Management's Prepared Remarks
Third Quarter 2022 Conference Call
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Hannah True
Manager, Finance and Corporate Strategy

If 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. 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

We had another excellent quarter with strong financial results, robust leasing activity and the third consecutive increase to our 2022 FFO outlook. Given continued investor uncertainty around the post-pandemic demand for office space, there are naturally questions about whether or not office landlords can sustain their operating performance. We have enjoyed consistent, healthy demand for office space across our Sun Belt portfolio for seven quarters in a row after only two quarters of below average new leasing during the first pandemic year of 2020. Customers and prospects have been making decisions on leasing space, and we have benefitted from the "flight to quality" to our high-quality portfolio. In our portfolio, since the beginning of 2021, new customers, whether from organic growth, in-migration or flight to quality, have generally offset those who downsize for work from home or hybrid work arrangements.

Our portfolio occupancy has increased 40 basis points over those seven quarters. During this time:

- we've averaged 322,000 square feet of second gen new leases per quarter, 16% above our prior 10-year average;
- we've averaged 12.7% GAAP rent growth and 1.2% cash rent growth;
- we've averaged 5.9 years of term, in line with our long-term average; and
- we've averaged net effective rents 1.5% higher than our average from 2018 and 2019.

While our second gen leasing performance has been strong and consistent, the third quarter was particularly noteworthy. New leasing volume of 518,000 square feet was our highest since 2014. Economics were robust on the total volume of over 1 million square feet, with an average term of 7.4 years, 1 ½ years more than both our five-quarter and 10-year averages, and net effective rents 22% above our five-quarter average.

We believe this performance validates our strategy of owning high-quality workplaces in the most dynamic and vibrant BBDs of our growing Sun Belt markets. With this strategy, we have consistently delivered solid metrics throughout the ups and downs of many business cycles and periods of changing office use patterns. While we don't have a crystal ball, there are obviously headwinds facing the US and global economy. To mitigate the impact of these potential headwinds, we bolstered our liquidity and proactively addressed our largest pending lease expirations, including substantially backfilling our largest 2023 lease expiration. This de-risks our forward leasing plan and leaves us with no remaining expirations representing more than 1% of revenues until late 2024.

Turning to investments, in the middle of August, we completed the previously announced acquisition of SIX50 at Legacy Union in Uptown Charlotte for $203 million. We're seeing excellent activity at the recently completed building, which is 80% leased and we're confident in the long-term outlook. With this acquisition, in less than three years since we entered the market, Charlotte now accounts for over 10% of our NOI. Occupancy in the rest of our Charlotte assets is 98%.

During the quarter, we also sold a mixed-use land parcel in Richmond in our Innsbrook BBD for $23 million, recognizing a $9 million FFO gain. This sale will facilitate the development of retail, residential and hotel uses adjacent to our 1.6 million square feet in Innsbrook. Importantly, the value of our existing and future office will be significantly enhanced by a growing amenity base. As we have mentioned previously, our land bank has never been more attractive with a full build-out of nearly $4 billion. The vast majority of this is master planned for mixed-use development, including office, and is adjacent to existing or future Highwoods assets.

We announced a 100% leased, boutique office building at Morrocroft in Charlotte's South Park BBD. Our team creatively manufactured this opportunity to build a $12 million high-quality project on a surface parking lot that had previously not been considered for development. This quarter, we placed in service Virginia Springs II in Nashville at 100% leased. This $38 million development encompasses 111,000 square feet and was started in late 2019 on a fully spec basis. The ability to deliver this project on-time, on-budget and 100% leased at its scheduled stabilization date despite the pandemic is a testament to our development and leasing team and a strong endorsement for the health of the Brentwood BBD.

Our current development pipeline is $533 million at our share. Our Midtown West project in Tampa is now 92.5% leased and will move to our in-service portfolio next quarter, also in line with our original pro forma. Our five in-process developments represent a total investment of $476 million at our share and are a combined 22% pre-leased. In Dallas, Granite Park Six, our 422,000 square foot office development in the Frisco/Plano BBD, continues to have healthy leasing interest, with more than three years until projected stabilization. 23Springs, our 642,000 square foot development in the Uptown BBD, has a scheduled completion date in 1Q25 and estimated stabilization date in 1Q28. We also have a strong pipeline of prospects for this project and continue to be confident about its long-term outlook.

With rising interest rates and reduced debt availability, the investment sales market has slowed, to state the obvious. Fortunately, our balance sheet is in excellent shape with low leverage and no debt maturities until 2025. We have existing liquidity to complete our development pipeline while maintaining ample dry powder even without assuming any additional asset sales.

Early in the third quarter, we announced our plan to exit Pittsburgh, albeit with no pre-set timetable. While we are now preparing these assets for sale, given the uncertainty in the investment sales market and our strong balance sheet, we can afford to be patient. Over the long run, operating with low leverage enables us to be opportunistic in seeking investments that improve the quality of our portfolio and increase our long-term growth rate, all the while staying true to our mantra of being disciplined allocators of our shareholders' capital.

Turning to our results, during the third quarter we delivered FFO of $1.04 per share, which included $0.07 per share of net land sale gains. The strong performance in the quarter gives us confidence to increase our 2022 FFO outlook again this quarter, the third consecutive increase since we first announced our outlook in February, even with $0.01 to $0.02 per share of higher anticipated interest expense in the fourth quarter. The new range implies a midpoint of $4.03 per share, up 3.5% from last year on an apples-to-apples basis excluding land sales. In addition to healthy FFO growth, as we've often said and can be seen clearly in our financial results, we continue to generate stronger cash flows.

To summarize, our markets, BBDs and portfolio have been resilient and continue to perform well as evidenced by our robust third quarter leasing and the de-risking of our forward lease expirations. Our attractive development pipeline is seeing strong prospect activity and is well-positioned to deliver future growth in NOI, FFO and cash flow. Our land bank has never been more attractive and provides a pipeline of future growth opportunities. Finally, our balance sheet is well-positioned to allow us to capitalize on new investment opportunities. This powerful combination, together with our track record of delivering consistent and compounding growth in earnings, cash flow and dividends while maintaining low financial leverage, makes us confident that we are uniquely positioned to grow, and we firmly believe the best days for Highwoods are ahead of us.

Brian Leary
Executive Vice President, Chief Operating Officer
Our team delivered strong financial and operating results in the third quarter as we continue to provide our customers with the high-quality and commute-worthy workplaces they need to retain, recruit and return talent. While we believe these metrics are definitive measures of past performance (seven quarters in a row as Ted highlighted), what conclusions can we draw about the future of work and the value proposition our BBD work-placemaking, both in urban and suburban locations, presents to those who value culture, creativity and collaboration, whether it be five days a week or via some hybrid model?

We can confidently conclude that the flight to quality is first and foremost a flight to quality of life. This is first apparent in the acceleration of the great migration to the shorter commute, lower cost-of-living, open-for-business and temperate clime of our Sun Belt markets. It is seconded by millennials discovering the benefits of homeownership, now the largest cohort of homebuyers whom the National Association of Realtors note are choosing the suburbs as their destination over 85% of the time. Being students of history, we believe the geography and influences of household formation is a powerful leading indicator that has shaped economic activity and consumer decision-making for generations. Our balanced BBD portfolio is well-served by both trends as our assets are in walkable amenity-rich mixed-use environments that deliver the best formula for a commute-worthy workplace experience.

In Nashville, where we signed 380,000 square feet and ended the quarter over 95% occupied, the team has been hard at work Highwoodtizing our high-quality assets in Brentwood and in Cool Springs, where a new central park with its food and beverage options, playground and live music venue led to our backfilling substantially all of our largest 2023 lease expiration. We also placed into service our 100% leased Virginia Springs II development in Brentwood which we announced in 2019 as a 100% spec development and which delivered and stabilized on time and on budget without missing a beat throughout the pandemic. Cushman & Wakefield noted, the Nashville market at-large posted positive net absorption for the quarter and increased rents 4% year-over-year.

While Nashville and Tennessee deserve to be at the top of many rankings, it is the great state of North Carolina, where we generate over a third of our NOI, that is CNBC's #1 State for Business in 2022. Additionally, Raleigh's #1 ranking by Bankrate as the best place to live in the US and over $3 billion in annual R&D dollars deployed by its universities continues to drive growth for the Triangle region. The market posted positive net absorption for the fourth consecutive quarter and market rents increased 5% year-over-year per Avison Young. We signed 186,000 square feet of leases in Raleigh and ended the quarter 91.4% occupied.

Down Interstate 85 in Charlotte, JLL reported that market rents are up 4.5% year-over-year and the market realized positive net absorption for the second consecutive quarter. We ended the quarter 94.3% occupied. With the acquisition of the 367,000 square foot SIX50 South Tryon tower, we now own two million square feet of the most compelling and commute-worthy buildings or development sites in all three of our targeted Charlotte BBDs – Uptown, the South End and South Park. Notably in Uptown, we are honored to have been chosen as the new home for the Atlantic Coast Conference's headquarters and the University of North Carolina's Kenan Flagler Business School's new Charlotte campus, two tremendous additions to our Legacy Union customer base. In South Park, we re-envisioned and re-zoned Morrocroft this quarter and this work-placemaking is paying off with the announcement of a new $12 million, 100% pre-leased boutique office building. Four Morrocroft will deliver in 2024 along with new food and beverage options for the whole of Morrocroft on land not previously envisioned or permitted for development. We've had a busy three years considering at this time in 2019 we owned no assets in Charlotte.

Looking to model our Charlotte growth and success in our newest market of Dallas, Texas, the region's continued performance provides positive tailwinds to our prospects there. Dallas has, once again, grown population and jobs quarter-over-quarter now topping 8 million residents and over 4 million people employed, both all-time highs. Per Moody's Analytics, office-using jobs grew 8.3% year-over-year with 93,000 new positions. With even the most conservative office density calculation, job growth like this produces real demand for office space across the market. As a reminder, we are under construction in partnership with NAIOP Developer-of-the-Year and Dallas-based Granite Properties on the 422,000 square foot Granite Park Six in Plano and the 642,000 square foot 23Springs in Uptown.

In summary, we believe the best and brightest are better together. We are hearing this from our customers and our continued performance bears this out. While office buildings are built out of concrete, steel and glass, the most solid of materials, talent now has the opportunity to be much more fluid with how it engages with the physical workplace and workweek. We are focused on making our portfolio the most talent-supportive and commute-worthy it can be. We believe in so doing, we'll create great value for our customers, Highwoods and, in turn, our shareholders.

Brendan Maiorana
Executive Vice President, Chief Financial Officer

In the third quarter, we reported net income of $38.3 million, or $0.36 per share, and FFO of $111.6 million, or $1.04 per share. The quarter included net land sale gains of $0.07, which were not included in our prior FFO outlook. Adjusting for the quarter-to-quarter fluctuations in land sale gains, term fees and credit reserves, the major drivers of the change from the second quarter to the third quarter were lower operating margins in 3Q, as we expected, a full quarter impact of the 2Q dispositions and higher average interest rates. These were partially offset by the contribution from the mid-quarter acquisition of SIX50 at Legacy Union in Charlotte. As expected, same property cash NOI growth was negative in the quarter due to higher op-ex and straight-line rent. GAAP NOI growth was positive and, as we have stated before, when GAAP NOI growth is higher than cash NOI growth, it is often a forward indicator of an upward sloping future cash NOI trend.

At the onset of the pandemic, our parking revenues and operating expenses fell sharply. Having slowly normalized over the past couple of years, we now believe 4Q22 will be a good representation of stabilized levels of op-ex and parking on a go-forward basis.

Our updated FFO outlook of $4.02 to $4.04 per share for the full year makes it three quarters of consecutive increases since we provided our original outlook in February. This includes $0.07 per share of net land sale gains in the third quarter, which were not included in the prior outlook, but also includes $0.01 to $0.02 per share of higher anticipated interest expense in the fourth quarter, driven by higher projected SOFR rates and the early repayment of our January 2023 bonds, which is offset by higher projected NOI. Excluding the third quarter land sale gains, the midpoint of the outlook is essentially unchanged from our prior outlook. The other line items in our outlook were largely unchanged other than some minor adjustments to G&A and straight-line rent. Ted mentioned that core FFO, which excludes land sale gains, is projected to be up 3.5% year-over-year at the midpoint of our updated 2022 outlook. This annual growth matches our compound annual growth rate since 2019 and is close to the

3.9% annual growth we've delivered since 2010. In addition, our cash flows have continued to strengthen at a faster pace than FFO during the past few years.

Now to our balance sheet. During the third quarter, we closed a $150 million delayed-draw unsecured bank term loan, which we used to help fund the acquisition of SIX50 at Legacy Union. This loan is scheduled to mature in May 2027 and bears interest at SOFR plus 105 basis points, the same spread as the term loan we obtained in May. Early in October, we obtained an additional $200 million unsecured bank term loan with the same SOFR borrowing spread and a maturity date in the fourth quarter of 2025. We used the proceeds from this term loan plus cash on hand and borrowings under our revolving credit facility to repay, without penalty, a $250 million, 3.75% unsecured bond that was originally scheduled to mature in January 2023. We now have no debt maturities until the fourth quarter of 2025.

We have approximately $360 million remaining to fund our share of the current development pipeline. We have construction loans in place at our Dallas JVs that will account for $190 million of this future spending, leaving only $170 million remaining from additional sources. Our revolver balance, adjusted for the early bond repayment, is approximately $160 million, leaving us nearly $600 million of additional capacity.

Our debt-to-EBITDAre ratio ticked up this quarter to 5.6x with our acquisition and the funding of our initial investment into our Dallas JVs, and without meaningful disposition proceeds. To be clear, our plan is to fund our business on a leverage-neutral basis over the long-term, which means we'll likely sell assets once the investment sales market stabilizes. Our low leverage affords us the flexibility to fully fund our development expenditures without the prerequisite of selling any assets or raising equity, and still maintain low overall leverage. We estimate our net debt-to-EBITDAre ratio will remain under 6x without any dispositions or equity issuances.

In summary, our balance sheet is in excellent shape with limited debt maturities and ample dry powder, giving us plenty of flexibility with our financing plans over the next several years and allowing us to be opportunistic with new investments.