Management's Prepared Remarks
Fourth Quarter 2019 Conference Call
February 5, 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 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.

Ted Klinck
President, Chief Executive Officer

2019 was an eventful and productive year for Highwoods. We ended the year strong, with impressive fourth quarter leasing results and FFO at the high end of our outlook. Our team is laser-focused on executing our market rotation plan, increasing occupancy and rents in the portfolio, and finding additional opportunities to further strengthen cash flow and drive our long-term growth.

Our markets continue to outperform national averages across a wide array of economic and real estate metrics. Population and office-using job growth is driving demand for office space in our BBDs. To that end, in ULI's 2020 Emerging Trends in Real Estate, three of our cities were listed in the top four nationally for Markets to Watch, and six of our eight were included in the top 11. There is great momentum across our portfolio footprint, as we continue to see numerous corporate relocations into our markets.

2019 included a lot of positive activity, namely, entering Charlotte with the $436 million acquisition of Bank of America Tower, making significant progress towards our planned exits of Greensboro and Memphis, backfilling a significant portion of 11000 Weston and 5332 Avion, announcing $150 million of development, and placing in-service $300 million of development that were a combined 99% leased. We accomplished this while transitioning the CEO and COO roles and posting strong leasing and portfolio fundamentals. We're pleased with this momentum as we start 2020.

Turning to our 2019 results, we delivered FFO of $3.33 per share. As you know, our results were impacted by the balance sheet write-offs associated with Laser Spine's sudden closure in the first quarter and the one-time costs from our market rotation plan. Excluding these items, our FFO and same property NOI growth would have been in the upper half of the outlook range we provided at the beginning of 2019.

During the year, we leased 3.9 million square feet of second gen office space, including 1.3 million square feet of new leases, with combined GAAP rent growth of 18.5% and cash rent growth of 4.7%, all while keeping leasing costs consistent with prior trends. Same property cash NOI growth was up 1.3%, or 2.8% excluding the impact of LSI. This compares to our original outlook of positive 2.0% to 3.0%.

We announced three spec development projects totaling $150 million. As we disclosed in last night's press release, GlenLake Seven is now 100% pre-leased and will stabilize three quarters ahead of pro forma. Our $500 million development pipeline is now 77% pre-leased. We also placed five developments in service, comprising 900,000 square feet, representing $300 million of investment, that are a combined 99% occupied. These projects were 52% pre-leased when announced. Development continues to be a key growth engine for our company.

Turning to our market rotation plan, we've completed $323 million, or roughly 75%, of phase one dispositions so far, including the pending $40 million sale of The Knollwood. We remain on track to complete phase one in the second quarter. We've used these proceeds to pay down debt associated with the fourth quarter acquisition of Bank of America Tower in Charlotte, an asset in a high growth market with upside through lease-up and expansion potential. As we stated in August when we first announced our plan, we expected phase one to be initially FFO neutral and cash flow accretive. Based on our 2020 outlook and execution thus far, we're on track with our initial expectations.

Our balance sheet remains in excellent shape and we have ample liquidity to fund our growth prospects, including continued investment in our development pipeline.

Turning to Q4, we delivered FFO of $0.91 per share, a 5.4% year-over-year increase. Our leasing performance was excellent. We leased 1.2 million square feet of second gen office space with GAAP rent growth of 19.8% and cash rent growth of 6.1%. We accomplished this volume of leasing with net effective rents of $18.17 per square foot, 14% higher than our prior five-quarter average. This includes backfilling half of 5332 Avion and renewing and expanding our largest remaining expiration through 2022, 160,000 square feet with MedSolutions in Nashville. We ended the quarter with portfolio occupancy of 92.2%, towards the upper end of our outlook of 91.7 to 92.3%.

The volume of work accomplished in 2019 sets us up well for the next several years. We expect cash flow to further strengthen as we move forward, bolstered by improving rents, development deliveries and the impact of our market rotation plan. As a result, we've increased our dividend for the fourth consecutive year to an annualized rate of $1.92 per share. Since the beginning of 2017, our dividend is up 13%.

In last night's earnings release, we provided our initial 2020 FFO outlook of $3.60 to $3.72 per share. As I mentioned earlier, 2019 was impacted by some unusual items, but even when excluding these, 2020 FFO growth is up more than 4.5% at the mid-point. Our outlook includes same property cash NOI growth of 3.25 to 4.25% and year-end occupancy of 91.0 to 92.3%. As highlighted in the press release, the anticipated impact of phase one dispositions is included in our 2020 FFO outlook. Our outlook for additional dispositions is $100 to $150 million. As is our custom, these have not been included in our FFO outlook. Our acquisition outlook has a low-end of zero and a placeholder of $200 million at the high-end. Our development announcement outlook is $100 to $250 million. We're having conversations with several large anchor prospects and have spec projects on the drawing board where we see continued demand for new product. This gives us confidence we will likely add more projects to our development pipeline in 2020.

In closing, I applaud our team for their dedication and focus throughout 2019. As I mentioned earlier, it was an eventful year for Highwoods, and throughout our team remained focused on leasing space and achieving strong rent growth, controlling operating expenses, finding high quality development projects that provide attractive risk-adjusted returns, and recycling assets consistent with our effort to continuously improve portfolio quality. We enter 2020 with a solid foundation and the ingredients for improved growth over the next few years. Our balance sheet is in excellent shape with ample room to fund our future growth plans, our $500 million development pipeline will deliver and stabilize through 2022, and we have organic upside potential in our portfolio through rent and occupancy growth.

Brian Leary
Executive Vice President, Chief Operating Officer

We finished the year strong and capped off a solid year of growth from our leasing teams in the fourth quarter. Second gen office leasing volume was over 1.2 million square feet, including 398,000 square feet of new leases, our highest quarterly new leasing volume since mid-2014, and we captured GAAP rent spreads of +19.8% and cash rent spreads of +6.1%. Our high quality, BBD-located portfolio has enabled our leasing team to drive rents higher, however, even more impressive is the consistent improvement in net effective rents. This quarter was especially noteworthy with net effective rents of $18.17 per square foot, 14% above our prior five quarter average. These healthy lease economics are showing up in our financial metrics, where we expect strong 2020 same property NOI growth even while occupancy is projected to be consistent year-over-year.

In Q4 we posted same property NOI growth of +1.1%, or up 2.6% excluding 5332 Avion. Our portfolio occupancy increased 80 basis points sequentially to 92.2%, finishing the year towards the upper end of our 91.7% to 92.3% range.

The biggest gains in sequential occupancy were in Tampa and Raleigh. Included in year-end occupancy is 92,000 square feet with Fanatics at 5332 Avion in Tampa. Cheers to our Tampa team for getting some solid points on the board so far at 5332 Avion. We're underway converting the three lower floors to traditional office at 5332 Avion, where we believe it will be one of the top office buildings in the Westshore submarket. In Raleigh, there were several medium-sized users that drove the improvement in year-end occupancy, without the benefit of 98,000 square feet at 11000 Weston that was signed but where occupancy hadn't yet commenced at year-end.

Reducing our near-term rollover risk is a constant focus and our hard work in this space during 2019 will pay dividends in 2020 and beyond. We only have 29% of revenues expiring through 2022, which is approximately 500 basis points lower than the average at this point during the past three years and expect our future rollover to diminish even further as we complete the market rotation plan with Greensboro and Memphis carrying a disproportionate share of our near-term roll.

Specifically, in the fourth quarter we renewed 133,000 square feet with MedSolutions – a 2021 expiration, and expanded them by an additional 27,000 square feet. We also renewed 91,000 square feet with Marsh in Atlanta, which included a downsize of 32,000 square feet, but where expiring rents were well below market. And, after renewing MetLife in Tampa and Vanderbilt in Nashville earlier in 2019, and signing a 238,000 square foot extension with the State of Georgia early in 2020, we're left with only three expirations greater than 100,000 square feet through 2022. As we mentioned previously, we expect T-Mobile to vacate 116,000 square feet in Tampa in the middle of 2020. The other two expirations are GSA leases; one in Atlanta where we have the FAA in 100,000 square feet where they remain in holdover status as we work on terms of a renewal, and the other in Tampa where we have the FBI in a 138,000 square foot build-to-suit and where we're working towards a long-term renewal.

From here, let's drill down on our markets where office fundamentals remain strong, driven by a common thread of robust demographic trends – population, job and wage growth, low-costs of living and conducting business and serving as centers of higher education and innovation.

In Atlanta, as reported by CBRE, the market posted positive net absorption of 726,000 square feet in the fourth quarter, and 1.7 million square feet for the year, with average Class A rents across the market up 4.5% year-over-year. We're tracking 5.9 million square feet of competitive office development underway which is 57% pre-leased, over half of which is in Midtown and where we have no direct exposure. Our Atlanta team signed 176,000 square feet of second generation leases during the quarter with GAAP rent spreads of +13%, while occupancy was essentially unchanged ending the quarter at 89.8%.

Turning to Raleigh, where it was recently ranked as the second-best Market to Watch in the US in ULI's Emerging Trends Report. High demand and falling vacancy have driven average Class A rates up 4.7% year over year, while new office buildings in the urban core now have asking rates of $40 per square foot or higher, according to Avison Young. We're tracking approximately 2.1 million square feet of competitive construction, which is spread over 5 submarkets, is 38% pre-leased and represents 5.1% of competitive stock. Our Raleigh team signed 184,000 square feet of second generation leases during the fourth quarter with healthy GAAP rent spreads of +31%. Portfolio occupancy improved 150 basis points sequentially to finish the year at 90.1%. Additionally, our Raleigh team has pre-leased 100% of GlenLake Seven, our $41 million, 126,000 square foot development project. We're pleased this building will stabilize in the first quarter of 2021, three quarters ahead of pro forma. For color, the last three spec projects started in Raleigh, 5000 CentreGreen, 751 Corporate Center and GlenLake Seven, are all now 99+% leased.

Finally, to the home of next year's Super Bowl in Tampa where Class A rental rates continue to increase in the CBD and Westshore, the BBDs where the majority of our portfolio is located. According to Cushman and Wakefield, office rents increased 5.6% year-over-year and class A occupancy in Westshore and the CBD is a combined 89.5%. We're tracking 1.1 million square feet of competitive construction in Westshore and the CBD, which is 33% pre-leased and represents 4.2% of competitive stock. During the quarter, our Tampa team signed 347,000 square feet of second generation leases with GAAP rent spreads of +22%. Portfolio occupancy improved 350 basis points sequentially to 93.2%, which benefitted from the Fanatics lease at 5332 Avion. At 5332 Avion we're underway with the lower 3-floor repositioning to prepare the balance of the building for traditional office users. As a reminder, our standard development practice is to design properties, including build-to-suits, to provide long-term, multi-customer office flexibility. We believe the Fanatics lease validates the flexibility we purposely include in all of our developments.

To wrap up, I couldn't be prouder of the results our team delivered with another excellent quarter of leasing with robust volume and strong net effective rents. We've advanced our goals with regard to future rollover, and enter 2020 with a lower three-year forward expiration total than we've had entering any of the past several years. The leasing environment remains healthy across our markets and BBDs for the high quality and well-located workplace options our portfolio provides. Finally, our $500 million development pipeline is 77% pre-leased, with good interest in the two projects with spec space remaining, and where we're poised to capture growth as the projects in the pipeline deliver in 2021 and 2022.

Mark Mulhern
Executive Vice President, Chief Financial Officer

2019 was an active and productive year for our company. We delivered FFO of $3.33 per share, at the high-end of our revised outlook. As you know, there were 17 cents of unusual items in 2019 that impacted FFO; most notably, the non-operational balance sheet write-offs associated with Laser Spine's sudden closure in the first quarter and costs associated with the market rotation plan. Excluding these items, our FFO would have been right at the mid-point of our original outlook, and this includes 10 months of lost NOI from Laser Spine as well as the dilutive impact from the sale of MetroCenter in Q2, which together reduced 2019 FFO by 6 cents per share.

In the fourth quarter, we delivered net income of 58 cents per share and FFO of 91 cents per share. As expected, we recorded 3 cents per share of NOI due to the November 14th acquisition of BofA Tower, which was offset by 2 cents a share of additional interest expense for the pre-funding and funding of the acquisition, and 1 cent of additional accrued severance costs associated with the planned closures of our offices in Greensboro and Memphis.

In last night's release, we provided our initial 2020 FFO outlook of $3.60-3.72 per share. At the mid-point, FFO is up approximately 10% year-over-year. Excluding the one-time items that impacted 2019, our 2020 outlook still implies 4.6% year-over-year growth at the mid-point. As we mentioned in August when we announced our market rotation plan, we expected phase one to be initially FFO neutral and cash flow accretive. While there is still work to be done to complete phase one, we're on track to meet our overall initial expectations, and we're confident there is significant long-term growth potential for us at B of A Tower and in Charlotte overall.

In addition to our FFO outlook, some of the other items in our 2020 outlook include:

- Same property NOI growth of positive 3.25 to 4.25%
- Year-end occupancy of 91.0% to 92.3%
- Straight line rent of $32 to $34 million
- G&A of $40 to $42 million
- Average shares outstanding of 106.6 to 107.6 million

A couple of items to note regarding our 2020 outlook:

- First, there aren't significant changes expected to our same property pool other than the addition of a few development properties that were placed in service and exclusion of the phase one dispositions, which weren't projected to have a meaningful impact on the same property numbers.
- Second, 5332 Avion is included in the same property pool. While we'll record GAAP revenue from Fanatics in 2020, we currently anticipate no cash NOI from 5332 Avion in 2020.
- Third, our occupancy is negatively impacted by 30 basis points from the phase one dispositions, and thus we expect occupancy will drop in the first quarter following the sale of the 94.2% occupied industrial portfolio.
- Fourth, our straight-line rent is expected to be higher in 2020 compared to 2019 primarily due to leases at B of A Tower and Fanatics at 5332 Avion.
- Fifth, our G&A outlook includes $700,000 of severance expense in Q1 associated with closing the Greensboro and Memphis offices.
- Sixth, deliveries from our development pipeline aren't projected to contribute significantly to earnings in 2020, as our current $500 million pipeline will not deliver and stabilize until 2021 and 2022.
- Seventh, and finally, we have no major financings planned for 2020 as our balance sheet is in excellent shape.

In summary, we project solid growth in 2020 driven primarily from organic growth in our operating portfolio. This highlights the healthy fundamentals across our business coupled with a higher quality portfolio and mix of markets that positions us for stronger and more sustainable growth over the long-term.

Last night, we also announced an increase in our annualized dividend from $1.90 to $1.92 per share. When evaluating the dividend, we balance our cash flow outlook, needs for capital reinvestment in the portfolio and our taxable income levels. The market rotation plan and our development pipeline will continue to contribute to our strengthening longer term cash flow profile.

Our leverage levels increased at year-end following the acquisition of B of A Tower and prior to receipt of the majority of proceeds from phase one of the market rotation plan. However, even with temporarily elevated leverage, our balance sheet was in excellent shape at year-end with debt-to-EBITDA of 5.2x. After receiving proceeds from last week's industrial sale, our credit facility balance is currently $34 million, down from $221 million at year-end. We expect another $40 million in proceeds from the sale of The Knollwood, plus additional proceeds as we complete the remainder of phase one. After issuing $750 million of long-term, unsecured notes in 2019, our maturity ladder is in great shape and we have less than $300 million of floating rate debt outstanding. We haven't issued any shares on the ATM since the second quarter of 2017. We're committed to grow within our targeted debt-to-EBITDA operating range of 4.5 to 5.5 times and have the flexibility to fund the remaining $277 million on our development pipeline without the prerequisite of issuing shares. We remain confident in our ability to fund our growth initiatives and maintain a strong balance sheet.

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 ATM program, which we filed via Form 424(b) this morning. This new program allows us to raise, from time to time, up to $300 million of common equity at market prices, less a 1.5% discount. As you know, keeping an ATM program in place is one of the many arrows we like to keep in our capital-raising quiver.