Highwoods PROPERTIES

Management's Prepared Remarks
First Quarter 2019 Conference Call
April 24, 2019

Brendan Maiorana
Senior Vice President, Finance and Investor Relations

If any of you have not received yesterday's earnings release or supplemental, they're both available on the investors section of our website at highwoods.com. On today's call, our review will include non-GAAP measures, such as FFO, NOI and EBITDA*re*. The release and supplemental include a reconciliation of these non-GAAP measures to the most directly comparable GAAP financial measures.

Forward-looking statements made during today's call are subject to risks and uncertainties, which are discussed at length in our press releases as well as our SEC filings. As you know, actual events and results can differ materially from these forward-looking statements. The Company does not undertake a duty to update any forward-looking statements.

Ed Fritsch
Chief Executive Officer

Fundamentals in our business remain healthy with rents continuing to rise and stable demand from existing and prospective customers. Based on what we're experiencing "on the ground" and from the macro economic forecasts we read, we expect the low-to-mid 2% economic growth environment to continue, which should keep unemployment low, productivity high, inflation in-check, and interest rates within the range seen during the past several years. We expect this "steady as she goes" backdrop to support healthy demand and keep a bridle on speculative supply.

Turning to our financial results, the sudden closure of Laser Spine on March 1st overshadowed an otherwise strong quarter of leasing and operating fundamentals. As many of you know, Laser Spine was an existing customer of Highwoods with an unblemished track record of timely payments and a strong credit profile when we came to terms on a build-to-suit for their corporate headquarters and surgery center in early 2014. Declining revenues following the negative outcome of a high profile patient lawsuit, coupled with taking on debt, drove a deterioration in their financial condition, which led to the sudden closure of their operations last month. We provided detailed information regarding the financial impact of Laser Spine's sudden closure in our March 3rd press release and again in last night's first quarter earnings release. Mark will provide additional financial details in his prepared remarks.

While undoubtedly very disappointing, and an unexpected, sizable hit to our 2019 financials, the impact from Laser Spine is manageable. Even with losing a full year of NOI and cash flow from our 11th largest customer, we still expect to post positive same property NOI growth and adequately cover our dividend. Please be assured, our entire team is heavily focused and working hard to backfill this space as quickly and prudently as possible.

The Laser Spine lease has already been terminated as part of Laser Spine's liquidation proceeding. Therefore, we have unrestricted access to the entirety of the premises and we are free to sign leases with replacement customers.

The interest we're seeing in what we will now refer to as "5332 Avion" is encouraging. As a reminder, it's standard practice for us to design the structure of our properties to provide long-term flexibility whether they be build-to-suit or multi-customer buildings. We design the building's configuration,

floorplates, stair towers, main entrances, parking, etc., with that flexibility in mind. This is particularly noteworthy for 5332 Avion, where nearly half the tenant improvements are dedicated to medical space. However, we designed 5332 Avion with traditional office bones to provide flexibility. This standard practice is serving us well as we work through options to backfill the building. We're receiving strong, unsolicited interest in 5332 from a number of highly qualified, full-building and multi-floor users. We are fortunate to have good activity, ranging from prospects studying CAD drawings to performing test fits and discussing lease terms.

Turning to our financials, we updated our 2019 FFO outlook. The revised range is $3.29 to $3.39 per share. The $3.34 mid-point is down $0.16 from our prior outlook, which is driven by the full-year $0.17 impact from Laser Spine, and $0.01 dilution from the sale of MetroCenter in suburban Orlando. Neither of these items were included in our prior outlook, and they were partially offset by improvement in the remainder of our business by $0.02. We also reduced our same property NOI growth outlook by 150 basis points solely due to Laser Spine. Excluding Laser Spine, our same property cash NOI growth outlook would be 2 to 3%.

We delivered first quarter FFO of $0.72 per share, including the $0.12 per share Laser Spine impact. We leased 723,000 square feet with strong leasing economics. Namely, GAAP rent spreads were +17.5%, cash rent spreads were +4.3%, and net effective rents were $16.64 per square foot, 8% above our prior five quarter average. Occupancy declined 70 basis points sequentially to 91.2%, driven by the 60 basis point impact from Laser Spine. As indicated by the mid-point of our outlook, we expect occupancy to improve by year-end, which assumes no re-letting of 5332 Avion at this point.

Our development program continues to deliver robust results. For example, a full year and a half ahead of pro forma, we placed in-service two properties that are a combined 99% occupied and represent a total investment of $56 million. 751 Corporate Center in Raleigh, our 91,000 square foot multi-customer property that we announced with 35% pre-leasing, is now over 98% occupied. And, our 113,000 square foot multi-customer Virginia Springs I project in Nashville is 100% occupied, up from 34% pre-leased at announcement. Our development pipeline is now $635 million and 93% pre-leased. This pipeline will provide meaningful cash flow as it delivers over the next few years.

With regard to construction costs, we continue to see them rise at approximately ½ a percent per month, in line with the zip code we've been communicating the past few years. Demand for new space has remained strong despite higher rents. As a reminder, our 2019 development announcement outlook is $100 to $375 million, with $41 million announced so far with GlenLake 7 in Raleigh. We continue to have conversations with a number of sizeable pre-lease prospects across several potential projects. This sustained level of interest leads us to believe the depth of demand should remain active.

Turning to building dispositions, subsequent to quarter end, we closed the sale of MetroCenter, a two-building, 183,000 square foot, non-core property for $32.5 million. This was the last of our suburban Orlando properties, down from a peak of 42% of the division's total square footage. Based on work completed year-to-date, we anticipate closing a number of sales during the second half of the year, and therefore our 2019 outlook for non-core dispositions remains $100 to $150 million.

We've kept our acquisition outlook unchanged at $0 to $200 million. For the few assets that have been in the market, pricing for BBD-located, Class A office properties remains highly competitive with cap rates carrying a 5-handle. We continue to evaluate on and off-market opportunities with a commitment to prudent investing.

Moving to the balance sheet, we issued a $350 million, 10-year bond in February with an effective interest rate of 4.38%. Adjusting for Laser Spine, our debt-to-EBITDA metrics remain in the middle of our stated comfort range of 4.5-to-5.5 times, even while continuing to fund our development pipeline without issuing any shares on our ATM since the 2nd quarter of 2017.

Overall, our properties are performing well with rents continuing to rise and good interest in the limited pockets of availability. Our highly pre-leased development pipeline will help drive increased FFO and cash flow as the projects deliver. We continue to have a disciplined focus on capital recycling and portfolio improvement which, combined with carefully managing op-ex, will result in improved operating metrics. Atop this, we have a strong balance sheet with multiple avenues to fund our continued growth.

Ted Klinck
President, Chief Operating Officer
During the quarter, we had strong leasing economics as evidenced by positive GAAP rent spreads of 17.5% and positive cash rent spreads of 4.3%, while also posting healthy net effective rents of $16.64 per square foot, 8% higher than our prior five quarter average. Atop virtually all of our leases having annual escalators, we've posted positive cash rent spreads in 11 of the past 12 quarters, including eight quarters greater than 3%, while over the same period increasing net effective rents by 14% and in-place cash rents by 10%.

Our portfolio was 91.2% occupied at quarter end, with five of our nine divisions 92.5% or greater. Atlanta and Raleigh, our two largest divisions by square footage, ended the quarter with occupancy below 90%, and thus present sizable organic growth potential. In addition to a positive backdrop with market fundamentals, we are optimistic about our portfolio and expiration outlook. We made meaningful progress the last several quarters reducing future near-term rollover risk, which leaves us with only 6.3% of revenues expiring for the remainder of 2019, and we're upbeat about renewal prospects of our large expirations through the end of 2020. We expect occupancy to improve late in the year. Our year-end occupancy outlook is 91.0% to 92.3%, compared to 91.2% at the end of the first quarter. The mid-point of our year-end outlook of around 91.6% is 40 basis points higher than where we ended the quarter, and assumes no year-end occupancy at 5332 Avion.

In a typical review of expirations larger than 100,000 square feet, we have only one remaining in 2019. This is a 100,000 square foot build to suit for the FAA adjacent to the Atlanta airport that we delivered in 2009. We remain confident in a renewal. We have three remaining large expirations in 2020, and are confident in two of the three. We are very optimistic regarding renewals on the two largest expirations, 210,000 square feet with Vanderbilt in Nashville, and 138,000 square feet with the FBI in Tampa. Finally, as previously stated, T-Mobile will vacate 116,000 square feet at Highwoods Preserve V in Tampa in 2Q 2020. Given our lead time and solid early interest, combined with a healthy parking ratio and efficient floorplates, we're optimistic about backfilling this space.

Now to our markets.

Atlanta posted positive net absorption of 583,000 square feet in the first quarter, as reported by CBRE. We're tracking 3.5 million square feet of multi-customer development underway, which is around 28% pre-leased. This represents 3% of total stock. Midtown has the most activity with around 2 million square feet under construction, while Buckhead only has one project with 340,000 square feet under construction. We signed 208,000 square feet of second generation leases during the quarter with robust GAAP rent spreads of +28%. We continue to make progress releasing the 228,000 square foot, 2635 Century Center property from the low of 20% occupancy in early 2018 to 57% at the end of the first quarter. Additionally, we have signed leases that will bring the property to 77%, plus LOIs for another 11%, taking the property to 88%. At Riverwood 200, our 300,000 square foot, $107 million, multi-customer development, which we announced 39% pre-leased, is currently 97% leased, up nearly 600 basis points from last quarter, and will be placed in service in the second quarter.

The Raleigh market garnered 611,000 square feet of positive net absorption during the quarter according to Avison Young. Class A asking rates increased 9% year-over-year and overall Class A

market occupancy decreased slightly over the same period, ending the quarter at 89%. During the first quarter, four buildings totaling 729,000 square feet were delivered that were 83% pre-leased. Currently, there is approximately 1.6 million square feet under construction spread over six submarkets that is 36% pre-leased, representing 3.2% of total stock. We signed 112,000 square feet of second generation leases during the first quarter with GAAP rent spreads of 12.7%. Our largest opportunity to increase occupancy is the 178,000 square foot 11000 Weston building. We've negotiated lease terms with a prospect for 37% of the space and have solid interest in the remainder.

According to CBRE, in Orlando during the first quarter, there was 252,000 square feet of positive net absorption, including 75,000 square feet in the CBD, where our entire portfolio resides. Market occupancy improved 20 basis points since year-end to 91.3%, while it's 91.6% in the CBD. Rents increased 3.6% during the past year in the CBD. There is 215,000 square feet under construction in the downtown market, which is 87% pre-leased. We signed 82,000 square feet of second generation leases during the quarter with positive GAAP rent spreads of 16.0% and a weighted average lease term of almost 7 years.

Lastly, Tampa experienced positive net absorption of 141,000 square feet for the quarter, as reported by Cushman & Wakefield. Class A rental rates in the CBD and Westshore each increased 6.5% year-over-year, where 92% of our portfolio is located. Occupancy remains healthy at 93.7% combined in these two submarkets. We're tracking 400,000 square feet under construction in Westshore and the CBD, which is 87% pre-leased and represents about 2% of total stock. We signed 105,000 square feet of second generation leases at strong GAAP rent spreads of 24.9%. We're focused on finding users to backfill the T-Mobile space at Preserve V upon their expiration in the second quarter of 2020, and of course as Ed covered in his comments, the re-letting of 5332 Avion.

In conclusion, we had a strong quarter of leasing with continued growth in net effective rents and healthy rent spreads. We're making good progress with future expirations and backfilling the few sizable vacancies in the second generation portfolio. Our $635 million, 93% pre-leased, 1.6 million square foot development pipeline has only two projects that are less than 97% pre-leased. The leasing environment remains healthy and is indicative of continued demand for quality, well-located 1st and 2nd gen office product.

Mark Mulhern
Executive Vice President, Chief Financial Officer
For the first quarter, we delivered net income of $0.07 per share and FFO of $0.72 per share. The quarter included $0.12 per share of FFO charges relating to Laser Spine's sudden closure.

I'll begin my comments on the quarter by walking through the details of the Laser Spine-related charges. The $12.1 million of FFO-related charges includes $1.1 million of accounts receivable credit losses, a $4.1 million write-off of the remaining balance of a note receivable, and the rest is attributable to non-cash straight line rent receivables and lease incentives. These items show up in our first quarter income statement in the rental and other revenue and other income line items.

Let's start with the $7.9 million of items impacting rental and other revenues. It's easiest to walk you through the details using the table at the bottom of page 4 in our Supplemental. The $7.9 million is broken down into three components. First, the write-off of $2.3 million of lease incentives is included in contractual rents. Second, the $4.5 million in straight line rent credit losses are included in the straight line rental income line item. Third, the $1.1 million in accounts receivable credit losses are included in other miscellaneous operating revenues.

We also wrote off $4.1 million of notes receivable, which affects other income on the face of the income statement.

These items make up the total 12 cents per share of FFO-related charges from Laser Spine recorded in the first quarter. Additionally, we wrote off $11.6 million of tenant improvements and deferred leasing costs associated with the building that affected only net income, not FFO. These items were recorded in depreciation and amortization on the income statement.

Excluding Laser Spine, the quarter was otherwise healthy and straightforward. We had no disposition or acquisition activity in the first quarter. We delivered MetLife III, a $65 million, 219,000 square foot build to suit in Raleigh, at the end of the quarter. Therefore, it will contribute to FFO starting in the second quarter.

As Ed mentioned, we updated our 2019 FFO outlook to $3.29 to $3.39 per share, representing a $0.16 per share reduction at the mid-point of our original range. The main changes are $0.17 reduction related to Laser Spine, which is the $0.12 impact we recognized in the first quarter and approximately $0.05 per share impact for the remaining three quarters, plus an estimated $0.01 per share of dilution from the $32.5 million sale of MetroCenter in Orlando after quarter-end. Our updated outlook otherwise implies an improvement of $0.02 per share given the sound business environment.

Our outlook for 2019 same property cash NOI growth is now 0.5% to 1.5%. The $1.1 million accounts receivable credit losses related to Laser Spine is included in same property NOI in Q1 which, combined with the forgone revenue for the remaining 10 months of the year, equates to Laser Spine having a 150 basis point full year impact on our 2019 same property growth outlook. Excluding Laser Spine, our outlook for same property cash NOI remains 2.0% to 3.0%, on target with our initial expectations.

Our straight line rental income outlook is down $4 million, driven by the $4.5 million straight-line rent credit losses associated with Laser Spine. Our year-end occupancy target is 91.0% to 92.3%. We ended the quarter at 91.2% and expect to be steady at the end of the second and third quarters before increasing in the fourth quarter. We reduced our G&A outlook by $1 million to a range of $39.5 million to $41.5 million, primarily driven by lower expected incentive compensation expense. The other items in our FFO outlook – acquisitions, dispositions, development announcements and average shares outstanding – remain unchanged.

Finally, even with the Laser Spine event, we remain confident in our 2019 dividend coverage and cash flow growth trajectory going-forward.

Our balance sheet remains in excellent shape. We issued $350 million of 10-year notes with an effective interest rate of 4.38%. We had strong support from fixed income investors, allowing us to ultimately price at a spread of 160 basis points over the US ten year, with the all-in yield impacted by the hedge we placed on the $225 million of notional principal. We used the proceeds to repay our $225 million, floating-rate term loan that was scheduled to mature in 2020 and reduce borrowings on our credit facility. We have a well-laddered debt schedule with no maturities until the middle of 2021.

Our debt-to-EBITDAre ratio increased to 5 times excluding Laser Spine, right at the middle of our stated comfort range of 4.5 to 5.5 times. As a reminder, this ratio is typically higher in the first quarter as we annualize the seasonally higher G&A in Q1 due to the timing of our annual long-term equity incentive grants. Plus, scheduled NOI coming on line from the delivery of Mars Petcare's HQ and MetLife III will bring the ratio in line with the levels we reported the past several quarters, even as we continue to fund our remaining development pipeline.

Lastly, we issued no shares on the ATM during the quarter. We continue to have strong access to capital and have many avenues to fund our continued growth.