

HIGHWOODS PROPERTIES INC  
Form 10-Q  
October 28, 2014

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2014

HIGHWOODS PROPERTIES, INC.

(Exact name of registrant as specified in its charter)

|   |                             |  |
|---|-----------------------------|--|
| Maryland  | 001-13100                   | 56-1871668                                 |
| (State or other jurisdiction<br>of incorporation or organization) | (Commission<br>File Number) | (I.R.S. Employer<br>Identification Number) |

HIGHWOODS REALTY LIMITED PARTNERSHIP

(Exact name of registrant as specified in its charter)

|   |                             |  |
|---|-----------------------------|--|
| North Carolina  | 000-21731                   | 56-1869557                                 |
| (State or other jurisdiction<br>of incorporation or organization) | (Commission<br>File Number) | (I.R.S. Employer<br>Identification Number) |

3100 Smoketree Court, Suite 600

Raleigh, NC 27604

(Address of principal executive offices) (Zip Code)

919-872-4924

(Registrants' telephone number, including area code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Highwoods Properties, Inc. Yes  No  Highwoods Realty Limited Partnership Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Highwoods Properties, Inc. Yes  No  Highwoods Realty Limited Partnership Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of 'large accelerated filer,' 'accelerated filer' and 'smaller reporting company' in Rule 12b-2 of the Securities Exchange Act.

Highwoods Properties, Inc.

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Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
Highwoods Realty Limited Partnership  
Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act).

Highwoods Properties, Inc. Yes  No  Highwoods Realty Limited Partnership Yes  No

The Company had 91,270,024 shares of Common Stock outstanding as of October 20, 2014.

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## EXPLANATORY NOTE

We refer to Highwoods Properties, Inc. as the “Company,” Highwoods Realty Limited Partnership as the “Operating Partnership,” the Company’s common stock as “Common Stock” or “Common Shares,” the Company’s preferred stock as “Preferred Stock” or “Preferred Shares,” the Operating Partnership’s common partnership interests as “Common Units” and the Operating Partnership’s preferred partnership interests as “Preferred Units.” References to “we” and “our” mean the Company and the Operating Partnership, collectively, unless the context indicates otherwise.

The Company conducts its activities through the Operating Partnership and is its sole general partner. The partnership agreement provides that the Operating Partnership will assume and pay when due, or reimburse the Company for payment of, all costs and expenses relating to the ownership and operations of, or for the benefit of, the Operating Partnership. The partnership agreement further provides that all expenses of the Company are deemed to be incurred for the benefit of the Operating Partnership.

Certain information contained herein is presented as of October 20, 2014, the latest practicable date for financial information prior to the filing of this Quarterly Report.

This report combines the Quarterly Reports on Form 10-Q for the period ended September 30, 2014 of the Company and the Operating Partnership. We believe combining the quarterly reports into this single report results in the following benefits:

- combined reports better reflect how management and investors view the business as a single operating unit;

- combined reports enhance investors' understanding of the Company and the Operating Partnership by enabling them to view the business as a whole and in the same manner as management;

- combined reports are more efficient for the Company and the Operating Partnership and result in savings in time, effort and expense; and

- combined reports are more efficient for investors by reducing duplicative disclosure and providing a single document for their review.

To help investors understand the significant differences between the Company and the Operating Partnership, this report presents the following separate sections for each of the Company and the Operating Partnership:

- Consolidated Financial Statements;

- the following Notes to Consolidated Financial Statements:

- Note 8 - Noncontrolling Interests; and

- Note 13 - Earnings Per Share and Per Unit;

- Item 4 - Controls and Procedures; and

- Item 6 - Certifications of CEO and CFO Pursuant to Sections 302 and 906 of the Sarbanes-Oxley Act.



HIGHWOODS PROPERTIES, INC.  
HIGHWOODS REALTY LIMITED PARTNERSHIP

QUARTERLY REPORT FOR THE PERIOD ENDED SEPTEMBER 30, 2014

TABLE OF CONTENTS

|  | Page |
|--|------|
| PART I - FINANCIAL INFORMATION   |      |
| ITEM 1. <u>FINANCIAL STATEMENTS (unaudited)</u>  | 4    |
| <u>HIGHWOODS PROPERTIES, INC.:</u>   |      |
| <u>Consolidated Balance Sheets at September 30, 2014 and December 31, 2013</u>   | 4    |
| <u>Consolidated Statements of Income for the Three and Nine Months Ended September 30, 2014 and 2013</u>               | 4    |
| <u>Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended September 30, 2014 and 2013</u> | 5    |
| <u>Consolidated Statements of Equity for the Nine Months Ended September 30, 2014 and 2013</u>                         | 6    |
| <u>Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2014 and 2013</u>                     | 7    |
| <u>HIGHWOODS REALTY LIMITED PARTNERSHIP:</u>   |      |
| <u>Consolidated Balance Sheets at September 30, 2014 and December 31, 2013</u>   | 9    |
| <u>Consolidated Statements of Income for the Three and Nine Months Ended September 30, 2014 and 2013</u>               | 10   |
| <u>Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended September 30, 2014 and 2013</u> | 11   |
| <u>Consolidated Statements of Capital for the Nine Months Ended September 30, 2014 and 2013</u>                        | 11   |
| <u>Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2014 and 2013</u>                     | 12   |
| <u>NOTES TO CONSOLIDATED FINANCIAL STATEMENTS</u>  | 14   |
| ITEM 2. <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>                   | 33   |
| <u>Disclosure Regarding Forward-Looking Statements</u>   | 33   |
| <u>Executive Summary</u>   | 34   |
| <u>Results of Operations</u>   | 35   |
| <u>Liquidity and Capital Resources</u>   | 38   |
| <u>Critical Accounting Estimates</u>   | 41   |
| <u>Non-GAAP Information</u>  | 41   |
| ITEM 3. <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>  | 45   |
| ITEM 4. <u>CONTROLS AND PROCEDURES</u>   | 45   |
| PART II - OTHER INFORMATION  |      |
| ITEM 6. <u>EXHIBITS</u>  | 46   |

Table of Contents

## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## HIGHWOODS PROPERTIES, INC.

## Consolidated Balance Sheets

(Unaudited and in thousands, except share and per share data)

|  | September 30,<br>2014 | December 31,<br>2013 |
|--|-----------------------|----------------------|
| Assets:  |                       |                      |
| Real estate assets, at cost:   |                       |                      |
| Land   | \$ 386,333            | \$ 393,602           |
| Buildings and tenant improvements  | 3,756,655             | 3,748,869            |
| Development in process   | 184,238               | 44,621               |
| Land held for development  | 89,010                | 110,374              |
|  | 4,416,236             | 4,297,466            |
| Less-accumulated depreciation  | (1,013,071 )          | (985,244 )           |
| Net real estate assets   | 3,403,165             | 3,312,222            |
| Real estate and other assets, net, held for sale   | 1,032                 | —                    |
| Cash and cash equivalents  | 11,600                | 10,184               |
| Restricted cash  | 10,633                | 14,169               |
| Accounts receivable, net of allowance of \$1,408 and \$1,648, respectively   | 29,970                | 26,430               |
| Mortgages and notes receivable, net of allowance of \$255 and \$302, respectively  | 10,501                | 26,409               |
| Accrued straight-line rents receivable, net of allowance of \$601 and \$1,063, respectively  | 136,578               | 126,014              |
| Investments in unconsolidated affiliates   | 30,248                | 29,901               |
| Deferred financing and leasing costs, net of accumulated amortization of \$108,878 and \$92,220, respectively  | 218,725               | 222,211              |
| Prepaid expenses and other assets, net of accumulated amortization of \$13,913 and \$12,905, respectively  | 42,635                | 39,561               |
| Total Assets   | \$ 3,895,087          | \$ 3,807,101         |
| Liabilities, Noncontrolling Interests in the Operating Partnership and Equity:   |                       |                      |
| Mortgages and notes payable  | \$ 2,013,824          | \$ 1,956,299         |
| Accounts payable, accrued expenses and other liabilities   | 229,996               | 218,962              |
| Financing obligations  | 23,519                | 26,664               |
| Total Liabilities  | 2,267,339             | 2,201,925            |
| Commitments and contingencies  |                       |                      |
| Noncontrolling interests in the Operating Partnership  | 114,248               | 106,480              |
| Equity:  |                       |                      |
| Preferred Stock, \$.01 par value, 50,000,000 authorized shares;<br>8.625% Series A Cumulative Redeemable Preferred Shares (liquidation preference \$1,000 per share), 29,077 shares issued and outstanding | 29,077                | 29,077               |
| Common Stock, \$.01 par value, 200,000,000 authorized shares;<br>91,270,024 and 89,920,915 shares issued and outstanding, respectively   | 913                   | 899                  |
| Additional paid-in capital   | 2,413,662             | 2,370,368            |
| Distributions in excess of net income available for common stockholders  | (948,929 )            | (920,433 )           |
| Accumulated other comprehensive loss   | (2,831 )              | (2,611 )             |
| Total Stockholders' Equity   | 1,491,892             | 1,477,300            |
| Noncontrolling interests in consolidated affiliates  | 21,608                | 21,396               |

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|   |              |              |
|---|--------------|--------------|
| Total Equity  | 1,513,500    | 1,498,696    |
| Total Liabilities, Noncontrolling Interests in the Operating Partnership and Equity | \$ 3,895,087 | \$ 3,807,101 |

See accompanying notes to consolidated financial statements.

HIGHWOODS PROPERTIES, INC.

Consolidated Statements of Income

(Unaudited and in thousands, except per share amounts)

|   | Three Months Ended |            | Nine Months Ended |            |
|---|--------------------|------------|-------------------|------------|
|   | September 30,      |            | September 30,     |            |
|   | 2014               | 2013       | 2014              | 2013       |
| Rental and other revenues   | \$ 152,629         | \$ 144,827 | \$ 453,804        | \$ 407,822 |
| Operating expenses:   |                    |            |                   |            |
| Rental property and other expenses  | 57,383             | 54,102     | 169,048           | 148,013    |
| Depreciation and amortization   | 48,287             | 47,338     | 146,895           | 128,050    |
| Impairments of real estate assets   | —                  | —          | 588               | —          |
| General and administrative  | 7,526              | 8,969      | 26,973            | 27,948     |
| Total operating expenses  | 113,196            | 110,409    | 343,504           | 304,011    |
| Interest expense:   |                    |            |                   |            |
| Contractual   | 20,962             | 22,683     | 62,352            | 67,879     |
| Amortization of deferred financing costs  | 819                | 963        | 2,270             | 2,860      |
| Financing obligations   | 567                | 26         | 301               | 87         |
|   | 22,348             | 23,672     | 64,923            | 70,826     |
| Other income:   |                    |            |                   |            |
| Interest and other income   | 1,054              | 1,582      | 3,863             | 4,982      |
| Losses on debt extinguishment   | (326 )             | (32 )      | (308 )            | (196 )     |
|   | 728                | 1,550      | 3,555             | 4,786      |
| Income from continuing operations before disposition of investment properties and activity in unconsolidated affiliates | 17,813             | 12,296     | 48,932            | 37,771     |
| Gains/(losses) on disposition of property   | 36,238             | 34         | 42,185            | (3 )       |
| Gain on acquisition of controlling interest in unconsolidated affiliate   | —                  | 7,451      | —                 | 7,451      |
| Equity in earnings/(losses) of unconsolidated affiliates  | 248                | (3,173 )   | 886               | (1,824 )   |
| Income from continuing operations   | 54,299             | 16,608     | 92,003            | 43,395     |
| Discontinued operations:  |                    |            |                   |            |
| Income from discontinued operations   | —                  | 1,514      | —                 | 5,853      |
| Impairments of real estate assets   | —                  | —          | —                 | (2,194 )   |
| Net gains on disposition of discontinued operations   | —                  | 37,946     | 384               | 52,353     |
|   | —                  | 39,460     | 384               | 56,012     |
| Net income  | 54,299             | 56,068     | 92,387            | 99,407     |
| Net (income) attributable to noncontrolling interests in the Operating Partnership                                      | (1,673 )           | (1,889 )   | (2,813 )          | (3,713 )   |
| Net (income) attributable to noncontrolling interests in consolidated affiliates  | (291 )             | (203 )     | (1,152 )          | (593 )     |
| Dividends on Preferred Stock  | (627 )             | (627 )     | (1,881 )          | (1,881 )   |
| Net income available for common stockholders  | \$ 51,708          | \$ 53,349  | \$ 86,541         | \$ 93,220  |
| Earnings per Common Share – basic:  |                    |            |                   |            |
| Income from continuing operations available for common stockholders   | \$ 0.57            | \$ 0.17    | \$ 0.96           | \$ 0.47    |
| Income from discontinued operations available for common stockholders   | —                  | 0.44       | —                 | 0.64       |
| Net income available for common stockholders  | \$ 0.57            | \$ 0.61    | \$ 0.96           | \$ 1.11    |
| Weighted average Common Shares outstanding – basic  | 90,668             | 87,467     | 90,299            | 83,793     |
| Earnings per Common Share – diluted:  |                    |            |                   |            |

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|   |          |          |          |          |
|---|----------|----------|----------|----------|
| Income from continuing operations available for common stockholders   | \$0.57   | \$0.17   | \$0.96   | \$0.47   |
| Income from discontinued operations available for common stockholders | —        | 0.44     | —        | 0.64     |
| Net income available for common stockholders                          | \$0.57   | \$0.61   | \$0.96   | \$1.11   |
| Weighted average Common Shares outstanding – diluted                  | 93,723   | 90,769   | 93,358   | 87,443   |
| Dividends declared per Common Share                                   | \$0.425  | \$0.425  | \$1.275  | \$1.275  |
| Net income available for common stockholders:                         |          |          |          |          |
| Income from continuing operations available for common stockholders   | \$51,708 | \$15,290 | \$86,169 | \$39,321 |
| Income from discontinued operations available for common stockholders | —        | 38,059   | 372      | 53,899   |
| Net income available for common stockholders                          | \$51,708 | \$53,349 | \$86,541 | \$93,220 |
| See accompanying notes to consolidated financial statements.          |          |          |          |          |

4

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Table of Contents

## HIGHWOODS PROPERTIES, INC.

Consolidated Statements of Comprehensive Income  
(Unaudited and in thousands)

|  | Three Months<br>Ended<br>September 30, |          | Nine Months Ended<br>September 30, |           |
|--|--|----------|------------------------------------|-----------|
|  | 2014                                   | 2013     | 2014                               | 2013      |
| Comprehensive income:  |  |          |                                    |           |
| Net income   | \$54,299                               | \$56,068 | \$92,387                           | \$99,407  |
| Other comprehensive income/(loss):                                   |  |          |                                    |           |
| Unrealized gains on tax increment financing bond                     | 23                                     | 97       | 293                                | 396       |
| Unrealized gains/(losses) on cash flow hedges                        | 913                                    | (1,798 ) | (3,337 )                           | 4,801     |
| Amortization of cash flow hedges                                     | 952                                    | 840      | 2,824                              | 2,428     |
| Total other comprehensive income/(loss)                              | 1,888                                  | (861 )   | (220 )                             | 7,625     |
| Total comprehensive income   | 56,187                                 | 55,207   | 92,167                             | 107,032   |
| Less-comprehensive (income) attributable to noncontrolling interests | (1,964 )                               | (2,092 ) | (3,965 )                           | (4,306 )  |
| Comprehensive income attributable to common stockholders             | \$54,223                               | \$53,115 | \$88,202                           | \$102,726 |

See accompanying notes to consolidated financial statements.

Table of Contents

## HIGHWOODS PROPERTIES, INC.

## Consolidated Statements of Equity

(Unaudited and in thousands, except share amounts)

|  | Number of<br>Common<br>Shares | Common<br>Stock | Series A<br>Cumulative<br>Redeemable<br>Preferred<br>Shares | Additional<br>Paid-In<br>Capital | Accumulated<br>Other<br>Compre-<br>hensive<br>Loss | Non-controlling<br>Interests in<br>Consolidated<br>Affiliates | Distributions<br>in Excess of<br>Net Income<br>Available<br>for<br>Common<br>Stockholders | Total        |
|--|-------------------------------|-----------------|---|----------------------------------|--|---|---|--------------|
| Balance at December 31, 2013   | 89,920,915                    | \$ 899          | \$ 29,077   | \$ 2,370,368                     | \$ (2,611 )  | \$ 21,396   | \$ (920,433 )   | \$ 1,498,696 |
| Issuances of<br>Common Stock, net<br>of shares redeemed<br>for tax withholdings                | 1,175,191                     | 12              | —   | 45,910                           | —  | —   | —   | 45,922       |
| Conversions of<br>Common Units to<br>Common Stock  | 4,417                         | —               | —   | 162                              | —  | —   | —   | 162          |
| Dividends on<br>Common Stock   | —                             | —               | —   | —                                | —  | —   | (115,037 )  | (115,037 )   |
| Dividends on<br>Preferred Stock  | —                             | —               | —   | —                                | —  | —   | (1,881 )  | (1,881 )     |
| Adjustment of<br>noncontrolling<br>interests in the<br>Operating Partnership<br>to fair value  | —                             | —               | —   | (8,955 )                         | —  | —   | —   | (8,955 )     |
| Distributions to<br>noncontrolling<br>interests in<br>consolidated affiliates                  | —                             | —               | —   | —                                | —  | (940 )  | —   | (940 )       |
| Issuances of<br>restricted stock   | 169,501                       | —               | —   | —                                | —  | —   | —   | —            |
| Share-based<br>compensation<br>expense, net of<br>forfeitures                                  | —                             | 2               | —   | 6,177                            | —  | —   | —   | 6,179        |
| Net (income)<br>attributable to<br>noncontrolling<br>interests in the<br>Operating Partnership | —                             | —               | —   | —                                | —  | —   | (2,813 )  | (2,813 )     |
| Net (income)<br>attributable to<br>noncontrolling<br>interests in<br>consolidated affiliates   | —                             | —               | —   | —                                | —  | 1,152   | (1,152 )  | —            |



|  |            |        |           |              |             |           |               |              |
|--|------------|--------|-----------|--------------|-------------|-----------|---------------|--------------|
| expense, net of forfeitures  |            |        |           |              |             |           |               |              |
| Net (income) attributable to noncontrolling interests in the Operating Partnership |            |        |           |              |             |           | (3,713 )      | (3,713 )     |
| Net (income) attributable to noncontrolling interests in consolidated affiliates   |            |        |           |              |             | 593       | (593 )        | —            |
| Comprehensive income:  |            |        |           |              |             |           |               |              |
| Net income   |            |        |           |              |             |           | 99,407        | 99,407       |
| Other comprehensive income   |            |        |           |              | 7,625       |           | —             | 7,625        |
| Total comprehensive income   |            |        |           |              |             |           |               | 107,032      |
| Balance at September 30, 2013  | 89,910,944 | \$ 899 | \$ 29,077 | \$ 2,371,925 | \$ (5,003 ) | \$ 21,178 | \$ (911,948 ) | \$ 1,506,128 |

See accompanying notes to consolidated financial statements.

Table of Contents

HIGHWOODS PROPERTIES, INC.  
Consolidated Statements of Cash Flows  
(Unaudited and in thousands)

|  | Nine Months Ended<br>September 30, |           |
|--|------------------------------------|-----------|
|  | 2014                               | 2013      |
| Operating activities:  |                                    |           |
| Net income   | \$92,387                           | \$99,407  |
| Adjustments to reconcile net income to net cash provided by operating activities:          |                                    |           |
| Depreciation and amortization  | 146,895                            | 133,556   |
| Amortization of lease incentives and acquisition-related intangible assets and liabilities | 249                                | 258       |
| Share-based compensation expense   | 6,179                              | 5,896     |
| Allowance for losses on accounts and accrued straight-line rents receivable                | 1,942                              | 1,029     |
| Accrued interest on mortgages and notes receivable   | (354)                              | —         |
| Amortization of deferred financing costs   | 2,270                              | 2,860     |
| Amortization of cash flow hedges   | 2,824                              | 2,428     |
| Amortization of mortgages and notes payable fair value adjustments                         | (845)                              | (1,015)   |
| Impairments of real estate assets  | 588                                | 2,194     |
| Losses on debt extinguishment  | 308                                | 196       |
| Net gains on disposition of property   | (42,569)                           | (52,350)  |
| Gain on acquisition of controlling interest in unconsolidated affiliate                    | —                                  | (7,451)   |
| Equity in (earnings)/losses of unconsolidated affiliates                                   | (886)                              | 1,824     |
| Changes in financing obligations   | (241)                              | (591)     |
| Distributions of earnings from unconsolidated affiliates                                   | 1,634                              | 3,129     |
| Changes in operating assets and liabilities:   |                                    |           |
| Accounts receivable  | (1,762)                            | (508)     |
| Prepaid expenses and other assets  | (2,927)                            | (2,188)   |
| Accrued straight-line rents receivable   | (16,202)                           | (12,368)  |
| Accounts payable, accrued expenses and other liabilities                                   | (5,815)                            | 10,206    |
| Net cash provided by operating activities  | 183,675                            | 186,512   |
| Investing activities:  |                                    |           |
| Investments in acquired real estate and related intangible assets, net of cash acquired    | (83,751)                           | (418,796) |
| Investment in acquired controlling interest in unconsolidated affiliate                    | —                                  | (32,818)  |
| Investments in development in process  | (122,106)                          | (16,634)  |
| Investments in tenant improvements and deferred leasing costs                              | (80,132)                           | (77,456)  |
| Investments in building improvements   | (39,401)                           | (38,702)  |
| Net proceeds from disposition of real estate assets  | 151,987                            | 161,970   |
| Distributions of capital from unconsolidated affiliates                                    | 725                                | 16,671    |
| Investments in mortgages and notes receivable  | (419)                              | (1,301)   |
| Repayments of mortgages and notes receivable   | 16,974                             | 437       |
| Investments in unconsolidated affiliates   | (6,425)                            | (429)     |
| Redemption of investment in unconsolidated affiliate                                       | 4,660                              | —         |
| Changes in restricted cash and other investing activities                                  | (1,296)                            | 5,484     |
| Net cash (used in) investing activities  | (159,184)                          | (401,574) |
| Financing activities:  |                                    |           |
| Dividends on Common Stock  | (115,037)                          | (107,750) |
| Redemptions of Common Units  | (93)                               | —         |
| Dividends on Preferred Stock   | (1,881)                            | (1,881)   |
| Distributions to noncontrolling interests in the Operating Partnership                     | (3,745)                            | (4,416)   |

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|  |          |            |   |
|--|----------|------------|---|
| Distributions to noncontrolling interests in consolidated affiliates   | (940     | ) (408     | ) |
| Proceeds from the issuance of Common Stock                             | 49,216   | 315,818    |   |
| Costs paid for the issuance of Common Stock                            | (600     | ) (7,678   | ) |
| Repurchase of shares related to tax withholdings                       | (2,694   | ) (2,539   | ) |
| Borrowings on revolving credit facility                                | 377,700  | 695,300    |   |
| Repayments of revolving credit facility                                | (443,400 | ) (511,900 | ) |
| Borrowings on mortgages and notes payable                              | 296,949  | —          |   |
| Repayments of mortgages and notes payable                              | (172,810 | ) (157,001 | ) |
| Payments on financing obligations                                      | (2,904   | ) (575     | ) |
| Payments of debt extinguishment costs                                  | (369     | ) —        |   |
| Contributions from noncontrolling interests in consolidated affiliates | —        | 16,240     |   |
| Additions to deferred financing costs and other financing activities   | (2,467   | ) (242     | ) |
| Net cash (used in)/provided by financing activities                    | (23,075  | ) 232,968  |   |
| Net increase in cash and cash equivalents                              | \$1,416  | \$17,906   |   |

See accompanying notes to consolidated financial statements.

Table of Contents

## HIGHWOODS PROPERTIES, INC.

Consolidated Statements of Cash Flows – Continued  
(Unaudited and in thousands)

|  | Nine Months Ended<br>September 30, |          |
|--|------------------------------------|----------|
|  | 2014                               | 2013     |
| Net increase in cash and cash equivalents            | \$1,416                            | \$17,906 |
| Cash and cash equivalents at beginning of the period | 10,184                             | 13,783   |
| Cash and cash equivalents at end of the period       | \$11,600                           | \$31,689 |

## Supplemental disclosure of cash flow information:

|  | Nine Months Ended<br>September 30, |          |
|--|------------------------------------|----------|
|  | 2014                               | 2013     |
| Cash paid for interest, net of amounts capitalized | \$63,340                           | \$67,786 |

## Supplemental disclosure of non-cash investing and financing activities:

|   | Nine Months Ended<br>September 30, |         |
|---|------------------------------------|---------|
|   | 2014                               | 2013    |
| Unrealized gains/(losses) on cash flow hedges   | \$(3,337)                          | \$4,801 |
| Conversions of Common Units to Common Stock   | 162                                | 28,788  |
| Changes in accrued capital expenditures   | 17,255                             | 12,778  |
| Write-off of fully depreciated real estate assets   | 29,953                             | 24,498  |
| Write-off of fully amortized deferred financing and leasing costs   | 17,138                             | 17,500  |
| Unrealized gains on marketable securities of non-qualified deferred compensation plan   | 149                                | 558     |
| Adjustment of noncontrolling interests in the Operating Partnership to fair value   | 8,955                              | 8,570   |
| Unrealized gains on tax increment financing bond  | 293                                | 396     |
| Assumption of mortgages and notes payable related to acquisition activities   | —                                  | 165,515 |
| Reclass of aggregate differences between historical cost basis and the basis reflected at the joint venture level for assets acquired | —                                  | 8,206   |

See accompanying notes to consolidated financial statements.

Table of Contents

## HIGHWOODS REALTY LIMITED PARTNERSHIP

## Consolidated Balance Sheets

(Unaudited and in thousands, except unit and per unit data)

|   | September 30,<br>2014 | December 31,<br>2013 |
|---|-----------------------|----------------------|
| Assets:   |                       |                      |
| Real estate assets, at cost:  |                       |                      |
| Land  | \$ 386,333            | \$ 393,602           |
| Buildings and tenant improvements   | 3,756,655             | 3,748,869            |
| Development in process  | 184,238               | 44,621               |
| Land held for development   | 89,010                | 110,374              |
|   | 4,416,236             | 4,297,466            |
| Less-accumulated depreciation   | (1,013,071 )          | (985,244 )           |
| Net real estate assets  | 3,403,165             | 3,312,222            |
| Real estate and other assets, net, held for sale  | 1,032                 | —                    |
| Cash and cash equivalents   | 11,706                | 10,281               |
| Restricted cash   | 10,633                | 14,169               |
| Accounts receivable, net of allowance of \$1,408 and \$1,648, respectively                                    | 29,970                | 26,430               |
| Mortgages and notes receivable, net of allowance of \$255 and \$302, respectively                             | 10,501                | 26,409               |
| Accrued straight-line rents receivable, net of allowance of \$601 and \$1,063, respectively                   | 136,578               | 126,014              |
| Investments in unconsolidated affiliates  | 30,248                | 29,901               |
| Deferred financing and leasing costs, net of accumulated amortization of \$108,878 and \$92,220, respectively | 218,725               | 222,211              |
| Prepaid expenses and other assets, net of accumulated amortization of \$13,913 and \$12,905, respectively     | 42,593                | 39,561               |
| Total Assets  | \$ 3,895,151          | \$ 3,807,198         |
| Liabilities, Redeemable Operating Partnership Units and Capital:  |                       |                      |
| Mortgages and notes payable   | \$ 2,013,824          | \$ 1,956,299         |
| Accounts payable, accrued expenses and other liabilities  | 229,932               | 218,887              |
| Financing obligations   | 23,519                | 26,664               |
| Total Liabilities   | 2,267,275             | 2,201,850            |
| Commitments and contingencies   |                       |                      |
| Redeemable Operating Partnership Units:   |                       |                      |
| Common Units, 2,936,955 and 2,943,872 outstanding, respectively   | 114,248               | 106,480              |
| Series A Preferred Units (liquidation preference \$1,000 per unit), 29,077 units issued and outstanding       | 29,077                | 29,077               |
| Total Redeemable Operating Partnership Units  | 143,325               | 135,557              |
| Capital:  |                       |                      |
| Common Units:   |                       |                      |
| General partner Common Units, 937,982 and 924,560 outstanding, respectively                                   | 14,655                | 14,508               |
| Limited partner Common Units, 89,923,233 and 88,587,546 outstanding, respectively                             | 1,451,119             | 1,436,498            |
| Accumulated other comprehensive loss  | (2,831 )              | (2,611 )             |
| Noncontrolling interests in consolidated affiliates   | 21,608                | 21,396               |
| Total Capital   | 1,484,551             | 1,469,791            |
| Total Liabilities, Redeemable Operating Partnership Units and Capital   | \$ 3,895,151          | \$ 3,807,198         |

See accompanying notes to consolidated financial statements.



Table of Contents

## HIGHWOODS REALTY LIMITED PARTNERSHIP

## Consolidated Statements of Income

(Unaudited and in thousands, except per unit amounts)

|   | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|---|-------------------------------------|-----------|------------------------------------|-----------|
|   | 2014                                | 2013      | 2014                               | 2013      |
| Rental and other revenues   | \$152,629                           | \$144,827 | \$453,804                          | \$407,822 |
| Operating expenses:   |                                     |           |                                    |           |
| Rental property and other expenses  | 57,383                              | 54,080    | 169,015                            | 147,995   |
| Depreciation and amortization   | 48,287                              | 47,338    | 146,895                            | 128,050   |
| Impairments of real estate assets   | —                                   | —         | 588                                | —         |
| General and administrative  | 7,526                               | 8,991     | 27,006                             | 27,966    |
| Total operating expenses  | 113,196                             | 110,409   | 343,504                            | 304,011   |
| Interest expense:   |                                     |           |                                    |           |
| Contractual   | 20,962                              | 22,683    | 62,352                             | 67,879    |
| Amortization of deferred financing costs  | 819                                 | 963       | 2,270                              | 2,860     |
| Financing obligations   | 567                                 | 26        | 301                                | 87        |
|   | 22,348                              | 23,672    | 64,923                             | 70,826    |
| Other income:   |                                     |           |                                    |           |
| Interest and other income   | 1,054                               | 1,582     | 3,863                              | 4,982     |
| Losses on debt extinguishment   | (326)                               | (32)      | (308)                              | (196)     |
|   | 728                                 | 1,550     | 3,555                              | 4,786     |
| Income from continuing operations before disposition of investment properties and activity in unconsolidated affiliates | 17,813                              | 12,296    | 48,932                             | 37,771    |
| Gains/(losses) on disposition of property   | 36,238                              | 34        | 42,185                             | (3)       |
| Gain on acquisition of controlling interest in unconsolidated affiliate   | —                                   | 7,451     | —                                  | 7,451     |
| Equity in earnings/(losses) of unconsolidated affiliates  | 248                                 | (3,174)   | 886                                | (1,875)   |
| Income from continuing operations   | 54,299                              | 16,607    | 92,003                             | 43,344    |
| Discontinued operations:  |                                     |           |                                    |           |
| Income from discontinued operations   | —                                   | 1,514     | —                                  | 5,853     |
| Impairments of real estate assets   | —                                   | —         | —                                  | (2,194)   |
| Net gains on disposition of discontinued operations   | —                                   | 37,946    | 384                                | 52,353    |
|   | —                                   | 39,460    | 384                                | 56,012    |
| Net income  | 54,299                              | 56,067    | 92,387                             | 99,356    |
| Net (income) attributable to noncontrolling interests in consolidated affiliates  | (291)                               | (203)     | (1,152)                            | (593)     |
| Distributions on Preferred Units  | (627)                               | (627)     | (1,881)                            | (1,881)   |
| Net income available for common unitholders   | \$53,381                            | \$55,237  | \$89,354                           | \$96,882  |
| Earnings per Common Unit – basic:   |                                     |           |                                    |           |
| Income from continuing operations available for common unitholders  | \$0.57                              | \$0.17    | \$0.96                             | \$0.47    |
| Income from discontinued operations available for common unitholders  | —                                   | 0.44      | —                                  | 0.64      |
| Net income available for common unitholders   | \$0.57                              | \$0.61    | \$0.96                             | \$1.11    |
| Weighted average Common Units outstanding – basic   | 93,196                              | 90,259    | 92,828                             | 86,920    |
| Earnings per Common Unit – diluted:   |                                     |           |                                    |           |
| Income from continuing operations available for common unitholders  | \$0.57                              | \$0.17    | \$0.96                             | \$0.47    |
| Income from discontinued operations available for common unitholders  | —                                   | 0.44      | —                                  | 0.64      |
| Net income available for common unitholders   | \$0.57                              | \$0.61    | \$0.96                             | \$1.11    |

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|  |          |          |          |          |
|--|----------|----------|----------|----------|
| Weighted average Common Units outstanding – diluted                  | 93,314   | 90,360   | 92,949   | 87,034   |
| Distributions declared per Common Unit                               | \$0.425  | \$0.425  | \$1.275  | \$1.275  |
| Net income available for common unitholders:                         |          |          |          |          |
| Income from continuing operations available for common unitholders   | \$53,381 | \$15,777 | \$88,970 | \$40,870 |
| Income from discontinued operations available for common unitholders | —        | 39,460   | 384      | 56,012   |
| Net income available for common unitholders                          | \$53,381 | \$55,237 | \$89,354 | \$96,882 |
| See accompanying notes to consolidated financial statements.         |          |          |          |          |

10

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Table of Contents

## HIGHWOODS REALTY LIMITED PARTNERSHIP

## Consolidated Statements of Comprehensive Income

(Unaudited and in thousands)

|  | Three Months Ended |                    | Nine Months Ended  |                    |
|--|--------------------|--------------------|--------------------|--------------------|
|  | September 30, 2014 | September 30, 2013 | September 30, 2014 | September 30, 2013 |
| Comprehensive income:  |                    |                    |                    |                    |
| Net income   | \$54,299           | \$56,067           | \$92,387           | \$99,356           |
| Other comprehensive income/(loss):                                   |                    |                    |                    |                    |
| Unrealized gains on tax increment financing bond                     | 23                 | 97                 | 293                | 396                |
| Unrealized gains/(losses) on cash flow hedges                        | 913                | (1,798 )           | (3,337 )           | 4,801              |
| Amortization of cash flow hedges                                     | 952                | 840                | 2,824              | 2,428              |
| Total other comprehensive income/(loss)                              | 1,888              | (861 )             | (220 )             | 7,625              |
| Total comprehensive income   | 56,187             | 55,206             | 92,167             | 106,981            |
| Less-comprehensive (income) attributable to noncontrolling interests | (291 )             | (203 )             | (1,152 )           | (593 )             |
| Comprehensive income attributable to common unitholders              | \$55,896           | \$55,003           | \$91,015           | \$106,388          |

See accompanying notes to consolidated financial statements.

## HIGHWOODS REALTY LIMITED PARTNERSHIP

## Consolidated Statements of Capital

(Unaudited and in thousands)

|   | Common Units              |                           | Accumulated Other Comprehensive Loss | Noncontrolling Interests in Consolidated Affiliates | Total       |
|---|---------------------------|---------------------------|--------------------------------------|---|-------------|
|   | General Partners' Capital | Limited Partners' Capital |                                      |   |             |
| Balance at December 31, 2013  | \$14,508                  | \$1,436,498               | \$ (2,611 )                          | \$ 21,396   | \$1,469,791 |
| Issuances of Common Units, net of units redeemed for tax withholdings   | 459                       | 45,463                    | —                                    | —   | 45,922      |
| Redemptions of Common Units   | (1 )                      | (92 )                     | —                                    | —   | (93 )       |
| Distributions paid on Common Units  | (1,183 )                  | (117,078 )                | —                                    | —   | (118,261 )  |
| Distributions paid on Preferred Units   | (19 )                     | (1,862 )                  | —                                    | —   | (1,881 )    |
| Share-based compensation expense, net of forfeitures  | 62                        | 6,117                     | —                                    | —   | 6,179       |
| Distributions to noncontrolling interests in consolidated affiliates  | —                         | —                         | —                                    | (940 )  | (940 )      |
| Adjustment of Redeemable Common Units to fair value and contributions/distributions from/to the General Partner | (83 )                     | (8,250 )                  | —                                    | —   | (8,333 )    |
| Net (income) attributable to noncontrolling interests in consolidated affiliates                                | (12 )                     | (1,140 )                  | —                                    | 1,152   | —           |
| Comprehensive income:   |                           |                           |                                      |   |             |
| Net income  | 924                       | 91,463                    | —                                    | —   | 92,387      |
| Other comprehensive loss  | —                         | —                         | (220 )                               | —   | (220 )      |
| Total comprehensive income  |                           |                           |                                      |   | 92,167      |
| Balance at September 30, 2014   | \$14,655                  | \$1,451,119               | \$ (2,831 )                          | \$ 21,608   | \$1,484,551 |

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|   | Common Units |             | Accumulated   | Noncontrolling |             |
|---|--------------|-------------|---------------|----------------|-------------|
|   | General      | Limited     | Other         | Interests in   | Total       |
|   | Partners'    | Partners'   | Comprehensive | Consolidated   |             |
|   | Capital      | Capital     | Loss          | Affiliates     |             |
| Balance at December 31, 2012  | \$11,427     | \$1,131,481 | \$ (12,628 )  | \$ 4,753       | \$1,135,033 |
| Issuances of Common Units, net of units redeemed for tax withholdings   | 3,056        | 302,545     | —             | —              | 305,601     |
| Distributions paid on Common Units  | (1,117 )     | (110,528 )  | —             | —              | (111,645 )  |
| Distributions paid on Preferred Units   | (19 )        | (1,862 )    | —             | —              | (1,881 )    |
| Share-based compensation expense, net of forfeitures  | 59           | 5,837       | —             | —              | 5,896       |
| Distributions to noncontrolling interests in consolidated affiliates  | —            | —           | —             | (408 )         | (408 )      |
| Contributions from noncontrolling interests in consolidated affiliates  | —            | —           | —             | 16,240         | 16,240      |
| Adjustment of Redeemable Common Units to fair value and contributions/distributions from/to the General Partner | 204          | 20,125      | —             | —              | 20,329      |
| Net (income) attributable to noncontrolling interests in consolidated affiliates                                | (6 )         | (587 )      | —             | 593            | —           |
| Comprehensive income:   |              |             |               |                |             |
| Net income  | 994          | 98,362      | —             | —              | 99,356      |
| Other comprehensive income  | —            | —           | 7,625         | —              | 7,625       |
| Total comprehensive income  |              |             |               |                | 106,981     |
| Balance at September 30, 2013   | \$14,598     | \$1,445,373 | \$ (5,003 )   | \$ 21,178      | \$1,476,146 |

See accompanying notes to consolidated financial statements.

Table of Contents

## HIGHWOODS REALTY LIMITED PARTNERSHIP

## Consolidated Statements of Cash Flows

(Unaudited and in thousands)

|  | Nine Months Ended<br>September 30, |           |
|--|------------------------------------|-----------|
|  | 2014                               | 2013      |
| Operating activities:  |                                    |           |
| Net income   | \$92,387                           | \$99,356  |
| Adjustments to reconcile net income to net cash provided by operating activities:          |                                    |           |
| Depreciation and amortization  | 146,895                            | 133,556   |
| Amortization of lease incentives and acquisition-related intangible assets and liabilities | 249                                | 258       |
| Share-based compensation expense   | 6,179                              | 5,896     |
| Allowance for losses on accounts and accrued straight-line rents receivable                | 1,942                              | 1,029     |
| Accrued interest on mortgages and notes receivable   | (354)                              | )         |
| Amortization of deferred financing costs   | 2,270                              | 2,860     |
| Amortization of cash flow hedges   | 2,824                              | 2,428     |
| Amortization of mortgages and notes payable fair value adjustments                         | (845)                              | (1,015)   |
| Impairments of real estate assets  | 588                                | 2,194     |
| Losses on debt extinguishment  | 308                                | 196       |
| Net gains on disposition of property   | (42,569)                           | (52,350)  |
| Gain on acquisition of controlling interest in unconsolidated affiliate                    | —                                  | (7,451)   |
| Equity in (earnings)/losses of unconsolidated affiliates                                   | (886)                              | 1,875     |
| Changes in financing obligations   | (241)                              | (591)     |
| Distributions of earnings from unconsolidated affiliates                                   | 1,634                              | 3,109     |
| Changes in operating assets and liabilities:   |                                    |           |
| Accounts receivable  | (1,762)                            | (508)     |
| Prepaid expenses and other assets  | (2,885)                            | (2,141)   |
| Accrued straight-line rents receivable   | (16,202)                           | (12,368)  |
| Accounts payable, accrued expenses and other liabilities                                   | (5,804)                            | 10,257    |
| Net cash provided by operating activities  | 183,728                            | 186,590   |
| Investing activities:  |                                    |           |
| Investments in acquired real estate and related intangible assets, net of cash acquired    | (83,751)                           | (418,796) |
| Investment in acquired controlling interest in unconsolidated affiliate                    | —                                  | (32,818)  |
| Investments in development in process  | (122,106)                          | (16,634)  |
| Investments in tenant improvements and deferred leasing costs                              | (80,132)                           | (77,456)  |
| Investments in building improvements   | (39,401)                           | (38,702)  |
| Net proceeds from disposition of real estate assets  | 151,987                            | 161,970   |
| Distributions of capital from unconsolidated affiliates                                    | 725                                | 16,671    |
| Investments in mortgages and notes receivable  | (419)                              | (1,301)   |
| Repayments of mortgages and notes receivable   | 16,974                             | 437       |
| Investments in unconsolidated affiliates   | (6,425)                            | (429)     |
| Redemption of investment in unconsolidated affiliate                                       | 4,660                              | —         |
| Changes in restricted cash and other investing activities                                  | (1,296)                            | 5,484     |
| Net cash (used in) investing activities  | (159,184)                          | (401,574) |
| Financing activities:  |                                    |           |
| Distributions on Common Units  | (118,261)                          | (111,645) |
| Redemptions of Common Units  | (93)                               | —         |
| Distributions on Preferred Units   | (1,881)                            | (1,881)   |
| Distributions to noncontrolling interests in consolidated affiliates                       | (940)                              | (408)     |

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|  |          |              |
|--|----------|--------------|
| Proceeds from the issuance of Common Units                             | 49,216   | 315,818      |
| Costs paid for the issuance of Common Units                            | (600     | ) (7,678 )   |
| Repurchase of units related to tax withholdings                        | (2,694   | ) (2,539 )   |
| Borrowings on revolving credit facility                                | 377,700  | 695,300      |
| Repayments of revolving credit facility                                | (443,400 | ) (511,900 ) |
| Borrowings on mortgages and notes payable                              | 296,949  | —            |
| Repayments of mortgages and notes payable                              | (172,810 | ) (157,001 ) |
| Payments on financing obligations                                      | (2,904   | ) (575 )     |
| Payments of debt extinguishment costs                                  | (369     | ) —          |
| Contributions from noncontrolling interests in consolidated affiliates | —        | 16,240       |
| Additions to deferred financing costs and other financing activities   | (3,032   | ) (834 )     |
| Net cash (used in)/provided by financing activities                    | (23,119  | ) 232,897    |
| Net increase in cash and cash equivalents                              | \$1,425  | \$17,913     |
| See accompanying notes to consolidated financial statements.           |          |              |

12

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Table of Contents

HIGHWOODS REALTY LIMITED PARTNERSHIP  
 Consolidated Statements of Cash Flows - Continued  
 (Unaudited and in thousands)

|  | Nine Months Ended<br>September 30, |          |
|--|------------------------------------|----------|
|  | 2014                               | 2013     |
| Net increase in cash and cash equivalents            | \$1,425                            | \$17,913 |
| Cash and cash equivalents at beginning of the period | 10,281                             | 13,867   |
| Cash and cash equivalents at end of the period       | \$11,706                           | \$31,780 |

## Supplemental disclosure of cash flow information:

|  | Nine Months Ended<br>September 30, |          |
|--|------------------------------------|----------|
|  | 2014                               | 2013     |
| Cash paid for interest, net of amounts capitalized | \$63,340                           | \$67,786 |

## Supplemental disclosure of non-cash investing and financing activities:

|   | Nine Months Ended<br>September 30, |           |
|---|------------------------------------|-----------|
|   | 2014                               | 2013      |
| Unrealized gains/(losses) on cash flow hedges   | \$(3,337 )                         | \$4,801   |
| Changes in accrued capital expenditures   | 17,255                             | 12,778    |
| Write-off of fully depreciated real estate assets   | 29,953                             | 24,498    |
| Write-off of fully amortized deferred financing and leasing costs   | 17,138                             | 17,500    |
| Unrealized gains on marketable securities of non-qualified deferred compensation plan   | 149                                | 558       |
| Adjustment of Redeemable Common Units to fair value   | 7,768                              | (20,921 ) |
| Unrealized gains on tax increment financing bond  | 293                                | 396       |
| Assumption of mortgages and notes payable related to acquisition activities   | —                                  | 165,515   |
| Reclass of aggregate differences between historical cost basis and the basis reflected at the joint venture level for assets acquired | —                                  | 8,206     |

See accompanying notes to consolidated financial statements.

Table of Contents

HIGHWOODS PROPERTIES, INC.  
HIGHWOODS REALTY LIMITED PARTNERSHIP  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2014

(tabular dollar amounts in thousands, except per share and per unit data)

(Unaudited)

1. Description of Business and Significant Accounting Policies

Description of Business

Highwoods Properties, Inc. (the “Company”) is a fully-integrated real estate investment trust (“REIT”) that provides leasing, management, development, construction and other customer-related services for its properties and for third parties. The Company conducts its activities through Highwoods Realty Limited Partnership (the “Operating Partnership”). At September 30, 2014, we owned or had an interest in 31.1 million rentable square feet of in-service office, industrial and retail properties, 0.9 million rentable square feet of office properties under development and approximately 500 acres of development land.

The Company is the sole general partner of the Operating Partnership. At September 30, 2014, the Company owned all of the Preferred Units and 90.9 million, or 96.9%, of the Common Units in the Operating Partnership. Limited partners own the remaining 2.9 million Common Units. During the nine months ended September 30, 2014, the Company redeemed 2,500 Common Units for less than \$0.1 million in cash and redeemed 4,417 Common Units for a like number of shares of Common Stock.

Common Stock Offerings

During the three and nine months ended September 30, 2014, the Company issued 875,701 and 949,578 shares of Common Stock, respectively, under its equity sales agreements at an average gross sales price of \$42.44 and \$42.12 per share, respectively, and received net proceeds, after sales commissions, of \$36.6 million and \$39.4 million, respectively. As a result of this activity and the redemptions discussed above, the percentage of Common Units owned by the Company increased from 96.8% at December 31, 2013 to 96.9% at September 30, 2014.

Basis of Presentation

Our Consolidated Financial Statements are prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”). Our Consolidated Statements of Income for the three and nine months ended September 30, 2013 were retrospectively revised from previously reported amounts to reflect in discontinued operations the operations for those properties classified as discontinued operations.

The Company's Consolidated Financial Statements include the Operating Partnership, wholly owned subsidiaries and those entities in which the Company has the controlling interest. The Operating Partnership's Consolidated Financial Statements include wholly owned subsidiaries and those entities in which the Operating Partnership has the controlling interest. All intercompany transactions and accounts have been eliminated. At September 30, 2014 and December 31, 2013, we had involvement with, but are not the primary beneficiary in, an entity that we concluded to be a variable interest entity (see Note 3).

The unaudited interim consolidated financial statements and accompanying unaudited consolidated financial information, in the opinion of management, contain all adjustments (including normal recurring accruals) necessary for a fair presentation of our financial position, results of operations and cash flows. We have condensed or omitted

certain notes and other information from the interim Consolidated Financial Statements presented in this Quarterly Report as permitted by SEC rules and regulations. These Consolidated Financial Statements should be read in conjunction with our 2013 Annual Report on Form 10-K.

#### Use of Estimates

The preparation of consolidated financial statements in accordance with GAAP requires us to make estimates and assumptions that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Actual results could differ from those estimates.

Table of Contents

HIGHWOODS PROPERTIES, INC.

HIGHWOODS REALTY LIMITED PARTNERSHIP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(tabular dollar amounts in thousands, except per share and per unit data)

1. Description of Business and Significant Accounting Policies – Continued

Recently Issued Accounting Standards

The Financial Accounting Standards Board ("FASB") recently issued an accounting standard update that requires only those real estate asset sales representing a strategic shift in operations (e.g., a disposal of a major geographic area or a major line of business) to be reflected in discontinued operations. This accounting standard update is required to be adopted in 2015. Early adoption is permitted, but only for real estate asset sales that have not been previously reflected as discontinued operations. We elected to early adopt the accounting standard update in the second quarter of 2014, resulting in the operations of current period dispositions and property classified as held for sale being included in continuing operations on our Consolidated Statements of Income. Prior to adoption, we were generally required to reflect all real estate asset sales as discontinued operations, which required reclassification of the earnings of the sold assets from continuing operations for all periods presented.

The FASB recently issued an accounting standard update that requires the use of a new five-step model to recognize revenue from customer contracts. The five-step model requires that we identify the contract with the customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract and recognize revenue when we satisfy the performance obligations. We will also be required to disclose information regarding the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The accounting standard update is required to be adopted in 2017. Retrospective application is required either to all periods presented or with the cumulative effect of initial adoption recognized in the period of adoption. We are in the process of evaluating this accounting standard update.

2. Real Estate Assets

Acquisitions

During the third quarter of 2014, we acquired an office property in Raleigh, NC encompassing 374,000 rentable square feet for a purchase price of \$83.8 million. We expensed \$0.2 million of acquisition costs (included in general and administrative expenses) related to this acquisition. The assets acquired and liabilities assumed were recorded at fair value as determined by management based on information available at the acquisition date and on current assumptions as to future operations.

Pro Forma Disclosure

During the third quarter of 2013, we acquired our joint venture partner's 60.0% interest in our HIW-KC Orlando, LLC joint venture, which owned five office properties in Orlando, FL encompassing 1.3 million rentable square feet, for a net purchase price of \$112.8 million. We previously accounted for our 40.0% interest in this joint venture using the equity method of accounting. The assets and liabilities of the joint venture are now wholly owned and are recorded in our Consolidated Financial Statements, including assets recorded at fair value of \$188.0 million and secured debt recorded at fair value of \$127.9 million, with an effective interest rate of 3.11%. This debt has since been repaid. As a result of acquiring a controlling interest in this joint venture, our previously held equity interest was remeasured at a fair value of \$75.2 million resulting in a gain of \$7.5 million, which represents the difference between the fair market value of our previously held equity interest and the carrying value of our investment on the date of acquisition. The

fair market value of our previously held equity interest was determined by management based on information available at the acquisition date and on current assumptions as to future operations.

During the third quarter of 2013, we also acquired an office property in Nashville, TN encompassing 520,000 rentable square feet for a net purchase price of \$150.1 million.

During the second quarter of 2013, we acquired an office property in Atlanta, GA encompassing 553,000 rentable square feet for a purchase price of \$140.1 million.

Table of Contents

HIGHWOODS PROPERTIES, INC.

HIGHWOODS REALTY LIMITED PARTNERSHIP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(tabular dollar amounts in thousands, except per share and per unit data)

## 2. Real Estate Assets – Continued

The following table sets forth a summary of the fair value of the major assets acquired and liabilities assumed relating to the 2013 acquisitions discussed in the preceding paragraphs:

|  | Total<br>Purchase<br>Price<br>Allocation |
|--|--|
| Real estate assets   | \$445,396                                |
| Acquisition-related intangible assets (in deferred financing and leasing costs)                                  | 50,595                                   |
| Mortgages and notes payable  | (127,891 )                               |
| Acquisition-related below market lease liabilities (in accounts payable, accrued expenses and other liabilities) | (17,818 )                                |
| Total allocation   | \$350,282                                |

The following table sets forth our revenues and net income, adjusted for interest expense and depreciation and amortization related to purchase price allocations, acquisition costs and equity in earnings of unconsolidated affiliates previously recognized as income assuming the 2013 acquisitions discussed in the preceding paragraphs had been completed as of January 1, 2012:

|  | Three Months<br>Ended September<br>30,<br>2013 | Nine Months Ended<br>September 30,<br>2013 |
|--|--|--|
| Pro forma revenues                     | \$149,754                                      | \$443,178                                  |
| Pro forma net income                   | \$49,818                                       | \$90,064                                   |
| Pro forma earnings per share - basic   | \$0.54   | \$1.00                                     |
| Pro forma earnings per share - diluted | \$0.54   | \$1.00                                     |

The 2013 acquisitions discussed in the preceding paragraphs resulted in revenues of \$10.0 million and \$10.3 million and net losses of \$0.1 million and \$0.4 million recorded in the Consolidated Statements of Income for the three and nine months ended September 30, 2013, respectively.

## Dispositions

During the third quarter of 2014, we sold:

• five office properties and a land parcel in a single transaction in Raleigh, NC for a sale price of \$58.7 million and recorded a gain on disposition of property of \$11.7 million;

• 11 office properties in Richmond, VA in separate transactions for an aggregate sale price of \$40.7 million and recorded aggregate gains on disposition of property of \$17.6 million;

six office and eight industrial properties in Greensboro, NC for a sale price of \$28.2 million (before closing credits to buyer of \$1.2 million for unfunded tenant improvements and \$0.4 million for free rent) and recorded a gain on disposition of property of \$4.7 million; and

an office property in Greenville, SC for a sale price of \$27.2 million (before closing credits to buyer of \$5.8 million for unfunded building and tenant improvements and \$1.8 million for free rent) and recorded a gain on disposition of property of \$2.2 million.

During the second quarter of 2014, we sold two land parcels in Atlanta, GA in separate transactions for an aggregate sale price of \$9.5 million and recorded aggregate gains on disposition of property of \$5.9 million.

Table of Contents

HIGHWOODS PROPERTIES, INC.

HIGHWOODS REALTY LIMITED PARTNERSHIP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(tabular dollar amounts in thousands, except per share and per unit data)

## 2. Real Estate Assets – Continued

## Impairments

During the second quarter of 2014, we recorded an impairment of real estate assets of \$0.6 million on an office property in Greensboro, NC. This impairment was due to a change in the assumed timing of future disposition and leasing assumptions, which reduced the future expected cash flows from the impaired property.

## 3. Mortgages and Notes Receivable

The following table sets forth our mortgages and notes receivable:

|  | September 30,<br>2014 | December 31,<br>2013 |
|--|-----------------------|----------------------|
| Seller financing (first mortgages)               | \$ —                  | \$ 16,454            |
| Less allowance                                   | —                     | —                    |
|  | —                     | 16,454               |
| Mortgage receivable (including accrued interest) | 10,300                | 9,435                |
| Less allowance                                   | —                     | —                    |
|  | 10,300                | 9,435                |
| Promissory notes                                 | 456                   | 822                  |
| Less allowance                                   | (255                  | ) (302               |
|  | 201                   | 520                  |
| Mortgages and notes receivable, net              | \$ 10,501             | \$ 26,409            |

During 2010, we provided seller financing in conjunction with two disposition transactions. We accounted for these dispositions using the installment method, whereby a gain on disposition of property was deferred until the seller financing was repaid. During the first quarter of 2014, the \$16.5 million of seller financing was fully repaid and we recorded the \$0.4 million gain on disposition of property.

During 2012, we provided \$8.6 million of secured acquisition financing to a third party. We also agreed to loan such third party \$8.4 million on a secured basis to fund future infrastructure development. As of September 30, 2014, \$0.7 million has been funded to the third party for infrastructure development. We concluded this arrangement to be an interest in a variable interest entity. However, since we do not have the power to direct matters that most significantly impact the activities of the entity, we do not qualify as the primary beneficiary. Accordingly, the entity is not consolidated. Our risk of loss with respect to this arrangement is limited to the carrying value of the mortgage receivable and the future infrastructure development funding commitment.

We evaluate the ability to collect our mortgages and notes receivable by monitoring the leasing statistics and/or market fundamentals of these assets. As of September 30, 2014, our mortgages and notes receivable were not in default and there were no other indicators of impairment.



Table of Contents

HIGHWOODS PROPERTIES, INC.

HIGHWOODS REALTY LIMITED PARTNERSHIP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(tabular dollar amounts in thousands, except per share and per unit data)

## 3. Mortgages and Notes Receivable - Continued

The following table sets forth our notes receivable allowance, which relates only to promissory notes:

|                                      | Three Months Ended |       | Nine Months Ended |       |
|--------------------------------------|--------------------|-------|-------------------|-------|
|                                      | September 30,      |       | September 30,     |       |
|                                      | 2014               | 2013  | 2014              | 2013  |
| Beginning notes receivable allowance | \$275              | \$376 | \$302             | \$182 |
| Recoveries/write-offs/other          | (20 )              | (36 ) | (47 )             | 158   |
| Total notes receivable allowance     | \$255              | \$340 | \$255             | \$340 |

## 4. Investments in Affiliates

## Unconsolidated Affiliates

We have equity interests of up to 50.0% in various joint ventures with unrelated third parties that are accounted for using the equity method of accounting because we have the ability to exercise significant influence over their operating and financial policies.

The following table sets forth the summarized income statements of our unconsolidated affiliates:

|  | Three Months Ended |            | Nine Months Ended |            |
|--|--------------------|------------|-------------------|------------|
|  | September 30,      |            | September 30,     |            |
|  | 2014               | 2013       | 2014              | 2013       |
| Income Statements:                           |                    |            |                   |            |
| Rental and other revenues                    | \$12,425           | \$16,911   | \$37,703          | \$64,362   |
| Expenses:                                    |                    |            |                   |            |
| Rental property and other expenses           | 6,441              | 8,733      | 18,880            | 31,681     |
| Depreciation and amortization                | 3,281              | 5,010      | 10,098            | 17,383     |
| Impairments of real estate assets            | —                  | 15,287     | —                 | 20,077     |
| Interest expense                             | 2,201              | 3,141      | 6,713             | 12,569     |
| Total expenses                               | 11,923             | 32,171     | 35,691            | 81,710     |
| Income/(loss) before disposition of property | 502                | (15,260 )  | 2,012             | (17,348 )  |
| Gains on disposition of property             | —                  | 8,256      | 1,949             | 8,323      |
| Net income/(loss)                            | \$502              | \$(7,004 ) | \$3,961           | \$(9,025 ) |

## Board of Trade Investment Company ("Board of Trade")

During the first quarter of 2014, Board of Trade sold an office property to an unrelated third party for gross proceeds of \$8.3 million and recorded a gain of \$1.9 million. As our cost basis was different from the basis reflected at the entity level, we recorded a net impairment charge on our investment of \$0.4 million. This charge represented the other-than-temporary decline in the fair value below the carrying value of our investment. During the second quarter

of 2014, our 49.0% interest in Board of Trade was redeemed in exchange for \$4.7 million in cash, which was received in the third quarter of 2014.

Highwoods KC Glenridge Office, LLC (“KC Glenridge”)

During the second quarter of 2014, KC Glenridge paid at maturity the remaining \$14.9 million balance on a secured mortgage loan with an effective interest rate of 4.84%.

Table of Contents

HIGHWOODS PROPERTIES, INC.

HIGHWOODS REALTY LIMITED PARTNERSHIP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(tabular dollar amounts in thousands, except per share and per unit data)

## 5. Intangible Assets and Below Market Lease Liabilities

The following table sets forth total intangible assets and acquisition-related below market lease liabilities, net of accumulated amortization:

|   | September 30,<br>2014 | December 31,<br>2013 |
|---|-----------------------|----------------------|
| Assets:   |                       |                      |
| Deferred financing costs  | \$ 19,512             | \$ 17,363            |
| Less accumulated amortization   | (7,193)               | (5,204)              |
|   | 12,319                | 12,159               |
| Deferred leasing costs (including lease incentives and above market lease and in-place lease acquisition-related intangible assets) | 308,091               | 297,068              |
| Less accumulated amortization   | (101,685)             | (87,016)             |
|   | 206,406               | 210,052              |
| Deferred financing and leasing costs, net   | \$ 218,725            | \$ 222,211           |
| Liabilities (in accounts payable, accrued expenses and other liabilities):  |                       |                      |
| Acquisition-related below market lease liabilities  | \$ 55,639             | \$ 55,323            |
| Less accumulated amortization   | (11,994)              | (8,478)              |
|   | \$ 43,645             | \$ 46,845            |

The following table sets forth amortization of intangible assets and below market lease liabilities:

|   | Three Months<br>Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|---|--|-----------|------------------------------------|-----------|
|   | 2014                                   | 2013      | 2014                               | 2013      |
| Amortization of deferred financing costs  | \$ 819                                 | \$ 963    | \$ 2,270                           | \$ 2,860  |
| Amortization of deferred leasing costs and acquisition-related intangible assets (in depreciation and amortization) | \$ 9,465                               | \$ 10,639 | \$ 29,443                          | \$ 26,603 |
| Amortization of lease incentives (in rental and other revenues)   | \$ 327                                 | \$ 347    | \$ 1,077                           | \$ 1,061  |
| Amortization of acquisition-related intangible assets (in rental and other revenues)                                | \$ 1,080                               | \$ 1,548  | \$ 3,310                           | \$ 2,499  |
| Amortization of acquisition-related intangible assets (in rental property and other expenses)                       | \$ 140                                 | \$ 140    | \$ 416                             | \$ 416    |
| Amortization of acquisition-related below market lease liabilities (in rental and other revenues)                   | \$(1,532)                              | \$(1,584) | \$(4,554)                          | \$(3,737) |

Table of Contents

HIGHWOODS PROPERTIES, INC.

HIGHWOODS REALTY LIMITED PARTNERSHIP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(tabular dollar amounts in thousands, except per share and per unit data)

## 5. Intangible Assets and Below Market Lease Liabilities - Continued

The following table sets forth scheduled future amortization of intangible assets and below market lease liabilities:

|  | Amortization of<br>Deferred<br>Financing<br>Costs | Amortization of<br>Deferred<br>Leasing Costs<br>and<br>Acquisition-Related<br>Intangible<br>Assets (in<br>Depreciation<br>and<br>Amortization) | Amortization<br>of<br>Lease<br>Incentives<br>(in Rental<br>and Other<br>Revenues) | Amortization<br>of<br>Acquisition-Related<br>Intangible<br>Assets (in<br>Rental and<br>Other<br>Revenues) | Amortization<br>of<br>Acquisition-Related<br>Intangible<br>Assets (in<br>Rental<br>Property and<br>Other<br>Expenses) | Amortization of<br>Acquisition-Related<br>Below Market<br>Lease<br>Liabilities (in<br>Rental and<br>Other<br>Revenues) |
|--|---|--|---|---|---|--|
| October 1 through<br>December 31, 2014   | \$776   | \$ 10,411  | \$339   | \$ 1,034  | \$ 136  | \$ (1,560 )  |
| 2015   | 3,074   | 36,795   | 1,148   | 3,612   | 553   | (5,978 )   |
| 2016   | 2,811   | 30,965   | 986   | 2,819   | 553   | (5,696 )   |
| 2017   | 2,518   | 26,845   | 908   | 2,276   | 553   | (5,424 )   |
| 2018   | 1,394   | 22,423   | 805   | 1,434   | 553   | (5,285 )   |
| Thereafter   | 1,746   | 53,619   | 2,782   | 3,771   | 1,086   | (19,702 )  |
|  | \$12,319  | \$ 181,058   | \$6,968   | \$ 14,946   | \$ 3,434  | \$ (43,645 )   |
| Weighted average<br>remaining amortization<br>periods as of September<br>30, 2014 (in years) | 4.6   | 6.8  | 8.2   | 6.5   | 6.2   | 8.4  |

The following table sets forth the intangible assets acquired and below market lease liabilities assumed as a result of 2014 acquisition activity:

|  | Acquisition-Related<br>Intangible<br>Assets<br>(amortized in<br>Rental and<br>Other<br>Revenues) | Acquisition-Related<br>Intangible Assets<br>(amortized in<br>Depreciation and<br>Amortization) | Acquisition-Related<br>Below Market<br>Lease Liabilities<br>(amortized in<br>Rental and Other<br>Revenues) |
|--|--|--|--|
| Amount recorded from acquisition activity  | \$ 27  | \$ 6,293   | \$ (1,353 )  |
| Weighted average remaining amortization periods as of<br>September 30, 2014 (in years) | 3.5  | 5.5  | 4.9  |

## 6. Mortgages and Notes Payable

The following table sets forth our mortgages and notes payable:

|                                   | September 30,<br>2014 | December 31,<br>2013 |
|-----------------------------------|-----------------------|----------------------|
| Secured indebtedness              | \$ 314,506            | \$ 488,664           |
| Unsecured indebtedness            | 1,699,318             | 1,467,635            |
| Total mortgages and notes payable | \$ 2,013,824          | \$ 1,956,299         |

At September 30, 2014, our secured mortgage loans were collateralized by real estate assets with an aggregate undepreciated book value of \$582.2 million.

Table of Contents

HIGHWOODS PROPERTIES, INC.

HIGHWOODS REALTY LIMITED PARTNERSHIP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(tabular dollar amounts in thousands, except per share and per unit data)

6. Mortgages and Notes Payable - Continued

Our \$475.0 million unsecured revolving credit facility is scheduled to mature in January 2018 and includes an accordion feature that allows for an additional \$75.0 million of borrowing capacity subject to additional lender commitments. Assuming no defaults have occurred, we have an option to extend the maturity for two additional six-month periods. The interest rate at our current credit ratings is LIBOR plus 110 basis points and the annual facility fee is 20 basis points. There was \$150.0 million and \$148.0 million outstanding under our revolving credit facility at September 30, 2014 and October 20, 2014, respectively. At both September 30, 2014 and October 20, 2014, we had \$0.1 million of outstanding letters of credit, which reduces the availability on our revolving credit facility. As a result, the unused capacity of our revolving credit facility at September 30, 2014 and October 20, 2014 was \$324.9 million and \$326.9 million, respectively.

During the third quarter of 2014, we prepaid the remaining \$36.9 million balance on a secured mortgage loan with an effective interest rate of 3.34% that was originally scheduled to mature in April 2015. We recorded \$0.3 million of loss on debt extinguishment related to this prepayment.

During the second quarter of 2014, the Operating Partnership issued \$300 million aggregate principal amount of 3.20% Notes due June 15, 2021, less original issue discount of \$3.1 million. These notes were priced at 98.983% for an effective yield of 3.363%. Underwriting fees and other expenses were incurred that aggregated \$2.4 million; these costs were deferred and will be amortized over the term of the notes.

During the second quarter of 2014, we prepaid without penalty the remaining \$123.7 million balance on a secured mortgage loan with an effective interest rate of 3.11% that was originally scheduled to mature in July 2014.

During the second quarter of 2014, we prepaid the remaining \$7.2 million balance on a secured mortgage loan with an effective interest rate of 3.32% that was originally scheduled to mature in August 2014. We recorded less than \$0.1 million of gain on debt extinguishment related to this prepayment.

We are currently in compliance with financial covenants and other requirements with respect to our consolidated debt.

7. Derivative Financial Instruments

Our interest rate swaps have been designated as and are being accounted for as cash flow hedges with changes in fair value recorded in other comprehensive income each reporting period. No gain or loss was recognized related to hedge ineffectiveness or to amounts excluded from effectiveness testing on our cash flow hedges during the nine months ended September 30, 2014. We have no collateral requirements related to our interest rate swaps.

Amounts reported in accumulated other comprehensive loss ("AOCL") related to derivatives will be reclassified to interest expense as interest payments are made on our variable-rate debt. During the period from October 1, 2014 through September 30, 2015, we estimate that \$3.2 million will be reclassified to interest expense.

The following table sets forth the gross fair value of our derivatives:

|   | September 30,<br>2014 | December 31,<br>2013 |
|---|-----------------------|----------------------|
| Derivatives:  |                       |                      |
| Derivatives designated as cash flow hedges in prepaid expenses and other assets:                        |                       |                      |
| Interest rate swaps   | \$ —                  | \$ 301               |
| Derivatives designated as cash flow hedges in accounts payable, accrued expenses and other liabilities: |                       |                      |
| Interest rate swaps   | \$ 959                | \$ 510               |

Table of Contents

HIGHWOODS PROPERTIES, INC.

HIGHWOODS REALTY LIMITED PARTNERSHIP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(tabular dollar amounts in thousands, except per share and per unit data)

## 7. Derivative Financial Instruments - Continued

The following table sets forth the effect of our cash flow hedges on AOCL and interest expense:

|   | Three Months<br>Ended<br>September 30, |            | Nine Months Ended<br>September 30, |         |
|---|--|------------|------------------------------------|---------|
|   | 2014                                   | 2013       | 2014                               | 2013    |
| Derivatives Designated as Cash Flow Hedges:   |  |            |                                    |         |
| Amount of unrealized gains/(losses) recognized in AOCL on derivatives<br>(effective portion):       |  |            |                                    |         |
| Interest rate swaps   | \$913                                  | \$(1,798 ) | \$(3,337 )                         | \$4,801 |
| Amount of losses reclassified out of AOCL into contractual interest<br>expense (effective portion): |  |            |                                    |         |
| Interest rate swaps   | \$952                                  | \$840      | \$2,824                            | \$2,428 |

## 8. Noncontrolling Interests

## Noncontrolling Interests in Consolidated Affiliates

At September 30, 2014, our noncontrolling interests in consolidated affiliates relates to our joint venture partner's 50.0% interest in office properties in Richmond, VA. Our joint venture partner is an unrelated third party.

## Noncontrolling Interests in the Operating Partnership

The following table sets forth the Company's noncontrolling interests in the Operating Partnership:

|   | Nine Months Ended<br>September 30, |           |
|---|------------------------------------|-----------|
|   | 2014                               | 2013      |
| Beginning noncontrolling interests in the Operating Partnership                   | \$106,480                          | \$124,869 |
| Adjustment of noncontrolling interests in the Operating Partnership to fair value | 8,955                              | 8,570     |
| Conversions of Common Units to Common Stock                                       | (162 )                             | (28,788 ) |
| Redemptions of Common Units   | (93 )                              | —         |
| Net income attributable to noncontrolling interests in the Operating Partnership  | 2,813                              | 3,713     |
| Distributions to noncontrolling interests in the Operating Partnership            | (3,745 )                           | (4,416 )  |
| Total noncontrolling interests in the Operating Partnership                       | \$114,248                          | \$103,948 |

The following table sets forth net income available for common stockholders and transfers from the Company's noncontrolling interests in the Operating Partnership:

|  | Three Months<br>Ended<br>September 30, | Nine Months Ended<br>September 30, |
|--|--|------------------------------------|
|--|--|------------------------------------|

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|  | 2014     | 2013     | 2014     | 2013      |
|--|----------|----------|----------|-----------|
| Net income available for common stockholders   | \$51,708 | \$53,349 | \$86,541 | \$93,220  |
| Increase in additional paid in capital from conversions of Common Units to Common Stock              | —        | 25,937   | 162      | 28,788    |
| Change from net income available for common stockholders and transfers from noncontrolling interests | \$51,708 | \$79,286 | \$86,703 | \$122,008 |

22

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Table of Contents

HIGHWOODS PROPERTIES, INC.

HIGHWOODS REALTY LIMITED PARTNERSHIP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(tabular dollar amounts in thousands, except per share and per unit data)

9. Disclosure About Fair Value of Financial Instruments

The following summarizes the three levels of inputs that we use to measure fair value.

Level 1. Quoted prices in active markets for identical assets or liabilities.

Our Level 1 asset is our investment in marketable securities that we use to pay benefits under our non-qualified deferred compensation plan. Our Level 1 liability is our non-qualified deferred compensation obligation. The Company's Level 1 noncontrolling interests in the Operating Partnership relate to the ownership of Common Units by various individuals and entities other than the Company.

Level 2. Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the related assets or liabilities.

Our Level 2 assets include the fair value of certain of our mortgages and notes receivable and certain of our interest rate swaps. Our Level 2 liabilities include the fair value of our mortgages and notes payable and the remainder of our interest rate swaps.

The fair value of mortgages and notes receivable and mortgages and notes payable is estimated by the income approach utilizing contractual cash flows and market-based interest rates to approximate the price that would be paid in an orderly transaction between market participants. The fair value of interest rate swaps is determined using the market standard methodology of netting the discounted future fixed cash receipts and the discounted expected variable cash payments. The variable cash payments of interest rate swaps are based on the expectation of future LIBOR interest rates (forward curves) derived from observed market LIBOR interest rate curves. In addition, credit valuation adjustments are incorporated in the fair values to account for potential nonperformance risk, but were concluded to not be significant inputs to the calculation for the periods presented.

Level 3. Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Our Level 3 assets include (1) certain of our mortgages and notes receivable, which were estimated by the income approach utilizing internal cash flow projections and market interest rates to estimate the price that would be paid in an orderly transaction between market participants, (2) our tax increment financing bond, which is not routinely traded but whose fair value is determined by the income approach utilizing contractual cash flows and market-based interest rates to estimate the projected redemption value based on quoted bid/ask prices for similar unrated municipal bonds, and (3) any real estate assets recorded at fair value on a non-recurring basis as a result of our quarterly impairment analysis, which were valued using the terms of definitive sales contracts or the sales comparison approach and substantiated with internal cash flow projections.

Our Level 3 liabilities include the fair value of our contingent consideration to acquire real estate assets and financing obligations, which were estimated by the income approach to approximate the price that would be paid in an orderly transaction between market participants, utilizing: (1) contractual cash flows; (2) market-based interest rates; and (3) a

number of other assumptions including demand for space, competition for customers, changes in market rental rates, costs of operation and expected ownership periods.

Table of Contents

HIGHWOODS PROPERTIES, INC.

HIGHWOODS REALTY LIMITED PARTNERSHIP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(tabular dollar amounts in thousands, except per share and per unit data)

## 9. Disclosure About Fair Value of Financial Instruments - Continued

The following table sets forth our assets and liabilities and the Company's noncontrolling interests in the Operating Partnership that are measured at fair value within the fair value hierarchy.

|  | Total       | Level 1<br>Quoted<br>Prices<br>in Active<br>Markets for<br>Identical<br>Assets or<br>Liabilities | Level 2<br>Significant<br>Observable<br>Inputs | Level 3<br>Significant<br>Unobservable<br>Inputs |
|--|-------------|--|--|--|
| Fair Value at September 30, 2014:  |             |  |  |  |
| Assets:  |             |  |  |  |
| Mortgages and notes receivable, at fair value (1)  | \$10,531    | \$—  | \$201  | \$ 10,330  |
| Marketable securities of non-qualified deferred compensation plan (in prepaid expenses and other assets)     | 3,553       | 3,553  | —  | —  |
| Tax increment financing bond (in prepaid expenses and other assets)  | 13,696      | —  | —  | 13,696   |
| Total Assets   | \$27,780    | \$3,553  | \$201  | \$ 24,026  |
| Noncontrolling Interests in the Operating Partnership  | \$114,248   | \$114,248  | \$—  | \$ —   |
| Liabilities:   |             |  |  |  |
| Mortgages and notes payable, at fair value (1)   | \$2,087,145 | \$—  | \$2,087,145                                    | \$ —   |
| Interest rate swaps (in accounts payable, accrued expenses and other liabilities)                            | 959         | —  | 959  | —  |
| Non-qualified deferred compensation obligation (in accounts payable, accrued expenses and other liabilities) | 3,553       | 3,553  | —  | —  |
| Financing obligations, at fair value (1)   | 22,654      | —  | —  | 22,654   |
| Total Liabilities  | \$2,114,311 | \$3,553  | \$2,088,104                                    | \$ 22,654  |
| Fair Value at December 31, 2013:   |             |  |  |  |
| Assets:  |             |  |  |  |
| Mortgages and notes receivable, at fair value (1)  | \$26,485    | \$—  | \$17,029                                       | \$9,456  |
| Interest rate swaps (in prepaid expenses and other assets)   | 301         | —  | 301  | —  |
| Marketable securities of non-qualified deferred compensation plan (in prepaid expenses and other assets)     | 3,996       | 3,996  | —  | —  |
| Tax increment financing bond (in prepaid expenses and other assets)  | 13,403      | —  | —  | 13,403   |
| Total Assets   | \$44,185    | \$3,996  | \$17,330                                       | \$22,859   |
| Noncontrolling Interests in the Operating Partnership  | \$106,480   | \$106,480  | \$—  | \$—  |
| Liabilities:   |             |  |  |  |
| Mortgages and notes payable, at fair value (1)   | \$2,037,385 | \$—  | \$2,037,385                                    | \$—  |
| Interest rate swaps (in accounts payable, accrued expenses and other liabilities)                            | 510         | —  | 510  | —  |

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|  |             |         |             |          |
|--|-------------|---------|-------------|----------|
| Non-qualified deferred compensation obligation (in accounts payable, accrued expenses and other liabilities) | 3,996       | 3,996   | —           | —        |
| Financing obligations, at fair value (1)   | 22,478      | —       | —           | 22,478   |
| Total Liabilities  | \$2,064,369 | \$3,996 | \$2,037,895 | \$22,478 |

(1) Amounts recorded at historical cost on our Consolidated Balance Sheets at September 30, 2014 and December 31, 2013.

Table of Contents

HIGHWOODS PROPERTIES, INC.

HIGHWOODS REALTY LIMITED PARTNERSHIP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(tabular dollar amounts in thousands, except per share and per unit data)

## 9. Disclosure About Fair Value of Financial Instruments - Continued

The following table sets forth the changes in our Level 3 asset and liability, which are recorded at fair value on our Consolidated Balance Sheets:

|   | Three Months Ended |                    | Nine Months Ended  |                    |
|---|--------------------|--------------------|--------------------|--------------------|
|   | September 30, 2014 | September 30, 2013 | September 30, 2014 | September 30, 2013 |
| Asset:  |                    |                    |                    |                    |
| Tax Increment Financing Bond:                               |                    |                    |                    |                    |
| Beginning balance   | \$ 13,673          | \$ 14,233          | \$ 13,403          | \$ 14,496          |
| Principal repayment   | —                  | —                  | —                  | (562 )             |
| Unrealized gains (in AOCL)                                  | 23                 | 97                 | 293                | 396                |
| Ending balance  | \$ 13,696          | \$ 14,330          | \$ 13,696          | \$ 14,330          |
| Liability:  |                    |                    |                    |                    |
| Contingent Consideration to Acquire Real Estate Assets:     |                    |                    |                    |                    |
| Beginning balance   | \$—                | \$384              | \$—                | \$563              |
| Unrecognized gains (in general and administrative expenses) | —                  | (193 )             | —                  | (372 )             |
| Ending balance  | \$—                | \$191              | \$—                | \$191              |

During 2007, we acquired a tax increment financing bond associated with a parking garage developed by us. This bond amortizes to maturity in 2020. The estimated fair value at September 30, 2014 was \$0.7 million below the outstanding principal due on the bond. If the discount rate used to fair value this bond was 100 basis points higher or lower, the fair value of the bond would have been \$0.4 million lower or \$0.4 million higher, respectively, as of September 30, 2014. We intend to hold this bond and have concluded that we will not be required to sell this bond before recovery of the bond principal. Payment of the principal and interest for the bond is guaranteed by us. We have recorded no credit losses related to the bond during the three and nine months ended September 30, 2014 and 2013. There is no legal right of offset with the liability, which we report as a financing obligation, related to this tax increment financing bond.

The following table sets forth quantitative information about the unobservable input of our Level 3 asset, which is recorded at fair value on our Consolidated Balance Sheets:

|                              | Valuation Technique | Unobservable Input | Rate |
|------------------------------|---------------------|--------------------|------|
| Asset:                       |                     |                    |      |
| Tax increment financing bond | Income approach     | Discount rate      | 9.7% |

Table of Contents

HIGHWOODS PROPERTIES, INC.

HIGHWOODS REALTY LIMITED PARTNERSHIP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(tabular dollar amounts in thousands, except per share and per unit data)

## 10. Share-Based Payments

During the nine months ended September 30, 2014, the Company granted 190,330 stock options with an exercise price equal to the closing market price of a share of Common Stock on the date of grant. The fair value of each option is estimated on the date of grant using the Black-Scholes option pricing model, which resulted in a weighted average grant date fair value per share of \$6.75. During the nine months ended September 30, 2014, the Company also granted 94,932 shares of time-based restricted stock and 74,569 shares of total return-based restricted stock with weighted average grant date fair values per share of \$37.76 and \$35.58, respectively. We recorded share-based compensation expense of \$0.8 million and \$1.2 million during the three months ended September 30, 2014 and 2013, respectively, and \$6.2 million and \$5.9 million during the nine months ended September 30, 2014 and 2013, respectively. At September 30, 2014, there was \$5.5 million of total unrecognized share-based compensation costs, which will be recognized over a weighted average remaining contractual term of 2.5 years.

## 11. Accumulated Other Comprehensive Loss

The following table sets forth the components of AOCL:

|  | Three Months Ended |            | Nine Months Ended |            |
|--|--------------------|------------|-------------------|------------|
|  | September 30,      |            | September 30,     |            |
|  | 2014               | 2013       | 2014              | 2013       |
| Tax increment financing bond:                    |                    |            |                   |            |
| Beginning balance                                | \$(759 )           | \$(1,599 ) | \$(1,029 )        | \$(1,898 ) |
| Unrealized gains on tax increment financing bond | 23                 | 97         | 293               | 396        |
| Ending balance                                   | (736 )             | (1,502 )   | (736 )            | (1,502 )   |
| Cash flow hedges:                                |                    |            |                   |            |
| Beginning balance                                | (3,960 )           | (2,543 )   | (1,582 )          | (10,730 )  |
| Unrealized gains/(losses) on cash flow hedges    | 913                | (1,798 )   | (3,337 )          | 4,801      |
| Amortization of cash flow hedges (1)             | 952                | 840        | 2,824             | 2,428      |
| Ending balance                                   | (2,095 )           | (3,501 )   | (2,095 )          | (3,501 )   |
| Total accumulated other comprehensive loss       | \$(2,831 )         | \$(5,003 ) | \$(2,831 )        | \$(5,003 ) |

(1) Amounts reclassified out of AOCL into contractual interest expense.

Table of Contents

HIGHWOODS PROPERTIES, INC.

HIGHWOODS REALTY LIMITED PARTNERSHIP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(tabular dollar amounts in thousands, except per share and per unit data)

## 12. Real Estate and Other Assets Held For Sale and Discontinued Operations

The following table sets forth the major classes of assets of our real estate and other assets, net, held for sale:

|  | September 30,<br>2014 | December 31,<br>2013 |
|--|-----------------------|----------------------|
| Assets:  |                       |                      |
| Land held for development                        | \$ 989                | \$ —                 |
| Net real estate assets                           | 989                   | —                    |
| Prepaid expenses and other assets                | 43                    | —                    |
| Real estate and other assets, net, held for sale | \$ 1,032              | \$ —                 |

The following table sets forth our operations that were classified as discontinued operations prior to the adoption of the accounting standard update discussed in Note 1:

|   | Three Months<br>Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|---|--|----------|------------------------------------|----------|
|   | 2014                                   | 2013     | 2014                               | 2013     |
| Rental and other revenues                           | \$—                                    | \$5,277  | \$—                                | \$18,537 |
| Operating expenses:                                 |  |          |                                    |          |
| Rental property and other expenses                  | —                                      | 2,312    | —                                  | 7,178    |
| Depreciation and amortization                       | —                                      | 1,451    | —                                  | 5,506    |
| Total operating expenses                            | —                                      | 3,763    | —                                  | 12,684   |
| Income from discontinued operations                 | —                                      | 1,514    | —                                  | 5,853    |
| Impairments of real estate assets                   | —                                      | —        | —                                  | (2,194 ) |
| Net gains on disposition of discontinued operations | —                                      | 37,946   | 384                                | 52,353   |
| Total discontinued operations                       | \$—                                    | \$39,460 | \$384                              | \$56,012 |

As of September 30, 2014, real estate and other assets, net, held for sale consisted of a land parcel in Richmond, VA and two land parcels in Raleigh, NC, none of which were classified as discontinued operations during the nine months ended September 30, 2014. As of December 31, 2013, there were no real estate and other assets, net, held for sale.

Table of Contents

HIGHWOODS PROPERTIES, INC.

HIGHWOODS REALTY LIMITED PARTNERSHIP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(tabular dollar amounts in thousands, except per share and per unit data)

## 13. Earnings Per Share and Per Unit

The following table sets forth the computation of basic and diluted earnings per share of the Company:

|   | Three Months<br>Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|---|--|----------|------------------------------------|----------|
|   | 2014                                   | 2013     | 2014                               | 2013     |
| Earnings per Common Share - basic:  |  |          |                                    |          |
| Numerator:  |  |          |                                    |          |
| Income from continuing operations   | \$54,299                               | \$16,608 | \$92,003                           | \$43,395 |
| Net (income) attributable to noncontrolling interests in the Operating Partnership from continuing operations   | (1,673 )                               | (488 )   | (2,801 )                           | (1,600 ) |
| Net (income) attributable to noncontrolling interests in consolidated affiliates from continuing operations   | (291 )                                 | (203 )   | (1,152 )                           | (593 )   |
| Dividends on Preferred Stock  | (627 )                                 | (627 )   | (1,881 )                           | (1,881 ) |
| Income from continuing operations available for common stockholders   | 51,708                                 | 15,290   | 86,169                             | 39,321   |
| Income from discontinued operations   | —                                      | 39,460   | 384                                | 56,012   |
| Net (income) attributable to noncontrolling interests in the Operating Partnership from discontinued operations   | —                                      | (1,401 ) | (12 )                              | (2,113 ) |
| Income from discontinued operations available for common stockholders   | —                                      | 38,059   | 372                                | 53,899   |
| Net income available for common stockholders  | \$51,708                               | \$53,349 | \$86,541                           | \$93,220 |
| Denominator:  |  |          |                                    |          |
| Denominator for basic earnings per Common Share – weighted average shares   | 90,668                                 | 87,467   | 90,299                             | 83,793   |
| Earnings per Common Share - basic:  |  |          |                                    |          |
| Income from continuing operations available for common stockholders   | \$0.57                                 | \$0.17   | \$0.96                             | \$0.47   |
| Income from discontinued operations available for common stockholders   | —                                      | 0.44     | —                                  | 0.64     |
| Net income available for common stockholders  | \$0.57                                 | \$0.61   | \$0.96                             | \$1.11   |
| Earnings per Common Share - diluted:  |  |          |                                    |          |
| Numerator:  |  |          |                                    |          |
| Income from continuing operations   | \$54,299                               | \$16,608 | \$92,003                           | \$43,395 |
| Net (income) attributable to noncontrolling interests in consolidated affiliates from continuing operations   | (291 )                                 | (203 )   | (1,152 )                           | (593 )   |
| Dividends on Preferred Stock  | (627 )                                 | (627 )   | (1,881 )                           | (1,881 ) |
| Income from continuing operations available for common stockholders before net (income) attributable to noncontrolling interests in the Operating Partnership | 53,381                                 | 15,778   | 88,970                             | 40,921   |
| Income from discontinued operations available for common stockholders   | —                                      | 39,460   | 384                                | 56,012   |
| Net income available for common stockholders before net (income) attributable to noncontrolling interests in the Operating Partnership                        | \$53,381                               | \$55,238 | \$89,354                           | \$96,933 |
| Denominator:  |  |          |                                    |          |
|   | 90,668                                 | 87,467   | 90,299                             | 83,793   |

|  |        |        |        |        |
|--|--------|--------|--------|--------|
| Denominator for basic earnings per Common Share – weighted average shares  |        |        |        |        |
| Add:   |        |        |        |        |
| Stock options using the treasury method  | 118    | 101    | 121    | 114    |
| Noncontrolling interests Common Units  | 2,937  | 3,201  | 2,938  | 3,536  |
| Denominator for diluted earnings per Common Share – adjusted weighted average shares and assumed conversions (1) (2) | 93,723 | 90,769 | 93,358 | 87,443 |
| Earnings per Common Share - diluted:   |        |        |        |        |
| Income from continuing operations available for common stockholders  | \$0.57 | \$0.17 | \$0.96 | \$0.47 |
| Income from discontinued operations available for common stockholders  | —      | 0.44   | —      | 0.64   |
| Net income available for common stockholders   | \$0.57 | \$0.61 | \$0.96 | \$1.11 |

Table of Contents

HIGHWOODS PROPERTIES, INC.

HIGHWOODS REALTY LIMITED PARTNERSHIP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(tabular dollar amounts in thousands, except per share and per unit data)

## 13. Earnings Per Share and Per Unit - Continued

There were 0.3 million options outstanding during both the three and nine months ended September 30, 2013 that were not included in the computation of diluted earnings per share because the impact of including such options would be anti-dilutive. There were no such options outstanding during both the three and nine months ended September 30, 2014.

(2) Includes all unvested restricted stock where dividends on such restricted stock are non-forfeitable.

The following table sets forth the computation of basic and diluted earnings per unit of the Operating Partnership:

|  | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|--|-------------------------------------|----------|------------------------------------|----------|
|  | 2014                                | 2013     | 2014                               | 2013     |
| Earnings per Common Unit - basic:  |                                     |          |                                    |          |
| Numerator:   |                                     |          |                                    |          |
| Income from continuing operations  | \$54,299                            | \$16,607 | \$92,003                           | \$43,344 |
| Net (income) attributable to noncontrolling interests in consolidated affiliates from continuing operations        | (291 )                              | (203 )   | (1,152 )                           | (593 )   |
| Distributions on Preferred Units   | (627 )                              | (627 )   | (1,881 )                           | (1,881 ) |
| Income from continuing operations available for common unitholders   | 53,381                              | 15,777   | 88,970                             | 40,870   |
| Income from discontinued operations available for common unitholders   | —                                   | 39,460   | 384                                | 56,012   |
| Net income available for common unitholders  | \$53,381                            | \$55,237 | \$89,354                           | \$96,882 |
| Denominator:   |                                     |          |                                    |          |
| Denominator for basic earnings per Common Unit – weighted average units  | 93,196                              | 90,259   | 92,828                             | 86,920   |
| Earnings per Common Unit - basic:  |                                     |          |                                    |          |
| Income from continuing operations available for common unitholders   | \$0.57                              | \$0.17   | \$0.96                             | \$0.47   |
| Income from discontinued operations available for common unitholders   | —                                   | 0.44     | —                                  | 0.64     |
| Net income available for common unitholders  | \$0.57                              | \$0.61   | \$0.96                             | \$1.11   |
| Earnings per Common Unit - diluted:  |                                     |          |                                    |          |
| Numerator:   |                                     |          |                                    |          |
| Income from continuing operations  | \$54,299                            | \$16,607 | \$92,003                           | \$43,344 |
| Net (income) attributable to noncontrolling interests in consolidated affiliates from continuing operations        | (291 )                              | (203 )   | (1,152 )                           | (593 )   |
| Distributions on Preferred Units   | (627 )                              | (627 )   | (1,881 )                           | (1,881 ) |
| Income from continuing operations available for common unitholders   | 53,381                              | 15,777   | 88,970                             | 40,870   |
| Income from discontinued operations available for common unitholders   | —                                   | 39,460   | 384                                | 56,012   |
| Net income available for common unitholders  | \$53,381                            | \$55,237 | \$89,354                           | \$96,882 |
| Denominator:   |                                     |          |                                    |          |
| Denominator for basic earnings per Common Unit – weighted average units  | 93,196                              | 90,259   | 92,828                             | 86,920   |
| Add:   |                                     |          |                                    |          |
| Stock options using the treasury method  | 118                                 | 101      | 121                                | 114      |
| Denominator for diluted earnings per Common Unit – adjusted weighted average units and assumed conversions (1) (2) | 93,314                              | 90,360   | 92,949                             | 87,034   |
| Earnings per Common Unit - diluted:  |                                     |          |                                    |          |

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|  |        |        |        |        |
|--|--------|--------|--------|--------|
| Income from continuing operations available for common unitholders   | \$0.57 | \$0.17 | \$0.96 | \$0.47 |
| Income from discontinued operations available for common unitholders | —      | 0.44   | —      | 0.64   |
| Net income available for common unitholders                          | \$0.57 | \$0.61 | \$0.96 | \$1.11 |

(1) There were 0.3 million options outstanding during both the three and nine months ended September 30, 2013 that were not included in the computation of diluted earnings per unit because the impact of including such options would be anti-dilutive. There were no such options outstanding during both the three and nine months ended September 30, 2014.

(2) Includes all unvested restricted stock where dividends on such restricted stock are non-forfeitable.

29

---

Table of Contents

HIGHWOODS PROPERTIES, INC.

HIGHWOODS REALTY LIMITED PARTNERSHIP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(tabular dollar amounts in thousands, except per share and per unit data)

## 14. Segment Information

The following tables summarize the rental and other revenues and net operating income, the primary industry property-level performance metric used by our chief operating decision maker which is defined as rental and other revenues less rental property and other expenses, for each of our reportable segments:

|                                 | Three Months Ended |           | Nine Months Ended |           |
|---------------------------------|--------------------|-----------|-------------------|-----------|
|                                 | September 30,      |           | September 30,     |           |
|                                 | 2014               | 2013      | 2014              | 2013      |
| Rental and Other Revenues:      |                    |           |                   |           |
| Office:                         |                    |           |                   |           |
| Atlanta, GA                     | \$24,682           | \$22,523  | \$71,286          | \$57,630  |
| Greenville, SC                  | 532                | 827       | 2,140             | 2,500     |
| Kansas City, MO                 | 4,218              | 4,064     | 12,401            | 12,067    |
| Memphis, TN                     | 10,186             | 9,644     | 30,076            | 28,680    |
| Nashville, TN                   | 20,139             | 15,147    | 59,926            | 43,411    |
| Orlando, FL                     | 8,991              | 8,441     | 27,059            | 12,894    |
| Piedmont Triad, NC              | 6,439              | 6,596     | 19,469            | 19,487    |
| Pittsburgh, PA                  | 14,259             | 14,191    | 42,030            | 41,835    |
| Raleigh, NC                     | 21,357             | 21,737    | 65,386            | 64,124    |
| Richmond, VA                    | 11,236             | 12,006    | 34,999            | 35,639    |
| Tampa, FL                       | 17,637             | 16,879    | 51,393            | 51,702    |
| Total Office Segment            | 139,676            | 132,055   | 416,165           | 369,969   |
| Industrial:                     |                    |           |                   |           |
| Atlanta, GA                     | 218                | 210       | 626               | 624       |
| Piedmont Triad, NC              | 2,982              | 2,998     | 8,676             | 9,238     |
| Total Industrial Segment        | 3,200              | 3,208     | 9,302             | 9,862     |
| Retail:                         |                    |           |                   |           |
| Kansas City, MO                 | 9,753              | 9,564     | 28,337            | 27,991    |
| Total Retail Segment            | 9,753              | 9,564     | 28,337            | 27,991    |
| Total Rental and Other Revenues | \$152,629          | \$144,827 | \$453,804         | \$407,822 |

Table of Contents

HIGHWOODS PROPERTIES, INC.

HIGHWOODS REALTY LIMITED PARTNERSHIP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(tabular dollar amounts in thousands, except per share and per unit data)

## 14. Segment Information - Continued

|  | Three Months<br>Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|--|--|-----------|------------------------------------|-----------|
|  | 2014                                   | 2013      | 2014                               | 2013      |
| Net Operating Income:  |  |           |                                    |           |
| Office:  |  |           |                                    |           |
| Atlanta, GA  | \$14,808                               | \$13,868  | \$42,826                           | \$35,936  |
| Greenville, SC   | 289                                    | 448       | 1,154                              | 1,400     |
| Kansas City, MO  | 2,671                                  | 2,597     | 7,974                              | 7,796     |
| Memphis, TN  | 6,024                                  | 5,408     | 17,420                             | 16,337    |
| Nashville, TN  | 13,590                                 | 10,311    | 40,742                             | 30,028    |
| Orlando, FL  | 5,087                                  | 4,950     | 15,809                             | 7,099     |
| Piedmont Triad, NC   | 4,105                                  | 4,257     | 12,352                             | 12,611    |
| Pittsburgh, PA   | 8,122                                  | 8,001     | 23,303                             | 23,322    |
| Raleigh, NC  | 14,611                                 | 14,920    | 45,969                             | 45,226    |
| Richmond, VA   | 7,165                                  | 7,910     | 23,106                             | 24,267    |
| Tampa, FL  | 10,304                                 | 9,930     | 30,370                             | 31,618    |
| Total Office Segment   | 86,776                                 | 82,600    | 261,025                            | 235,640   |
| Industrial:  |  |           |                                    |           |
| Atlanta, GA  | 124                                    | 122       | 368                                | 361       |
| Piedmont Triad, NC   | 2,218                                  | 2,187     | 6,246                              | 6,797     |
| Total Industrial Segment   | 2,342                                  | 2,309     | 6,614                              | 7,158     |
| Retail:  |  |           |                                    |           |
| Kansas City, MO  | 6,157                                  | 5,837     | 17,186                             | 17,066    |
| Total Retail Segment   | 6,157                                  | 5,837     | 17,186                             | 17,066    |
| Corporate and other  | (29 )                                  | (21 )     | (69 )                              | (55 )     |
| Total Net Operating Income   | 95,246                                 | 90,725    | 284,756                            | 259,809   |
| Reconciliation to income from continuing operations before disposition of investment properties and activity in unconsolidated affiliates: |  |           |                                    |           |
| Depreciation and amortization  | (48,287 )                              | (47,338 ) | (146,895)                          | (128,050) |
| Impairments of real estate assets  | —                                      | —         | (588 )                             | —         |
| General and administrative expenses  | (7,526 )                               | (8,969 )  | (26,973 )                          | (27,948 ) |
| Interest expense   | (22,348 )                              | (23,672 ) | (64,923 )                          | (70,826 ) |
| Other income   | 728                                    | 1,550     | 3,555                              | 4,786     |
| Income from continuing operations before disposition of investment properties and activity in unconsolidated affiliates                    | \$17,813                               | \$12,296  | \$48,932                           | \$37,771  |

Table of Contents

HIGHWOODS PROPERTIES, INC.

HIGHWOODS REALTY LIMITED PARTNERSHIP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(tabular dollar amounts in thousands, except per share and per unit data)

15. Subsequent Events

On October 17, 2014, we sold an industrial property and a land parcel in Atlanta, GA for a sale price of \$11.4 million and expect to record a gain on disposition of property of \$1.7 million.

32

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Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The Company is a fully integrated office REIT that owns, develops, acquires, leases and manages properties primarily in the best business districts (BBDs) of Atlanta, Kansas City, Memphis, Nashville, Orlando, Pittsburgh, Raleigh, Richmond, Tampa and the Triad. The Company conducts its activities through the Operating Partnership. The Operating Partnership is managed by the Company, its sole general partner. Additional information about us can be found on our website at [www.highwoods.com](http://www.highwoods.com). Information on our website is not part of this Quarterly Report.

You should read the following discussion and analysis in conjunction with the accompanying Consolidated Financial Statements and related notes contained elsewhere in this Quarterly Report.

Disclosure Regarding Forward-Looking Statements

Some of the information in this Quarterly Report may contain forward-looking statements. Such statements include, in particular, statements about our plans, strategies and prospects under this section. You can identify forward-looking statements by our use of forward-looking terminology such as "may," "will," "expect," "anticipate," "estimate," "continue" or similar words. Although we believe that our plans, intentions and expectations reflected in or suggested by such forward-looking statements are reasonable, we cannot assure you that our plans, intentions or expectations will be achieved. When considering such forward-looking statements, you should keep in mind the following important factors that could cause our actual results to differ materially from those contained in any forward-looking statement:

- the financial condition of our customers could deteriorate;
- we may not be able to lease or release second generation space, defined as previously occupied space that becomes available for lease, quickly or on as favorable terms as old leases;
- we may not be able to lease our newly constructed buildings as quickly or on as favorable terms as originally anticipated;
- we may not be able to complete development, acquisition, reinvestment, disposition or joint venture projects as quickly or on as favorable terms as anticipated;
- development activity by our competitors in our existing markets could result in an excessive supply of office properties relative to customer demand;
- our markets may suffer declines in economic growth;
- unanticipated increases in interest rates could increase our debt service costs;
- unanticipated increases in operating expenses could negatively impact our operating results;
- we may not be able to meet our liquidity requirements or obtain capital on favorable terms to fund our working capital needs and growth initiatives or repay or refinance outstanding debt upon maturity; and
- the Company could lose key executive officers.

This list of risks and uncertainties, however, is not intended to be exhaustive. You should also review the other cautionary statements we make in "Business – Risk Factors" set forth in our 2013 Annual Report on Form 10-K. Given

these uncertainties, you should not place undue reliance on forward-looking statements. We undertake no obligation to publicly release the results of any revisions to these forward-looking statements to reflect any future events or circumstances or to reflect the occurrence of unanticipated events.

Table of Contents

## Executive Summary

Our Strategic Plan focuses on:

- owning high-quality, differentiated real estate assets in the BBDs of our core markets;
- improving the operating results of our existing properties through concentrated leasing, asset management, cost control and customer service efforts;
- developing and acquiring office properties in BBDs that improve the overall quality of our portfolio and generate attractive returns over the long term for our stockholders;
- disposing of properties no longer considered to be core assets primarily due to location, age, quality and overall strategic fit; and
- maintaining a conservative and flexible balance sheet with ample liquidity to meet our funding needs and growth prospects.

While we own and operate a limited number of industrial and retail properties, our operating results depend heavily on successfully leasing and operating our office properties. Economic growth and employment levels in our core markets are and will continue to be important factors in predicting our future operating results.

The key components affecting our rental and other revenues are average occupancy, rental rates, cost recovery income, new developments placed in service, acquisitions and dispositions. Average occupancy generally increases during times of improving economic growth, as our ability to lease space outpaces vacancies that occur upon the expirations of existing leases. Average occupancy generally declines during times of slower economic growth, when new vacancies tend to outpace our ability to lease space. Asset acquisitions, dispositions and new developments placed in service directly impact our rental revenues and could impact our average occupancy, depending upon the occupancy rate of the properties that are acquired, sold or placed in service. A further indicator of the predictability of future revenues is the expected lease expirations of our portfolio. As a result, in addition to seeking to increase our average occupancy by leasing current vacant space, we also must concentrate our leasing efforts on renewing our existing leases prior to expiration. For more information regarding our lease expirations, see "Properties - Lease Expirations" in our 2013 Annual Report. Our occupancy increased from 89.9% at December 31, 2013 to 91.0% at September 30, 2014.

Whether or not our rental revenue tracks average occupancy proportionally depends upon whether GAAP rents under signed new and renewal leases are higher or lower than the GAAP rents under expiring leases. Annualized rental revenues from second generation leases expiring during any particular year are generally less than 15% of our total annual rental revenues. The following table sets forth information regarding second generation leases signed during the third quarter of 2014 (we define second generation leases as leases with new customers and renewals of existing customers in space that has been previously occupied under our ownership and leases with respect to vacant space in acquired buildings):

|  | Office  |         | Industrial |         | Retail |         |
|--|---------|---------|------------|---------|--------|---------|
|  | New     | Renewal | New        | Renewal | New    | Renewal |
| Leased space (in rentable square feet) | 357,159 | 583,261 | 73,562     | 64,679  | 5,747  | 12,906  |
|  | 6.7     | 4.5     | 9.6        | 3.0     | 3.5    | 5.4     |

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Average term (in years - rentable square foot weighted)

|  |         |         |         |         |         |         |
|--|---------|---------|---------|---------|---------|---------|
| Base rents (per rentable square foot) (1)          | \$24.55 | \$23.82 | \$4.20  | \$4.59  | \$23.09 | \$35.46 |
| Rent concessions (per rentable square foot) (1)    | (1.05 ) | (0.41 ) | (0.11 ) | (0.06 ) | —       | —       |
| GAAP rents (per rentable square foot) (1)          | \$23.50 | \$23.41 | \$4.09  | \$4.53  | \$23.09 | \$35.46 |
| Tenant improvements (per rentable square foot) (1) | \$3.23  | \$1.66  | \$0.49  | \$0.10  | \$5.20  | \$4.22  |
| Leasing commissions (per rentable square foot) (1) | \$0.89  | \$0.41  | \$0.14  | \$0.07  | \$0.32  | \$—     |

(1) Weighted average per rentable square foot on an annual basis over the lease term.

## Table of Contents

Compared to previous leases in the same spaces, annual combined GAAP rents for new and renewal leases signed in the third quarter were \$23.45 per rentable square foot, or 3.5% higher, for office leases, \$4.30 per rentable square foot, or 4.1% higher, for industrial leases and \$31.65 per rentable square foot, or 2.3% higher, for retail leases.

We strive to maintain a diverse, stable and creditworthy customer base. We have an internal guideline whereby customers that account for more than 3% of our revenues are periodically reviewed with the Company's Board of Directors. No customer currently accounts for more than 2% of our revenues other than the Federal Government, which accounted for less than 7% of our revenues on an annualized basis, as of September 30, 2014.

Our expenses primarily consist of rental property expenses, depreciation and amortization, general and administrative expenses and interest expense. From time to time, expenses also include impairments of real estate assets. Rental property expenses are expenses associated with our ownership and operation of rental properties and include expenses that vary somewhat proportionately to occupancy levels, such as janitorial services and utilities, and expenses that do not vary based on occupancy, such as property taxes and insurance. Depreciation and amortization is a non-cash expense associated with the ownership of real property and generally remains relatively consistent each year, unless we buy, place in service or sell assets, since we depreciate our properties and related building and tenant improvement assets on a straight-line basis over fixed lives. General and administrative expenses consist primarily of management and employee salaries and other personnel costs, corporate overhead and short and long-term incentive compensation.

We intend to maintain a conservative and flexible balance sheet that allows us to capitalize on favorable development and acquisition opportunities as they arise. We have announced the commencement of \$147 million of new development in 2014 and anticipate commencing up to an additional \$103 million of new development during the remainder of 2014. Such projects would likely not be placed in service until 2015 or beyond. To date in 2014, we have acquired \$92 million of new properties and sold \$180 million of non-core assets. We anticipate acquiring up to an additional \$208 million of new properties and selling up to an additional \$5 million of non-core assets during the remainder of 2014. We generally seek to acquire and develop assets that improve the average quality of our overall portfolio and deliver consistent and sustainable value for our stockholders over the long-term. Whether or not an asset acquisition or new development results in higher per share net income or funds from operations ("FFO") in any given period depends upon a number of factors, including whether the net operating income for any such period exceeds the actual cost of capital used to finance the acquisition. Forward-looking information regarding 2014 operating performance contained below under "Results of Operations" excludes the impact of any potential acquisitions or dispositions.

## Results of Operations

Three Months Ended September 30, 2014 and 2013

### Rental and Other Revenues

Rental and other revenues were \$7.8 million, or 5.4%, higher in the third quarter of 2014 as compared to 2013 primarily due to 2013 acquisitions and development properties placed in service and higher same property revenues, which increased rental and other revenues by \$10.1 million and \$1.0 million, respectively. Same property rental and other revenues were higher primarily due to higher average GAAP rents per rentable square foot and higher cost recovery income, partly offset by a bankruptcy settlement in 2013, higher termination fees in 2013 and a decrease in average occupancy to 91.1% in the third quarter of 2014 from 91.4% in the third quarter of 2013. These increases were partly offset by \$1.8 million in lost revenue from property dispositions and the recognition of \$1.1 million of deferred leasing commission income in 2013 that was received in connection with the acquisition of our joint venture partner's 60.0% interest in our HIW-KC Orlando, LLC joint venture.

## Operating Expenses

Rental property and other expenses were \$3.3 million, or 6.1%, higher in the third quarter of 2014 as compared to 2013 primarily due to 2013 acquisitions and development properties placed in service and higher same property operating expenses, which increased operating expenses by \$3.4 million and \$0.7 million, respectively. Same property operating expenses were higher primarily due to higher utilities, contract services and taxes in 2014, partly offset by lower repairs and maintenance in 2014. These increases were partly offset by \$0.7 million in operating expense savings from property dispositions in 2014.

Operating margin, defined as rental and other revenues less rental property and other expenses expressed as a percentage of rental and other revenues, was slightly lower at 62.4% for the third quarter of 2014 as compared to 62.6% for the third quarter of 2013.

Depreciation and amortization was \$0.9 million, or 2.0%, higher in the third quarter of 2014 as compared to 2013 primarily due to 2013 acquisitions and development properties placed in service.

## Table of Contents

General and administrative expenses were \$1.4 million, or 16.1%, lower in the third quarter of 2014 as compared to 2013 primarily due to lower incentive compensation and acquisition costs, partly offset by higher company-wide base salaries.

### Interest Expense

Interest expense was \$1.3 million, or 5.6%, lower in the third quarter of 2014 as compared to 2013 primarily due to lower average interest rates and higher capitalized interest, partly offset by higher average debt balances.

### Other Income

Other income was \$0.8 million, or 53.0%, lower in the third quarter of 2014 as compared to 2013 primarily due to the repayments in the first quarter of 2014 of \$16.5 million of mortgages receivable, which consisted of seller financing provided in connection with 2010 disposition transactions and a higher loss on debt extinguishment in 2014.

### Gains on Disposition of Property and Net Gains on Disposition of Discontinued Operations

With the adoption of the discontinued operations accounting standard update in the second quarter of 2014, gains on disposition of property are now generally included in continuing operations. Prior to adoption, such gains were generally classified as discontinued operations. Total gains were \$1.7 million lower in the third quarter of 2014 as compared to 2013 due to lower disposition activity in 2014.

### Gain on Acquisition of Controlling Interest in Unconsolidated Affiliate

We recorded a gain on acquisition of controlling interest in unconsolidated affiliate of \$7.5 million in the third quarter of 2013 due to acquiring our joint venture partner's 60.0% interest in our HIW-KC Orlando, LLC joint venture. We had no comparable transactions in the third quarter of 2014.

### Equity in Earnings/(Losses) of Unconsolidated Affiliates

Equity in earnings/(losses) of unconsolidated affiliates was \$3.4 million higher in the third quarter of 2014 as compared to 2013 primarily due to our share of impairment of real estate assets on an office property in our Highwoods DLF 98/29, LLC joint venture of \$3.5 million in 2013, which resulted from a change in the assumed timing of future disposition.

### Earnings Per Common Share - Diluted

Diluted earnings per share was \$0.04, or 6.6%, lower in the third quarter of 2014 as compared to 2013 due to a decrease in net income for the reasons discussed above and an increase in the weighted average Common Shares outstanding.

### Nine Months Ended September 30, 2014 and 2013

#### Rental and Other Revenues

Rental and other revenues were \$46.0 million, or 11.3%, higher in the nine months ended September 30, 2014 as compared to 2013 primarily due to 2013 acquisitions and development properties placed in service, which increased rental and other revenues by \$49.8 million, partly offset by \$1.7 million of lost revenue from property dispositions and

the recognition of \$1.1 million of deferred leasing commission income in 2013 that was received in connection with the acquisition of our joint venture partner's 60.0% interest in our HIW-KC Orlando, LLC joint venture.

#### Operating Expenses

Rental property and other expenses were \$21.0 million, or 14.2%, higher in the nine months ended September 30, 2014 as compared to 2013 primarily due to 2013 acquisitions and development properties placed in service, which accounted for \$18.4 million of the increase, and higher same property operating expenses of \$4.1 million. Same property operating expenses were higher primarily due to higher utilities and snow removal costs as a result of harsher than normal winter conditions in 2014. These increases were partly offset by a \$0.7 million decrease in expenses from property dispositions in 2014.

## Table of Contents

Operating margin, defined as rental and other revenues less rental property and other expenses expressed as a percentage of rental and other revenues, was lower at 62.7% for the nine months ended September 30, 2014 as compared to 63.7% for the nine months ended September 30, 2013.

Depreciation and amortization was \$18.8 million, or 14.7%, higher in the nine months ended September 30, 2014 as compared to 2013 primarily due to 2013 acquisitions and development properties placed in service.

We recorded an impairment of real estate assets of \$0.6 million in the nine months ended September 30, 2014 on an office property in Greensboro, NC. Prior to the adoption of the discontinued operations accounting standard update in the second quarter of 2014, such comparable impairments were classified as discontinued operations in the nine months ended September 30, 2013. We recorded impairments of real estate assets of \$1.1 million on seven industrial properties in Atlanta, GA in the first quarter of 2013 and \$1.1 million on four properties in a single office park in Winston-Salem, NC in the second quarter of 2013. These impairments were due to a change in the assumed timing of future dispositions and leasing assumptions.

General and administrative expenses were \$1.0 million, or 3.5%, lower in the nine months ended September 30, 2014 as compared to 2013 primarily due to lower acquisition costs, partly offset by higher incentive compensation and company-wide base salaries.

### Interest Expense

Interest expense was \$5.9 million, or 8.3%, lower in the nine months ended September 30, 2014 as compared to 2013 primarily due to lower average interest rates and higher capitalized interest, partly offset by higher average debt balances.

### Other Income

Other income was \$1.2 million, or 25.7%, lower in the nine months ended September 30, 2014 as compared to 2013 primarily due to the repayments in the first quarter of 2014 of \$16.5 million of mortgages receivable, which consisted of seller financing provided in connection with 2010 disposition transactions.

### Gains on Disposition of Property and Net Gains on Disposition of Discontinued Operations

With the adoption of the discontinued operations accounting standard update in the second quarter of 2014, gains on disposition of property are now generally included in continuing operations. Prior to adoption, such gains were generally classified as discontinued operations. Total gains were \$9.8 million lower in the nine months ended September 30, 2014 as compared to 2013 due to lower disposition activity in 2014.

### Gain on Acquisition of Controlling Interest in Unconsolidated Affiliate

We recorded a gain on acquisition of controlling interest in unconsolidated affiliate of \$7.5 million in the nine months ended September 30, 2013 due to acquiring our joint venture partner's 60.0% interest in our HIW-KC Orlando, LLC joint venture. We had no comparable transactions in the nine months ended September 30, 2014.

### Equity in Earnings/(Losses) of Unconsolidated Affiliates

Equity in earnings/(losses) of unconsolidated affiliates was \$2.7 million higher in the nine months ended September 30, 2014 as compared to 2013 primarily due to our \$4.5 million share of impairments of real estate assets on certain office properties in our Highwoods DLF 98/29, LLC joint venture in the first and third quarters of 2013, which

resulted from changes in the assumed timing of future dispositions and/or leasing assumptions. Partly offsetting this increase in 2014 is a net impairment of our previous investment in Board of Trade Investment Company in the first quarter of 2014 and the acquisitions of certain joint venture interests and assets in the third quarter of 2013.

Earnings Per Common Share - Diluted

Diluted earnings per common share was \$0.15, or 13.5%, lower in the nine months ended September 30, 2014 as compared to 2013 due to a decrease in net income for the reasons discussed above and an increase in the weighted average Common Shares outstanding.

Table of Contents

## Liquidity and Capital Resources

## Overview

Our goal is to maintain a conservative and flexible balance sheet with access to multiple sources of debt and equity capital and sufficient availability under our revolving credit facility. We generally use rents received from customers to fund our operating expenses, recurring capital expenditures and distributions. To fund property acquisitions, development activity or building renovations and repay debt upon maturity, we may use current cash balances, sell assets, obtain new debt and/or issue equity. Our debt generally consists of unsecured debt securities, unsecured bank term loans, mortgage debt and borrowings under our unsecured revolving credit facility.

## Statements of Cash Flows

We report and analyze our cash flows based on operating activities, investing activities and financing activities. The following table sets forth the changes in the Company's cash flows (\$ in thousands):

|   | Nine Months Ended |            |            |
|---|-------------------|------------|------------|
|   | September 30,     |            |            |
|   | 2014              | 2013       | Change     |
| Net Cash Provided By Operating Activities           | \$183,675         | \$186,512  | \$(2,837 ) |
| Net Cash (Used In) Investing Activities             | (159,184 )        | (401,574 ) | 242,390    |
| Net Cash (Used In)/Provided By Financing Activities | (23,075 )         | 232,968    | (256,043 ) |
| Total Cash Flows                                    | \$1,416           | \$17,906   | \$(16,490) |

In calculating net cash related to operating activities, depreciation and amortization, which are non-cash expenses, are added back to net income. As a result, we have historically generated a positive amount of cash from operating activities. From period to period, cash flow from operations depends primarily upon changes in our net income, as discussed more fully above under "Results of Operations," changes in receivables and payables, and net additions or decreases in our overall portfolio, which affect the amount of depreciation and amortization expense.

Net cash related to investing activities generally relates to capitalized costs incurred for leasing and major building improvements and our acquisition, development, disposition and joint venture capital activity. During periods of significant net acquisition and/or development activity, our cash used in such investing activities will generally exceed cash provided by investing activities, which typically consists of cash received upon the sale of properties and distributions of capital from our joint ventures.

Net cash related to financing activities generally relates to distributions, incurrence and repayment of debt, and issuances, repurchases or redemptions of Common Stock, Common Units and Preferred Stock. As discussed previously, we use a significant amount of our cash to fund distributions. Whether or not we have increases in the outstanding balances of debt during a period depends generally upon the net effect of our acquisition, disposition, development and joint venture activity. We generally use our revolving credit facility for daily working capital purposes, which means that during any given period, in order to minimize interest expense, we may record significant repayments and borrowings under our revolving credit facility.

The decrease in net cash provided by operating activities in the nine months ended September 30, 2014 as compared to 2013 was primarily due to higher cash paid for operating expenses in 2014, partly offset by higher net cash from the operations of properties acquired in 2013.

The decrease in net cash used in investing activities in the nine months ended September 30, 2014 as compared to 2013 was primarily due to lower acquisition activity and higher repayments of mortgages and notes receivable in 2014, partly offset by higher development activity, lower net proceeds from dispositions of real estate assets and lower distributions of capital from unconsolidated affiliates in 2014.

The change in net cash (used in)/provided by financing activities in the nine months ended September 30, 2014 as compared to 2013 was primarily due to lower proceeds from the issuance of Common Stock, higher aggregate dividends on Common Stock due to higher shares outstanding, lower contributions from noncontrolling interests in consolidated affiliates and higher net debt borrowings in 2014.

Table of Contents

## Capitalization

The following table sets forth the Company's capitalization (in thousands, except per share amounts):

|   | September 30,<br>2014 | December 31,<br>2013 |
|---|-----------------------|----------------------|
| Mortgages and notes payable, at recorded book value | \$ 2,013,824          | \$ 1,956,299         |
| Financing obligations                               | \$ 23,519             | \$ 26,664            |
| Preferred Stock, at liquidation value               | \$ 29,077             | \$ 29,077            |
| Common Stock outstanding                            | 91,270                | 89,921               |
| Common Units outstanding (not owned by the Company) | 2,937                 | 2,944                |
| Per share stock price at period end                 | \$ 38.90              | \$ 36.17             |
| Market value of Common Stock and Common Units       | \$ 3,664,652          | \$ 3,358,927         |
| Total capitalization                                | \$ 5,731,072          | \$ 5,370,967         |

At September 30, 2014, our mortgages and notes payable and outstanding preferred stock represented 35.6% of our total capitalization and 41.6% of the undepreciated book value of our assets.

Our mortgages and notes payable as of September 30, 2014 consisted of \$314.5 million of secured indebtedness with a weighted average interest rate of 5.94% and \$1,699.3 million of unsecured indebtedness with a weighted average interest rate of 4.05%. The secured indebtedness was collateralized by real estate assets with an aggregate undepreciated book value of \$582.2 million.

## Current and Future Cash Needs

Rental and other revenues are our principal source of funds to meet our short-term liquidity requirements. Other sources of funds for short-term liquidity needs include available working capital and borrowings under our existing revolving credit facility, which had \$326.9 million of availability at October 20, 2014. Our short-term liquidity requirements primarily consist of operating expenses, interest and principal amortization on our debt, distributions and capital expenditures, including building improvement costs, tenant improvement costs and lease commissions. Building improvements are capital costs to maintain or enhance existing buildings not typically related to a specific customer. Tenant improvements are the costs required to customize space for the specific needs of customers. We anticipate that our available cash and cash equivalents and cash provided by operating activities, together with cash available from borrowings under our revolving credit facility, will be adequate to meet our short-term liquidity requirements.

Our long-term liquidity uses generally consist of the retirement or refinancing of debt upon maturity (including mortgage debt, our revolving credit facility, term loans and other unsecured debt), funding of existing and new building development or land infrastructure projects and funding acquisitions of buildings and development land. Our expected future capital expenditures for started and/or committed new development projects were approximately \$167 million at September 30, 2014. Additionally, we may, from time to time, retire some or all of our remaining outstanding Preferred Stock and/or unsecured debt securities through redemptions, open market repurchases, privately negotiated acquisitions or otherwise.

We expect to meet our long-term liquidity needs through a combination of:

• cash flow from operating activities;

• bank term loans and borrowings under our revolving credit facility;

the issuance of unsecured debt;

the issuance of secured debt;

the issuance of equity securities by the Company or the Operating Partnership; and

the disposition of non-core assets.

39

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## Table of Contents

### Acquisition and Disposition Activity

During the third quarter of 2014, we acquired an office property in Raleigh, NC encompassing 374,000 rentable square feet for a purchase price of \$83.8 million. We expensed \$0.2 million of acquisition costs (included in general and administrative expenses) related to this acquisition. The assets acquired and liabilities assumed were recorded at fair value as determined by management based on information available at the acquisition date and on current assumptions as to future operations. We have invested or intend to invest an additional \$8.3 million of planned building improvements. As of the closing date, based on the total anticipated investment of \$92.1 million, the capitalization rate for the acquisition of this building, which was 82.1% occupied, is 6.7% using projected GAAP net operating income for 2015. These forward-looking statements are subject to risks and uncertainties. See “Disclosure Regarding Forward-Looking Statements.”

In the normal course of business, we regularly evaluate potential acquisitions. As a result, from time to time, we may have one or more potential acquisitions under consideration that are in varying stages of evaluation, negotiation or due diligence, including potential acquisitions that are subject to non-binding letters of intent or enforceable contracts. Consummation of any transaction is subject to a number of contingencies, including the satisfaction of customary closing conditions. No assurances can be provided that we will acquire any properties in the future. Acquired properties may fail to perform in accordance with our expectations due to lease-up risk, renovation cost risks and other factors. In addition, the renovation and improvement costs we incur in bringing an acquired property up to market standards may exceed our estimates. Acquired properties could change our liquidity position, capital resources and revenues and expenses.

During the third quarter of 2014, we sold:

• five office properties and a land parcel in a single transaction in Raleigh, NC for a sale price of \$58.7 million and recorded a gain on disposition of property of \$11.7 million;

• 11 office properties in Richmond, VA in separate transactions for an aggregate sale price of \$40.7 million and recorded aggregate gains on disposition of property of \$17.6 million;

six office and eight industrial properties in Greensboro, NC for a sale price of \$28.2 million (before closing credits to buyer of \$1.2 million for unfunded tenant improvements and \$0.4 million for free rent) and recorded a gain on disposition of property of \$4.7 million; and

an office property in Greenville, SC for a sale price of \$27.2 million (before closing credits to buyer of \$5.8 million for unfunded building and tenant improvements and \$1.8 million for free rent) and recorded a gain on disposition of property of \$2.2 million.

On October 17, 2014, we sold an industrial property and a land parcel in Atlanta, GA for a sale price of \$11.4 million and expect to record a gain on disposition of property of \$1.7 million.

### Financing Activity

During the first quarter of 2014, we entered into separate sales agreements with each of Merrill Lynch, Pierce, Fenner & Smith Incorporated, Robert W. Baird & Co. Incorporated, BB&T Capital Markets, a division of BB&T Securities, LLC, Capital One Securities, Inc., Comerica Securities, Inc., Jefferies LLC, Mitsubishi UFJ Securities (USA), Inc., Morgan Stanley & Co. LLC, Piper Jaffray & Co., RBC Capital Markets, LLC and Wells Fargo Securities, LLC. During the third quarter of 2014, the Company issued 875,701 shares of Common Stock at an average gross sales price of \$42.44 per share and received net proceeds, after sales commissions, of \$36.6 million. We paid an aggregate

of \$0.6 million in sales commissions to Piper Jaffray & Co. and BB&T Capital Markets during the third quarter of 2014.

Our \$475.0 million unsecured revolving credit facility is scheduled to mature in January 2018 and includes an accordion feature that allows for an additional \$75.0 million of borrowing capacity subject to additional lender commitments. Assuming no defaults have occurred, we have an option to extend the maturity for two additional six month periods. The interest rate at our current credit ratings is LIBOR plus 110 basis points and the annual facility fee is 20 basis points. The interest rate and facility fee are based on the higher of the publicly announced ratings from Moody's Investors Service or Standard & Poor's Ratings Services. We use our revolving credit facility for working capital purposes and for the short-term funding of our development and acquisition activity and, in certain instances, the repayment of other debt. The continued ability to borrow under the revolving credit facility allows us to quickly capitalize on strategic opportunities at short-term interest rates. There was \$150.0 million and \$148.0 million outstanding under our revolving credit facility at September 30, 2014 and October 20, 2014, respectively. At both September 30, 2014 and October 20, 2014, we had \$0.1 million of outstanding letters of credit, which reduces the availability on

Table of Contents

our revolving credit facility. As a result, the unused capacity of our revolving credit facility at September 30, 2014 and October 20, 2014 was \$324.9 million and \$326.9 million, respectively.

During the third quarter of 2014, we prepaid the remaining \$36.9 million balance on a secured mortgage loan with an effective interest rate of 3.34% that was originally scheduled to mature in April 2015.

We regularly evaluate the financial condition of the financial institutions that participate in our credit facilities and as counterparties under interest rate swap agreements using publicly available information. Based on this review, we currently expect these financial institutions to perform their obligations under our existing facilities and swap agreements.

## Covenant Compliance

We are currently in compliance with financial covenants and other requirements with respect to our consolidated debt. Although we expect to remain in compliance with these covenants and ratios for at least the next year, depending upon our future operating performance, property and financing transactions and general economic conditions, we cannot assure you that we will continue to be in compliance.

Our revolving credit facility and bank term loans require us to comply with customary operating covenants and various financial requirements. Upon an event of default on the revolving credit facility, the lenders having at least 51.0% of the total commitments under the revolving credit facility can accelerate all borrowings then outstanding, and we could be prohibited from borrowing any further amounts under our revolving credit facility, which would adversely affect our ability to fund our operations.

As of September 30, 2014, the Operating Partnership has the following unsecured notes outstanding (\$ in thousands):

|                        | Face<br>Amount | Carrying<br>Amount | Stated<br>Interest Rate | Effective<br>Interest Rate |   |
|------------------------|----------------|--------------------|-------------------------|----------------------------|---|
| Notes due March 2017   | \$379,685      | \$379,398          | 5.850                   | % 5.880                    | % |
| Notes due April 2018   | \$200,000      | \$200,000          | 7.500                   | % 7.500                    | % |
| Notes due June 2021    | \$300,000      | \$297,099          | 3.200                   | % 3.363                    | % |
| Notes due January 2023 | \$250,000      | \$247,821          | 3.625                   | % 3.752                    | % |

The indenture that governs these outstanding notes requires us to comply with customary operating covenants and various financial ratios. The trustee or the holders of at least 25.0% in principal amount of either series of bonds can accelerate the principal amount of such series upon written notice of a default that remains uncured after 60 days.

We may not be able to repay, refinance or extend any or all of our debt at maturity or upon any acceleration. If any refinancing is done at higher interest rates, the increased interest expense could adversely affect our cash flow and ability to pay distributions. Any such refinancing could also impose tighter financial ratios and other covenants that restrict our ability to take actions that could otherwise be in our best interest, such as funding new development activity, making opportunistic acquisitions, repurchasing our securities or paying distributions.

## Off Balance Sheet Arrangements

During the second quarter of 2014, our 49.0% interest in Board of Trade Investment Company was redeemed in exchange for \$4.7 million in cash, which was received in the third quarter of 2014.

## Critical Accounting Estimates

There were no changes made by management to the critical accounting policies in the nine months ended September 30, 2014. For a description of our critical accounting estimates, see “Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Estimates” in our 2013 Annual Report on Form 10-K.

#### Non-GAAP Information

The Company believes that FFO, FFO available for common stockholders and FFO available for common stockholders per share are beneficial to management and investors and are important indicators of the performance of any equity REIT. Because these FFO calculations exclude such factors as depreciation, amortization and impairments of real estate assets and gains or losses

Table of Contents

from sales of operating real estate assets, which can vary among owners of identical assets in similar conditions based on historical cost accounting and useful life estimates, they facilitate comparisons of operating performance between periods and between other REITs. Management believes that historical cost accounting for real estate assets in accordance with GAAP implicitly assumes that the value of real estate assets diminishes predictably over time. Since real estate values have historically risen or fallen with market conditions, many industry investors and analysts have considered the presentation of operating results for real estate companies that use historical cost accounting to be insufficient on a stand-alone basis. As a result, management believes that the use of FFO, FFO available for common stockholders and FFO available for common stockholders per share, together with the required GAAP presentations, provides a more complete understanding of the Company's performance relative to its competitors and a more informed and appropriate basis on which to make decisions involving operating, financing and investing activities.

FFO, FFO available for common stockholders and FFO available for common stockholders per share are non-GAAP financial measures and therefore do not represent net income or net income per share as defined by GAAP. Net income and net income per share as defined by GAAP are the most relevant measures in determining the Company's operating performance because these FFO measures include adjustments that investors may deem subjective, such as adding back expenses such as depreciation, amortization and impairments. Furthermore, FFO available for common stockholders per share does not depict the amount that accrues directly to the stockholders' benefit. Accordingly, FFO, FFO available for common stockholders and FFO available for common stockholders per share should never be considered as alternatives to net income, net income available for common stockholders or net income available for common stockholders per share as indicators of the Company's operating performance.

The Company's presentation of FFO is consistent with FFO as defined by the National Association of Real Estate Investment Trusts, which is calculated as follows:

Net income/(loss) computed in accordance with GAAP;

Less net income attributable to noncontrolling interests in consolidated affiliates;

Plus depreciation and amortization of depreciable operating properties;

Less gains, or plus losses, from sales of depreciable operating properties and acquisition of controlling interest in unconsolidated affiliate, plus impairments on depreciable operating properties and excluding items that are classified as extraordinary items under GAAP;

Plus or minus our share of adjustments, including depreciation and amortization of depreciable operating properties, for unconsolidated partnerships and joint ventures (to reflect funds from operations on the same basis); and

Plus or minus adjustments for depreciation and amortization and gains/(losses) on sales of depreciable operating properties, plus impairments on depreciable operating properties, and noncontrolling interests in consolidated affiliates related to discontinued operations.

In calculating FFO, the Company includes net income attributable to noncontrolling interests in the Operating Partnership, which the Company believes is consistent with standard industry practice for REITs that operate through an UPREIT structure. The Company believes that it is important to present FFO on an as-converted basis since all of the Common Units not owned by the Company are redeemable on a one-for-one basis for shares of its Common Stock.



Table of Contents

The following table sets forth the Company's FFO, FFO available for common stockholders and FFO available for common stockholders per share (\$ in thousands, except per share amounts):

|  | Three Months<br>Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|--|--|-----------|------------------------------------|-----------|
|  | 2014                                   | 2013      | 2014                               | 2013      |
| Funds from operations:   |  |           |                                    |           |
| Net income   | \$54,299                               | \$56,068  | \$92,387                           | \$99,407  |
| Net (income) attributable to noncontrolling interests in consolidated affiliates | (291 )                                 | (203 )    | (1,152 )                           | (593 )    |
| Depreciation and amortization of real estate assets                              | 47,612                                 | 46,775    | 144,805                            | 126,337   |
| Impairments of depreciable properties  | —                                      | —         | 588                                | —         |
| (Gains) on disposition of depreciable properties                                 | (36,279 )                              | —         | (36,279 )                          | —         |
| (Gain) on acquisition of controlling interest in unconsolidated affiliate        | —                                      | (7,451 )  | —                                  | (7,451 )  |
| Unconsolidated affiliates:   |  |           |                                    |           |
| Depreciation and amortization of real estate assets                              | 1,085                                  | 1,628     | 3,039                              | 5,735     |
| Impairments of depreciable properties  | —                                      | 3,487     | —                                  | 4,507     |
| Impairment of investment in unconsolidated affiliate                             | —                                      | —         | 1,353                              | —         |
| (Gains) on disposition of depreciable properties                                 | —                                      | —         | (955 )                             | (431 )    |
| Discontinued operations:   |  |           |                                    |           |
| Depreciation and amortization of real estate assets                              | —                                      | 1,451     | —                                  | 5,506     |
| Impairments of depreciable properties  | —                                      | —         | —                                  | 2,194     |
| (Gains) on disposition of depreciable properties                                 | —                                      | (37,946 ) | (384 )                             | (52,353 ) |
| Funds from operations  | 66,426                                 | 63,809    | 203,402                            | 182,858   |
| Dividends on Preferred Stock   | (627 )                                 | (627 )    | (1,881 )                           | (1,881 )  |
| Funds from operations available for common stockholders                          | \$65,799                               | \$63,182  | \$201,521                          | \$180,977 |
| Funds from operations available for common stockholders per share                | \$0.70                                 | \$0.70    | \$2.16                             | \$2.07    |
| Weighted average shares outstanding (1)  | 93,723                                 | 90,769    | 93,358                             | 87,443    |

(1)Includes assumed conversion of all potentially dilutive Common Stock equivalents.

In addition, the Company believes net operating income from continuing operations (“NOI”) and same property NOI are useful supplemental measures of the Company’s property operating performance because such metrics provide a performance measure of the revenues and expenses directly involved in owning real estate assets and a perspective not immediately apparent from net income or FFO. The Company defines NOI as rental and other revenues from continuing operations, less rental property and other expenses from continuing operations. The Company defines cash NOI as NOI less straight-line rent and lease termination fees. Other REITs may use different methodologies to calculate NOI and same property NOI.

As of September 30, 2014, our same property portfolio consisted of 225 in-service office, industrial and retail properties encompassing 24.4 million rentable square feet that were wholly owned during the entirety of the periods presented (from January 1, 2013 to September 30, 2014). As of December 31, 2013, our same property portfolio consisted of 247 in-service office, industrial and retail properties encompassing 24.1 million rentable square feet that were wholly owned during the entirety of the periods presented (from January 1, 2012 to December 31, 2013). The change in our same property portfolio was due to the addition of eight office properties encompassing 1.6 million rentable square feet acquired during 2012 and one newly developed office property encompassing 0.1 million rentable square feet placed in service during 2012. These additions were offset by the removal of 23 office properties and eight industrial properties encompassing 1.4 million rentable square feet that were sold during 2014 in addition to 0.1

million rentable square feet that was transferred to development during 2014.

Rental and other revenues related to properties not in our same property portfolio were \$29.2 million and \$22.3 million for the three months ended September 30, 2014 and 2013, respectively, and \$87.7 million and \$41.7 million for the nine months ended September 30, 2014 and 2013, respectively. Rental property and other expenses related to properties not in our same property portfolio were \$11.9 million and \$9.2 million for the three months ended September 30, 2014 and 2013, respectively, and \$34.6 million and \$17.7 million for the nine months ended September 30, 2014 and 2013, respectively.

Table of Contents

The following table sets forth the Company's NOI and same property NOI:

|   | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|---|-------------------------------------|-----------|------------------------------------|-----------|
|   | 2014                                | 2013      | 2014                               | 2013      |
| Income from continuing operations before disposition of investment properties and activity in unconsolidated affiliates | \$17,813                            | \$12,296  | \$48,932                           | \$37,771  |
| Other income  | (728 )                              | (1,550 )  | (3,555 )                           | (4,786 )  |
| Interest expense  | 22,348                              | 23,672    | 64,923                             | 70,826    |
| General and administrative expenses   | 7,526                               | 8,969     | 26,973                             | 27,948    |
| Impairments of real estate assets   | —                                   | —         | 588                                | —         |
| Depreciation and amortization   | 48,287                              | 47,338    | 146,895                            | 128,050   |
| Net operating income from continuing operations   | 95,246                              | 90,725    | 284,756                            | 259,809   |
| Less – non same property and other net operating income   | (17,317 )                           | (13,104 ) | (53,084 )                          | (23,963 ) |
| Total same property net operating income from continuing operations   | \$77,929                            | \$77,621  | \$231,672                          | \$235,846 |
| Rental and other revenues   | \$152,629                           | \$144,827 | \$453,804                          | \$407,822 |
| Rental property and other expenses  | 57,383                              | 54,102    | 169,048                            | 148,013   |
| Total net operating income from continuing operations   | 95,246                              | 90,725    | 284,756                            | 259,809   |
| Less – non same property and other net operating income   | (17,317 )                           | (13,104 ) | (53,084 )                          | (23,963 ) |
| Total same property net operating income from continuing operations   | \$77,929                            | \$77,621  | \$231,672                          | \$235,846 |
| Total same property net operating income from continuing operations   | \$77,929                            | \$77,621  | \$231,672                          | \$235,846 |
| Less – straight-line rent and lease termination fees  | (3,254 )                            | (2,676 )  | (8,117 )                           | (10,374 ) |
| Same property cash net operating income from continuing operations  | \$74,675                            | \$74,945  | \$223,555                          | \$225,472 |

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For information regarding our market risk as of December 31, 2013, see "Quantitative and Qualitative Disclosures About Market Risk" in our 2013 Annual Report on Form 10-K.

ITEM 4. CONTROLS AND PROCEDURES

SEC rules require us to maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our annual and periodic reports filed with the SEC is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. The Company's CEO and CFO have concluded that the disclosure controls and procedures of the Company and the Operating Partnership were each effective at the end of the period covered by this Quarterly Report.

SEC rules also require us to establish and maintain internal control over financial reporting designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. There were no changes in internal control over financial reporting during the three months ended September 30, 2014 that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. There were also no changes in internal control over financial reporting during the three months ended September 30, 2014 that materially affected, or are reasonably likely to materially affect, the Operating Partnership's internal control over financial reporting.

Table of Contents

## PART II - OTHER INFORMATION

## ITEM 6. EXHIBITS

| Exhibit Number | Description   |
|----------------|---|
| 10.1           | Executive Supplemental Employment Agreement, dated as of September 29, 2014 between the Company and Mark F. Mulhern (filed as part of the Company's Current Report on Form 8-K dated October 1, 2014) |
| 12.1           | Statement re: Computation of Ratios of the Company  |
| 12.2           | Statement re: Computation of Ratios of the Operating Partnership  |
| 31.1           | Certification of CEO Pursuant to Section 302 of the Sarbanes-Oxley Act for the Company  |
| 31.2           | Certification of CFO Pursuant to Section 302 of the Sarbanes-Oxley Act for the Company  |
| 31.3           | Certification of CEO Pursuant to Section 302 of the Sarbanes-Oxley Act for the Operating Partnership  |
| 31.4           | Certification of CFO Pursuant to Section 302 of the Sarbanes-Oxley Act for the Operating Partnership  |
| 32.1           | Certification of CEO Pursuant to Section 906 of the Sarbanes-Oxley Act for the Company  |
| 32.2           | Certification of CFO Pursuant to Section 906 of the Sarbanes-Oxley Act for the Company  |
| 32.3           | Certification of CEO Pursuant to Section 906 of the Sarbanes-Oxley Act for the Operating Partnership  |
| 32.4           | Certification of CFO Pursuant to Section 906 of the Sarbanes-Oxley Act for the Operating Partnership  |
| 101.INS        | XBRL Instance Document  |
| 101.SCH        | XBRL Taxonomy Extension Schema Document   |
| 101.CAL        | XBRL Taxonomy Extension Calculation Linkbase Document   |
| 101.DEF        | XBRL Taxonomy Extension Definition Linkbase Document  |
| 101.LAB        | XBRL Extension Labels Linkbase  |
| 101.PRE        | XBRL Taxonomy Extension Presentation Linkbase Document  |

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, each of the registrants has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Highwoods Properties, Inc.

By: /s/ Mark F. Mulhern  
Mark F. Mulhern  
Senior Vice President and Chief Financial Officer

Highwoods Realty Limited Partnership

By: Highwoods Properties, Inc., its sole general partner

By: /s/ Mark F. Mulhern  
Mark F. Mulhern  
Senior Vice President and Chief Financial Officer

Date: October 28, 2014