

HIGHWOODS PROPERTIES INC
Form 10-Q/A
March 03, 2008

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

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

For the quarterly period ended March 31, 2007

Commission file number: 001-13100

HIGHWOODS PROPERTIES, INC.

(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction
of incorporation or organization)

56-1871668
(I.R.S. Employer
Identification Number)

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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 No

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 Company had 56,879,322 shares of common stock outstanding as of May 1, 2007.

HIGHWOODS PROPERTIES, INC.

QUARTERLY REPORT FOR THE PERIOD ENDED MARCH 31, 2007

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EXPLANATORY NOTE

The sole purpose of this amended Quarterly Report is to set forth unaudited interim financial statements for the periods presented on a restated basis that present cash disposition proceeds that are set aside and designated or intended to fund future tax-deferred exchanges of qualifying real estate investments as restricted cash rather than as cash and cash equivalents (see Note 14 to the Consolidated Financial Statements). In addition, in accordance with Statement of Financial Accounting Standard No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, (SFAS No. 144), the operations of any property sold during the nine months ended December 31, 2007 have been reclassified into discontinued operations. 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 2006 Annual Report on Form 10-K. As permitted by Rule 12b-15 of the Securities Exchange Act, this amended filing includes the complete text of only those items amended. Accordingly, Part I, Items 3 and 4, and Part II, Items 1 through 5, have been omitted from this filing.

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 reflect 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.

HIGHWOODS PROPERTIES, INC.**Consolidated Balance Sheets**

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

	March 31, 2007		December 31, 2006
Assets:			
		(as restated - see Note 14)	
Real estate assets, at cost:			
Land	\$ 350,245		\$ 345,548
Buildings and tenant improvements	2,615,830		2,573,032
Development in process	108,074		101,899
Land held for development	108,843		111,988
	3,182,992		3,132,467
Less-accumulated depreciation	(609,148	)	(588,307
Net real estate assets	2,573,844		2,544,160
Real estate and other assets, net, held for sale	5,519		34,944
Cash and cash equivalents	927		16,690
Restricted cash	17,769		2,027
Accounts receivable, net of allowance of \$1,011 and \$1,253, respectively	24,830		23,347
Notes receivable, net of allowance of \$780 and \$786, respectively	7,295		7,871
Accrued straight-line rents receivable, net of allowance of \$749 and \$301, respectively	69,920		68,364
Investment in unconsolidated affiliates	61,763		60,359
Deferred financing and leasing costs, net of accumulated amortization	68,885		66,352
Prepaid expenses and other assets	19,952		20,739
Total Assets	\$ 2,850,704		\$ 2,844,853
Liabilities, Minority Interest and Stockholders' Equity:			
Mortgages and notes payable	\$ 1,487,509		\$ 1,465,129
Accounts payable, accrued expenses and other liabilities	139,858		156,737
Financing obligations	35,529		35,530
Total Liabilities	1,662,896		1,657,396
Commitments and Contingencies (see Note 11)			
Minority interest	70,369		79,726
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), 104,945 shares issued and outstanding at March 31, 2007 and December 31, 2006	104,945		104,945
8% Series B Cumulative Redeemable Preferred Shares (liquidation preference \$25 per share), 3,700,000 shares issued and outstanding at March 31, 2007 and December 31, 2006	92,500		92,500
Common stock, \$.01 par value, 200,000,000 authorized shares; 56,710,660 and 56,211,148 shares issued and outstanding at March 31, 2007 and December 31, 2006, respectively	567		562
Additional paid-in capital	1,435,679		1,449,337
Distributions in excess of net earnings	(514,879	)	(538,098
Accumulated other comprehensive loss	(1,373	)	(1,515
Total Stockholders' Equity	1,117,439		1,107,731
Total Liabilities, Minority Interest and Stockholders' Equity	\$ 2,850,704		\$ 2,844,853

See accompanying notes to consolidated financial statements.

HIGHWOODS PROPERTIES, INC.**Consolidated Statements of Income**

(Unaudited and in thousands, except per share amounts)

	Three Months Ended	
	March 31,	
	2007	2006
Rental and other revenues	\$ 106,691	\$ 99,288
Operating expenses:		
Rental property and other expenses	38,276	35,359
Depreciation and amortization	29,142	27,136
General and administrative	10,911	8,692
Total operating expenses	78,329	71,187
Interest expenses:		
Contractual	22,689	23,810
Amortization of deferred financing costs	566	744
Financing obligations	992	942
	24,247	25,496
Other income:		
Interest and other income	1,515	1,969
	1,515	1,969
Income before disposition of property, insurance gain, minority interest and equity in earnings of unconsolidated affiliates	5,630	4,574
Gains on disposition of property, net	16,743	4,310
Gain from property insurance settlement	4,128	-
Minority interest	(2,585)	(486)
Equity in earnings of unconsolidated affiliates	9,717	2,083
Income from continuing operations	33,633	10,481
Discontinued operations:		
Income from discontinued operations, net of minority interest	663	1,907
Gains on sales of discontinued operations, net of minority interest	18,262	1,758
	18,925	3,665
Net income	52,558	14,146
Dividends on preferred stock	(4,113)	(4,724)
Excess of preferred stock redemption cost over carrying value		(1,803)
Net income available for common stockholders	\$ 48,445	\$ 7,619
Net income per common share - basic:		
Income from continuing operations	\$ 0.52	\$ 0.07
Income from discontinued operations	0.34	0.07
Net income	\$ 0.86	\$ 0.14
Weighted average common shares outstanding - basic	56,040	53,813
Net income per common share - diluted:		
Income from continuing operations	\$ 0.52	\$ 0.07
Income from discontinued operations	0.33	0.07
Net income	\$ 0.85	\$ 0.14
Weighted average common shares outstanding - diluted	61,900	60,588
Dividends declared per common share	\$ 0.425	\$ 0.425

See accompanying notes to consolidated financial statements.

HIGHWOODS PROPERTIES, INC.**Consolidated Statement of Stockholders Equity****For the Three Months Ended March 31, 2007**

(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 Compre- hensive Loss	Distributions in Excess of Net Earnings	Total
Balance at December 31, 2006	56,211,148	\$ 562	\$ 104,945	\$ 92,500	\$ 1,449,337	\$ (1,515	)\$ (538,098	)\$ 1,107,731
Cumulative effect adjustment resulting from the adoption of FASB Interpretation No. 48	-	-	-	-	-	-	(1,424	) (1,424
Issuance of Common Stock	431,627	4	-	-	984	-	-	988
Common Stock dividends	-	-	-	-	-	-	(23,802	) (23,802
Preferred Stock dividends	-	-	-	-	-	-	(4,113	) (4,113
Adjustment to minority interest of unitholders in the Operating Partnership	-	-	-	-	(15,773	) -	-	(15,773
Issuance of restricted stock, net	67,885	-	-	-	-	-	-	-
Amortization of restricted stock and stock options	-	1	-	-	1,131	-	-	1,132
Other comprehensive income	-	-	-	-	-	142	-	142
Net income	-	-	-	-	-	-	52,558	52,558
Balance at March 31, 2007	56,710,660	\$ 567	\$ 104,945	\$ 92,500	\$ 1,435,679	\$ (1,373	)\$ (514,879	)\$ 1,117,439

See accompanying notes to consolidated financial statements.

HIGHWOODS PROPERTIES, INC.**Consolidated Statements of Cash Flows**

(Unaudited and in thousands)

	Three Months Ended	
	March 31,	
	2007	2006
	(as restated - see Note 14)	
Operating activities:		
Net income	\$ 52,558	\$ 14,146
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	29,746	28,750
Amortization of lease incentives	222	163
Amortization of restricted stock and stock options	1,132	845
Amortization of deferred financing costs	566	744
Amortization of accumulated other comprehensive loss	142	177
Gains on disposition of property	(36,486)	(6,204)
Gain from property insurance settlement	(4,128)	-
Minority interest	4,119	815
Equity in earnings of unconsolidated affiliates	(9,717)	(2,083)
Change in financing obligations	(1)	128
Distributions of earnings from unconsolidated affiliates	1,962	2,354
Changes in operating assets and liabilities:		
Accounts receivable	(1,057)	2,358
Prepaid expenses and other assets	223	124
Accrued straight-line rents receivable	(1,572)	(2,521)
Accounts payable, accrued expenses and other liabilities	(11,965)	84
Net cash provided by operating activities	25,744	39,880
Investing activities:		
Additions to real estate assets and deferred leasing costs	(66,275)	(34,783)
Proceeds from disposition of real estate assets	65,028	158,677
Proceeds from property insurance settlement	4,940	-
Distributions of capital from unconsolidated affiliates	6,383	1,371
Net repayments in notes receivable	576	513
Contributions to unconsolidated affiliates	-	(100)
Cash assumed upon consolidation of unconsolidated affiliate	-	645
Changes in restricted cash and other investing activities	(15,582)	(624)
Net cash (used in)/ provided by investing activities	(4,930)	125,699
Financing activities:		
Distributions paid on Common Stock and Common Units	(25,766)	(25,237)
Redemption of Preferred Stock	-	(50,000)
Dividends paid on Preferred Stock	(4,113)	(4,724)
Distributions of earnings to minority partner in consolidated affiliate	(928)	(127)
Net proceeds from the sale of Common Stock	988	310
Repurchase of Common Units	(27,402)	(1,497)
Borrowings on revolving credit facility	106,400	92,000
Repayments of revolving credit facility	(416,900)	(104,500)
Borrowings on mortgages and notes payable	401,571	-
Repayments of mortgages and notes payable	(68,696)	(48,829)
Contributions from minority interest partner	1,045	-
Additions to deferred financing costs and other financing activities	(2,776)	(43)
Net cash used in financing activities	(36,577)	(142,647)
Net (decrease)/increase in cash and cash equivalents	\$ (15,763)	\$ 22,932
Cash and cash equivalents at beginning of the period	16,690	1,212
Cash and cash equivalents at end of the period	\$ 927	\$ 24,144

See accompanying notes to consolidated financial statements.

HIGHWOODS PROPERTIES, INC.

Consolidated Statements of Cash Flows - Continued

(Unaudited and in thousands)

Supplemental disclosure of cash flow information:

	Three Months Ended	
	March 31,	
	2007	2006
Cash paid for interest, net of amounts capitalized (excludes cash distributions to owners of sold properties accounted for as financings of \$663 and \$482 for 2007 and 2006, respectively)	\$ 22,666	\$ 21,316

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:

	Three Months Ended	
	March 31,	
	2007	2006
Assets:		
Net real estate assets	\$ -	\$ 42,948
Restricted cash	-	(1,865)
Accounts receivable	-	102
Accrued straight-line rents receivable	-	962
Investments in unconsolidated affiliates	-	(2,066)
Deferred financing and leasing costs, net	-	287
	\$ -	\$ 40,368
Liabilities:		
Mortgages and notes payable	\$ -	\$ 39,964
Accounts payable, accrued expenses and other liabilities	-	(1,652)
	\$ -	\$ 38,312
Minority Interest and Stockholders Equity	\$ -	\$ 2,056

See accompanying notes to consolidated financial statements.

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2007

(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 substantially all of its activities through Highwoods Realty Limited Partnership (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), all of the Company's assets are owned directly or indirectly by the Operating Partnership. As of March 31, 2007, the Company directly and/or through the Operating Partnership wholly owned: 320 in-service office, industrial and retail properties; 109 rental residential units; 625 acres of undeveloped land suitable for future development, of which 421 acres are considered core holdings; and an additional 16 properties under development.

At March 31, 2007, the Company owned all of the preferred partnership interests ("Preferred Units") and 93.2% 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 three months ended March 31, 2007, the Company redeemed 618,257 Common Units for \$27.4 million in cash, which increased the percentage of Common Units owned by the Company from 92.2% at December 31, 2006 to 93.2% at March 31, 2007. 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

The Consolidated Financial Statements of the Company are prepared in accordance with U.S. Generally Accepted Accounting Principles ("GAAP"). Certain amounts in the December 31, 2006 Consolidated Balance Sheet have been reclassified to conform to the current presentation. As more fully described in Note 9, as required by SFAS No. 144, the Consolidated Balance Sheet at December 31, 2006 was revised from previously reported amounts to reflect in real estate and other assets held for sale those properties held for sale at March 31, 2007. The Consolidated Statements of Income for the three months ended March 31, 2006 were also revised from previously reported amounts to reflect in discontinued operations the operations of any property sold in all of 2007.

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 Consolidated Financial Statements include the Operating Partnership, wholly owned subsidiaries and those subsidiaries in which the Company owns 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 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*, the Company consolidates partnerships, joint ventures and limited liability companies when the Company controls the major operating and financial policies of the entity through majority ownership or in its capacity as general partner or managing member. In addition, the Company consolidates those entities, if any, where the Company is deemed to be the primary beneficiary in a variable interest entity (as defined by FASB Interpretation No. 46 (revised December 2003) *Consolidation of Variable Interest Entities* (FIN 46(R))). All significant intercompany transactions and accounts have been eliminated.

The accompanying unaudited financial information, in the opinion of management, contains all adjustments (including normal recurring accruals) necessary for a fair presentation of the Company's financial position, results of operations and cash flows. The Company has 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 the Company's 2006 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.

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. 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. 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. The Company conducts 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. The Company records 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, the Company 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 *Impact of Newly Adopted and Issued Accounting Standards* below and Note 12 for discussion of the effect of FIN 48 on the Company's accounting for income taxes.

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 an office condominium project, as described below. As of March 31, 2007, minority interest in the Operating Partnership consisted of approximately 4.1 million Common Units. 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, the Company has 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 its assets warrant a distribution as determined by the agreement. In accordance with the disclosure provisions of SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (SFAS No. 150), the Company estimates the value of minority interest distributions would have been approximately \$10.9 million had the entity been liquidated as of March 31, 2007. This 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, the Company would have no obligation to remit any consideration to the minority interest holder.

In the fourth quarter of 2006, the Company entered into an agreement with REES to ground lease certain development land to special purpose entities owned by REES. Under the agreement, REES makes an equity contribution to each such entity in an amount equal to 7% of the costs of constructing properties on the entity's land (not to exceed \$4.0 million outstanding in the aggregate at any time). REES earns an agreed fixed return for its economic investment in the entity. The balance of development costs are funded by third party construction loans. Until such third party construction loans are obtained, the remaining 93% of costs are loaned by the Company to the entity. Subject to the exercise of a purchase option, it is expected that the properties will be acquired by the Company 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. Because the Company is considered the primary beneficiary, the Company consolidates these special purpose entities in accordance with FIN 46(R). Consolidated entities will be re-evaluated for primary beneficiary status when the entity undertakes additional activity, such as placing the development projects in-service. REES's investment in these 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.

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, the Company's taxable REIT subsidiary formed Plaza Residential LLC with Dominion Partners LLC (Dominion). Plaza Residential was formed to develop and sell 139 residential condominiums to be constructed above an office tower being developed by the Company in Raleigh, NC. Dominion has a 7% equity interest in the project and 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. The Company is consolidating this majority owned joint venture and inter-company transactions have been eliminated in the Consolidated Financial Statements.

Following is minority interest as reflected in the Company's Consolidated Statements of Income and Consolidated Balance Sheets:

	Three Months Ended	
	March 31,	
	2007	2006
Amount shown as minority interest in continuing operations (1)	\$ (2,585)	\$ (486)
Amount related to income from discontinued operations	(53)	(193)
Amount related to gains on sales of discontinued operations	(1,481)	(136)
Total minority interest in net income	\$ (4,119)	\$ (815)

(1) 2007 and 2006 includes \$0.18 million and \$0.09 million related to the consolidated entities other than the Operating Partnership.

	March 31,	December 31,
	2007	2006
Minority interest in the Operating Partnership	\$ 67,194	\$ 76,848
Minority interest in Markel	2,071	2,118
Minority interest in REES	947	760
Minority interest in Plaza Residential	157	-
Total minority interest	\$ 70,369	\$ 79,726

Impact of Newly Adopted and Issued Accounting Standards

In June 2006, the FASB issued FIN 48, which the Company adopted as of January 1, 2007. See Note 12 for further discussion.

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In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures concerning fair value measurements. SFAS No. 157 becomes effective for the Company on January 1, 2008. The Company is currently evaluating the impact SFAS No. 157 will have on its financial condition and results of operations.

In December 2006, the FASB issued FSP EITF 00-19-2, Accounting for Registration Payment Arrangements, to specify that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement should be separately recognized and measured in accordance with FASB Statement No. 5, Accounting for Contingencies. The FSP is effective immediately for registration payment arrangements and the financial instruments subject to those arrangements that are entered into or modified subsequent to the issuance date of this FSP and effective for fiscal years beginning after December 15, 2006 and interim periods within those fiscal years for arrangements that were entered into prior to the issuance of this FSP. See Note 5 for discussion of a registration rights agreement the Company entered into in the first quarter of 2007.

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 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. SFAS No. 159 becomes effective for the Company on January 1, 2008. The Company is currently evaluating the impact SFAS No. 159 will have on its financial condition and results of operations.

2. INVESTMENTS IN UNCONSOLIDATED AND OTHER AFFILIATES

The Company has various joint ventures with unrelated investors and has retained equity interests ranging from 12.5% to 50.0% in these joint ventures. The Company accounts for its unconsolidated joint ventures using the equity method of accounting. As a result, the assets and liabilities of these joint ventures for which the Company uses the equity method of accounting are not included on the Company's consolidated balance sheet.

During the third quarter of 2006, three of the Company's 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. The Company received 50.0% of such distributions. As a result of these distributions, the Company's investment account in these joint ventures became negative. The new debt is non-recourse; however, the Company and its 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 11. Therefore, in accordance with SOP 78-9, "Accounting for Investments in Real Estate Ventures," the Company recorded the distributions as a reduction of the investment account and included the resulting negative investment balances of \$6.7 million in accounts payable, accrued expenses and other liabilities in the Consolidated Balance Sheet at March 31, 2007.

The Company has had a number of consolidated joint ventures. SF-HIW Harborview Plaza, LP is accounted for as a financing arrangement pursuant to SFAS No. 66, "Accounting for Sales of Real Estate" (SFAS ~~66~~), as described in Note 3 to the Consolidated Financial Statements in the Company's 2006 Annual Report on Form 10-K; MG-HIW, LLC was accounted for as a financing arrangement pursuant to SFAS No. 66 as described in Note 3 to the Consolidated Financial Statements in the Company's 2006 Annual Report on Form 10-K; The Vinings at University Center, LLC was consolidated pursuant to FIN 46(R) as described further below until late 2006 upon the sale of the venture's assets and distribution of its net cash assets to its partners; and Markel, REES and Plaza Residential, which are discussed in Note 1, are each consolidated.

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 March 31, 2007 and combined summarized income statements for the Company's unconsolidated joint ventures for the three months ended March 31, 2007 and 2006 were as follows:

Joint Venture	Location of Properties	Total Rentable	Ownership	
		Square Feet (000)	Interest	%
Board of Trade Investment Company	Kansas City, MO	166	49.00	%
Dallas County Partners I, LP	Des Moines, IA	641	50.00	%
Dallas County Partners II, LP	Des Moines, IA	272	50.00	%
Dallas County Partners III, LP	Des Moines, IA	7	50.00	%
Fountain Three	Des Moines, IA	785	50.00	%
RRHWoods, LLC	Des Moines, IA	800	(1) 50.00	%
Kessinger/Hunter, LLC	Kansas City, MO		(2) 26.50	%
4600 Madison Associates, LLC	Kansas City, MO	262	12.50	%
Plaza Colonnade, LLC	Kansas City, MO	290	50.00	%
Highwoods DLF 98/29, LP	Atlanta, GA; Charlotte, NC; Greensboro, NC; Raleigh, NC; Orlando, FL; Baltimore, MD	923	22.81	%
Highwoods DLF 97/26 DLF 99/32, LP	Atlanta, GA; Greensboro, NC; Orlando, FL	822	42.93	%
Highwoods KC Glenridge Office, LP	Atlanta, GA	185	40.00	%
Highwoods KC Glenridge Land, LP	Atlanta, GA		40.00	%
HIW-KC Orlando LLC	Orlando, FL	1,274	40.00	%
Concourse Center Associates, LLC	Greensboro, NC	118	50.00	%
Weston Lakeside, LLC	Raleigh, NC		(3) 50.00	%
Total		6,545	(4)	

(1) Includes a 31,000 square foot office building currently under development and 418 rental residential units.

(2) This joint venture provides property management, leasing and brokerage services and provides certain construction-related services to certain Wholly Owned Properties; therefore, no rentable square feet is provided.

(3) This joint venture was constructing 332 rental residential units at December 31, 2006. These assets were sold in February 2007 as described below.

(4) Total does not include in-service operating properties held by consolidated joint ventures totaling 618,000 square feet.

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

	Three Months Ended	
	March 31, 2007	2006
Income Statements:		
Revenues	\$ 38,017	\$ 34,018
Expenses:		
Operating expenses	15,163	14,239
Depreciation and amortization	7,253	6,998
Interest expense and loan cost amortization	8,632	8,324
Total expenses	31,048	29,561
Income before disposition of property	6,969	4,457
Gains on disposition of property	20,621	-
Net income	\$ 27,590	\$ 4,457
The Company's share of:		
Net income (1)	\$ 9,717	\$ 2,083
Depreciation and amortization (real estate related)	\$ 2,866	\$ 2,675
Interest expense and loan cost amortization	\$ 3,661	\$ 3,480
Gains on disposition of property	\$ 7,158	\$ -

(1) The Company's share of net income differs from its weighted average ownership percentage in the joint ventures' net income due to the Company's purchase accounting and other related adjustments.

On September 27, 2004, the Company and an affiliate of Crosland, Inc. (Crosland) formed Weston Lakeside, LLC, in which the Company has a 50.0% ownership interest. On June 29, 2005, the Company contributed 22.4 acres of land at an agreed upon value of \$3.9 million to this joint venture, and Crosland contributed approximately \$2.0 million in cash. Immediately thereafter, the joint venture distributed approximately \$1.9 million to the Company and the Company recorded a gain of \$0.5 million. Crosland managed and operated this joint venture, which constructed approximately 332 rental residential units in three buildings, at a total estimated cost of approximately \$33 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. The joint venture financed the development with a \$28.4 million construction loan guaranteed by Crosland. The Company provided certain development services for the project and received a fee equal to 1.0% of all project costs excluding land. The Company has 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. Mortgage debt in the amount of \$27.1 million was paid off and various development related costs were paid. The joint venture recorded a gain of \$11.3 million in the first quarter of 2007 related to this sale and the Company recorded \$5.0 million as its proportionate share through equity in earnings of unconsolidated affiliates. The Company's share of the gain was less than 50.0% due to Crosland's preferred return as the developer. The Company received a net distribution of \$6.1 million and may receive a further small and final distribution. As of May 1, 2007, the joint venture is dormant pending the final distribution to the partners.

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

Highwoods DLF 98/29, L.P.

The Company has a 22.81% interest in a joint venture (DLF I) with Schweiz-Deutschland-USA Dreilander Beteiligung Objekt DLF 98/29-Walker Fink-KG ("DLF"). The Company is the property manager and leasing agent of DLF I 's properties and receives 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. The Company recorded \$2.1 million as its proportionate share of this gain through equity in earnings of unconsolidated affiliates.

For additional information regarding the Company 's other investments in unconsolidated and other affiliates, see Note 2 to the Consolidated Financial Statements in the Company 's 2006 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 Note 5 herein and Note 3 to the Consolidated Financial Statements in the Company 's 2006 Annual Report on Form 10-K.

4. ASSET DISPOSITIONS

Gains, losses and impairments on disposition of properties, net, from dispositions not classified as discontinued operations, consisted of the following:

	Three Months Ended	
	March 31,	
	2007	2006
Gains on disposition of land	\$ 15,835	\$ 3,040
Gains on disposition of depreciable properties	908	1,270
Total	\$ 16,743	\$ 4,310

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The above gains on land and depreciable properties in the first quarter of 2006 include deferred gain recognition from prior sales and adjustments to prior sale transactions.

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

	Three Months Ended	
	March 31,	
	2007	2006
Gains on disposition of depreciable properties	\$ 19,743	\$ 1,894
Allocable minority interest	(1,481)	(136)
Total	\$ 18,262	\$ 1,758

See Note 9 for information on discontinued operations and impairment of long-lived assets.

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

The Company's consolidated mortgages and notes payable consisted of the following at March 31, 2007 and December 31, 2006:

	March 31, 2007	December 31, 2006
Secured mortgage loans	\$ 675,724	\$ 741,629
Unsecured loans	811,785	(1) 723,500
Total	\$ 1,487,509	\$ 1,465,129

(1) Represents stated amount less \$1.2 million original issue discount on bonds issued in 2007.

As of March 31, 2007, the Company's outstanding mortgages and notes payable were secured by real estate assets with an aggregate undepreciated book value of approximately \$1.0 billion.

The Company's \$450.0 million unsecured revolving credit facility is initially scheduled to mature on May 1, 2009. Assuming no default exists, the Company has an option to extend the maturity date by one additional year and, at any time prior to May 1, 2008, may request increases in the borrowing availability under the credit facility by up to an additional \$50 million. The interest rate is LIBOR plus 80 basis points and the annual base facility fee is 20 basis points. The revolving credit facility had \$366.9 million of availability as of May 1, 2007.

The Company's revolving credit facility and the indenture that governs the Operating Partnership's outstanding notes require it to comply with customary operating covenants and various financial and operating ratios. The Company and the Operating Partnership are each currently in compliance with all such requirements.

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. The notes were issued under the indenture, dated as of December 1, 1996, among the Operating Partnership, the Company and U.S. Bank National Association (as successor in interest to Wachovia Bank, N.A.), the trustee, and pursuant to resolutions of the Board of Directors of the Company and an officers' certificate dated as of March 22, 2007 establishing the terms of the notes. The Company 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. In connection with the completion of the offering, the Company and the Operating Partnership entered into a registration rights agreement dated March 22, 2007 with the initial purchasers of the notes. The registration rights agreement requires the Operating Partnership to file, within 90 days after the closing date of the sale of the notes, a registration statement with respect to an offer to exchange the notes for other freely tradable notes that are registered under the Securities Act of 1933 and to cause such exchange offer registration statement to become effective within 180 days after the closing date. The Operating Partnership is required to complete the exchange offer within 210 days after the closing date. If the Operating

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Partnership fails to comply with the provisions of the registration rights agreement, the interest rate will be increased by 0.25% per annum during the

90-day period immediately following the default and will increase by 0.25% per annum at the end of each subsequent 90-day period, but in no event shall such increase exceed 0.50% per annum. Management currently believes that the Company will timely fulfill its obligations under the registration rights agreement and, accordingly, no amounts have been recorded for potential future additional interest costs.

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**

The Company's financing obligations consisted of the following at March 31, 2007 and December 31, 2006:

	March 31, 2007	December 31, 2006
SF-HIW Harborview, LP financing obligation (1)	\$ 16,146	\$ 16,157
Tax increment financing obligation (2)	18,308	18,308
Capitalized ground lease obligation (3)	1,075	1,065
Total	\$ 35,529	\$ 35,530

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- (1) See Note 3 to the Consolidated Financial Statements in the Company's 2006 Annual Report on Form 10-K for further discussion of this financing obligation.
- (2) In connection with tax increment financing for construction of a public garage related to an office building constructed by the Company in 2000, the Company is 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. The Company also receives 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.
- (3) Represents a capitalized lease obligation to the lessor of land on which the Company is constructing a new building. The Company is 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. The Company intends 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.

6. EMPLOYEE BENEFIT PLANS**Officer, Management and Director Compensation Programs**

The Company's officers participate in an annual non-equity incentive program whereby they are eligible for incentive payments based on a percentage of their annual base salary. In addition to considering the pay practices of the Company's peer group in determining each officer's

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incentive payment percentage, the officer's ability to influence the Company's performance is also considered. Each officer has a target annual non-equity incentive payment percentage that ranges from 25.0% to 85.0% of base salary depending on the officer's position. The officer's actual incentive payment for the year is the product of the target annual incentive payment percentage times a performance factor, which can range from zero to 200.0%. This performance factor depends upon the relationship between how various performance criteria compare with predetermined goals. For an officer who has division responsibilities, goals for certain performance criteria are based partly on the division's actual performance relative to that division's established goals for each criteria and partly on actual total Company performance relative to the same criteria. Incentive payments are accrued and expensed in the year earned and are generally paid in the first quarter of the following year.

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

6. EMPLOYEE BENEFIT PLANS - Continued

Certain other members of management participate in an annual non-equity incentive program whereby a target annual cash incentive payment is established based upon the job responsibilities of their position. Incentive payment eligibility ranges from 10.0% to 40.0% of annual base salary. The actual incentive payment is determined by the overall performance of the Company and the individual's performance during each year. These incentive payments are also accrued and expensed in the year earned and are generally paid in the first quarter of the following year.

The Company's officers generally receive annual grants of stock options and restricted stock on or about March 1 of each year under the Amended and Restated 1994 Stock Option Plan (the "Stock Option Plan"). Stock options have also been granted to the Company's directors; currently, directors do not receive annual stock option grants. Restricted stock grants are also made annually to directors and certain non-officer employees. As of March 31, 2007, 9.0 million shares of Common Stock were authorized for issuance under the Stock Option Plan. Stock options issued prior to 2005 vest ratably over four years and remain outstanding for 10 years. Stock options issued beginning in 2005 vest ratably over a four-year period and remain outstanding for seven years. The value of all options as of the date of grant is calculated using the Black-Scholes option-pricing model.

The Company generally makes annual grants of time-based restricted stock under its Stock Option Plan to its directors, officers and other employees. Shares of time-based restricted stock issued prior to 2005 generally vest 50.0% three years from the date of grant and the remaining 50.0% five years from date of grant. Shares of time-based restricted stock that were issued to officers and employees in 2005 will vest one-third on the third anniversary, one-third on the fourth anniversary and one-third on the fifth anniversary of the date of grant. Shares of time-based restricted stock that were issued to officers and employees in 2006 and 2007 will vest 25% on the first, second, third and fourth anniversary dates, respectively. Shares of time-based restricted stock issued to directors generally vest 25% on January 1 of each successive year after the grant date. The value of grants of time-based restricted stock is based on the market value of Common Stock as of the date of grant and is amortized to expense over the respective vesting or service periods.

The Company also has issued shares of restricted stock to officers under its Stock Option Plan that will vest if the Company's total shareholder return exceeds the average total returns of a selected group of peer companies over a three-year period. If the Company's total shareholder return does not equal or exceed such average total returns, none of the total return-based restricted stock will vest. The 2006 and 2007 grants also contain a provision allowing for partial vesting if the annual total return in any given year of the three-year period exceeds 9% on an absolute basis. The grant date fair values of each such share of total return-based restricted stock are being amortized to expense on a straight-line method over the three-year period.

The Company also has issued shares of performance-based restricted stock to officers under its Stock Option Plan that will vest pursuant to performance-based criteria. The performance-based criteria are based on whether or not the Company meets or exceeds at the end of three-year performance periods certain operating and financial goals established under its Strategic Plan. To the extent actual performance equals or exceeds threshold performance goals, the portion of shares of performance-based restricted stock that vest can range from 50% to 100%. If actual performance does not meet such threshold goals, none of the performance-based restricted stock will vest. The fair value of performance-based restricted share grants is based on the market value of Common Stock as of the date of grant and the estimated performance to be achieved at the end of the three-year period. Such fair value is being amortized to expense over the three-year performance periods,

adjusting for the expected level of vesting that will occur at those dates.

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

6. EMPLOYEE BENEFIT PLANS - Continued

Up to 100% of additional total return-based restricted stock and up to 50% of additional performance-based restricted stock may be issued at the end of the three-year periods if actual performance exceeds certain levels of performance. Such additional shares, if any, would be fully vested when issued. The Company will also accrue and record expense for additional performance-based shares during the three-year period to the extent issuance of the additional shares is expected based on the Company's current and projected actual performance. In accordance with SFAS No. 123(R), no expense is recorded for additional shares of total return-based restricted stock that may be issued at the end of the three-year period since that possibility is already reflected in the grant date fair value.

During the three months ended March 31, 2007 and 2006, the Company recognized approximately \$1.2 million and \$0.9 million, respectively, of stock-based compensation expense. As of March 31, 2007, there was \$8.6 million of total unrecognized stock-based compensation costs, which will be recognized over a weighted average remaining contractual term of 2.4 years.

Using the Black-Scholes options valuation model, the weighted average fair values of options granted during the three months ended March 31, 2007 and 2006 were \$6.32 and \$3.98, respectively, per option. The fair values of the options granted in 2007 and 2006 were estimated at the grant dates using the following weighted average assumptions:

	Three Months Ended		
	March 31, 2007	2006	
Risk free interest rate (1)	4.50	% 4.63	%
Common stock dividend yield (2)	4.05	% 5.21	%
Expected volatility (3)	18.91	% 18.89	%
Average expected option life (years) (4)	5.75	4.75	
Options granted	143,629	241,151	

(1) Represents interest rate on US treasury bonds having the same life as the estimated life of the Company's options.

(2) The dividend yield is calculated utilizing the dividends paid for the previous one-year period and the Company's stock price on the date of grant.

(3) Based on historical volatility of the Company's stock over a period relevant to the related stock option grant.

(4) The average expected option life for the grants are based on an analysis of historical company data.

The following table summarizes information about stock option activity during the three months ended March 31, 2007:

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Options Outstanding

	Number of Shares	Weighted Average Exercise Price
Balances at December 31, 2006	2,975,071	\$ 24.67
Options granted	143,629	41.93
Options forfeited	(67,828)	27.93
Options cancelled	-	-
Options exercised	(834,181)	23.37
Balances at March 31, 2007	2,216,691	\$ 26.17

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

6. EMPLOYEE BENEFIT PLANS - Continued

Cash received or receivable from options exercised was \$7.1 million for the three months ended March 31, 2007. The total intrinsic value of options exercised during the three months ended March 31, 2007 was \$18.6 million. No options were exercised during the three months ended March 31, 2006. The total intrinsic value of options outstanding at March 31, 2007 and 2006 was \$29.9 million and \$49.1 million, respectively. The Company generally does not permit the net cash settlement of exercised stock options, but does permit net share settlement for certain qualified exercises. The Company has a policy of issuing new shares to satisfy stock option exercises.

The following table sets forth information at March 31, 2007 about (a) the outstanding number of vested stock options and those expected to vest and (b) the number of those options that are exercisable.

	Number of Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value (in 000s)	Weighted Average Remaining Life (years)
Outstanding	2,127,685	\$ 26.09	\$ 28,846	4.80
Exercisable	1,488,228	\$ 23.96	\$ 23,116	4.34

The following table summarizes activity in the three months ended March 31, 2007 for all time-based restricted stock grants:

	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested shares outstanding at December 31, 2006	255,120	\$ 27.12
Awarded and issued (1)	54,516	42.13
Vested (2)	(33,688)	) 28.19
Forfeited	(21,641)	) 26.58
Surrendered for payment of withholding taxes upon vesting (2)	(24,924)	) 28.05
Nonvested shares outstanding at March 31, 2007	229,383	\$ 30.48

(1) The weighted average fair value at grant date of time-based restricted shares issued during each of the three months ended March 31, 2007 and 2006 was \$2.3 million.

(2)

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The vesting date fair value of time-based restricted shares that vested during the three months ended March 31, 2007 and 2006 was \$2.6 million and \$1.6 million, respectively.

HIGHWOODS PROPERTIES, INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

6. EMPLOYEE BENEFIT PLANS - Continued

The following table summarizes activity in the three months ended March 31, 2007 for all performance-based and total return-based restricted stock grants:

	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested shares outstanding at December 31, 2006	106,646	\$ 28.58
Awarded and issued (1)	40,620	39.23
Vested	-	-
Forfeited	(5,610)	27.70
Surrendered for payment of withholding taxes upon vesting	-	-
Nonvested shares outstanding at March 31, 2007	141,656	\$ 31.67

(1) The weighted average fair value at grant date of performance and total return-based restricted shares issued during each of the three months ended March 31, 2007 and 2006 was \$1.6 million.

1999 Shareholder Value Plan

Grants under the 1999 Shareholder Value Plan were intended to reward the executive officers of the Company when the total shareholder returns measured by increases in the market value of Common Stock plus dividends exceeded a comparable index of the Company's peers over a three-year period. Annual grants under this Plan up to 2004 would result in cash payments based on the Company's percentage change in shareholder return compared to the composite index of its peer group. If the Company's performance was not at least 100% of the peer group, no payout was made. To the extent performance exceeds the peer group, the payout would have increased. No new grants were made under the 1999 Shareholder Value Plan subsequent to 2004. The 1999 Shareholder Value Plan is accounted for as a liability award and, accordingly, at each period-end, a liability equal to the current computed fair value under the plan for all outstanding plan units, adjusted for the three-year vesting period, is recorded with corresponding charges or credits to compensation expense. For the grants issued in early 2004 and whose three-year performance period ended on December 31, 2006, a liability of approximately \$0.7 million was recorded at December 31, 2006 with an offset to compensation expense. During the three months ended March 31, 2007, an additional \$0.2 million was recorded as a liability with an offset to compensation expense. The Company paid the \$0.9 million obligation in the first quarter of 2007. No compensation expense was recorded under this plan for the three months ended March 31, 2006.

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

6. EMPLOYEE BENEFIT PLANS - Continued

Retirement Plan

Effective for 2006, the Company adopted a retirement plan applicable to all employees, including executive officers, who, at the time of retirement, have at least 30 years of continuous qualified service or are at least 55 years old and have at least 10 years of continuous qualified service. Subject to advance retirement notice and execution of a non-compete agreement with the Company, eligible retirees would be entitled to receive a pro rata amount of the annual incentive payment earned during the year of retirement. Stock options and time-based restricted stock granted by the Company to such eligible retiree during his or her employment would be non-forfeitable and become exercisable according to the terms of their original grants. Eligible retirees would also be entitled to receive a pro rata amount of any performance-based and total return-based restricted stock originally granted to such eligible retiree during his or her employment that subsequently vests after the retirement date according to the terms of their original grants. The benefits of this retirement plan apply only to restricted stock and stock option grants beginning in 2006 and will be phased in by applying the benefits to 25% of grants made in 2006, to 50% of grants made in 2007, to 75% of grants made in 2008 and to 100% of grants made in 2009 and thereafter. For employees who meet the retirement eligibility requirements, their grants are fully expensed immediately to the extent of the phased-in benefits because there is no future service required in order to have full rights to the grants. Compensation expense related to the retirement plan was approximately \$0.4 million and \$0.2 million in the three months ended March 31, 2007 and 2006, respectively. Grants made prior to 2006 are unaffected.

Deferred Compensation

The Company has a deferred compensation plan pursuant to which each executive officer and director can elect to defer a portion of base salary and/or annual incentive payment (or director fees) for investment in various unrelated mutual funds. Prior to January 1, 2006, executive officers and directors also could elect to defer cash compensation for investment in units of phantom common stock of the Company. At the end of each calendar quarter, any executive officer and director who deferred compensation into phantom stock was credited with units of phantom stock at a 15.0% discount. Dividends on the phantom units are assumed to be issued in additional units of phantom stock at a 15.0% discount. If an officer that deferred compensation under this plan leaves the Company's employ voluntarily or for cause within two years after the end of the year in which such officer deferred compensation for units of phantom stock, at a minimum, the 15.0% discount and any deemed dividends are forfeited. Over the two-year vesting period, the Company records additional compensation expense equal to the 15.0% discount, the accrued dividends and any changes in the market value of Common Stock from the date of the deferral, which aggregated \$0.04 million and \$0.6 million for the three months ended March 31, 2007 and 2006, respectively. Cash payments from the plan for the three months ended March 31, 2007 and 2006 were \$0.1 million and \$0.08 million, respectively. Transfers made from the phantom stock investment to other investments in the deferred compensation plan for the three months ended March 31, 2007 was \$0.4 million.

401(k) Savings Plan

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The Company has a 401(k) savings plan covering substantially all employees who meet certain age and employment criteria. The Company contributes amounts for each participant at a rate of 75% of the employee's contribution (up to 6% of each employee's salary). During the three months ended March 31, 2007 and 2006, the Company contributed \$0.4 million and \$0.3 million, respectively, to the 401(k) savings plan. Administrative expenses of the plan are paid by the Company.

HIGHWOODS PROPERTIES, INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

6. EMPLOYEE BENEFIT PLANS - Continued**Employee Stock Purchase Plan**

The Company has an Employee Stock Purchase Plan for all active employees under which employees can elect to contribute up to 25.0% of their base and annual incentive compensation for the purchase of Common Stock. At the end of each three-month offering period, the contributions in each participant's account balance, which includes accrued dividends, are applied to acquire shares of Common Stock at a cost that is calculated at 85.0% of the lower of the average closing price on the New York Stock Exchange on the five consecutive days preceding the first day of the quarter or the five days preceding the last day of the quarter. The Operating Partnership issues one Common Unit to the Company in exchange for the price paid for each share of Common Stock. Securities and Exchange Commission (SEC) rules prohibited the Company from issuing shares of Common Stock pursuant to the plan under the Company's Form S-8 registration statement during 2005 and a portion of 2006 because of the delay in the filing of the Company's SEC reports. As a result, no shares were issued during this period under the plan, and the funds were held by a trustee. In September 2006, the funds were released by the trustee and 48,035 shares were issued. In addition, in the three months ended March 31, 2007, the Company issued 5,895 shares of Common Stock under the Employee Stock Purchase Plan. The discount on newly issued shares is expensed by the Company as additional compensation and aggregated \$0.03 and \$0.05 million in the three months ended March 31, 2007 and 2006, respectively.

7. DERIVATIVE FINANCIAL INSTRUMENTS

Accumulated Other Comprehensive Loss (AOCL) at March 31, 2007 and December 31, 2006 was \$1.4 million and \$1.5 million, respectively, and consisted 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 (see Note 8). The Company expects that the portion of the cumulative loss recorded in AOCL at March 31, 2007 associated with these derivative instruments, which will be recognized as interest expense within the next 12 months, will be approximately \$0.4 million.

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 activities not reflected in the Consolidated Statements of Income. The components of other comprehensive income are as follows:

	Three Months Ended	
	March 31,	2006
	2007	2006
Net income	\$ 52,558	\$ 14,146

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Other comprehensive income:		
Amortization of hedging gains and losses included in other comprehensive income	142	177
Total other comprehensive income	142	177
Total comprehensive income	\$ 52,700	\$ 14,323

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

9. DISCONTINUED OPERATIONS AND THE IMPAIRMENT OF LONG-LIVED ASSETS

As part of its business strategy, the Company will 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 redemption of Preferred Stock, or other purposes. The table below sets forth the net operating results and net carrying value of those assets classified as discontinued operations in the Company's Consolidated Financial Statements. These assets classified as discontinued operations comprise 4.2 million square feet of office and industrial properties and 173 rental residential units sold during 2006 and all of 2007. 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 the ongoing operations of the Company to discontinued operations, and the Company will not have any significant continuing involvement in the operations after the disposal transactions:

	Three Months Ended	
	March 31,	
	2007	2006
Rental and other revenues	\$ 2,293	\$ 6,173
Operating expenses:		
Rental property and other expenses	983	2,382
Depreciation and amortization	604	1,614
Total operating expenses	1,587	3,996
Interest expense	-	103
Other income	10	26
Income before minority interest in the Operating Partnership and gains on sales of discontinued operations	716	2,100
Minority interest in discontinued operations	(53)	(193)
Income from discontinued operations, net of minority interest in the Operating Partnership	663	1,907
Gains on sales of discontinued operations	19,743	1,894
Minority interest in discontinued operations	(1,481)	(136)
Gains on sales of discontinued operations, net of minority interest in the Operating Partnership	18,262	1,758
Total discontinued operations	\$ 18,925	\$ 3,665

The net book value of properties classified as discontinued operations that were sold during 2006 and all of 2007 aggregated \$282.6 million.

SFAS No. 144 also 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 three months ended March 31, 2007 and 2006, 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 three months ended March 31, 2007 and 2006.

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

9. DISCONTINUED OPERATIONS AND THE IMPAIRMENT OF LONG-LIVED ASSETS - Continued

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 three months ended March 31, 2007 and 2006, no indicators of impairment existed for assets held for use. Therefore, no impairment losses were recorded in the three months ended March 31, 2007 and 2006.

The following table includes the major classes of assets and liabilities of the properties classified as held for sale as of March 31, 2007 and December 31, 2006:

	March 31,	December 31,
	2007	2006
Land	\$ -	\$ 3,462
Land held for development	5,391	14,983
Buildings and tenant improvements	-	21,949
Accumulated depreciation	-	(6,829)
Net real estate assets	5,391	33,565
Deferred leasing costs, net	-	435
Accrued straight line rents receivable	-	727
Prepaid expenses and other	128	217
Total assets	\$ 5,519	\$ 34,944
Tenant security deposits, deferred rents and accrued costs (1)	\$ 220	\$ 525

(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)

10. EARNINGS PER SHARE

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

	Three Months Ended	
	March 31,	
	2007	2006
Basic income per share:		
Numerator:		
Income from continuing operations	\$ 33,633	\$ 10,481
Preferred Stock dividends	(4,113)	(4,724)
Excess of Preferred Stock redemption costs over carrying value	-	(1,803)
Income from continuing operations available for common stockholders	29,520	3,954
Income from discontinued operations	18,925	3,665
Net income available for common stockholders	\$ 48,445	\$ 7,619
Denominator:		
Denominator for basic earnings per share weighted average share ⁽¹⁾	56,040	53,813
Basic earnings per share:		
Income from continuing operations	\$ 0.52	\$ 0.07
Income from discontinued operations	0.34	0.07
Net income	\$ 0.86	\$ 0.14
Diluted income per share:		
Numerator:		
Income from continuing operations	\$ 33,633	\$ 10,481
Preferred Stock dividends	(4,113)	(4,724)
Excess of Preferred Stock redemption costs over carrying value	-	(1,803)
Minority interest in the Operating Partnership	2,405	395
Income from continuing operations available for common stockholders	31,925	4,349
Income from discontinued operations	18,925	3,665
Minority interest in the Operating Partnership in discontinued operations	1,534	329
Income from discontinued operations	20,459	3,994
Net income available for common stockholders	\$ 52,384	\$ 8,343
Denominator:		
Denominator for basic earnings per share adjusted weighted average share ⁽¹⁾	56,040	53,813
Add:		
Employee and director stock options and warrants	1,060	1,198
Common Units	4,542	5,422
Unvested restricted stock	258	155
Denominator for diluted earnings per share adjusted weighted average shares and assumed conversions	61,900	60,588 (2)
Diluted earnings per share:		
Income from continuing operations	\$ 0.52	\$ 0.07
Income from discontinued operations	0.33	0.07

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Net income	\$ 0.85	\$ 0.14
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- (1) Weighted average shares exclude shares of unvested restricted stock pursuant to SFAS 128.
- (2) Options and warrants aggregating approximately 1.0 million shares were outstanding during the three months ended March 31, 2006 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 that period.

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

11. COMMITMENTS AND CONTINGENCIES