

HIGHWOODS PROPERTIES INC
Form 10-Q
November 07, 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 September 30, 2008

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)

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, 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 Accelerated filer Non-accelerated filer Smaller reporting company

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

The Company had 63,566,893 shares of common stock outstanding as of October 31, 2008.

HIGHWOODS PROPERTIES, INC.

QUARTERLY REPORT FOR THE PERIOD ENDED SEPTEMBER 30, 2008

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

We refer to Highwoods Properties, Inc. as the Company, Highwoods Realty Limited Partnership as the Operating Partnership, the Company's common stock as Common Stock, the Company's preferred stock as Preferred Stock, the Operating Partnership's common partnership interests as Common Units, the Operating Partnership's preferred partnership interests as Preferred Units and 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.

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Table of Contents**HIGHWOODS PROPERTIES, INC.****CONSOLIDATED BALANCE SHEETS**

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

| | September 30, 2008 | December 31, 2007 |
|---|-------------------------------|------------------------------|
| Assets: | | |
| Real estate assets, at cost: | | |
| Land | \$ 360,496 | \$ 357,841 |
| Buildings and tenant improvements | 2,824,695 | 2,708,989 |
| Development in process | 79,354 | 101,661 |
| Land held for development | 100,271 | 103,365 |
| | 3,364,816 | 3,271,856 |
| Less-accumulated depreciation | (700,517) | (649,765) |
| Net real estate assets | 2,664,299 | 2,622,091 |
| Real estate and other assets, net, held for sale | 8,607 | 10,466 |
| Cash and cash equivalents | 13,667 | 3,140 |
| Restricted cash | 8,940 | 15,896 |
| Accounts receivable, net of allowance of \$1,275 and \$935, respectively | 23,755 | 23,521 |
| Notes receivable, net of allowance of \$452 and \$68, respectively | 3,660 | 5,226 |
| Accrued straight-line rents receivable, net of allowance of \$1,406 and \$440, respectively | 79,505 | 74,427 |
| Investment in unconsolidated affiliates | 68,470 | 58,046 |
| Deferred financing and leasing costs, net of accumulated amortization | 73,224 | 72,188 |
| Prepaid expenses and other assets | 40,345 | 41,954 |
| Total Assets | \$ 2,984,472 | \$ 2,926,955 |
| Liabilities, Minority Interest and Stockholders Equity: | | |
| Mortgages and notes payable | \$ 1,588,954 | \$ 1,641,987 |
| Accounts payable, accrued expenses and other liabilities | 150,862 | 157,766 |
| Financing obligations | 35,195 | 35,071 |
| Total Liabilities | 1,775,011 | 1,834,824 |
| Commitments and Contingencies | | |
| Minority interest | 70,289 | 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), 29,092 and 82,937 shares issued and outstanding at September 30, 2008 and December 31, 2007, respectively | 29,092 | 82,937 |
| 8% Series B Cumulative Redeemable Preferred Shares (liquidation preference \$25 per share), 2,100,000 shares issued and outstanding at both September 30, 2008 and December 31, 2007 | 52,500 | 52,500 |
| Common stock, \$.01 par value, 200,000,000 authorized shares; 63,545,368 and 57,167,193 shares issued and outstanding at September 30, 2008 and December 31, 2007, respectively | 635 | 572 |
| Additional paid-in capital | 1,656,516 | 1,448,055 |
| Distributions in excess of net earnings | (597,254) | (561,093) |
| Accumulated other comprehensive loss | (2,317) | (938) |

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| | | |
|---|--------------|--------------|
| Total Stockholders' Equity | 1,139,172 | 1,022,033 |
| Total Liabilities, Minority Interest and Stockholders' Equity | \$ 2,984,472 | \$ 2,926,955 |

See accompanying notes to consolidated financial statements.

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Table of Contents**HIGHWOODS PROPERTIES, INC.****CONSOLIDATED STATEMENTS OF INCOME**

(Unaudited and in thousands, except per share amounts)

| | Three Months Ended | | Nine Months Ended | |
|---|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Rental and other revenues | \$ 116,207 | \$ 107,580 | \$ 346,154 | \$ 318,188 |
| Operating expenses: | | | | |
| Rental property and other expenses | 42,165 | 38,682 | 122,591 | 113,909 |
| Depreciation and amortization | 32,109 | 31,891 | 94,359 | 90,476 |
| Impairment of assets held for use | | 789 | | 789 |
| General and administrative | 8,885 | 9,649 | 29,362 | 31,428 |
| Total operating expenses | 83,159 | 81,011 | 246,312 | 236,602 |
| Interest expenses: | | | | |
| Contractual | 22,995 | 23,728 | 69,803 | 69,514 |
| Amortization of deferred financing costs | 714 | 616 | 2,038 | 1,791 |
| Financing obligations | 783 | 981 | 2,287 | 2,968 |
| | 24,492 | 25,325 | 74,128 | 74,273 |
| Other income: | | | | |
| Interest and other income | 1,019 | 1,469 | 3,425 | 5,094 |
| | 1,019 | 1,469 | 3,425 | 5,094 |
| Income before disposition of property, insurance gain, minority interest and equity in earnings of unconsolidated affiliates | 9,575 | 2,713 | 29,139 | 12,407 |
| Net gains on disposition of property | 1,745 | 1,288 | 1,852 | 20,372 |
| Gain from property insurance settlement | | | | 4,128 |
| Minority interest | (813) | (262) | (2,313) | (3,202) |
| Equity in earnings of unconsolidated affiliates | 1,214 | 1,207 | 4,723 | 12,930 |
| Income from continuing operations | 11,721 | 4,946 | 33,401 | 46,635 |
| Discontinued operations: | | | | |
| Income from discontinued operations, net of minority interest | 50 | 846 | 811 | 2,646 |
| Net gains on sales of discontinued operations, net of minority interest | 2,940 | 6,175 | 11,125 | 24,533 |
| Release of FASB FIN 48 tax liability | | 1,473 | | 1,473 |
| | 2,990 | 8,494 | 11,936 | 28,652 |
| Net income | 14,711 | 13,440 | 45,337 | 75,287 |
| Dividends on preferred stock | (2,451) | (2,680) | (8,127) | (10,639) |
| Excess of preferred stock redemption/repurchase cost over carrying value | (108) | (842) | (108) | (2,285) |
| Net income available for common stockholders | \$ 12,152 | \$ 9,918 | \$ 37,102 | \$ 62,363 |
| Net income per common share - basic: | | | | |
| Income from continuing operations | \$ 0.16 | \$ 0.03 | \$ 0.44 | \$ 0.60 |
| Income from discontinued operations | 0.05 | 0.15 | 0.21 | 0.51 |
| Net income | \$ 0.21 | \$ 0.18 | \$ 0.65 | \$ 1.11 |
| Weighted average common shares outstanding - basic | 58,497 | 56,628 | 57,387 | 56,376 |

Net income per common share - diluted:

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| | | | | |
|--|----------|----------|----------|----------|
| Income from continuing operations | \$ 0.16 | \$ 0.02 | \$ 0.43 | \$ 0.59 |
| Income from discontinued operations | 0.05 | 0.15 | 0.21 | 0.50 |
| Net income | \$ 0.21 | \$ 0.17 | \$ 0.64 | \$ 1.09 |
| Weighted average common shares outstanding - diluted | 62,938 | 61,396 | 61,865 | 61,611 |
| Dividends declared per common share | \$ 0.425 | \$ 0.425 | \$ 1.275 | \$ 1.275 |

See accompanying notes to consolidated financial statements.

Table of Contents**HIGHWOODS PROPERTIES, INC.****CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY****For the Nine Months Ended September 30, 2008**

(Unaudited and in thousands, except share amounts)

| | Number of | | | | Additional | Accum- | Distri- | |
|---|------------------|---------------|------------------|------------------|-------------------|----------------|------------------|--------------|
| | Common | Common | Series A | Series B | Paid-In | ulated | butions | |
| | Shares | Stock | Preferred | Preferred | Capital | Other | in Excess | Total |
| | | | | | | Compre- | of Net | |
| | | | | | | hensive | Earnings | |
| | | | | | | Loss | Loss | |
| Balance at December 31, 2007 | 57,167,193 | \$ 572 | \$ 82,937 | \$ 52,500 | \$ 1,448,055 | \$ (938) | \$ (561,093) | \$ 1,022,033 |
| Issuances of Common Stock, net | 6,167,284 | 62 | | | 209,722 | | | 209,784 |
| Redemptions of Common Units to Common Stock | 44,814 | | | | 1,524 | | | 1,524 |
| Common Stock dividends | | | | | | | (73,263) | (73,263) |
| Preferred Stock dividends | | | | | | | (8,127) | (8,127) |
| Adjustment to minority interest of unitholders in the Operating Partnership | | | | | (9,523) | | | (9,523) |
| Issuances of restricted stock, net | 166,077 | | | | | | | |
| Amortization of restricted stock and stock options | | 1 | | | 5,284 | | | 5,285 |
| Redemptions/repurchases of Preferred Stock | | | (53,845) | | 1,454 | | (108) | (52,499) |
| Comprehensive income: Net income | | | | | | | 45,337 | 45,337 |
| Other comprehensive loss | | | | | | | (1,379) | (1,379) |
| Total comprehensive income | | | | | | | | 43,958 |
| Balance at September 30, 2008 | 63,545,368 | \$ 635 | \$ 29,092 | \$ 52,500 | \$ 1,656,516 | \$ (2,317) | \$ (597,254) | \$ 1,139,172 |

See accompanying notes to consolidated financial statements.

Table of Contents**HIGHWOODS PROPERTIES, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited and in thousands)

| | Nine Months Ended | |
|---|--------------------------|-------------|
| | September 30, | |
| | 2008 | 2007 |
| Operating activities: | | |
| Net income | \$ 45,337 | \$ 75,287 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 83,151 | 82,425 |
| Amortization of lease commissions | 11,441 | 10,532 |
| Amortization of lease incentives | 783 | 719 |
| Amortization of restricted stock and stock options | 5,285 | 3,814 |
| Amortization of deferred financing costs | 2,038 | 1,791 |
| Amortization of accumulated other comprehensive loss | 174 | 431 |
| Impairment of assets held for use | | 789 |
| Net gains on disposition of properties | (13,742) | (46,835) |
| Gain from property insurance settlement | | (4,128) |
| Minority interest | 3,134 | 5,329 |
| Equity in earnings of unconsolidated affiliates | (4,723) | (12,930) |
| Release of FASB FIN 48 tax liability | | (1,424) |
| Change in financing obligations | 124 | 302 |
| Distributions of earnings from unconsolidated affiliates | 4,561 | 5,169 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (747) | (3,555) |
| Prepaid expenses and other assets | (1,429) | (4,209) |
| Accrued straight-line rents receivable | (5,263) | (3,367) |
| Accounts payable, accrued expenses and other liabilities | (1,983) | 10,669 |
| Net cash provided by operating activities | 128,141 | 120,809 |
| Investing activities: | | |
| Additions to real estate assets and deferred leasing costs | (165,722) | (212,148) |
| Proceeds from disposition of real estate assets | 37,258 | 109,639 |
| Proceeds from property insurance settlement | | 4,940 |
| Distributions of capital from unconsolidated affiliates | 2,343 | 14,998 |
| Net repayments of notes receivable | 1,566 | 2,714 |
| Contributions to unconsolidated affiliates | (12,341) | (4,716) |
| Changes in restricted cash and other investing activities | 8,295 | (13,345) |
| Net cash used in investing activities | (128,601) | (97,918) |
| Financing activities: | | |
| Distributions paid on Common Stock and Common Units | (78,290) | (77,717) |
| Redemption/repurchase of Preferred Stock | (52,499) | (62,256) |
| Dividends paid on Preferred Stock | (8,127) | (10,639) |
| Distributions to minority partner in consolidated affiliate | (3,247) | (1,893) |
| Net proceeds from the issuance of Common Stock | 209,784 | 6,716 |
| Repurchase of Common Units | (3,293) | (27,402) |
| Borrowings on revolving credit facility | 350,650 | 318,800 |
| Repayments of revolving credit facility | (445,950) | (509,000) |
| Borrowings on mortgages and notes payable | 177,918 | 413,491 |
| Repayments of mortgages and notes payable | (135,742) | (87,012) |
| Payments on financing obligations | | (913) |
| Contributions from minority interest partner | 625 | 5,111 |
| Additions to deferred financing costs | (842) | (3,399) |
| Net cash provided by/(used in) financing activities | 10,987 | (36,113) |
| Net increase/(decrease) in cash and cash equivalents | 10,527 | (13,222) |

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| | | |
|--|-----------|----------|
| Cash and cash equivalents at beginning of the period | 3,140 | 16,690 |
| Cash and cash equivalents at end of the period | \$ 13,667 | \$ 3,468 |

See accompanying notes to consolidated financial statements.

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Table of Contents**HIGHWOODS PROPERTIES, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS - Continued**

(Unaudited and in thousands)

Supplemental disclosure of cash flow information:

| | Nine Months Ended | |
|--|--------------------------|-------------|
| | September 30, | |
| | 2008 | 2007 |
| Cash paid for interest, net of amounts capitalized (excludes cash distributions to owners of sold properties accounted for as financings of \$1,219 and \$1,676 for 2008 and 2007, respectively) | \$ 77,198 | \$ 69,220 |

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 nine months ended September 30, 2007.

| | Nine Months Ended | |
|--|--------------------------|-------------|
| | September 30, | |
| | 2008 | 2007 |
| Assets: | | |
| Prepaid expenses and other assets | \$ (1,553) | \$ (1,553) |
| Liabilities: | | |
| Accounts payable, accrued expenses and other liabilities | \$ | \$ |
| Minority Interest and Stockholders Equity | \$ (1,553) | \$ |

See accompanying notes to consolidated financial statements.

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HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 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 September 30, 2008, the Company and/or the Operating Partnership wholly owned: 311 in-service office, industrial and retail properties; 96 rental residential units; 619 acres of undeveloped land suitable for future development, of which 479 acres are considered core holdings; and an additional 10 properties under development.

At September 30, 2008, the Company owned all of the preferred partnership interests (Preferred Units) and 94.2% 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. During the nine months ended September 30, 2008, the Company redeemed 106,613 Common Units for \$3.3 million in cash and redeemed 44,814 Common Units for a like number of shares of Common Stock.

Common Stock Offering

On September 12, 2008, the Company sold 5.5 million shares of Common Stock for net proceeds of \$195.0 million. As required by the terms of the partnership agreement of the Operating Partnership, the net proceeds from the offering were contributed to the Operating Partnership in exchange for 5.5 million additional Common Units. The net impact of the offering and the redemptions discussed above increased the percentage of Common Units owned by the Company from 93.3% at December 31, 2007 to 94.2% at September 30, 2008. In September 2008, a portion of the net proceeds of the offering were used to repurchase 53,845 outstanding 8 5/8% Series A Cumulative Redeemable Preferred Shares for an aggregate purchase price of \$52.5 million. The remaining net proceeds from the offering were used to reduce the amount of borrowings outstanding under our revolving credit facility.

Basis of Presentation

Our Consolidated Financial Statements are prepared in accordance with U.S. Generally Accepted Accounting Principles (GAAP). 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 September 30, 2008. The Consolidated Statements of Income for the three and nine months ended September 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 nine 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. All significant intercompany transactions and accounts have been eliminated.

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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 as permitted by SEC rules and regulations. 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.

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). 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. Our financial statements include the operations of our taxable REIT subsidiary which is not entitled to a dividends paid deduction.

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 of September 30, 2008, minority interest in the Operating Partnership consisted of 3.9 million Common Units, which had an aggregate market value of \$138.9 million based on the \$35.56 per share closing price of the Common Stock as of such date.

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

| | Three Months Ended | | Nine Months Ended | |
|--|-------------------------------|-------------|-------------------------------|-------------|
| | September 30, 2008 | 2007 | September 30, 2008 | 2007 |
| Amount shown as minority interest in continuing operations (1) | \$ (813 |) \$ (262 |) \$ (2,313 |) \$ (3,202 |
| Amount related to income from discontinued operations | (3 |) (60 |) (56 |) (197 |
| Amount related to gains on sales of discontinued operations | (197 |) (442 |) (765 |) (1,930 |
| Total minority interest in net income | \$ (1,013 |) \$ (764 |) \$ (3,134 |) \$ (5,329 |

-
- (1) Minority interest related to the consolidated entities other than the Operating Partnership amounted to \$201,000 and \$170,000, respectively, for the three months ended September 30, 2008 and 2007 and \$590,000 and \$518,000, respectively, for the nine months ended September 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)

1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES - Continued

| | September 30, 2008 | December 31, 2007 |
|--|-----------------------|----------------------|
| Minority interest in the Operating Partnership | \$ 65,517 | \$ 63,294 |
| Minority interest in Markel | 3,975 | 3,446 |
| Minority interest in REES | | 2,561 |
| Minority interest in Plaza Residential | 797 | 797 |
| Total minority interest | \$ 70,289 | \$ 70,098 |

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 8).

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 chose to measure no additional eligible items at fair value.

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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. SFAS No. 141(R) will affect our accounting for any qualifying acquisitions subsequent to January 1, 2009.

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. SFAS No. 160 will affect the presentation of minority interest on our Consolidated Balance Sheets, Statements of Income and Statements of Stockholders Equity for all periods presented subsequent to January 1, 2009.

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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 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 could affect our accounting for real estate dispositions subsequent to January 1, 2009.

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 will expand our disclosures related to our derivative instruments and hedging activities beginning in the first quarter of 2009 as a result of SFAS No. 161.

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 do not believe FSP FAS 142-3 will have a material effect 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 will include our unvested restricted stock in our calculation of basic and diluted EPS beginning in the first quarter of 2009 as a result of FSP EITF 03-6-1.

In October 2008, the FASB issued FSP FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active (FSP FAS 157-3). FSP FAS 157-3 clarifies the application of SFAS No. 157, Fair Value Measurements, in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. We adopted FSP FAS 157-3 for this Quarterly Report and such adoption did not have a material 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)****2. INVESTMENTS IN UNCONSOLIDATED 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.

Combined summarized income statements for our unconsolidated joint ventures for the three and nine months ended September 30, 2008 and 2007 were as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|---------------------------|-----------------|--------------------------|------------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Income Statements: | | | | |
| Revenues | \$ 40,949 | \$ 34,350 | \$ 120,677 | \$ 107,507 |
| Expenses: | | | | |
| Operating expenses | 20,492 | 15,844 | 58,955 | 46,000 |
| Depreciation and amortization | 9,079 | 8,196 | 25,707 | 22,977 |
| Interest expense and loan cost amortization | 9,258 | 8,675 | 26,950 | 25,665 |
| Total expenses | 38,829 | 32,715 | 111,612 | 94,642 |
| Income before disposition of property | 2,120 | 1,635 | 9,065 | 12,865 |
| Gains on disposition of property | | | | 20,621 |
| Net income | \$ 2,120 | \$ 1,635 | \$ 9,065 | \$ 33,486 |
| Our share of: | | | | |
| Net income (1) | \$ 1,214 | \$ 1,207 | \$ 4,723 | \$ 12,930 |
| Depreciation and amortization (real estate related) | \$ 3,136 | \$ 3,107 | \$ 9,466 | \$ 8,851 |
| Interest expense and loan cost amortization | \$ 3,704 | \$ 3,617 | \$ 10,924 | \$ 10,836 |
| 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.

In March 2008, we and an affiliate of Schweiz-Deutschland-USA Dreilander Beteiligung Objekt DLF 98/29-Walker Fink-KG ("DLF") formed a new joint venture, Highwoods DLF Forum, LLC, in which we have a 25.0% ownership interest. 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 \$113 million. We contributed \$12.3 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.

3. INVESTMENT ACTIVITIES

Acquisitions

During the third quarter, we acquired an aggregate of 8.3 acres of land in the Atlanta metropolitan area for an aggregate purchase price of \$2.1 million.

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

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

3. INVESTMENT ACTIVITIES - Continued**Dispositions**

We previously had a contract to acquire development land in the Bluegrass Valley office development project. Under the terms of the contract, the development land was to be purchased in phases. In May 2003, 4.0 acres of the remaining acres not yet acquired by us were taken by the Georgia Department of Transportation to develop a roadway interchange for consideration of \$1.8 million. The Department of Transportation took possession and title of the property in June 2003. As part of the terms of the contract, we were entitled to and received in 2003 the \$1.8 million proceeds from the condemnation. In July 2003, we appealed the condemnation and sought additional payment from the state; the recognition of any gain was deferred pending resolution of the appeal process. Upon settlement of this claim in September 2008, we received an additional payment of \$624,000. We, therefore, recorded gain on the sale of this land of \$1.7 million in the third quarter of 2008.

In the first quarter of 2008, we sold an office property totaling 30,000 rentable square feet located in the Kansas City, Missouri metropolitan area for \$6.0 million. A gain of \$3.1 million was recorded in the first quarter of 2008.

In the second quarter of 2008, we sold non-core land of 6.4 acres in Tampa, Florida for \$2.0 million and office properties aggregating 271,000 rentable square feet located in the Kansas City, Missouri metropolitan area for \$21.7 million. Gains of \$0.1 million and \$4.9 million, respectively, were recorded in the second quarter of 2008.

In the third quarter of 2008, we sold an industrial property aggregating 250,000 rentable square feet located in the Winston-Salem, North Carolina metropolitan area for \$8.2 million. A gain of \$3.2 million was recorded in the third quarter of 2008.

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

| | Three Months Ended | | Nine Months Ended | |
|------------------------------|-------------------------------|-------------|-------------------------------|-------------|
| | September 30, 2008 | 2007 | September 30, 2008 | 2007 |
| Gains on disposition of land | \$ 1,727 | \$ 225 | \$ 1,816 | \$ 17,029 |

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| | | | | |
|--|----------|----------|----------|-----------|
| Gains on disposition of depreciable properties | 18 | 1,063 | 36 | 3,343 |
| Total | \$ 1,745 | \$ 1,288 | \$ 1,852 | \$ 20,372 |

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

| | Three Months Ended | | Nine Months Ended | |
|--|-----------------------|----------|-----------------------|-----------|
| | September 30, 2008 | 2007 | September 30, 2008 | 2007 |
| Gains on disposition of depreciable properties | \$ 3,137 | \$ 7,001 | \$ 11,890 | \$ 26,847 |
| Impairments on disposition of depreciable properties | | (384) | | (384) |
| Allocable minority interest | (197) | (442) | (765) | (1,930) |
| Total | \$ 2,940 | \$ 6,175 | \$ 11,125 | \$ 24,533 |

See Note 9 for information on discontinued operations.

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

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

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

3. INVESTMENT ACTIVITIES - Continued**Development**

We currently have under development 10 office and industrial properties aggregating 1.8 million square feet and 139 for-sale residential units. The aggregate cost of these properties is currently expected to total approximately \$336 million when fully leased and completed, of which \$241 million was incurred as of September 30, 2008. The weighted average pre-leasing of such development projects (excluding the residential units) was 72% at September 30, 2008. Six of these properties aggregating 1.3 million square feet and \$204 million projected total investment were completed and transferred to completed real estate assets or deferred financing and leasing costs at various times prior to September 30, 2008, but had not yet reached projected 95.0% stabilized occupancy. The remaining development properties are still under construction and are included in Development in Process in the Consolidated Balance Sheet.

4. MORTGAGES AND NOTES PAYABLE

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

| | September 30, | December 31, |
|------------------------|----------------------|---------------------|
| | 2008 | 2007 |
| Secured mortgage loans | \$ 669,986 | \$ 665,311 |
| Unsecured loans | 918,968 | 976,676 |
| Total | \$ 1,588,954 | \$ 1,641,987 |

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

Our \$450.0 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 interest rate would increase to LIBOR plus 140 or 155 basis points if our credit rating were to fall below investment grade according to two of three credit rating agencies. The revolving credit facility had \$315.9 million of availability at September 30, 2008.

On February 1, 2008, we paid off at maturity \$100.0 million of 7.13% 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. The interest rate would increase to LIBOR plus 160 basis points if our credit rating were to fall below investment grade according to two of three credit rating agencies. Proceeds from this loan were used to reduce the outstanding borrowings under our revolving credit facility and for short-term investments.

In July 2008, REES, a consolidated joint venture (see Note 1 to the Consolidated Financial Statements in our 2007 Annual Report on Form 10-K) fully repaid the remaining \$17.5 million outstanding under a secured construction loan.

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.

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HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

5. EMPLOYEE BENEFIT PLANS

During the nine months ended September 30, 2008, we granted under our Amended and Restated 1994 Stock Option Plan (the "Stock Option Plan") 319,091 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 92,150 shares of time-based restricted stock and 67,618 shares of performance-based and total return-based restricted stock with a weighted-average grant date fair value per share of \$30.13 and \$30.19, 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. We recorded stock-based compensation expense of \$1.3 million and \$1.0 million during the three months ended September 30, 2008 and 2007, respectively, and \$5.3 million and \$3.9 million during the nine months ended September 30, 2008 and 2007, respectively.

6. DERIVATIVE FINANCIAL INSTRUMENTS AND OTHER FINANCIAL INSTRUMENTS AVAILABLE FOR SALE

Accumulated Other Comprehensive Loss ("AOCL") at September 30, 2008 was \$2.3 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 available 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 \$765,000 as of September 30, 2008. We expect that the portion of the cumulative loss recorded in AOCL at September 30, 2008 associated with these derivative instruments, which will be recognized as interest expense within the next 12 months, will be approximately \$204,000.

In January 2008, we entered into two floating-to-fixed interest rate swaps for a one-year period with respect to an aggregate of \$50.0 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 3.3% for \$30.0 million of borrowings and 3.2% for \$20.0 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 \$50.0 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 2.5%. 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 gain recorded in AOCL at September 30, 2008 associated with these derivative instruments, which will be recognized within the next 12 months, will be \$573,000. See Note 8 for Fair Value Measurements disclosure.

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We currently have an investment in bonds that were issued by a municipal authority in connection with tax increment financing for a development that we constructed in Kansas City, Missouri in a prior period. These bonds are classified as available for sale and thus are being recorded at fair value with the offset recorded in AOCL. The amount of unrealized loss at September 30, 2008 was \$2.1 million. See Note 8 for Fair Value Measurements disclosure.

Table of Contents**HIGHWOODS PROPERTIES, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(tabular dollar amounts in thousands, except per share data)****7. OTHER COMPREHENSIVE INCOME/(LOSS)**

Other comprehensive income/(loss) 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/(loss) are as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|-------------------------------|-------------|-------------------------------|-------------|
| | September 30, 2008 | 2007 | September 30, 2008 | 2007 |
| Net income | \$ 14,711 | \$ 13,440 | \$ 45,337 | \$ 75,287 |
| Other comprehensive income/(loss): | | | | |
| Unrealized loss on available for sale securities | (1,751) | | (2,126) | |
| Net gains on cash-flow hedges | 49 | | 573 | |
| Amortization of hedging gains and losses included in other comprehensive income | 47 | 146 | 174 | 431 |
| Total other comprehensive income/(loss) | (1,655) | 146 | (1,379) | 431 |
| Total comprehensive income | \$ 13,056 | \$ 13,586 | \$ 43,958 | \$ 75,718 |

8. 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.

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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 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)

8. 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 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 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.

The following tables set forth the financial assets and liabilities as of September 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 | | |
|---------------------------------|------------------|-------------------------------|---------------|------------------|
| | | Level 1 | Level 2 | Level 3 |
| | | Quoted Prices in | Significant | |
| | | Active Markets | Other | Significant |
| | | for Identical | Observable | Unobservable |
| | Balance at | Assets | Inputs | Inputs |
| | September 30, | | | |
| | 2008 | | | |
| Assets | | | | |
| Marketable securities (1) | \$ | \$ 6,301 | \$ | \$ |
| Tax Increment Financing Bonds | 18,790 | | | 18,790 |
| Interest rate swaps | 573 | | 573 | |
| Total Assets | \$ 19,363 | \$ 6,301 | \$ 573 | \$ 18,790 |
| Liabilities | | | | |
| Deferred compensation | \$ | \$ 6,301 | \$ | \$ |
| Harborview financing obligation | 16,659 | | | 16,659 |
| Total Liabilities | \$ 16,659 | \$ 6,301 | \$ | \$ 16,659 |

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

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

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

8. FAIR VALUE MEASUREMENTS - Continued

| | Fair Value Measurements Using Significant Unobservable Inputs (Level 3) | |
|--|--|---|
| Assets: | | |
| Tax Increment Financing Bonds | | |
| Beginning balance as of June 30, 2008 | \$ | |
| Transfers into Level 3 | 20,541 | |
| Unrealized loss included in AOCL | (1,751 |) |
| Ending balance as of September 30, 2008 | \$ 18,790 | |
| Liabilities: | | |
| Harborview Financing Obligation | | |
| Beginning balance as of June 30, 2008 | \$ 16,620 | |
| Payments on financing obligation | (419 |) |
| Interest expense on financing obligation | 458 | |
| Ending balance as of September 30, 2008 | \$ 16,659 | |

| | Fair Value Measurements Using Significant Unobservable Inputs (Level 3) | |
|---|--|---|
| Assets: | | |
| Tax Increment Financing Bonds | | |
| Beginning balance as of December 31, 2007 | \$ | |
| Transfers into Level 3 | 20,541 | |
| Unrealized loss included in AOCL | (1,751 |) |
| Ending balance as of September 30, 2008 | \$ 18,790 | |

Liabilities:

Harborview Financing Obligation

| | | |
|---|-----------|---|
| Beginning balance as of December 31, 2007 | \$ 16,566 | |
| Payments on financing obligation | (1,219 |) |
| Interest expense on financing obligation | 1,312 | |
| Ending balance as of September 30, 2008 | \$ 16,659 | |

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

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

9. 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. Those assets classified as discontinued operations comprise 1.8 million square feet of office and industrial properties and 13 rental residential units sold during 2007 and the nine months ended September 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 | | Nine Months Ended | |
|--|--------------------|----------|-------------------|-----------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Rental and other revenues | \$ 70 | \$ 3,285 | \$ 1,936 | \$ 10,147 |
| Operating expenses: | | | | |
| Rental property and other expenses | 17 | 1,610 | 839 | 4,846 |
| Depreciation and amortization | | 773 | 233 | 2,481 |
| Total operating expenses | 17 | 2,383 | 1,072 | 7,327 |
| Other income | | 4 | 3 | 23 |
| Income before minority interest and gains on sales of discontinued operations | 53 | 906 | 867 | 2,843 |
| Minority interest in discontinued operations | (3) | (60) | (56) | (197) |
| Income from discontinued operations, net of minority interest | 50 | 846 | 811 | 2,646 |
| Gains on sales of discontinued operations | 3,137 | 6,617 | 11,890 | 26,463 |
| Minority interest in discontinued operations | (197) | (442) | (765) | (1,930) |
| Net gains on sales of discontinued operations, net of minority interest | 2,940 | 6,175 | 11,125 | 24,533 |
| Net income from discontinued operations before release of FASB FIN 48 tax liability | 2,990 | 7,021 | 11,936 | 27,179 |
| Release of FASB FIN 48 tax liability | | 1,473 | | 1,473 |
| Total discontinued operations | \$ 2,990 | \$ 8,494 | \$ 11,936 | \$ 28,652 |

Table of Contents**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 | | Nine Months Ended | |
|---|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Basic income per share: | | | | |
| Numerator: | | | | |
| Income from continuing operations | \$ 11,721 | \$ 4,946 | \$ 33,401 | \$ 46,635 |
| Preferred Stock dividends | (2,451) | (2,680) | (8,127) | (10,639) |
| Excess of Preferred Stock redemption/repurchase costs over carrying value | (108) | (842) | (108) | (2,285) |
| Income from continuing operations available for common stockholders | 9,162 | 1,424 | 25,166 | 33,711 |
| Income from discontinued operations | 2,990 | 8,494 | 11,936 | 28,652 |
| Net income available for common stockholders | \$ 12,152 | \$ 9,918 | \$ 37,102 | \$ 62,363 |
| Denominator: | | | | |
| Denominator for basic earnings per share weighted average shares (1) | 58,497 | 56,628 | 57,387 | 56,376 |
| Basic earnings per share: | | | | |
| Income from continuing operations | \$ 0.16 | \$ 0.03 | \$ 0.44 | \$ 0.60 |
| Income from discontinued operations | 0.05 | 0.15 | 0.21 | 0.51 |
| Net income | \$ 0.21 | \$ 0.18 | \$ 0.65 | \$ 1.11 |
| Diluted income per share: | | | | |
| Numerator: | | | | |
| Income from continuing operations | \$ 11,721 | \$ 4,946 | \$ 33,401 | \$ 46,635 |
| Preferred Stock dividends | (2,451) | (2,680) | (8,127) | (10,639) |
| Excess of Preferred Stock redemption/repurchase costs over carrying value | (108) | (842) | (108) | (2,285) |
| Minority interest in the Operating Partnership | 612 | 92 | 1,723 | 2,684 |
| Income from continuing operations available for common stockholders | 9,774 | 1,516 | 26,889 | 36,395 |
| Income from discontinued operations | 2,990 | 8,494 | 11,936 | 28,652 |
| Minority interest in the Operating Partnership in discontinued operations | 200 | 502 | 821 | 2,127 |
| Income from discontinued operations | 3,190 | 8,996 | 12,757 | 30,779 |
| Net income available for common stockholders | \$ 12,964 | \$ 10,512 | \$ 39,646 | \$ 67,174 |
| Denominator: | | | | |

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| | | | | |
|--|---------|---------|---------|---------|
| Denominator for basic earnings per share adjusted weighted | | | | |
| average shares (1) | 58,497 | 56,628 | 57,387 | 56,376 |
| Add: | | | | |
| Employee and director stock options and warrants | 302 | 494 | 336 | 744 |
| Common Units | 3,928 | 4,061 | 3,947 | 4,234 |
| Unvested restricted stock | 211 | 213 | 195 | 257 |
| Denominator for diluted earnings per share adjusted weighted | | | | |
| average shares and assumed conversions (2) | 62,938 | 61,396 | 61,865 | 61,611 |
| Diluted earnings per share: | | | | |
| Income from continuing operations | \$ 0.16 | \$ 0.02 | \$ 0.43 | \$ 0.59 |
| Income from discontinued operations | 0.05 | 0.15 | 0.21 | 0.50 |
| Net income | \$ 0.21 | \$ 0.17 | \$ 0.64 | \$ 1.09 |

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HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

10. 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 328,000 and 177,000 shares were outstanding during the three months ended September 30, 2008 and 2007, respectively, and 175,000 and 141,000 shares were outstanding during the nine months ended September 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.

Table of Contents**HIGHWOODS PROPERTIES, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(tabular dollar amounts in thousands, except per share data)****11. 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 September 30, 2008, no tenant of the Wholly Owned Properties comprised more than 7.6% of our consolidated revenues.

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

| | Three Months Ended | | Nine Months Ended | |
|---|-----------------------|-----------|-----------------------|-----------|
| | September 30, 2008 | 2007 | September 30, 2008 | 2007 |
| Rental and Other Revenues: (1) (2) | | | | |
| Office: | | | | |
| Atlanta, GA | \$ 11,751 | \$ 10,400 | \$ 34,950 | \$ 31,347 |
| Greenville, SC | 3,553 | 3,232 | 10,296 | 9,732 |
| Kansas City, MO | 3,989 | 3,820 | 11,555 | 10,703 |
| Memphis, TN | 6,349 | 5,991 | 18,848 | 17,991 |
| Nashville, TN | 16,152 | 13,257 | 47,825 | 39,495 |
| Orlando, FL | 2,279 | 1,615 | 6,457 | 4,796 |
| Piedmont Triad, NC | 6,266 | 6,834 | 19,136 | 19,968 |
| Raleigh, NC | 17,487 | 16,092 | 53,310 | 47,104 |
| Richmond, VA | 11,767 | 11,516 | 35,809 | 33,385 |
| Tampa, FL | 16,801 | 15,427 | 49,467 | 45,770 |
| Other | 685 | 465 | 1,720 | 1,889 |
| Total Office Segment | 97,079 | 88,649 | 289,373 | 262,180 |
| Industrial: | | | | |
| Atlanta, GA | 3,828 | 3,939 | 11,756 | 11,728 |

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| | | | | |
|---------------------------------|------------|------------|------------|------------|
| Kansas City, MO | 5 | 5 | 15 | 15 |
| Piedmont Triad, NC | 3,723 | 3,410 | 11,030 | 10,118 |
| Total Industrial Segment | 7,556 | 7,354 | 22,801 | 21,861 |
| Retail: | | | | |
| Kansas City, MO | 11,021 | 11,130 | 32,370 | 32,863 |
| Piedmont Triad, NC | 253 | 149 | 708 | 406 |
| Total Retail Segment | 11,274 | 11,279 | 33,078 | 33,269 |
| Residential: | | | | |
| Kansas City, MO | 298 | 298 | 902 | 878 |
| Total Residential Segment | 298 | 298 | 902 | 878 |
| Total Rental and Other Revenues | \$ 116,207 | \$ 107,580 | \$ 346,154 | \$ 318,188 |

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

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

11. SEGMENT INFORMATION - Continued

| | Three Months Ended | | Nine Months Ended | |
|--|-----------------------|----------|-----------------------|-----------|
| | September 30, 2008 | 2007 | September 30, 2008 | 2007 |
| Net Operating Income: (1) (2) | | | | |
| Office: | | | | |
| Atlanta, GA | \$ 6,762 | \$ 6,549 | \$ 21,784 | \$ 20,112 |
| Greenville, SC | 2,153 | 1,896 | 6,264 | 5,846 |
| Kansas City, MO | 2,324 | 2,208 | 6,463 | 5,878 |
| Memphis, TN | 3,925 | 3,332 | 11,395 | 10,345 |
| Nashville, TN | 10,790 | 8,183 | 31,930 | 25,229 |
| Orlando, FL | 1,224 | 1,415 | 3,644 | 3,287 |
| Piedmont Triad, NC | 3,947 | 4,663 | 12,012 | 12,624 |
| Raleigh, NC | 11,940 | 9,760 | 36,258 | 30,247 |
| Richmond, VA | 7,685 | 8,145 | 23,957 | 23,257 |
| Tampa, FL | 10,083 | 9,346 | 30,053 | 27,629 |
| Other | 398 | 57 | 854 | 570 |
| Total Office Segment | 61,231 | 55,554 | 184,614 | 165,024 |
| Industrial: | | | | |
| Atlanta, GA | 2,777 | 2,975 | 8,677 | 8,963 |
| Kansas City, MO | 3 | 3 | 7 | 7 |
| Piedmont Triad, NC | 2,759 | 2,616 | 8,496 | 7,820 |
| Total Industrial Segment | 5,539 | 5,594 | 17,180 | 16,790 |
| Retail: | | | | |
| Kansas City, MO | 6,936 | 7,461 | 20,754 | 21,763 |
| Piedmont Triad, NC | 203 | 139 | 577 | 334 |
| Raleigh, NC | (20) | (26) | (67) | (64) |
| Total Retail Segment | 7,119 | 7,574 | 21,264 | 22,033 |
| Residential: | | | | |
| Kansas City, MO | 153 | 176 | 505 | 432 |
| Total Residential Segment | 153 | 176 | 505 | 432 |
| Total Net Operating Income | 74,042 | 68,898 | 223,563 | 204,279 |
| Reconciliation to income before disposition of property, insurance gain, minority interest and equity in earnings of unconsolidated affiliates: | | | | |
| Depreciation and amortization | (32,109) | (31,891) | (94,359) | (90,476) |
| Impairment of assets held for use | | (789) | | (789) |
| General and administrative expense | (8,885) | (9,649) | (29,362) | (31,428) |
| Interest expenses | (24,492) | (25,325) | (74,128) | (74,273) |
| Interest and other income | 1,019 | 1,469 | 3,425 | 5,094 |

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| | | | | |
|--|----------|----------|-----------|-----------|
| Income before disposition of property, insurance gain, minority interest and equity in earnings of unconsolidated affiliates | \$ 9,575 | \$ 2,713 | \$ 29,139 | \$ 12,407 |
|--|----------|----------|-----------|-----------|

(1) Net of discontinued operations.

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

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HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

12. SUBSEQUENT EVENTS

In October 2008, we acquired a 135,000 square foot office building in Memphis, Tennessee in exchange for 183,587 Common Units and the assumption of \$7.8 million of 8.15% secured debt, which will be recorded at fair value, that matures in February 2016. We expect to incur or have incurred approximately \$1.7 million of near-term building improvements and other costs related to this acquisition.

In October 2008, we entered into a floating-to-fixed interest rate swap with PNC Bank, N.A. for a one-year period with respect to an aggregate of \$25.0 million of borrowings outstanding under our \$137.5 million term loan. This swap fixes the underlying LIBOR rate upon which interest on such borrowings are based at 2.35%.

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

We are a fully integrated, self-administered and self-managed equity REIT that provides leasing, management, development, construction and other customer-related services for our properties and for third parties. As of September 30, 2008, we owned or had an interest in 383 in-service office, industrial and retail properties, encompassing 34.8 million square feet, which includes six in-service office, industrial and retail development properties that had not yet reached 95% stabilized occupancy aggregating 1.3 million square feet, and 514 rental residential units. We are based in Raleigh, North Carolina, and our properties and development land are located in Florida, Georgia, Iowa, Kansas, Maryland, Mississippi, Missouri, North Carolina, South Carolina, Tennessee and Virginia. Additional information about us can be found on our website at www.highwoods.com. Information on our website is not part of this Quarterly Report.

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

DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

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

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

the financial condition of our tenants could deteriorate;

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

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

difficulties in obtaining additional capital to satisfy our future cash needs or increases in interest rates could adversely impact our ability to fund important business initiatives and increase our debt service costs;

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we may not be able to meet our liquidity requirements or obtain capital on favorable terms to fund our working capital needs and growth initiatives or to repay or refinance outstanding debt upon maturity;

in light of the current dislocations in the credit markets, one or more of our banking partners could suffer unexpected financial difficulties that cause them to default on their obligations under our existing revolving credit facility and/or revolving construction facility, which would make it difficult for us to meet our short- and long-term liquidity needs;

we could lose key executive officers; and

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

This list of risks and uncertainties, however, is not intended to be exhaustive. You should also review the other cautionary statements we make in *Business Risk Factors* set forth in our 2007 Annual Report on Form 10-K.

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

RESULTS OF OPERATIONS

In accordance with SFAS No. 144 and as described in Note 9 to the Consolidated Financial Statements, we reclassified the operations and/or gain/(loss) from disposal of certain properties to discontinued operations for all periods presented if the operations and cash flows have been or will be eliminated from our ongoing operations and we will not have any significant continuing involvement in the operations after the disposal transaction and the properties were either sold during 2007 and the first nine months of 2008 or were held for sale at September 30, 2008. There were no properties sold during 2007 and the first nine months of 2008 that did not meet the conditions as stipulated by SFAS No. 144.

Three Months Ended September 30, 2008 and 2007

The following table sets forth information regarding our unaudited results of operations for the three months ended September 30, 2008 and 2007 (\$ in millions):

| | Three Months Ended | | 2008 to 2007 | | |
|---|---------------------------|-------------|---------------------|--------------------|---|
| | September 30, 2008 | 2007 | \$ Change | % of Change | |
| Rental and other revenues | \$ 116.2 | \$ 107.6 | \$ 8.6 | 8.0 | % |
| Operating expenses: | | | | | |
| Rental property and other expenses | 42.2 | 38.7 | 3.5 | 9.0 | |
| Depreciation and amortization | 32.1 | 31.9 | 0.2 | 0.6 | |
| Impairment of assets held for use | - | 0.8 | (0.8) | (100.0) |) |
| General and administrative | 8.9 | 9.6 | (0.7) | (7.3) |) |
| Total operating expenses | 83.2 | 81.0 | 2.2 | 2.7 | |
| Interest expenses: | | | | | |
| Contractual | 23.0 | 23.7 | (0.7) | (3.0) |) |
| Amortization of deferred financing costs | 0.7 | 0.6 | 0.1 | 16.7 | |
| Financing obligations | 0.7 | 1.0 | (0.3) | (30.0) |) |
| | 24.4 | 25.3 | (0.9) | (3.6) |) |
| Other income: | | | | | |
| Interest and other income | 1.0 | 1.4 | (0.4) | (28.6) |) |
| | 1.0 | 1.4 | (0.4) | (28.6) |) |
| Income before disposition of property, minority interest and equity in earnings of unconsolidated affiliates | 9.6 | 2.7 | 6.9 | 255.6 | |
| Net gains on disposition of property | 1.7 | 1.3 | 0.4 | 30.8 | |
| Minority interest | (0.8) |) (0.3) |) (0.5) | (166.7) |) |
| Equity in earnings of unconsolidated affiliates | 1.2 | 1.2 | - | - | |
| Income from continuing operations | 11.7 | 4.9 | 6.8 | 138.8 | |
| Discontinued operations: | | | | | |

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| | | | | | |
|--|---------|--------|--------|---------|---|
| Income from discontinued operations, net of minority interest | 0.1 | 0.8 | (0.7 |)(87.5 |) |
| Net gains on sales of discontinued operations, net of minority interest | 2.9 | 6.2 | (3.3 |)(53.2 |) |
| Release of FASB FIN 48 tax liability | - | 1.5 | (1.5 |)(100.0 |) |
| | 3.0 | 8.5 | (5.5 |)(64.7 |) |
| Net income | 14.7 | 13.4 | 1.3 | 9.7 | |
| Dividends on preferred stock | (2.4 |) (2.7 |) 0.3 | 11.1 | |
| Excess of preferred stock redemption/repurchase cost over carrying value | (0.1) | (0.8 |) 0.7 | 87.5 | |
| Net income available for common stockholders | \$ 12.2 | \$ 9.9 | \$ 2.3 | 23.2 | % |

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Rental and Other Revenues

While we own and operate a limited number of industrial, retail and residential properties, our operating results depend heavily on successfully leasing our office properties. Economic growth in Florida, Georgia, North Carolina and Tennessee is and will continue to be an important determinative factor in predicting our future operating results.

The key components affecting our rental revenue stream are dispositions, acquisitions, new developments placed in service, average occupancy and rental rates. Average occupancy generally increases during times of improving economic growth, as our ability to lease space outpaces vacancies that occur upon the expirations of existing leases. Average occupancy generally declines during times of slower economic growth, when new vacancies tend to outpace our ability to lease space. Asset acquisitions, dispositions and new developments placed in service directly impact our rental revenues and could impact our average occupancy, depending upon the occupancy rate of the properties that are acquired, sold or placed in service. A further indicator of the predictability of future revenues is the expected lease expirations of our portfolio. As a result, in addition to seeking to increase our average occupancy by leasing current vacant space, we also must concentrate our leasing efforts on renewing leases on expiring space. Whether or not our rental revenue tracks average occupancy proportionally depends upon whether rents under new leases signed are higher or lower than the rents under the previous leases.

Rental and other revenues increased \$8.6 million in the third quarter of 2008 compared to 2007 primarily as a result of the contribution from developed properties placed in service in 2007 and the first nine months of 2008 and higher same property rental revenue, driven by higher average occupancy, in certain locations in 2008 as compared to 2007.

Operating Expenses

Our expenses primarily consist of rental property expenses, depreciation and amortization, general and administrative expenses and interest expense. Rental property expenses are expenses associated with our ownership and operation of rental properties and include expenses that vary somewhat, such as common area maintenance and utilities, and relatively fixed expenses, such as property taxes and insurance. Some of these variable expenses may be lower when our average occupancy declines. Depreciation and amortization is a non-cash expense associated with the ownership of real property and generally remains relatively consistent each year, unless we buy or sell assets, since we depreciate our properties on a straight-line basis over fixed lives. General and administrative expenses, net of amounts capitalized, consist primarily of management and employee salaries and other personnel costs, corporate and division overhead and long-term incentive compensation.

Rental property and other expenses from continuing operations (real estate taxes, utilities, insurance, repairs and maintenance and other property-related expenses) increased \$3.5 million in the third quarter of 2008 compared to the third quarter of 2007, primarily as a result of the additional operating expenses of developed properties placed in service in 2007 and the nine months ended September 30, 2008 and general inflationary increases in certain operating expenses, such as utility costs, insurance costs and real estate taxes.

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Rental and other revenues less rental property and other expenses increased \$5.1 million in 2008 compared to 2007. This is primarily the result of higher margins on development properties and higher revenues from higher average occupancy.

In the third quarter of 2007, one land parcel had indicators of impairment where the carrying value exceeded the sum of estimated undiscounted future cash flows. Therefore, impairment of assets held for use of \$0.8 million was recorded in the third quarter of 2007.

The \$0.7 million decrease in general and administrative expenses is primarily related to lower external audit and legal fees and a decrease in the adjustment related to our deferred compensation liability.

Interest Expenses

Interest expense depends primarily upon the amount of our borrowings, the weighted average interest rates on our debt and the amount of interest capitalized on development projects.

The \$0.7 million decrease in contractual interest expense is primarily the result of a decrease in average borrowings in 2008 compared to 2007 and a decrease in weighted average interest rates on outstanding debt, offset

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by a decrease in capitalized interest of \$0.6 million for the third quarter of 2008 compared to the third quarter of 2007.

Net Gains on Disposition of Property

Net gains on dispositions of properties not classified as discontinued operations was \$1.7 million and \$1.3 million for the three months ended September 30, 2008 and 2007, respectively. Gains are dependent on the specific assets sold, their historical cost basis and other factors, and can vary significantly from period to period.

Discontinued Operations

In accordance with SFAS No. 144, we classified net income of \$3.0 million and \$8.5 million, net of minority interest, as discontinued operations for the three months ended September 30, 2008 and 2007, respectively. These amounts relate to 1.8 million square feet of office and industrial properties and 13 rental residential units sold during 2007 and the nine months ended September 30, 2008. These amounts include net gains on the sale of these properties of \$2.9 million and \$6.2 million, net of minority interest, in the three months ended September 30, 2008 and 2007, respectively. During the three months ended September 30, 2007, we recorded \$1.5 million for the release of a liability recorded in accordance with FIN 48.

Table of Contents**Nine Months Ended September 30, 2008 and 2007**

The following table sets forth information regarding our unaudited results of operations for the nine months ended September 30, 2008 and 2007 (\$ in millions):

| | Nine Months Ended | | | | |
|---|--------------------------|-------------|---------------------|--------------------|----------|
| | September 30, | | 2008 to 2007 | | |
| | 2008 | 2007 | \$ Change | % of Change | % |
| Rental and other revenues | \$ 346.2 | \$ 318.2 | \$ 28.0 | 8.8 | |
| Operating expenses: | | | | | |
| Rental property and other expenses | 122.6 | 113.9 | 8.7 | 7.6 | |
| Depreciation and amortization | 94.4 | 90.5 | 3.9 | 4.3 | |
| Impairment of assets held for use | - | 0.8 | (0.8) | (100.0) |) |
| General and administrative | 29.4 | 31.4 | (2.0) | (6.4) |) |
| Total operating expenses | 246.4 | 236.6 | 9.8 | 4.1 | |
| Interest expenses: | | | | | |
| Contractual | 69.8 | 69.5 | 0.3 | 0.4 | |
| Amortization of deferred financing costs | 2.0 | 1.8 | 0.2 | 11.1 | |
| Financing obligations | 2.3 | 3.0 | (0.7) | (23.3) |) |
| | 74.1 | 74.3 | (0.2) | (0.3) |) |
| Other income: | | | | | |
| Interest and other income | 3.4 | 5.1 | (1.7) | (33.3) |) |
| | 3.4 | 5.1 | (1.7) | (33.3) |) |
| Income before disposition of property, insurance gain, minority interest and equity in earnings of unconsolidated affiliates | 29.1 | 12.4 | 16.7 | 134.7 | |
| Net gains on disposition of property | 1.9 | 20.4 | (18.5) | (90.7) |) |
| Gain from property insurance settlement | | 4.1 | (4.1) | (100.0) |) |
| Minority interest | (2.3) | (3.2) | 0.9 | 28.1 | |
| Equity in earnings of unconsolidated affiliates | 4.7 | 12.9 | (8.2) | (63.6) |) |
| Income from continuing operations | 33.4 | 46.6 | (13.2) | (28.3) |) |
| Discontinued operations: | | | | | |
| Income from discontinued operations, net of minority interest | 0.8 | 2.7 | (1.9) | (70.4) |) |
| Net gains on sales of discontinued operations, net of minority interest | 11.1 | 24.5 | (13.4) | (54.7) |) |
| Release of FASB FIN 48 tax liability | - | 1.5 | (1.5) | (100.0) |) |
| | 11.9 | 28.7 | (16.8) | (58.5) |) |
| Net income | 45.3 | 75.3 | (30.0) | (39.8) |) |
| Dividends on preferred stock | (8.1) | (10.6) | 2.5 | 23.6 | |
| Excess of preferred stock redemption/repurchase cost over carrying value | (0.1) | (2.3) | 2.2 | 95.7 | |
| Net income available for common stockholders | \$ 37.1 | \$ 62.4 | \$ (25.3) | (40.5) |)% |

Rental and Other Revenues

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Rental and other revenues increased \$28.0 million in the first nine months of 2008 compared to 2007 primarily as a result of the contribution from developed properties placed in service in 2007 and the first nine months of 2008 and higher same property rental revenue, driven by higher average occupancy, in certain locations in 2008 as compared to 2007.

Operating Expenses

Rental property and other operating expenses from continuing operations (real estate taxes, utilities, insurance, repairs and maintenance and other property-related expenses) increased \$8.7 million in the first nine months of 2008

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compared to the first nine months of 2007, primarily as a result of the additional operating expenses of developed properties placed in service in 2007 and the nine months ended September 30, 2008 and general inflationary increases in certain operating expenses, such as utility costs, insurance costs and real estate taxes.

Rental and other revenues less rental property and other operating expenses increased \$19.3 million in 2008 compared to 2007. This is primarily the result of higher margins on development properties and higher revenues from higher average occupancy.

The \$3.9 million increase in depreciation and amortization is primarily a result of the contribution from development properties placed in service in 2007 and the nine months ended September 30, 2008 and an increase in building improvements, tenant improvements and deferred leasing costs related to those buildings placed in service.

In the nine months ended September 30, 2007, one land parcel had indicators of impairment where the carrying value exceeded the sum of estimated undiscounted future cash flows. Therefore, impairment of assets held for use of \$0.8 million was recorded in the nine months ended September 30, 2007.

The \$2.0 million decrease in general and administrative expenses is primarily related to lower external legal and audit fees, lower condominium marketing costs and a decrease in the adjustment related to our deferred compensation liability. These decreases are partially offset by higher compensation related costs.

Financing Obligation

The \$0.7 million decrease in financing obligations is primarily the result of lower fair market amortization and interest expense for the first nine months of 2008 compared to the first nine months of 2007.

Other Income

The \$1.7 million decrease in interest and other income is primarily related to a decrease in income from 2007 to 2008 related to our investments in marketable securities which we use to pay benefits under our deferred compensation plan, offset by interest income from our investment in TIF bonds.

Net Gains on Disposition of Property; Gain from Property Insurance Settlement; Minority Interest; Equity in Earnings of Unconsolidated Affiliates

Net gains on dispositions of properties not classified as discontinued operations was \$1.9 million and \$20.4 million for the nine months ended September 30, 2008 and 2007, respectively. Gains are dependent on the specific assets sold, their historical cost basis and other factors, and can vary significantly from period to period.

In the first nine months of 2007, we recorded a \$4.1 million gain from finalization of a prior year insurance claim.

The decrease in minority interest expense of \$0.9 million was primarily due to a corresponding decrease in the Operating Partnership's income from continuing operations, after Preferred Unit distributions.

Equity in earnings of unconsolidated affiliates decreased \$8.2 million from 2007. The decrease primarily resulted from the sale of certain properties and recognition of a substantial lease termination fee in certain of our unconsolidated affiliates.

Discontinued Operations

In accordance with SFAS No. 144, we classified net income of \$11.9 million and \$28.7 million, net of minority interest, as discontinued operations for the nine months ended September 30, 2008 and 2007, respectively. These amounts relate to 1.8 million square feet of office and industrial properties and 13 rental residential units sold during 2007 and the nine months ended September 30, 2008. These amounts include net gains on the sale of these properties of \$11.1 million and \$24.5 million, net of minority interest, in the nine months ended September 30, 2008 and 2007, respectively. During the nine months ended September 30, 2007, we recorded \$1.5 million for the release of a liability recorded in accordance with FIN 48.

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Dividends on Preferred Stock and Excess of Preferred Stock Redemption/Repurchase Cost Over Carrying Value

Preferred stock dividends decreased \$2.5 million due to the reduction in outstanding Preferred Stock balances in 2007 and 2008. In addition, net income available for common stockholders was reduced by \$0.1 million and \$2.3 million in the nine months ended September 30, 2008 and 2007, respectively, related to the excess of redemption cost over the net carrying value of Preferred Stock.

LIQUIDITY AND CAPITAL RESOURCES

Because we are a REIT, we are required under the federal tax laws to distribute at least 90% of our REIT taxable income, excluding capital gains, to our stockholders. We generally use rents received from customers and proceeds from sales of non-core development land to fund our operating expenses, recurring capital expenditures and stockholder dividends. To fund property acquisitions, development activity or building renovations, we may sell other assets and may incur debt from time to time. Our debt generally consists of mortgage debt, unsecured debt securities and borrowings under our credit facilities.

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

If any of our lenders ever accelerated outstanding debt due to an event of default, we would not be able to borrow any further amounts under our revolving credit facility, which would adversely affect our ability to fund our operations. If our debt cannot be paid, refinanced or extended at maturity or upon acceleration, in addition to our failure to repay our debt, we may not be able to make distributions to stockholders at expected levels or at all. Furthermore, if any refinancing is done at higher interest rates, the increased interest expense would adversely affect our cash flows and ability to pay dividends to stockholders. Any such refinancing could also impose tighter financial ratios and other covenants that would restrict our ability to take actions that would otherwise be in our stockholders' best interest, such as funding new development activity, making opportunistic acquisitions, repurchasing our securities or paying dividends.

To generate additional capital to fund our growth and other strategic initiatives and to lessen the ownership risks typically associated with owning 100.0% of a property, we may sell some of our properties or contribute them to joint ventures. When we create a joint venture with a strategic partner, we usually contribute one or more properties that we own and/or vacant land to a newly formed entity in which we retain an interest of 50.0% or less. In exchange for our equal or minority interest in the joint venture, we generally receive cash from the partner and retain some or all of the management income relating to the properties in the joint venture. The joint venture itself will frequently borrow money on its own behalf to finance the acquisition of, and/or leverage the return upon, the properties being acquired by the joint venture or to build or acquire additional buildings. Such borrowings are typically on a non-recourse or limited recourse basis. We generally are not liable for the debts of our joint ventures, except to the extent of our equity investment, unless we have directly guaranteed any of that debt. In most cases, we and/or our strategic partners are required to guarantee customary exceptions to non-recourse liability in non-recourse loans.

We also may sell additional Common Stock or Preferred Stock or issue Common Units to fund additional growth or to reduce our debt. In addition, we may from time to time use available funds to redeem or repurchase Common Units and Preferred Stock for cash. In the future, we may from time to time retire some or all of our remaining outstanding Preferred Stock through redemptions, open market repurchases, privately negotiated acquisitions or otherwise.

Table of Contents**Statement of Cash Flows**

As required by GAAP, we report and analyze our cash flows based on operating activities, investing activities and financing activities. The following table sets forth the changes in our cash flows in the first nine months of 2008 as compared to the first nine months of 2007 (in thousands):

| | Nine Months Ended | | |
|---|-------------------------------|--------------|---------------|
| | September 30, 2008 | 2007 | Change |
| Cash Provided By Operating Activities | \$ 128,141 | \$ 120,809 | \$ 7,332 |
| Cash Used In Investing Activities | (128,601) | (97,918) | (30,683) |
| Cash Provided by/(Used In) Financing Activities | 10,987 | (36,113) | 47,100 |
| Total Cash Flows | \$ 10,527 | \$ (13,222) | \$ 23,749 |

The increase of \$7.3 million in cash provided by operating activities in 2008 compared to 2007 was primarily the result of higher cash flows from net income as adjusted for depreciation and amortization, net gains on disposition of properties, a gain from a property insurance settlement, minority interest, equity in earnings of unconsolidated affiliates and distributions of earnings from unconsolidated affiliates, which resulted in a \$16.4 million increase in cash provided by operating activities. Partially offsetting this increase was the net change in operating assets and liabilities, which resulted in a \$9.0 million decrease in cash provided by operating activities.

The increase of \$30.7 million in cash used in investing activities in 2008 compared to 2007 was primarily a result of a decrease in proceeds from disposition of real estate assets and distributions of capital from unconsolidated affiliates and an increase in contributions to unconsolidated affiliates. Partially offsetting these changes were a decrease in additions to real estate assets and deferred leasing costs and an increase in changes in restricted cash and other investing activities.

The increase of \$47.1 million in cash provided by/(used in) financing activities in 2008 compared to 2007 was primarily a result of an increase in net proceeds from the issuance of Common Stock, an increase in borrowings on our revolving credit facility, a decrease in redemption/repurchase of Preferred Stock and a decrease in cash paid for repurchase of Common Units. Partially offsetting these changes were a decrease in borrowings on mortgages and notes payable and an increase in repayments of mortgages and notes payable.

Capitalization

The following table sets forth our capitalization as of September 30, 2008 and December 31, 2007 (in thousands, except per share amounts):

| September 30, 2008 | December 31, 2007 |
|-------------------------------|------------------------------|
|-------------------------------|------------------------------|

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| | | |
|---|--------------|--------------|
| Mortgages and notes payable, at recorded book value | \$ 1,588,954 | \$ 1,641,987 |
| Financing obligations | \$ 35,195 | \$ 35,071 |
| Preferred Stock, at liquidation value | \$ 81,592 | \$ 135,437 |
| Common Stock and Common Units outstanding | 67,451 | 61,224 |
| Per share stock price at period | \$ 35.56 | \$ 29.38 |
| Market value of Common Stock and Common Units | 2,398,558 | 1,798,761 |
| Total market capitalization with debt and obligations | \$ 4,104,299 | \$ 3,611,256 |

Based on our total market capitalization of \$4.1 billion at September 30, 2008 (at the September 30, 2008 per share stock price of \$35.56 and assuming the redemption for shares of Common Stock of the 3.9 million Common Units not owned by the Company), our mortgages and notes payable represented 38.7% of our total market capitalization.

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Mortgages and notes payable at September 30, 2008 were comprised of \$670.0 million of secured indebtedness with a weighted average interest rate of 6.49% and \$919.0 million of unsecured indebtedness with a weighted average interest rate of 5.85%. As of September 30, 2008, our outstanding mortgages and notes payable were secured by real estate assets with an aggregate undepreciated book value of \$1.1 billion.

We do not intend to reserve funds to retire existing secured or unsecured debt upon maturity. For a more complete discussion of our long-term liquidity needs, see [Liquidity and Capital Resources - Current and Future Cash Needs](#).

Recent Developments

In October 2008, we acquired a 135,000 square foot office building in Memphis, Tennessee in exchange for 183,587 Common Units and the assumption of \$7.8 million of 8.15% secured debt, which will be recorded at fair value, that matures in February 2016. We expect to incur or have incurred approximately \$1.7 million of near-term building improvements and other costs related to this acquisition.

In October 2008, we entered into a floating-to-fixed interest rate swap with PNC Bank, N.A. for a one-year period with respect to an aggregate of \$25.0 million of borrowings outstanding under our \$137.5 million term loan. This swap fixes the underlying LIBOR rate upon which interest on such borrowings are based at 2.35%.

Financing and Investments Activity

On September 12, 2008, the Company sold 5.5 million shares of Common Stock for net proceeds of \$195.0 million. As required by the terms of the partnership agreement of the Operating Partnership, the net proceeds from the offering were contributed to the Operating Partnership in exchange for 5.5 million additional Common Units. In September 2008, a portion of the net proceeds of the offering were used to repurchase 53,845 outstanding 8 5/8% Series A Cumulative Redeemable Preferred Shares for an aggregate purchase price of \$52.5 million. The remaining net proceeds from the offering were used to reduce the amount of borrowings outstanding under our revolving credit facility.

Our \$450.0 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 interest rate would increase to LIBOR plus 140 or 155 basis points if our credit rating were to fall below investment grade according to two of three credit rating agencies. As of September 30, 2008, we had \$132.5 million borrowed on this revolving credit facility. Our revolving credit facility is syndicated as follows (in thousands):

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| Name of Lender | Total Commitment | Amount | Unfunded |
|--------------------------------|---------------------|--|---|
| | | Outstanding at September 30, 2008 | Commitment at September 30, 2008 |
| Bank of America, N.A. | \$ 50,000 | \$ 14,722 | \$ 35,278 |
| Branch Banking and Trust Co. | 50,000 | 14,722 | 35,278 |
| Wachovia Bank, N.A. | 50,000 | 14,722 | 35,278 |
| Wells Fargo Bank, N.A. | 50,000 | 14,722 | 35,278 |
| Emigrant Bank | 35,000 | 10,306 | 24,694 |
| Eurolypo AG, New York Branch | 35,000 | 10,306 | 24,694 |
| PNC Bank, N.A. | 30,000 | 8,833 | 21,167 |
| Regions Bank | 30,000 | 8,833 | 21,167 |
| Comerica Bank | 25,000 | 7,361 | 17,639 |
| RBC Bank | 25,000 | 7,361 | 17,639 |
| Union Bank of California, N.A. | 25,000 | 7,361 | 17,639 |
| US Bank | 20,000 | 5,890 | 14,110 |
| First Horizon Bank | 15,000 | 4,417 | 10,583 |
| Chevy Chase Bank | 10,000 | 2,944 | 7,056 |
| Total | \$ 450,000 | \$ 132,500 | \$ 317,500 |

The unfunded commitment in the table above includes \$1.6 million in outstanding letters of credit, which effectively reduces the availability under our revolving credit facility to \$315.9 million as of September 30, 2008.

On February 1, 2008, we paid off at maturity \$100.0 million of 7.13% 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. The interest rate would increase to LIBOR plus 160 basis points if our credit rating were to fall below investment grade according to two of three credit rating agencies. Proceeds from this loan were used to reduce the outstanding borrowings under our revolving credit facility and for short-term investments.

In July 2008, REES, a consolidated joint venture (see Note 1 to the Consolidated Financial Statements in our 2007 Annual Report on Form 10-K), fully repaid the remaining \$17.5 million outstanding under a secured construction loan.

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

If any of our lenders ever accelerated outstanding debt due to an event of default, we would not be able to borrow any further amounts under our revolving credit facility, which would adversely affect our ability to fund our operations. If our debt cannot be paid, refinanced or extended at maturity or upon acceleration, in addition to our failure to repay our debt, we may not be able to make distributions to stockholders at expected

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levels or at all. Furthermore, if any refinancing is done at higher interest rates, the increased interest expense would adversely affect our cash flows and ability to pay dividends to stockholders. Any such refinancing could also impose tighter financial ratios and other covenants that would restrict our ability to take actions that would otherwise be in our stockholders' best interest, such as funding new development activity, making opportunistic acquisitions, repurchasing our securities or paying dividends.

In March 2008, we and an affiliate of DLF formed a new joint venture, Highwoods DLF Forum, LLC, in which we have a 25.0% ownership interest. 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 \$113 million. We contributed \$12.3 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. We account for this unconsolidated joint venture using the equity method of accounting.

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Current and Future Cash Needs

Rental and other revenues are our principal source of funds to meet our short-term liquidity requirements, which primarily consist of operating expenses, debt service, stockholder dividends, any guarantee obligations and recurring capital expenditures. In addition, we could incur tenant improvement costs and lease commissions related to any releasing of vacant space. As of September 30, 2008, other than principal amortization on certain secured loans, we have no outstanding debt that matures prior to the end of 2008.

We generally expect to fund our short-term liquidity needs through a combination of available working capital, cash flows from operations and borrowings under our revolving credit facility and revolving construction facilities (which had \$315.9 million and \$72.2 million of availability, respectively, as of September 30, 2008). We regularly evaluate the financial condition of our banking partners using publicly available information, particularly in light of the current dislocations in the credit market. Based on this review, we currently expect our banking partners, which are major financial institutions, to perform their obligations under our existing facilities.

Our long-term liquidity needs generally include the funding of capital expenditures to lease space to our customers, maintain the quality of our existing properties and build new properties. Capital expenditures include tenant improvements, building improvements, new building completion costs and land infrastructure costs. Tenant improvements are the costs required to customize space for the specific needs of first-generation and second-generation customers. Building improvements are recurring capital costs not related to a specific customer to maintain existing buildings. New building completion costs are expenses for the construction of new buildings. Land infrastructure costs are expenses to prepare development land for future development activity that is not specifically related to a single building. Excluding recurring capital expenditures for leasing costs and tenant improvements and for normal building improvements, our expected future capital expenditures for started and/or committed new development projects were \$95.3 million at September 30, 2008. A significant portion of these future expenditures are currently subject to binding contractual arrangements. Our long-term liquidity needs also include the funding of development projects, selective asset acquisitions and the retirement of mortgage debt, amounts outstanding under our revolving credit facility and long-term unsecured debt.

Our goal is to maintain a conservative and flexible balance sheet. Accordingly, we expect to meet our long-term liquidity needs through a combination of:

borrowings under unsecured financing arrangements that we may obtain, such as the issuance by the Operating Partnership of unsecured debt securities;

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

borrowings under other secured mortgages or construction loans that we may obtain;

the selective disposition of non-core assets; and

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the sale or contribution of some of our Wholly Owned Properties, development projects and development land to strategic joint ventures to be formed with unrelated investors, which would have the net effect of generating additional capital through such sale or contributions.

We expect to use such sources to meet our long-term liquidity requirements either through direct payments or repayments of borrowings under our revolving credit facility. As mentioned above, we do not intend to reserve funds to retire existing secured or unsecured indebtedness upon maturity. Instead, we will seek to refinance such debt at maturity or retire such debt through the issuance of equity or debt securities or from proceeds from sales of properties. In the future, we may from time to time retire some or all of our remaining outstanding Preferred Stock through redemptions, open market repurchases, privately negotiated acquisitions or otherwise.

We anticipate that our available cash and cash equivalents and cash flows from operating activities, with cash available from borrowings and other sources, will be adequate to meet our capital and liquidity needs in both the short and long term. However, if these sources of funds are insufficient or unavailable, our ability to pay dividends to stockholders and satisfy other cash payments may be adversely affected.

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Off Balance Sheet Arrangements

We have several off balance sheet joint venture and guarantee arrangements. The joint ventures were formed with unrelated investors to generate additional capital to fund property acquisitions, repay outstanding debt, fund other strategic initiatives and lessen the risks typically associated with owning 100.0% of a property. When we create a joint venture with a partner, we usually contribute cash or wholly owned assets to a newly formed entity in which we retain an equal or minority interest. For financial reporting purposes, certain assets we sold have been accounted for as financing arrangements.

As of September 30, 2008, our unconsolidated joint ventures had \$856.2 million of total assets and \$657.3 million of total liabilities as reflected in their financial statements. At September 30, 2008, our weighted average equity interest based on the total assets of these unconsolidated joint ventures was 37.4%. During the nine months ended September 30, 2008, these unconsolidated joint ventures earned \$9.1 million of total net income of which our share, after appropriate purchase accounting and other adjustments, was \$4.7 million.

As of September 30, 2008, our unconsolidated joint ventures had \$619.0 million of outstanding mortgage debt. All of this joint venture debt is non-recourse to us except (1) in the case of customary exceptions pertaining to such matters as misuse of funds, environmental conditions and material misrepresentations and (2) those guarantees and loans described in Note 15 to the Consolidated Financial Statements in our 2007 Annual Report on Form 10-K.

Interest Rate Hedging Activities

To meet, in part, our long-term liquidity requirements, we borrow funds at a combination of fixed and variable rates. Borrowings under our revolving credit facility bear interest at variable rates. Our long-term debt, which consists of secured and unsecured long-term financings and the issuance of unsecured debt securities, typically bears interest at fixed rates although some loans bear interest at variable rates. Our interest rate risk management objectives are to limit the impact of interest rate changes on earnings and cash flows and to lower our overall borrowing costs. To achieve these objectives, from time to time, we may enter into interest rate hedge contracts such as collars, swaps, caps and treasury lock agreements in order to mitigate our interest rate risk with respect to various debt instruments. We do not hold or issue these derivative contracts for trading or speculative purposes. The interest rate on all of our variable rate debt is adjusted at one and three month intervals, subject to settlements under interest rate hedge contracts. We also enter into treasury lock agreements from time to time in order to limit our exposure to an increase in interest rates with respect to future debt offerings.

In January 2008, we entered into two floating-to-fixed interest rate swaps for a one-year period with respect to an aggregate of \$50.0 million of borrowings outstanding under our revolving credit facility or other floating rate debt. These swaps fix the underlying LIBOR rate upon which interest on such borrowings is based at 3.3% for \$30.0 million of borrowings and 3.2% for \$20.0 million of borrowings. The counterparty under the \$30.0 million swap is PNC Bank and the counterparty under the \$20.0 million swap is Bank of America. These swaps were designated as hedges under SFAS No. 133. Accordingly, the swaps are being accounted for as cash flow hedges.

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 \$50.0 million of borrowings outstanding under our term loan or other floating rate debt. The swap fixes the underlying LIBOR rate upon which interest

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on such borrowings is based at 2.5%. The counterparty under this swap is Bank of America. The swap was designated as a hedge under SFAS No. 133. Accordingly, the swap is being accounted for as a cash flow hedge.

CRITICAL ACCOUNTING ESTIMATES

There were no changes to the critical accounting policies made by management in the nine months ended September 30, 2008, except as set forth in Note 1 to the Consolidated Financial Statements under Impact of Newly Adopted and Issued Accounting Standards. For a description of our critical accounting estimates, see Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Estimates in our 2007 Annual Report on Form 10-K.

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FUNDS FROM OPERATIONS

We believe that FFO and FFO per share are beneficial to management and investors and are important indicators of the performance of any equity REIT. Because FFO and FFO per share calculations exclude such factors as depreciation and amortization of real estate assets and gains or losses from sales of operating real estate assets (which can vary among owners of identical assets in similar conditions based on historical cost accounting and useful life estimates), they facilitate comparisons of operating performance between periods and between other REITs. Our management believes that historical cost accounting for real estate assets in accordance with GAAP implicitly assumes that the value of real estate assets diminishes predictably over time. Since real estate values have historically risen or fallen with market conditions, many industry investors and analysts have considered the presentation of operating results for real estate companies that use historical cost accounting to be insufficient by itself. As a result, management believes that the use of FFO and FFO per share, together with the required GAAP presentations, provide a more complete understanding of our performance relative to our competitors and a more informed and appropriate basis on which to make decisions involving operating, financing and investing activities.

FFO and FFO per share as disclosed by other REITs may not be comparable to our calculation of FFO and FFO per share as described below. However, you should also be aware that FFO and FFO per share are non-GAAP financial measures and therefore do not represent net income or net income per share as defined by GAAP. Net income and net income per share as defined by GAAP are the most relevant measures in determining our operating performance because FFO and FFO per share include adjustments that investors may deem subjective, such as adding back expenses such as depreciation and amortization. Furthermore, FFO per share does not depict the amount that accrues directly to the stockholders' benefit. Accordingly, FFO and FFO per share should never be considered as alternatives to net income or net income per share as indicators of our operating performance.

Our calculation of FFO, which we believe is consistent with the calculation of FFO as defined by the National Association of Real Estate Investment Trusts (NAREIT) and which appropriately excludes the cost of capital improvements and related capitalized interest, is as follows:

Net income (loss) computed in accordance with GAAP;

Less dividends to holders of Preferred Stock and less excess of Preferred Stock redemption/repurchase cost over carrying value;

Plus depreciation and amortization of assets uniquely significant to the real estate industry;

Less gains, or plus losses, from sales of depreciable operating properties (but excluding impairment losses) and excluding items that are classified as extraordinary items under GAAP;

Plus or minus adjustments for unconsolidated partnerships and joint ventures (to reflect funds from operations on the same basis); and

Plus or minus adjustments for depreciation and amortization and gains/(losses) on sales and minority interest related to discontinued operations.

Further, in calculating FFO, we add back minority interest in the income from the Operating Partnership, which we believe is consistent with standard industry practice for REITs that operate through an UPREIT structure. We believe that it is important to present FFO on an as-converted basis since all of the Common Units not owned by the Company are redeemable on a one-for-one basis for shares of our Common Stock.

Other REITs may not define FFO in accordance with the current NAREIT definition or may interpret the current NAREIT definition differently than we do.

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FFO and FFO per share for the three and nine months ended September 30, 2008 and 2007 are summarized in the following table (\$ in thousands, except per share amounts):

| | Three Months Ended September 30, 2008 | | 2007 | | Nine Months Ended September 30, 2008 | | 2007 | |
|---|--|-----------|-----------|-----------|---|-----------|------------|-----------|
| | Amount | Per Share | Amount | Per Share | Amount | Per Share | Amount | Per Share |
| Funds from operations: | | | | | | | | |
| Net income | \$ 14,711 | | \$ 13,440 | | \$ 45,337 | | \$ 75,287 | |
| Dividends to preferred stockholders | (2,451) | | (2,680) | | (8,127) | | (10,639) | |
| Excess of Preferred Stock redemption/repurchase cost over carrying value | (108) | | (842) | | (108) | | (2,285) | |
| Net income available for common stockholders | 12,152 | \$ 0.21 | 9,918 | \$ 0.17 | 37,102 | \$ 0.64 | 62,363 | \$ 1.09 |
| Add/(Deduct): | | | | | | | | |
| Depreciation and amortization of real estate assets | 31,639 | 0.50 | 31,294 | 0.51 | 92,887 | 1.50 | 88,634 | 1.44 |
| Gains on disposition of depreciable properties | (18) | | (1,063) | (0.02) | (36) | | (3,343) | (0.05) |
| Minority interest from the Operating Partnership in income from operations | 612 | | 92 | | 1,723 | | 2,684 | |
| Unconsolidated affiliates: | | | | | | | | |
| Depreciation and amortization of real estate assets | 3,136 | 0.05 | 3,107 | 0.05 | 9,466 | 0.16 | 8,851 | 0.14 |
| Gains on disposition of depreciable properties | | | | | | | (7,158) | (0.12) |
| Discontinued operations: | | | | | | | | |
| Depreciation and amortization of real estate assets | | | 773 | 0.01 | 233 | | 2,481 | 0.04 |
| Gains on disposition of depreciable properties | (3,137) | (0.05) | (7,001) | (0.11) | (11,890) | (0.19) | (26,847) | (0.44) |
| Minority interest from the Operating Partnership in income from discontinued operations | 200 | | 502 | | 821 | | 2,127 | |
| Release of FASB FIN 48 tax liability | | | (1,473) | (0.02) | | | (1,473) | (0.02) |
| Funds from operations | \$ 44,584 | \$ 0.71 | \$ 36,149 | \$ 0.59 | \$ 130,306 | \$ 2.11 | \$ 128,319 | \$ 2.08 |
| Weighted average shares outstanding (1) | 62,938 | | 61,396 | | 61,865 | | 61,611 | |

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

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The effects of potential changes in interest rates are discussed below. Our market risk discussion includes forward-looking statements and represents an estimate of possible changes in fair value or future earnings that would occur assuming hypothetical future movements in interest rates. These disclosures are not precise indicators of expected future effects, but only indicators of reasonably possible effects. As a result, actual future results may differ materially from those presented. See Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources and the Notes to Consolidated Financial Statements for a description of our accounting policies and other information related to these financial instruments.

As of September 30, 2008, we had \$1,287.0 million of fixed rate debt outstanding. The estimated aggregate fair market value of this debt at September 30, 2008 was \$1,180.0 million. If interest rates increase by 100 basis points, the aggregate fair market value of our fixed rate debt as of September 30, 2008 would decrease by \$48.6 million. If interest rates decrease by 100 basis points, the aggregate fair market value of our fixed rate debt as of September 30, 2008 would increase by \$51.7 million.

As of September 30, 2008, we had \$302.0 million of variable rate debt outstanding. If the weighted average interest rate on this variable rate debt had been 100 basis points higher or lower during the 12 months ended September 30, 2008, our interest expense relating to this debt would increase or decrease by approximately \$3.0 million.

As of September 30, 2008, we had floating-to-fixed interest rate swaps with respect to an aggregate of \$100.0 million of borrowings outstanding under our revolving credit facility. The swaps fix the underlying LIBOR rate under which interest on such borrowings is based at a weighted average of 2.88%. If LIBOR interest rates increase or decrease by 100 basis points, the aggregate fair market value of the swaps as of September 30, 2008 would decrease or increase by \$837,000 and \$815,000, respectively.

In addition, we are exposed to certain losses in the event of nonperformance by the counterparties, which are PNC Bank, N.A. and Bank of America, N.A., under the swaps. We regularly evaluate the financial condition of our counterparties using publicly available information, particularly in light of the current dislocations in the credit market. Based on this review, we currently expect the counterparties, which are major financial institutions, to perform fully under the swaps. However, if a counterparty defaults on its obligations under the swap, we could be required to pay the full rates on the applicable debt, even if such rates were in excess of the rate in the contract.

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ITEM 4. CONTROLS AND PROCEDURES

SEC rules require us to maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our annual and periodic reports filed with the SEC is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. As defined in Rule 13a-15(e) under the Exchange Act, disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us is accumulated and communicated to our management, including our CEO and CFO, to allow timely decisions regarding required disclosure. Our CEO and CFO believe that our disclosure controls and procedures were effective at the end of the period covered by this Quarterly Report.

SEC rules also require us to establish and maintain internal control over financial reporting designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepting accounting principles. As defined in Rule 13a-15(f) under the Exchange Act, internal control over financial reporting includes those policies and procedures that:

pertain to the maintenance of records that in reasonable detail accurately and fairly reflect our transactions and dispositions of assets;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepting accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of management and directors; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

There were no changes in our internal control over financial reporting during the third quarter of 2008 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II - OTHER INFORMATION

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During the third quarter of 2008, the Company issued an aggregate of 27,314 shares of Common Stock to holders of Common Units in the Operating Partnership upon the redemption of a like number of Common Units in private offerings exempt from the registration requirements pursuant to Section 4(2) of the Securities Act. Each of the holders of Common Units was an accredited investor under Rule 501 of the Securities Act. The resale of such shares was registered by the Company under the Securities Act.

ITEM 6. EXHIBITS

| Exhibit Number | Description |
|---------------------------|---|
| 1.1 | Underwriting Agreement (filed as part of the Company's Current Report on Form 8-K dated September 12, 2008) |
| 31.1 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act |
| 31.2 | Certification Pursuant to Section 302 of the Sarbanes-Oxley Act |
| 32.1 | Certification Pursuant to Section 906 of the Sarbanes-Oxley Act |
| 32.2 | Certification Pursuant to Section 906 of the Sarbanes-Oxley Act |

SIGNATURES

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

HIGHWOODS PROPERTIES, INC.

By: /s/ TERRY L. STEVENS
Terry L. Stevens
Senior Vice President and Chief Financial Officer

Date: November 7, 2008