HIGHWOODS PROPERTIES INC
Form 10-Q
August 08, 2008

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

____

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2008

Commission file number: 001-13100

____

HIGHWOODS PROPERTIES, INC.

(Exact name of registrant as specified in its charter)

Maryland	**56-1871668**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

3100 Smoketree Court, Suite 600, Raleigh, N.C.

(Address of principal executive office)

27604

(Zip Code)

(919) 872-4924

(Registrant s telephone number, including area code)

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 x No o

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

Large accelerated filer x Accelerated filer o Non-accelerated filer o Smaller reporting company o

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

The Company had 57,632,497 shares of common stock outstanding as of June 30, 2008.

HIGHWOODS PROPERTIES, INC.

QUARTERLY REPORT FOR THE PERIOD ENDED JUNE 30, 2008

TABLE OF CONTENTS

Table of Contents

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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.

The information furnished in the accompanying Consolidated Financial Statements reflects all adjustments (consisting of normal recurring accruals) that are, in our opinion, necessary for a fair presentation of the aforementioned financial statements for the interim period.

The aforementioned financial statements should be read in conjunction with the notes to Consolidated Financial Statements, Management s Discussion and Analysis of Financial Condition and Results of Operations and Risk Factors included herein and in our 2007 Annual Report on Form 10-K.

Table of Contents

HIGHWOODS PROPERTIES, INC.

CONSOLIDATED BALANCE SHEETS

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

	June 30, 2008	December 31, 2007
Assets:		
Real estate assets, at cost:		
Land	$ 356,447	$ 356,600
Buildings and tenant improvements	2,745,462	2,703,983
Development in process	122,381	101,661
Land held for development	98,134	103,365
	3,322,424	3,265,609
Less-accumulated depreciation	(680,310)	(648,142)
Net real estate assets	2,642,114	2,617,467
Real estate and other assets, net, held for sale	13,242	15,150
Cash and cash equivalents	4,033	3,140
Restricted cash	28,941	15,896
Accounts receivable, net of allowance of $919 and $935, respectively	32,121	23,521
Notes receivable, net of allowance of $144 and $68, respectively	3,750	5,226
Accrued straight-line rents receivable, net of allowance of $976 and $440, respectively	78,542	74,427
Investment in unconsolidated affiliates	68,877	58,046
Deferred financing and leasing costs, net of accumulated amortization	73,682	72,128
Prepaid expenses and other assets	43,604	41,954
Total Assets	$ 2,988,906	$ 2,926,955
Liabilities, Minority Interest and Stockholders' Equity:		
Mortgages and notes payable	$ 1,732,082	$ 1,641,987
Accounts payable, accrued expenses and other liabilities	147,287	157,766
Financing obligations	35,145	35,071
Total Liabilities	1,914,514	1,834,824
Commitments and Contingencies (see Note 12)		
Minority interest	67,389	70,098
Stockholders' Equity:		
Preferred Stock, $.01 par value, 50,000,000 authorized shares;		
8 5/8% Series A Cumulative Redeemable Preferred Shares (liquidation preference $1,000 per share), 82,937 shares issued and outstanding at both June 30, 2008 and December 31, 2007	82,937	82,937
8% Series B Cumulative Redeemable Preferred Shares (liquidation preference $25 per share), 2,100,000 shares issued and outstanding at both June 30, 2008 and December 31, 2007	52,500	52,500
Common stock, $.01 par value, 200,000,000 authorized shares; 57,632,497 and 57,167,193 shares issued and outstanding at June 30, 2008 and December 31, 2007, respectively	576	572
Additional paid-in capital	1,456,448	1,448,055
Distributions in excess of net earnings	(584,796)	(561,093)
Accumulated other comprehensive loss	(662)	(938)

Total Stockholders' Equity	1,007,003	1,022,033
Total Liabilities, Minority Interest and Stockholders' Equity	$ 2,988,906	$ 2,926,955

See accompanying notes to consolidated financial statements.

Table of Contents

HIGHWOODS PROPERTIES, INC.

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited and in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
Rental and other revenues	$ 115,853	$ 105,146	$ 229,947	$ 210,608
Operating expenses:				
Rental property and other expenses	41,572	37,587	80,426	75,227
Depreciation and amortization	31,365	29,756	62,250	58,585
General and administrative	10,766	10,868	20,477	21,779
Total operating expenses	83,703	78,211	163,153	155,591
Interest expenses:				
Contractual	23,345	23,097	46,808	45,786
Amortization of deferred financing costs	686	609	1,324	1,175
Financing obligations	764	995	1,504	1,987
	24,795	24,701	49,636	48,948
Other income:				
Interest and other income	1,604	2,115	2,406	3,625
	1,604	2,115	2,406	3,625
Income before disposition of property, insurance gain, minority interest and equity in earnings of unconsolidated affiliates	8,959	4,349	19,564	9,694
Net gains on disposition of property	107	2,341	107	19,084
Gain from property insurance settlement				4,128
Minority interest	(679)	(376)	(1,500)	(2,940)
Equity in earnings of unconsolidated affiliates	1,520	2,006	3,509	11,723
Income from continuing operations	9,907	8,320	21,680	41,689
Discontinued operations:				
Income from discontinued operations, net of minority interest	374	873	761	1,800
Net gains on sales of discontinued operations, net of minority interest	4,702	96	8,185	18,358
	5,076	969	8,946	20,158
Net income	14,983	9,289	30,626	61,847
Dividends on preferred stock	(2,838)	(3,846)	(5,676)	(7,959)
Excess of preferred stock redemption cost over carrying value		(1,443)		(1,443)
Net income available for common stockholders	$ 12,145	$ 4,000	$ 24,950	$ 52,445
Net income per common share - basic:				
Income from continuing operations	$ 0.12	$ 0.05	$ 0.28	$ 0.57
Income from discontinued operations	0.09	0.02	0.16	0.36
Net income	$ 0.21	$ 0.07	$ 0.44	$ 0.93
Weighted average common shares outstanding - basic	56,940	56,460	56,833	56,216
Net income per common share - diluted:				
Income from continuing operations	$ 0.12	$ 0.05	$ 0.28	$ 0.57
Income from discontinued operations	0.09	0.02	0.16	0.35
Net income	$ 0.21	$ 0.07	$ 0.44	$ 0.92
Weighted average common shares outstanding - diluted	61,492	61,562	61,290	61,709

Dividends declared per common share	$ 0.425	$ 0.425	$ 0.850	$ 0.850

See accompanying notes to consolidated financial statements.

Table of Contents

HIGHWOODS PROPERTIES, INC.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

For the Six Months Ended June 30, 2008

(Unaudited and in thousands, except share amounts)

	Number of Common Shares	Common Stock	Series A Preferred	Series B Preferred	Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Distributions in Excess of Net Earnings	Total
Balance at December 31, 2007	57,167,193	$ 572	$ 82,937	$ 52,500	$ 1,448,055	$ (938)	$ (561,093)	$ 1,022,033
Issuance of Common Stock, net	281,827	3			6,119			6,122
Redemption of Common Units to Common Stock	17,500				591			591
Common Stock dividends							(48,653)	(48,653)
Preferred Stock dividends							(5,676)	(5,676)
Adjustment to minority interest of unitholders in the Operating Partnership					(2,256)			(2,256)
Issuance of restricted stock, net	165,977							
Amortization of restricted stock and stock options		1			3,939			3,940
Comprehensive income:								
Net income							30,626	30,626
Other comprehensive income/(loss)						276		276
Total comprehensive income								30,902
Balance at June 30, 2008	57,632,497	$ 576	$ 82,937	$ 52,500	$ 1,456,448	$ (662)	$ (584,796)	$ 1,007,003

See accompanying notes to consolidated financial statements.

Table of Contents

HIGHWOODS PROPERTIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited and in thousands)

	Six Months Ended June 30, 2008	2007
Operating activities:		
Net income	$ 30,626	$ 61,847
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	54,878	52,984
Amortization of lease commissions	7,605	7,309
Amortization of lease incentives	486	500
Amortization of restricted stock and stock options	3,940	2,623
Amortization of deferred financing costs	1,324	1,175
Amortization of accumulated other comprehensive loss	126	285
Net gains on disposition of property	(8,860)	(38,930)
Gain from property insurance settlement		(4,128)
Minority interest	2,121	4,565
Equity in earnings of unconsolidated affiliates	(3,509)	(11,723)
Change in financing obligations	74	153
Distributions of earnings from unconsolidated affiliates	3,461	3,841
Changes in operating assets and liabilities:		
Accounts receivable	3,282	(631)
Prepaid expenses and other assets	(2,575)	(1,471)
Accrued straight-line rents receivable	(4,298)	(2,461)
Accounts payable, accrued expenses and other liabilities	(5,438)	937
Net cash provided by operating activities	83,243	76,875
Investing activities:		
Additions to real estate assets and deferred leasing costs	(114,376)	(136,921)
Proceeds from disposition of real estate assets	29,452	73,903
Proceeds from property insurance settlement		4,940
Distributions of capital from unconsolidated affiliates	1,499	13,396
Net repayments in notes receivable	1,476	2,551
Contributions to unconsolidated affiliates	(12,341)	(4,716)
Changes in restricted cash and other investing activities	(22,589)	(15,655)
Net cash used in investing activities	(116,879)	(62,502)
Financing activities:		
Distributions paid on Common Stock and Common Units	(52,009)	(51,700)
Redemption of Preferred Stock		(40,000)
Dividends paid on Preferred Stock	(5,676)	(7,959)
Distributions to minority partner in consolidated affiliate	(471)	(1,775)
Net proceeds from the sale of Common Stock	6,122	6,214
Repurchase of Common Units	(3,293)	(27,402)
Borrowings on revolving credit facility	242,550	232,500
Repayments of revolving credit facility	(212,350)	(458,000)
Borrowings on mortgages and notes payable	164,995	402,585
Repayments of mortgages and notes payable	(105,161)	(84,679)
Contributions from minority interest partner	625	5,068
Additions to deferred financing costs	(803)	(3,315)
Net cash provided by/(used in) financing activities	34,529	(28,463)
Net increase/(decrease) in cash and cash equivalents	893	(14,090)
Cash and cash equivalents at beginning of the period	3,140	16,690
Cash and cash equivalents at end of the period	$ 4,033	$ 2,600

See accompanying notes to consolidated financial statements.

Table of Contents

HIGHWOODS PROPERTIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS - Continued

(Unaudited and in thousands)

Supplemental disclosure of cash flow information:

	Six Months Ended June 30, 2008	2007
Cash paid for interest, net of amounts capitalized (excludes cash distributions to owners of sold properties accounted for as financings of $800 and $1,175 for 2008 and 2007, respectively)	$ 50,459	$ 41,062

Supplemental disclosure of non-cash investing and financing activities:

The following table summarizes the net asset acquisitions and dispositions subject to mortgage notes payable and other non-cash transactions. There were no non-cash investing and financing activities during the six months ended June 30, 2007.

	Six Months Ended June 30, 2008	2007
Assets:		
Prepaid expenses and other assets	$ 292	$
	$ 292	$
Liabilities:		
Accounts payable, accrued expenses and other liabilities	$ 142	$
	$ 142	$
Minority Interest and Stockholders Equity	$ 150	$

See accompanying notes to consolidated financial statements.

7

Table of Contents

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2008

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

(Unaudited)

1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Highwoods Properties, Inc., together with its consolidated subsidiaries (the "Company"), is a fully-integrated, self-administered and self-managed equity real estate investment trust ("REIT") that operates in the southeastern and midwestern United States. The Company conducts virtually all of its activities through Highwoods Realty Limited Partnership (the Operating Partnership). At June 30, 2008, the Company and/or the Operating Partnership wholly owned: 312 in-service office, industrial and retail properties; 96 rental residential units; 610 acres of undeveloped land suitable for future development, of which 475 acres are considered core holdings; and an additional 10 properties under development.

At June 30, 2008, the Company owned all of the preferred partnership interests (Preferred Units) and 93.6% of the common partnership interests ("Common Units") in the Operating Partnership. Limited partners (including certain officers and directors of the Company) own the remaining Common Units. Generally, the Operating Partnership is required to redeem each Common Unit at the request of the holder thereof for cash equal to the value of one share of the Company s Common Stock, $.01 par value (the Common Stock), based on the average of the market price for the 10 trading days immediately preceding the notice date of such redemption, provided that the Company at its option may elect to acquire any such Common Units presented for redemption for cash or one share of Common Stock. The Common Units owned by the Company are not redeemable. During the six months ended June 30, 2008, the Company redeemed 106,613 Common Units for $3.3 million in cash and redeemed 17,500 Common Units for a like number of shares of Common Stock, which increased the percentage of Common Units owned by the Company from 93.3% at December 31, 2007 to 93.6% at June 30, 2008. Preferred Units in the Operating Partnership were issued to the Company in connection with the Company s Preferred Stock offerings in 1997 and 1998 (the Preferred Stock). The net proceeds raised from each of the Preferred Stock issuances were contributed by the Company to the Operating Partnership in exchange for the Preferred Units. The terms of each series of Preferred Units parallel the terms of the respective Preferred Stock as to dividends, liquidation and redemption rights.

Basis of Presentation

Our Consolidated Financial Statements are prepared in accordance with U.S. Generally Accepted Accounting Principles (GAAP). As more fully described in Notes 4 and 10, as required by Statement of Financial Accounting Standard No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS No. 144), the Consolidated Balance Sheet at December 31, 2007 was revised from previously reported amounts to reflect in real estate and other assets held for sale those properties held for sale at June 30, 2008. The Consolidated Statements of Income for the three and six months ended June 30, 2007 were also revised from previously reported amounts to reflect in discontinued operations the operations of any property sold or held for sale in the first six months of 2008.

The Consolidated Financial Statements include the Operating Partnership, wholly owned subsidiaries and those subsidiaries in which we own a majority voting interest with the ability to control operations of the subsidiaries and where no substantive participating rights or substantive kick out rights have been granted to the minority interest holders. In accordance with Emerging Issues Task Force (EITF) Issue No. 04-5, Determining Whether a General Partner or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights, we consolidate partnerships, joint ventures and limited liability companies when we control the major operating and financial policies of the entity through majority ownership or in our capacity as general partner or managing member. In addition, we consolidate those entities, if any, where we are deemed to be the primary beneficiary in a variable interest entity (as defined by Financial Accounting Standards Board (FASB) Interpretation No. 46 (revised December 2003) Consolidation of Variable Interest Entities (FIN 46(R))). All significant intercompany transactions and accounts have been eliminated.

Table of Contents

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES - Continued

The unaudited interim financial statements and accompanying unaudited financial information, in the opinion of management, contain all adjustments (including normal recurring accruals) necessary for a fair presentation of our financial position, results of operations and cash flows. We have condensed or omitted certain notes and other information from the interim financial statements presented in this Quarterly Report on Form 10-Q. These financial statements should be read in conjunction with our 2007 Annual Report on Form 10-K.

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

Restricted Cash

Restricted cash represents cash deposits that are legally restricted or held by third parties on our behalf. They include security deposits from sales contracts on residential condominiums, construction-related escrows, property disposition proceeds set aside and designated or intended to fund future tax-deferred exchanges of qualifying real estate investments, escrows and reserves for debt service, real estate taxes and property insurance established pursuant to certain mortgage financing arrangements, and deposits given to lenders to un-encumber secured properties.

Income Taxes

The Company has elected and expects to continue to qualify as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended (the Code). A corporate REIT is a legal entity that holds real estate assets and, through the payment of dividends to stockholders, is generally permitted to reduce or avoid the payment of federal and state income taxes at the corporate level. To maintain qualification as a REIT, the Company is required to distribute to its stockholders at least 90.0% of its annual REIT taxable income, excluding capital gains. Continued qualification as a REIT depends on the Company s ability to satisfy the dividend distribution tests, stock ownership requirements and various other qualification tests prescribed in the Code. If the Company fails to qualify as a REIT in any taxable year, it will be subject to federal and state income taxes and may not be able to qualify as a REIT for four subsequent taxable years. We conduct certain business activities through a taxable REIT subsidiary, as permitted under the Code. The taxable REIT subsidiary is subject to federal and state income taxes on its net taxable income. We record provisions for income taxes, to the extent required under SFAS No. 109, Accounting for Income Taxes (SFAS No. 109), based on its income recognized for financial statement purposes, including the effects of temporary differences between such income and the amount recognized for tax purposes. Additionally, beginning January 1, 2007, we began to recognize and measure the effects of uncertain tax positions under FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes, an interpretation of SFAS No. 109. See Note 13 for discussion of the effect of FIN 48 on our accounting for income taxes.

Table of Contents

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES - Continued

Minority Interest

Minority interest in the accompanying Consolidated Financial Statements relates primarily to the ownership by various individuals and entities other than the Company of Common Units in the Operating Partnership. In addition, minority interest is also recorded for the 50.0% interest in a consolidated affiliate, Highwoods-Markel Associates, LLC (Markel), the equity interest owned by a third party in a consolidated venture formed during 2006 with Real Estate Exchange Services (REES), and the 7% equity interest owned by a third party in Plaza Residential, LLC, a consolidated joint venture formed in February 2007 related to a residential condominium project, as described below. As of June 30, 2008, minority interest in the Operating Partnership consisted of approximately 3.9 million Common Units, which had an aggregate market value of $123.6 million based on the $31.42 per share closing price of the Common Stock as of such date. Minority interest in the net income of the Operating Partnership is computed by applying the weighted average percentage of Common Units not owned by the Company during the period (as a percent of the total number of outstanding Common Units) to the Operating Partnership s net income after deducting distributions on Preferred Units. The result is the amount of minority interest expense (or income) recorded for the period. In addition, when a minority unitholder redeems a Common Unit for a share of Common Stock or cash, the minority interest is reduced and the Company s share in the Operating Partnership is increased. At the end of each reporting period, the Company determines the amount that represents the minority unitholders share of the net assets (at book value) of the Operating Partnership and compares this amount to the minority interest balance that resulted from transactions during the period involving minority interest. The Company adjusts the minority interest liability to the computed share of net assets with an offsetting adjustment to the Company s paid in capital.

The organizational documents of Markel require the entity to be liquidated through the sale of its assets upon reaching December 31, 2100. As controlling partner, we have an obligation to cause this property-owning entity to distribute proceeds of liquidation to the minority interest partner in these partially owned properties only if the net proceeds received by the entity from the sale of our assets warrant a distribution as determined by the agreement. The estimated settlement value is based on estimated third party consideration realizable by the entity upon a hypothetical disposition of the properties and is net of all other assets and liabilities. The actual amount of any distributions to the minority interest holder in this entity is difficult to predict due to many factors, including the inherent uncertainty of real estate sales. If the entity s underlying assets are worth less than the underlying liabilities on the date of such liquidation, we would have no obligation to remit any consideration to the minority interest holder.

In the fourth quarter of 2006, we entered into an agreement with REES to ground lease certain development land to special purpose entities owned by REES. Under the agreement, REES will contribute 7% of the costs of constructing properties on this land not to exceed $4.0 million outstanding at any time. REES will generally earn an agreed fixed return for its economic investment in these entities. The balance of development costs will be funded by third party construction loans. If third party construction loans are not obtained, the remaining 93% of costs are loaned to the entities by us. Subject to the exercise of a purchase option, it is expected that we will acquire the properties in the future at an amount generally equal to the actual development costs incurred plus the fixed return earned by REES for its economic investment in these entities. As we are considered the primary beneficiary, we consolidate these entities in accordance with FIN 46(R). These entities will be re-evaluated for primary beneficiary status when the entities undertake additional activity, such as placing the development projects in-service. REES s investment in the entities is included in minority interest as shown in the tables below. All costs to form the entities and other related fees have been expensed as incurred.

10

Table of Contents

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES - Continued

In the first quarter of 2007, our taxable REIT subsidiary formed Plaza Residential, LLC with Dominion Partners, LLC (Dominion). Plaza Residential was formed to develop and sell 139 residential condominiums being constructed above an office tower being developed by us in Raleigh, NC. Dominion has a 7% equity interest in the joint venture, will perform development services for the joint venture for a market development fee and guarantees 40.0% of the construction financing. Dominion will also receive 35.0% of the net profits from the joint venture once the partners have received distributions equal to their equity plus a 12.0% return on their equity. We are consolidating this majority owned joint venture and intercompany transactions have been eliminated in the Consolidated Financial Statements. At June 30, 2008, binding sale contracts had been executed for all of the residential condominiums. $4.1 million of deposits related to these contracts (non-refundable unless the joint venture defaults on its obligation to deliver the units) had been received and are reflected in restricted cash with a corresponding amount in other liabilities. We will account for the sale of the residential condominiums in accordance with SFAS No. 66, Accounting for Sales of Real Estate (SFAS No. 66) and will record the sales when the related closings take place.

Following is minority interest as reflected in our Consolidated Statements of Income and Consolidated Balance Sheets:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Amount shown as minority interest in continuing operations (1)	$ (679)	$ (376)	$ (1,500)	$ (2,940)
Amount related to income from discontinued operations	(26)	(63)	(53)	(137)
Amount related to gains on sales of discontinued operations	(325)	(7)	(568)	(1,488)
Total minority interest in net income	$ (1,030)	$ (446)	$ (2,121)	$ (4,565)

(1) Minority interest related to the consolidated entities other than the Operating Partnership amounted to $0.2 million for each of the three months ended June 30, 2008 and 2007 and $0.4 million and $0.3 million, respectively, for the six months ended June 30, 2008 and 2007.

	June 30, 2008	December 31, 2007
Minority interest in the Operating Partnership	$ 60,042	$ 63,294
Minority interest in Markel	3,989	3,446
Minority interest in REES	2,561	2,561
Minority interest in Plaza Residential	797	797
Total minority interest	$ 67,389	$ 70,098

Table of Contents

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES - Continued

Impact of Newly Adopted and Issued Accounting Standards

In September 2006, the FASB issued Statement No. 157, Fair Value Measurements (SFAS No. 157), which defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. The statement applies whenever other statements require or permit assets or liabilities to be measured at fair value. SFAS No. 157 became effective for fiscal years beginning after November 15, 2007, except for nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis, for which application has been deferred for one year. We adopted SFAS No. 157 in the first quarter of 2008 (See Note 9).

In November 2006, the FASB ratified EITF Issue No. 06-8, Applicability of the Assessment of a Buyer s Continuing Investment under FASB Statement No. 66 for Sales of Condominiums. EITF No. 06-8 provided additional guidance on whether the seller of a condominium unit is required to evaluate the buyer s continuing investment under SFAS No. 66 in order to recognize profit from the sale under the percentage of completion method. The EITF concluded that both the buyer s initial and continuing investment must meet the criteria in SFAS No. 66 in order for condominium sale profits to be recognized under the percentage of completion method. Sales of condominiums not meeting the continuing investment test must be accounted for under the deposit method. We adopted EITF No. 06-8 in the first quarter of 2008 and such adoption did not have an effect on our financial condition or results of operations.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS No. 159), which permits all entities to choose to measure eligible items at fair value at specified election dates. We adopted SFAS No. 159 on January 1, 2008 and such adoption did not have an effect on our financial condition or results of operations.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations (SFAS No. 141(R)), which addresses principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree. SFAS No. 141(R) becomes effective for us on January 1, 2009. We are currently evaluating the impact SFAS No. 141(R) will have on our financial condition and results of operations.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51 (SFAS No. 160), which establishes accounting and presentation standards for a noncontrolling interest in a subsidiary and amends certain of ARB No. 51 s consolidation procedures for consistency with other business combination standards. SFAS No. 160 becomes effective for us on

January 1, 2009. We are currently evaluating the impact SFAS No. 160 will have on our financial condition and results of operations.

In December 2007, the FASB ratified EITF Issue No. 07-6 Accounting for the Sale of Real Estate Subject to the Requirements of FASB Statement No. 66, *Accounting for Sales of Real Estate,* When the Agreement Includes a Buy-Sell Clause (EITF No. 07-6), which addresses whether a buy-sell clause represents a prohibited form of continuing involvement that would preclude partial sale and profit recognition pursuant to SFAS No. 66. We adopted EITF No. 07-6 in the first quarter of 2008 and such adoption did not have an effect on our financial condition or results of operations.

Table of Contents

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES - Continued

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities (SFAS No. 161), which amends and expands the disclosure requirements of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. This statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. SFAS No. 161 becomes effective for us on January 1, 2009. We are currently evaluating the impact SFAS No. 161 will have on our financial condition and results of operations.

In April 2008, the FASB issued FSP FAS 142-3, Determination of the Useful Life of Intangible Assets (FSP FAS 142-3). FSP FAS 142-3 removes the requirement of SFAS No. 142, Goodwill and Other Intangible Assets, for an entity to consider, when determining the useful life of an acquired intangible asset, whether the intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions associated with the intangible asset. FSP FAS 142-3 becomes effective for us on January 1, 2009. We are currently evaluating the impact FSP FAS 142-3 will have on our financial condition and results of operations.

In June 2008, the FASB issued FSP EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities (FSP EITF 03-6-1). FSP EITF 03-6-1 addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, need to be included in the earnings allocation in computing earnings per share under the two-class method as described in SFAS No. 128, Earnings per Share. FSP EITF 03-6-1 becomes effective for us on January 1, 2009. We are currently evaluating the impact FSP EITF 03-6-1 will have on our financial condition and results of operations.

2. INVESTMENTS IN UNCONSOLIDATED AND OTHER AFFILIATES

We have retained equity interests ranging from 12.5% to 50.0% in various joint ventures with unrelated investors. We account for our unconsolidated joint ventures using the equity method of accounting. As a result, the assets and liabilities of these joint ventures for which we use the equity method of accounting are not included on our Consolidated Balance Sheet.

During the third quarter of 2006, three of our joint ventures made distributions aggregating $17.0 million as a result of a refinancing of debt related to various properties held by the joint ventures. We received 50.0% of such distributions. As a result of these distributions, our investment account in these joint ventures became negative. The new debt is non-recourse; however, we and our partner have guaranteed other debt and have contractual obligations to support the joint ventures, which are included in the Guarantees and Other Obligations table in Note 15 to the Consolidated Financial Statements in our 2007 Annual Report on Form 10-K. Therefore, in accordance with SOP 78-9, Accounting for Investments in Real Estate Ventures, we recorded the distributions as a reduction of the investment account and included the resulting negative investment balances of $11.1 million in accounts payable, accrued expenses and other liabilities in the Consolidated Balance Sheet at June 30, 2008.

Four of our joint ventures are consolidated. SF-HIW Harborview Plaza, LP is accounted for as a financing arrangement pursuant to SFAS No. 66, as described in Note 3 to the Consolidated Financial Statements in our 2007 Annual Report on Form 10-K. Markel, REES and Plaza Residential, which are discussed in Note 1, are each consolidated.

Table of Contents

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

2. INVESTMENTS IN UNCONSOLIDATED AND OTHER AFFILIATES - Continued

Investments in unconsolidated affiliates as of June 30, 2008 and combined summarized income statements for our unconsolidated joint ventures for the three and six months ended June 30, 2008 and 2007 were as follows:

Joint Venture	Location of Properties	Ownership Interest	
Board of Trade Investment Company	Kansas City, MO	49.00	%
Kessinger/Hunter, LLC	Kansas City, MO	26.50	%
4600 Madison Associates, LLC	Kansas City, MO	12.50	%
Plaza Colonnade, LLC	Kansas City, MO	50.00	%
Dallas County Partners I, LP	Des Moines, IA	50.00	%
Dallas County Partners II, LP	Des Moines, IA	50.00	%
Dallas County Partners III, LP	Des Moines, IA	50.00	%
Fountain Three	Des Moines, IA	50.00	%
RRHWoods, LLC	Des Moines, IA	50.00	%
Highwoods DLF 98/29, LP	Atlanta, GA; Charlotte, NC; Greensboro, NC; Raleigh, NC; Orlando, FL; Baltimore, MD	22.81	%
Highwoods DLF 97/26 DLF 99/32, LP	Atlanta, GA; Greensboro, NC; Orlando, FL	42.93	%
Highwoods KC Glenridge Office, LP	Atlanta, GA	40.00	%
Highwoods KC Glenridge Land, LP	Atlanta, GA	40.00	%
HIW-KC Orlando, LLC	Orlando, FL	40.00	%
Concourse Center Associates, LLC	Greensboro, NC	50.00	%
Highwoods DLF Forum, LLC	Raleigh, NC	25.00	%

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Income Statements:				
Revenues	$ 41,199	$ 35,140	$ 79,728	$ 73,157
Expenses:				
Operating expenses	20,032	14,993	38,463	30,156
Depreciation and amortization	9,170	7,528	16,628	14,781
Interest expense and loan cost amortization	9,205	8,358	17,692	16,990
Total expenses	38,407	30,879	72,783	61,927
Income before disposition of property	2,792	4,261	6,945	11,230

Gains on disposition of property				20,621
Net income	$ 2,792	$ 4,261	$ 6,945	$ 31,851
Our share of:				
Net income (1)	$ 1,520	$ 2,006	$ 3,509	$ 11,723
Depreciation and amortization (real estate related)	$ 3,395	$ 2,878	$ 6,330	$ 5,744
Interest expense and loan cost amortization	$ 3,691	$ 3,558	$ 7,220	$ 7,219
Gains on disposition of property	$	$	$	$ 7,158

(1) Our share of net income differs from our weighted average ownership percentage in the joint ventures net income due to our purchase accounting and other related adjustments.

Table of Contents

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

2. INVESTMENTS IN UNCONSOLIDATED AND OTHER AFFILIATES - Continued

On September 27, 2004, we and an affiliate of Crosland, Inc. (Crosland) formed Weston Lakeside, LLC, in which we had a 50.0% ownership interest. Crosland managed and operated this joint venture, which constructed 332 rental residential units in three buildings at a total cost of approximately $33.7 million. Crosland received 3.25% of all project costs other than land as a development fee and 3.5% of the gross revenue of the joint venture in management fees. We provided certain development services for the project and received a fee equal to 1.0% of all project costs excluding land. We accounted for this joint venture using the equity method of accounting. On February 22, 2007, the joint venture sold the 332 rental residential units to a third party for gross proceeds of $45.0 million and paid off all of its outstanding debt and various development related costs. The joint venture recorded a gain of $11.3 million in the first quarter of 2007 related to this sale and we recorded $5.0 million as our proportionate share through equity in earnings of unconsolidated affiliates. Our share of the gain was less than 50.0% due to Crosland s preferred return as the developer. We received aggregate net distributions of $6.2 million. Weston Lakeside, LLC has been dissolved.

We have a 22.81% interest in a joint venture (DLF I) with Schweiz-Deutschland-USA Dreilander Beteiligung Objekt DLF 98/29-Walker Fink-KG ("DLF"). We are the property manager and leasing agent of DLF I s properties and receive customary management and leasing fees. On March 12, 2007, DLF I sold five properties to a third party for gross proceeds of $34.2 million and recorded a gain of $9.3 million related to this sale. We recorded $2.1 million as our proportionate share of this gain through equity in earnings of unconsolidated affiliates. On May 21, 2007, DLF I acquired Eola Park Centre, a 167,000 square foot office building in Orlando, Florida, for $39.3 million. In June 2007, the joint venture obtained a $27.7 million loan secured by Eola Park Centre. Simultaneously with DLF I s acquisition of Eola Park Centre, we separately acquired an adjacent parcel of development land for $2.0 million on a wholly-owned basis.

In March 2008, we and an affiliate of DLF formed a new joint venture, Highwoods DLF Forum, LLC, in which we have a 25.00% ownership interest. Upon formation of this joint venture, we contributed $0.8 million of cash. On April 3, 2008, Highwoods DLF Forum, LLC acquired The Forum, which is a 635,000 square foot office park in Raleigh, North Carolina, for approximately $113 million. We contributed an additional $11.5 million to Highwoods DLF Forum, LLC and, simultaneously with the acquisition of The Forum, the joint venture obtained a $67.5 million secured loan. We are the property manager and leasing agent for the office park and receive customary management fees and leasing commissions.

For additional information regarding our other investments in unconsolidated and other affiliates, see Note 2 to the Consolidated Financial Statements in our 2007 Annual Report on Form 10-K.

3. FINANCING ARRANGEMENTS

For information regarding sale transactions that have been accounted for as financing arrangements under paragraphs 25 through 29 of SFAS No. 66, see Notes 5 and 9 herein and Note 3 to the Consolidated Financial Statements in our 2007 Annual Report on Form 10-K.

Table of Contents

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

4. INVESTMENT ACTIVITIES AND IMPAIRMENT OF LONG-LIVED ASSETS

Dispositions

Gains from dispositions not classified as discontinued operations consisted of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Gains on disposition of land	$ 89	$ 969	$ 89	$ 16,804
Gains on disposition of depreciable properties	18	1,372	18	2,280
Total	$ 107	$ 2,341	$ 107	$ 19,084

Net gains on sales of discontinued operations, net of minority interest, consisted of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Gains on disposition of depreciable properties	$ 5,027	$ 103	$ 8,753	$ 19,846
Allocable minority interest	(325)	(7)	(568)	(1,488)
Total	$ 4,702	$ 96	$ 8,185	$ 18,358

See Note 10 for information on discontinued operations.

The above gains on land and depreciable properties include deferred gain recognition from prior sales.

Development

We currently have a number of properties and projects under development. The aggregate incurred cost of our development activity through June 30, 2008 is $122 million and is shown as Development in Process in the Consolidated Balance Sheet. In addition to these properties under development, other development properties have been completed during 2007 and the first six months of 2008 and their costs have been transferred from Development in Process to Land, to Buildings and Improvements and related asset accounts in the Consolidated Balance Sheet; not all of such properties have yet achieved estimated projected 95% stabilized occupancy as of June 30, 2008.

Impairments of Long-Lived Assets

SFAS No. 144 requires that a long-lived asset classified as held for sale be measured at the lower of the carrying value or fair value less cost to sell. During the six months ended June 30, 2008 and 2007, there were no properties held for sale which had a carrying value that was greater than fair value less cost to sell; therefore, no impairment loss was recognized in the Consolidated Statements of Income for the six months ended June 30, 2008 and 2007.

SFAS No. 144 also requires that if indicators of impairment exist, the carrying value of a long-lived asset classified as held for use be compared to the sum of its estimated undiscounted future cash flows. If the carrying value is greater than the sum of its undiscounted future cash flows, an impairment loss should be recognized for the excess of the carrying amount of the asset over its estimated fair value. In each of the six months ended June 30, 2008 and 2007, no indicators of impairment existed for assets held for use. Therefore, no impairment losses were recorded in the six months ended June 30, 2008 and 2007.

Table of Contents

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

5. MORTGAGES, NOTES PAYABLE AND FINANCING OBLIGATIONS

Our consolidated mortgages and notes payable consisted of the following at June 30, 2008 and December 31, 2007:

	June 30, 2008	December 31, 2007
Secured mortgage loans	$ 687,644	$ 665,311
Unsecured loans	1,044,438	976,676
Total	$ 1,732,082	$ 1,641,987

As of June 30, 2008, our secured mortgage loans were secured by real estate assets with an aggregate undepreciated book value of approximately $1.1 billion.

Our $450 million unsecured revolving credit facility is initially scheduled to mature on May 1, 2009. Assuming no default exists, we have an option to extend the maturity date by one additional year. The interest rate is LIBOR plus 80 basis points and the annual base facility fee is 20 basis points. The revolving credit facility had $190 million of availability at June 30, 2008.

On March 22, 2007, the Operating Partnership issued $400 million aggregate principal amount of 5.85% Notes due March 15, 2017, net of original issue discount of $1.2 million. We used the net proceeds from the issuance of the notes to repay borrowings outstanding under an unsecured non-revolving credit facility that was obtained on January 31, 2007 (which was subsequently terminated) and under the revolving credit facility.

On June 5, 2007, two three-year secured construction loans totaling $24.7 million with interest at 175 basis points over LIBOR were obtained by REES, a consolidated joint venture (see Note 1). Subsequently, on July 17, 2007, REES obtained an additional $13.7 million, three-year secured construction loan with interest at 165 basis points over LIBOR. In October 2007, REES paid off one of the original secured construction loans, which had accounted for $4.4 million of the original $24.7 million. At June 30, 2008, $27.9 million was outstanding under these two remaining loans.

On December 20, 2007, we closed a $70 million secured revolving construction facility. The loan matures on December 20, 2010. The interest rate is based on LIBOR plus 85 basis points. At June 30, 2008, there was $4.7 million outstanding on this secured credit facility.

In December 2007, Plaza Residential, LLC, a consolidated joint venture (see Note 1), obtained a two-year, $34.1 million secured construction loan with interest at 140 basis points over LIBOR. At June 30, 2008, there was $14.5 million outstanding on this loan.

On February 1, 2008, we paid off at maturity $100.0 million of 7.125% unsecured notes using borrowings under our revolving credit facility. On February 26, 2008, we closed a $137.5 million three-year term loan that bears interest at LIBOR plus 110 basis points. Proceeds from this loan were used to reduce the outstanding borrowings under our revolving credit facility and for short-term investments.

Our revolving credit facility, our term loan and the indenture that governs the Operating Partnership s outstanding notes require us to comply with customary operating covenants and various financial and operating ratios. We and the Operating Partnership are each currently in compliance with all such requirements.

Table of Contents

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

5. MORTGAGES, NOTES PAYABLE AND FINANCING OBLIGATIONS - Continued

Financing Obligations

Our financing obligations consisted of the following at June 30, 2008 and December 31, 2007:

	June 30, 2008	December 31, 2007
SF-HIW Harborview, LP financing obligation (1)	$ 16,620	$ 16,566
Tax increment financing obligation (2)	17,395	17,395
Capitalized ground lease obligation (3)	1,130	1,110
Total	$ 35,145	$ 35,071

(1) See Note 3 to the Consolidated Financial Statements in our 2007 Annual Report on Form 10-K for further discussion of this financing obligation. See Note 9 for Fair Value Measurement disclosure.

(2) In connection with tax increment financing for construction of a public garage related to an office building, we are obligated to pay fixed special assessments over a 20-year period. The net present value of these assessments, discounted at 6.93% at the inception of the obligation, which represents the interest rate on the underlying bond financing, is shown as a financing obligation in the Consolidated Balance Sheet. We also receive special tax revenues and property tax rebates recorded in interest and other income, which are intended, but not guaranteed, to provide funds to pay the special assessments.

On December 3, 2007, we acquired for $20.9 million the remaining outstanding bonds, at par value, that were issued by a municipal authority in connection with this tax increment financing. These available for sale securities are carried at estimated fair value with unrealized gains or losses reported in other comprehensive income, in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. See Note 9 for Fair Value Measurement disclosure.

(3) Represents a capitalized lease obligation to the lessor of land on which we are constructing a new building. We are obligated to make fixed payments to the lessor through October 2022 and the lease provides for fixed price purchase options in the ninth and tenth years of the lease. We intend to exercise the purchase option in order to prevent an economic penalty related to conveying the building to the lessor at the expiration of the lease. The net present value of the fixed rental payments and purchase option through the ninth year was calculated using a discount rate of 7.1%. The assets and liabilities under the capital lease are recorded at the lower of the present value of minimum lease payments or the fair value. The liability accretes each month for the difference between the interest rate on the financing obligation and the fixed payments. The accretion will continue until the liability equals the purchase option of the land in the ninth year of the lease.

Table of Contents

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

6. EMPLOYEE BENEFIT PLANS

Compensation Programs

During the six months ended June 30, 2008, we granted under our Amended and Restated 1994 Stock Option Plan (the Stock Option Plan) 0.3 million stock options at an exercise price equal to the closing market price of a share of our common stock on the date of grant. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model, which resulted in a weighted-average grant date fair value per share of $3.18. We also granted 0.09 million shares of time-based restricted stock and 0.07 million shares of performance-based and total return-based restricted stock with a weighted-average grant date fair value per share of $30.09 and $30.18, respectively. Shares of total return-based restricted stock issued in 2008 will generally vest only to the extent our absolute total return for the three-year period ended December 31, 2010 is at least 22% or if our total return exceeds 100% of the peer group index. See Note 6 to the Consolidated Financial Statements and Item 11, Executive Compensation, included or incorporated by reference in our 2007 Annual Report on Form 10-K for additional information regarding our equity incentive and other compensation plans.

During the six months ended June 30, 2008 and 2007, we recognized approximately $3.9 million and $2.7 million, respectively, of stock-based compensation expense. As of June 30, 2008, there was $12.4 million of total unrecognized stock-based compensation costs, which will be recognized over a weighted average remaining contractual term of 2.4 years.

7. DERIVATIVE FINANCIAL INSTRUMENTS AND OTHER FINANCIAL INSTRUMENTS HELD FOR SALE

Accumulated Other Comprehensive Loss (AOCL) at June 30, 2008 was $0.7 million and consisted of deferred gains and losses from past cash flow hedging instruments, deferred losses on current cash flow hedges and the mark to market adjustment for bonds that are classified as held for sale.

The amount of deferred gains and losses from past cash flow hedging instruments which are being recognized as interest expense over the terms of the related debt aggregated $0.8 million (see Note 8). We expect that the portion of the cumulative loss recorded in AOCL at June 30, 2008 associated with these derivative instruments, which will be recognized as interest expense within the next 12 months, will be approximately $0.09 million.

In January 2008, we entered into two floating-to-fixed interest rate swaps for a one-year period with respect to an aggregate of $50 million of borrowings outstanding under our revolving credit facility and other floating rate debt. These swaps fix the underlying LIBOR rate under which interest on such borrowings is based at 3.26% for $30 million of borrowings and 3.24% for $20 million of borrowings. In April 2008, we entered into an additional floating-to-fixed interest rate swap for a two-year period with respect to an aggregate of $50 million of borrowings outstanding under our term loan or other floating rate debt. The swap fixes the underlying LIBOR rate under which interest on such borrowings is based at 2.52%. These swaps were designated as hedges under SFAS No. 133. Accordingly, the swaps are being accounted for as cash flow hedges. We expect that the portion of the cumulative loss or gain recorded in AOCL at June 30, 2008 associated with these derivative instruments, which will be recognized within the next 12 months, will be $0.1 million and $0.6 million, respectively. See Note 9 for Fair Value Measurement disclosure.

We currently have an investment in bonds that were issued by a municipal authority in connection with tax increment financing (see Note 5). These bonds are currently being held for sale and thus are being recorded at fair value with the offset recorded in AOCL. The amount of unrealized loss at June 30, 2008 was $0.4 million. See Note 9 for Fair Value Measurement disclosure.

Table of Contents

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

8. OTHER COMPREHENSIVE INCOME

Other comprehensive income represents net income plus the changes in certain amounts deferred in accumulated other comprehensive income/(loss) related to hedging and other activities not reflected in the Consolidated Statements of Income. The components of other comprehensive income are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Net income	$ 14,983	$ 9,289	$ 30,626	$ 61,847
Other comprehensive income:				
Unrealized gain/(loss) on available for sale securities	187		(374)	
Net gains on cash-flow hedges	933		524	
Amortization of hedging gains and losses included in other comprehensive income	46	143	126	285
Total other comprehensive income	1,166	143	276	285
Total comprehensive income	$ 16,149	$ 9,432	$ 30,902	$ 62,132

9. FAIR VALUE MEASUREMENTS

As stated in Note 1, on January 1, 2008, we adopted SFAS No. 157 for our financial assets and liabilities. Our adoption of SFAS No. 157 did not impact our financial position, results of operations or liquidity. In accordance with FASB Staff Position No. FAS 157-2, Effective Date of FASB Statement No. 157 (FSP FAS 157-2), we elected to defer until January 1, 2009 the adoption of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis. The adoption of SFAS No. 157 for those assets and liabilities within the scope of FSP FAS 157-2 is not expected to have a material impact on our financial position, results of operations or liquidity.

SFAS No. 157 provides a framework for measuring fair value and requires expanded disclosure regarding fair value measurements. SFAS No. 157 defines fair value as the price that would be received for an asset or the exit price that would be paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date. SFAS No. 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs, where available. The following summarizes the three levels of inputs required by the standard that we use to measure fair value, as well as the assets and liabilities that we value using those levels of inputs.

Level 1. Quoted prices in active markets for identical assets or liabilities. Our Level 1 assets are comprised of investments in marketable securities which we use to pay benefits under our deferred compensation plan. Our Level 1 liabilities are our obligations to pay certain deferred compensation plan benefits whereby participants have designated investment options (primarily mutual funds) to serve as the basis for measurement of the notional value of their accounts.

Level 2. Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the related assets or liabilities. Our Level 2 assets are bonds that are not routinely traded but whose fair value is determined using an estimate of projected redemption value predicated upon quoted bid/ask prices for similar unrated bonds. Our Level 2 liabilities are interest rate swaps whose fair value is determined using a price model predicated upon observable market inputs.

Table of Contents

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

9. FAIR VALUE MEASUREMENTS - Continued

Level 3. Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Our Level 3 liabilities consist of the right of our joint venture partner in SF-HIW Harborview Plaza, LP to put its 80% equity interest in SF-HIW Harborview Plaza, LP to us in exchange for cash at any time during the one-year period commencing September 11, 2014. Because of the put option, this transaction is accounted for as a financing transaction. Accordingly, the assets and liabilities and operations related to Harborview Plaza, the property owned by SF-HIW Harborview Plaza, LP, including any new financing by the partnership, remain in our Consolidated Financial Statements. As a result, we have established a financing obligation equal to the net equity contributed by the other partner. At the end of each annual reporting period, the balance of the financing obligation is adjusted to equal the greater of the original financing obligation or the current fair value of the put option. Due to the lack of observable market quotes for the put option, we utilize a valuation model predicated upon capitalization rates and discounted cash flows, which take into account estimates such as future lease rollovers, lease up activity and future expenditures, to calculate the estimated fair value of the put option. The estimated fair value of the put option was $15.7 million and $15.6 million at June 30, 2008 and December 31, 2007, respectively. This amount is adjusted by a related valuation allowance account, which is being amortized prospectively through September 2014 as interest expense on financing obligation. The amount of the valuation allowance account was $0.9 million and $1.0 million at June 30, 2008 and December 31, 2007, respectively. The amount amortized into interest expense from the valuation allowance was $0.07 million during the six months ended June 30, 2008. For more information regarding this joint venture, see Note 3 to the Consolidated Financial Statements in our 2007 Annual Report on Form 10-K.

The following table sets forth the financial assets and liabilities as of June 30, 2008 that we measured at fair value on a recurring basis by level within the fair value hierarchy. As required by SFAS No. 157, assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to their fair value measurement.

		Fair Value Measurements Using		
	Balance at June 30, 2008	Level 1 Quoted Prices in Active Markets for Identical Assets	Level 2 Significant Other Observable Inputs	Level 3 Significant Unobservable Inputs
Assets				
Marketable securities (1)	$ 7,224	$ 7,224	$	$
Taxable bonds	20,541		20,541	
Interest rate swaps	665		665	
Total Assets	$ 28,430	$ 7,224	$ 21,206	$
Liabilities				
Interest rate swaps	$ 141	$	$ 141	$
Deferred compensation	7,224	7,224		

Harborview financing obligation	15,743			15,743
Harborview valuation allowance	877			877
Total Liabilities	$ 23,985	$ 7,224	$ 141	$ 16,620

(1) The marketable securities are held through our officer deferred compensation plans.

21

Table of Contents

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

10. DISCONTINUED OPERATIONS

As part of our business strategy, we from time to time selectively dispose of non-core properties in order to use the net proceeds for investments, for repayment of debt and/or retirement of Preferred Stock, or other purposes. The table below sets forth the net operating results of those assets classified as discontinued operations in our Consolidated Financial Statements. These assets classified as discontinued operations comprise 1.5 million square feet of office and industrial properties and 13 rental residential units sold during 2007 and the six months ended June 30, 2008 and a 0.3 million square foot industrial property held for sale at June 30, 2008. These long-lived assets relate to disposal activities that were initiated subsequent to the effective date of SFAS No. 144, or that met certain stipulations prescribed by SFAS No. 144. The operations of these assets have been reclassified from our ongoing operations to discontinued operations, and we will not have any significant continuing involvement in the operations after the disposal transactions:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Rental and other revenues	$ 674	$ 3,340	$ 1,866	$ 6,862
Operating expenses:				
Rental property and other expenses	266	1,617	822	3,236
Depreciation and amortization	9	791	233	1,708
Total operating expenses	275	2,408	1,055	4,944
Other income	1	4	3	19
Income before minority interest and gains on sales of discontinued operations	400	936	814	1,937
Minority interest in discontinued operations	(26)	(63)	(53)	(137)
Income from discontinued operations, net of minority interest	374	873	761	1,800
Gains on sales of discontinued operations	5,027	103	8,753	19,846
Minority interest in discontinued operations	(325)	(7)	(568)	(1,488)
Gains on sales of discontinued operations, net of minority interest	4,702	96	8,185	18,358
Total discontinued operations	$ 5,076	$ 969	$ 8,946	$ 20,158

The net book value of properties classified as discontinued operations that were sold during 2007 and the six months ended June 30, 2008 and held for sale at June 30, 2008 aggregated $97.2 million.

Table of Contents

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

10. DISCONTINUED OPERATIONS - Continued

The following table includes the major classes of assets and liabilities of the properties classified as held for sale as of June 30, 2008 and December 31, 2007:

	June 30, 2008	December 31, 2007
Land	$ 1,241	$ 1,241
Land held for development	8,547	10,404
Buildings and tenant improvements	4,979	5,006
Accumulated depreciation	(1,647)	(1,623)
Net real estate assets	13,120	15,028
Deferred leasing costs, net	64	59
Accrued straight line rents receivable	3	1
Prepaid expenses and other	55	62
Total assets	$ 13,242	$ 15,150
Tenant security deposits, deferred rents and accrued costs (1)	$ 129	$ 100

(1) Included in accounts payable, accrued expenses and other liabilities.

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

11. EARNINGS PER SHARE

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

	Three Months Ended June 30, 2008	2007	Six Months Ended June 30, 2008	2007
Basic income per share:				
Numerator:				
Income from continuing operations	$ 9,907	$ 8,320	$ 21,680	$ 41,689
Preferred Stock dividends	(2,838)	(3,846)	(5,676)	(7,959)
Excess of Preferred Stock redemption costs over carrying value		(1,443)		(1,443)
Income from continuing operations available for common stockholders	7,069	3,031	16,004	32,287
Income from discontinued operations	5,076	969	8,946	20,158
Net income available for common stockholders	$ 12,145	$ 4,000	$ 24,950	$ 52,445
Denominator:				
Denominator for basic earnings per share weighted average shares (1)	56,940	56,460	56,833	56,216
Basic earnings per share:				
Income from continuing operations	$ 0.12	$ 0.05	$ 0.28	$ 0.57
Income from discontinued operations	0.09	0.02	0.16	0.36
Net income	$ 0.21	$ 0.07	$ 0.44	$ 0.93
Diluted income per share:				
Numerator:				
Income from continuing operations	$ 9,907	$ 8,320	$ 21,680	$ 41,689
Preferred Stock dividends	(2,838)	(3,846)	(5,676)	(7,959)
Excess of Preferred Stock redemption costs over carrying value		(1,443)		(1,443)
Minority interest in the Operating Partnership	488	208	1,111	2,592
Income from continuing operations available for common stockholders	7,557	3,239	17,115	34,879
Income from discontinued operations	5,076	969	8,946	20,158
Minority interest in the Operating Partnership in discontinued operations	351	70	621	1,625
Income from discontinued operations	5,427	1,039	9,567	21,783
Net income available for common stockholders	$ 12,984	$ 4,278	$ 26,682	$ 56,662
Denominator:				
	56,940	56,460	56,833	56,216

Denominator for basic earnings per share adjusted weighted average shares (1)				
Add:				
Employee and director stock options and warrants	420	722	331	883
Common Units	3,946	4,104	3,957	4,322
Unvested restricted stock	186	276	169	288
Denominator for diluted earnings per share adjusted weighted average shares and assumed conversions (2)	61,492	61,562	61,290	61,709
Diluted earnings per share:				
Income from continuing operations	$ 0.12	$ 0.05	$ 0.28	$ 0.57
Income from discontinued operations	0.09	0.02	0.16	0.35
Net income	$ 0.21	$ 0.07	$ 0.44	$ 0.92

Table of Contents

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

11. EARNINGS PER SHARE - Continued

(1) Weighted average shares exclude shares of unvested restricted stock pursuant to SFAS No. 128, Earnings per Share.

(2) Options and warrants aggregating approximately 0.2 million and 0.1 million shares were outstanding during the three months ended June 30, 2008 and 2007, respectively, and 0.4 million and 0.1 million shares were outstanding during the six months ended June 30, 2008 and 2007, respectively, but were not included in the computation of diluted earnings per share because the exercise prices of the options and warrants were higher than the average market price of Common Stock during these periods.

12. COMMITMENTS AND CONTINGENCIES

Concentration of Credit Risk

We maintain cash and cash equivalent investments and restricted cash at financial institutions. The combined account balances at each institution typically exceed FDIC insurance coverage and, as a result, there is a concentration of credit risk related to amounts on deposit in excess of FDIC insurance coverage.

Land Leases

Certain properties in our wholly owned portfolio are subject to land leases expiring through 2082. Rental payments on these leases are adjusted annually based on either the consumer price index (CPI) or on a pre-determined schedule. Land leases subject to increases under a pre-determined schedule are accounted for under the straight-line method. Total expense recorded for land leases was $0.7 million for each of the six months ended June 30, 2008 and 2007.

Environmental Matters

Substantially all of our in-service properties have been subjected to Phase I environmental assessments (and, in certain instances, Phase II environmental assessments). Such assessments and/or updates have not revealed, nor is management aware of, any environmental liability that management believes would have a material adverse effect on the accompanying Consolidated Financial Statements.

Guarantees and Other Obligations

For information regarding guarantees and other obligations as of December 31, 2007, see Note 15 to the Consolidated Financial Statements in our 2007 Annual Report on Form 10-K. There were no material changes to this information in the six months ended June 30, 2008.

Litigation, Claims and Assessments

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, the estimated loss is accrued and charged to income 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, results of operations or cash flows.

Table of Contents

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

13. INCOME TAXES

Our financial statements include the operations of our taxable REIT subsidiary that is not entitled to a dividends paid deduction and is subject to corporate federal, state and local income taxes. As a REIT, we may also be subject to certain federal excise taxes if we engage in certain types of transactions.

Other than the liability for an uncertain tax position and related accrued interest under FIN 48 discussed below, no provision has been made pursuant to SFAS No. 109 for federal and state income taxes during the six months ended June 30, 2008 and 2007 because the Company qualified as a REIT, distributed the necessary amount of taxable income and, therefore, incurred no income tax expense during the periods. The taxable REIT subsidiary has operated at a cumulative taxable loss through June 30, 2008 of approximately $9.4 million and has paid no income taxes since its formation. In addition to the $3.6 million deferred tax asset for these cumulative tax loss carryforwards, the taxable REIT subsidiary also had net deferred tax assets of approximately $1.2 million comprised primarily of tax versus book basis differences in certain investments and depreciable assets held by the taxable REIT subsidiary. Because the future tax benefit of the cumulative losses is not assured, the approximate $4.8 million net deferred tax asset position of the taxable REIT subsidiary has been fully reserved as management does not believe that it is more likely than not that the net deferred tax asset will be realized. Accordingly, no tax benefit has been recognized in the accompanying Consolidated Financial Statements. The tax benefit of the cumulative losses could be recognized for financial reporting purposes in future periods to the extent the taxable REIT subsidiary generates sufficient taxable income.

We adopted FIN 48, on January 1, 2007 and recorded a $1.4 million liability, which included $0.2 million of accrued interest, for an uncertain tax position, with the related expense reflected as a reduction to the beginning balance of distributions in excess of net earnings. This liability was included in accounts payable, accrued expenses and other liabilities. During the third quarter of 2007, the liability for the uncertain tax position was released, and income recognized, upon the expiration of the applicable statute of limitations. In addition, the liability of $0.05 million of interest that was accrued in 2007 relating to this liability was also released. We continue to examine our tax positions and do not believe we have any uncertain tax positions that would result in a FIN 48 reserve as of June 30, 2008.

Table of Contents

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

14. SEGMENT INFORMATION

Our principal business is the acquisition, development and operation of rental real estate properties. We evaluate our business by product type and by geographic locations. These segments and our disclosures below are expanded from what we reported in our Annual Report on Form 10-K for 2007 due to expanded internal reporting information used by our chief operating decision maker starting in the first quarter of 2008. Each product type has different customers and economic characteristics as to rental rates and terms, cost per square foot of buildings, the purposes for which customers use the space, the degree of maintenance and customer support required and customer dependency on different economic drivers, among others. The operating results by geographic grouping are also regularly reviewed by our chief operating decision maker for assessing performance and other purposes. There are no material inter-segment transactions.

The accounting policies of the segments are the same as those described in Note 1 included herein. Further, all operations are within the United States and, at June 30, 2008, no tenant of the Wholly Owned Properties comprised more than 7.5% of our consolidated revenues.

The following table summarizes the rental income, net operating income and assets for each reportable segment for the three and six months ended June 30, 2008 and 2007:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Rental and Other Revenues: (1) (2)				
Office:				
Atlanta, GA	$ 11,673	$ 10,560	$ 23,199	$ 20,947
Greenville, SC	3,527	3,403	6,743	6,500
Kansas City, MO	3,841	3,534	7,566	6,883
Memphis, TN	6,334	6,214	12,499	12,000
Nashville, TN	16,095	13,612	31,673	26,238
Orlando, FL	2,245	1,584	4,178	3,181
Piedmont Triad, NC	6,489	6,439	12,870	13,134
Raleigh, NC	17,302	15,215	35,823	31,012
Richmond, VA	12,575	11,198	24,042	21,869
Tampa, FL	16,832	14,988	32,666	30,343
Other	528	486	1,035	1,424
Total Office Segment	97,441	87,233	192,294	173,531
Industrial:				
Atlanta, GA	3,805	3,986	7,928	7,789

Kansas City, MO	5	5	10	10
Piedmont Triad, NC	3,567	3,195	7,307	6,708
Total Industrial Segment	7,377	7,186	15,245	14,507
Retail:				
Kansas City, MO	10,477	10,307	21,349	21,733
Piedmont Triad, NC	260	132	455	257
Total Retail Segment	10,737	10,439	21,804	21,990
Residential:				
Kansas City, MO	298	288	604	580
Total Residential Segment	298	288	604	580
Total Rental and Other Revenues	$ 115,853	$ 105,146	$ 229,947	$ 210,608

Table of Contents

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

14. SEGMENT INFORMATION - Continued

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Net Operating Income: (1) (2)				
Office:				
Atlanta, GA	$ 7,461	$ 6,855	$ 15,022	$ 13,563
Greenville, SC	2,166	2,155	4,111	3,950
Kansas City, MO	2,200	1,959	4,139	3,670
Memphis, TN	3,817	3,503	7,470	7,013
Nashville, TN	10,514	8,878	21,140	17,046
Orlando, FL	1,307	896	2,420	1,872
Piedmont Triad, NC	4,041	3,846	8,065	7,961
Raleigh, NC	11,416	10,019	24,318	20,487
Richmond, VA	8,255	7,709	16,272	15,112
Tampa, FL	10,291	8,882	19,970	18,283
Other	125	441	456	513
Total Office Segment	61,593	55,143	123,383	109,470
Industrial:				
Atlanta, GA	2,771	3,015	5,900	5,988
Kansas City, MO	2	2	4	4
Piedmont Triad, NC	2,781	2,450	5,737	5,204
Total Industrial Segment	5,554			