferred unitholders	73,638	73,716
9.25% Series D Cumulative Redeemable Preferred unitholders		44,321
Common unitholders of the Operating Partnership	59,491	65,675
Total minority interests	133,129	183,712

STOCKHOLDERS EQUITY (Note 13):		
Preferred stock, $.01 par value, 21,840,000 shares authorized, none issued and outstanding		
7.45% Series A Cumulative Redeemable Preferred stock, $.01 par value, 1,700,000 shares authorized, none issued and outstanding		
Series B Junior Participating Preferred stock, $.01 par value, 400,000 shares authorized, none issued and outstanding		
9.25% Series D Cumulative Redeemable Preferred stock, $.01 par value, 1,000,000 shares authorized, none issued and outstanding		
7.80% Series E Cumulative Redeemable Preferred stock, $.01 par value, 1,610,000 shares authorized, issued and outstanding	38,425	38,437
7.50% Series F Cumulative Redeemable Preferred stock, $.01 par value, 3,450,000 shares authorized, issued and outstanding	83,157	
Common stock, $.01 par value, 150,000,000 shares authorized, 28,548,597 and 28,209,213 shares issued and outstanding, respectively	286	282
Additional paid-in capital	515,518	508,250
Deferred compensation	(1,412)	(852)
Distributions in excess of earnings	(89,427)	(63,084)
Total stockholders equity	546,547	483,033
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 1,609,024	$ 1,516,428

See accompanying notes to consolidated financial statements.

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KILROY REALTY CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per share data)

	Year Ended December 31,		
	2004	2003	2002
	(As Restated, see Note 27)		
REVENUES (Note 20):			
Rental income	$ 196,191	$ 177,346	$ 173,931
Tenant reimbursements	21,156	19,665	20,854
Other property income (Note 19)	1,202	23,998	2,672
Total revenues	218,549	221,009	197,457
EXPENSES:			
Property expenses	34,010	30,910	28,007
Real estate taxes	16,344	15,061	14,440
Provision for bad debts	886	1,503	6,712
Ground leases (Note 16)	1,401	1,296	1,354
General and administrative expenses (Notes 15 and 19)	34,021	20,095	12,902
Interest expense	33,994	30,515	30,629
Depreciation and amortization (Notes 2 and 8)	58,620	55,471	57,750
Total expenses	179,276	154,851	151,794
OTHER INCOME AND EXPENSE:			
Net settlement payments on interest rate swaps	(2,893)	(3,218)	(6,819)
Gain (loss) on derivative instruments	3,099	704	(244)
Interest and other income	521	196	513
Total other income (expense)	727	(2,318)	(6,550)
INCOME FROM CONTINUING OPERATIONS BEFORE NET GAIN ON DISPOSITIONS AND MINORITY INTERESTS	40,000	63,840	39,113
Net gain on dispositions of operating properties (Note 3)			896
INCOME FROM CONTINUING OPERATIONS BEFORE MINORITY INTERESTS	40,000	63,840	40,009
MINORITY INTERESTS:			
Distributions on Cumulative Redeemable Preferred units	(9,579)	(13,163)	(13,500)
Original issuance costs of redeemed preferred units (Note 12)	(1,200)	(945)	
Minority interest in earnings of Operating Partnership attributable to continuing operations	(3,218)	(6,533)	(3,714)
Recognition of previously reserved Development LLC preferred return (Note 12)			3,908
Minority interest in earnings of Development LLCs			(1,024)
Total minority interests	(13,997)	(20,641)	(14,330)
INCOME FROM CONTINUING OPERATIONS	26,003	43,199	25,679
DISCONTINUED OPERATIONS (Note 21)			

Revenues from discontinued operations	7,134	10,231	17,706
Expenses from discontinued operations	(3,929)	(5,901)	(9,677)
Net gain on dispositions of discontinued operations	6,148	3,642	6,570
Impairment loss on property held for sale	(726)		
Minority interest in earnings of Operating Partnership attributable to discontinued operations	(1,089)	(1,055)	(1,844)
Total income from discontinued operations	7,538	6,917	12,755
NET INCOME	$ 33,541	$ 50,116	$ 38,434
PREFERRED DIVIDENDS	(3,553)	(349)	
NET INCOME AVAILABLE FOR COMMON STOCKHOLDERS	$ 29,988	$ 49,767	$ 38,434
Income from continuing operations per common share basic (Note 22)	$ 0.79	$ 1.56	$ 0.94
Income from continuing operations per common share diluted (Note 22)	$ 0.79	$ 1.54	$ 0.93
Net income per common share basic (Note 22)	$ 1.06	$ 1.81	$ 1.40
Net income per common share diluted (Note 22)	$ 1.06	$ 1.79	$ 1.39
Weighted average shares outstanding basic (Note 22)	28,244,459	27,526,684	27,449,676
Weighted average shares outstanding diluted (Note 22)	28,422,027	27,737,791	27,722,197
Dividends declared per common share (Note 23)	$ 1.98	$ 1.98	$ 1.98

See accompanying notes to consolidated financial statements.

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KILROY REALTY CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(in thousands, except share and per share data)

		Common Stock						
	Preferred Stock	Number of Shares	Common Stock	Additional Paid-in Capital	Deferred Compensation	Distributions in Excess of Earnings	Accumulated Net Other Comp. Loss	Total
BALANCE AT DECEMBER 31, 2001 (as previously reported)	$	27,426,071	$ 274	$ 481,186	$ (1,891)	$ (33,163)	$ (5,778)	$ 440,628
Prior period restatement adjustments (Note 27)				(554)		(8,261)	5,553	(3,262)
BALANCE AT DECEMBER 31, 2001 (As Restated, see Note 27)		27,426,071	274	480,632	(1,891)	(41,424)	(225)	437,366
Net income (As Restated, see Note 27)						38,434		38,434
Net other comprehensive income (Note 11) (As Restated, see Note 27)							225	225
Comprehensive income (As Restated, see Note 27)								38,659
Repurchase of common stock (Note 13)		(518,571)	(5)	(11,776)				(11,781)
Exchange of common units of the Operating Partnership (Note 12)		222,270	2	5,490				5,492
Exercise of stock options (Note 15)		208,381	2	4,247				4,249
Issuance of restricted stock (Notes 13 and 15)		81,729		2,105	(2,105)			
Non-cash amortization of restricted stock grants (Note 15)					2,742			2,742
Stock option expense (Notes 2 and 15)				23				23
Adjustment for minority interest (Note 2) (As Restated, see Note 27)				12,210				12,210
Dividends declared per common share ($1.98 per share)						(54,778)		(54,778)
BALANCE AT DECEMBER 31, 2002 (As Restated, see Note 27)		27,419,880	273	492,931	(1,254)	(57,768)		434,182
Net income (As Restated, see Note 27)						50,116		50,116
Issuance of preferred stock	38,437							38,437
Exercise of stock options (Note 15)		664,528	8	13,444				13,452
Issuance of restricted stock (Notes 13 and 15)		123,678	1	2,639	(1,671)			969
Exchange of common units of the Operating Partnership (Notes 12 and 13)		82,439	1	1,874				1,875
Repurchase of common stock (Note 13)		(78,630)	(1)	(1,713)				(1,714)
Non-cash amortization of restricted stock grants, net of forfeitures (Note 15)		(2,682)			2,073			2,073
Stock option expense (Notes 2 and 15)				26				26

Adjustment for minority interest (Note 2) (As Restated, see Note 27)				(951)				(951)
Preferred dividends						(349)		(349)
Dividends declared per common share ($1.98 per share)						(55,083)		(55,083)
BALANCE AT DECEMBER 31, 2003 (As Restated, see Note 27)	38,437	28,209,213	282	508,250	(852)	(63,084)		483,033
Net income (As Restated, see Note 27)						33,541		33,541
Issuance of preferred stock	83,145							83,145
Exercise of stock options (Note 15)		96,325	1	2,051				2,052
Issuance of restricted stock (Notes 13 and 15)		114,843	1	3,994	(2,751)			1,244
Exchange of common units of the Operating Partnership (Note 12)		165,171	2	4,435				4,437
Repurchase of common stock (Note 13)		(36,955)		(1,275)				(1,275)
Non-cash amortization of restricted stock grants (Note 15)					2,191			2,191
Stock option expense (Notes 2 and 15)				27				27
Adjustment for minority interest (Note 2) (As Restated, see Note 27)				(1,964)				(1,964)
Preferred dividends						(3,553)		(3,553)
Dividends declared per common share ($1.98 per share)						(56,331)		(56,331)
BALANCE AT DECEMBER 31, 2004 (As Restated, see Note 27)	$ 121,582	28,548,597	$ 286	$ 515,518	$ (1,412)	$ (89,427)		$ 546,547

See accompanying notes to consolidated financial statements.

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KILROY REALTY CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands)

	Year Ended December 31,		
	2004	**2003**	**2002**
	(As Restated, Note 27)		
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 33,541	$ 50,116	$ 38,434
Adjustments to reconcile net income to net cash provided by operating activities (including discontinued operations):			
Depreciation and amortization of building and improvements and leasing costs	59,496	57,045	60,920
Impairment loss on property held for sale	726		
Provision for uncollectible tenant receivables	(153)	2,096	2,233
Provision for uncollectible deferred rent receivables	1,080	(320)	4,683
Distributions on Cumulative Redeemable Preferred units	9,579	13,163	13,500
Minority interests in earnings of Operating Partnership	4,307	7,588	5,558
Minority interests in earnings of Development LLCs			(2,884)
Depreciation of furniture, fixtures and equipment	901	954	982
Non-cash amortization of restricted stock grants	3,345	3,129	3,424
Amortization of deferred financing costs	1,915	1,977	2,675
Amortization of above/below market rents, net	(34)		
Non-cash charge for original issuance costs of redeemed preferred units	1,200	945	
Net gain on dispositions of operating properties	(6,148)	(3,642)	(7,466)
Non-cash amortization of deferred revenue for reimbursement of tenant improvements	(1,898)	(1,521)	(1,279)
(Gain) loss on derivative instruments	(3,099)	(704)	244
Net settlement payments on interest rate swaps	2,893	3,218	6,819
Other	20	(173)	60
Changes in assets and liabilities:			
Current receivables	229	(3,941)	(278)
Deferred rent receivables	(11,632)	(7,691)	(9,307)
Deferred leasing costs	(3,236)	(960)	(1,013)
Prepaid expenses and other assets	1,258	(1,832)	(1,786)
Accounts payable, accrued expenses and other liabilities	17,465	3,302	(5,648)
Rents received in advance and tenant security deposits	8,758	1,650	12,538
Net cash provided by operating activities	120,513	124,399	122,409
CASH FLOWS FROM INVESTING ACTIVITIES:			
Expenditures for operating properties	(22,957)	(27,556)	(17,680)
Expenditures for development and redevelopment projects and undeveloped land	(43,501)	(69,062)	(88,901)
Acquisition of operating properties and undeveloped land	(95,497)		(7,569)
Acquisition of minority interest in Development LLC s			(2,189)
Net proceeds received from dispositions of operating properties	33,439	34,076	46,499
Net cash settlement payments on interest rate swaps	(2,981)	(3,177)	(7,246)
Decrease (increase) in restricted cash	8,226	(1,744)	(1,401)
Net cash used in investing activities	(123,271)	(67,463)	(78,487)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of secured debt	115,218	107,340	155,664
Proceeds from issuance of unsecured senior notes	144,000		
Net (repayments) borrowing on unsecured line of credit	(68,000)	(20,000)	100,000
Principal payments on secured debt and unsecured term facility	(150,825)	(88,329)	(208,214)
Net proceeds from issuance of preferred stock (Note 13)	83,145	38,437	

Redemption of preferred units (Note 13)	(45,000)	(35,000)	
Repurchase of common stock (Note 13)	(1,275)	(1,714)	(11,398)
Financing costs	(4,083)	(377)	(7,634)
Proceeds from exercise of stock options	2,052	13,452	4,248
Distributions paid to common stockholders and common unitholders	(64,268)	(63,057)	(61,609)
Distribution paid to preferred stockholders and preferred unitholders	(13,245)	(13,573)	(13,500)
Net distributions to minority interests in Development LLCs			(2,189)
Net cash used in financing activities	(2,281)	(62,821)	(44,632)
Net decrease in cash and cash equivalents	(5,039)	(5,885)	(710)
Cash and cash equivalents, beginning of year	9,892	15,777	16,487
Cash and cash equivalents, end of year	$ 4,853	$ 9,892	$ 15,777
SUPPLEMENTAL CASH FLOW INFORMATION:			
Cash paid for interest, net of capitalized interest of $7,111, $9,641 and $10,823 at December 31, 2004, 2003 and 2002, respectively	$ 28,092	$ 27,096	$ 27,082
NON-CASH TRANSACTIONS:			
Accrual of distributions payable to common stockholders and common unitholders (Note 13)	$ 16,106	$ 16,020	$ 15,670
Issuance of common limited partnership units of the Operating Partnership to acquire minority interest in Development LLCs (Note 12)			$ 38,689

See accompanying notes to consolidated financial statements.

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KILROY REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Three Years Ended December 31, 2004

1. Organization and Ownership

Kilroy Realty Corporation (the Company) owns, operates, develops and acquires office and industrial real estate located in California, Washington and Arizona. The Company, which qualifies and operates as a self-administered real estate investment trust (REIT) under the Internal Revenue Code of 1986, as amended, commenced operations upon the completion of its initial public offering in January 1997. The Company is the successor to the real estate business of the Kilroy Group, which consisted of the combination of Kilroy Industries (KI) and various entities, the properties of which were under the common control of KI and/or its stockholders, including the Company s Chairman of the Board of Directors, John B. Kilroy, Sr., and the Company s President and Chief Executive Officer, John B. Kilroy, Jr.

As of December 31, 2004, the Company s stabilized portfolio of operating properties was comprised of 84 office buildings (the Office Properties) and 49 industrial buildings (the Industrial Properties, and together with the Office Properties, the Properties) which encompassed approximately 7.7 million and 4.6 million rentable square feet, respectively, and was 94.6% occupied. The Company s stabilized portfolio of operating properties excludes properties currently under construction or lease-up properties. The Company defines lease-up properties as properties recently developed or redeveloped by the Company that have not yet reached 95% occupancy and are within one year following substantial completion. At December 31, 2004, the Company had two office properties encompassing an aggregate of approximately 309,600 rentable square feet, which were in the lease-up phase. In addition, as of December 31, 2004, the Company had two office development properties under construction, which when complete are expected to encompass an aggregate of approximately 103,300 rentable square feet. All of the Company s development and lease-up properties are located in Southern California.

The Company owns its interests in all of the Properties through Kilroy Realty, L.P. (the Operating Partnership) and Kilroy Realty Finance Partnership, L.P. (the Finance Partnership). The Company conducts substantially all of its activities through the Operating Partnership in which, as of December 31, 2004 and 2003, it owned an 87.7% and 87.2% general partnership interest, respectively. The remaining 12.3% and 12.8% common limited partnership interest in the Operating Partnership as of December 31, 2004 and 2003, respectively, was owned by certain of the Company s executive officers and directors, certain of their affiliates, and other outside investors (see Note 12). Kilroy Realty Finance, Inc, (Finance Inc.), a wholly-owned subsidiary of the Company, is the sole general partner of the Finance Partnership and owns a 1% general partnership interest. The Operating Partnership owns the remaining 99% limited partnership interest. The Company conducts substantially all of its development services through Kilroy Services, LLC (KSLLC) which, as of December 31, 2003, was owned 99.0% by the Operating Partnership and 1.0% by the Company. On January 1, 2004, KSLLC became a wholly-owned subsidiary of the Operating Partnership. Unless otherwise indicated, all references to the Company include the Operating Partnership, the Finance Partnership, KSLLC and all wholly-owned subsidiaries of the Company.

In 1999, the Company, through the Operating Partnership, became a 50% managing member in two limited liability companies (the Development LLCs), which were formed to develop two multi-phased office projects in San Diego, California. The Allen Group, a group of affiliated real estate development and investment companies based in San Diego, California, was the other 50% member of the Development LLCs. On March 25, 2002, the Company acquired The Allen Group s interest in the assets and assumed The Allen Group s proportionate share of the liabilities of the Development LLCs (see Note 12). Subsequent to this transaction, the Development LLCs were liquidated and dissolved.

The Development LLCs were consolidated for financial reporting purposes prior to their dissolution on March 25, 2002 since the Company controlled all significant development and operating decisions.

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KILROY REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Basis of Presentation and Significant Accounting Policies

Basis of Presentation:

The consolidated financial statements of the Company include the consolidated financial position and results of operations of the Company, the Operating Partnership, the Finance Partnership, KSLLC and all wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in the consolidated financial statements.

Significant Accounting Policies:

Operating properties Operating properties are carried at the lower of historical cost less accumulated depreciation or estimated fair value. Properties held for sale are reported at the lower of the carrying value or the fair value less estimated cost to sell. The cost of operating properties includes the purchase price or development costs of the properties. Costs incurred for the acquisition, renovation and betterment of the operating properties are capitalized to the Company s investment in that property. Maintenance and repairs are charged to expense as incurred. The Company s stabilized portfolio of operating properties consists of all of the Company s Office and Industrial Properties, excluding properties currently under construction or lease-up properties. Lease-up properties are included in land and improvements and building and improvements on the consolidated balance sheets.

An operating property is evaluated for potential impairment whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. In the event that periodic assessments reflect that the carrying amount of a property exceeds the sum of the undiscounted cash flows (excluding interest) that are expected to result from the use and eventual disposition of the property, the Company would recognize an impairment loss to the extent the carrying amount exceeded the fair value of the property. The Company estimates the fair value using available market information or other industry valuation techniques such as present value calculations. In the first quarter of 2004, the Company recorded a $0.7 million impairment loss (see Note 3). The Company did not record any impairment losses during the years ended December 31, 2003 or 2002.

Depreciation and amortization of buildings and improvements The cost of buildings and improvements are depreciated on the straight-line method over estimated useful lives of 25 to 40 years for buildings and the shorter of the lease term or useful life, ranging from one to 15 years, for tenant improvements. Depreciation expense for buildings and improvements for the three years ended December 31, 2004, 2003 and 2002, was $51.8 million, $48.9 million, and $42.6 million, respectively.

Construction in progress Project costs clearly associated with the development and construction of a real estate project are capitalized as construction in progress. In addition, interest, loan fees, real estate taxes, general and administrative expenses that are directly associated with

and incremental to the Company s development activities, and other costs are capitalized during the period in which activities necessary to get the property ready for its intended use are in progress, including the pre-development and lease-up phases. Once the development and construction of the building shell of a real estate project is completed, the costs capitalized to construction in progress are transferred to land and improvements and buildings and improvements on the consolidated balance sheets as the historical cost of the property. During the lease-up period, the Company depreciates costs associated with the portion of the project that is occupied.

Property acquisitions In accordance with Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations* (SFAS 141), the Company allocates the purchase price of acquired properties to land, buildings and improvement and identified tangible and intangible assets and liabilities associated with in-place leases (including tenant improvements, unamortized leasing commissions, value of above and below-market

KILROY REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

leases, acquired in-place lease values, and tenant relationships, if any) based on their respective estimated fair values. The fair value of the tangible assets of the acquired properties considers the value of the properties as if vacant as of the acquisition date.

Amounts allocated to land are derived from comparable sales of land within the same region. Amounts allocated to buildings and improvements, tenant improvements and unamortized leasing commissions are based on current market replacement costs and other market rate information.

The amount allocated to acquired in-place leases is determined based on management s assessment of current market conditions and the estimated lease-up periods for the respective spaces. The amount allocated to acquired in-place leases is included in deferred leasing costs and other related intangible assets in the balance sheet and amortized as an increase to amortization expense over the remaining non-cancelable term of the respective leases.

The value allocable to the above or below market component of an acquired in-place lease is determined based upon the present value (using a discount rate which reflects the risks associated with the acquired leases) of the difference between (i) the contractual rents to be paid pursuant to the lease over its remaining term, and (ii) management s estimate of the rents that would be paid using fair market rental rates over the remaining term of the lease. The amounts allocated to above or below market leases are included in other assets or other liabilities in the balance sheet and are amortized on a straight-line basis as an increase or reduction of rental income over the remaining non-cancelable term of the respective leases. As of December 31, 2004 and 2003, the Company had a net liability related to above and below market leases of $6.5 million and $0.5 million, respectively. Following is the estimated net amortization at December 31, 2004 for the next five years:

Year	(in 000 s)
2005	$ 1,212
2006	1,199
2007	1,191
2008	1,169
2009	889
Thereafter	862
Total	$ 6,522

Cash and cash equivalents The Company considers all money market funds with an original maturity of three months or less at the date of purchase to be cash equivalents.

Restricted cash Restricted cash consists of cash held as collateral to provide credit enhancement for the Company s mortgage debt, cash reserves for property taxes, capital expenditures and tenant improvements.

Revenue recognition. In accordance with Statement of Financial Accounting Standards No. 13, Accounting for Leases, minimum annual rental revenue is recognized in rental revenues on a straight-line basis over the term of the related lease. In addition, the Company records a capital asset when reimbursements are received from tenants for leasehold improvements constructed by the Company, with the offsetting side of this accounting entry recorded to deferred revenue. The deferred revenue is amortized as additional rental revenue over the life of the related lease. Tenant reimbursement revenue, which is comprised of additional amounts recoverable from tenants for common area maintenance expenses and certain other recoverable expenses is recognized as revenue in the period in which the related expenses are incurred.

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KILROY REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Allowances for uncollectible tenant and deferred rent receivables Tenant receivables and deferred rent receivables are carried net of the allowances for uncollectible current tenant receivables and deferred rent. Management s determination of the adequacy of these allowances is based primarily upon evaluations of historical loss experience, individual receivables, current economic conditions, and other relevant factors. The allowances are increased or decreased through the provision for bad debts.

Deferred leasing costs Costs incurred in connection with property leasing are capitalized as deferred leasing costs. Deferred leasing costs consist primarily of leasing commissions which are amortized on the straight-line method over the lives of the leases which generally range from one to 15 years. Management re-evaluates the remaining useful lives of leasing costs as the creditworthiness of the Company s tenants and economic and market conditions change. If management determines the estimated remaining life of the respective lease has changed, the Company adjusts the amortization period.

Deferred financing costs Costs incurred in connection with debt financing are capitalized as deferred financing costs. Deferred financing costs consist primarily of loan fees which are amortized using the straight-line method, which approximates the effective interest method, over the terms of the respective loans.

Derivative financial instruments The Company is exposed to the effect of interest rate changes in the normal course of business. The Company mitigates these risks by following established risk management policies and procedures which include the periodic use of derivatives. The Company s primary strategy in entering into derivative contracts is to minimize the volatility that changes in interest rates on its variable rate debt could have on its future cash flows. The Company does not enter into derivatives for speculative purposes. The Company employs derivatives that are intended to manage the Company s exposure to interest rate risk. However, the designation memos for these derivatives do not meet the technical requirements under SFAS 133, and thus the instruments do not qualify for hedge accounting.

The Company recognizes all of its derivatives as either assets or liabilities on the Company s consolidated balance sheet at fair value. Unrealized gains and losses related to the change in the market value of the derivatives from period to period are recognized in earnings in gains or losses on derivative instruments.

Minority interests Minority interests represent the preferred and common limited partnership interests in the Operating Partnership and interests held by The Allen Group in the Development LLCs prior to their dissolution on March 25, 2002 (see Note 12). Net income after preferred distributions is allocated to the common limited partners of the Operating Partnership (Minority Interest of the Operating Partnership) based on their ownership percentage of the Operating Partnership. The common limited partner ownership percentage is determined by dividing the number of common units held by the Minority Interest of the Operating Partnership by the total common units outstanding. The issuance of additional shares of common stock or common units results in changes to the Minority Interest of the Operating Partnership percentage as well as the total net assets of the Company. As a result, all common transactions result in an allocation between the stockholders equity and Minority Interest of the Operating Partnership in the accompanying consolidated balance sheets to account for the change in the Minority Interest of the Operating Partnership ownership percentage as well as the change in total net assets of the Company.

Other property income Other property income primarily includes amounts recorded in connection with lease terminations (see Note 19).

Income taxes The Company has elected to be taxed as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended (the Code). To qualify as a REIT, the Company must distribute annually at least 90% of its adjusted taxable income, as defined in the Code, to its stockholders and satisfy

KILROY REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

certain other organizational and operating requirements. The Company generally will not be subject to federal income taxes if it distributes 100% of its taxable income for each year to its stockholders. If the Company fails to qualify as a REIT in any taxable year, it will be subject to federal income taxes (including any applicable alternative minimum tax) on its taxable income at regular corporate rates and may not be able to qualify as a REIT for four subsequent taxable years. Even if the Company qualifies for taxation as a REIT, it may be subject to certain state and local taxes on its income and property, and to federal income taxes and excise taxes on its undistributed taxable income. The Company believes that it has met all of the REIT distribution and technical requirements for the years ended December 31, 2004, 2003 and 2002 and was not subject to any federal income taxes (see Note 23 for tax treatment of the Company s distributions). Management intends to continue to adhere to these requirements and maintain the Company s REIT status.

In addition, any taxable income from the Company s taxable REIT subsidiary, which was formed in August 2002, is subject to federal, state, and local income taxes. For the years ended December 31, 2004, 2003 and 2002, the taxable REIT subsidiary did not have any GAAP or taxable net income and therefore did not incur any income tax expense.

Reclassifications Certain prior year amounts have been reclassified to conform to the current year s presentation. The Company reclassified the change in restricted cash in the consolidated statements of cash flows from a financing activity to an investing activity for all periods presented.

Use of estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates.

Fair value of financial instruments The Company calculates the fair value of financial instruments using available market information and appropriate present value or other valuation techniques such as discounted cash flow analyses. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. The derived fair value estimates cannot always be substantiated by comparison to independent markets and in many cases, could not be realized in immediate settlement of the instrument. Fair values for certain financial instruments and all non-financial instruments are not required to be disclosed. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company at December 31, 2004 and 2003.

Concentration of credit risk 128 of the Company s total 133 Properties are located in Southern California. The ability of the tenants to honor the terms of their respective leases is dependent upon the economic, regulatory and social factors affecting the communities in which the tenants operate.

As of December 31, 2004, 2003 and 2002, the Company s ten largest office tenants represented approximately 28.9%, 29.7% and 32.2% of total contractual annual base rental revenues and its ten largest industrial tenants represented approximately 8.0%, 8.1% and 8.9%, respectively, of total contractual annual base rental revenues. Of this amount, the Company s largest tenant, The Boeing Company, accounted for approximately 6.2%, 7.5% and 9.5% of the Company s total annual contractual base revenues, for the years ended December 31, 2004, 2003 and 2002,

respectively. At both December 31, 2004 and 2003, the Company had approximately $0.6 million in outstanding receivables from this tenant which were primarily reimbursement billings.

The Company has cash in financial institutions which is insured by the Federal Deposit Insurance Corporation (FDIC) up to $0.1 million per institution. At December 31, 2004 and 2003, the Company had cash accounts in excess of FDIC insured limits.

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KILROY REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stock Option Accounting

At December 31, 2004, the Company had one stock option and incentive plan, which is described more fully in Note 15. Effective January 1, 2002, the Company voluntarily adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* (SFAS 123), prospectively for all employee stock option awards granted or settled after January 1, 2002. Under the fair value recognition provisions of SFAS 123, total compensation expense related to stock options is determined using the fair value of the stock options on the date of grant. Total compensation expense is then recognized on a straight-line basis over the option vesting period.

Prior to 2002, the Company accounted for stock options issued under the recognition and measurement provisions of APB Opinion 25 Accounting for Stock Issued to Employees and related Interpretations. The following table illustrates the effect on net income and earnings per share if the fair value based method had been applied to all outstanding and unvested awards in each period.

	Year Ended December 31,		
	2004	2003	2002
	(in thousands, except per share amounts)		
Net income available for common stockholders, as reported	$ 29,988	$ 49,767	$ 38,434
Add: Stock option expense included in reported net income	27	26	23
Deduct: Total stock option expense determined under fair value recognition method for all awards	(30)	(108)	(160)
Pro forma net income available for common stockholders	$ 29,985	$ 49,685	$ 38,297
Net income per common share:			
Basic as reported	$ 1.06	$ 1.81	$ 1.40
Basic pro forma	$ 1.06	$ 1.80	$ 1.40
Diluted as reported	$ 1.06	$ 1.79	$ 1.39
Diluted pro forma	$ 1.05	$ 1.79	$ 1.38

The Company did not issue stock options in 2004 and 2003. The fair value of each option grant issued in 2002 is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions: (a) dividend yield of 7.03% (b) expected volatility of the Company s stock of 24.6% (c) risk free interest rate of 4.88%, and (d) expected option life of seven years. The effects of applying

the fair value provisions of SFAS 123 are not representative of the effects on net income and disclosed pro forma net income for future years because options vest over three years as discussed in Note 15 and additional awards can be made in future years.

Recent Accounting Pronouncements

In April 2004, the Financial Accounting Standards Board (FASB) issued FASB Staff Position FAS 129-1, Disclosure Requirements under FASB Statement No. 129, Disclosure of Information about Capital Structure, Relating to Contingently Convertible Financial Instruments (FSP FAS 129-1). FSP FAS 129-1 provides guidance on disclosures of contingently convertible financial instruments, including those containing contingent conversion requirements that have not been met and are not otherwise required to be included in the calculation of diluted earnings per share. The statement was effective immediately, and applies to all existing and newly created securities. The adoption of this statement did not have a material effect on the Company s results of operations or financial condition.

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KILROY REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In December 2004, the FASB issued Statement 123 (revised), Share-Based Payment (FAS 123(R)). FAS 123 (R) requires that all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. The new standard will be effective in the first reporting period ending after June 15, 2005. The adoption of this statement is not expected to have a material effect on the Company s results of operations or financial condition.

3. Dispositions and Acquisitions

Acquisition of Operating Properties and Undeveloped Land

In December 2004, the Company acquired a property in northern San Diego County from an unaffiliated third-party for a purchase price of $98.0 million. The acquisition included two office buildings, which encompass an aggregate of approximately 281,800 rentable square feet, and 4.0 acres of undeveloped land. The buildings were 90% leased as of the acquisition date. The Company paid $95.4 million in cash and assumed $2.6 million of outstanding obligations for tenant improvements relating to the acquired leases in satisfaction of the purchase price. The acquisition was funded with borrowings under the Company s revolving unsecured credit facility.

In August 2002, the Company acquired one industrial property, including undeveloped land adjacent to one of the Company s stabilized redevelopment projects, located in Santa Ana, California, from an unaffiliated third party for approximately $8.1 million. The property encompasses approximately 107,000 rentable square feet and was 100% leased as of December 31, 2004.

Dispositions

During the year ended December 31, 2004, the Company sold the following properties:

Location	Property Type	Month of Disposition	Number of Buildings	Rentable Square Feet	Sales Price (in millions)
3750 University Avenue Riverside, CA	Office	May	1	125,000	$ 19.5
12752/12822 Monarch Street	Industrial	September	1	277,000	15.3

Garden Grove, CA				
Total	2	402,000	$	34.8

The Company had classified the office property located in Riverside as held for sale as of March 31, 2004, and recorded a $0.7 million impairment loss in the first quarter of 2004 to reflect the property on the balance sheet at its estimated fair market value less selling costs.

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KILROY REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During the year ended December 31, 2003, the Company sold the following properties:

Location	Property Type	Month of Disposition	Number of Buildings	Rentable Square Feet	Sales Price ($ in millions)
4351 Latham Avenue Riverside, CA	Office	April	1	21,300	$ 2.8
5770 Armada Drive Carlsbad, CA	Office	May	1	81,700	14.4
Anaheim Corporate Center Anaheim, CA	Office	June	4	157,800	13.8
4361 Latham Avenue Riverside, CA	Office	July	1	30,600	4.7
Total			7	291,400	$ 35.7

During the year ended December 31, 2002, the Company sold the following properties:

Location	Property Type	Month of Disposition	Number of Buildings	Rentable Square Feet	Sales Price ($ in millions)
3990 Ruffin Road San Diego, CA	Office	September	1	45,600	$ 6.5
23600/23610 Telo Avenue Torrance, CA	Office	November	2	80,000	7.1
Walnut Park Business Center Diamond Bar, CA	Industrial	November	3	165,700	12.0
1240/1250 Lakeview Boulevard Anaheim, CA	Office	November	2	78,900	9.0

Alton Business Center						
Irvine, CA	Industrial	December	9	143,100		13.6
Total			17	513,300	$	48.2

During the years ended December 31, 2004, 2003 and 2002, the Company recorded a net gain of approximately $6.1 million, $3.6 million, and $6.6 million, respectively, in connection with the sale of these properties. The Company used the net cash proceeds from the sale of these properties to fund its development and redevelopment programs, pay down principal on mortgage loans and to repay borrowings under the Credit Facility (defined in Note 10), and finance the Company s share repurchase program (see Note 13). The net income and the net gain on disposition for these properties and the impairment loss have been included in discontinued operations for the years ended December 31, 2004, 2003 and 2002 (see Note 21).

During the year ended December 31, 2002, the Company recognized a gain of approximately $896,000 related to the disposition of an industrial property in Irvine, California that the Company sold in October 2001. This additional gain had previously been reserved for financial reporting purposes until certain contingencies associated with the disposition were resolved. The net income and the net gain on disposition for this property has been included in continuing operations for the year ended December 31, 2002 as it relates to property sold prior to the prospective adoption of Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144) (see Note 21).

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KILROY REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Development and Redevelopment Projects

Stabilized Development Projects

During the year ended December 31, 2004, the Company added the following development project to the Company s stabilized portfolio. This project was completed in 2003 and in the lease-up phase as of December 31, 2003.

Project Name / Submarket/City	Property Type	Completion Date	Stabilization Date	Number of Buildings	Rentable Square Feet
12400 High Bluff Del Mar San Diego, CA	Office	Q3 2003	Q3 2004	1	208,500

During the year ended December 31, 2003, the Company added the following three development projects to the Company s stabilized portfolio. All of these projects were completed in 2002 and in the lease-up phase as of December 31, 2002.

Project Name / Submarket/City	Property Type	Completion Date	Stabilization Date	Number of Buildings	Rentable Square Feet
12100 W. Olympic Blvd West Los Angeles Los Angeles, CA	Office	Q2 2002	Q2 2003	1	151,000
999 Sepulveda Blvd El Segundo, CA	Office	Q3 2002	Q3 2003	1	133,300
3721 Valley Centre Drive Del Mar	Office	Q3 2002	Q3 2003	1	114,800

San Diego, CA		
Total	3	399,100

Lease-Up Redevelopment Projects

During the year ended December 31, 2004, the Company completed the following redevelopment projects, which were in the lease-up phase as of December 31, 2004:

Project Name / Submarket/City	Pre and Post Redevelopment Property Type	Completion Date	Estimated Stabilization Date (1)	Number of Buildings	Rentable Square Feet
5717 Pacific Center Blvd. Sorrento Mesa San Diego, CA	Office to Life Science	Q1 2004	Q1 2005	1	68,000
909 Sepulveda Blvd. El Segundo, CA	Office	Q3 2004	Q3 2005	1	241,600
Total				2	309,600

(1) Based on management s estimation of the earlier of stabilized occupancy (95%) or one year from the date of substantial completion.

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KILROY REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Development Projects Under Construction

During the year ended December 31, 2004, the Company commenced construction on the following two development projects:

Project Name / Submarket/City	Property Type	Estimated Completion Date	Estimated Stabilization Date (1)	Number of Buildings	Rentable Square Feet
15227 Avenue of Science I-15 Corridor San Diego, CA	Office	Q3 2005	Q3 2006	1	65,900
15253 Avenue of Science I-15 Corridor San Diego, CA	Office	Q3 2005	Q3 2006	1	37,400
Total				2	103,300

(1) Based on Management s estimation of the earlier of the stabilized occupancy (95%) or one year from the date of substantial completion.

5. Current Receivables

Current receivables consisted of the following at December 31:

	2004	2003
	(in thousands)	
Tenant rent, reimbursements, and other receivables	$ 10,762	$ 11,291
Allowance for uncollectible tenant receivables	(5,919)	(6,372)
Current receivables, net	$ 4,843	$ 4,919

6. Deferred Rent Receivables

Deferred rent receivables consisted of the following at December 31:

	2004	2003
	(in thousands)	
Deferred rent	$ 53,388	$ 42,471
Allowance for deferred rent	(6,572)	(5,667)
Deferred rent receivables, net	$ 46,816	$ 36,804

7. Deferred Leasing Costs and Other Related Intangibles

Deferred leasing costs and other related intangibles are summarized as follows at December 31:

	2004	2003
	(in thousands)	
Deferred leasing costs	$ 73,001	$ 61,054
Value of in-place leases	6,775	
Subtotal	79,776	61,054
Accumulated amortization	(29,065)	(25,013)
Deferred leasing costs and other related intangibles, net	$ 50,711	$ 36,041

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KILROY REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Charge for Previously Capitalized Leasing Costs

In 2002, Peregrine Systems, Inc. (Peregrine) leased four office buildings totaling approximately 423,900 rentable square feet under four separate leases. Peregrine had filed a voluntary petition for relief under Chapter 11 of the bankruptcy code on September 22, 2002. Peregrine had advised the Company that it likely would not need all of the buildings upon resolution of its financial issues, therefore, during the year ended December 31, 2002, the Company recorded a $5.3 million charge to depreciation and amortization for leasing commissions and certain tenant improvements that were previously capitalized in connection with the leases with Peregrine. In addition, the Company recorded a $0.5 million charge to general and administrative expenses for costs the Company paid for a fifth and final building that was to be leased to Peregrine. Peregrine surrendered this building back to the Company in June 2002, at which time it was still under construction and was not yet included in the Company s portfolio of operating properties (see Note 19).

9. Deferred Financing Costs

Deferred financing costs are summarized as follows at December 31:

	2004	2003
	(in thousands)	
Deferred financing costs	$ 20,256	$ 15,750
Fair value of interest rate cap agreements (See Note 11)		4
Accumulated amortization	(14,407)	(12,097)
Deferred financing costs, net	$ 5,849	$ 3,657

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KILROY REALTY CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. Debt

Secured Debt

The following table sets forth the composition of the Company s secured debt at December 31:

	2004	2003
	(in thousands)	
Mortgage note payable, due April 2009, fixed interest at 7.20%, monthly principal and interest payments	$ 84,857	$ 86,811
Mortgage loan payable, due August 2012, fixed interest at 5.57%, monthly principal and interest payments	80,648	
Mortgage loan payable, due August 2008, fixed interest at 3.80%, monthly principal and interest payments	78,168	79,640
Mortgage note payable, due December 2011, fixed interest at 6.70%, monthly principal and interest payments	77,404	78,377
Mortgage loan payable, due August 2012, fixed interest at 4.95%, monthly principal and interest payments	33,917	
Mortgage loan payable, due January 2009, interest at LIBOR plus 1.10% and 1.75% at December 31, 2004 and 2003, respectively (3.50% and 2.91% at December 31, 2004 and 2003, respectively), monthly interest only payments(a)	31,000	31,000
Mortgage loan payable, due December 2005, interest at LIBOR plus 1.10% and 1.40% at December 31, 2004 and 2003, respectively (3.50% and 2.56% at December 31, 2004 and 2003, respectively), monthly interest only payments(a)	29,000	29,000
Mortgage note payable, due May 2017, fixed interest at 7.15%, monthly principal and interest payments	24,377	25,555
Mortgage loan payable, due August 2007, fixed interest at 6.51%, monthly principal and interest payments	17,529	17,747
Mortgage loan payable, due November 2014, fixed interest at 8.13%, monthly principal and interest payments	10,733	12,324
Mortgage note payable, due December 2005, fixed interest at 8.45%, monthly principal and interest payments	10,349	10,974
Mortgage note payable, due June 2009, fixed interest at 8.43%, monthly principal and interest payments	4,827	6,790
Mortgage loan payable, due August 2007, fixed interest at 7.21%, monthly principal and interest payments	4,669	4,823
Mortgage note payable, due November 2008, fixed interest at 8.21%, monthly principal and interest payments	2,963	4,353
		74,819

Mortgage note payable, due January 2005, fixed interest at 8.35%, monthly principal and interest payments(b)	
Construction loan payable, due September 2004, interest at LIBOR plus 1.85% (2.91% at December 31, 2003)(b)	43,582