Highwoods PROPERTIES

Management's Prepared Remarks
Third Quarter 2020 Conference Call
October 28, 2020

Brendan Maiorana
Executive Vice President, Finance

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. Also, 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 and the Company does not undertake a duty to update any forward-looking statements.

Currently, one of the most significant factors that could cause actual outcomes to differ materially from our forward-looking statements is the potential adverse effect of the COVID-19 pandemic, and federal, state and local regulatory guidelines and private business actions to control it, on our financial condition, operating results and cash flows, our customers, the real estate market in which we operate, the global economy and the financial markets. The extent to which the COVID-19 pandemic impacts us and our customers will depend on future developments, which are highly uncertain and cannot be predicted with confidence, including the scope, severity and duration of the pandemic and the resulting economic recession and potential changes in customer behavior, among others.

Ted Klinck
President, Chief Executive Officer

Let me start by saying I hope you are all well and your families are safe and healthy. As mentioned on our last call, the Highwoods teams across our markets have safely returned to our offices, which is allowing us to reap the benefits of collaboration and our Company's unique culture. Across our 27 million square foot portfolio we estimate utilization is approximately 25% on average, which has increased since the end of the summer, but is below our first COVID-revised outlook we provided in April. We don't expect a sizable increase in utilization until at least early 2021.

It remains difficult to predict the duration and severity of the current recession and when leasing activity will recover. While we're all hoping for a return to pre-pandemic office fundamentals, we're still well positioned in the current environment given our lack of large customer expirations over the next few years, our ability to control op-ex and the built-in growth from our highly pre-leased development pipeline. Plus, we further strengthened our fortress balance sheet this quarter by raising $400 million of 10½ year bonds at an attractive rate. We have ample liquidity to fund the remaining spend on our development pipeline and still have plenty of dry powder to capitalize on future growth opportunities.

In addition to having a high-quality portfolio and strong balance sheet, our markets continue to benefit from positive demographic trends – both population and job growth. To this end, the Urban Land Institute's recently published 2021 Emerging Trends in Real Estate report listed Raleigh as the #1 market for overall real estate prospects. Nashville came in at #3, Charlotte #5, Tampa #6 and Atlanta #11. These 5 markets constitute more than 75% of our NOI. We're seeing this national story of jobs migrating to our footprint verified in the inquiries we're receiving. We've hosted numerous out of town

prospects seeking space – ranging from large to small – and our partners at the various economic development agencies across our markets indicate the pipeline of out of town users seeking relocations continues to be robust.

On a related note, the big elephant in the room for office landlords is obviously the long-term impact of work-from-home policies. Brian will go into more detail about what we're seeing in our markets and, while it's still early, work-from-home has not yet had any meaningful impact on leasing decisions by existing customers or prospects. Thus far, we've only experienced a few small customers who elected not to renew based on their plan to work from home, and some of these may be temporary solutions.

In the third quarter, we delivered FFO of $0.86 per share, which included a cumulative $0.05 impact from a debt extinguishment charge and non-cash write-offs of straight line rent due to the conversion of certain leases from fixed rent to percentage rent. Adjusting for these items, our FFO would've been $0.91 per share, a solid performance given the challenging economic environment. In addition to healthy FFO, our portfolio metrics were strong. In-place cash rents are up 5.2% compared to a year ago, which helped drive same property cash NOI growth of +2.2% excluding the impact of temporary rent relief deals, even with average occupancy down. This performance was consistent with last quarter's +2.4%. As expected, occupancy dipped sequentially to 90.2% driven predominantly by T-Mobile's expiration in Tampa. We expect occupancy to hold firm around 90% in the fourth quarter.

We leased 660,000 square feet of second gen office space with GAAP rent growth of 12.5% and cash rent growth of 5.0%, and this was done with limited leasing capex, which drove net effective rents 7.2% higher than our prior five quarter average. New leasing volume rebounded to 190,000 square feet, and while still below our normal quarterly volume of 200,000 to 250,000 square feet, we're encouraged by the sequential uptick and improved level of prospect activity over the past month.

Since the start of the pandemic, our monthly rent collections have been consistently strong. We collected 99.7% of our rents in the third quarter and have collected 99.7% of October rents. Temporary rent deferrals equate to 1.2% of annual revenues, unchanged from last quarter, and repayments are occurring on schedule. To date, we've received repayment of approximately 25% of total deferrals and remain on track to be largely repaid by the end of 2021.

Turning to investments. We have made significant progress on phase two of our market rotation plan to exit Greensboro and Memphis. We closed $23 million of dispositions early in the third quarter that we disclosed in our 2nd quarter earnings release, and we expect $128 million of dispositions in the fourth quarter. These sales will bring phase two dispositions to $151 million for the year at prices that are in line with our pre-pandemic expectations. As reflected in our updated FFO outlook, these sales will be dilutive in the near-term as we carry excess cash on our balance sheet, but we're confident we'll be able to replace this income as we redeploy the proceeds.

On the acquisition side, for the few high-quality buildings that have come to market since the pandemic started, pricing has been very competitive, especially for buildings with high occupancy, limited near-term lease roll and credit-worthy customers. We're actively looking for opportunities to deploy capital, which is why we kept our 2020 acquisition outlook range unchanged at $0 to $200 million. However, we'll stay true to our mantra of being disciplined allocators of capital and only seek opportunities where risk-adjusted returns make sense for our shareholders.

Our 1.2 million square foot, $503 million development pipeline remains on budget and on schedule. We've funded 73% to date and expect to fund most of the remaining $138 million by the end of next year. Since our last call we have signed leases at both of our spec projects, one at Midtown West in Tampa and the other at Virginia Springs II in Nashville. These deals bring our overall pre-leased rate to 79%. In addition to the leases signed, we have seen increased prospect activity at both of these projects in the past several weeks. The three other projects in our development pipeline are fully pre-leased and

on schedule to meet their delivery dates. Upon stabilization, our pipeline will provide more than $40 million of NOI, of which more than $32 million is already secured through signed leases. New build-to-suit and anchor pre-lease conversations have slowed down compared to pre-pandemic levels. We don't expect any new project announcements this year, and therefore we took the possibility of new development announcements out of our updated 2020 outlook. However, we're still having conversations with prospects that could lead to build-to-suits or highly pre-leased development announcements in 2021.

Now to our updated 2020 FFO outlook of $3.59 to $3.61 per share. As I mentioned earlier, we incurred $0.05 of expenses this quarter due to debt extinguishment charges and non-cash straight line rent write-offs. In addition, fourth quarter dispositions will be dilutive by a penny per share. These items, which negatively impact our full year results by $0.06 in the aggregate, were not in our prior outlook of $3.59 to $3.68. Excluding these items, the mid-point of our updated range is up 2 ½ cents compared to last quarter. As a reminder, potential lost rents from customer defaults and non-cash straight-line credit losses for the remainder of 2020 are too speculative to project.

Finally, our performance the past few quarters demonstrates our ability to quickly adapt to changing macro conditions through reduced op-ex and meeting customers' needs with flexible and creative lease solutions. Plus, our limited lease expirations puts us in good position to mitigate the impact from the recession. We also have built-in growth from our development pipeline and have a balance sheet with plenty of capacity to pursue additional growth opportunities. We're cognizant of the near-term challenges facing us from the current environment, but we're confident we have the ingredients to drive sustainable growth over the long-term.

Brian Leary
Executive Vice President, Chief Operating Officer

While leasing volume was lower in the third quarter than the second, we did see a sequential increase in activity levels. During the quarter we signed 660,000 square feet of second-generation leases with GAAP rent spreads of +12.5%, cash rent growth of 5.0% and net effective rents that were 7% above our prior five-quarter average, just short of the record set in the fourth quarter of 2019. With regard to new leasing, activity picked up in the third quarter with 190,000 square feet of new deals and 8,000 square feet of expansions. The renewal of the FAA in Atlanta during the quarter finalized our last remaining expiration over 100,000 square feet during the next two-plus years. With this renewal in hand, we now have only 18% of our portfolio expiring over the next 9 quarters, which is down over 500 basis points compared to this point a year ago and our long-term historical average.

As Ted discussed, rent relief deals held steady at 1.2% of our annual revenues. With in-bound relief requests slowing to a trickle we're focused on rent collections and creative solutions for customers with needs-based requests. To that end, and as a testament to the quality of our customers, our collections are strong with 99.7% of all rents collected in the third quarter and for October. As we mentioned in the press release, we also converted a small number of leases from fixed rent to percentage rent. These few leases were done for customers whose businesses have been severely impacted by social distancing measures, and we preserved the potential to receive full rent over the life of the lease.

Let's now drill down and take a closer look at our markets where activity has picked up since Labor Day. Across the board and specifically in Tampa, Raleigh, Nashville and Atlanta, tours are up, new requests for proposals have come in and we are seeing inbound interest from out-of-town prospects looking to grow or relocate to our markets. To this end, 25% of new deals in the quarter are new-to-market, coming from the west coast, Midwest and Northeast.

We've consistently touted our BBD-location strategy, which contains a mix of highly amenitized urban and suburban locations across our footprint. We've seen validation of this strategy in the superlatives

provided in the recently-released 2021 Emerging Trends in Real Estate report – published annually by ULI and PricewaterhouseCoopers. Four of our markets place in the top six, including our hometown of Raleigh – where we own and operate close to 5,000,000 square feet – coming in at #1.

As one would expect, and consistent with previous recessions, the availability of sublease space is increasing. However, in our portfolio sublease space remained steady in the third quarter. Price discovery on rents is limited due to low volume and a high proportion of short term renewals, but for the moment face rates are holding steady, while we do expect downward pressure on net effective rents as concessions increase. Vacancy increased 20 bps across our markets for the quarter.

As Ted mentioned, we haven't seen work from home policies have a big impact on customer leasing decisions. Specifically, in 2020, we have had seven customers, ranging in size from 1,200 to 4,300 square feet, who did not renew leases in favor of working from home, and several of these indicated this decision may be temporary. We believe the characteristics that made our markets centers of growth prior to the pandemic are receiving increased attention as organizations and individuals reevaluate their geographic plans and preferences. Anecdotal evidence suggests the attractiveness of our markets could be an accelerant for inbound relocations for corporate users and individuals. Our highly amenitized BBDs are generating significant interest where less dense workplaces and plentiful parking are welcome alternatives for many customers.

In Charlotte, where after five years straight of positive quarterly absorption, the market recorded its first negative quarter in the third quarter, with the footnote that rents are up 3% and major inbound announcements such as Centene's 1,000,000 square feet and 3,000+ new jobs are just now getting going, while construction on major new offices for Honeywell, Lending Tree, Duke Energy and the Lowes Global Technology Center are still finishing up. Markedly different from the previous recession, Charlotte is now recognized as a growing and stable tech hub – exemplified by its #1 ranking atop RCLCo and CapRidge's STEM Job Growth Index.

In good company on the same Index at #5 for growth, and with an already-established global reputation as a tech hub, the Raleigh market posted positive net absorption in the third quarter. Our portfolio occupancy there held firm and we signed 167,000 square feet.

Let's now go down to the home of the Stanley Cup winners, World Series competitors and, at the very least, Super Bowl-hosters in Tampa where rents have increased 4% year-over-year and the market saw over 200,000 square feet of in-bound inquiries from out-of-market prospects this quarter. Labeled a "Boom Market" and a member of the "Super Sun Belt" by ULI's Emerging Trends report, Tampa is highlighted as a metro area with less exposure to industries most affected by COVID-19 – in addition to its low cost of living and business friendly government. Our talented Tampa team was busy in 3Q. The team signed 80,000 square feet of leases and toured several prospects through Avion and Midtown Tampa – where the mixed-use development is racing toward delivery next year, and where our new 150,000 square foot office building is rising directly above an REI, next door to Whole Foods and luxury apartments, and down the block from Shake Shack and two new hotels.

In closing, we wouldn't be where we are today without the tireless dedication of our amazing team – from every maintenance tech, property manager and leasing agent, each Highwoods colleague adds their individual excellence in the pursuit of superlative results. By developing, leasing, operating and maintaining our portfolio ourselves, we do so as stewards entrusted with creating and sustaining the ideal environment for our customers to thrive in. Doing so in normal times is exceptional, doing so throughout a pandemic is extraordinary. To each and every one of them, we sincerely say "thank you."

Mark Mulhern
Executive Vice President, Chief Financial Officer
In the third quarter, we delivered net income of $40.3 million, or $0.39 cents per share, and FFO of $91.7 million, or $0.86 cents per share. As Ted mentioned, the quarter included a debt extinguishment charge and non-cash straight line credit losses, which reduced FFO by $0.05 cents per share. Neither of these items were included in our prior FFO outlook. Excluding these two items, our FFO would have been $0.91 cents per share, which compares favorably to $0.88 cents per share in last year's third quarter, also after excluding one-time items associated with the market rotation plan from a year ago. To put this in context, "clean" FFO is up about 3.5% year-over-year with leverage essentially unchanged, while we have entered Charlotte with a trophy building, exited the majority of our Greensboro and Memphis properties, and operated during a pandemic and severe recession. This growth was due to higher rents, reduced operating expenses, keeping tight control on G&A and taking advantage of the debt markets to reduce interest expense. The macro environment remains challenging, but we've been pleased with our ability to adapt quickly and deliver strong financial results.

Our balance sheet is in excellent shape. We issued $400 million of 10 ½ year bonds with an interest rate of 2.65%. We used some of the proceeds to retire $150 million of our 2021 bonds early and repaid a $100 million term loan due in early 2022. After repaying the balance outstanding on our revolving line of credit and continuing to fund development we ended the quarter with $119 million of cash on hand. Our net debt-to-adjusted EBITDAre ratio was steady at 5.0x and our leverage ratio, including preferred stock, is 36.6%. We have $138 million left to spend to complete our development pipeline and no debt maturities until June 2021. The combination of more than $700 million of current liquidity and projected fourth quarter disposition proceeds puts us in a strong position to fund our remaining capital obligations while leaving us ample room for future growth opportunities without the need to raise additional capital.

Turning to our outlook, we've updated our FFO range to $3.59 to $3.61 per share. This includes $6.5 million, or $0.06 cents per share of dilution from the following items that weren't in our prior outlook:

- $3.7 million debt extinguishment charge;
- $1.5 million non-cash straight line rent credit losses due to conversion of leases from fixed rent to percentage rent; and
- $1.3 million net impact of lower FFO from 4th quarter dispositions

Excluding these items, our FFO outlook would've been up 2 ½ cents at the mid-point. Last quarter we detailed a penny of dilution from items that weren't in our original FFO outlook. When adjusting for these non-operational or non-cash items that were not in our original outlook, the mid-point of our revised range would be a penny per share above the mid-point of our original FFO outlook we provided in early February. Given the significant impact the pandemic and ensuing recession has had on the economy and our business, we believe our operating and financial results have been excellent.

Last quarter, we provided a list of projected impacts from the COVID-19 induced economic slowdown, with the primary takeaway that parking revenues were expected to be low for the remainder of the year, but this reduction would largely be offset by lower op-ex. We didn't update this table in last evening's press release because our expectations are essentially unchanged. We also continue to expect cash flow to improve in the near-term due to lower leasing cap-ex.

As Ted mentioned, we expect to close $123 million in dispositions before year-end, which will bring 2020 dispositions to $151 million, excluding the $338 million of phase one market rotation plan dispositions we completed in the first quarter. We have maintained our original acquisition outlook of $0 to $200 million as we're currently evaluating certain opportunities. We don't expect any development announcements this year, and thus have eliminated this potential from our outlook.

Finally, as you know, we will provide our 2021 outlook with our fourth quarter earnings release in early February. However, here are a few noteworthy items to highlight as we get close to the new year:

- First, we're fortunate as we have ample liquidity and low leverage to deploy capital into potential growth opportunities.
- Second, we're carrying more cash than normal on our balance sheet following our debt issuance in the third quarter, which will be dilutive in the near-term, but should normalize as we pay-off the remainder of the 2021 bonds in April and fund development expenditures.
- Third, we expect $40 million of NOI from our development pipeline upon completion and stabilization, and most of this is secured through signed leases. GlenLake 7 will deliver in early 2021, while the other projects in the pipeline are expected to contribute more substantially in 2022.
- Last, we've been able to quickly adapt to the current environment by reducing op-ex to offset lower parking revenues, and while we expect op-ex will rise as portfolio utilization increases, we believe we'll be able to hold on to some of these savings even as utilization levels recover.

Looking forward, we continue to remain positive about the long-term outlook for Highwoods.