Management's Prepared Remarks
Second Quarter 2021 Conference Call
July 27, 2021

Brendan Maiorana
Executive Vice President of Finance and Treasurer

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 EBITDAre. 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, including the ongoing adverse effect of the COVID-19 pandemic on our financial condition and operating results. These risks and uncertainties 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 and the Company does not undertake a duty to update any forward-looking statements.

Ted Klinck
President, Chief Executive Officer

Let me start by saying we continue to see an increase in more normalized activity across our portfolio and markets. It remains difficult to predict the progression of the pandemic and economic recovery, particularly given the concern over variants, but leasing and parking are both recovering nicely. Utilization rates have risen throughout the second quarter and are currently around 40% across our portfolio, up from 30% last quarter. Based on discussions with our customers, we expect a meaningful increase in utilization after Labor Day.

As I mentioned on our last call, leasing activity in the first quarter was relatively solid, especially for new deals. This trend accelerated during the second quarter as we signed 899,000 square feet of second gen leases, our highest total since the fourth quarter of 2019, and included 323,000 square feet of new deals. This is above our long-term average of 250,000 square feet for new leases. We signed 52 new deals, also above our long-term average and our highest quarterly count of new leases since 2014. Obviously, the strong leasing activity in the quarter hasn't yet shown up in our occupancy stats, where we ended the quarter at 89.5% across the entire portfolio, but this leasing will benefit us in future quarters as our new customers move in. With the improving macro-environment, especially in our markets, we're optimistic going forward.

Rents on signed leases continue to be a little softer than they were pre-pandemic, but we believe are holding up reasonably well considering the challenges over the past 18 months. For the 899,000 square feet of second gen leases signed during the quarter, rents spreads were down slightly at -0.6% on a cash basis while up 8.9% on a GAAP basis. Overall, since the start of the pandemic, net effective rents across our markets are down on average 5-10%, primarily as a result of higher concessions. Fortunately, net effective rents have stabilized in the first half of the year. Further, we continue to see a migration to higher quality buildings with well capitalized owners, which plays to our strengths.

Turning to our results, we delivered FFO of $0.93 per share in the second quarter. Our same property cash NOI growth was very strong at 11.1%, which benefitted from the repayment of temporary rent deferrals agreed to during the first months of the pandemic. Excluding these repayments, same property cash NOI growth would still have been a robust 5.3%. As illustrated in last night's release, we have updated our 2021 FFO outlook to $3.62 to $3.73 per share, up $0.075 at the mid-point from our prior outlook. At the mid-point, $0.03 to $0.04 of the increase is due to our improved operational outlook and $0.04 is from the anticipated net impact of our planned investment activity, which consists of the PAC acquisition and the sale of an additional $207 to $257 million of existing non-core assets by year-end. In addition to the increase in our FFO outlook, we also raised our same property cash NOI growth outlook to 4.25 to 5.5%, up 50 basis points at the mid-point, and we increased the low-end of year-end occupancy outlook. Our new range is 89.5% to 91.5%.

Moving to investments, as you all know, we have agreed to acquire a portfolio of office assets from PAC and accelerate the sale of $500 to $600 million of non-core assets by mid-2022. We're excited about doubling our presence in Charlotte and entering the South Park BBD, adding to our leading position in downtown Raleigh and entering the North Hills BBD in Raleigh. We closed one disposition in the quarter, the 100% leased Preserve VII property in North Tampa for gross proceeds of $43 million. We have numerous other non-core properties in various stages of the marketing process. Our disposition plan is tracking our expectations – both in terms of pricing and timing – and we believe we are well-positioned to meet our target of $250 to $300 million of non-core sales by the end of 2021, including the $43 million already closed. As I mentioned, while we're highly focused on closing the portfolio acquisition from PAC and executing on our non-core disposition plan, we continue to assess additional investment opportunities. Outsized job growth and population growth continue to fuel interest in Sun Belt markets, which has caused pricing for high quality assets in the BBDs of our markets to remain competitive. Rest assured, we will continue to be disciplined allocators of capital and seek only those opportunities that we believe provide healthy risk-adjusted returns.

Turning to development, our pipeline is $394 million and 78% pre-leased. Our $285 million Asurion project in Nashville is on-time and on-budget and will deliver in the fourth quarter. At Virginia Springs II, our recently delivered project in the Brentwood BBD of Nashville, we signed two leases totaling 20,000 square feet during the quarter, which brings the leased rate to 50%, 5 quarters ahead of pro forma stabilization, and we have strong interest in additional space. Finally, at our office project in Midtown Tampa, while we didn't sign any leases during the quarter, we have strong interest from a number of prospects and remain confident in the long-term outlook for the development. The overall Midtown Tampa mixed-use project is just now finishing up with additional retailers opening by the day. There is growing energy around the project, whether from prospective office users, new residents, hotel guests or customers shopping and dining. In addition, we are starting to see increased interest from prospective build-to-suit and anchor customers. We believe this is another sign of a return to healthy office fundamentals across our markets. We have up to $250 million of potential development announcements in our 2021 outlook, have a land bank that can support more than $2 billion of future development and we hope to announce new projects later in the year.

Two other items before I turn the call over to Brian. First, we announced a $0.50 quarterly dividend last evening, which equates to an annualized amount of $2.00 per share. This represents an increase of 4.2% over the prior amount and is our fifth dividend increase since the start of 2017. We've long stated that our cash flow continues to strengthen, which provides strong dividend coverage even with our higher payout. Second, as we also announced last evening, Mark plans to retire at the end of this year. Mark has been an exceptional contributor to Highwoods over the past decade, first as a Board member and second as our CFO. I know I speak on behalf of the entire Highwoods family when I say that it has been our privilege to work alongside Mark. Under Mark's stewardship, we have maintained a fortress balance sheet, continued our long-standing practice of candor and transparency and further strengthened and streamlined our already strong financial reporting and accounting processes. We wish Mark, his wife Kelly and the rest of the Mulhern family the best as he promotes himself into retirement. I am thrilled that Brendan will assume the CFO role upon Mark's departure. As you all know, Brendan has been a key contributor to our leadership team since his first day at Highwoods in May 2016 and has been deeply involved in all of our strategic, investment and financing activities. We expect a seamless transition.

Brian Leary
Executive Vice President, Chief Operating Officer
With two quarters behind us, it has become apparent that the portfolio resiliency we highlighted last quarter is proving the able foundation from which our team is delivering solid results. Our markets are open for business, our customers have returned, or are returning to the office and most customers see the workplace as an important tool in delivering results. There are signs across the portfolio that give us optimism for the future - from in-office utilization rates in Orlando that have climbed to over 60%, to Nashville's airport surpassing 2019 passenger levels to one of our downtown Pittsburgh restaurants achieving sales 20% higher than at the same time in 2019. Couple these anecdotal signs-of-life with major job announcements made since the start of the pandemic that represent 50,000 new jobs and over $7 billion in direct investment, there's an undeniable momentum and a return of optimistic sentiments permeating our markets.

With regard to our customers who merited a rent deferral during the depths of the pandemic, over 80% has been repaid on schedule. For those restaurants repaying via percentage rent, the majority should be back in the black early next year. With these needs-based accommodations playing out as underwritten, this is hopefully the last time we'll need to discuss this subject on a call.

As Ted highlighted, leasing accelerated in the second quarter with Raleigh, Atlanta, Nashville and Richmond representing 75% of our total volume. Occupancy was relatively flat sequentially ending the quarter at 89.5%, and as stated last quarter, we expect occupancy to remain steady in the third quarter. Given our strong leasing activity and positive overall market fundamentals, we are confident this will improve in future quarters as reflected in the mid-point of our updated year-end occupancy outlook.

Now, to our markets.

After weathering the pandemic, Atlanta, Charlotte and Raleigh posted positive net absorption for the quarter and Raleigh led the pack this quarter with 321,000 square feet signed. Occupancy in Raleigh decreased slightly from last quarter, ending at 90.6%, with market rents up 4% and office employment growth up 4.5% both on a year-over-year basis. And, all of this is before the impact of recent announcements by Google and Apple that will add thousands of new jobs to the market.

In Nashville, we signed 106,000 square feet and ended the quarter at 94.1% occupied. Our 111,000 square foot VA Springs II development project is now 50% pre-leased and we have solid interest in the balance. This project is scheduled to stabilize in Q3 2022. We remain on schedule and on budget with Asurion's global headquarters and look forward to placing this $285M asset into service in the fourth quarter. As noted earlier, Music City is back in business with travelers outpacing 2019 levels – including 350,000 downtown for the Fourth of July. On the jobs front, positive momentum continues in the city where Oracle has now closed on approximately 60 acres for their billion-dollar campus and where they plan to hire 8,500 new office-using jobs and Amazon has commenced construction on the second tower for their Operations Center of Excellence - a sign they expect to continue hiring workers in the city to fulfill their 5,000 job goal there.

Moving on to Atlanta where our team signed over 150,000 square feet of leases in the quarter. Year over year office employment growth was 6.1%, higher than the national average of 5.5%. The Atlanta market experienced positive net absorption in the quarter while market rents dipped slightly, down less than one percent year over year.

Not to be outdone by its bigger rivals, Richmond leased over 98,000 square feet for the quarter and is off to a good start in the third quarter with interest from tech, insurance and construction prospects.

Overall, we're encouraged by the strong new leasing activity our team delivered in the first half of the year, and we're off to a solid start early in the third quarter with several new leases already signed and good prospect activity across our markets.

To close, our markets and portfolio continue to not only show their resilience but are centers for activity and growth. While we readily acknowledge that how and where people can and will work has been influenced by the forced experiment we've all been subject to these past 18 months, we are more enthusiastic than ever about the power of place in cultivating talent and culture, solving problems and achieving great things. It is through our work-placemaking efforts that we enable our customers and their teams to achieve together what they cannot apart…and because of this, we remain bullish on the days ahead.

Mark Mulhern
Executive Vice President, Chief Financial Officer
In the second quarter, we delivered net income of $59.3 million, or $0.57 per share, and FFO of $99.5 million, or $0.93 per share, an increase from $0.91 in the first quarter. The quarter included the $43 million sale of Preserve VII, which did not have much of an impact on our financial results since it didn't close until late in June. In other words, this was a relatively clean quarter without unusual items. Our results benefitted from a full quarter contribution of the Forum, where we acquired our partner's 75% interest for $138 million incremental investment in January, and included a full quarter of NOI from our GlenLake Seven development. As a reminder, GlenLake Seven is our $44 million, 125,000 square foot development in Raleigh that is 100% leased and was delivered in March. In addition, we had higher same property NOI growth. The combination of these items – approximately $0.01 from net investment activity and $0.01 from higher same property income – drove the $0.02 sequential increase in the quarter.

Our balance sheet is in excellent shape. In April we used cash on hand plus borrowings on our revolver to repay at par the remaining $150 million of notes that had an effective interest rate of 3.36%, two months earlier than the stated June 2021 maturity. We funded $55 million of earnest money deposits for the planned acquisition of office assets from PAC in the second quarter, and deposited another $5 million subsequent to quarter-end. This leaves approximately $200 million of cash required to initially fund the remaining cash portion of the purchase price. We have multiple sources of available liquidity to satisfy this obligation, including a six-month unsecured $200 million bridge facility that we expect to obtain from JP Morgan, nearly $600 million of remaining capacity on our $750 million revolver, and $43 million of 1031 exchange funds held in escrow from Preserve VII. Said differently, once we close the PAC acquisition we will still have plenty of liquidity available for potential future opportunities. Further, we are 87% funded on our $394 million development pipeline, which leaves roughly $50 million remaining to fully fund the three remaining projects, and we have no debt maturities until November 2022. During the quarter we issued a modest amount of shares on the ATM at an average price of $46.11 per share for net proceeds of $6.8 million. This is our first issuance since the second quarter of 2017. ATM issuances remain one of the many arrows in our quiver and we continue to believe are an efficient and measured way to fund incremental investments, particularly our development pipeline, on a leverage-neutral basis.

Turning to our expectations for the rest of the year, we've updated our 2021 FFO outlook to $3.62 to $3.73 per share, with the mid-point up $0.075 since April and up $0.095 at the mid-point from our original 2021 outlook provided in February. Rolling forward from our prior outlook in April, we have increased the mid-point $0.035 on an apples-to-apples basis, or up $0.06 at the low end and $0.01 at the high end. This improved operational outlook is driven by higher same property NOI and increased contribution from development properties. In addition, the updated FFO outlook includes the anticipated impact from the planned acquisition from PAC and our plan to accelerate non-core dispositions of $250 to $300 million by the end of the year, including the sale of Preserve VII that closed in the second quarter. This net investment activity is expected to have a $0.02 to $0.06 positive impact on 2021 FFO. The high and low ends of the range are largely dependent on the timing of the PAC acquisition and planned dispositions. In addition to our improved 2021 FFO outlook, we also increased our same property cash NOI growth outlook to a range of 4.25% to 5.5%, up 50 basis points at the mid-point. Since the pandemic, we've regularly commented on parking revenues, and while we're still tracking well below 2019 levels, we have seen an uptick in parking over the past couple of months, contributing to our improving outlook.

In addition to solid FFO, our cash flows continue to strengthen – something that we have often highlighted, but where it's clearly materializing in our reported results. Our expectation for continued cash flow growth is being driven primarily by delivery of our development projects and continuous recycling out of older, more capex intensive properties into newer, more capital efficient properties. As Ted mentioned, this improved cash flow outlook helped drive our decision to increase the quarterly dividend 4.2% to an annualized rate of $2.00 per share.

Finally, thanks to all of you on the phone for your patience and support in my time here at Highwoods. As you all know, Brendan is exceptionally well-prepared for this role and will serve all Highwoods constituents well. The future here with Ted, Brian and Brendan at the helm is very bright and I wish them all the best.