Management's Prepared Remarks
Third Quarter 2021 Conference Call
October 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. 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, including the ongoing adverse effect of the COVID-19 pandemic on our financial condition and operating results. 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 are pleased with our solid financial and operational results in the third quarter. Given the emergence of the delta variant, utilization across our portfolio did not increase as much in the third quarter as we anticipated, leveling off around 40%. We now do not expect usage to meaningfully increase until the new year. While the progression of the pandemic and the resulting impact on office utilization remain difficult to predict, customers and prospects fortunately continue to sign leases and our parking revenues continue to recover nicely.

As I mentioned on our last call, leasing activity has been healthy, particularly for new deals. We signed 672,000 square feet of second gen leases, including 245,000 square feet of new deals. In total, we signed 96 leases during the quarter, including 46 new deals, consistent with our long-term average. So far this year we've signed 140 new deals, which puts us on pace to eclipse our annual high-water mark. Plus, we signed 83,000 square feet of first gen leases on the development pipeline.

In addition to healthy volume, rents on signed leases increased 19.3% on a GAAP basis and 4.3% on a cash basis. The weighted average term was also solid at 6.3 years reflecting growing confidence in the long-term value of the office for our customers. Leasing capex increased, but this was offset by higher face rents and longer terms. We're often asked about the effect of the pandemic on net effective rents. We don't track apples-to-apples net effective rent spreads. However, if we look solely at the change in 2nd gen net effective rents on signed deals from 2019 to 2021 year-to-date, the decline is roughly at the midpoint of the 5% to 10% average decline across our markets we've mentioned previously, which in our experience is also consistent with a typical recessionary pattern. As we noted last quarter, we continue to believe net effective rents have stabilized.

As you may have seen from local media reports, two customers in our top 20 announced this quarter plans to move out upon expiration and relocate to new developments. In both cases, we have at least three years of lease term remaining, in-place rents are substantially below market and these buildings are among the best in their BBDs.

As the war for talent accelerates, we are strong believers that well-located office space in highly-amenitized Best Business Districts will become a competitive recruiting advantage for employers. This flight to higher-quality buildings, in the best locations and with well capitalized owners, plays to our strengths. Our markets and portfolio continue to generate activity and growth further demonstrating their resilience and quality.

Turning to our results, we delivered strong FFO of $0.96 per share in the third quarter. Our same property cash NOI growth was also strong at 6.4%, including the repayment of temporary rent deferrals agreed to during the first months of the pandemic. Excluding these repayments, same property cash NOI growth would still have been a healthy 5.2%, consistent with last quarter. In last night's release, we updated our 2021 FFO outlook to $3.73 to $3.76 per share, up seven cents at the mid-point from our prior outlook, and up 16½ cents from our initial 2021 FFO outlook provided in February. We also raised our same property cash NOI growth outlook to 6.0% to 7.0%, up more than 150 basis points at the mid-point from our prior outlook.

Moving to investments, as we previously disclosed, we acquired the office portfolio from PAC in late July for a total investment of $683 million, including planned near-term building improvements. We've already signed leases ahead of schedule at healthy rents and are seeing strong interest across the portfolio in Charlotte and Raleigh as well as the development parcel in the Cumberland/Galleria BBD of Atlanta, around the corner from where the Braves are hosting the World Series at Truist Park. As you know, we plan to bring our balance sheet back to pre-acquisition levels by accelerating the sale of $500 to $600 million of non-core assets by mid-2022. We closed two dispositions for $120 million in the third quarter, bringing our total to $163 million since we first announced the acquisition. We are confident we'll end the year towards the high end of our outlook of $250 to $300 million.

Turning to development, we delivered our $285 million build-to-suit for Asurion in Nashville, the largest development project in Highwoods history. Completing this project ahead of schedule and on budget, in the midst of a pandemic, is a true testament to the strength of our development team and our partners at Brasfield & Gorrie and Hastings Architecture. We delivered the keys on this incredible workplace to our new customer three months early. Following delivery of the Asurion build-to-suit, our $109 million development pipeline consists of Virginia Springs II in the Brentwood BBD of Nashville and Midtown West in the Westshore BBD of Tampa. We signed 83,000 square feet of leases on these developments during the quarter, bringing leasing to 59% for both buildings. We have a pipeline of strong prospects to bring these properties to stabilization by the second half of next year. We increased the low end of our development announcement outlook from $0 to $100 million, demonstrating the growing confidence we have in potential announcements before year-end. The high end remains $250 million. We continue to see strong interest from prospective build-to-suit and anchor customers. We believe companies planning significant investments in physical workplaces is yet another sign of a return to healthy office fundamentals across our markets.

Our well-located land bank, which can support more than $2 billion of future development, is a true differentiator for Highwoods and will drive value creation over the long-term. We are thrilled to have acquired the remaining 77 acres of development land at Ovation in the Cool Springs district of Franklin, TN, one of Nashville's BBDs, for a total purchase price of $57.8 million. We will partner with the City of Franklin to reimagine Ovation as one of the premier mixed-use addresses in the country and anticipate working with high-quality retail, multi-family and hotel developers to realize the tremendous potential of this live-work-play property, while retaining full control of the office development sites.

Before I turn the call over to Brian, I would like to reiterate the strong financial and operating performance we have delivered so far in 2021:

- we delivered the $285 million Asurion project on budget and ahead of schedule;
- we acquired a $683 million portfolio of office properties with attractive long-term returns;
- since announcing the acquisition, we have sold $163 million of non-core properties at attractive valuations;
- we raised our quarterly dividend over 4%;
- we increased the mid-point of our FFO outlook 16½ cents per share since the beginning of the year; and
- we did this all while maintaining a strong and flexible balance sheet with a debt-to-EBITDAre ratio of 5.6x.

Brian Leary
Executive Vice President, Chief Operating Officer
While the economy bore the brunt of the delta variant's impact in the third quarter, we believe our positive results for the period are a product of the clear and consistent BBD strategy Highwoods has been focused on for a long time. Developing, operating and owning BBD-located and talent-centric workplaces has proved our portfolio's resiliency in the face of unprecedented times and provides a strong foundation for future growth. Customers are returning to the office – some sooner than others. But the common chorus we hear is that place matters and that while many see a more flexible workplace, and perhaps more accurately, work week ahead, most have told us that they are at their very best when they are together vs being remote. This sentiment is inherent in the healthy quarterly leasing volume and metrics our team posted. This is also consistent with our markets being highlighted in the most recent edition of ULI and PwC's Emerging Trends in Real Estate and where we have significant best-in-class workplace options across 11.8 million square feet in the BBDs of Nashville and Raleigh, which rank #1 and #2, respectively, and where 44% of our 3Q NOI was generated. The great migration continues to accelerate as talented companies and individuals migrate to the SunBelt where cities and states are open for business, housing is affordable and commute times and modes, more manageable.

At 90.4%, occupancy increased 90 basis points from last quarter and we foresee occupancy holding steady for balance of the year. Tour and RFP activity is getting back to pre-pandemic levels as many organizations that delayed decision-making of any scope or scale since the spring of 2020 are now ready to discuss their long-term office plans. With 140 new customers signing on to join the portfolio so far this year, led by engineering and healthcare/life science customers, we're enthusiastic about where their plans may take them with many new to the market and with plans for growth.

Now, to our markets, which are increasingly being discovered by individuals, organizations and investors based on the prevalence of out-of-state license plates at the grocery store and the unending stream of housing sales above listings, sometimes sight unseen. There continue to be more data points supporting our markets' "open-for-business" and "let's-get-back-to-work" mentality, such as JLL noting Atlanta, Charlotte and Nashville pushed above 2019 leasing levels and the Atlanta market posting positive net absorption of 478,000 square feet for the quarter.

In Raleigh, we signed 135,000 square feet of leases for the quarter and activity there is off to a quick start in the fourth quarter. Market vacancy decreased slightly year over year and market rents are up nearly 4%. We expect Raleigh to be at or near the top of many lists for years to come with several additional new job announcements this quarter, including three new headquarters relocations, adding to the strong list of relocations from the first half of 2021.

In Nashville, we signed 76,000 square feet of second gen leases and achieved quarter-end occupancy of 95.3%. Our development team completed the new 553,000 square foot Asurion headquarters anchoring our Gulch Central mixed-use development that stretches the better part of three city blocks and is adjacent to Nashville's Amazon HQ2.

In addition, we had a strong leasing quarter in our development pipeline. We signed 83,000 square feet of first gen leases at Virginia Springs II and Midtown West bringing the leased rate up to 59% from 24% last quarter. We continue to see strong interest in both projects and are tracking well towards their projected stabilizations in the latter half of 2022.

As Ted mentioned, we have a sizable land bank that can support over $2 billion of future development. Having completed nearly $1 billion of successful development since 2016, we're confident development will continue to drive future growth and value creation. To this end, we're extremely excited about our purchase of the remaining acreage at Ovation in Nashville's suburban Williamson County, listed by Kiplinger as the 10th most affluent in the nation. These 145 acres, already home to Mars PetCare's US headquarters that we developed in 2019, represent one of the premier mixed-use opportunities in the nation and is where we can build an additional 1.2 million square feet of office amid significant densities of complementary residential, retail and hotel uses.

In conclusion, we're fortunate to be weathering the storm well. With our high-quality portfolio and unmatched all-under-one-roof team to develop, lease, operate and maintain it, we are supporting our customers' ability to achieve together what they cannot apart. Because of this, our customers are growing more than they're not, they're investing in new space and they see their workplaces as competitive currency to retain and recruit the very best talent available. Our development team has delivered the very best examples of our work-placemaking and is busy reloading the pipeline for the next generation of commute-worthy buildings. Our exceptional people and portfolio have produced results we're proud of this quarter and throughout the pandemic. It truly is a team effort and each and every member of the Highwoods family plays a meaningful role in our success.

Mark Mulhern
Executive Vice President, Chief Financial Officer

In the third quarter, we delivered net income of $72.1 million, or $0.69 per share, and FFO of $102.8 million, or $0.96 per share, an increase from $0.93 in the second quarter. As Ted mentioned, we closed on the acquisition from PAC in late July, delivered the $285 million Asurion development in September and sold $120 million of non-core assets at the end of the quarter. While there were a lot of moving parts from investment activity in the quarter, there weren't a lot of unusual operational items that impacted our financial results.

Turning to the balance sheet, our leverage obviously ticked up temporarily due to this quarter's acquisition. However, we are very pleased that our debt-to-EBITDAre was 5.6x in the third quarter, less than a half-a-turn increase from 5.2x in the prior quarter. We're making solid progress on our non-core disposition plan, having sold $163 million of the planned $500 to $600 million, and are on track to return our balance sheet to pre-acquisition metrics by mid-2022. Further, we have ample liquidity with $615 million currently available on our revolving credit facility, limited debt maturities until late 2022 and expected disposition proceeds over the next several quarters.

During the quarter, we issued a modest amount of shares on the ATM at an average price of $45.81 per share for net proceeds of $6.8 million, consistent with the ATM activity in the second quarter. ATM issuances remain one of the many arrows in our quiver and we continue to believe are an efficient and measured way to fund incremental investments, particularly our development pipeline, on a leverage-neutral basis. As Ted mentioned, we increased the low end of our development announcement outlook to $100 million, signifying our growing confidence in future development starts. The modest ATM issuance so far in 2021 gives us a head start on funding these future investments.

Regarding our expectations for the rest of the year, we've updated our 2021 FFO outlook to $3.73 to $3.76 per share, with the mid-point up seven cents since July and up 16½ cents from our original 2021 outlook provided in February. Rolling forward from our prior outlook in July, the rationale for the increase was:

- 1 cent higher per share impact from the combination of the acquisition and corresponding non-core dispositions;
- 1 to 2 cents higher per share impact due to earlier than expected delivery of the Asurion build-to-suit; and
- 4 to 5 cents higher per share impact from core operations due to our robust third quarter results and outlook for the remainder of the year.

Compared to our original FFO outlook provided in February, here are the major moving parts:

- 5 to 7 cents higher per share impact from acquisition and disposition activity on a net basis;
- 3 to 5 cents from the early delivery of Asurion and faster-than-expected lease-up of the remainder of the development pipeline;
- Approximately 2 cents from rising parking revenues, particularly transient parking; and
- 4 to 5 cents from better-than-expected core operations.

In addition to our improved 2021 FFO outlook, we also increased our same property cash NOI growth outlook to a range of 6.0% to 7.0%, up more than 150 basis points at the mid-point from our July outlook.

Since the onset of the pandemic, we've regularly commented on parking revenues and operating expenses given the reduced utilization rates. We're still tracking well below normal on both op-ex and parking revenues, but recently we've seen a notable increase in transient parking revenue. The trajectory of op-ex and parking revenues continues to be challenging to forecast. With that said, we do expect an increase in both line items in the fourth quarter compared to our quarterly averages so far in 2021.

In addition to our solid FFO, our cash flows continue to strengthen. Since 2016, we've sold nearly $1.8 billion of non-core properties, acquired $1.3 billion of high-quality assets in the BBDs of our Sun Belt markets and delivered $940 million of development. We are very proud to have consistently grown our FFO per share while simultaneously making meaningful improvements to the quality of our portfolio. The strengthening of our cash flows since 2016 is evidenced by a 22% increase in average in-place cash rents, an 18% increase in our dividend and a steadily declining payout ratio over that same time frame. Our strengthening cash flows and continuous portfolio improvement, combined with a land bank that can support over $2 billion of future development and our proven track record as a developer, makes us confident about our long-term outlook.

Finally, this is my 28th and last quarterly earnings call at Highwoods. I really appreciate all your interest in Highwoods and great questions over the years. As you know, Brendan is well-qualified for the CFO role and will do a great job helping to continue Highwoods' strong track record of success.