Management's Prepared Remarks
First Quarter 2024 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 are 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 an excellent quarter executing on our key priorities and delivering solid financial results. First, we signed 922,000 square feet of second gen leases, including over 400,000 square feet of new leases and 36,000 square feet of net expansions. This volume of work will benefit us in future periods as the new leases commence. Second, we signed 157,000 square feet of first gen leases in our development pipeline. We continue to see solid interest in these best-in-class projects, which will provide approximately $40 million of incremental NOI upon stabilization and be a significant growth driver for our cash flows. Third, we delivered Four Morrocroft, an 18,000 square foot, $12 million build-to-suit that we developed at our Morrocroft property in the South Park BBD of Charlotte. As you may recall, this creative office development is situated on a surface parking lot with zero basis. While Four Morrocroft is one of our smaller developments, it demonstrates our resourcefulness in cultivating and generating attractive risk-adjusted returns for our shareholders. Finally, we sold nearly $80 million of non-core properties in Raleigh, including over $60 million that closed early in the second quarter. These sales improve our portfolio quality, increase our long-term cash flow growth and further strengthen our liquidity and already strong balance sheet.

We expect our solid leasing momentum to continue as our markets generate outsized population and job growth given their high quality of life and business friendly environments. Simply put, our markets and our BBDs are where people and companies want to live, work and play. This is why our portfolio has outperformed the national average, our markets and our submarkets – all because customers and prospects are attracted to our commute-worthy buildings. Plus, being a long-term landlord with a strong balance sheet that can fund tenant improvements and leasing commissions and care for our best-in-class properties is proving to be a clear competitive advantage for us. Contrary to popular opinion, we're seeing strong demand across our portfolio – whether they be brand new trophy assets or well-located second gen properties and whether they be suburban or urban. We believe financially capable landlords who provide value to customers and prospects will see healthy demand across a wide variety of price points.

Turning to our quarterly results, we delivered FFO of $0.89 per share and same property cash NOI growth of +0.3%. As expected, our occupancy dipped modestly to 88.5%.

Our 2024 FFO outlook is a penny and a half lower at the midpoint due to higher-than-expected interest rates and the dilutive impact of non-core asset sales already completed, neither of which were factored into our initial outlook. These items are partially offset by higher projected NOI. The strong leasing start to the year modestly helps 2024, but most of the new leasing will drive upside in 2025 and beyond.

We've also had a successful start to the year with non-core asset sales, and we're prepping additional properties for potential disposition. We now expect to sell up to an additional $150 million during the remainder of the year. The volume and timing of dispositions will depend on how conditions in the investment sales market play out, but we've been encouraged by the response we've seen in recent quarters to our marketing efforts and the modest improvement in the capital markets for prospective buyers.

While we don't have any acquisitions included in our 2024 outlook, we continue to build the foundation for future investment opportunities. Similar to the first few years coming out of the Global Financial Crisis, we believe compelling investment opportunities will arise, but these will take time to play out. We're comfortable being patient as we continue to have conversations with owners and lenders of "wish list" properties in our markets.

Our development pipeline is now $506 million following the delivery of the 100%-leased Four Morrocroft building in Charlotte. With 157,000 square feet of first gen leases signed during the quarter, our pipeline is now 41% leased. A big chunk of the activity was at our 642,000 square foot, $460 million, 23Springs project in Uptown Dallas that we are developing in a 50/50 joint venture with Granite. 23Springs is now 54% pre-leased a year prior to scheduled completion and four years before the estimated stabilization. The largest lease signed was a current law firm customer at our 98% occupied McKinney & Olive property just a couple of blocks away who needs to expand by nearly 50%. Given we couldn't accommodate their growth at McKinney & Olive, we were able to accommodate their growth at 23Springs. We already have excellent activity to backfill their space at McKinney & Olive more than two years before their scheduled move to 23Springs. We made modest leasing progress at Granite Park Six in Dallas and GlenLake III in Raleigh. Both of these developments delivered late last year and are projected to stabilize in 2026. These buildings are best-in-class in their respective BBDs and prospect activity is accelerating. We're confident in the long-term outlook and expect these developments to drive solid cash flow growth for us in future years. Midtown East in Tampa, our 143,000 square foot, $83 million project that we are developing in a 50/50 joint venture with Bromley in the Westshore BBD, is seeing strong interest from prospects given we're the only office project currently under construction in the entire market. We're 16% pre-leased and are very encouraged by the strong interest, more than two years before scheduled stabilization.

We don't expect to announce any new development projects during the year. Obviously, this isn't unique to Highwoods. It's very difficult for new starts to pencil in the current environment. We're not seeing meaningful reductions in hard costs and interest rates continue to be elevated. Plus, for other developers who are capital-constrained, securing capital for new office construction is very challenging. As a result, new starts have plummeted and, with current development pipelines that will largely be delivered across our markets over the next few quarters, the lack of new supply in future periods will play to our advantage as users seek high-quality properties from landlords with strong financial resources.

In conclusion, as we have for the past few years, we acknowledge the headwinds in the office sector, yet we're bullish about the future for Highwoods. First, our portfolio has never been better, and it will continue to improve as we sell additional non-core properties and deliver our $500 million development pipeline. Second, we have significant organic growth potential within our operating portfolio where we've already leased some of our existing vacancy and have solid interest on expected future vacancy. Third, our balance sheet is in excellent shape and will enable us to capitalize on future growth opportunities. And finally, even with higher interest rates, our underlying cash flows remain strong, which allows us to keep investing Highwoodtizing capital to generate higher returns on our existing portfolio.

Brian Leary
Executive Vice President, Chief Operating Officer

As we mentioned on last quarter's call, our leasing teams got off to a strong start in 2024. We maintained our positive momentum through the end of the first quarter and signed 97 deals and exceeded our five-quarter average with 922,000 square feet signed. New leasing volume of 422,000 square feet was the second highest quarterly total since 2014. Average term was also strong at nearly 7 years, one year longer than our prior five quarter average. Tampa, Atlanta and Raleigh signed nearly three-fourths of this quarter's total volume with average terms of 7.5 years. Expansions outpaced contractions two-to-one and while lease economics reflect a highly competitive market, we will prioritize occupancy as needed over pushing rental rates to lean on our strengths as a long-term owner while strengthening our long-term cash flows.

In addition, we are seeing strong activity across our $500 million development pipeline. As Ted mentioned, we signed 157,000 square feet of first gen leases, including 129,000 at 23 Springs - our JV development in Uptown Dallas. The 129,000 square feet of preleasing at 23Springs follows the 105,000 square foot lease we announced last quarter. 23Springs is now 54% preleased – one year before completion and four years before our estimated stabilization in the first quarter of 2028.

The quality of our portfolio, our sponsorship and the commute-worthy lifestyle office experience we provide our customers is giving us a clear edge in today's leasing environment. We're seeing strong demand at various price points across our portfolio. As demonstrated by strong leasing volume in our development pipeline, the top of the market is doing well, but we continue to see the most demand in our markets for our well located second gen assets. This is because a large segment of customers and prospects prioritize a premier office experience at rents that are more affordable than a trophy price point.

Moving to our markets, Tampa recorded the most volume in the quarter with 267,000 square feet signed. Our 16% pre-leased Midtown East development is the only Class A office development under construction in Tampa and is on-time and on-budget for a Q1 2025 delivery. Solid inbound interest continues as the building advances toward completion. According to Cushman & Wakefield, Midtown East's Westshore BBD was the most active submarket in Tampa during the quarter capturing nearly one-third of all leasing activity. Further, CBRE is currently tracking several large users in the market and over 2.6 million square feet of demand. We leased a lot of our vacancy earlier this year at Tampa Bay Park, and we're now working to fill pockets of vacancy at Meridian where we have solid traction.

Moving to Atlanta, the MSA recently passed Philadelphia and Washington, DC as the nation's sixth largest and is the second largest metropolitan area on the East Coast according to the latest population estimates from the US Census Bureau. Our Atlanta team signed 199,000 square feet for the quarter, of which 160,000 was new. This represents the greatest share of new leasing across the portfolio.

Further north in Raleigh, which was recently ranked number two in the Milken Institute's annual Best Performing Cities report, our team signed 201,000 square feet in the quarter. We averaged close to eight years of lease term and over half of this leasing activity was new. Raleigh is joined by Nashville, Dallas and Charlotte in Milken's top ten best performing cities list.

In summary, our leasing pipeline is healthy and we are pleased by the flow of inbound proposal and tour requests across our portfolio. We believe this is emblematic of our simple and straightforward strategy of creating commute-worthy experiences in the SunBelt's best business districts.

Brendan Maiorana
Executive Vice President, Chief Financial Officer
In the fourth quarter, we delivered net income of $26.1 million, or $0.25 per share, and FFO of $96.0 million, or $0.89 per share. There were no unusual items in the quarter. We are pleased with the quarterly results, which demonstrate the resiliency of our operations and continued strong cash flows.

Rolling forward from the fourth quarter and excluding the $0.08 per share of unusual items in Q4, FFO per share was $0.02 lower in the first quarter. Higher G&A, which we incur every year during the first quarter due to the expensing of equity grants for certain employees, and the full quarter impact of November's bond issuance reduced FFO by $0.04 per share. These headwinds were partially offset by $0.02 per share of higher NOI, which nets to the $0.02 sequential reduction.

Our balance sheet remains in excellent shape. At March 31st, we had $850 million of available liquidity, which has increased to $915 million following the non-core dispositions we closed in early April. We have a little over $200 million left to fund on our development pipeline and no consolidated debt maturities until May of 2026. We do have one mortgage that matures in the third quarter of this year at our unconsolidated McKinney & Olive joint venture. This is a low leverage loan and we're reviewing financing options with Granite Properties, our partner. We may ultimately decide to jointly repay this loan upon maturity and seek longer term financing when the lending environment is more attractive. Given our ample liquidity, we have many options available. This also demonstrates the strategic value of having such a financially capable joint venture partner in Granite.

As Ted mentioned, we have updated our 2024 FFO outlook to $3.46 to $3.61 per share, which implies a $0.015 reduction at the mid-point. The reduction is driven by the $0.03 dilutive impact from the asset sales completed since our outlook was provided in February and higher than anticipated interest rates for the remainder of 2024, partially offset by $0.015 of higher anticipated NOI. It's still early in the year and therefore our range remains wide with several variables – most around projected property tax savings which aren't assured yet.

We're pleased with the non-core property sales completed thus far. While modestly dilutive to near-term FFO, as we have long stated, our capital recycling program has been accretive to our cash flows while also improving our long-term growth rate. We've increased the midpoint of our same property cash NOI outlook and moved the high end of total dispositions to $230 million (including the $80 million we've closed so far). All other items in our outlook remain unchanged.

As Ted and Brian mentioned, we had a strong leasing quarter, especially new leasing volume. Many of the new leases signed in the quarter won't commence until late this year or next year, and therefore will not have a meaningful financial impact on 2024 results. This volume of work will obviously bolster results in future years. As you know, we try to be as open and transparent as possible with our stakeholders and we've stated for quite some time that we expect occupancy will trough in the first half of next year. We still expect this to be the case, but if we can continue to post strong leasing volumes, we believe our trough occupancy level will be higher than our original expectations and our recovery will be faster.

You may have seen in our supplemental package that we have made some adjustments to how we present property-level operational information. Starting this quarter and going forward, we are now including in-service properties owned by consolidated and unconsolidated joint ventures at our share. We are doing the same thing with respect to the presentation of our same property operational results in the supplemental. For those of you who would rather see same property results on a consolidated basis only, all of the ingredients are itemized in the same property reconciliation table in the back of the earnings release. These changes have a relatively modest impact on our property-level metrics this quarter as JVs today comprise less than 3% of our business but will increase to around 8% as our development properties are placed in service.

To wrap up, we're very encouraged about the future for Highwoods. Our high-quality Sun Belt portfolio is located in the BBDs where talent wants to be, which is clearly demonstrated by our performance this quarter. We have strong embedded growth potential within our operating portfolio and approximately $40 million of future NOI as our development pipeline stabilizes, our balance sheet is in excellent shape, and our cash flows continue to be resilient.