Management's Prepared Remarks
Fourth Quarter 2023 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 a strong end to a strong year for Highwoods. In the fourth quarter, we:

- enjoyed solid leasing, in terms of both volume and economics;
- acquired a best-in-class property in Uptown Dallas;
- placed in-service our highly successful Midtown West development in Tampa;
- announced Midtown East, our second development in Midtown Tampa; and
- delivered strong FFO of $0.96 per share.

Our healthy leasing during the fourth quarter is somewhat contradictory to the broader macro environment, with interest rates up sharply, limited capital availability and widespread concerns of a pending recession. We continue to believe that to be resilient, our portfolio must be diversified, and not be overly reliant on any single customer, market, submarket, industry or lease size. This diversification is a core component of our long-stated, simple and straightforward goal to generate attractive and sustainable returns over the long term. Our largest market, Raleigh, is less than 22% of revenues, our largest customer, Bank of America, is less than 4%, our top 20 customers account for less than 30%, our largest industry, the highly diversified Professional, Scientific and Technical Services category, is less than 30%, and our average lease size is under 15,000 square feet. We believe this purposeful diversification, our high quality portfolio, and continued strong population and job growth across our markets has driven our strong leasing since the onset of the pandemic, including throughout last year.

In 2022, we signed 1.5 million square feet of new leases, the most in any year since 2014. We ended the year on a positive note with 337,000 square feet of new leasing and 924,000 square feet of total second gen leasing. In the fourth quarter, we signed 28 expansions, nearly half of our renewal count, with expansions outpacing contractions by a ratio of 3.5 to 1.0, equating to 81,000 square feet of net expansions. In addition, we signed a 312,000 square foot renewal at a 50/50 JV property in Richmond. This renewal was for 100% of the customer's prior space with a roll-up in cash rents and limited TIs. As a reminder, JV leasing is not included in our overall leasing statistics.

As we move into 2023, our occupancy and same property cash NOI will be negatively impacted by the 263,000 square foot move-out by Tivity in the Cool Springs BBD of Nashville at the end of this month, a space that we have already substantially backfilled. The backfill customer's lease isn't scheduled to commence until early 2024. As is our practice, we do not remove in-service buildings from our same property pool.

In addition to our solid leasing efforts in 2022, we are also pleased with our investment activity during the year. We:

- acquired $400 million of best-in-class assets in Charlotte and Dallas, both with meaningful long-term growth potential;
- placed in-service roughly $100 million of 99% leased development;
- announced over $400 million of development in Dallas, Atlanta, Tampa and Charlotte; and
- sold $133 million of non-core land and buildings.

This volume of work, combined with our high-quality office portfolio in the strongest BBDs throughout the Sun Belt, gives us the building blocks we need to generate additional long-term growth.

Turning to our results, we delivered FFO of $0.96 per share in the fourth quarter. Our full year FFO was $4.03 per share, including $0.13 of net land sale gains. Excluding land sale gains, our full year FFO was $3.90 per share, 6 cents above the mid-point of our initial 2022 outlook even with the unanticipated sharp rise in interest rates.

Turning to investments, in the fourth quarter, we expanded our presence in the dynamic Dallas market by once again partnering with local sharpshooter Granite Properties – this time to acquire McKinney & Olive in Uptown Dallas in a 50/50 JV for a total investment of $197 million (at our share). McKinney & Olive is a trophy mixed-use building with approximately 500,000 square feet of office and 50,000 square feet of retail. The building is well-leased with growing customers and average rents estimated to be 35% below market. This investment, priced below replacement cost, provides a unique combination of an attractive going-in cash flow yield with the opportunity to earn development-like returns as we roll rents up to market. Further, this building is only four blocks from our 23Springs development, providing ample opportunity for leasing and operating synergies with what we believe will be two of the best buildings in Uptown.

During the quarter, we also announced the Midtown East development in a 50/50 JV. This project will encompass 143,000 square feet in the highly successful Midtown Tampa mixed-use development. The total cost is estimated at $83 million with our share being half of that. This announcement follows our first office development in Midtown Tampa, Midtown West, which we placed in service during the fourth quarter, as originally scheduled, at 97% leased. We started Midtown West on a fully spec basis in late 2019. Despite the pandemic, the project leased up successfully at rents at-or-above our original pro forma.

Our 1.6 million square foot development pipeline now represents a total investment of $518 million (at our share) across five different markets and is a combined 21% pre-leased. Three of those developments, representing nearly 800,000 square feet and $234 million of total investment (at our share), are scheduled to deliver in 2023 but are not projected to stabilize until 1Q'25 through 1Q'26.

With rising interest rates and reduced debt availability, the investment sales market has slowed meaningfully over the past few quarters. Fortunately, our balance sheet is in excellent shape, which allows us to be patient with our disposition efforts. Over the long-run, we will continue our strategy of monetizing properties we believe have below average growth prospects, limited upside or are capex intensive, and use the proceeds to replenish our dry powder and ultimately recycle into higher growth properties. As illustrated in our 2023 outlook, we expect to be a net seller this year, although the volume of dispositions will depend upon the stabilization of the office investment sales market. Our plan is to sell up to $400 million of non-core assets this year, while we believe acquisitions are unlikely.

Our initial 2023 FFO outlook is $3.66 to $3.82 per share. At the mid-point, interest expense will be significantly higher due to rising rates, and we also project higher same property operating expenses. Same property cash NOI growth is projected to be flat at the mid-point, below our historical average, due to higher opex and lower average occupancy, largely as a result of the Tivity move-out. While our 2023 FFO outlook is below 2022 actual results, as a reminder we have grown normalized FFO per share each year for 12 consecutive years at a 4% compounded average rate.

Since the onset of COVID at the beginning of 2020, we have acquired 3.2 million square feet of best-in-class office assets for a total investment of $1.2 billion, delivered 1.2 million square feet of highly leased office development for a total investment of nearly $500 million and sold 6.4 million square feet of non-core properties for $1 billion, all the while growing normalized FFO per share 11% and continuing to strengthen our cash flows. With our ever-improving portfolio quality, we're now even more resilient and better poised for long-term growth.

In conclusion, while our high-growth BBDs and high-quality portfolio receive most of the attention from our shareholders, our humble, hard-working and talented teammates are the ones who drive our success. I would like to thank our entire Highwoods team for their continued commitment and tireless dedication to our company during the past year. It is their effort that has positioned us for continued success for many years to come.

Brian Leary
Executive Vice President, Chief Operating Officer

As Ted mentioned, a strong fourth quarter capped off a strong 2022 and a strong three-year run through the pandemic that saw the team and portfolio meet every challenge and produce compelling results. We've leaned into our BBD strategy to upgrade markets and assets by taking a deliberate approach to diversify geographic reach across the Sunbelt's high-growth markets, which include six of the top ten and five of the top six US Markets to Watch per the most-recent PwC/Urban Land Institute Emerging Trends in Real Estate report. Within these markets, our BBDs are both urban and suburban and have proved successful in meeting our customers where they prefer to be. Suburban workplaces have proven to be competitive options when weighing an individual's and organization's flight to quality-of-life calculus as evidenced by the highest physical occupancy and leasing activity across our portfolio and the Sunbelt.

It is our belief that the greatest determining factor of a workplace being "commute-worthy" is the magnitude of the commute burden the "worthiness" has to overcome. Our urban and suburban BBD portfolio provides a variety of options and amenities with regard to "commute-worthiness" and has attracted a customer base across a broad spectrum of industries and sizes. Small and medium-sized customers, our bread-and-butter with an average customer size less than 15,000 square feet, are disproportionately back in the office and expanding. This customer mix has allowed our portfolio to weather the ebbs and flows of previous cycles, a pandemic, and evolutions in the so called "future of work."

While concrete, steel and glass may not be the most flexible of materials, we are formalizing the variety of flexible work options we offer under our Highwoods Commons banner based on the success we've had to date. Whether it is convening a Town Hall in our Spark conferencing hubs, taking occupancy on one of our dedicated full-floor spec suite collections or booking one of our ultimate zoom rooms, called the (co)lab, The Commons platform provides our customers scalable flexibility with regard to space and duration and can be tailored to their specific needs. It includes both formal and informal spaces – all conceived around collaboration and the platform enters 2023 having delivered over 100 such spaces with healthy new net rental income associated with it.

This deliberate diversification across a variety of factors makes our portfolio more resilient. Coupled with our approach to creating compelling and competitive work-placemaking experiences, we are confident that the Highwoods portfolio will continue to serve as a location-of-choice for the best and brightest individuals and organizations.

To that end, our team finished the year with solid financial and operating results for the fourth quarter, signing 924,000 square feet, including 28 expansions, the most net expansions we have signed since the beginning of 2018. As Ted mentioned, this does not include the 100% renewal of our 312,000 square foot J/V-owned property in Richmond through 2034. Net effective rents for the quarter were higher than our five-quarter average and our net effective rents for the year represent a record high. While there is often much focus on cash or GAAP rent spreads, we have long stated that our leasing focus is securing the best overall economics. For example, we may trade lower face rents for lower TIs or free rent if the overall net effective rents are attractive. Our all-time high for net effective rents during the year is a strong endorsement of our Sun Belt, BBD and diversified portfolio strategy.

Drilling down on our market activity, in Raleigh we signed 263,000 square feet and ended the quarter 92% occupied and where market rents grew 5.1% year-over-year per CBRE. Our local team is seeing healthy activity so far this year and we expect this to continue – led by job growth in professional and financial service companies.

Second in terms of volume for the quarter, Nashville signed 225,000 square feet and is nearing the finish line on Highwoodtizing almost a million square feet of assets in Brentwood and Cool Springs, the two BBDs that garnered the majority of leasing activity for the entire Nashville market in 2022. Our signature re-imagining and repositioning of these assets have been well-received leading to the substantial backfill of our portfolio's largest 2023 lease roll in Tivity five months prior to expiration. According to Cushman & Wakefield, the Nashville market posted positive net absorption for the quarter and a 4.7% year-over-year increase in market rent. As Ted mentioned, occupancy will be lower in our Nashville portfolio in 2023 as Tivity vacates and our replacement customer's lease doesn't commence until the beginning of 2024.

Moving further south to Tampa, which leads the State of Florida for net New York City resident relocations, we placed in service our 97% leased Midtown West joint venture development in the quarter and announced Midtown East, a 143,000 square foot mixed-use development which will offer the highest views in the Westshore BBD. Midtown has established itself as an address-of-choice for blue chip organizations who have placed a priority on recruiting, retaining and returning talent.

Our newest markets in Charlotte and Dallas are great examples of decisively leaning into our simple and straight-forward strategy and executing successfully via the wide and deep relationships we've built over time. With the off-market acquisition of 650 South Tryon in Charlotte, the Queen City now stands as Highwoods' fourth largest contributor to NOI. The December acquisition of McKinney & Olive, a 557,000 SF, 99%-leased tower in the heart of Dallas' Uptown BBD, which was tops in the market for annual absorption and rental growth for 2022, we're on track for Dallas to contribute 6% of proforma NOI to our bottom line following the completion and stabilization of our two development projects.

In conclusion, each and every Highwoods teammate remains focused on making our diverse portfolio the most talent-supportive and commute-worthy it can be. We believe this approach will enable our customers and their teams to achieve together what they cannot apart and when we do this, we will create value for our customers and in turn, our shareholders.

Brendan Maiorana
Executive Vice President, Chief Financial Officer

In the fourth quarter, we delivered net income of $27.6 million, or $0.26 per share, and FFO of $103.1 million, or $0.96 per share. There were no significant unusual items in the quarter. For the year, our FFO of $4.03 per share came in at the mid-point of the upwardly revised outlook we provided in October. This was 19 cents above the midpoint of our original 2022 FFO outlook. Excluding $0.13 per share of land sale gains, net of impairments, core FFO in 2022 was $3.90 per share, or 6 cents above the midpoint of our original outlook.

The upside in core FFO in 2022 compared to the midpoint of our initial outlook was due to:

- 8 cents of higher NOI, largely driven by lower than forecast op-ex and higher parking revenues;
- 2 cents from less disposition activity than originally planned; and
- 1 cent from acquisitions.

These items combined for 11 cents of upside and were partially offset by 5 cents of higher interest expense attributable to higher than forecasted rates on our variable rate debt.

In addition to strong FFO during the year, our cash flows continue to strengthen. Even with what we believe is an attractive current dividend yield of over 6.5%, we had strong coverage in 2022 with a CAD payout ratio under 75%, providing us meaningful retained cash flow to reinvest. We have been purposeful with our focus on strengthening cash flows. We've sold assets that were capital inefficient and recycled into acquisitions and development projects with higher long-term cash flow yields. To quantify this, since 2019 our cash NOI is higher by 16%, or $75 million, and our capital spend – leasing and maintenance capex – is down 8%, or $12 million, resulting in $87 million more in cash generated from our portfolio and a ratio of capex to NOI that has improved by 15%, without any meaningful increase in our equity base. Capex spend is often lumpy quarter-to-quarter or year-to-year, but regardless of the short-term fluctuations, the trend is clear. Our portfolio has become more efficient and our cash flows have continued to strengthen.

Our balance sheet is in excellent shape. We ended the year with debt-to-EBITDAre of 5.9x, up from the third quarter due to the acquisition of McKinney & Olive and continued investment in our development pipeline, but still low overall. We have ample liquidity, with over $550 million between our line of credit and undrawn amounts on the construction loans at our Dallas development JVs, which provides us plenty of room to fund the remaining $359 million to complete our development pipeline.

We have purposely set up the balance sheet with ample flexibility as we have over $900 million of debt that is prepayable without penalty, and no consolidated debt maturities until the end of 2025. This fits well with our investment plan for the year where we expect to be a net seller. We expect to reduce our floating rate debt exposure as we move throughout the year with planned disposition proceeds. We also have a solid pool of unencumbered assets and the financial flexibility to obtain longer-term fixed rate debt.

As Ted mentioned, our FFO outlook for 2023 is $3.66 to $3.82 per share. As you know, the largest headwind for our 2023 outlook is higher interest rates. Based on the current SOFR curve, we expect to incur $0.25 to $0.30 per share of higher interest expense in 2023 compared to what the forward curve implied just 12 months ago. I mentioned earlier we purposely structured our balance sheet to provide us optionality to be able to repay debt without penalty. While this means we expect higher projected interest expense in the short term, given the forecasted peak in SOFR during 2023 and with no fixed rate debt maturities until 2027, we are positioned to benefit from a downward trend in the interest rate curve after this year.

In our release last night, we stated an anticipated headwind of $0.08 per share at the mid-point from higher op-ex, net of anticipated recoveries. The higher projected op-ex, combined with lower average occupancy, principally related to the Tivity move-out, has negatively impacted our same property cash NOI outlook in 2023. Year-over-year same property comparisons are often helpful, but 2023 is somewhat distorted by the unusually low op-ex from the first half of 2022. Using our more normalized 2nd half of 2022 as a comparison point, we expect positive cash NOI growth in our same property pool in 2023.

Finally, as you may have noticed, we made some routine SEC filings yesterday and this morning. Under SEC rules, S-3 shelf registration statements sunset every three years. It has been three years since our last shelf filing. As a result, last evening, we filed a new S-3 with the SEC. This was a joint shelf filing by the REIT and the Operating Partnership that registers an indeterminate number of debt securities, preferred stock and common stock for future capital markets transactions. With this new shelf in place, we also needed to refresh our long-standing ATM program, which we filed via Form 424(b) this morning. As you know, keeping an ATM program in place is one of the many arrows we like to keep in our capital-raising quiver. To be clear, the FFO per share outlook that we provided in last night's release assumes no ATM issuances during 2023.