Management's Prepared Remarks
First Quarter 2017 Conference Call
April 26, 2017

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. The release and supplemental include a reconciliation of these non-GAAP measures to the most directly comparable GAAP financial measures.

Any forward-looking statements made during today's call are subject to risks and uncertainties and these are discussed at length in our annual and quarterly 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

Business conditions remain good for our customers and prospects, and for Highwoods. We continue to see steady demand for our well-located BBD office product as many office users continue to grow their businesses in a prudent, need-based manner. The overriding economic question continues to be: "how long will this expansion last?" Or, the proverbial "What inning are we in?" We'll leave picking the inning or the length of the game to others, but the slow, steady cadence of positive economic growth has given us an economic cycle a longer duration than most prior cycles. Therefore, we expect more at bats and the key drivers that support this belief are the solid fundamentals that remain in place, such as:

- Southeast population and job growth continue to significantly outpace the national average.
- Our footprint continues to enjoy business friendly environments.
- Our markets continue to experience positive net absorption.
- New supply remains limited; and
- Rents continue to rise.

Further, the capital markets remain healthy for our customers and for us. While interest rates have trended up since the US ten year bottomed out at 1.4% last summer, they still remain well below long-term averages. While the consensus forecast indicates a modest increase in long-term rates going forward, even if the forecast becomes reality, borrowing rates should still be relatively low.

This healthy capital markets environment continues to support the outlook for our business. First, our view is customers and prospects are generally comfortable about growing their businesses, whether it's an existing customer needing to expand or a build-to-suit prospect looking to relocate and/or consolidate multiple locations into one, modern-day facility. Second, our access to capital, as demonstrated by ongoing support from our equity and fixed income investors and banking partners, bolsters our growth initiatives, particularly in funding our development pipeline.

Turning to the first quarter, we delivered a clean 80 cents of FFO per share. This is a solid year-over-year increase in our core performance, with significantly lower average leverage.

With this strong start to the year, combined with sound business conditions expected for the remainder of the year, we increased the low-end of our FFO outlook despite a penny of dilution from a disposition that wasn't previously included in our forecast. In addition, we raised our outlook for same property cash NOI growth by 25 basis points. In short, we are delivering higher core FFO per share with improved portfolio quality, a stronger balance sheet, and a further simplified platform.

On the operational front, we posted strong same property cash NOI growth. Cash rent spreads on signed leases were positive 4.4% and GAAP rent spreads were positive 16.6%. Net effective rents were $15.28 per square foot, more than 10% above our prior five quarter average.

As expected, our occupancy dropped from year-end, primarily driven by HCA's move-out in Nashville on January 1st. We've made decent progress with the backfill of their space, signing 37% of the space and having a strong prospect for another 7%.

Disposition and acquisition activity was quiet in the first quarter.

On dispositions, we sold a single-customer, somewhat specialized building in East Memphis for $13 million. We have additional non-core properties in various stages of marketing that would put us towards the high-end of our $50 to $150 million outlook. Reinvesting non-core disposition proceeds into our accretive development pipeline remains a core component of our Strategic Plan.

On acquisitions, we've kept our outlook unchanged at $0 to $200 million, as there is not a lot of institutional quality assets on the market right now. For the few assets that we've seen in the market, pricing for BBD-located Class A office properties remains competitive with initial cap rates carrying a 5-handle. We continue to evaluate on and off-market opportunities with a focus on prudent investing.

We had a very active quarter with our development program. We placed $96 million of 93% leased development in service during the quarter. In addition, we announced $126 million of new projects this quarter, which are 86% pre-leased. Further, we signed a total of 398,000 square feet of first gen leases. Our development pipeline now encompasses 1.8 million square feet, with a total anticipated investment of $549 million, and is 83% pre-leased on a dollar weighted basis.

The largest of our first quarter development announcements is the $96 million, 224,000 square foot, U.S. headquarters for Mars Petcare at Ovation in Nashville. After an extensive process of master planning, re-zoning, and constructing the project's infrastructure, this is a terrific announcement to kick-off our planned 1.4 million square foot office portion of Ovation. We are excited that a large, internationally recognized brand with such strong financials has chosen Ovation for its U.S. headquarters. We are flattered to be working with Mars Petcare and their endorsement of Ovation should heighten the attractiveness of the project to other potential users.

We placed two buildings in service during the quarter. First is Seven Springs West in Nashville… a $59 million, seven story, multi-customer building in our 707,000 square foot Seven Springs complex. This building is 91% leased and we are working with a strong prospect that will take us to 95%. Second is GlenLake V in Raleigh, a $37 million, multi-customer building that is 96% leased.

On April 7th, we hosted a topping out celebration for our 34 story, Bridgestone Americas headquarters building in Nashville. Vertical construction is nearing substantial completion and infill is well underway. We are now in the process of turning over lower level floors to our customer for FF&E installations.

At Riverwood 200 in Atlanta, we're now 79% pre-leased with more than two years until pro forma stabilization. This $107 million project will deliver next quarter.

At 5000 CentreGreen in Raleigh, the building has taken shape, which has driven an increase in prospect activity, as evidenced by our 43,000 square feet of leasing during the quarter. The building is now 26% pre-leased and we have a strong prospect for another 13%. As a reminder, we have pro forma'd the building to stabilize in 3Q'19.

We continue to see a steady pipeline of potential build-to-suit and/or anchor customers for development projects. While it's always difficult to forecast if and when a sizable user will commit to a development, we are very comfortable with our outlook of $126 to $220 million of announcements and the continued replenishment of our development pipeline. Development continues to be a core competency for us and an ongoing engine of strengthening cash flow and earnings growth.

The combination of strong operating fundamentals, additional savings from maturing high coupon debt, a strong balance sheet, and scheduled delivery of development projects sets the table for continued growth in our earnings, cash flow, and NAV over the next several years.

Ted Klinck
Executive Vice President, Chief Operating and Investment Officer

We had solid activity this quarter with strong leasing economics. We leased 715,000 square feet of second gen office space, and year-over-year asking rents continue to increase. Average in-place cash rental rates across our office portfolio grew to $24.40 per square foot, 4.4% higher than a year ago. Office occupancy in our same property portfolio was up 10 basis points compared to one year ago, while overall portfolio occupancy dropped 40 basis points since the end of 2016, driven by the move-out of HCA, partially offset by additional leasing in the portfolio.

For office leases signed in the fourth quarter, starting cash rent increased 4.4% while GAAP rent grew 16.6%. Importantly, net effective rents, which include the full load for op-ex, TIs, leasing commissions and free rent, were $15.28 per square foot, or more than 10% higher than our prior five quarter average. The average term was 5.3 years, and while this is down modestly from our recent trend, it was driven lower by three fairly sizable shorter term renewals.

Turning to our operational performance in the quarter, we grew same property cash NOI by 5.5% compared to a year ago. This growth was driven by higher rents on new deals signed, annual in-place rent bumps, and unusually low operating expenses. While we expect NOI growth will moderate in subsequent quarters as operating expenses normalize, the strong start in Q1 and solid outlook for the remainder of the year caused us to increase our same property cash NOI outlook to 2.75-to-3.5%.

We ended the quarter at 92.7% occupancy. We have good customer and prospect activity, but as we mentioned on our last call we have some upcoming known move-outs in Buckhead and Richmond, and therefore we expect occupancy to dip to around 92% in Q2 and Q3 and recover in Q4. Based on the current pipeline of leasing activity, we remain comfortable with our year-end occupancy projection of 92.2% to 93.2%. We don't provide guidance on rent economics, but we feel good about the health of our markets and the ability to continue to garner improving net effective rents.

Now, turning to our markets. While there is always some noise in the quarterly stats, the outlook for rents and absorption across our footprint continues to be positive.

Over the past few years Tampa and Orlando's job growth have consistently ranked high versus the national average. While the recovery of the Florida office markets has been slower than our other southeastern cities, Tampa is picking up steam and Orlando is showing promise.

Our occupancy in Tampa is now 92%, up 370 basis points over the past 12 months, with continued solid customer and prospect activity. According to JLL, asking rents across the city are up 3.9% over the past 12 months and vacancy is down 240 basis points. With no new speculative office construction, we expect solid fundamentals to continue.

In comparison to our other markets, our occupancy in Orlando at 87.7% has lagged, but we're seeing improved activity, and we forecast occupancy to clip 89% by year-end. The bright side of our low occupancy in Orlando is that it represents a meaningful opportunity for internal growth.

In Raleigh, rents continue to move steadily higher. Per Avison Young, Class A rents increased 3.8% year-over-year. Further, vacancy dropped 160 basis points to 8.0% and first quarter net absorption totaled 535,000 square feet. New supply in Raleigh is higher than most of our other markets at 2.1 million square feet, but at 4.8% of total inventory, 39% pre-leased and spread across several submarkets, we believe new supply is basically in sync with demand. In our portfolio, we signed 80,000 square feet of second gen deals in the quarter with GAAP rent growth of 22.5%. Our quarter-end occupancy was 92.5%, and we project occupancy to move higher during the balance of the year. At Charter Square, the 65% occupied building we acquired in CBD Raleigh last September, we have signed leases and LOIs that will take occupancy to 82%.

Turning to Atlanta, first and foremost the collapse of a small section of I-85 has been national news. While an unfortunate event, the commutes to and from our buildings have been largely unaffected. The currently disclosed outside date for completion is June 15th, with heavy incentives to finish earlier. In our portfolio, we continue to generate strong rents as evidenced by GAAP rent spreads of +16.7% on signed deals in Q1. As we noted on the last call, we expect occupancy in Atlanta to dip in the middle of the year as there are two larger customers moving out in Buckhead. We anticipate releasing the space at rental rates 10-plus% higher than the expiring rates. Our Riverwood 200 project is scheduled to deliver at the end of Q2. We're now 79% pre-leased, up 600 basis points during the quarter, and we pro forma'd stabilization in Q2'19.

In Nashville, leasing activity and rents continue to be strong. The market's vacancy rate is 6.9%, well below the 10-year historical average of 9.7%. Class A average asking rents increased 4% quarter-over-quarter. Occupancy in our portfolio was 94.2% at the end of the quarter, down from 99.6% at the end of the year driven by the HCA move-out, but we expect occupancy to improve in subsequent quarters. As we've stated in the past, we keep a watchful eye on development activity in Nashville. We're tracking about 2.5 million square feet, or roughly 5% of stock, under construction that is approximately two-thirds pre-leased. The market's steady demand suggests the remainder of this product will be appropriately absorbed.

In conclusion, while we have some backfill opportunities ahead of us, leasing volumes continue to be solid, reflecting positive momentum in our markets and demand for our well-located BBD office product.

Mark Mulhern
Executive Vice President, Chief Financial Officer

We have had a positive start to the year as indicated by our first quarter financial results. As Ed outlined, we delivered FFO of 80 cents per share. Last year's first quarter FFO of 82 cents included 3 cents of land sale gains and term fees, and another 2 cents from owning Country Club Plaza for 60 days with 45% overall leverage. Adjusted for the unusual items and temporary high leverage in last year's first quarter, we delivered strong core FFO growth this quarter. The increase was driven by higher rents across the portfolio, lower operating expenses and added NOI from development that came online.

Turning to our balance sheet and financing activities, we ended the quarter with leverage of 36.2% and debt-to-EBITDA of 5.05 turns. These metrics are up modestly from the end of the year, which is largely attributable to the payment of the 80 cent per share special dividend in January. We remain in the middle of our stated comfort range of 4.5 to 5.5x debt to EBITDA and are well positioned to fund our growth initiatives.

We raised $300 million in a ten year bond deal in March that was priced to yield 4.04%. The effective interest rate of the bonds is 3.78% after factoring in a $7.3 million gain from our prior hedge of $150 million of the underlying treasury at 1.90%. Those proceeds were used to pay off a $380 million maturity with an effective interest rate of 5.88%.

We also expanded a five-year unsecured bank term loan by another $50 million at LIBOR plus 110 basis points.

We had two financing transactions after quarter-end. The first is a new $100 million secured loan that closed earlier this week. The loan has a twelve year term with a 4.0% coupon and is secured by our Pinnacle building in Nashville. Those proceeds will be used next Monday to pay off a $108 million maturing secured loan on the PPG buildings in Pittsburgh with an effective interest rate of 4.2%. This refinancing extends out our maturity ladder at a competitive fixed rate while improving our unencumbered NOI to 95%. Second, also this week, we obtained $150M of forward-starting swaps that lock the underlying 10-year treasury at 2.44% in advance of a potential financing before May 15, 2018.

As Ed mentioned, we tightened our FFO outlook to $3.29 to $3.40 per share, and increased our range of growth in same property cash NOI by 25 basis points for the full year. In keeping with our long-standing practice, the revised FFO outlook includes $0.01 per share of dilution from the sale of a property in Memphis that wasn't previously included in our outlook. It's worth considering a couple of modeling items in addition to scheduled development deliveries and movement in our operating portfolio NOI. First, we will receive approximately $8 million in early possession rent from Bridgestone in Q2 and Q3 ahead of the scheduled completion of their US headquarters building in Nashville late in Q3. Second, we will receive interest expense savings from the bond refinancing completed late in the first quarter.

Our Q1 same property cash NOI growth was 5.5% primarily driven by higher rents and lower operating costs. We project a more normalized pattern of operating expenses for the remainder of 2017 which should put our same property cash NOI growth for the year inside our upwardly revised range of 2.75 to 3.5%.

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

- Our first quarter G&A costs are approximately $3 million higher than the run rate for the next three quarters due to the routine 1st quarter expensing of annual long term equity grants.
- The GAAP income statement for Q1 2016 reflects the very significant book gain of approximately $420 million, or $4.22 per share, primarily from the sales of our Country Club Plaza assets distorting the year over year net income comparison.
- As Ed noted, we expect to be in the mid-to-high end of outlook on dispositions. Consistent with our past practice, we do not include in our outlook the FFO impact from potential acquisitions or dispositions until such transactions are announced.