Management's Prepared Remarks
First Quarter 2018 Conference Call
April 25, 2018

Brendan Maiorana
Senior Vice President, Finance and Investor Relations
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 EBITDA*re*. 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. The Company does not undertake a duty to update any forward-looking statements.

Ed Fritsch
President, Chief Executive Officer
During our first quarter call in early February, we discussed the volatility in the financial markets, including the drop in the RMZ index. Financial markets remain in flux with the US 10-year yield hovering around 3.0% and REIT stocks down around 10% on average thus far in 2018. Most REITs, including office REITs, are now generally trading at discounts to NAV. In contrast to share price performance of REITs, the fundamentals of the economy and our business platform are healthy. The key factors underpinning the positive outlook for our business continue to apply, namely:

- the jobs picture remains positive and our Southeastern footprint continues to outpace the national average;
- markets continue to experience positive net absorption;
- construction costs are keeping a bridle on speculative development; and
- rents continue to rise.

Despite this year's decline in REIT equity prices, we remain confident in our ongoing ability to fund our development pipeline and other business initiatives. First, our very conservative debt metrics provide us with significant dry powder, while remaining well within our long-stated comfort zones. Second, we continue to expect to sell around $100 million annually of non-core assets. Third, our cash flow continues to strengthen given the ongoing delivery and stabilization of our well pre-leased development pipeline.

During the first quarter, we leased over 850,000 square feet of second generation office space, including 220,000 square feet of new leasing and 171,000 square feet of expansion leases. In addition to solid volume, our leasing metrics were strong. We posted robust GAAP rent growth of 19.7%, healthy cash rent growth of 4.6%, strong net effective rents of $15.84 per square foot and an average term of 6.0 years. The evidence of strong rent growth working its way through our portfolio can be observed in our same property cash NOI that was up 2.9% year-over-year despite modestly lower average occupancy and higher operating expenses. We are pleased to have delivered FFO of $0.85 per share during the quarter. Our first quarter results include $1.9 million, or nearly $0.02, from the $4.8 million restoration fee in Raleigh we mentioned on last quarter's call which Mark will discuss in detail.

Turning to development, our $440 million pipeline is 83% pre-leased on a dollar-weighted basis. We're progressing as expected across our pipeline. Our 9 projects, including our two major build-to-suits, are tracking on-time and on-budget. The $96 million, 224,000 square foot U.S. headquarters for Mars Petcare recently topped out and is projected to deliver in the summer of 2019. Our $65 million, 219,000 square foot third building for MetLife's Global Technology Campus is also right on track and we're looking forward to delivering this project in Q2 of 2019. We are now 90% leased at our $107 million, 299,000 square foot Riverwood 200 project in Atlanta. While we still have more than a year before our targeted stabilization date, we have solid prospect activity that will enable us to achieve occupancy in the mid-90s. We're now 66% leased at 5000 CentreGreen, our $41 million, 167,000 square foot property in Raleigh that we started 100% spec, and we have strong prospects that will bring us to over 90%. As a follow up to our previously disclosed negotiations with Asurion regarding a potential $252 million headquarters building in the Gulch District in CBD Nashville, we are working towards the execution of a mutually beneficial agreement by the middle of the year and the process is tracking nicely. Beyond Asurion, we continue to chase additional development opportunities, mostly on Company-owned land, and we're comfortable with our outlook of $100 to $350 million of 2018 development announcements. During the quarter, as we disclosed on February 6th, we acquired two development parcels totaling 9 acres in CBD Nashville using $50 million of 1031 exchange proceeds. Our overall core land inventory can support development of $1.9 billion of additional office.

With regard to dispositions, we continue to have a well-defined pipeline of non-core assets at various stages of marketing. We are comfortable maintaining our disposition outlook for 2018 of $61 million to $136 million, including the pending $31 million sale of Highwoods Tower Two scheduled to close next week.

Lastly, on the capital front, we continue to evaluate building acquisitions in BBD locations, but there aren't many high quality assets that owners are willing to sell and, for those who are, pricing remains elevated on what we have underwritten.

In summary, our business remains strong. We're continuing to see steady interest from customers and we anticipate ending the year with occupancy around where we ended the first quarter following a projected dip in the second and third quarters. As always, we're leveraging our brand and our synergistic platform, while keeping a keen focus on expense management. With a more fortified balance sheet and essentially no debt maturities until 2020, we are well positioned to fund our growth objectives.

Ted Klinck
Executive Vice President, Chief Operating and Investment Officer

We remain upbeat about our outlook given healthy fundamentals. Southeastern markets continue to benefit from a positive jobs and economic environment. Our markets have met or beaten the national average for annual employment growth 27 consecutive quarters. These regions continue to retain and attract highly qualified candidates, ranging from recent college grads to seasoned professionals, who are drawn to the diverse and dynamic career opportunities, high quality of life and below average cost of living. Employers benefit from access to this robust talent pool as well as the business friendly environments.

Turning to the quarter, we leased 857,000 square feet of second gen office space with an average term of 6.0 years. We garnered net effective rents of $15.84 per square foot, 9.0% above our prior five-quarter average. We signed 220,000 square feet of new second generation office leases and 171,000 square feet of expansions. New deal volume was roughly in line with our recent average while the expansion activity was approximately double our typical volume. Our strong leasing activity makes us optimistic for the remainder of the year.

Rent spreads were strong this quarter. GAAP rent spreads were positive 19.7%, well above the prior five quarter average of 14.7%, and we were able to post heathy cash rent spreads of positive 4.6%. In addition to our second gen leasing activity, we signed 74,000 square feet of first generation office leases since our Q4 call in February. Our development pipeline is now 83% pre-leased on a dollar-weighted basis. Average in-place cash rents were 3.8% higher at quarter end compared to a year ago, which is indicative of solid rent growth over the last several quarters, healthy annual escalators on nearly all of our leases, and strong rents at recently delivered development projects. Our first quarter same property cash NOI growth was +2.9% despite average occupancy being down 50 basis points compared to Q1 2017 and operating expenses up around 3%.

We've increased the bottom end of our year-end occupancy outlook 25 basis points to 91.50% while maintaining the high end of 92.75%. We anticipate occupancy to decrease over the next couple quarters to around 91%, with an uptick at the end of the year to around 92%. The largest known move-out this year is Fidelity, who will give back 178,000 square feet in the Raleigh division's Weston submarket in the third quarter. As a reminder, Fidelity's natural lease expiration is the end of November, and we'll receive the remainder of their full rent through the end of the natural term in Q3. Our 1.2 million square foot in-service portfolio in Weston was 100% occupied at the end of the first quarter.

Raleigh's job growth continues to fuel demand for high-quality office space. Raleigh posted 2.0% office employment growth year-over-year, 60 basis points higher than the national average. We expect the positive trends to continue with announced hiring initiatives from Credit Suisse, MetLife and Ipreo, among others. Per Avison Young, the overall market's Class A vacancy was 9.2%, a 100 basis point improvement since December 31st. Class A rents were up 3.5% year-over-year. There is 2.5 million square feet under construction spread across six submarkets. We believe 1.1 million square feet is competitive to our BBD-located portfolio and is approximately 50% pre-leased. We continue to generate strong rents as evidenced by GAAP rent spreads of positive 22.2% on signed deals in Q1. Our in-service Raleigh portfolio is 94.3% occupied, up 180 basis points year-over-year. We're pleased to announce a recently signed deal for approximately 35,000 square feet at our 5000 CentreGreen development. This deal brings the project to 66% leased. There is strong interest in the remainder of the space and we remain confident in our lease-up plans.

Turning to Atlanta, market fundamentals remain healthy fueled by Q1'18 year-over-year job growth of 2.0%, spurring Class A annual rent growth of 5.7% as reported by CBRE. Net absorption moderated this quarter to positive 130,000 square feet compared to the recent average of around 250,000 square feet, but this quarter's absorption was solely driven by Class A properties, indicating continued demand for high-quality product in Atlanta. We signed 217,000 square feet of second gen leases in Atlanta with an average term of 8.3 years. Although tenant improvements moved up, we continue to push rents as evidenced by the quarter's positive 20.5% GAAP rent spreads. During the quarter, we signed 11 leases totaling 82,000 square feet in Buckhead. We remain very bullish on the Buckhead submarket and our portfolio, particularly given its quality and competitively-advantaged location. The FBI vacated 137,000 square feet in Century Center in the first quarter. As we discussed on the last call, we've backfilled 28% of the vacancy and continue to see steady activity on the remaining space. Finally, as Ed mentioned, we're now 90% leased at Riverwood 200 and have prospects to bring the building to the mid-90s.

In Nashville, the unemployment rate is 2.6%, reported by Cushman and Wakefield to be the lowest of any US metro area with more than one million people. Nashville's office employment growth year-over-year was 2.5% versus the national average of 1.4%. As mentioned last call, approximately 2.0 million square feet delivered in Nashville throughout 2017. The market is responding well to the new product as overall vacancy held steady in Q1 at 8.5% and Class A vacancy improved 20 basis points, ending at 9.3%. Our Nashville portfolio occupancy was 95.0% at the end of Q1. We signed 141,000 square feet of second gen leases at robust GAAP spreads of positive 31.5%.

Lastly, in Tampa, net absorption as reported by JLL was 247,000 square feet, the highest in the last seven quarters. Overall vacancy was 11.4%, down 60 basis points compared to year-end, and Class A vacancy decreased 40 basis points to 8.3%. Tampa's absence of development, stapled with 2.5% year-over-year office employment growth and a dwindling supply of available quality office space, all contribute to a positive backdrop for rent growth. We are excited by the overall progress of Tampa and our portfolio, which was 94.2% occupied at the end of Q1.

In conclusion, positive fundamentals across our markets offer a healthy environment for our business. We anticipate demand for quality, well-located office space will continue.

Mark Mulhern
Executive Vice President, Chief Financial Officer

We delivered net income of $32.4 million, or 31 cents per share, and FFO of $90.7 million or 85 cents per share, a 7% increase year over year. Compared to the fourth quarter of 2017, the sequential drivers of the nearly $2 million FFO increase were:

- Higher NOI by approximately $4.5 million, driven by higher average rents, higher NOI from recently delivered development projects and a higher restoration fee from Fidelity that I'll describe in more detail shortly.

These were partially offset by:

- Higher G&A by approximately $2 million. As you'll recall, this is the normal annual pattern for us as we have increased expense from long-term equity grants in the first quarter of each year; and
- Modestly higher interest expense due to closing our $350 million bond offering in early March, six weeks ahead of the repayment of our $200 million bond maturity on April 16th.

As noted in our release, effective with the first quarter, we are now reporting EBITDA*re* consistent with recent NAREIT guidance. With net debt-to-EBITDA*re* of 4.77 turns and leverage of 36.0%, our balance sheet remains in excellent shape. Our strong leverage metrics put us towards the lower end of our stated comfort range of 4.5 to 5.5x net debt-to-EBITDA*re* and we have significant liquidity to fund our growth initiatives. As noted on page 17 of our supplemental, we've already funded 64% of our total expected investment of $440 million on our current development pipeline.

As I mentioned, we raised $350 million in a 10-year bond deal with an effective interest rate of 4.06%, after factoring in a $7.2 million gain from our prior hedge of $150 million of the underlying treasury at 2.44%. The majority of the proceeds were used to pay down our revolving line of credit. We had zero drawn on our $600 million line of credit at quarter end. Subsequent to quarter end, we paid off the $200 million bond, which had an effective interest rate of 7.5%. We were very pleased with the execution of this offering, which extends our maturity ladder at a favorable fixed rate. Our next meaningful maturity is not until June 2020.

As Ed mentioned, we tightened our 2018 FFO outlook to $3.37 to $3.47 per share, a midpoint of $3.42 per share, a penny increase to our previous midpoint. While we typically do not include the effect of any future acquisitions or dispositions, our FFO forecast does assume the previously-announced planned sale of Highwoods Tower Two in Raleigh for $31.0 million closes May 1st and the proceeds are held in 1031 escrow. The proceeds include $1.0 million for an adjacent two-acre parcel resulting in a half-penny land sale gain.

Before we take your questions, a few other items to note:

- First, our same property cash NOI growth is expected to moderate in the remainder of the year due to lower average occupancy and the timing and seasonality of operating expenses. We expect occupancy will bottom out in the third quarter due to the impact of known vacancies, predominantly driven by Fidelity, and then trend upward by year-end.
- Second, for modeling purposes, at the mid-point of our outlook, we expect FFO in the second and third quarters will be roughly comparable to the first quarter, before anticipated improvement in the fourth quarter. Of note, we recognized $1.9 million of the Fidelity restoration fee in Q1 and we'll recognize a comparable amount in Q2. In Q3, we will recognize two extra months of rent from Fidelity, which includes its payment of originally scheduled rent under its lease that would otherwise run through the end of November. These unusual items relating to Fidelity's departure end after the third quarter, creating a "clean" run-rate from 11000 Weston in Q4 with no projected occupancy or rent.
- Finally, as we have signaled for the past few years, our free cash flow continues to strengthen with the delivery of our well pre-leased development pipeline and consistent performance of our same store portfolio.