Highwoods®

Management's Prepared Remarks
Second Quarter 2023 Conference Call
July 26, 2023

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If you have not received yesterday's earnings release or supplemental, they are 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. 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

During the second quarter, we once again had strong financial and operational results. We further improved our portfolio quality and balance sheet by selling $51 million of non-core assets, leasing activity was healthy, we demonstrated resiliency with our FFO results in the face of higher interest rates, and we posted solid cash flows.

Our markets continue to attract talent as seen by outsized population and job growth compared to other major US cities. CNBC recently published its annual ranking of the top states for business– every core market in which we operate had its state ranked #8 or higher. North Carolina, our home state, which garners the largest share of our total revenues and where we generate 35% of our NOI, was ranked #1 for the second straight year. It is no secret that the state's two biggest metros, Raleigh and Charlotte, generate the majority of the economic growth for North Carolina. Virginia, Tennessee and Georgia followed right behind at #2, #3 and #4, while Texas was #6 and Florida #8. We have long highlighted the benefits of the southeastern United States, with its strong demographic trends, business-friendly environments, low cost of living and high quality of life. In fact, according to Bloomberg, the southeast has accounted for two-thirds of all job growth across the country since early 2020, almost double its pre-pandemic share.

The main question, however, is how do these demographic and national trends translate to results for Highwoods? Let's take a step back and look at our performance:

- We've generated positive same property cash NOI growth for ten consecutive years;
- Our total NOI over the last four quarters is 16% higher than full year 2019;
- Our net effective rents on leases signed over the last 4 quarters is 8.5% higher than our 2019 average; and
- At the mid-point of our 2023 outlook, our FFO per share implies 7% growth over 2019, despite the headwind of higher interest rates.

While availability rates are at cyclical highs, according to JLL, construction starts are down 75% over the past 12 months compared to the prior 5-year annual average and lower-quality office is being taken out of stock at an unprecedented pace. These governors on supply should lead to a reduced amount of available office space, particularly after subleased space continues to get absorbed. This plays directly to our strengths as users strongly prefer high-quality office space in BBD locations with well-capitalized landlords.

Population and job growth continue to be strong across our footprint, demonstrated by 12 leases signed this quarter from users new to market. Most of these are small-to-medium sized leases, which is our sweet spot. As our customers continue to bring their talent back to the office, they are increasingly determining their long-term space needs. As an example, we signed two sizable renewals this quarter far in advance of their lease expirations and they maintained or increased their leased space.

At quarter-end, occupancy was 89.0%. Leasing volume was strong with 918,000 square feet of second gen space, including 222,000 square feet of new leases. Our leasing count was robust with 110 total signed leases, including 39 new leases. Leasing economics were healthy. Rent spreads were +14.7% on a GAAP basis and +0.5% on a cash basis and net effective rents were almost 6% higher than our trailing four quarter average and 12% higher than our pre-pandemic average in 2019. Average rental rates in our portfolio are 3.0% higher on a cash basis compared to one year ago.

Turning to our results, we delivered FFO of $0.94 per share in the second quarter. As expected, same property cash NOI growth was -1.1% as we absorbed higher op-ex and lower occupancy driven by the temporary downtime on the former Tivity space. As a reminder, we do not take vacant buildings out of our same property pool.

On the investment front, we sold three non-core buildings for total proceeds of $51.3 million at a combined 7% GAAP cap rate. These sales were in Raleigh and Tampa, in non-BBD locations. Given the current capital markets environment, we are lowering our 2023 disposition outlook to a total of $200 million, including assets sold to date. Our $518 million development pipeline continues to progress well with all projects on time and on budget. We are 23% pre-leased with at least two years until projected stabilization across all of our spec projects. We have $300 million left to fund and we project annualized NOI of $40 million upon stabilization. We are seeing good prospect activity across our development projects. At GlenLake 3 in Raleigh, we signed an 18,000 square foot user and are seeing increased interest as this project nears completion. We have strong demand at 23Springs in Uptown Dallas and we expect 2827 Peachtree in Atlanta to stabilize by year-end. Following lease-up of Midtown West in Tampa to 100% earlier this year, we are seeing early interest at Midtown East, which has only just broken ground. Midtown East is the only office development under construction in the entire Tampa market and doesn't deliver until the first quarter of 2025.

Turning to our 2023 outlook, we now project full year FFO of $3.69 to $3.81 per share, flat at the mid-point from our outlook in April despite a meaningful interest rate headwind in the last 90 days.

Before I turn the call over to Brian, I want to acknowledge the challenges currently facing the office sector including hybrid work, higher interest rates and the difficultly of obtaining financing for office buildings today. In addition, despite the resilient jobs market, office owners are impacted by the cyclical demand headwinds when heading into a recession or a low-growth environment. As businesses become more cautious about their own growth prospects, they typically become more cautious about their space needs. This will likely pressure occupancy and net effective rents until the office market regains its footing.

However, we remain confident over the long-term because:

- Our SunBelt portfolio is in the region of the country with the strongest demographics and job growth;
- We have a high-quality office portfolio in BBD locations that we believe will continue to outperform the market;
- Our purposeful diversification, whether it be by market, by industry, by customer or by lease size, should enable us to deliver resilient operational performance, which has been among the strongest in the office sector over the past several years;
- Our $518 million development pipeline will generate meaningful NOI as it delivers and stabilizes; and
- Our balance sheet is strong with ample liquidity to fund the remainder of our development spending and all debt maturities until 2026.

Brian Leary
Executive Vice President, Chief Operating Officer

As Ted highlighted, our performance in the second quarter showcases the robust and enduring demand for premium office space in the SunBelt's best business districts and where our team signed 918,000 square feet for the quarter – 20% above our five-quarter average. This includes 222,000 square feet of new leasing over 39 deals, which is in line with our average quarterly new deal count for years 2018 and 2019.

Our leasing activity was diverse among industries with law and engineering firms leading activity for the quarter. We continue to see healthy interest from our small-to-medium sized businesses, our core customers, which continue to maintain the highest levels of physical occupancy throughout our footprint. Echoing this trend, JLL recently reported that year-to-date, companies have enacted new attendance policies for 1.5 million office workers and another one million expected to face similar requirements in the second half of 2023.

Delivering across five markets, our 1.6 million square foot development pipeline is on-time, on-budget, generating significant inbound activity and is generally delivering into voids in our markets and BBDs with regard to new and competitive inventory.

Starting with North Carolina, CNBC's #1 state for business for the second year in a row, the Raleigh market saw 139,000 square feet of positive net absorption for the quarter according to CBRE, office-using employment growth remained above the national average and Apple filed plans to begin work on its previously announced 281-acre campus. Our team signed 276,000 square feet of second gen leases with GAAP rent spreads of 16.4%. Moving to our GlenLake III development, where we remain on schedule for completion in the third quarter, our team signed over 18,000 square feet, bringing the leased percentage to 23%.

In Charlotte, as noted by CBRE, our BBDs experienced positive net absorption and quarter-over-quarter leasing activity for the overall market was up 46%. During the quarter, we signed 104,000 square feet and our two million square foot portfolio is 94.6% occupied.

Heading west to Music City, CBRE highlighted the market's positive quarterly net absorption of 744,000 square feet, Amazon occupied their HQ2 in downtown Nashville and California mainstay In-n-Out Burger announced they would be building their 100,000 square foot Eastern territory office in Franklin. Our team leased 89,000 square feet in the quarter with positive GAAP rent spreads of 17%. We are completing the Highwoodtizing of our Cool Springs buildings and we saw the greatest Brentwood tour activity since the start of the pandemic.

I should also note that Nashville's teammates to the South in Orlando have been hard at work filling up their portfolio which is now 90.7% occupied and has over 200 basis points of additional momentum in the leasing pipeline.

In conclusion, while we aren't immune to the global economic headwinds, the prevalence of sublease space or hybrid future of work, we're off to a good start for the third quarter, our leasing pipeline is healthy, and we are benefitting from the flight to quality and capital occurring in the marketplace. We believe our people are our trophy assets and it is because of their commitment and ability to deliver the greatest commute-worthy experiences that we continue to deliver the positive results we have.

Brendan Maiorana
Executive Vice President, Chief Financial Officer

In the second quarter, we delivered net income of $42.3 million, or $0.40 per share, and FFO of $101.0 million, or $0.94 per share. Results were in line with our expectations, with no significant unusual items. Rolling forward from last quarter, FFO decreased $0.04 due to:

- lower NOI, which reduced FFO by $0.05, driven by lower top line revenue from reduced average occupancy due primarily to the Tivity move-out and higher operating expenses (this reduced NOI was in line with our forecast); and
- higher interest expense, driven by an increase in SOFR, which reduced FFO by $0.02.

This total reduction of $0.07 was partially offset by lower G&A, which added $0.03. The combination of these items nets to the $0.04 reduction in sequential FFO from the first quarter to the second quarter.

As Ted and Brian mentioned, our quarterly leasing stats were solid, with net effective rents showing continued resilience. And, it is not just our leasing stats. Cash flows remain healthy despite the significant headwind from higher interest rates. We believe the resiliency of our cash flows is largely attributable to the active asset recycling we've completed over the past several years. Since 2019, we have sold $1.2 billion of capital-intensive, non-core buildings and recycled into $2.2 billion of newer properties that are less capex intensive and have a higher long-term growth rate. While we are pleased with the progress we've made, portfolio improvement is a continuous process, and therefore we expect to sell additional assets over time. This may result in some uneven quarters from an earnings perspective, but we believe the long-term result will be similar to what has occurred over the past several years – strengthening cash NOI with a more resilient portfolio of high-quality buildings, all while maintaining a flexible balance sheet with ample liquidity.

Turning to our balance sheet, we ended the quarter with net debt-to-EBITDAre of 6.0x, nearly flat from Q1 even though we continued to fund our development pipeline and had lower EBITDA attributable to the NOI headwinds I just mentioned. Further, we improved our liquidity by selling $51 million of non-core properties and we received a net $40 million from the repayment of our preferred equity investment in the McKinney & Olive joint venture. We did provide $10 million of seller financing for a 6-month term at 50% LTV on our sale of Indy Park One; we expect this loan to be repaid in the fourth quarter. We now have nearly $750 million of total existing liquidity, more than enough to fund all of our current capital commitments, including development spending and debt maturities, which total roughly $500 million, through the expiration of our revolving credit facility in March 2026. We do expect disposition proceeds in future quarters and we may be opportunistic and potentially raise additional debt capital later this year or next, but our strong liquidity position allows us to be patient.

As Ted mentioned, we have updated our outlook with no change to the mid-point of our FFO range, which is now $3.69 to $3.81 per share. We have lowered the year-end occupancy range to 88.5% to 90.0%. This is always a challenging metric to forecast given it is a point estimate on the last day of the year. Part of the reason for the reduction is certain customers where we previously projected their leases would commence before year-end, but now expect their leases not to officially commence until early 2024. This change in timing has impacted our projected straight-line rent outlook for 2023. Otherwise, there were no major changes to our FFO outlook. A couple of items to keep in mind going-forward. First, our operating margin in Q1 and Q2 was higher than originally anticipated, which was largely attributable to lower op-ex. We expect lower operating margins in the second half of the year – some of this is normal seasonality, while we also expect some increased repairs & maintenance spending in the second half. Other items that could cause a notable change to our FFO outlook include whether we pursue additional capital raising or other capital recycling initiatives. We did reduce our disposition outlook to up to $200 million for the full year, which includes the $51 million closed to date. As a reminder, any future dispositions are not included in our FFO outlook. Any disposition proceeds would bolster our liquidity and further improve our balance sheet metrics.

In summary, we're pleased with our financial and operating performance in the first half of the year and we're encouraged by the resilience our portfolio has exhibited over the past few years. Further, the lack of new development and capital challenges facing many of the office landlords we compete against positions us for continued strong performance. We believe our strategy of owning high-quality properties in BBD locations in the SunBelt while maintaining a flexible balance sheet with ample liquidity is why we have been able to consistently grow earnings year after year, while simultaneously upgrading our portfolio quality, improving our long-term growth rate and increasing our resiliency.