Highwoods®

Management's Prepared Remarks
First Quarter 2023 Conference Call
April 26, 2023

Hannah True
Manager, Finance and Corporate Strategy

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 first quarter, we once again had strong financial and operational results. Leasing activity was solid, same property cash NOI growth was positive, FFO per share was healthy with a sequential increase from the fourth quarter, our cash flows continue to strengthen and we reinforced our already fortress balance sheet by bolstering our near-term liquidity.

Our well-diversified, high-quality portfolio continues to outperform versus our markets and compared to other major metros throughout the US. As we stated last quarter, we believe that to be resilient we must be diversified, which is a core component of our long-stated, simple and straightforward goal of generating attractive and sustainable returns over the long-term. With nearly 2,000 customers, our portfolio is located in 8 core Sunbelt markets with a sharpshooter focus on best business districts, which are both urban and suburban. Our largest market is Raleigh, with just over 20% of our total NOI, our largest customer, Bank of America, is less than 4% of total revenues, our largest industry, Financial Services, is less than 20% of our revenues, our average lease size is under 15,000 square feet and our median lease size is 5,000 square feet.

Further, we believe there is a clear preference for quality when choosing office space, not just high-quality buildings, but also high-quality locations and, of increasing importance, high-quality, financially stable landlords. Our portfolio is outperforming our submarkets by an average of 590 basis points on occupancy, and this outperformance increases to 750 basis points when compared to the US average. We believe we are well-positioned to increase this outperformance as customers and prospects focus even more intently on the quality of the building and the financial health of the property and its owner.

That being said, our portfolio is not immune to the cyclical headwinds that all office landlords face during an economic downturn. While tour activity remains encouraging, we do expect demand will be negatively impacted as customers and prospects become more cautious about their own businesses in the near-term. We do believe that high-quality landlords with high-quality portfolios will, more often than not, benefit from the flight-to-quality.

From a usage perspective, we continue to be encouraged that our customers are increasingly returning to the office. While overall office utilization has not returned to pre-pandemic levels, customers in our markets, from all industries, are realizing the difficulties of replicating the culture, creativity and productivity of their teams when away from the office. Our goal is to provide our customers an environment where their teams want to come into the office to be with their colleagues or, said another way, provide workplaces that are commute-worthy.

Turning to the quarter, we delivered FFO of $0.98 per share. Same property cash NOI growth was solid at +0.8% despite the headwinds of lower occupancy due to a large known customer move-out in Nashville which has already been backfilled, but whose lease doesn't commence until early next year. At quarter-end, occupancy was 89.6%. While overall leasing square footage volume declined modestly with 520,000 square feet of second gen space, including 220,000 square feet of new leases, the number of leases signed remained stable at around 100 for the quarter. Each year, first quarter volume is typically lighter than subsequent quarters given the rush of getting deals done before December 31st. Of note, we signed net expansions of over 50,000 square feet, which follows a strong fourth quarter, and the number of expansions outpaced contractions by a ratio of 5 to 1. Rent spreads were +15.9% on a GAAP basis and +2.0% on a cash basis. Average rental rates are 3.0% higher on a cash basis compared to one year ago.

While it was a quiet quarter on the investment front, we're actively assembling the building blocks to further strengthen the resiliency and long-term growth of our portfolio. We've been busy prepping potential dispositions and have a variety of non-core buildings and non-core land in the market for possible disposition. Our disposition outlook remains up to $400 million for the year, though the upper half of the range seems unlikely given the current capital markets environment. Over time, we're confident in our ability to recycle out of non-core assets, which will help replenish our dry powder for future investment opportunities.

Our $518 million development pipeline continues to progress well with all projects on time and on budget. We are 22% pre-leased with at least two years until projected stabilization across all of our spec projects. We have about $320 million left to fund and we project NOI of approximately $40 million upon stabilization. Our next development delivery, 2827 Peachtree in Atlanta, is scheduled for completion in the third quarter with projected stabilization in 1Q'25 and is already 88% pre-leased with strong interest from additional prospects.

Turning to our 2023 outlook, we now project full year FFO of $3.68 to $3.82 per share, up a penny at the midpoint since our initial outlook in February. Same property cash NOI is projected to be -0.5% to +1.0%, up 25 basis points at the midpoint. All other line items are unchanged.

Before I turn the call over to Brian, I would like to briefly reiterate our performance and outlook:

- Our diversified portfolio across the best urban and suburban BBDs in the Sunbelt continues to perform very well;
- We're prudently investing in our portfolio through our spec suite program and Highwoodtizing projects that will drive additional portfolio outperformance;
- Our $518 million development pipeline will generate meaningful cash flow as it delivers and stabilizes;
- Our full-year 2023 outlook for same property cash NOI and FFO per share are higher at the respective midpoints than originally forecasted; and
- Our balance sheet is strong with a debt-to-EBITDA ratio of 5.9x with ample existing liquidity to fund the remainder of our development spending and all debt maturities until 2026.

Brian Leary
Executive Vice President, Chief Operating Officer

We are pleased with the performance of the portfolio this quarter and appreciate the hard work our teammates have put in to support our customers as they recruit, retain and return their very best to the office. We believe the Highwoods portfolio is tailor-made to capitalize on the flight to commute-worthy experiences in our open-for-business and growing Sunbelt markets.

As Ted mentioned, we believe there are reasons to take a cautious approach around demand growth in the office space as we approach the rest of the year, yet our team continues to see healthy interest from small-to-medium sized organizations and a clear preference towards quality, which includes locations, buildings and owners. This dynamic plays directly to our strengths as our high-quality BBDs, workplaces and sponsorship is resulting in strong outperformance for our buildings. While our portfolio has historically operated at higher occupancy levels than our competition, this outperformance has increased by 490 basis points since the onset of the pandemic and is now nearly 6.0% higher than the markets where we operate. We believe this spread can continue to increase as customers and prospects focus even more on quality.

While some larger customers are holding off on real estate decisions or using this opportunity to streamline operations, our core customers, small-to-medium sized businesses, continue to grow and have consistently generated the highest office utilization in our portfolio. Further, we continue to see customers of all sizes increasing their average number of days in the office. To illustrate this point, our same property parking revenues were up 19% in the first quarter compared to last year and up 9% sequentially from the fourth quarter. In the fourth quarter, we added 80,000 square feet of net expansions and, in this quarter, we added an additional 50,000 square feet. We see our small-to-medium size average customer as a strength within our portfolio, and they serve as a general proxy for the diversified Sunbelt economy.

Turning to market activity for the quarter, CBRE reports that in Tampa, there are 2.3 million square feet of tenant requirements in the market, and it posted positive net absorption for the quarter. Our team there led the quarter for leasing volume with 112,000 square feet of leases signed. In addition, we're already seeing steady interest in our recently announced 143,000 square foot Midtown East development slated for completion in 2025. This project is the only new construction underway in the Westshore or downtown BBDs. With its neighboring project, Midtown West, now over 97% leased, we have benefited from Midtown becoming the premier Westshore address to live, work and play.

Atlanta proved to be our second most active market in terms of leasing activity during the quarter with 81,000 square feet of leases signed. It should be noted, however, that this number does not include leases signed at our joint venture development, 2827 Peachtree, which is now 88% pre-leased, up from 75% at year-end, and on schedule to be completed in the third quarter. Consistent with our own portfolio and experience, JLL noted that the great majority of activity in Atlanta was by tenants less than 10,000 square feet.

Moving to North Carolina, which was again named Business Facilities' most recent "Best State for Business" and where we have approximately 35% of our NOI in the Raleigh and Charlotte markets. We have seen strong activity at 650 South Tryon, our 367,000 square foot asset in Charlotte, which has leased up to 88%, up from 79% when we acquired the building last August. We have also begun construction on our boutique build-to-suit for United Bank in Charlotte's South Park BBD. In Raleigh, our team signed leases for 75,000 square feet and we ended the quarter with occupancy of 90.4% across our 6.3 million square foot portfolio. Our GlenLake III mixed-use development is on track to be delivered on time and within budget by the third quarter of this year.

The work-placemaking experience we are delivering to our customers is competitive currency as they recruit, retain and return talent to the office. They are telling us this in word and in action based on our sustained results throughout the pandemic and now into 2023. We believe our ability to deliver the highest quality workplace experiences has Highwoods well-positioned for the long-term. These experiences are delivered personally by our exceptional Highwoods teammates who manage, lease and maintain our buildings themselves and we so very much appreciate their hard work.

Brendan Maiorana
Executive Vice President, Chief Financial Officer
In the first quarter, we delivered net income of $43.8 million, or $0.42 per share, and FFO of $105.7 million, or $0.98 per share. There were no significant unusual items in the quarter. We had a small term fee and an even smaller land sale gain, both of which were anticipated in our original 2023 outlook that we published in early February. Rolling forward from last quarter's FFO, we posted an increase of 2 cents per share:

- Higher NOI contributed 5 cents, driven by higher rental revenue, improving parking income and higher operating margins;
- Higher unconsolidated JV income contributed 2 cents, primarily driven by the full quarter contribution of McKinney & Olive and also included the deconsolidation of our 50% interest in the Markel JV in Richmond;
- Other income and miscellaneous items added 1 cent for a total of 8 cents of upside; partially offset by
- 3 cents of higher G&A, mostly due to the accounting impact of our annual long-term equity incentive grants which are customarily made in the first quarter each year; and
- 3 cents of higher interest expense.

The combination of these items nets to the 2 cent increase in core FFO from the fourth quarter of 2022 to the first quarter of 2023.

Turning to our balance sheet, where we ended the quarter with net debt-to-EBITDAre of 5.9x, flat from year-end even though we continued to fund our development pipeline and had no meaningful disposition proceeds. We further strengthened our liquidity by obtaining a $200 million, 5-year interest only mortgage with a 5.69% fixed rate secured by Bank of America Tower in Charlotte. This execution highlights the benefits of our low-levered, largely unsecured balance sheet combined with our high-quality portfolio. We were able to pivot to the mortgage market where pricing is currently more efficient and attractive than the unsecured market, yet still maintain a largely unencumbered asset pool and maintain strong credit metrics for our bondholders and banking partners. At quarter-end, we had $685 million of existing liquidity and this amount increased to $725 million following the redemption of our preferred equity investment in the McKinney & Olive JV. We have only $329 million remaining to fund on our development pipeline and no consolidated debt maturities until the fourth quarter of 2025. We have ample liquidity to fund all of our capital needs, including development spending and debt maturities, through the expiration of our line of credit in March 2026 without the need to raise any additional capital or receive any disposition proceeds. To be clear, we do expect disposition proceeds as we move throughout this year, and we plan to be opportunistic about raising additional debt capital later this year or next, but our liquidity position affords us the ability to be patient. In addition, our investment grade credit ratings were recently affirmed by both of our rating agencies with stable outlooks.

As Ted mentioned, we've updated our outlook with an increase to the midpoints of same property cash NOI and FFO. Our revised FFO range is $3.68 to $3.82 per share, up $0.01 per share at the midpoint. The major changes from our prior outlook at the midpoint of the range are a two-cent increase from higher anticipated NOI attributable to stronger leasing, better parking revenues and lower opex, partially offset by a one-cent reduction from the net impact of the $40 million redemption of our M&O preferred equity investment.

As mentioned earlier, we started with a strong first quarter. A couple of items to keep in mind going-forward. First, our operating margin in Q1 was higher than originally anticipated, which was largely attributable to lower operating expenses. Some of the reduced expense items are expected to be incurred later in the year and, therefore, we project operating margins will be 100-150 basis points lower for the full year compared to Q1. Second, we will incur the full quarter impact of two large customer move-outs in Q1, most of which has been backfilled but won't commence until next year. Finally, with the redemption of the preferred equity investment in the M&O JV that had been previously paying us monthly distributions at a rate of SOFR plus 350 basis points, other income will be lower.

We have included up to $400 million of potential dispositions in our outlook. While the upper half of the range may be challenging to reach this year given the current state of the investment sales market, we are seeing good interest in smaller buildings and some of our land parcels that are better suited to non-office development. We expect any disposition proceeds would bolster our liquidity and further improve our balance sheet metrics.

Finally, as we've mentioned many times during the past several years, our cash flows continue to strengthen. This quarter is an excellent example as our cash available after distribution was $20 million, even after absorbing a full quarter's impact from higher interest rates. The ability to recycle capital back into the business, whether into development, acquisitions or Highwoodtizing projects, is a major reason why we've been able to consistently grow earnings year after year, on a leverage-neutral basis, while simultaneously upgrading our portfolio quality, improving our long-term growth rate and increasing our resiliency.