Highwoods
PROPERTIES

Management's Prepared Remarks
First Quarter 2021 Conference Call
April 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. 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.

One of the most significant factors that could cause actual outcomes to differ materially from our forward-looking statements is the ongoing adverse effect of the COVID-19 pandemic 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 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 its ongoing impact on the U.S. economy and potential changes in customer behavior, among others.

Ted Klinck
President, Chief Executive Officer
Let me start by saying our buildings, which have remained open since the start of the pandemic, are starting to see utilization rates rise, albeit modestly. We estimate portfolio utilization is around 30%, up about 5% from three months ago. Generally, small and medium sized customers are returning to their offices faster than larger users, though we are now hearing customers of all sizes are planning to return to their offices over the next few months.

As I mentioned last quarter, it remains difficult to predict the duration and severity of the current recession and when leasing will return to pre-pandemic levels, but activity has definitely picked up compared to one quarter ago. During the first quarter, we signed 553,000 square feet of second generation leases, including 247,000 square feet of new deals, roughly in line with our long-term average for new leases. The count of new deals signed was a healthy 42, also around our long-term average. In addition, we continue to see increased requests for proposals, showings, and space planning from prospects, and there are several existing customers requesting renewals far in advance of their expirations. With the improving macro environment, particularly in our markets, we're optimistic going forward.

Part of our optimism stems from the numerous companies who have announced job growth plans in our markets. Companies such as Oracle, Google, Fidelity, Microsoft, Robinhood, NTT, ServiceMaster, Adecco, Airbnb and BioGen have all announced hiring plans in our markets in just the past three months. Some are migrating from other locations and others are expanding. Plus, just this week, Apple announced plans to build out what will become its largest campus on the east coast, right here in Raleigh where it will hire over 3,000 people with average salaries of $187,000 and invest over $1 billion.

Importantly, these employers are not planning major work from home initiatives in our markets. Rather, their major investments represent new workplaces that will bring employees together vs. working from home.

Rents on signed leases are naturally a little softer than they were pre-pandemic, but we believe are holding up reasonably well considering the challenges over the past year. For the 553,000 square feet of second generation leases signed during the quarter, rents were modestly positive with 0.5% cash rent growth and 8.1% GAAP rent growth. On average, the movement in market rents is consistent with what we have anticipated with net effective rents down 5-10% as a result of higher concessions. What we are seeing is a migration to higher quality buildings, and in particular small-to-medium sized users that are seeking space in the best buildings in the BBDs across our markets.

Turning to our results, we delivered FFO of $0.91 per share in the first quarter. Our same property cash NOI growth was also strong at 5.7% and 4.8% when excluding temporary rent deferral repayments. As expected, occupancy dipped in the first quarter to 89.6%, where we expect it to remain before improving late in the year. Our first quarter results and outlook for the remainder of the year give us the confidence to increase our FFO outlook to $3.54 to $3.66 per share, up 2 cents per share at the mid-point. This outlook does not include any impact from the planned investment activities we announced last week: our agreement to acquire a portfolio of office assets from Preferred Apartment Communities (PAC); and ultimately fund the acquisition by accelerating the sale of non-core assets. We will update our outlook when the acquisition closes. In addition to the increase in our FFO outlook, we also raised our same property cash NOI growth outlook to 3.50-to-5.25%, up nearly 40 basis points at the mid-point.

Turning to investments, obviously, the biggest investment news for our Company is our agreement to acquire a portfolio of office assets from PAC for a total investment of $769 million and the corresponding acceleration of $500 to $600 million of non-core dispositions. We expect to close the PAC acquisition in the third quarter. As you know from our call last week, we're upbeat about this acquisition as it improves our portfolio quality, increases our long-term growth rate and provides immediate and ongoing financial benefits. An important component of our strategy is to fund the acquisition primarily by selling non-core assets across several markets. Our plan is to sell $500-600 million by mid-2022, roughly half of which we expect to close by year-end 2021. Most of the buildings teed up for sale in 2021 are fully occupied, single-tenant properties with long weighted average lease terms, which we believe will garner strong reception from prospective buyers. These properties are already in the market or will be launched soon. We're not seeing any significant change in asset prices compared to pre-pandemic values for high-quality assets with limited near-term lease roll in the BBDs of our markets. Job and population growth that regularly exceed national averages, combined with the maturation of our cities, continues to fuel interest in Sun Belt markets. In fact, institutional investors who have historically focused only on gateway markets are now focusing on our markets, validating what we've been saying for many years.

Turning to development, we placed in service two 100% leased developments that have a combined value of $108 million and encompass 345,000 square feet. Our remaining pipeline is now $394 million and is 75% 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 best-in-class project in the Brentwood BBD of Nashville, we signed a 30,000 square foot lease during the quarter, which brings pre-leasing to 32%, six quarters before projected stabilization. Finally, at our office project in Midtown Tampa, prospect activity is increasing as the overall mixed-use development is nearing completion. The Element and Aloft hotels opened before the Super Bowl, the REI co-op opened in March, the Whole Foods, Shake Shack and numerous other restaurants and retailers are scheduled to open in the coming months, and the apartments have begun leasing to new residents.

Before I turn the call over to Brian, I would like to reiterate our strong performance so far this year. To recap, in the first quarter, we:

- collected over 99% of rents;
- signed 247,000 square feet of new leases;
- delivered two 100% leased development projects representing an investment of $108 million; and
- maintained a strong balance sheet with leverage of 37% and a debt-to-EBITDAre ratio of 5.1x.

Given this performance, we have updated our 2021 per share FFO outlook, with a 2 cent increase at the mid-point, and raised our same property cash NOI outlook nearly 40 basis points at the mid-point. We have limited lease rollover risk during the next few years, built-in growth from delivery of our development pipeline, recovering momentum in our markets and improving activity within our own leasing pipeline. And, we're excited to once again deploy our proven playbook of opportunistically using our balance sheet for attractive investments, such as the planned acquisition of a desirable and resilient portfolio of office assets from PAC, and then subsequently selling non-core assets with less upside to return our balance sheet to pre-acquisition metrics to reload our dry powder. In summary, we're confident we have the ingredients in place to drive sustainable growth over the long-term.

Brian Leary
Executive Vice President, Chief Operating Officer
A resilient and diversified portfolio in markets benefiting from an acceleration of the great migration to the southeast and a dedicated team of professionals who maintain, manage and lease – all under one Highwoods roof – enabled us to weather the unprecedented challenges of 2020. With the first quarter being the initial barometer of what the business looks like moving from triage to recovery, we believe 2021 is off to a solid start.

First, with regard to those customers who had proven needs-based rent relief earlier in the pandemic, 73% of this consideration has been repaid and the balance is on schedule. Further, all markets where we operate are open with regard to office occupancy and municipal mandates. We are seeing utilization rates rise across the portfolio and expect this trend to continue over the coming months.

Our SunBelt markets have been recognized lately for what we believe has been compelling for quite some time. The number, magnitude and quality of in-bound job creation announcements highlights the evolution of these cities into dynamic 18-hour national talent attractors.

Last week, we announced the planned portfolio acquisition from PAC. This transaction will add two high barrier-to-entry SunBelt BBDs to our portfolio, establish a bulwark in SouthPark Charlotte with five of the eight best buildings in the submarket and reinforce our leading position in Downtown Raleigh. We believe the PAC properties fit perfectly with our BBD strategy – high quality assets with excellent growth prospects that will improve our near-term and longer-term cash flows.

Our markets turned the page on a new year in January and have had a noted increase in activity, inbounds, tours and RFPs. This activity translated into 553,000 square feet of second generation leasing with GAAP rent growth of 8.1% and cash rent growth of 0.5%. As Ted mentioned, what's most encouraging is the 247,000 square feet of new leases signed in the quarter, consistent with our long-term average. Given our limited lease roll the next few years, we expect renewal leasing volume will be lower than our historical average. As a result, we think new lease volume is an important barometer of the return of healthy activity across our markets. Occupancy did drop 70 basis points sequentially to 89.6%, but this was expected based on our expiration schedule, and is a normal seasonal pattern for our portfolio. We expect occupancy to remain around current levels in the second and third quarters before rebounding late in the year.

Now, to our markets.

Starting here in Raleigh where on Monday Apple announced their plans to invest over $1 billion for a new campus and engineering hub. Our 5.8 million square foot portfolio was over 91% occupied at quarter-end, our team signed 97,000 square feet of leases and we put into service two, 100%-leased office buildings. We don't have any remaining development projects in our pipeline in Raleigh, but we have land that can support over 1.2 million square feet of future development in the strongest urban and suburban BBDs in the market. While clearly the plum reward of a competitive exercise, Apple's announcement this week joins Google, Fidelity, Fuji Film, Eli Lilly and Xerox, as the latest in a string of notable announcements to create or grow offices in Raleigh.

As you know, Charlotte has long been a priority for us and expansion at the right time and in the right location has been on our radar since our re-entry in the fall of 2019. Our acquisitions from PAC will double our presence in the Queen City which, similar to Raleigh, saw over 10,000 new jobs announced over the past few years. While new supply increased across the city during the past several years, there are no projects currently under construction in SouthPark and rents increased at a near 6% compounded annual growth rate from 2013 through 2020.

Moving west to Music City…Amazon's previous headline-grabbing 5,000 job announcement in Nashville was recently surpassed by Oracle's commitment to invest $1.2 billion in the city with its planned 1.2 million square foot campus for 8,500 new employees downtown along the east bank of the Cumberland River. By the end of the first quarter, our 4.6 million square foot portfolio in Nashville was 93% occupied, our team had signed over 130,000 square feet of leases in the quarter and we've started to see some increased usage of our parking garages. We continue to pay close attention to supply in Nashville, but we're comforted by the limited amount of supply outside of the CBD and Gulch, where we have no meaningful lease expirations until 2025. At our 111,000 square foot Virginia Springs II development in Brentwood, we used our omni-channel marketing platform to secure a 30,000 square foot customer, bringing the building to 32% pre-leased in advance of its estimated stabilization date of Q3 2022. We remain on budget and on schedule with Asurion's 553,000 square foot global headquarters, which will be placed in service in the fourth quarter. This will anchor our development in the Gulch where we have a fantastic mixed-use land assemblage and where we can develop an additional 1 million square feet. Plus, we can develop another million square feet in Cool Springs at our Ovation mixed-use development.

Not to be outdone by its Tennessee neighbor, Atlanta, where we signed 117,000 square feet in the quarter with solid GAAP rent growth, is further solidifying its status as a major tech hub, ranking third nationally in start-ups. Cushman and Wakefield is predicting Atlanta will add more than 20,000 new tech jobs by 2030 - a number already threatened by Microsoft's 15,000-job announcement in February which in its own words "puts Atlanta on the path toward becoming one of Microsoft's largest hubs in the United States in the coming decade, after Puget Sound and Silicon Valley."

In closing, our markets and portfolio have proven resilient and we believe will grow stronger as the nation emerges from the pandemic and recession. Highwoods is in the work placemaking business, and it is through the workplaces we create that our customers can achieve together what they cannot apart. By doing this, we believe our buildings will remain locations-of-choice and, combined with strong demographic trends across our footprint, provide a strong tailwind for our fundamentals.

Mark Mulhern
Executive Vice President, Chief Financial Officer
In the first quarter, we delivered net income of $54.5 million, or $0.52 per share, and FFO of $97.5 million, or $0.91 per share. The quarter included the $31 million sale of the FAA building in Atlanta and the acquisition of our partner's 75% interest in the Forum office portfolio in Raleigh for a $138 million incremental investment. Both of these transactions closed in January and, in March, we delivered GlenLake Seven, our $44 million, 125,000 square foot development in Raleigh that is 100% leased. Other than these investment activities, there were no other significant items in the first quarter that impacted our financial results.

FFO accelerated sequentially from the fourth quarter primarily driven by lower operating expenses, lower G&A and the acquisition of the Forum using cash on hand. In addition to our solid FFO, our cash flows continue to strengthen, something that we have often highlighted, but where it's clearly materializing in our reported results. The improvement in cash flow is driven by delivery of our development projects over the past few years and continuously recycling out of older, more capex-intensive properties into newer, more capital-efficient assets.

Our balance sheet is in excellent shape. We recast our revolving line of credit and increased our borrowing capacity from $600 million to $750 million, reduced the borrowing spread 10 basis points to LIBOR plus 90 basis points and extended the maturity to March 2025 plus two 6-month extension options. We ended the quarter with $49 million of cash on hand. In April, we used cash on hand plus borrowings on our revolver to repay the remaining $150 million of June 2021 bonds at par and funded the $50 million earnest money deposit for the planned acquisition of office assets from PAC. As of now, we have nearly $600 million of remaining capacity on our revolver, only $66 million left to fund of our $394 million development pipeline and no debt maturities until November 2022.

The total investment of $769 million for the PAC transaction includes the assumption of secured loans relating to the core assets estimated to be recorded at fair value of $403 million plus $28 million of planned near-term building improvements. This leaves approximately $250 million of cash required to initially fund the remainder of the purchase price and, as I mentioned, we have already deposited $50 million of earnest money using the revolver. The remaining $200 million will be funded through a six-month unsecured bridge facility that we expect to obtain from JP Morgan. This bridge facility, which can be extended for an additional six months, will have terms comparable to our revolving credit facility.

As Ted mentioned, with the planned PAC acquisition, we're deploying the playbook we've successfully used two other times over the past five years of flexing our balance sheet strength for opportunities as they arise and subsequently returning to pre-deal metrics by selling non-core properties. The combination of a high-quality pool of liquid disposition properties, expected growth in NOI – primarily from our development pipeline – and meaningful retained cash flow, gives us confidence that we'll return our balance sheet metrics to pre-acquisition levels by the middle of next year.

Turning to our outlook, we've updated our FFO outlook to $3.54 to $3.66 per share, with the mid-point up 2 cents from the beginning of the year. This does not include the planned acquisition from PAC or our plan to accelerate non-core dispositions. We will update our outlook once the acquisition closes. The increase in the mid-point is essentially driven by higher NOI, which has also resulted in an increase to our same property cash NOI outlook to 3.50% to 5.25%, up nearly 40 basis points at the mid-point.

We continue to expect utilization rates across our portfolio will remain low in the second quarter and then recover in the third and fourth quarters. Many of you have asked about our parking revenue forecast given the reduction in parking revenues since the beginning of the pandemic. We still expect parking revenues to remain significantly lower in 2021, which is consistent with our initial outlook in February. Once parking returns to pre-pandemic levels, it will provide upside to our current run-rate.

Looking forward, we continue to remain positive about the long-term outlook for the company. We believe the improvement in cash flows is validating the asset recycling program we've employed over the past several years, and we continue to have a constructive view of our cash flow profile going forward due to:

- the long-term positive outlook for our markets;
- our limited lease rollover during the next several years;
- our highly pre-leased $394 million development pipeline;
- the planned acquisition of core properties from PAC; and
- our plan to accelerate the sale of non-core assets.