

HIGHWOODS PROPERTIES INC  
Form 10-K  
March 01, 2007  
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## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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### FORM 10-K

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**Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the fiscal year ended December 31, 2006

OR

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-13100

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## HIGHWOODS PROPERTIES, INC.

(Exact name of registrant as specified in its charter)

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**Maryland**  
(State or other jurisdiction  
of incorporation or organization)

**3100 Smoketree Court, Suite 600**

**Raleigh, N.C. 27604**

(Address of principal executive offices) (Zip Code)

**919-872-4924**

**56-1871668**  
(I.R.S. Employer

Identification No.)

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(Registrant's telephone number, including area code)

**Securities registered pursuant to Section 12(b) of the Act:**

<b>Title of Each Class</b>	<b>Name of Each Exchange on Which Registered</b>
<b>Common Stock, \$.01 par value</b>	<b>New York Stock Exchange</b>
<b>8 5/8% Series A Cumulative Redeemable Preferred Shares</b>	<b>New York Stock Exchange</b>
<b>8% Series B Cumulative Redeemable Preferred Shares</b>	<b>New York Stock Exchange</b>

**Securities registered pursuant to Section 12(g) of the Act:**

**NONE**

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Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Exchange Act. Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act. Yes  No

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. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Securities Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act). Yes  No

The aggregate market value of shares of the Registrant's Common Stock held by non-affiliates (based upon the closing sale price on the New York Stock Exchange) on June 30, 2006 was approximately \$1.9 billion. As of February 15, 2007, there were 56,237,458 shares of Common Stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's Proxy Statement to be filed in connection with its Annual Meeting of Stockholders to be held May 18, 2007 are incorporated by reference in Part II, Item 5 and Part III, Items 10, 11, 12, 13 and 14 of this Form 10-K.

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**PART I**

We refer to (1) Highwoods Properties, Inc. as the "Company," (2) Highwoods Realty Limited Partnership as the "Operating Partnership," (3) the Company's common stock as "Common Stock," (4) the Company's preferred stock as "Preferred Stock," (5) the Operating Partnership's common partnership interests as "Common Units," (6) the Operating Partnership's preferred partnership interests as "Preferred Units" and (7) in-service properties (excluding rental residential units) to which the Company and/or the Operating Partnership have title and 100.0% ownership rights as the "Wholly Owned Properties."

**ITEM 1. BUSINESS**

**General**

The Company is a fully-integrated, self-administered and self-managed equity real estate investment trust ( REIT ) that began operations through a predecessor in 1978. The Company completed its initial public offering in 1994 and its Common Stock is traded on the New York Stock Exchange ( NYSE ) under the symbol HIW. We are one of the largest owners and operators of suburban office, industrial and retail properties in the southeastern and midwestern United States. At December 31, 2006, we:

wholly owned 322 in-service office, industrial and retail properties, encompassing approximately 26.9 million rentable square feet, and 109 rental residential units;

owned an interest (50.0% or less) in 70 in-service office and industrial properties, encompassing approximately 7.4 million rentable square feet, and 418 rental residential units. Five of these in-service office properties are consolidated at December 31, 2006 as more fully described in Notes 1 and 3 to the Consolidated Financial Statements;

wholly owned 719 acres of undeveloped land, approximately 435 acres of which are considered core holdings and which are suitable to develop approximately 5.3 million rentable square feet of office and industrial space;

were developing or re-developing 16 wholly owned properties comprising approximately 2.7 million square feet and 139 for-sale condominiums that were under construction or were completed but had not achieved 95% stabilized occupancy; and

were developing through 50.0% owned joint ventures (a) an office property of approximately 31,000 square feet that was completed in 2006 but had not achieved 95% stabilized occupancy and (b) a for-rent residential project comprising 332 units in three buildings. The Company conducts substantially all of its activities through the Operating Partnership. Other than 22.4 acres of undeveloped land, 13 rental residential units and the Company's interest in the Kessinger/Hunter, LLC and 4600 Madison Associates, LLC joint ventures (see Note 2 to the Consolidated Financial Statements), all of the Company's assets are owned directly or indirectly by the Operating Partnership. The Company is the sole general partner of the Operating Partnership. At December 31, 2006, the Company owned all of the Preferred Units and 92.2% of the Common Units in the Operating Partnership. Limited partners (including certain officers and directors of the Company) own the remaining Common Units. Each Common Unit is redeemable by the holder for the cash value of one share of Common Stock or, at the Company's option, one share of Common Stock. Preferred Units in the Operating Partnership were issued to the Company in connection with the Company's Preferred Stock offerings that occurred in 1997 and 1998.

The Company was incorporated in Maryland in 1994. The Operating Partnership was formed in North Carolina in 1994. Our executive offices are located at 3100 Smoketree Court, Suite 600, Raleigh, North Carolina 27604 and our telephone number is (919) 872-4924. We maintain offices in each of our primary markets.

Our business is the acquisition, development and operation of rental real estate properties. We operate office, industrial, retail and residential properties. There are no material inter-segment transactions. See Note 17 to the Consolidated Financial Statements for a summary of the rental income, net operating income and assets for each reportable segment.



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In addition to this Annual Report, we file or furnish quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission ( SEC ). All documents that we file or furnish with the SEC are made available as soon as reasonably practicable free of charge on our corporate website, which is <http://www.highwoods.com>. The information on this website is not and should not be considered part of this Annual Report and is not incorporated by reference in this document. This website is only intended to be an inactive textual reference. You may also read and copy any document that we file or furnish at the public reference facilities of the SEC at 100 F. Street, N.E., Room 1580, Washington, D.C. 20549. Please call the SEC at (800) 732-0330 for further information about the public reference facilities. These documents also may be accessed through the SEC's electronic data gathering, analysis and retrieval system ( EDGAR ) via electronic means, including the SEC's home page on the Internet (<http://www.sec.gov>). In addition, since some of our securities are listed on the NYSE, you can read similar information about us at the offices of the NYSE at 20 Broad Street, New York, New York 10005.

During 2006, we filed unqualified Section 303A certifications with the NYSE. We have also filed the CEO and CFO certifications required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002 as exhibits to our 2006 Annual Report.

**Customers**

The following table sets forth information concerning the 20 largest customers of our Wholly Owned Properties (including properties classified as held for sale) as of December 31, 2006:

Customer	Rental Square Feet	Annualized Cash Rental Revenue <sup>(1)</sup> (in thousands)	Percent of Total Annualized Cash Rental Revenue <sup>(1)</sup>	Weighted Average Remaining Lease Term in Years
Federal Government	1,532,005	\$ 26,486	6.79%	8.1
AT&T	672,986	12,701	3.25	2.1
PricewaterhouseCoopers	332,931	8,475	2.17	3.3
State of Georgia	360,683	7,252	1.86	3.2
T-Mobile USA	205,855	5,287	1.36	7.0
Syniverse Technologies, Inc.	198,750	4,581	1.17	9.8
US Airways	293,007	3,995	1.02	0.8
Volvo	278,940	3,974	1.02	3.3
Lockton Companies	151,076	3,713	0.95	8.2
Northern Telecom	246,000	3,651	0.94	1.2
SCI Services, Inc.	162,784	3,499	0.90	10.6
Metropolitan Life Insurance	174,944	3,437	0.88	7.0
BB&T	209,237	3,131	0.80	5.6
Fluor Enterprises, Inc.	147,041	2,658	0.68	4.8
Jacob's Engineering Group, Inc.	181,794	2,535	0.65	9.0
Vanderbilt University	126,617	2,386	0.61	8.8
Lifepoint Corporate Services	122,703	2,351	0.60	4.5
Wachovia	97,792	2,109	0.54	3.3
Icon Clinical Research	101,249	2,066	0.53	6.1
The Martin Agency	118,518	2,038	0.52	10.3
<b>Total <sup>(2)</sup></b>	<b>5,714,912</b>	<b>\$ 106,325</b>	<b>27.24%</b>	<b>5.8</b>

(1) Annualized Cash Rental Revenue is cash rental revenue (base rent plus additional rent based on the level of operating expenses, excluding straight-line rent) for the month of December 2006 multiplied by 12.

(2) Excludes customers that may lease space in joint venture properties that are consolidated but are not Wholly Owned Properties.

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### Operating Strategy

**Efficient, Customer Service-Oriented Organization.** We provide a complete line of real estate services to our customers and third parties. We believe that our in-house development, acquisition, construction management, leasing and property management services allow us to respond to the many demands of our existing and potential customer base. We provide our customers with cost-effective services such as build-to-suit construction and space modification, including tenant improvements and expansions. In addition, the breadth of our capabilities and resources provides us with market information not generally available. We believe that the operating efficiencies achieved through our fully integrated organization also provide a competitive advantage in setting our lease rates and pricing other services.

**Capital Recycling Program.** Our strategy has been to focus our real estate activities in markets where we believe our extensive local knowledge gives us a competitive advantage over other real estate developers and operators. Through our capital recycling program, we generally seek to:

selectively dispose of non-core properties in order to use the net proceeds to improve our balance sheet by reducing outstanding debt and Preferred Stock balances, to make new investments or for other purposes;

engage in the development of office and industrial projects in our existing geographic markets, primarily in suburban in-fill business parks; and

acquire selective suburban office and industrial properties in our existing geographic markets at prices below replacement cost that offer attractive returns.

Our capital recycling activities benefit from our local market presence and knowledge. Because our division officers have significant real estate experience in their respective markets, we believe that we are in a better position to evaluate capital recycling opportunities than many of our competitors. In addition, our relationships with our customers and those tenants at properties for which we conduct third-party fee-based services may lead to development projects when these tenants seek new space.

The following table summarizes the changes in square footage in our in-service Wholly Owned Properties during the past three years:

	2006	2005	2004
	(rentable square feet in thousands)		
<b>Office, Industrial and Retail Properties:</b>			
Dispositions	(2,982)	(4,641)	(1,263)
Contributions to Joint Ventures			(1,270) <sup>(1)</sup>
Developments Placed In-Service <sup>(2)</sup>	33	713	141
Redevelopment/Other	(74)	(133)	(21)
Acquisitions	70		1,357 <sup>(1)</sup>
<b>Net Change of In-Service Wholly Owned Properties</b>	<b>(2,953)</b>	<b>(4,061)</b>	<b>(1,056)</b>

(1) Includes 1,270,000 square feet of properties in Orlando, Florida acquired from MG-HIW, LLC in March 2004 and contributed to HIW-KC Orlando, LLC in June 2004.

(2) We consider a development project to be stabilized upon the earlier of the original projected stabilization date or the date such project is at least 95% occupied.

**Conservative and Flexible Balance Sheet.** We are committed to maintaining a conservative and flexible balance sheet that allows us to capitalize on favorable development and acquisition opportunities as they arise. We expect to meet our short- and long-term liquidity requirements through a combination of any one or more of:

cash flow from operating activities;

borrowings under our credit facilities;

the issuance of unsecured debt;

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the issuance of secured debt;

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

the selective disposition of non-core land and other assets; and

private equity capital raised from unrelated joint venture partners involving the sale or contribution of our Wholly Owned Properties, development projects or development land.

**Geographic Diversification.** We do not believe that our operations are significantly dependent upon any particular geographic market. Today, including our various joint ventures, our portfolio consists primarily of office and industrial properties throughout the Southeast, retail and office properties in Kansas City, Missouri, including one significant mixed retail and office property, and office properties in Des Moines, Iowa.

### **Competition**

Our properties compete for tenants with similar properties located in our markets primarily on the basis of location, rent, services provided and the design and condition of the facilities. We also compete with other REITs, financial institutions, pension funds, partnerships, individual investors and others when attempting to acquire, develop and operate properties.

### **Employees**

As of December 31, 2006, the Company had 476 employees.

## **ITEM 1A. RISK FACTORS**

An investment in our equity and debt securities involves various risks. All investors should carefully consider the following risk factors in conjunction with the other information contained in this Annual Report before trading in our securities. If any of these risks actually occur, our business, operating results, prospects and financial condition could be harmed.

**Our performance is subject to risks associated with real estate investment.** We are a real estate company that derives most of our income from the ownership and operation of our properties. There are a number of factors that may adversely affect the income that our properties generate, including the following:

**Economic Downturns.** Downturns in the national economy, particularly in the Southeast, generally will negatively impact the demand and rental rates for our properties.

**Oversupply of Space.** An oversupply of space in our markets would typically cause rental rates and occupancies to decline, making it more difficult for us to lease space at attractive rental rates.

**Competitive Properties.** If our properties are not as attractive to tenants (in terms of rent, services, condition or location) as properties owned by our competitors, we could lose tenants to those properties or receive lower rental rates.

**Renovation Costs.** In order to maintain the quality of our properties and successfully compete against other properties, we periodically must spend money to maintain, repair and renovate our properties.

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**Customer Risk.** Our performance depends on our ability to collect rent from our customers. Our financial condition could be adversely affected by financial difficulties experienced by a major customer, or by a number of smaller customers, including bankruptcies, insolvencies or general downturns in business.

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**Reletting Costs.** As leases expire, we try to either relet the space to the existing customer or attract a new customer to occupy the space. In either case, we likely will incur significant costs in the process, including potentially substantial tenant improvement expense or lease incentives. In addition, if market rents have declined since the time the expiring lease was executed, the terms of any new lease likely will not be as favorable to us as the terms of the expiring lease, thereby reducing the rental revenue earned from that space.

**Regulatory Costs.** There are a number of government regulations, including zoning, tax and accessibility laws, that apply to the ownership and operation of our properties. Compliance with existing and newly adopted regulations may require us to incur significant costs on our properties.

**Rising Operating Costs.** Costs of operating our properties, such as real estate taxes, utilities, insurance, maintenance and other costs, can rise faster than our ability to increase rental income. While we do receive some additional rent from our tenants that is based on recovering a portion of operating expenses, generally increased operating expenses will negatively impact our net operating income. Our revenues and expense recoveries are subject to longer term leases and may not be quickly increased sufficient to recover an increase in operating costs and expenses.

**Fixed Nature of Costs.** Most of the costs associated with owning and operating a property are not necessarily reduced when circumstances such as market factors and competition cause a reduction in rental revenues from the property. Increases in such fixed operating expenses, such as increased real estate taxes or insurance costs, would reduce our net income.

**Environmental Problems.** Federal, state and local laws and regulations relating to the protection of the environment may require a current or previous owner or operator of real property to investigate and clean up hazardous or toxic substances or petroleum product releases at the property. The clean up can be costly. The presence of or failure to clean up contamination may adversely affect our ability to sell or lease a property or to borrow funds using a property as collateral.

**Competition.** A number of other major real estate investors with significant capital compete with us. These competitors include publicly-traded REITs, private REITs, private real estate investors and private institutional investment funds.

**Future acquisitions and development properties may fail to perform in accordance with our expectations and may require renovation and development costs exceeding our estimates.** In the normal course of business, we typically evaluate potential acquisitions, enter into non-binding letters of intent, and may, at any time, enter into contracts to acquire additional properties. Our acquisition investments 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. We may not have the financial resources to make suitable acquisitions or renovations on favorable terms or at all.

In addition to acquisitions, we periodically consider developing and constructing properties. Risks associated with development and construction activities include:

the unavailability of favorable financing;

construction costs exceeding original estimates;

construction and lease-up delays resulting in increased debt service expense and construction costs; and

lower than anticipated occupancy rates and rents at a newly completed property causing a property to be unprofitable.



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If new developments are financed through construction loans, there is a risk that, upon completion of construction, permanent financing for newly developed properties will not be available or will be available only on disadvantageous terms. Development activities are also subject to risks relating to our ability to obtain, or delays in obtaining, all necessary zoning, land-use, building, occupancy and other required governmental and utility company authorizations.

**Illiquidity of real estate investments and the tax effect of dispositions could significantly impede our ability to sell assets or to respond to favorable or adverse changes in the performance of our properties.** Because real estate investments are relatively illiquid, our ability to promptly sell one or more properties in our portfolio in response to changing economic, financial and investment conditions is limited. In addition, we have a significant amount of mortgage debt under which we could incur significant prepayment penalties if such loans were paid off in connection with the sale of the underlying real estate assets. Such loans, even if assumed by a buyer rather than being paid off, could reduce the sale proceeds we receive if we sold such assets.

We intend to continue to sell some of our properties in the future. However, we cannot predict whether we will be able to sell any property for the price or on the terms set by us, or whether the price or other terms offered by a prospective purchaser would be acceptable to us. We also cannot predict the length of time needed to find a willing purchaser and to close the sale of a property.

Certain of our properties have low tax bases relative to their fair value, and accordingly, the sale of such assets would generate significant taxable gains unless we sold such properties in a tax-free exchange under Section 1031 of the Internal Revenue Code or another tax-free or tax-deferred transaction. For an exchange to qualify for tax-deferred treatment under Section 1031, the net proceeds from the sale of a property must be held by an escrow agent until applied toward the purchase of real estate qualifying for gain deferral. Given the competition for properties meeting our investment criteria, there could be a delay in reinvesting such proceeds. Any delay in using the reinvestment proceeds to acquire additional income producing assets would reduce our income from operations.

In addition, the sale of certain properties acquired in the J.C. Nichols Company merger in July 1998, including assets acquired in connection with Section 1031 exchanges with properties originally acquired in the J.C. Nichols Company merger, would require us to pay corporate-level tax under Section 1374 of the Internal Revenue Code on the built-in gain relating to such properties unless we sold such properties in a tax-free exchange under Section 1031 of the Internal Revenue Code or another tax-free or tax-deferred transaction. This tax will no longer apply after July 2008 because we will have owned the assets for 10 years or more. As a result, we may choose not to sell these properties even if management determines that such a sale would otherwise be in the best interests of our stockholders. We have no current plans to dispose of any properties in a manner that would require us to pay corporate-level tax under Section 1374. However, we would consider doing so if our management determines that a sale of a property would be in our best interests based on consideration of a number of factors, including the price being offered for the property, the operating performance of the property, the tax consequences of the sale and other factors and circumstances surrounding the proposed sale.

**Because holders of our Common Units, including some of our officers and directors, may suffer adverse tax consequences upon the sale of some of our properties, it is possible that we may sometimes make decisions that are not in your best interest.** Holders of Common Units may suffer adverse tax consequences upon our sale of certain properties. Therefore, holders of Common Units, including certain of our officers and directors, may have different objectives than our stockholders regarding the appropriate pricing and timing of a property's sale. Although we are the sole general partner of the Operating Partnership and have the exclusive authority to sell all of our individual Wholly Owned Properties, officers and directors who hold Common Units may seek to influence us not to sell certain properties even if such sale might be financially advantageous to stockholders or influence us to enter into tax deferred exchanges with the proceeds of such sales when such a reinvestment might not otherwise be in our best interests.

**The success of our joint venture activity depends upon our ability to work effectively with financially sound partners.** Instead of owning properties directly, we have in some cases invested, and may continue to invest, as a partner or a co-venturer with one or more third parties. Under certain circumstances, this type of investment may involve risks not otherwise present, including the possibility that a partner or co-venturer might become bankrupt or that a partner or co-venturer might have business interests or goals inconsistent with ours. Also, such a partner or co-venturer may take action contrary to our instructions or requests or contrary to provisions in our joint venture agreements that could harm us.

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**Our insurance coverage on our properties may be inadequate.** We carry comprehensive insurance on all of our properties, including insurance for liability, fire, windstorms, flood and business interruption. Insurance companies, however, limit coverage against certain types of losses, such as losses due to terrorist acts, named windstorms and toxic mold. Thus, we may not have insurance coverage, or sufficient insurance coverage, against certain types of losses and/or there may be decreases in the insurance coverage available. Should an uninsured loss or a loss in excess of our insured limits occur, we could lose all or a portion of the capital we have invested in a property or properties, as well as the anticipated future revenue from the property or properties. If any of our properties were to experience a catastrophic loss, it could disrupt our operations, delay revenue and result in large expenses to repair or rebuild the property. Such events could adversely affect our financial condition. Our existing property, casualty and liability insurance policies are scheduled to expire on June 30, 2007.

**Our use of debt to finance our operations could have a material adverse effect on our cash flow and ability to make distributions.** We are subject to risks normally associated with debt financing, such as the sufficiency of cash flow to meet required payment obligations, difficulty in complying with financial ratios and other covenants and the ability to refinance existing indebtedness. Increases in interest rates on our variable rate debt would increase our interest expense. If we fail to comply with the financial ratios and other covenants under our credit facilities, we would likely not be able to borrow any further amounts under such facilities, which could adversely affect our ability to fund our operations, and our lenders could accelerate outstanding debt.

We generally do not intend to reserve funds to retire existing secured or unsecured debt upon maturity. 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 dividends to stockholders. 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 stockholders' best interest, such as funding new development activity, making opportunistic acquisitions, repurchasing our securities or paying distributions. If we do not meet our mortgage financing obligations, any properties securing such indebtedness could be foreclosed on, which would have a material adverse effect on our cash flow and ability to make distributions.

**We may be subject to taxation as a regular corporation if we fail to maintain our REIT status.** Our failure to qualify as a REIT for income tax purposes would have serious adverse consequences to our stockholders. Many of the requirements for taxation as a REIT are highly technical and complex and depend upon various factual matters and circumstances that may not be entirely within our control. For example, to qualify as a REIT, at least 95.0% of our gross income must come from certain sources that are itemized in the REIT tax laws. We are also required to distribute to stockholders at least 90.0% of our REIT taxable income, excluding capital gains. The fact that we hold substantially all of our assets through the Operating Partnership and its subsidiaries further complicates the application of the REIT requirements. Even a technical or inadvertent mistake could jeopardize our REIT status. Furthermore, Congress and the Internal Revenue Service ( IRS ) might change the tax laws and regulations and the courts might issue new rulings that make it more difficult, or impossible, for us to remain qualified as a REIT. If we fail to qualify as a REIT, we would be subject to federal income tax at regular corporate rates. Also, unless the IRS granted us relief under certain statutory provisions, we would remain disqualified as a REIT for four years following the year we first failed to qualify. If we failed to qualify as a REIT, we would have to pay significant income taxes and would, therefore, have less cash available for investments or to pay dividends to stockholders. This would likely have a significant adverse effect on the value of our securities. In addition, if we lost our REIT status, we would no longer be required to pay dividends to stockholders.

**Because provisions contained in Maryland law, our charter and our bylaws may have an anti-takeover effect, investors may be prevented from receiving a control premium for their shares.** Provisions contained in our charter and bylaws as well as Maryland general corporation law may have anti-takeover effects that delay, defer or prevent a takeover attempt, and thereby prevent stockholders from receiving a control premium for their shares. For example, these provisions may defer or prevent tender offers for our Common Stock or purchases of large blocks of our Common Stock, thus limiting the opportunities for our stockholders to receive a premium for their Common Stock over then-prevailing market prices. These provisions include the following:

**Ownership limit.** Our charter prohibits direct, indirect or constructive ownership by any person or entity of more than 9.8% of our outstanding capital stock. Any attempt to own or transfer shares of our capital stock in excess of the ownership limit without the consent of our Board of Directors will be void.

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**Preferred Stock.** Our charter authorizes our Board of Directors to issue Preferred Stock in one or more classes and to establish the preferences and rights of any class of Preferred Stock issued. These actions can be taken without stockholder approval. The issuance of Preferred Stock could have the effect of delaying or preventing someone from taking control of us, even if a change in control were in our stockholders' best interest.

**Staggered board.** Our Board of Directors is divided into three classes. As a result, each director generally serves for a three-year term. This staggering of our Board may discourage offers for us or make an acquisition of us more difficult, even when an acquisition is in the best interest of our stockholders.

**Maryland control share acquisition statute.** Maryland's control share acquisition statute applies to us, which means that persons, entities or related groups that acquire more than 20% of our Common Stock may not be able to vote such excess shares under certain circumstances if such shares were acquired in one or more transactions not approved by at least two-thirds of our outstanding Common Stock held by disinterested stockholders.

**Maryland unsolicited takeover statute.** Under Maryland law, our Board of Directors could adopt various anti-takeover provisions without the consent of stockholders. The adoption of such measures could discourage offers for us or make an acquisition of us more difficult, even when an acquisition is in the best interest of our stockholders.

**Anti-takeover protections of Operating Partnership agreement.** Upon a change in control of the Company, the limited partnership agreement of the Operating Partnership requires certain acquirers to maintain an umbrella partnership real estate investment trust ( UPREIT ) structure with terms at least as favorable to the limited partners as are currently in place. For instance, the acquirer would be required to preserve the limited partner's right to continue to hold tax-deferred partnership interests that are redeemable for capital stock of the acquirer. Some change of control transactions involving the Company could require the approval of two-thirds of the limited partners of the Operating Partnership (other than the Company). These provisions may make a change of control transaction involving the Company more complicated and therefore might decrease the likelihood of such a transaction occurring, even if such a transaction would be in the best interest of the Company's stockholders.

**Dilutive effect of stockholder rights plan.** We have a stockholder rights plan, which is currently scheduled to expire on October 6, 2007, pursuant to which our existing stockholders would have the ability to acquire additional Common Stock at a significant discount in the event a person or group attempts to acquire us on terms that our Board of Directors does not approve. These rights are designed to deter a hostile takeover by increasing the takeover cost. As a result, such rights could discourage offers for us or make an acquisition of us more difficult, even when an acquisition is in the best interest of our stockholders. The rights plan should not interfere with any merger or other business combination the Board of Directors approves since we may generally terminate the plan at any time at nominal cost.

**Material weaknesses in our internal control over financial reporting could directly or indirectly cause a material misstatement of our financial statements. Additionally, no assurance can be provided that we will be able to prevent or detect material misstatements to our financial statements in the future.** Material weaknesses in our internal control over financial reporting could cause a material misstatement of our financial statements. Our internal control over financial reporting was not effective at December 31, 2006. For a description of the material weaknesses that existed as of such date, see Item 9A. Controls and Procedures. Although we have taken various measures to improve our internal control over financial reporting, we have not yet completed all of our planned remediation activities. As a result, no assurance can be provided that we will be able to prevent or detect material misstatements to our financial statements in the future. Furthermore, because of the material weaknesses that have existed in our internal control over financial reporting, we cannot assure you that our disclosure controls and procedures are currently effective.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.





**Table of Contents****ITEM 2. PROPERTIES****Wholly Owned Properties**

As of December 31, 2006, we owned all of the ownership interests in 322 in-service office, industrial and retail properties, encompassing approximately 26.9 million rentable square feet, and 109 rental residential units, including 0.3 million rentable square feet with a net book value of \$19.8 million that was classified as held for sale. The following table sets forth information about our Wholly Owned Properties (including properties classified as held for sale) and our development properties as of December 31, 2006 and 2005:

	December 31, 2006		December 31, 2005	
	Rentable Square Feet	Percent Leased/ Pre-Leased	Rentable Square Feet	Percent Leased/ Pre-Leased
<b>In-Service:</b>				
Office <sup>(1)</sup>	19,244,000	89.0%	21,412,000	87.5%
Industrial	6,281,000	91.7	6,977,000	92.4
Retail <sup>(2)</sup>	1,327,000	95.7	1,416,000	97.5
<b>Total or Weighted Average</b>	<b>26,852,000<sup>(3)</sup></b>	<b>90.0%</b>	<b>29,805,000<sup>(3)</sup></b>	<b>89.1%</b>
<b>Development:</b>				
<b>Completed Not Stabilized<sup>(4)</sup></b>				
Office <sup>(1)</sup>	504,000	62.8%		
Industrial	418,000	44.0		
Retail			9,600	87.0%
<b>Total or Weighted Average</b>	<b>922,000</b>	<b>54.3%</b>	<b>9,600</b>	<b>87.0%</b>
<b>In Process <sup>(5)</sup></b>				
Office <sup>(1)</sup>	1,357,000	55.3%	533,000	37.2%
Industrial	383,000			
Retail				
For Sale Residential <sup>(6)</sup>	139 units			
<b>Total or Weighted Average <sup>(3)</sup></b>	<b>1,740,000</b>	<b>43.1%</b>	<b>533,000</b>	<b>37.2%</b>
<b>Total:</b>				
Office <sup>(1)</sup>	21,105,000		21,945,000	
Industrial	7,082,000		6,977,000	
Retail <sup>(2)</sup>	1,327,000		1,425,600	
<b>Total or Weighted Average <sup>(3) (5) (7)</sup></b>	<b>29,514,000</b>		<b>30,347,600</b>	

(1) Substantially all of our office properties are located in suburban markets.

(2) Excludes 430,000 square feet of basement space in the Country Club Plaza and other Kansas City retail properties.

(3) Rentable square feet excludes the 109 residential units.

(4) We consider a development project to be stabilized upon the earlier of the original projected stabilization date or the date such project is at least 95% occupied.

(5)

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December 31, 2005 excludes a 156-unit multi-family residential property under development that was 50.0% owned and which was consolidated (see Notes 1, 2 and 4 to the Consolidated Financial Statements). This development commenced in late 2004 and was sold in late 2006.

- (6) In January 2007, we executed a joint venture agreement for this development. We now have a 93% interest and will consolidate this joint venture. There are currently 309 reservations for the 139 units. Reservations are fully refundable until mid 2007 at which time binding sales contracts will be accepted and non-refundable deposits will be retained. Residential units and reservation numbers are not part of the In-Process total or weighted average for square feet and pre-leasing percentage.
- (7) Excludes the following joint venture properties that are consolidated but are not Wholly Owned Properties: (1) one office property that was sold to SF-HIW Harborview Plaza, LP, a 20% owned joint venture, but which is accounted for as a financing under SFAS No. 66 and thus remains consolidated as described in Note 3 to the Consolidated Financial Statements, and (2) four office properties owned by Highwoods-Markel Associates, LLC, a 50% owned joint venture, which is consolidated beginning January 1, 2006, as described in Notes 1 and 2 to the Consolidated Financial Statements.

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The following table sets forth geographic information about our in service Wholly Owned properties (including properties classified as held for sale) at December 31, 2006

Market	Rentable Square Feet	Occupancy	Percentage of Annualized Cash Rental Revenue <sup>(1)</sup>			
			Office	Industrial	Retail	Total
Raleigh, NC <sup>(2)</sup>	3,810,000	86.1%	14.6%			14.6%
Atlanta, GA	5,515,000	94.0	10.3	4.0%		14.3
Kansas City, MO	2,225,000 <sup>(3)</sup>	90.1	4.3		9.7%	14.0
Tampa, FL	2,332,000	97.7	13.2			13.2
Nashville, TN	2,876,000	91.6	13.0			13.0
Piedmont Triad, NC <sup>(4)</sup>	5,195,000	88.7	7.0	3.7		10.7
Richmond, VA	2,024,000	89.8	8.9			8.9
Memphis, TN	1,197,000	91.8	5.6			5.6
Greenville, SC	1,108,000	75.3	3.4	0.1		3.5
Orlando, FL	218,000	100.0	1.2			1.2
Columbia, SC	252,000	48.7	0.5			0.5
Other	100,000	73.6	0.5			0.5
<b>Total <sup>(5)</sup></b>	<b>26,852,000</b>	<b>90.0%</b>	<b>82.5%</b>	<b>7.8%</b>	<b>9.7%</b>	<b>100.0%</b>

(1) Annualized Cash Rental Revenue is cash rental revenue (base rent plus additional rent based on the level of operating expenses, excluding straight-line rent) for the month of December 2006 multiplied by 12.

(2) The Raleigh market encompasses the Raleigh, Durham, Cary and Research Triangle metropolitan area.

(3) Excludes 430,000 square feet of basement space in the Country Club Plaza and other Kansas City retail properties.

(4) The Piedmont Triad market encompasses the Greensboro and Winston-Salem metropolitan area.

(5) Excludes the following joint venture properties that are consolidated but are not Wholly Owned Properties: (1) one office property that was sold to SF-HIW Harborview Plaza, LP, a 20% owned joint venture, but which is accounted for as a financing under SFAS No. 66 and thus remains consolidated as described in Note 3 to the Consolidated Financial Statements, and (2) four office properties owned by Highwoods-Markel Associates, LLC, a 50% owned joint venture, which is consolidated beginning January 1, 2006, as described in Notes 1 and 2 to the Consolidated Financial Statements.

**Development Land**

We wholly owned 719 acres of development land as of December 31, 2006. We estimate that we can develop approximately 5.3 million square feet of office and industrial space on the approximately 435 acres that we consider core long term holdings for our future development needs. Our development land is zoned and available for office and industrial development, and nearly all of the land has utility infrastructure in place. We believe that our commercially zoned and unencumbered land in existing business parks gives us a development advantage over other commercial real estate development companies in many of our markets. Any future development, however, is dependent on the demand for office and industrial space in the area, the availability of favorable financing and other factors, and no assurance can be given that any construction will take place on the development land. In addition, if construction is undertaken on the development land, we will be subject to the risks associated with construction activities, including the risks that occupancy rates and rents at a newly completed property may not be sufficient to make the property profitable, construction costs may exceed original estimates and construction and lease-up may not be completed on schedule, resulting in increased debt service expense and construction expense. We may also develop properties other than office and industrial on certain parcels with unrelated joint venture partners. We consider approximately 284 acres of our development land at December 31, 2006 to be non-core assets because this land is not necessary for our foreseeable future development needs. We are actively working to dispose of such non-core development land through sales to other parties or contributions to joint ventures. Approximately 108 acres with a net book value of \$14.4 million are under contract to be sold and are included in Real estate and other assets, net, held for sale in our Consolidated Balance Sheet at December 31, 2006.

**Table of Contents****Other Properties**

As of December 31, 2006, we owned an interest (50.0% or less) in 70 in-service properties. These properties include primarily office and industrial buildings encompassing approximately 7.4 million rentable square feet and 418 rental residential units. The following table sets forth information about the stabilized in-service joint venture properties by segment and by geographic location at December 31, 2006:

Market	Rentable Square Feet	Occupancy	Percentage of Annualized Cash Rental Revenue (1)				Total
			Office	Industrial	Retail	Multi-Family	
Des Moines, Iowa	2,475,000 <sup>(2)</sup>	93.6% <sup>(3)</sup>	28.4%	4.2%	1.0%	3.4%	37.0%
Orlando, Florida	1,686,000	94.7	27.2				27.2
Atlanta, Georgia	835,000	95.0	11.4				11.4
Kansas City, Missouri	721,000	82.2	8.8				8.8
Richmond, Virginia <sup>(4)</sup>	413,000	100.0	5.0				5.0
Raleigh, North Carolina <sup>(5)</sup>	455,000	99.6	3.7				3.7
Piedmont Triad, North Carolina <sup>(6)</sup>	364,000	100.0	3.6				3.6
Tampa, Florida <sup>(7)</sup>	205,000	100.0	2.0				2.0
Charlotte, North Carolina	148,000	100.0	0.8				0.8
Other	110,000	100.0	0.5				0.5
<b>Total</b>	<b>7,412,000</b>	<b>94.3%</b>	<b>91.4%</b>	<b>4.2%</b>	<b>1.0%</b>	<b>3.4%</b>	<b>100.0%</b>

- (1) Annualized Cash Rental Revenue is cash rental revenue (base rent plus additional rent based on the level of operating expenses, excluding straight-line rent) for the month of December 2006 multiplied by 12.
- (2) Excludes 418 residential units.
- (3) Excludes residential occupancy percentage of 95.9%.
- (4) We own a 50.0% interest in this joint venture (Highwoods-Markel Associates, LLC) which is consolidated (see Notes 1 and 2 to the Consolidated Financial Statements).
- (5) The Raleigh market encompasses the Raleigh, Durham, Cary and Research Triangle metropolitan area.
- (6) The Piedmont Triad market encompasses the Greensboro and Winston-Salem metropolitan area.
- (7) We own a 20.0% interest in this joint venture (SF-HIW Harborview Plaza, LP) which is consolidated (see Notes 1 and 3 to the Consolidated Financial Statements).

In addition to the properties described above, as of December 31, 2006, two joint ventures in which we hold 50.0% interests were developing a 332-unit residential property and had developed a 31,000 square foot office building that was completed but had not yet achieved stabilized occupancy. The following table sets forth information about these properties at December 31, 2006 (\$ in thousands):

Property	% Ownership	Market	Rentable Square Feet	Anticipated Total Investment	Investment at 12/31/2006	Pre-leasing	Actual or Estimated Completion Date	Estimated Stabilization Date
Brickstone	50.0%	Des Moines	31,000	\$ 5,149	\$ 4,343	35%	4Q06	4Q07
Weston Lakeside	50.0%	Raleigh	332 units	33,200	31,104	43%	1Q07(1)	1Q08
<b>Total</b>			<b>31,000</b>	<b>\$ 38,349</b>	<b>\$ 35,447</b>			

- (1) Estimated Completion Date is the date the last unit is expected to be delivered; currently there are 136 units leased. In 2006, the Weston Lakeside joint venture entered into a contract to sell to a third party all of the assets, which sale occurred in February 2007, as described in more detail in Note 2 to the Consolidated Financial Statements.



**Table of Contents****Lease Expirations**

The following tables set forth scheduled lease expirations for existing leases at our Wholly Owned Properties (including properties classified as held for sale but excluding residential units) as of December 31, 2006. The tables include (1) expirations of leases in properties that are completed but not yet stabilized and (2) the effects of any early renewals exercised by tenants as of December 31, 2006.

**Office Properties <sup>(1)</sup>:**

Lease Expiring	Rentable Square Feet Subject to Expiring Leases	Percentage of Leased Square Footage Represented by Expiring Leases	Annualized Cash Rental Revenue Under Expiring Leases <sup>(2)</sup> (\$ in thousands)	Average Annual Rental Rate Per Square Foot for Expirations	Percent of Annualized Cash Rental Revenue Represented by Expiring Leases <sup>(2)</sup>
2007 <sup>(3)</sup>	1,554,029	9.0%	\$ 28,027	\$ 18.04	8.7%
2008	2,145,074	12.4	39,793	18.55	12.4
2009	2,799,327	16.1	53,375	19.07	16.5
2010	2,323,591	13.4	46,889	20.18	14.6
2011	2,804,723	16.2	51,220	18.26	15.9
2012	1,731,147	10.0	30,337	17.52	9.4
2013	838,925	4.8	15,145	18.05	4.7
2014	550,008	3.2	10,668	19.40	3.3
2015	667,412	3.8	13,427	20.12	4.2
2016	729,111	4.2	13,882	19.04	4.3
Thereafter	1,198,962	6.9	19,253	16.06	6.0
	<b>17,342,309</b>	<b>100.0%</b>	<b>\$ 322,016</b>	<b>\$ 18.57</b>	<b>100.0%</b>

**Industrial Properties:**

Lease Expiring	Rentable Square Feet Subject to Expiring Leases	Percentage of Leased Square Footage Represented by Expiring Leases	Annualized Cash Rental Revenue Under Expiring Leases <sup>(2)</sup> (\$ in thousands)	Average Annual Rental Rate Per Square Foot for Expirations	Percent of Annualized Cash Rental Revenue Represented by Expiring Leases <sup>(2)</sup>
2007 <sup>(4)</sup>	1,011,155	17.0%	\$ 5,807	\$ 5.74	19.1%
2008	1,214,386	20.3	5,589	4.60	18.3
2009	961,855	16.2	5,226	5.43	17.1
2010	558,583	9.4	3,004	5.38	9.8
2011	639,024	10.8	3,123	4.89	10.2
2012	257,895	4.3	1,287	4.99	4.2
2013	166,289	2.8	1,032	6.21	3.4
2014	212,965	3.6	1,151	5.40	3.8
2015	169,882	2.9	695	4.09	2.3
2016	264,597	4.5	883	3.34	2.9
Thereafter	486,150	8.2	2,724	5.60	8.9
	<b>5,942,781</b>	<b>100.0%</b>	<b>\$ 30,521</b>	<b>\$ 5.14</b>	<b>100.0%</b>

- 
- (1) Excludes the following joint venture properties that are consolidated but are not Wholly Owned Properties: (1) one office property that was sold to SF-HIW Harborview Plaza, LP, a 20% owned joint venture, but which is accounted for as a financing under SFAS No. 66 and thus remains consolidated as described in Note 3 to the Consolidated Financial Statements and (2) four office properties owned by Highwoods-Markel Associates, LLC, a 50% owned joint venture, which is consolidated beginning January 1, 2006, as described in Notes 1 and 2 to the Consolidated Financial Statements.
  - (2) Annualized Cash Rental Revenue is cash rental revenue (base rent plus additional rent based on the level of operating expenses, excluding straight-line rent) for the month of December 2006 multiplied by 12.
  - (3) Includes 68,000 square feet of leases that are on a month-to-month basis, which represent 0.2% of total annualized cash rental revenue.
  - (4) Includes 86,000 square feet of leases that are on a month-to-month basis, which represent 0.1% of total annualized cash rental revenue.

**Table of Contents****Retail Properties:**

Lease Expiring	Rentable Square Feet Subject to Expiring Leases	Percentage of Leased Square Footage Represented by Expiring Leases	Annualized Cash Rental Revenue Under Expiring Leases <sup>(1)</sup> (\$ in thousands)	Average Annual Rental Rate Per Square Foot for Expirations	Percent of Annualized Cash Rental Revenue Represented by Expiring Leases <sup>(1)</sup>
2007 <sup>(2)</sup>	65,255	5.1%	\$ 1,771	\$ 27.14	4.7%
2008	126,550	10.0	3,658	28.91	9.7
2009	142,868	11.3	4,032	28.22	10.7
2010	98,944	7.8	3,438	34.75	9.1
2011	71,009	5.6	2,075	29.22	5.5
2012	143,793	11.3	4,322	30.06	11.5
2013	55,903	4.4	2,174	38.89	5.8
2014	86,274	6.8	1,673	19.39	4.4
2015	130,127	10.2	4,232	32.52	11.2
2016	67,224	5.3	2,639	39.26	7.0
Thereafter	281,837	22.2	7,653	27.15	20.4
	<b>1,269,784</b>	<b>100.0%</b>	<b>\$ 37,667</b>	<b>\$ 29.66</b>	<b>100.0%</b>

**Total <sup>(3)</sup>:**

Lease Expiring	Rentable Square Feet Subject to Expiring Leases	Percentage of Leased Square Footage Represented by Expiring Leases	Annualized Cash Rental Revenue Under Expiring Leases <sup>(1)</sup> (\$ in thousands)	Average Annual Rental Rate Per Square Foot for Expirations	Percent of Annualized Cash Rental Revenue Represented by Expiring Leases <sup>(1)</sup>
2007 <sup>(4)</sup>	2,630,439	10.7%	\$ 35,605	\$ 13.54	9.1%
2008	3,486,010	14.2	49,040	14.07	12.6
2009	3,904,050	16.0	62,633	16.04	16.0
2010	2,981,118	12.1	53,331	17.89	13.7
2011	3,514,756	14.3	56,418	16.05	14.4
2012	2,132,835	8.7	35,946	16.85	9.2
2013	1,061,117	4.3	18,351	17.29	4.7
2014	849,247	3.5	13,492	15.89	3.5
2015	967,421	3.9	18,354	18.97	4.7
2016	1,060,932	4.3	17,404	16.40	4.5
Thereafter	1,966,949	8.0	29,630	15.06	7.6
	<b>24,554,874</b>	<b>100.0%</b>	<b>\$ 390,204</b>	<b>\$ 15.89</b>	<b>100.0%</b>

(1) Annualized Cash Rental Revenue is cash rental revenue (base rent plus additional rent based on the level of operating expenses, excluding straight-line rent) for the month of December 2006 multiplied by 12.

(2) Includes 3,000 square feet of leases that are on a month-to-month basis or less than 0.1% of total annualized cash rental revenue.

(3)



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Excludes the following joint venture properties that are consolidated but are not Wholly Owned Properties: (1) one office property that was sold to SF-HIW Harborview Plaza, LP, a 20% owned joint venture, but which is accounted for as a financing under SFAS No. 66 and thus remains consolidated as described in Note 3 to the Consolidated Financial Statements and (2) four office properties owned by Highwoods-Markel Associates, LLC, a 50% owned joint venture, which is consolidated beginning January 1, 2006, as described in Notes 1 and 2 to the Consolidated Financial Statements.

- (4) Includes 157,000 square feet of leases that are on a month-to-month basis, which represent 0.3% of total annualized cash rental revenue.

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**ITEM 3. LEGAL PROCEEDINGS**

We are from time to time a party to a variety of legal proceedings, claims and assessments arising in the ordinary course of our business. We regularly assess the liabilities and contingencies in connection with these matters based on the latest information available. For those matters where it is probable that we have incurred or will incur a loss and the loss or range of loss can be reasonably estimated, reserves are recorded in the Consolidated Financial Statements. In other instances, because of the uncertainties related to both the probable outcome and amount or range of loss, a reasonable estimate of liability, if any, cannot be made. Based on the current expected outcome of such matters, none of these proceedings, claims or assessments is expected to have a material adverse effect on our business, financial condition and results of operations.

In June, August, September and October 2006, we received assessments for state excise taxes and related interest amounting to approximately \$4.5 million, related to periods 2002 through 2004. We believe that we are not subject to such taxes and have vigorously disputed the assessment. Based on the advice of counsel concerning the status of settlement discussions and on our own analysis, we currently believe it is probable that all excise tax assessments, including potential assessments for 2005 and 2006, can be settled by the payment of franchise taxes of approximately \$0.5 million, and in the fourth quarter of 2006 such amount was accrued and charged to operating expenses. Legal fees related to this matter were nominal and were charged to operating expenses as incurred in 2006.

As previously disclosed, the SEC's Division of Enforcement issued a confidential formal order of investigation in connection with the Company's previous restatement of its financial results. In November 2006, the Company was informed that the SEC's Division of Enforcement had closed its investigation and was not taking any action with respect to this matter.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

**Table of Contents****ITEM X. EXECUTIVE OFFICERS OF THE REGISTRANT**

The following table sets forth information with respect to our executive officers:

<b>Name</b>	<b>Age</b>	<b>Position and Background</b>
Edward J. Fritsch	48	<p>Director, President and Chief Executive Officer.</p> <p>Mr. Fritsch became our chief executive officer and chair of the investment committee of our board of directors on July 1, 2004 and our president in December 2003. Prior to that, Mr. Fritsch was our chief operating officer from January 1998 to July 2004 and was a vice president and secretary from June 1994 to January 1998. Mr. Fritsch joined our predecessor in 1982 and was a partner of that entity at the time of our initial public offering in June 1994. Mr. Fritsch serves on the University of North Carolina's Board of Visitors, the Board of Trustees of St. Timothy's Episcopal School and the Board of Directors of the YMCA of the Triangle.</p>
Michael E. Harris	57	<p>Executive Vice President and Chief Operating Officer.</p> <p>Mr. Harris became chief operating officer in July 2004. Prior to that, Mr. Harris was a senior vice president and was responsible for our operations in Memphis, Nashville, Kansas City and Charlotte. Mr. Harris was executive vice president of Crocker Realty Trust prior to its merger with us in 1996. Before joining Crocker Realty Trust, Mr. Harris served as senior vice president, general counsel and chief financial officer of Towermarc Corporation, a privately owned real estate development firm. Mr. Harris is a member of the Advisory Board of Directors of SouthTrust Bank of Memphis and Allen &amp; Hoshall, Inc.</p>
Terry L. Stevens	58	<p>Vice President and Chief Financial Officer.</p> <p>Prior to joining us in December 2003, Mr. Stevens was executive vice president, chief financial officer and trustee for Crown American Realty Trust, a public REIT. Before joining Crown American Realty Trust, Mr. Stevens was director of financial systems development at AlliedSignal, Inc., a large multi-national manufacturer. Mr. Stevens was also an audit partner with Price Waterhouse for approximately seven years. Mr. Stevens currently serves as trustee, chairman of the Audit Committee and member of the Investment and Finance Committee of First Potomac Realty Trust, a public REIT. Mr. Stevens is a member of the American and the Pennsylvania Institutes of Certified Public Accountants.</p>
Gene H. Anderson	61	<p>Director, Senior Vice President and Regional Manager.</p> <p>Mr. Anderson has been a senior vice president since our combination with Anderson Properties, Inc. in February 1997, and in July 2006 became Executive Vice President of Highwoods Development, LLC, a taxable subsidiary of the Company formed to pursue the development of office and industrial properties for existing customers in core and non-core markets. Additionally, Mr. Anderson manages our Atlanta operations and oversees our Triad operations. Mr. Anderson served as president of Anderson Properties, Inc. from 1978 to February 1997. Mr. Anderson was past president of the Georgia chapter of the National Association of Industrial and Office Properties and is a national board member of the National Association of Industrial and Office Properties.</p>

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<b>Name</b>	<b>Age</b>	<b>Position and Background</b>
Michael F. Beale	53	<p>Senior Vice President and Regional Manager.</p> <p>Mr. Beale manages our Orlando and oversees our Tampa operations. Prior to joining us in 2000, Mr. Beale served as vice president of Koger Equity, Inc., where he was responsible for Koger's acquisitions and developments throughout the Southeast. Mr. Beale is currently the president of the Central Florida Chapter of the National Association of Industrial and Office Properties and also serves on various committees for the Mid-Florida Economic Development Commission.</p>
Mack D. Pridgen III	57	<p>Vice President, General Counsel and Secretary.</p> <p>Prior to joining us in 1997, Mr. Pridgen was a partner with Smith Helms Mulliss &amp; Moore, L.L.P. and prior to that a partner with Arthur Andersen &amp; Co. Mr. Pridgen is an attorney and a certified public accountant.</p>
W. Brian Reames	43	<p>Senior Vice President and Regional Manager.</p> <p>Mr. Reames became senior vice president and regional manager in August 2004. Mr. Reames manages our Nashville and oversees our Memphis, Greenville and Columbia operations. Prior to that, Mr. Reames was vice president responsible for the Nashville division, a position he held since 1999. Mr. Reames was a partner and owner at Eakin &amp; Smith, Inc., a Nashville-based office real estate firm, from 1989 until its merger with us in 1996. Mr. Reames is a past Nashville chapter President of the National Association of Industrial and Office Properties. He is currently serving on the Board of Directors of H.G. Hill Realty and the Nashville Zoo and as President of the Board of Trustees at Harding Academy in Nashville, Tennessee.</p>

**Table of Contents****PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our Common Stock is traded on the NYSE under the symbol "HIW." The following table sets forth the quarterly high and low stock prices per share reported on the NYSE for the quarters indicated and the dividends paid per share during such quarter.

Quarter Ended	2006			2005		
	High	Low	Dividend	High	Low	Dividend
March 31	\$ 34.77	\$ 29.20	\$ .425	\$ 27.82	\$ 24.27	\$ .425
June 30	36.18	29.56	.425	30.54	26.15	.425
September 30	38.15	35.39	.425	31.86	28.43	.425
December 31	41.31	36.40	.425	29.91	26.72	.425

On February 15, 2007, the last reported stock price of our Common Stock on the NYSE was \$45.70 per share and we had 1,574 common stockholders of record.

The following stock price performance graph compares the performance of our Common Stock to the S&P 500, the Russell 2000 and the FTSE NAREIT Equity REIT Index. In 2006, the National Association of Real Estate Investment Trusts replaced the equity index previously used by us in our performance graph with the FTSE NAREIT Equity REIT Index. FTSE Group is an independent company whose sole business is the creation and management of indexes and associated data services. The stock price performance graph assumes an investment of \$100 in our Common Stock and the three indices on December 31, 2001 and further assumes the reinvestment of all dividends. Equity REITs are defined as those that derive more than 75.0% of their income from equity investments in real estate assets. The FTSE NAREIT Equity REIT Index includes all REITs listed on the NYSE, the American Stock Exchange or the NASDAQ National Market System. Stock price performance is not necessarily indicative of future results.

Index	Period Ending					
	12/31/01	12/31/02	12/31/03	12/31/04	12/31/05	12/31/06
Highwoods Properties, Inc.	100.00	93.74	117.04	136.77	149.32	224.80
S&P 500	100.00	77.90	100.25	111.16	116.61	135.03
Russell 2000	100.00	79.52	117.09	138.55	144.86	171.47
FTSE NAREIT Equity REIT Index	100.00	103.82	142.37	187.33	210.12	283.78

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The performance graph is being furnished as part of this Annual Report solely in accordance with the requirement under Rule 14a-3(b)(9) to furnish our stockholders with such information and, therefore, is not deemed to be filed, or incorporated by reference in any filing, by the Company or the Operating Partnership under the Securities Act of 1933 or the Securities Exchange Act of 1934.

We intend to continue to pay quarterly dividends to holders of shares of Common Stock and make distributions to holders of Common Units. Future dividends and distributions will be at the discretion of the Board of Directors and will depend on our actual funds from operations, our financial condition, capital requirements, the annual dividend requirements under the REIT provisions of the Internal Revenue Code and such other factors as the Board of Directors deems relevant. See Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Stockholder Dividends.

During 2006, cash dividends on Common Stock totaled \$1.70 per share, \$0.97 of which represented return of capital for income tax purposes. The minimum dividend per share of Common Stock required for the Company to maintain its REIT status (excluding any net capital gains) was \$0.24 per share in 2005. Aggregate dividends paid on Preferred Stock exceeded REIT taxable income (excluding capital gains) in 2006, which resulted in no required dividend on Common Stock in 2006 for REIT qualification purposes.

During the fourth quarter of 2006, we did not issue any Common Stock that was not registered under the Securities Act of 1933 nor did we repurchase any Common Stock or Preferred Stock.

The Company has a Dividend Reinvestment and Stock Purchase Plan under which holders of Common Stock may elect to automatically reinvest their dividends in additional shares of Common Stock and may make optional cash payments for additional shares of Common Stock. The administrator of the Dividend Reinvestment and Stock Purchase Plan has been instructed by the Company to purchase Common Stock in the open market for purposes of satisfying the Company's obligations thereunder. However, the Company may in the future elect to satisfy such obligations by issuing additional shares of Common Stock.

The Company has an Employee Stock Purchase Plan for all active employees, under which participants may contribute up to 25.0% of their compensation for the purchase of Common Stock. Generally, at the end of each three-month offering period, each participant's account balance is applied to acquire newly issued shares of Common Stock at a cost that is calculated at 85.0% of the lower of the average closing price on the NYSE on the five consecutive days preceding the first day of the quarter or the five days preceding the last day of the quarter.

Information about our equity compensation plans and other related stockholder matters is incorporated herein by reference to the Company's Proxy Statement to be filed in connection with our annual meeting of stockholders to be held on May 18, 2007.

**Table of Contents****ITEM 6. SELECTED FINANCIAL DATA**

The following selected financial data as of December 31, 2006 and 2005 and for each of the three years in the period ended December 31, 2006 is derived from the Company's audited Consolidated Financial Statements included elsewhere herein. The selected financial data as of December 31, 2004, 2003 and 2002 and for each of the two years in the period ended December 31, 2003 is derived from previously issued financial statements and, as required by SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, ( SFAS No. 144 ), results and balance sheet data for the years ended December 31, 2005, 2004, 2003 and 2002 were reclassified from previously reported amounts to reflect in discontinued operations the operations for those properties sold or held for sale in 2006 which qualified for discontinued operations presentation. The information in the following table should be read in conjunction with the Company's audited Consolidated Financial Statements and related notes included herein (\$ in thousands, except per share data):

	Years Ended December 31,				
	2006	2005	2004	2003	2002
<b>Rental and other revenues</b>	\$ 416,798	\$ 396,075	\$ 389,587	\$ 414,745	\$ 424,354
<b>Income from continuing operations</b>	\$ 36,465	\$ 27,728	\$ 21,044	\$ 7,906	\$ 32,780
<b>Income/(loss) from continuing operations available for common stockholders</b>	\$ 17,599	\$ (3,782)	\$ (9,808)	\$ (22,946)	\$ 1,928
<b>Net income</b>	\$ 53,744	\$ 62,458	\$ 41,577	\$ 42,649	\$ 80,052
<b>Net income available for common stockholders</b>	\$ 34,878	\$ 30,948	\$ 10,725	\$ 11,797	\$ 49,200
<b>Net income per common share basic:</b>					
Income/(loss) from continuing operations	\$ 0.32	\$ (0.07)	\$ (0.18)	\$ (0.43)	\$ 0.04
Net income	\$ 0.64	\$ 0.58	\$ 0.20	\$ 0.22	\$ 0.93
<b>Net income per common share diluted:</b>					
Income/(loss) from continuing operations	\$ 0.31	\$ (0.07)	\$ (0.18)	\$ (0.43)	\$ 0.04
Net income	\$ 0.62	\$ 0.58	\$ 0.20	\$ 0.22	\$ 0.93
<b>Dividends declared per common share</b>	\$ 1.70	\$ 1.70	\$ 1.70	\$ 1.86	\$ 2.34
	December 31,				
	2006	2005	2004	2003	2002
<b>Balance Sheet Data:</b>					
Total assets	\$ 2,844,853	\$ 2,908,978	\$ 3,239,658	\$ 3,513,224	\$ 3,745,269
Total mortgages and notes payable	\$ 1,465,129	\$ 1,471,616	\$ 1,572,574	\$ 1,718,274	\$ 1,796,167
Financing obligations	\$ 35,530	\$ 34,154	\$ 65,309	\$ 125,777	\$ 122,666
Co-venture obligation		\$	\$	\$	\$ 43,511

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**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

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

**DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS**

Some of the information in this Annual Report may contain forward-looking statements. Such statements include, in particular, statements about our plans, strategies and prospects under this section and under the heading "Business." You can identify forward-looking statements by our use of forward-looking terminology such as "may," "will," "expect," "anticipate," "estimate," "continue" or other 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:

speculative development activity by our competitors in our existing markets could result in an excessive supply of office, industrial and retail properties relative to tenant demand;

the financial condition of our tenants could deteriorate;

we may not be able to complete development, acquisition, reinvestment, disposition or joint venture projects as quickly or on as favorable terms as anticipated;

we may not be able to lease or release space quickly or on as favorable terms as old leases;

increases in interest rates would increase our debt service costs;

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 to repay or refinance outstanding debt upon maturity;

we could lose key executive officers; and

our southeastern and midwestern markets may suffer unexpected declines in economic growth.

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 elsewhere in this Annual Report.

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.

**OVERVIEW**

We are a fully integrated, self-administered and self-managed equity REIT that provides leasing, management, development, construction and other customer-related services for our properties and for third parties. As of December 31, 2006, we owned or had an interest in 392 in-service office, industrial and retail properties, encompassing approximately 34.3 million square feet, which includes seven in-service office and



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industrial development properties that had not yet reached 95% stabilized occupancy aggregating approximately 953,000 square feet, and 527 rental residential units. As of that date, we also owned development land and other properties under development as described under Business above. We are based in Raleigh, North Carolina, and our properties and development land are located in Florida, Georgia, Iowa, Kansas, Maryland, Missouri, North Carolina, South Carolina, Tennessee and Virginia.

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### **Results of Operations**

Approximately 82% of our rental and other revenue from continuing operations in 2006 was derived from our office properties. As a result, while we own and operate a limited number of industrial, retail and residential properties, our operating results depend heavily on successfully leasing our office properties. Furthermore, since approximately 65% of our annualized revenues from office properties come from properties located in Florida, Georgia, North Carolina and Tennessee, economic growth in those states is and will continue to be an important determinative factor in predicting our future operating results.

The key components affecting our rental revenue stream are dispositions, acquisitions, new developments placed in service, average occupancy and rental rates. 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 leases on expiring space. For more information regarding our lease expirations, see [Properties Lease Expirations](#).

Whether or not our rental revenue tracks average occupancy proportionally depends upon whether rents under new leases signed are higher or lower than the rents under the previous leases. The average rental rate per square foot on second generation and renewal leases signed in our Wholly Owned Properties compared to the rent under the previous leases (based on straight line rental rates) was 2.5% higher in 2006, 2.2% lower in 2005 and 1.5% lower in 2004. The annualized rental revenues from second generation leases signed during any particular year is generally less than 15% of our total annual rental revenues.

Our expenses primarily consist of rental property expenses, depreciation and amortization, general and administrative expenses and interest expense. 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 common area maintenance 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 or sell assets, since we depreciate our properties and related building and tenant improvement assets on a straight-line basis over a fixed life. General and administrative expenses, net of amounts capitalized, consist primarily of management and employee salaries and other personnel costs, corporate overhead and long-term incentive compensation. Interest expense depends upon the amount of our borrowings, the weighted average interest rates on our debt and the amount of interest capitalized on development projects.

### **Liquidity and Capital Resources**

We incur capital expenditures to lease space to our customers and to maintain the quality of our properties to successfully compete against other properties. Tenant improvements are the costs required to customize the space for the specific needs of the customer. Lease commissions are costs incurred to find the customer for the space. Lease incentives are costs paid to or on behalf of tenants to induce them to enter into leases and that do not relate to customizing the space for the tenant's specific needs. Building improvements are recurring capital costs not related to a customer to maintain the buildings. As leases expire, we either attempt to relet the space to an existing customer or attract a new customer to occupy the space. Generally, customer renewals require lower leasing capital expenditures than reletting to new customers. However, market conditions such as supply of available space on the market, as well as demand for space, drive not only customer rental rates but also tenant improvement costs. Leasing capital expenditures are amortized over the term of the lease and building improvements are depreciated over the appropriate useful life of the assets acquired. Both are included in depreciation and amortization in results of operations.

Because we are a REIT, we are required under the federal tax laws to distribute at least 90.0% of our REIT taxable income, excluding capital gains, to our stockholders. We generally use rents received from customers and proceeds from sales of non-core development land to fund our operating expenses, recurring capital expenditures and stockholder dividends. To fund property acquisitions, development activity or building renovations, we may sell

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other assets and may incur debt from time to time. As of December 31, 2006, we had \$741.6 million of secured debt outstanding and \$723.5 million of unsecured debt outstanding. Our debt generally consists of mortgage debt, unsecured debt securities and borrowings under our credit facilities.

On January 31, 2007, we obtained a \$150 million unsecured non-revolving credit facility. This facility has an initial term of six months and can be extended at our option for two additional three-month periods provided we are not in default. This facility has identical interest rate terms and financial covenants as our revolving credit facility. We currently plan to repay all amounts outstanding under the non-revolving facility with proceeds from newly issued secured or unsecured debt. As of February 15, 2007, we had borrowed \$60.0 million on the non-revolving facility.

As of December 31, 2006 and February 15, 2007, we had approximately \$113 million and \$216 million, respectively, of additional combined borrowing availability under our existing unsecured credit facilities and under our secured revolving construction credit facility.

Our credit facilities and the indenture governing our outstanding long-term unsecured debt securities require us to satisfy various operating and financial covenants and performance ratios. As a result, to ensure that we do not violate the provisions of these debt instruments, we may from time to time be limited in undertaking certain activities that may otherwise be in the best interest of our stockholders, such as repurchasing capital stock, acquiring additional assets, increasing the total amount of our debt or increasing stockholder dividends. We review our current and expected operating results, financial condition and planned strategic actions on an ongoing basis for the purpose of monitoring our continued compliance with these covenants and ratios. Any unwaived event of default could result in an acceleration of some or all of our debt, severely restrict our ability to incur additional debt to fund short- and long-term cash needs or result in higher interest expense.

To generate additional capital to fund our growth and other strategic initiatives and to lessen the ownership risks typically associated with owning 100.0% of a property, we may sell some of our properties or contribute them to joint ventures. When we create a joint venture with a strategic partner, we usually contribute one or more properties that we own and/or vacant land to a newly formed entity in which we retain an interest of 50.0% or less. In exchange for our equal or minority interest in the joint venture, we generally receive cash from the partner and retain some or all of the management income relating to the properties in the joint venture. The joint venture itself will frequently borrow money on its own behalf to finance the acquisition of, and/or leverage the return upon, the properties being acquired by the joint venture or to build or acquire additional buildings. Such borrowings are typically on a non-recourse or limited recourse basis. We generally are not liable for the debts of our joint ventures, except to the extent of our equity investment, unless we have directly guaranteed any of that debt. In most cases, we and/or our strategic partners are required to guarantee customary exceptions to non-recourse liability in non-recourse loans. See Note 15 to the Consolidated Financial Statements for additional information on certain debt guarantees. We have historically also sold additional Common Stock or Preferred Stock or issued Common Units to fund additional growth or to reduce our debt, but we have limited those efforts since 1998 because funds generated from our capital recycling program in recent years have provided sufficient funds to satisfy our liquidity needs. In addition, we have recently used funds from our capital recycling program to redeem Common Units and Preferred Stock for cash.

**Table of Contents****RESULTS OF OPERATIONS****Comparison of 2006 to 2005**

The following table sets forth information regarding our results of operations for the years ended December 31, 2006 and 2005 (\$ in millions). As noted above and as more fully described in Note 1 to the Consolidated Financial Statements, as required by SFAS No. 144, results for the year ended December 31, 2005 were reclassified from previously reported amounts to reflect in discontinued operations the operations for those properties sold or held for sale in 2006 which qualified for discontinued operations presentation.

	Years Ended December 31,		2006 to 2005	
	2006	2005	\$ Change	% Change
<b>Rental and other revenues</b>	\$ 416.8	\$ 396.1	\$ 20.7	5.2%
<b>Operating expenses:</b>				
Rental property and other expenses	153.5	141.6	11.9	8.4
Depreciation and amortization	115.0	109.6	5.4	4.9
Impairment of assets held for use	2.6	7.6	(5.0)	(65.8)
General and administrative	37.3	33.0	4.3	13.0
<b>Total operating expenses</b>	<b>308.4</b>	<b>291.8</b>	<b>16.6</b>	<b>5.7</b>
<b>Interest expense:</b>				
Contractual	94.2	98.7	(4.5)	(4.6)
Amortization of deferred financing costs	2.4	3.4	(1.0)	(29.4)
Financing obligations	4.2	5.0	(0.8)	(16.0)
	100.8	107.1	(6.3)	(5.9)
<b>Other income/(expense):</b>				
Interest and other income	7.0	7.1	(0.1)	(1.4)
Settlement of bankruptcy claim	1.6		1.6	100.0
Loss on debt extinguishments	(0.5)	(0.5)		
	8.1	6.6	1.5	22.7
<b>Income/(loss) before disposition of property, minority interest and equity in earnings of unconsolidated affiliates</b>	<b>15.7</b>	<b>3.8</b>	<b>11.9</b>	<b>313.2</b>
Gains on disposition of property, net	16.2	14.1	2.1	14.9
Minority interest	(2.2)	0.5	(2.7)	(540.0)
Equity in earnings of unconsolidated affiliates	6.8	9.3	(2.5)	(26.9)
<b>Income from continuing operations</b>	<b>36.5</b>	<b>27.7</b>	<b>8.8</b>	<b>31.8</b>
<b>Discontinued operations:</b>				
Income from discontinued operations, net of minority interest	3.4	11.5	(8.1)	(70.4)
Gains, net of impairments, on sales of discontinued operations, net of minority interest	13.9	23.2	(9.3)	(40.1)
	17.3	34.7	(17.4)	(50.2)
<b>Net income</b>	<b>53.8</b>	<b>62.4</b>	<b>(8.6)</b>	<b>(13.8)</b>
Dividends on preferred stock	(17.1)	(27.2)	10.1	37.1
Excess of preferred stock redemption cost over carrying value	(1.8)	(4.3)	2.5	58.1
<b>Net income available for common stockholders</b>	<b>\$ 34.9</b>	<b>\$ 30.9</b>	<b>\$ 4.0</b>	<b>12.9%</b>

***Rental and Other Revenues***

The increase in rental and other revenues from continuing operations was primarily the result of higher average occupancy in 2006 as compared to 2005, the contribution from developed properties placed in service in the latter part of 2005 and in 2006 and the consolidation of the Market joint venture effective January 1, 2006, as discussed in Note 1 to the Consolidated Financial Statements. These increases were partly offset by a decrease in lease termination fees from 2005 to 2006 and the recognition of Eastshore as a completed sale which occurred in the third quarter of 2005.

As of the date of this filing, we continue to see modest improvements in employment trends in most of our markets and an improving economic climate in the Southeast. There has been modest but steady positive absorption of office space in most of our markets during the past year. Also, we expect to deliver approximately 1.1 million square feet of new office and industrial development properties by the end of 2007, which are 38% pre-leased (weighted based on investment) as of December 31, 2006. We have sold and expect to sell additional non-core properties in 2007 that will probably be classified as discontinued operations.

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### ***Rental Property and Other Expenses***

The increase in rental and other operating expenses primarily was a result of general inflationary increases in certain operating expenses, such as salaries, benefits, utility costs and real estate taxes, expenses of developed properties placed in service in the latter part of 2005 and 2006 and the consolidation of the Markel joint venture effective January 1, 2006, as discussed in Note 1 to the Consolidated Financial Statements. These increases were partly offset by a decrease in operating expenses as a result of the recognition of Eastshore as a completed sale which occurred in the third quarter of 2005.

Operating margin, defined as rental and other revenue less rental property and other expenses expressed as a percentage of rental and other revenues, decreased from 64.3% in 2005 to 63.2% in 2006. This decrease in margin was primarily caused by operating expenses increasing from inflationary pressures at a higher rate than our rental revenues and operating cost recoveries.

We expect rental and other operating expenses to increase in 2007 as compared to 2006 from anticipated inflationary increases in certain fixed operating expenses, particularly higher utility costs, and by operating expenses of the development properties placed in service during 2006 and 2007.

The increase in depreciation and amortization is primarily a result of the contribution from developed properties placed in service in the latter part of 2005 and in 2006 and the consolidation of the Markel joint venture effective January 1, 2006, as discussed in Note 1 to the Consolidated Financial Statements. These increases were partly offset by a decrease related to the recognition of Eastshore as a completed sale which occurred in the third quarter of 2005.

For 2006, one office property had indicators of impairment where the carrying value exceeded the sum of the estimated undiscounted future cash flows. Therefore, an impairment of assets held for use of \$2.6 million was recorded in the year ended December 31, 2006. For 2005, one land parcel and one office property had indicators of impairment where the carrying value exceeded the sum of estimated undiscounted future cash flows. Therefore, impairments of assets held for use aggregating \$7.6 million were recorded in the year ended December 31, 2005.

The increase in general and administrative expenses was primarily related to higher annual and long-term incentive compensation costs and from deferred compensation, a portion of which is recognized based on increases in the total return on our Common Stock, which was 50.6% in 2006, higher salary and fringe benefit costs from annual employee wage and salary increases, inflationary effects on other general and administrative expenses and costs related to the retirement of a certain officer at June 30, 2006.

In 2007, general and administrative expenses are expected to decrease slightly as the total return-based equity incentive compensation and deferred compensation costs are expected to be lower than in 2006, partly offset by anticipated inflationary increases in non-equity compensation, benefits and other costs.

### ***Interest Expense***

The decrease in contractual interest was primarily due to a decrease in average borrowings from \$1,511 million in the year ended December 31, 2005 to \$1,441 million in the year ended December 31, 2006, partially offset by an increase in weighted average interest rates on outstanding debt from 6.80% in the year ended December 31, 2005 to 6.92% in the year ended December 31, 2006. In addition, capitalized interest in 2006 was approximately \$2.1 million higher compared to 2005 due to increased development activity and higher average construction and development costs. Interest allocated to discontinued operations was \$1.2 million in 2005 compared to \$0.6 million in 2006.

The decrease in amortization of deferred financing costs was primarily related to obtaining the new revolving credit facility in May 2006, as discussed further in the Note 5 to the Consolidated Financial Statements, resulting in a reduction of amortization of deferred financing costs of approximately \$1.0 million from 2005 to 2006.

The decrease in interest from financing obligations was primarily a result of the completed sale of three buildings in Richmond, Virginia (the Eastshore transaction) in the third quarter of 2005 and the elimination of the related financing obligation. Partly offsetting this decrease was an increase in 2006 related to SF-HIW Harborview

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Plaza LP primarily from amortization of the option discount, as described in Note 3 to the Consolidated Financial Statements.

Total interest expense is expected to decline in 2007 primarily from lower average interest rates as a result of completed and planned debt refinancings in late 2006 and early 2007 at rates that are lower than the prior debt and higher capitalized interest from increased development project costs in 2007 compared to 2006. Average debt balances are not expected to vary materially from 2006 in 2007 since we generally expect to fund costs associated with our development activity in 2007 with proceeds from property dispositions.

### ***Settlement of Bankruptcy Claim***

In 2006, we received a settlement of a bankruptcy claim in the amount of \$1.6 million related to leases with a former tenant that were terminated in 2003. See Note 18 to the Consolidated Financial Statements for further discussion.

### ***Loss on Debt Extinguishments***

In 2006, we had \$0.5 million from losses on early extinguishments of debt, including our old revolving credit facility and bank term loan, which were paid off in the second quarter of 2006 upon the closing of our new revolving credit facility. The \$0.5 million of loss in 2005 relates to loans that were paid off early in 2005 from proceeds raised from disposition activities.

### ***Gains on Disposition of Property; Minority Interest; Equity in Earnings of Unconsolidated Affiliates***

Net gains on dispositions of properties not classified as discontinued operations were \$16.2 million in the year ended December 31, 2006 compared to \$14.1 million for the year ended December 31, 2005; the components of net gains are described in Note 4 to the Consolidated Financial Statements. Gains are dependent on the specific assets sold, their historical cost basis and other factors, and can vary significantly from period to period.

Minority interest changed from \$0.5 million of income in the year ended December 31, 2005 to \$2.2 million of expense in the year ended December 31, 2006. In 2005, the Operating Partnership had a loss from continuing operations after Preferred Unit distributions which caused minority interest income. In 2006, the Operating Partnership had income from continuing operations after Preferred Unit distributions, resulting in minority interest expense related to the Operating Partnership. In addition, minority interest in 2006 includes \$0.6 million from the consolidation of the Markel joint venture, the accounting for which changed from equity method to consolidation effective January 1, 2006, as described in Note 1 to the Consolidated Financial Statements.

The decrease in equity in earnings of unconsolidated affiliates primarily resulted from the consolidation of the Markel joint venture in 2006, and from \$0.7 million of our share of a loss on early debt extinguishment from refinancing of loans in the Des Moines joint ventures in the third quarter of 2006. The Markel joint venture contributed \$0.8 million to equity in earnings of unconsolidated affiliates during the year ended December 31, 2005. In addition, capitalization of interest ceased and full depreciation commenced beginning December 2005 for the office property in the Plaza Colonnade, LLC joint venture which caused an approximate \$0.6 million reduction in equity in earnings of unconsolidated affiliates in 2006 compared to 2005.

### ***Discontinued Operations***

In accordance with SFAS No. 144, we classified net income of \$17.3 million and \$34.7 million as discontinued operations for the year ended December 31, 2006 and 2005, respectively. These amounts relate to 7.6 million square feet of office and industrial properties and 202 residential units sold during 2005 and 2006 and 0.3 million square feet of property held for sale at December 31, 2006. These amounts include net gains on the sale of these properties of \$13.9 million and \$23.2 million in the year ended December 31, 2006 and 2005, respectively.

**Table of Contents*****Preferred Stock Dividends and Excess of Preferred Stock Redemption Costs in Excess of Carrying Value***

The decreases in Preferred Stock dividends and excess of Preferred Stock redemption costs over carrying value were due to the redemptions of \$130.0 million of Preferred Stock in the third quarter of 2005 and \$50.0 million of Preferred Stock in the first quarter of 2006.

***Net Income and Net Income Allocable to Common Stockholders***

We recorded net income of \$53.8 million in 2006 compared to \$62.4 million in 2005, and net income allocable to common stockholders of \$34.9 million in 2006 compared to \$30.9 million in 2005; these changes resulted from the various factors described above.

**Comparison of 2005 to 2004**

The following table sets forth information regarding our results of operations for the years ended December 31, 2005 and 2004 (\$ in millions). As noted above and as more fully described in Note 1 to the Consolidated Financial Statements, as required by SFAS No. 144, results for the years ended December 31, 2005 and 2004 were reclassified from previously reported amounts to reflect in discontinued operations the operations for those properties sold or held for sale in 2006 which qualified for discontinued operations presentation.

	Years Ended December 31,		2005 to 2004	
	2005	2004	\$ Change	% Change
<b>Rental and other revenues</b>	\$ 396.1	\$ 389.6	\$ 6.5	1.7%
<b>Operating expenses:</b>				
Rental property and other expenses	141.6	137.9	3.7	2.7
Depreciation and amortization	109.6	108.8	0.8	0.7
Impairment of assets held for use	7.6		7.6	100.0
General and administrative	33.0	41.5	(8.5)	(20.5)
<b>Total operating expenses</b>	<b>291.8</b>	<b>288.2</b>	<b>3.6</b>	<b>1.2</b>
<b>Interest expense:</b>				
Contractual	98.7	104.8	(6.1)	(5.8)
Amortization of deferred financing costs	3.4	3.7	(0.3)	(8.1)
Financing obligations	5.0	10.0	(5.0)	(50.0)
	107.1	118.5	(11.4)	(9.6)
<b>Other income/(expense):</b>				
Interest and other income	7.1	6.1	1.0	16.4
Settlement of bankruptcy claim		14.4	(14.4)	(100.0)
Loss on debt extinguishments	(0.5)	(12.4)	11.9	96.0
	6.6	8.1	(1.5)	(18.5)
<b>Income/(loss) before disposition of property, minority interest and equity in earnings of unconsolidated affiliates</b>	<b>3.8</b>	<b>(9.0)</b>	<b>12.8</b>	<b>142.2</b>
Gains on disposition of property, net	14.1	21.6	(7.5)	(34.7)
Minority interest	0.5	1.0	(0.5)	(50.0)
Equity in earnings of unconsolidated affiliates	9.3	7.4	1.9	25.7
<b>Income from continuing operations</b>	<b>27.7</b>	<b>21.0</b>	<b>6.7</b>	<b>31.9</b>
<b>Discontinued operations:</b>				
Income from discontinued operations, net of minority interest	11.5	17.7	(6.2)	(35.0)
Gains, net of impairments, on sales of discontinued operations, net of minority interest	23.2	2.8	20.4	728.6



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	34.7	20.5	14.2	69.3
<b>Net income</b>	62.4	41.5	20.9	50.4
Dividends on preferred stock	(27.2)	(30.8)	3.6	11.7
Excess of preferred stock redemption cost over carrying value	(4.3)		(4.3)	(100.0)
<b>Net income available for common stockholders</b>	\$ 30.9	\$ 10.7	\$ 20.2	188.8%

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### ***Rental and Other Revenues***

The \$6.5 million increase in rental and other revenues from continuing operations was primarily the result of higher average occupancy in 2005 compared to 2004, revenues contributed from new development properties placed in service during the second half of 2005, and higher termination fee income in 2005. These positive increases were partially offset by a reduction in revenues from sold properties that were not classified as discontinued operations.

### ***Operating Expenses***

Rental and other operating expenses from continuing operations (real estate taxes, utilities, insurance, repairs and maintenance and other property-related expenses) increased \$3.7 million in 2005 compared to 2004, primarily as a result of higher average occupancy in 2005 and general inflationary increases in certain operating expenses, such as salaries, benefits, utility costs and real estate taxes. These increases were partially offset by a reduction in operating expenses from sold properties that were not classified as discontinued operations.

Operating margin, defined as rental and other revenue less rental property and other expenses expressed as a percentage of rental and other revenues, decreased from 64.7% in 2004 to 64.3% in 2005. This decrease in margin was primarily caused by operating expenses increasing from inflationary pressures at a higher rate than our rental revenues and operating cost recoveries.

Depreciation and amortization from continuing operations increased slightly in 2005. This slight increase primarily resulted from a relatively higher proportion in 2005 of leasing assets (tenant improvements and deferred leasing costs) which have shorter lives compared to buildings which are depreciated over 40 years. This was partially offset by a reduction in depreciation and amortization from sold properties that were not classified as discontinued operations.

Impairments on assets held for use were \$7.6 million in 2005 compared to none in 2004. In 2005 one land parcel and one office property, which are classified as held for use, had indicators of impairment where the carrying value exceeded the sum of projected undiscounted future cash flows. Accordingly, we recognized impairment losses of \$7.6 million during the year ended December 31, 2005.

The \$8.5 million decrease in general and administrative expenses in 2005 as compared to 2004 primarily relates to (1) \$4.6 million recognized in 2004 in connection with a retirement package for our former chief executive officer (see Note 18 to the Consolidated Financial Statements) and (2) a \$5.4 million decrease in 2005 compared to 2004 primarily relating to costs of personnel, consultants and our independent auditors in connection with (a) the initial implementation of Section 404 of the Sarbanes-Oxley Act in 2004, (b) evaluation of a strategic transaction in 2004, and (c) the preparation and audit of the restated Consolidated Financial Statements included in our 2004 Annual Report on Form 10-K. These decreases were partially offset by \$1.6 million net increase primarily related to higher long-term incentive compensation costs, salary and fringe benefit costs and other costs.

### ***Interest Expense***

The \$6.1 million decrease in contractual interest was primarily due to a decrease in average borrowings from \$1,657 million in 2004 to \$1,508 million in 2005, partially offset by an increase in weighted average interest rates on outstanding debt from 6.46% in 2004 to 6.76% in 2005. The decrease in average debt balances outstanding in 2005 was primarily due to the debt reductions made during 2005 as described in Note 5 to the Consolidated Financial Statements. In addition, capitalized interest in 2005 was approximately \$1.9 million higher compared to 2004 due to increased development activity and higher average construction and development costs.

The \$5.0 million decrease in interest expense on financing obligations was primarily a result of the purchase of our partner's interest in the Orlando City Group properties in MG-HIW, LLC on March 2, 2004 which eliminated the requirement to record financing obligation interest expense with respect to the Orlando City Group properties after that date (see Note 3 to the Consolidated Financial Statements).

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***Other Income/Expense***

In 2004, we received net proceeds of \$14.4 million as a result of the settlement of the bankruptcy of WorldCom (See Note 18 to our Consolidated Financial Statements for further discussion on this settlement).

Loss on debt extinguishments decreased \$11.9 million from \$12.4 million in 2004 to \$0.5 million in 2005. In 2004, a \$12.3 million loss was recorded related to the retirement of the Exercisable Put Option Notes described in Note 5 to the Consolidated Financial Statements. The \$0.5 million of loss in 2005 relates to certain of our loans that were paid off early in 2005 from proceeds raised from disposition activities.

***Gains on Disposition of Property; Minority Interest; Equity in Earnings of Unconsolidated Affiliates***

Net gains on dispositions of properties not classified as discontinued operations were \$14.1 million in 2005 compared to \$21.6 million in 2004; the components of net gains are described in Note 4 to the Consolidated Financial Statements. Gains and impairments are dependent on the specific assets sold, their historical cost basis and other factors, and can vary significantly from period to period.

Minority interest decreased from \$1.0 million of income in the year ended December 31, 2004 to \$0.5 million of income in the year ended December 31, 2005 due to a corresponding decrease in the Operating Partnership's loss from continuing operations after Preferred Unit distributions.

The \$1.9 million increase in equity in earnings from continuing operations of unconsolidated affiliates was primarily a result of an increase related to the formation of the HIW-KC Orlando, LLC joint venture in late June 2004, which contributed approximately \$1.4 million of additional equity in earnings from continuing operations of unconsolidated affiliates in 2005. In addition, the Plaza Colonnade, LLC joint venture, which was placed in service in the