HIGHWOODS PROPERTIES INC
Form 10-Q/A
November 15, 2004
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

AMENDMENT NO. 1

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

THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2004

Commission file number: 001-13100

HIGHWOODS PROPERTIES, INC.

(Exact name of registrant as specified in its charter)

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

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

(Address of principal executive office)

27604

(Zip Code)

(919) 872-4924

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the Registrant is an accelerated filer (as defined in rule 12b-2 of the Securities Exchange Act). Yes x No ¨

The Company has only one class of common stock, par value $0.01 per share, with 53,713,181 shares outstanding as of October 22, 2004.

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EXPLANATORY NOTE

The Company is filing this amended Quarterly Report on Form 10-Q for the three months ended March 31, 2004 to restate its previously reported financial results as of March 31, 2004 and December 31, 2003 and for the three months ended March 31, 2004 and 2003. These restatements are primarily due to adjustments relating to the accounting for a limited number of the Company s prior real estate sales transactions occurring between 1999 and March 31, 2004, reclassifications related to discontinued operations, accounting for minority interest, accounting for a debt retirement transaction and other items. For more details, see Note 11 to the Consolidated Financial Statements contained herein.

Management of the Company is ultimately responsible for preparing and presenting the Company s financial statements in accordance with GAAP. As part of these processes, we consulted with Ernst & Young LLP in their capacity as our independent auditors regarding the application of GAAP. In particular, we consulted with Ernst & Young LLP regarding certain of the real estate sales transactions with continuing involvement, accounting for the MOPPRS debt extinguishment in 2003, accounting for minority interest in the Operating Partnership, and accounting for the compensation costs to be recognized in 2004 in connection with the retirement of the Company s former CEO.

Real Estate Sales Transactions. As part of its previously disclosed capital recycling program, the Company has completed a significant number of real estate sales transactions during the last five years. Certain transactions involved sales where the Company retained a partial ownership interest or had continuing involvement with the properties. The forms of continuing involvement included guarantee of a return on investment, guarantee of partial rental income from specific tenants, seller financing, or, in one instance, a 97.0% fair-market-value put option granted to the buyer.

In the Company s historical financial statements, these transactions were accounted for as sales, and a portion or all of the resultant gains from these transactions were deferred because of the continuing involvement. The nature of all material continuing involvement was disclosed in the Company s quarterly and annual regulatory and financial filings with the Securities and Exchange Commission and the Company s annual reports.

Adjustments have been made with respect to the accounting treatment for certain of those transactions where the Company had some form of continuing involvement to comply with the guidance of Statement of Financial Accounting Standards (SFAS) No. 66, Accounting for Sales of Real Estate. For three of the transactions, the largest of which is the sale in late 2000 of properties into the previously disclosed MG-HIW, LLC joint venture, the Company has adjusted its Consolidated Financial Statements to account for these transactions as financing and/or profit-sharing arrangements rather than as sales. Accordingly, the assets, related liabilities and operations are now included in the Company s Consolidated Financial Statements. In the other instances, the transactions have continued to be reported as sales, but the timing and amount of gain recognition have now changed due to the Company s continuing involvement. This is in accordance with SFAS No. 66.

Discontinued Operations. Certain properties were sold to joint ventures where the Company retained a minority interest. In addition, in other sales transactions the Company was retained by the buyer to perform management and leasing services. Since January 1, 2002, the Company applied discontinued operations presentation under SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets for the operations of those sold properties for the periods prior to the date of sale. Due to the partial interest retained through joint ventures and the continuing management fee income earned from such sold properties, the properties do not require discontinued operations presentation under SFAS No. 144. Accordingly, the Company will adjust its Consolidated Statements of Income for 2001 through 2003 to classify such items as continuing operations; these reclassifications do not impact net income or FFO.

Minority Interest. In its Consolidated Financial Statements, the Company previously computed minority interest in the net income of its majority owned subsidiary, Highwoods Realty Limited Partnership (the Operating Partnership), for each reporting period by applying the weighted average ownership percentage of the minority common unitholders times the Operating Partnership s net income available to common unitholders (continuing operations and discontinued operations) for the period before deducting distributions to preferred unitholders. In the restated Consolidated Financial Statements, minority interest has been adjusted by applying the weighted average ownership percentage of the minority common unitholders times the Operating Partnership s net income (continuing operations and discontinued operations) for the period after deducting distributions to preferred unitholders.

Accounting for MOPPRS Debt Retirement. This transaction, which occurred in early February 2003, is described in detail in Note 11. The Company had previously accounted for the transaction as an exchange of indebtedness under EITF 96-19, Debtor s Accounting for a Modification or Exchange of Debt Instruments and recorded $14.7 million in deferred financing costs, representing the excess of amounts paid to retire the MOPPRS and the related remarketing option over the MOPPRS net carrying value and related deferred credits. The Company has now determined that this transaction should have been accounted for as a debt extinguishment under EITF 96-19.

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Accordingly, the $14.7 million has been charged to loss on debt extinguishment in the first quarter of 2003 rather than as deferred financing costs as previously recorded. In addition, the amortization expense related to the previous net deferred financing costs, which aggregated approximately $0.3 million in the first quarter of 2003 and approximately $0.4 million per quarter thereafter, has been reversed in the restated Consolidated Financial Statements.

Other Matters. In addition to the above, the Company identified several other matters that have been adjusted, as described in Note 11 to the Consolidated Financial Statements.

Impact on Financial Statements. The impact of the restatements on the Company s Consolidated Balance Sheets as of March 31, 2004 and December 31, 2003 and Consolidated Statements of Operations for the three months ended March 31, 2004 and 2003, is shown in tables in Note 11 to the Consolidated Financial Statements.

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HIGHWOODS PROPERTIES, INC.

QUARTERLY REPORT FOR THE PERIOD ENDED MARCH 31, 2004

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

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

The aforementioned financial statements should be read in conjunction with the notes to Consolidated Financial Statements and Management s Discussion and Analysis of Financial Condition and Results of Operations included herein and in our 2003 amended Annual Report on Form 10-K.

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HIGHWOODS PROPERTIES, INC.

Consolidated Balance Sheets

(Unaudited and in thousands, except per share amounts)

(Restated)

	March 31, 2004	December 31, 2003
	(Unaudited)	
Assets:		
Real estate assets, at cost:		
Land and improvements	$ 407,057	$ 405,132
Buildings and tenant improvements	2,960,142	2,945,581
Development in process	9,574	7,478
Land held for development	203,667	202,526
Furniture fixtures and equipment	21,950	21,818
	3,602,390	3,582,535
Less accumulated depreciation	(545,380)	(521,108)
Net real estate assets	3,057,010	3,061,427
Property held for sale	213,539	231,413
Cash and cash equivalents	17,637	21,551
Restricted cash	5,989	4,602
Accounts receivable, net	13,452	18,176
Notes receivable	10,779	10,066
Accrued straight-line rents receivable	61,475	58,912
Investments in unconsolidated affiliates	69,630	62,417
Other assets:		
Deferred leasing costs	102,194	98,162
Deferred financing costs	19,484	19,286
Prepaid expenses and other	11,341	10,443
	133,019	127,891
Less accumulated amortization	(57,840)	(53,432)
Other assets, net	75,179	74,459
Total Assets	$ 3,524,690	$ 3,543,023
Liabilities and Stockholders Equity:		
Mortgages and notes payable	$ 1,790,039	$ 1,717,765
Accounts payable, accrued expenses and other liabilities	98,224	101,608
Financing obligations	62,994	124,063

Total Liabilities	1,951,257	1,943,436
Minority interest in the Operating Partnership	123,901	127,776
Stockholders Equity:		
Preferred stock, $.01 par value, 50,000,000 authorized shares;		
8 5/8% Series A Cumulative Redeemable Preferred Shares (liquidation preference $1,000 per share), 104,945 shares issued and outstanding at March 31, 2004 and December 31, 2003	104,945	104,945
8% Series B Cumulative Redeemable Preferred Shares (liquidation preference $25 per share), 6,900,000 shares issued and outstanding at March 31, 2004 and December 31, 2003	172,500	172,500
8% Series D Cumulative Redeemable Preferred Shares (liquidation preference $250 per share), 400,000 shares issued and outstanding at March 31, 2004 and December 31, 2003	100,000	100,000
Common stock, $.01 par value, 200,000,000 authorized shares; 53,631,176 and 53,474,403 shares issued and outstanding at March 31, 2004 and December 31, 2003, respectively	536	535
Additional paid-in capital	1,414,108	1,408,888
Distributions in excess of net earnings	(332,443)	(306,938)
Accumulated other comprehensive loss	(3,525)	(3,650)
Deferred compensation	(6,589)	(4,469)
Total Stockholders Equity	1,449,532	1,471,811
Total Liabilities and Stockholders Equity	$ 3,524,690	$ 3,543,023

See accompanying notes to consolidated financial statements.

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HIGHWOODS PROPERTIES, INC.

Consolidated Statements of Operations

(Unaudited and in thousands, except per share amounts)

(Restated)

	Three Months Ended March 31,	
	2004	**2003**
Rental and other revenues	$ 120,924	$ 127,432
Operating expenses:		
Rental property and other expenses	44,661	43,482
Depreciation and amortization	36,004	36,486
General and administrative	10,667	4,672
Total operating expenses	91,332	84,640
Interest expense:		
Contractual	27,215	30,159
Amortization of deferred financing costs	1,144	897
Financing obligations	4,693	4,877
	33,052	35,933
Other income/expense:		
Interest and other income	1,758	1,177
Loss on debt extinguishment		(14,653)
	1,758	(13,476)
Loss before disposition of property, co-venture expense, minority interest and equity in earnings of unconsolidated affiliates	(1,702)	(6,617)
Gains on disposition of property, net	1,070	804
Co-venture expense		(2,086)
Minority interest in the Operating Partnership	689	1,606
Equity in earnings of unconsolidated affiliates	1,284	1,149
Income/(loss) from continuing operations	1,341	(5,144)
Discontinued operations:		
Income from discontinued operations, net of minority interest	169	1,049

Gain on sale of discontinued operations, net of minority interest	3,436	6
	3,605	1,055
Net income/(loss)	4,946	(4,089)
Dividends on preferred stock	(7,713)	(7,713)
Net loss attributable to common stockholders	$ (2,767)	$ (11,802)
Net loss per common share basic:		
Loss from continuing operations	$ (0.12)	$ (0.24)
Income from discontinued operations	0.07	0.02
Net loss	$ (0.05)	$ (0.22)
Weighted average common shares outstanding basic	53,174	53,142
Net loss per common share diluted:		
Loss from continuing operations	$ (0.12)	$ (0.24)
Income from discontinued operations	0.07	0.02
Net loss	$ (0.05)	$ (0.22)
Weighted average common shares outstanding diluted	53,174	53,142
Dividends declared per common share	$ 0.425	$ 0.585

See accompanying notes to consolidated financial statements.

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HIGHWOODS PROPERTIES, INC.

Consolidated Statement of Stockholders Equity

(Unaudited and $ in thousands, except share amounts)

For the Three Months Ended March 31, 2004

(Restated)

	Number of Common Shares	Common Stock	Series A Preferred	Series B Preferred	Series D Preferred	Additional Paid-In Capital	Deferred Compen-sation	Accumulated Other Compre-hensive Loss	Distributions in Excess of Net Earnings	Total
Balance at December 31, 2003 (as reported)	**53,474,403**	**$ 535**	**$ 104,945**	**$ 172,500**	**$ 100,000**	**$ 1,393,103**	**$ (4,433)**	**$ (3,650)**	**$ (271,971)**	**$ 1,491,029**
Restatement adjustments						15,785	(36)		(34,967)	(19,218)
Balance at December 31, 2003 (restated)	53,474,403	535	104,945	172,500	100,000	1,408,888	(4,469)	(3,650)	(306,938)	1,471,811
Issuance of Common Stock	12,524					320				320
Conversion of Common Units to Common Stock	54,308					1,404				1,404
Common Stock dividends									(22,738)	(22,738)
Preferred Stock dividends									(7,713)	(7,713)
Adjustments to minority interest of unitholders in the Operating Partnership						(479)				(479)
Issuance of deferred compensation	89,941	1				2,868	(2,869)			
Fair value of stock options issued						1,107	(1,107)			
Amortization of deferred compensation							1,856			1,856
								125		125

Other comprehensive income										
Net Income									4,946	4,946
Balance at March 31, 2004	53,631,176	$ 536	$ 104,945	$ 172,500	$ 100,000	$ 1,414,108	$ (6,589)	$ (3,525)	$ (332,443)	$ 1,449,532

See accompanying notes to consolidated financial statements.

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HIGHWOODS PROPERTIES, INC.

Consolidated Statements of Cash Flows

(Unaudited and in thousands)

(Restated)

	Three Months Ended March 31,	
	2004	**2003**
Operating activities:		
Income/(loss) from continuing operations	$ 1,341	$ (5,144)
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	36,004	36,486
Amortization of deferred compensation	1,856	165
Amortization of deferred financing costs	1,144	897
Amortization of accumulated other comprehensive loss	210	437
Equity in earnings of unconsolidated affiliates	(1,284)	(1,149)
Loss on debt extinguishments		14,653
Gain on disposition of property, net	(1,070)	(804)
Minority interest in the Operating Partnership	(689)	(1,606)
Discontinued operations	218	1,593
Changes in financing obligations	1,431	1,613
Changes in co-venture obligation		729
Changes in operating assets and liabilities	(3,199)	(6,083)
Net cash provided by operating activities	35,962	41,787
Investing activities:		
Additions to real estate assets	(30,113)	(27,418)
Proceeds from disposition of real estate assets	21,774	2,388
Distributions from unconsolidated affiliates	1,945	4,059
Investments in notes receivable	(11)	(1,175)
Contributions to unconsolidated affiliates	(9,988)	
Other investing activities	(67)	(199)
Net cash used in investing activities	(16,460)	(22,345)
Financing activities:		
Distributions paid on common stock and common units	(25,368)	(35,248)
Dividends paid on preferred stock	(7,713)	(7,713)
Net proceeds from the sale of common stock	320	128
Repurchase of common stock and common units	(50)	(2,751)

Borrowings on revolving loan	175,500	68,000
Repayment of revolving loan	(100,000)	(32,000)
Borrowings on mortgages and notes payable		20,000
Repayment of mortgages and notes payable	(3,226)	(4,419)
Payments on financing obligations	(62,500)	
Additions to deferred financing costs	(379)	(152)
Payments on debt extinguishments		(16,282)
Net cash used in financing activities	(23,416)	(10,437)
Net (decrease)/increase in cash and cash equivalents	(3,914)	9,005
Cash and cash equivalents at beginning of the period	21,551	15,796
Cash and cash equivalents at end of the period	$ 17,637	$ 24,801
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 22,689	$ 24,374

See accompanying notes to consolidated financial statements.

HIGHWOODS PROPERTIES, INC.

Consolidated Statements of Cash Flows - Continued

(Unaudited and in thousands)

(Restated)

Supplemental disclosure of non-cash investing and financing activities:

The following table summarizes the net assets acquired subject to mortgage notes payable and other non-cash transactions:

	Three Months Ended March 31,	
	2004	**2003**
Assets:		
Net real estate assets	$ 1,600	$
Notes receivable	702	
Investment in unconsolidated affiliates	(2,173)	1,694
	$ 129	$ 1,694
Liabilities:		
Accounts payable accrued expenses and other liabilities	129	1,694
	$ 129	$ 1,694

See accompanying notes to consolidated financial statements.

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HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2004

(Restated and Unaudited)

1. Description of Business and Basis of Presentation

Description of Business

Highwoods Properties, Inc. and its consolidated subsidiaries (the Company) is a self-administered and self-managed real estate investment trust (REIT) that operates in the southeastern and midwestern United States. The Company s wholly owned assets include: 468 in-service office, industrial and retail properties; 1,255 acres of undeveloped land suitable for future development; and an additional four properties under development (the Wholly Owned Properties).

The Company conducts substantially all of its activities through, and substantially all of its interests in the properties are held directly or indirectly by, Highwoods Realty Limited Partnership (the Operating Partnership). The Company is the sole general partner of the Operating Partnership. At March 31, 2004, the Company owned 100.0% of the preferred partnership interests (Preferred Units) and 89.7% of the common partnership interests (Common Units) in the Operating Partnership. Holders of Common Units may redeem them for the cash value of one share of the Company s Common Stock, $.01 par value (the Common Stock), or, at the Company s option, one share of Common Stock. During the three months ended March 31, 2004, the Company redeemed from limited partners (including certain officers and directors of the Company) 1,960 Common Units for $0.05 million in cash and converted 54,308 Common Units in exchange for Common Stock on a one-for-one basis. These transactions increased the percentage of Common Units owned by the Company from 89.5% at December 31, 2003 to 89.7% at March 31, 2004. The three series of Preferred Units in the Operating Partnership were issued to the Company in connection with the Company s three Preferred Stock offerings in 1997 and 1998. The net proceeds raised from each of the three Preferred Stock issuances were contributed by the Company to the Operating Partnership in exchange for preferred interests in the Operating Partnership. The terms of each series of Preferred Units generally parallel the terms of the respective Preferred Stock as to dividends, liquidation and redemption rights.

Basis of Presentation

The Consolidated Financial Statements of the Company include the Operating Partnership, wholly owned subsidiaries and those subsidiaries in which the Company owns a majority voting interest with the ability to control operations of the subsidiaries and where no approval, veto or other important rights have been granted to the minority shareholders. In accordance with Statement of Position 78-9, Accounting for Investments in Real Estate Ventures, the Company consolidates partnerships, joint ventures and limited liability companies when the Company controls the major operating and financial policies of the entity through majority ownership or in its capacity as general partner or managing member. The

Company does not consolidate entities where the other interest holders have important rights, including approving decisions to encumber the entities with debt and acquire or dispose of properties. In addition, the Company consolidates those entities, if any, where the Company is deemed to be the primary beneficiary in a variable interest entity (as defined by FASB Interpretation No. 46 (revised December 2003) Consolidation of Variable Interest Entities (FIN 46)). All significant intercompany transactions and accounts have been eliminated.

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 (the Code), as amended. As a REIT, the Company generally will not be subject to federal or state income taxes on its net income that it distributes to stockholders. Continued qualification as a REIT depends on the Company s ability to satisfy the dividend distribution tests, stock ownership requirements, and various other qualification tests prescribed in the Code. In June 1994, the Company formed a taxable REIT subsidiary, as permitted under the Code, through which it conducts certain business activities; the taxable REIT subsidiary is subject to federal and state income taxes on its net taxable income and the Company records provisions for such taxes to the extent required based on its income recognized for financial statement purposes, including the effects of temporary differences between such income and that recognized for tax purposes.

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HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

1. Description of Business and Basis of Presentation - Continued

The accompanying financial information has not been audited, but in the opinion of management, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of our financial position, results of operations and cash flows have been made. The Company has condensed or omitted certain notes and other information from the interim financial statements presented in this amended Quarterly Report on Form 10-Q. These financial statements should be read in conjunction with the Company s 2003 amended Annual Report on Form 10-K.

The preparation of financial statements in accordance with Accounting Principles Generally Accepted in the United States (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.

Restated and reclassified financial data. As more fully described in Note 11, the Consolidated Financial Statements as of March 31, 2004 and December 31, 2003 and for the three months ended March 31, 2004 and 2003 have been restated to reflect adjustments for certain asset sales in which the Company has continuing involvement to conform with paragraphs 25 through 29 of Statement of Financial Accounting Standards (SFAS) No. 66, Accounting for Sales of Real Estate, accounting for minority interest in the net income of the Operating Partnership, accounting for a debt retirement and other matters. The adjustments resulted in the following decreases in net income and in net income per share basic and net income per share diluted (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2004	2003
Net income	$ (938)	$ (15,261)
Net income per share basic (1)	$ (0.02)	$ (0.28)
Net income per share diluted (1)	$ (0.02)	$ (0.28)

(1) Amounts represent reduction in net income available to common stockholders per share, which includes preferred dividends.

The Company also made certain reclassifications related to discontinued operations and for presentation of certain tenant reimbursements as revenue, rather than a reduction of operating expenses. Certain amounts originally reported in the March 31, 2003 and December 31, 2003 financial statements have been reclassified to conform to the March 31, 2004 presentation and accounting for discontinued operations (see Note 7 for further discussion). These reclassifications had no effect on net income or stockholders equity as previously reported.

Minority interest in the Operating Partnership. Minority interest in the accompanying Consolidated Financial Statements relates to the common ownership interests in the Operating Partnership owned by various individuals and entities other than the Company. As of March 31, 2004, the minority interest in the Operating Partnership consisted of 6.15 million Common Units. As described in Note 11, the Company adjusted its method for computing minority interest in the net income of the Operating Partnership. Minority interest in the net income of the Operating Partnership is computed by applying the weighted average percentage of Common Units not owned by the Company (as a percent of the total number of outstanding Common Units) to the Operating Partnership s net income after deducting distributions on Preferred Units. The result is the amount of minority interest expense recorded for the period. In addition, when a common unitholder redeems a Common Unit for a share of Common Stock or cash, the minority interest is reduced and the Company s share in the Operating Partnership is increased. At the end of each reporting period, the Company determines the amount that represents the minority unitholders share of the net assets (at book value) of the Operating Partnership and compares this amount to the minority interest balance that resulted from transactions during the period involving minority interest. The Company adjusts the minority interest liability to the computed share of net assets with an offsetting adjustment to the Company s paid in capital.

Following is the minority interest in the net income of the Operating Partnership (in thousands):

	Three Months Ended March 31,	
	2004	**2003**
Minority Interest in continuing operations	$ 689	$ 1,606
Amount related to income from discontinued operations	(20)	(137)
Amount related to gain on sale of discontinued operations	(399)	
Total Minority Interest in net income of the Operating Partnership	$ 270	$ 1,469

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HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Investments in Unconsolidated Affiliates

During the past several years, the Company has formed various joint ventures with unrelated investors. The Company has retained minority equity interests ranging from 12.50% to 50.00% in these joint ventures. The Company has accounted for its unconsolidated joint ventures using the equity method of accounting. As a result, the assets and liabilities of these joint ventures for which it uses the equity method of accounting are not included on the Company s Consolidated Balance Sheet. Two joint ventures are accounted for as financing and/or profit sharing arrangements pursuant to SFAS No. 66, as described in Notes 3 and 11, and accordingly are not reflected in the table below.

The following table sets forth information regarding the Company s unconsolidated joint ventures as recorded on the joint ventures books for the three months ended March 31, 2004 and 2003 ($ in thousands):

		Three Months Ended March 31, 2004					Three Months Ended March 31, 2003				
	Percent Owned	Revenue	Operating Expenses	Interest	Depr/ Amort	Net Income/ (Loss)	Revenue	Operating Expenses	Interest	Depr/ Amort	Net Income/ (Loss)
Income Statement Data:											
Board of Trade Investment Company	49.00%	$ 633	$ 434	$ 14	$ 112	$ 73	$ 608	$ 395	$ 17	$ 100	$ 96
Dallas County Partners **(1)**	50.00%	2,547	1,524	680	464	(121)	2,411	1,410	695	472	(166)
Dallas County Partners II **(1)**	50.00%	1,595	711	570	186	128	1,566	689	599	206	72
Fountain Three **(1)**	50.00%	1,834	835	536	379	84	1,763	760	572	356	75
RRHWoods, LLC **(1)**	50.00%	3,311	1,874	675	851	(89)	3,507	1,791	673	835	208
Kessinger/Hunter, LLC	26.50%	1,538	1,229		174	135	1,397	1,160		159	78
4600 Madison Associates, LP	12.50%	1,215	562	287	421	(55)	1,493	592	299	394	208
Highwoods DLF 98/29, LP	22.81%	4,960	1,346	1,137	880	1,597	4,643	1,348	1,153	862	1,280
Highwoods DLF 97/26 DLF 99/32, LP	42.93%	3,796	1,005	1,140	1,083	568	4,182	1,123	1,152	1,001	906
Highwoods-Markel Associates, LLC	50.00%	1,671	385	586	368	332	812	438	238	143	(7)
MG-HIW Peachtree Corners III, LLC **(2)**	50.00%						34	25	25	19	(35)
MG-HIW Metrowest I, LLC **(3)**	50.00%		5			(5)		8			(8)
MG-HIW Metrowest II, LLC **(3)**	50.00%	141	88	39	70	(56)	123	109	44	79	(109)
Concourse Center Associates, LLC	50.00%	526	141	175	85	125	526	138	173	76	139
Plaza Colonnade, LLC	50.00%	1			1		4		1		3
Highwoods KC Glenridge, LLC **(4)**	40.00%	326	97		46	183					

Total	$ 24,094	$ 10,236	$ 5,839	$ 5,120	$ 2,899	$ 23,069	$ 9,986	$ 5,641	$ 4,702	$ 2,740

(1) Des Moines joint ventures.

(2) As part of the MG-HIW, LLC acquisition on July 29, 2003, the Company was assigned Miller Global s 50.0% equity interest in the single property encompassing 53,896 square feet owned by MG-HIW Peachtree Corners III, LLC. As a result, this entity became wholly owned as of July 29, 2003 and is consolidated commencing as of that date.

(3) On March 2, 2004, the Company exercised an option to acquire its partner s 50.0% equity interest in the assets of MG-HIW Metrowest I, LLC and MG-HIW Metrowest II, LLC. The Company paid its partner $3.2 million for such remaining interest and a $7.4 million construction loan was paid in full by the Company. The assets encompass 87,832 square feet of property and 7.0 acres of development land zoned for the development of 90,000 square feet of office space. This acquisition increased the Company s ownership interest to 100.0% and these entities are consolidated commencing as of March 2, 2004.

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Investments in Unconsolidated Affiliates - Continued

(4) The Company and Kapital-Consult, a European investment firm, formed this joint venture partnership, which on February 26, 2004 acquired from a third party Glenridge Point Office Park, consisting of two office buildings aggregating 185,000 square feet located in the Central Perimeter sub-market of Atlanta. The buildings are 91.1% occupied as of March 31, 2004. The Company contributed $10.0 million to the joint venture in return for a 40.0% equity interest and Kapital-Consult contributed $14.9 million for a 60.0% equity interest in the partnership. The joint venture entered into a $16.5 million ten-year secured loan on the assets. The Company is the manager and leasing agent for this property and will receive customary management fees and leasing commissions. The acquisition also included 2.9 acres of development land that can accommodate 150,000 square feet of office space.

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities (VIEs), the primary objective of which is to provide guidance on the identification of entities for which control is achieved through means other than voting rights and to determine when and which business enterprise should consolidate the VIEs. This new model applies when either (1) the equity investors (if any) do not have a controlling financial interest or (2) the equity investment at risk is insufficient to finance the entity s activities without additional financial support. FIN 46 also requires additional disclosures. FIN 46 was effective immediately for interests acquired subsequent to January 31, 2003 and is effective March 31, 2004 for interests in VIEs created before February 1, 2003. The Company assessed its variable interests, including the joint ventures listed above, and determined the interests were not VIEs. As a result, the provisions of FIN 46 did not have an impact on the Company s financial condition or results of operations.

See Note 13 for information regarding HIW-KC Orlando, LLC.

3. Financing Arrangements

The following summarizes sales transactions that are accounted for as financing and/or profit-sharing arrangements under paragraphs 25 through 29 under SFAS No. 66 as further described in Note 11.

MG-HIW, LLC

MG-HIW, LLC is a joint venture formed in 2000 between the Company and Miller Global. As more fully described in Note 3 to the Consolidated Financial Statements contained in the Company s amended Annual Report on Form 10-K, the transaction did not qualify for sale treatment under SFAS No. 66 and, consequently, has been accounted for in part as a profit-sharing arrangement and in part as a financing transaction.

As previously disclosed, on March 2, 2004, the Company exercised an option and acquired its partner s 80.0% equity interest in five properties encompassing 1.3 million square feet located in the central business district of Orlando, Florida. At the closing of the transaction, the Company paid its partner, Miller Global, $62.5 million and a $7.5 million letter of credit delivered to the seller in connection with the option was cancelled. Since the initial contribution of these assets was accounted for as a financing arrangement and since the financing obligation was adjusted each period for a 20.0% leveraged internal rate of return guarantee, no gain or loss was recognized upon the extinguishment of the financing obligation.

SF-HIW Harborview, LP

On September 11, 2002, the Company contributed Harborview Plaza, an office building located in Tampa, Florida, to SF-HIW Harborview Plaza, LP (Harborview LP), a newly formed entity, in exchange for a 20.0% limited partnership interest and $35.4 million in cash. The Company also entered into a master lease agreement with Harborview, LP for five years on the vacant space in the building (approximately 20%) and guaranteed payment of tenant improvements and lease commissions of $1.2 million. The Company s maximum exposure to loss under the master lease agreement was $2.1 million at September 11, 2002 and was $1.3 million at March 31, 2004. Additionally, the Company s partner in Harborview LP was granted the right to put its 80.0% equity interest in Harborview LP to the Company in exchange for cash at any time during the one-year period commencing on September 11, 2014. The value of the 80.0% equity interest will be determined at the time, if ever, that such partner elects to exercise its put right, based upon the then fair market value of Harborview LP s assets and liabilities less 3.0%, which was intended to cover normal costs of a sale transaction.

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Financing Arrangements - Continued

Because of the put option and master lease agreement, this transaction is accounted for as a financing transaction as described in Note 11. Consequently, the assets, liabilities and operations related to Harborview Plaza, the property owned by Harborview LP, including any new financing by the partnership, remain on the books of the Company. As a result, the Company has established a financing obligation equal to the net equity contributed by the other partner. At the end of each reporting period, the balance of the financing obligation is adjusted to equal the current fair value, which is $13.5 million at March 31, 2004, but not less than the original financing obligation. This adjustment is amortized prospectively through September 2014. Additionally, the net income from the operations before depreciation of Harborview Plaza allocable to the 80.0% partner is recorded as interest expense on financing obligation. The Company continues to depreciate the property and record all of the depreciation on its books. Additionally, any payments made under the master lease agreement are expensed as incurred ($0.02 million and $0.13 million was expensed during the three months ended March 31, 2004 and 2003, respectively) and any amounts paid under the tenant improvement and lease commission guarantee are capitalized and amortized to expense over the remaining lease term. At such time as the put option expires or otherwise is terminated, the Company will record the transaction as a sale and recognize gain on sale.

Eastshore

On November 26, 2002, the Company sold three buildings located in Richmond, Virginia (the Eastshore transaction) for a total purchase price of $28.5 million in cash, which was paid in full by the buyer at closing. Each of the sold properties is a single tenant building leased on a triple-net basis to Capital One Services, Inc., a subsidiary of Capital One Financial Services, Inc.

In connection with the sale, the Company entered into a rental guarantee agreement for each building for the benefit of the buyer to guarantee any rent shortfalls which may be incurred in the payment of rent and re-tenanting costs for a five-year period from the date of sale (through November 2007). The Company s maximum exposure to loss under the rental guarantee agreements was $18.7 million at the date of sale and $15.2 million as of March 31, 2004. No payments were made by the Company during the three months ended March 31, 2004 and 2003 with respect to these rent guarantees. However, in June 2004, the Company began to make monthly payments to the buyer, at an annual rate of $0.1 million, as a result of the existing tenant renewing a lease in one building at a lower rental rate.

These rent guarantees are a form of continuing involvement as prescribed by SFAS No. 66. Because the guarantees cover the entire space occupied by a single tenant under a triple-net lease arrangement, the Company s guarantees are considered a guaranteed return on the buyer s investment for an extended period of time. Therefore, the transaction has been accounted for as a financing transaction. Accordingly, the assets and operations are included in these Consolidated Financial Statements, and a financing obligation of $28.5 million was recorded which represents the amount received from the buyer. The income from the operations of the properties, other than depreciation, is allocated 100.0% to the owner as interest expense on financing obligation. Payments made under the rent guarantees are charged to expense as incurred. This transaction will be recorded as a completed sale transaction in the future when the maximum exposure to loss under the guarantees is equal to or less than the related gain.

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HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Related Party Transactions

The Company has previously reported that it has had a contract to acquire development land in the Bluegrass Valley office development project from GAPI, Inc., a corporation controlled by an executive officer and director of the Company. On January 17, 2003, the Company acquired an additional 23.5 acres of this land from GAPI, Inc. for cash and shares of Common Stock valued at $2.3 million. In May 2003, 4.0 acres of the remaining acres not yet acquired by the Company was 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 between the Company and GAPI, Inc., the Company was entitled to the proceeds from the condemnation of $1.8 million, less the contracted purchase price between the Company and GAPI, Inc. for the condemned property of $0.7 million. On September 30, 2003, as a result of the condemnation, the Company received the proceeds of $1.8 million. A related party payable of $0.7 million to GAPI, Inc. related to the condemnation of the development land is included in accounts payable, accrued expenses and other liabilities in the Company s Consolidated Balance Sheet at March 31, 2004.

5. Derivative Financial Instruments

The interest rates on all of the Company s variable rate debt are currently adjusted at one to three month intervals, subject to settlements under interest rate hedge contracts. Net payments made to counter parties under interest rate hedge contracts were nominal in 2004 and were recorded as increases to interest expense.

In addition, the Company is exposed to certain losses in the event of non-performance by the counter party under the interest rate hedge contracts. The Company expects the counter party, which is a major financial institution, to perform fully under the contracts. However, if the counter party was to default on its obligations under the interest rate hedge contracts, the Company could be required to pay the full rates on its debt, even if such rates were in excess of the rate in the contracts.

During the year ended December 31, 2003, the Company entered into and subsequently terminated three interest rate swap agreements related to a ten-year fixed rate financing completed on December 1, 2003. These swap agreements were designated as cash flow hedges and the unamortized effective portion of the cumulative gain on these derivative instruments was $3.7 million at March 31, 2004 and is being reported as a component of AOCL in stockholders equity. This deferred gain is being recognized in net income as a reduction of interest expense in the same period or periods during which interest expense on the hedged fixed rate financing effects net income. The Company expects that approximately $0.3 million will be recognized in the next 12 months.

In 2003, the Company also entered into two interest rate swaps related to a floating rate credit facility. The swaps effectively fix the one month LIBOR rate on $20.0 million of floating rate debt at 1.59% from January 2, 2004 until May 31, 2005. These swap agreements are designated as cash flow hedges and the effective portion of the cumulative loss on these derivative instruments was $0.06 million at March 31, 2004. The Company expects that the portion of the cumulative loss recorded in AOCL at March 31, 2004 associated with these derivative instruments, which will be recognized within the next 12 months, will be approximately $0.07 million.

At March 31, 2004, approximately $5.8 million of deferred financing costs from past cash flow hedging instruments remain in AOCL, including those described above. These costs are recognized as interest expense as the underlying debt is repaid and amounted to $0.2 million and $0.4 million during the quarters ended March 31, 2004 and 2003, respectively. The Company expects that the portion of the cumulative loss recorded in AOCL at March 31, 2004 associated with these derivative instruments, which will be recognized within the next 12 months, will be approximately $0.8 million.

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HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. Other Comprehensive Income

Other comprehensive income represents net income plus the results of certain stockholders equity changes not reflected in the Consolidated Statements of Operations. The components of other comprehensive income are as follows (in thousands):

	Three Months Ended March 31,	
	2004	**2003**
Net income/(loss)	$ 4,946	$ (4,089)
Other comprehensive income:		
Unrealized derivative losses on cashflow hedges	(85)	
Amortization of hedging gains and losses included in other comprehensive income	210	437
Total other comprehensive income	125	437
Total comprehensive income	$ 5,071	$ (3,652)

7. Discontinued Operations and Impairment of Long-Lived Assets

In October 2001, the FASB issued SFAS No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets. SFAS No. 144 supercedes SFAS No. 121 Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be disposed of and the accounting and reporting provisions for disposals of a segment of business as addressed in Accounting Principles Board (APB) Opinion No. 30 Reporting the Results of Operations-Reporting the Effects of the Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions.

The net operating results and net carrying value of assets classified as discontinued operations in the Company s Consolidated Statements of Operations comprise: 0.9 million square feet of property, 122.8 acres of revenue-producing land and four apartment units sold during 2004 and 2003 and 0.1 million square feet of property and 88 apartment units held for sale at March 31, 2004 are shown in the following table. These long-lived assets relate to disposal activities that were initiated subsequent to the effective date of SFAS No. 144 and are classified as discontinued operations in the Company s Consolidated Statements of Operations since the operations and cash flows have been or will be eliminated from the ongoing operations of the Company, and the Company will not have any significant continuing involvement in the operations after the disposal transaction (in thousands):

	Three Months Ended March 31,	
	2004	2003
Total revenue	$ 403	$ 2,671
Operating expenses:		
Rental property and other expenses	187	657
Depreciation and amortization	29	407
Total operating expenses	216	1,064
Interest expense		429
Other income	2	8
Income before minority interest in the Operating Partnership and gain on sale of discontinued operations	189	1,186
Minority interest in discontinued operations	(20)	(137)
Income from discontinued operations, net of minority interest in the Operating Partnership	169	1,049
Gain on sale of discontinued operations	3,835	6
Minority interest in discontinued operations	(399)	
Gain on sale/impairment of discontinued operations, net of minority interest in the Operating Partnership	3,436	6
Total discontinued operations	$ 3,605	$ 1,055
Carrying value of assets held for sale and assets sold during the period	$ 4,493	$ 80,655

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HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. Discontinued Operations and Impairment of Long-Lived Assets - Continued

SFAS No. 144 also requires that a long-lived asset classified as held for sale be measured at the lower of the carrying value or fair value less cost to sell. During the three months ended March 31, 2004, the Company determined that no properties held for sale had a carrying value that was greater than fair value less cost to sell; therefore, no impairment loss was recognized in the Consolidated Statements of Operations for the three months ended March 31, 2004. For 2003, an impairment loss related to one office property whose carrying value was greater than its fair value less cost to sell, which has now been sold, was $0.1 million. This impairment loss is included in loss on sale of discontinued operations in the Consolidated Statement of Operations for the three months ended March 31, 2003.

See Note 13 for discussion of a subsequent event involving the sale of certain assets at the Highwoods Preserve office campus in Tampa, Florida and an agreement to sell 30.0 acres of land in suburban Baltimore, Maryland and related impairment losses that were recognized in the second quarter of 2004.

SFAS No. 144 also requires that if indicators of impairment exist, the carrying value of a long-lived asset classified as held for use be compared to the sum of its estimated undiscounted future cash flows. If the carrying value is greater than the sum of its undiscounted future cash flows, an impairment loss should be recognized for the excess of the carrying amount of the asset over its estimated fair value. At March 31, 2004 and 2003, because there were no properties held for use with indicators of impairment where the carrying value exceeds the sum of estimated undiscounted future cash flows, no impairment loss related to held for use properties was recognized during the three months ended March 31, 2004 and 2003.

8. Stock based Compensation

In accordance with Statement of Financial Accounting Standards No. 148 Accounting for Stock-based Compensation Transition and Disclosure (SFAS No. 148), the Company expenses all stock options issued on or after January 1, 2003 over the vesting period based upon the fair value of the award on the date of grant. General and administrative expenses for the three months ended March 31, 2004 and 2003 include amortization related to the vesting of stock options granted subsequent to January 1, 2003 of $0.05 million and $0.01 million, respectively. The unamortized value of option grants since January 1, 2003 aggregates $1.2 million. See below for the amounts that would have been deducted from net income if the Company had elected to expense the fair value of all stock option awards that had vested rather than only those awards issued subsequent to January 1, 2003:

	Three Months Ended March 31,	
	2004	**2003**
	($ in thousands, except per share amounts)	

Net loss attributable to common stockholders as reported	$	(2,767)	$	(11,802)
Add: Stock option expense included in reported net income		532[(1)]		(226)[(2)]
Deduct: Total stock option expense determined under fair value recognition method for all awards		(639)[(1)]		(66)[(2)]
Pro forma net (loss)/income attributable to common stockholders	$	(2,874)	$	(11,962)
Basic net loss per common share - as reported	$	(0.05)	$	(0.22)
Basic net loss per common share - pro forma	$	(0.05)	$	(0.23)
Diluted net loss per common share - as reported	$	(0.05)	$	(0.22)
Diluted net loss per common share - pro forma	$	(0.05)	$	(0.23)

(1) Amounts include the stock option expense recorded in the first quarter of 2004 for the accelerated vesting related to the retirement of the Company s Chief Executive Officer in June 2004 as well as the expense recorded for the dividend equivalent rights as discussed in Note 11.

(2) Amounts include the effects of accounting for the dividend equivalent rights as discussed in Note 11.

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. Commitments and Contingencies

Concentration of Credit Risk

The Company maintains its cash and cash equivalent investments at financial institutions. The combined account balances at each institution typically exceed the FDIC insurance coverage and, as a result, there is a concentration of credit risk related to amounts on deposit in excess of FDIC insurance coverage. Management of the Company believes that the potential risk of loss is remote.

Contracts

The Company has entered into contracts related to tenant improvements and the development of certain properties totaling $25.2 million as of March 31, 2004. The amounts remaining to be paid under these contracts as of March 31, 2004 totaled $17.1 million.

Environmental Matters

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

Joint Ventures

Certain properties owned in joint ventures with unaffiliated parties have buy/sell options that may be exercised to acquire the other partner s interest by either the Company or its joint venture partner if certain conditions are met as set forth in the respective joint venture agreement.

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HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. Commitments and Contingencies - Continued

Guarantees and Other Obligations

The following is a tabular presentation and related discussion of various guarantees and other obligations as of March 31, 2004 and additional guarantees and obligations that arose after March 31, 2004:

Entity or Transaction	Type of Guarantee or Other Obligation	Amount Recorded/ Deferred	Date Guarantee Expires
		($ in thousands)	
Des Moines Joint Ventures **(1),(6)**	Debt	$	Various
RRHWoods, LLC **(2),(7)**	Debt	$	8/2006
Plaza Colonnade **(2),(8)**	Construction loan and completion	$ 2,844	2/2006
Plaza Colonnade **(2),(8)**	Letter of credit	$	12/2004
SF-HIW Harborview, LP **(3),(5)**	Rent and tenant improvement **(4)**	$	9/2007
SF-HIW Harborview, LP **(3),(5)**	Purchase obligation	$ 13,503	9/2015
Eastshore (Capital One) **(3),(9)**	Rent **(4)**	$	11/2007
Capital One **(3),(10)**	Rent **(4)**	$ 3,051	10/2009
Industrial **(3),(11)**	Rent **(4)**	$ 2,218	12/2006
Highwoods DLF 97/26 DLF 99/32, LP **(2),(12)**	Rent **(4)**	$ 855	6/2008
Guarantees that arose after March 31, 2004:			
RRHWoods, LLC and Dallas County Partners **(2),(13)**	Indirect debt **(4)**	$ 1,290	6/2014
HIW-KC Orlando, LLC **(3),(14)**	Rent **(4)**	$ 629	4/2011
HIW-KC Orlando, LLC **(3),(14)**	Leasing Costs	$ 4,101	12/2024

(1) Represents guarantees entered into prior to the January 1, 2003 effective date of FIN 45 for initial recognition and measurement.
(2) Represents guarantees that fall under the initial recognition and measurement requirements of FIN 45.
(3) Represents guarantees that are excluded from the fair value accounting and disclosure provisions of FIN 45 since the existence of such guarantees prevents sale treatment and/or the recognition of profit from the sale transaction.
(4) The maximum potential amount of future payments disclosed below for these guarantees assumes the Company pays the maximum possible liability under the guaranty with no offsets or reductions. If the space is leased, it assumes the existing tenant defaults at March 31, 2004 and the space remains unleased through the remainder of the guaranty term. If the space is vacant, it assumes the space remains vacant through the expiration of the guaranty. Since it is assumed that no new tenant will occupy the space, lease commissions, if applicable, are excluded.
(5) As more fully described in Note 3, in 2002 the Company granted its partner in SF-HIW Harborview, LP a put option and also entered into a master lease arrangement for five years covering vacant space in the building owned by the partnership and agreed to pay certain tenant improvement costs. The maximum potential amount of future payments as of March 31, 2004 the Company could be required to make related to the rent guarantees and tenant improvements is $1.4 million.
(6)

The Company has guaranteed certain loans in connection with the Des Moines joint ventures. The maximum potential amount of future payments the Company could be required to make under the guarantees is $25.3 million. Of this amount, $8.6 million arose from housing revenue bonds that require credit enhancements in addition to the real estate mortgages. The bonds bear a floating interest rate, which at March 31, 2004 averaged 0.97% and mature in 2015. Guarantees of $9.5 million will expire upon two industrial buildings becoming 93.8% and 95.0% leased or when the related loans mature. As of March 31, 2004, these buildings were 90.0% and 64.0% leased, respectively. The remaining $7.2 million in guarantees relate to loans on four office buildings that were in the lease-up phase at the time the loans were initiated. Each of the loans will expire by May 2008. The average occupancy of the four buildings at March 31, 2004 is 92.0%. If the joint ventures are unable to repay the outstanding balance under the loans, the Company will be required, under the terms of the agreements, to repay the outstanding balance. Recourse provisions exist to enable the Company to recover some or all of such payments from the joint ventures assets and/or the other partner. The joint ventures currently generate sufficient cash flow to cover the debt service required by the loans.

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HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. Commitments and Contingencies - Continued

(7) In connection with the RRHWoods, LLC joint venture, the Company renewed its guarantee of $6.2 million to a bank in July 2003; this guarantee expires in August 2006 and may be renewed by the Company. The bank provides a letter of credit securing industrial revenue bonds, which mature in 2015. The Company would be required to perform under the guarantee should the joint venture be unable to repay the bonds. The Company has recourse provisions in order to recover from the joint venture s assets and the other partner for amounts paid in excess of their proportionate share. The property collateralizing the bonds is 100.0% leased and currently generates sufficient cash flow to cover the debt service required by the bond financing. As a result, no liability has been recorded in the Company s Balance Sheet.

(8) With respect to the Plaza Colonnade, LLC joint venture, the Company has included $2.8 million in other liabilities and adjusted the investment in unconsolidated affiliates by $2.8 million on its Consolidated Balance Sheet at March 31, 2004 related to two separate guarantees of a construction loan agreement and a construction completion agreement. The construction loan matures in February 2006, with two one-year options to extend the maturity date that are conditional on completion and lease-up of the project. The term of the construction completion agreement requires the core and shell of the building to be completed by December 15, 2005. Currently, the building is scheduled to be completed in December 2004. Both guarantees arose from the formation of the joint venture to construct an office building. If the joint venture is unable to repay the outstanding balance under the construction loan agreement or complete the construction of the office building, the Company would be required, under the terms of the agreements, to repay its 50.0% share of the outstanding balance under the construction loan and complete the construction of the office building. On March 30, 2004, the Industrial Development Authority of the City of Kansas City, Missouri issued $18.5 million in non-recourse bonds to finance public improvements made by the joint venture for the benefit of the Kansas City Missouri Public Library. Since the joint venture leases the land for the office building from the library, the joint venture is obligated to build certain public improvements. The net bond proceeds of $16.3 million will be used to reimburse the joint venture for its costs. As funds are transferred from the bond fund to the construction lender, the Company s exposure is reduced. The maximum potential amount of future payments by the Company under these agreements is $27.6 million if the construction loan is fully funded. No recourse provisions exist that would enable the Company to recover from the other partner amounts paid under the guarantee. However, given that the loan is collateralized by the building, the Company and their partner could obtain and liquidate the building to recover the amounts paid should the Company be required to perform under the guarantee.

In addition to the Plaza Colonnade, LLC construction loan and completion agreement described above, the partners collectively provided $12.0 million in letters of credit in December 2002, $6.0 million by the Company and $6.0 million by its partner. The Company and its partner would be held liable under the letter of credit agreements should the joint venture not complete construction of the building. The letters of credit expire in December 31, 2004. No recourse provisions exist that would enable the Company to recover from the other partner amounts drawn under the letter of credit. The building is nearing completion and the first tenant is expected to take occupancy in the fourth quarter of 2004.

(9) As more fully described in Note 3, in connection with the sale of three office buildings to a third party in 2002 (the Eastshore transaction), the Company agreed to guarantee rent shortfalls and re-tenanting costs for a five-year period of time from the date of sale (i.e., through November 2007). The maximum potential amount of future payments related to this guarantee the Company could be required to make as of March 31, 2004 is $15.2 million. These three buildings are currently leased to a single tenant, Capital One Services, Inc., a subsidiary of Capital One Financial Services, Inc., under leases that expire from May 2006 to March 2010.

(10) In connection with an unrelated disposition of 298,000 square feet of property in 2003 (the Capital One transaction) which was fully leased to Capital One Services, Inc., a subsidiary of Capital One Financial Services, Inc., the Company agreed to guarantee to the buyer, over various contingency periods through October 2009, any rent shortfalls on certain space. Because of this guarantee, in accordance with SFAS No. 66, the Company deferred $4.4 million of the total $8.4 million gain. The deferred portion of the gain is recognized when each contingency period is concluded. As a result, the Company recognized $1.3 million of the deferred gain in 2003 and an additional $0.1 million during the first quarter of 2004. The Company s total contingent liability of $3.0 million with respect to the guarantee is included in the deferred gain as of March 31, 2004.

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. Commitments and Contingencies - Continued

(11) In December 2003, the Company sold 1.9 million square feet of industrial property for $58.4 million in cash, a $5.0 million note receivable that bears interest at 12.0% and a $1.7 million note receivable that bears interest at 8.0%. In addition, the Company agreed to guarantee, over various contingency periods through December 2006, any rent shortfalls on 16.3% of the rentable square footage of the industrial property, which is occupied by two tenants. The Company s contingent liability with respect to such guarantee as of March 31, 2004 is $2.2 million. The total gain as a result of the transaction was $5.2 million. Because the terms of the notes require only interest payments to be made by the buyer until 2005, in accordance with SFAS No. 66, the entire $5.2 million gain was deferred and offset against the note receivable on the balance sheet and the cost recovery method is being used for this transaction. Accordingly, once sufficient principal amounts have been paid on the note receivable so that the note receivable balance is equal to the deferred gain, the gain will be recognized as additional payments are made on the notes.

(12) In the Highwoods DLF 97/26 DLF 99/32, LP joint venture, a single tenant currently leases an entire building under a lease scheduled to expire June 30, 2008. The tenant also leases space in other buildings owned by the Company. In conjunction with an overall restructuring of the tenant s leases with the Company and with this joint venture, the Company agreed to certain changes to the lease with the joint venture in September 2003. The modifications include allowing the tenant to terminate the lease on January 1, 2006, reducing the rent obligation by 50.0% and converting the net lease to a full service lease with the tenant liable for 50.0% of these costs beginning January 1, 2006. In turn, the Company agreed to compensate the joint venture for any economic losses incurred as a result of these lease modifications. Based on the lease guarantee agreement, the Company recorded approximately $0.9 million in other liabilities and recorded a deferred charge of $0.9 million in September 2003. However, should new tenants occupy the vacated space during the two and a half year guarantee period, the Company s liability under the guarantee would diminish. The Company s maximum potential amount of future payments with regards to this guarantee as of March 31, 2004 is $1.1 million. No recourse provisions exist to enable the Company to recover the amounts paid to the joint venture under this lease guarantee arrangement.

(13) RRHWOODS, LLC and Dallas County Partners each developed a new office building in Des Moines, Iowa. On June 25, 2004, the joint ventures financed both buildings with a $7.4 million 10-year loan from a bank. As an inducement to make the loan at 6.3% long-term rate, the Company and its partner agreed to master lease the vacant space and guaranteed $1.6 million or $0.8 million each with limited recourse. As leasing improves, the obligations under the loan agreement diminish. As of June 30, 2004, the Company recorded $1.3 million in other liabilities and $1.3 million as a deferred charge on its Consolidated Balance Sheet with respect to this guarantee. The maximum potential amount of future payments that the Company could be required to make based on the current leases in place is approximately $4.8 million. The likelihood of the Company paying on its $0.8 million guarantee is remote since the master lease payments provide the required 1.3 debt coverage ratio and should the Company have to pay, it would recover the $0.8 million from other joint venture assets.

(14) As more fully described in Note 13, in connection with the formation of HIW-KC Orlando, LLC, the Company agreed to guarantee rent to the joint venture for 3,248 rentable square feet commencing in August 2004 and expiring in April 2011. Additionally, the Company agreed to guarantee leasing costs for approximately 11% of the joint venture s total square footage. The Company believes its estimate related to the leasing costs guarantee is accurate. However, if its assumptions prove to be incorrect, future losses may occur.

Litigation

The Company is party to a variety of legal proceedings arising in the ordinary course of its business. The Company believes that it is adequately covered by insurance. Accordingly, none of such proceedings are expected to have a material adverse effect on the Company s business, financial condition or results of operations.

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. Segment Information

The sole business of the Company is the acquisition, development and operation of rental real estate properties. The Company operates office, industrial and retail properties and apartment units. There are no material inter-segment transactions.

The Company s chief operating decision maker (CDM) assesses and measures operating results based upon property level net operating income. The operating results for the individual assets within each property type have been aggregated since the CDM evaluates operating results and allocates resources on a property-by-property basis within the various property types.

All operations are within the United States and at March 31, 2004, no tenant of the Company s wholly owned properties, which includes in-service properties (excluding apartment units) to which the Company has title and 100.0% ownership rights, comprises more than 10.0% of the respective consolidated revenues. The following table summarizes the restated rental income, net operating income and assets for each reportable segment for the three months ended March 31, 2004 and 2003 (in thousands):

	Three Months Ended March 31,	
	2004	**2003**
Rental and Other Revenues (A):		
Office segment	$ 102,703	$ 107,267
Industrial segment	8,407	10,091
Retail segment	9,473	9,730
Apartment segment	341	344
Total Rental and Other Revenues	$ 120,924	$ 127,432
Net Operating Income (A):		
Office segment	$ 63,306	$ 68,981
Industrial segment	6,450	7,953
Retail segment	6,378	6,875
Apartment segment	129	141
Total Net Operating Income	76,263	83,950
Reconciliation to income before disposition of property, co-venture expense, minority interest and equity in earnings of unconsolidated affiliates:		
Depreciation and amortization	(36,004)	(36,486)

Interest expense	(33,052)	(35,933)
General and administrative expenses	(10,667)	(4,672)
Interest and other income	1,758	1,177
Loss on debt extinguishment		(14,653)
Loss before disposition of property, co-venture expense, minority interest and equity in earnings of unconsolidated affiliates	$ (1,702)	$ (6,617)

	March 31,	
	2004	**2003**
Total Assets:		
Office segment	$ 2,802,778	$ 2,916,921
Industrial segment	270,611	352,808
Retail segment	267,749	295,141
Apartment segment	13,968	13,758
Corporate and other	169,584	182,126
Total Assets	$ 3,524,690	$ 3,760,754

(A) Net of discontinued operations.

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. Restated Financial Data

Overview

The Company has restated its Consolidated Financial Statements as of March 31, 2004 and December 31, 2003 and for the three months ended March 31, 2004 and 2003. The restatements relate to the following general matters, as discussed further below. The tables that follow provide a reconciliation between amounts previously reported and the restated amounts in the Consolidated Balance Sheets as of March 31, 2004 and December 31, 2003 and the Consolidated Statements of Operations for the three months ended March 31, 2004 and 2003.

Accounting for real estate sales transactions with continuing involvement by the Company. Since 1999, the Company completed several real estate sale transactions that involved either (i) sales of real estate to third parties or to joint ventures in which the Company retained an interest, and/or (ii) continuing involvement by the Company in the real estate in the form of a put option, guarantee of the sellers return on investment, seller financing, and guarantee of rental income from specific tenants or specific spaces, including re-tenanting costs. In its historical financial statements filed prior to the date hereof, the Company believed that such transactions should be accounted for as sales and deferred some or all of the resultant gains in consideration of the continuing involvement until such time as the continuing involvement obligation expired. Under this method of accounting, deferred gains are either subsequently reduced as obligations are paid or recognized as the obligations expire. Furthermore, at the time those transactions occurred, the Company identified those with guarantees and other types of continuing involvement and disclosed the nature and amount of any material continuing involvement relationships (guarantees, etc.). The Company has now determined that certain adjustments should be made with respect to the accounting treatment for certain of those transactions where the Company had some form of continuing involvement to conform with paragraphs 25 through 29 of SFAS No. 66. For three of the transactions, the largest of which is the sale in late 2000 of properties into the previously disclosed MG-HIW, LLC joint venture, the Company has adjusted its Consolidated Financial Statements to account for these three transactions as financing and/or profit-sharing arrangements rather than as sales, as more fully described in Note 3. Under these methods, the assets, related liabilities and operations are now included in the Company s Consolidated Financial Statements. In the other instances, the transactions have continued to be reported as sales, but the timing and amount of gain recognition was changed due to the Company s continuing involvement, including certain transactions that occurred prior to January 1, 2001. These adjustments in the aggregate resulted in a (decrease) to previously reported net income of $(3.9) million for the three months ended March 31, 2004.

Presentation and classification of discontinued operations with continuing involvement by the Company. In the Company s previous Consolidated Financial Statements for the three months ended March 31, 2004 and 2003, the Company had classified as discontinued operations under SFAS No. 144 several properties that were sold or transferred to joint ventures in which the Company retained a financial interest and other sold properties where the Company was retained by the new owner to provide management and leasing services. However, the Company has now determined that because of such continuing involvement, these sold properties do not qualify for discontinued operations classification under SFAS No. 144. Accordingly, the results of operations from such properties have now been reclassified into income from continuing operations for the three months ended March 31, 2004 and 2003 in the accompanying Consolidated Financial Statements. These reclassifications did not impact net income in any period.

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. Restated Financial Data - Continued

Minority interest. In its Consolidated Financial Statements, the Company previously computed minority interest in the net income in its majority owned subsidiary, the Operating Partnership, for each reporting period by applying the weighted average ownership percentage of the minority common unitholders times the Operating Partnership s net income for the period (continuing operations and discontinued operations) before deducting distributions to preferred unitholders. In the restated Consolidated Financial Statements, minority interest has been adjusted by applying the weighted average ownership percentage of the minority common unitholders times the Operating Partnership s net income available to common unitholders (continuing operations and discontinued operations) for the period after deducting distributions to preferred unitholders. These adjustments increased net income by $0.8 million for the three months ended March 31, 2004. In addition, at the end of each reporting period, the Company determines the amount that represents the minority unitholders share of the net assets (at book value) of the Operating Partnership and compares this amount to the minority interest balance that resulted from transactions during the period involving minority interest. The Company adjusts the minority interest liability to the computed share of net assets with an offsetting adjustment to the Company s paid in capital.

Accounting for MOPPRS Debt Retirement. The Company had previously accounted for the transaction as an exchange of indebtedness under EITF 96-19 and recorded in deferred financing cost $14.7 million, representing the excess of amounts paid to retire the MOPPRS and the related remarketing option over the MOPPRS net carrying value and related deferred credits. The Company has now determined that this transaction should have been accounted for as a debt extinguishment under EITF 96-19. Accordingly, the $14.7 million has been charged to loss on debt extinguishment in the first quarter of 2003 rather than as deferred financing costs as previously recorded. In addition, the amortization expense related to the previous net deferred financing costs, which aggregated approximately $250,000 in the first quarter of 2003 and approximately $370,000 in the first quarter of 2004 has been reversed in the restated Consolidated Financial Statements.

Other matters. In addition to the above, the Company identified several other matters that have been adjusted, which in the aggregate resulted in a (decrease) in net income of ($1.8) million for the three months ended March 31, 2004. These adjustments included (1) adjustments to defer, to the extent of the Company s ownership interests, certain leasing, development and certain other fee income charged by the Company to joint ventures and which the joint ventures capitalized in their financial statements, and to recognize such deferred amounts as fee income during the periods in which the related capitalized amounts in the joint ventures financial statements are recognized as expense, which reduced net income; (2) accounting for the impact of dividend equivalent rights that were granted in 1997, which reduced net income; (3) reclassification of certain revenue and expense items to present them on a gross basis instead of a net basis which resulted in no impact on net income; (4) recognizing as long term debt certain tax increment financing (TIF) bonds issued in late 1998 by a municipality and as real estate assets the related parking garage asset constructed from the TIF proceeds, together with related income and expenses, in accordance with EITF 91-10; and (5) an adjustment to the cost of the CEO retirement package from what was previously reported (see Note 12).

Following is a description of the three transactions previously accounted for as sales but now accounted for as financing and/or profit-sharing arrangements.

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HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. Restated Financial Data - Continued

- MG-HIW, LLC

As discussed in Note 3, in December 2000, the Company created a joint venture named MG-HIW, LLC with Miller Global Properties, LLC (Miller Global), pursuant to which the Company sold or contributed to MG-HIW, LLC 19 office properties in Atlanta, Raleigh, Tampa and Orlando (each a City Group). The Company retained a 20.0% interest and Miller Global obtained an 80.0% interest.

With respect to the properties originally contributed by the Company to the Orlando City Group, the Company assumed obligations to make improvements to the assets, as well as master lease obligations and guarantees on certain vacant space. The Company also provided a guaranteed leveraged internal rate of return (IRR) of 20.0% on the approximate $50.0 million of Miller Global s equity that related to the properties in the Orlando City Group. The IRR guarantee was for the duration of MG-HIW, LLC.

The Company treated the transaction with respect to the Orlando City Group and the non-Orlando City Groups as a sale in 2000 and recognized partial gain after establishing accruals for estimated obligations, at that time. During the duration of MG-HIW, LLC (which concluded prior to the date hereof as explained below), the Company paid out approximately $14.6 million in guarantee obligations to MG-HIW, LLC, which was comprised of $6.7 million in building improvements, tenant improvements and lease commissions and $7.9 million of rental support.

The Company has now concluded under SFAS No. 66 that the sale of the 80.0% interest in the properties in the Orlando City Group should be accounted for as a financing rather than as a sale due to the 20.0% IRR guarantee. Consequently, in these Consolidated Financial Statements the assets, liabilities and operations related to the properties in the Orlando City Group remain on the books of the Company and a financing obligation has been established for the amount of equity contributed by Miller Global related to the Orlando City Group. This financing obligation is adjusted each period by accreting the obligation up to the 20.0% guaranteed internal rate of return by a charge to interest expense, such that the financing obligation equals at the end of each period the amount due to Miller Global, including the 20.0% guaranteed return. The Company continues to depreciate the Orlando properties and record all the depreciation on its books. On March 2, 2004, the Company exercised an option and acquired Miller Global s 80.0% interest in the Orlando City Group. See Note 3.

Based on the nature and extent of certain rental guarantees made by the Company with respect to the non-Orlando City Group properties, the Company has also now concluded that the sale of the non-Orlando properties to MG-HIW, LLC should be accounted for as a profit-sharing arrangement. Under this profit-sharing arrangement, in these Consolidated Financial Statements the assets, liabilities and operations of the properties in the non-Orlando City Groups remain on the books of the Company, and a co-investor obligation has been established for the amount of equity contributed by Miller Global related to the non-Orlando City Groups. The income from operations of the properties, excluding depreciation, is allocated 80.0% to Miller Global and reported as co-venture expense in the Company s Consolidated Financial Statements. The Company continues to depreciate the non-Orlando properties and record all the depreciation on its books. In July 2003, the Company repurchased Miller Global s interest in the non-Orlando City Groups for approximately $28.0 million, which resulted in a gain of $16.3 million related to the settlement of the co-venture obligation.

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. Restated Financial Data - Continued

- SF-HIW Harborview, LP

As discussed in Note 3, on September 11, 2002, the Company contributed Harborview Plaza to SF-HIW Harborview, LP, a newly formed entity, in exchange for a 20.0% limited partnership interest and $35.4 million in cash. The other partner contributed $12.6 million of cash and a new loan was obtained by the partnership for $22.8 million. In connection with this disposition, the Company entered into a master lease agreement with SF-HIW Harborview, LP for five years on the vacant space in the building (approximately 20.0%). The Company also guaranteed to SF-HIW Harborview, LP the payment of tenant improvements and lease commissions of $1.2 million. The Company s maximum exposure to loss under this master lease agreement was $2.1 million at September 11, 2002 and was $1.3 million at March 31, 2004. Additionally, the Company s partner in SF-HIW Harborview, LP was granted the right to put its 80.0% equity interest in SF-HIW Harborview, LP to the Company in exchange for cash at any time during the one-year period commencing on September 11, 2014. The value of the 80.0% equity interest will be determined at the time, if ever, that such partner elects to exercise its put right, based upon the then fair market value of SF-HIW Harborview, LP s assets and liabilities less 3.0%, which was intended to cover normal costs of a sale transaction.

The Company originally recorded the transaction as a sale and deferred recognition of a $4.3 million gain. Because the put option and the master lease agreement are deemed to be forms of continuing involvement as discussed in paragraphs 26 and 28 of SFAS No. 66, the Company has now concluded that the sale of Harborview Plaza should be accounted for as a financing transaction. Consequently, in these Consolidated Financial Statements the assets, liabilities and operations related to Harborview Plaza, the property owned by Harborview LP, including any new financing by the partnership, remain on the books of the Company. The Company established a financing obligation equal to the net equity contributed by the other partner. At the end of each reporting period, the balance of the financing obligation is adjusted to equal the current fair value but not less than the original financing obligation. This adjustment is amortized prospectively through September 2014. Additionally, the net income from the operations before depreciation of Harborview Plaza allocable to the 80.0% partner is recorded as interest expense on the financing obligation. The Company depreciates the property and records all of the depreciation on its books. Additionally, any payments made under the master lease agreement are expensed as incurred ($0.02 million and $0.13 million was expensed during the three months ended March 31, 2004 and 2003, respectively) and any amounts paid under the tenant improvement and lease commission guarantee are capitalized and amortized to expense over the remaining lease term. At such time as the put option expires or otherwise is terminated, the Company will record the transaction as a sale and recognize gain on sale.

- Eastshore

As discussed in Note 3, on November 26, 2002 the Company sold three buildings located in Richmond, Virginia for a total purchase price of $28.5 million in cash, which was paid in full by the buyer at closing. These three buildings are currently leased to a single tenant, Capital One Services, Inc., a subsidiary of Capital One Financial Services, Inc., under leases that expire from May 2006 to March 2010. The Company recorded the transaction as a sale and deferred a $6.9 million gain.

In connection with the sale, the Company entered into a rental guarantee agreement for each building for the benefit of the buyer to guarantee any rent shortfalls which may be incurred for the payment of rent and re-tenanting costs for a five-year period from the date of sale (through November 2007). The Company s maximum exposure to loss under the rental guarantee agreements was $18.7 million at the date of sale and was $15.2 million at March 31, 2004.

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. Restated Financial Data - Continued

The Company has now concluded that these rent guarantees are a form of continuing involvement as discussed in paragraph 28 of SFAS No. 66. Because the guarantee is for the entire space occupied by a single tenant under a triple-net lease arrangement, the Company s guarantee is considered a guaranteed return on the buyer s investment for an extended period of time. Therefore, in these Consolidated Financial Statements, the transaction is accounted for as a financing transaction, following the accounting method described in Note 3.

HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. Restated Financial Data - Continued

The following condensed Consolidated Balance Sheet and Statement of Operations data reconciles previously reported and restated financial information.

Balance Sheet

	March 31, 2004			December 31, 2003				
	As Reported	Restatement Adjustments	Restated	As Reported	Discontinued Operations	As Reported with Discontinued Operations	Restatement Adjustments	Restated
Net real estate assets	$ 3,200,465	$ (143,455)	$ 3,057,010	$ 2,982,302	$ 10,346	$ 2,992,648	$ 68,779	$ 3,061,427
Property held for sale	38,467	175,072	213,539	65,724	(10,271)	55,453	175,960	231,413
Cash, cash equivalents and restricted cash	25,045	(1,419)	23,626	24,884		24,884	1,269	26,153
Accounts, notes and straightline rents receivable net	89,778	(4,072)	85,706	93,639		93,639	(6,485)	87,154
Investments in unconsolidated affiliates	68,553	1,077	69,630	74,665		74,665	(12,248)	62,417
Other assets net	86,215	(11,036)	75,179	85,595	(75)	85,520	(11,061)	74,459
Total Assets	$ 3,508,523	$ 16,167	$ 3,524,690	$ 3,326,809	$	$ 3,326,809	$ 216,214	$ 3,543,023
Mortgages and notes payable	$ 1,767,239	$ 22,800	$ 1,790,039	$ 1,558,758	$	$ 1,558,758	$ 159,007	$ 1,717,765
Accounts payable, accrued expenses and other liabilities	108,199	(9,975)	98,224	111,772		111,772	(10,164)	101,608
Financing obligations		62,994	62,994				124,063	124,063
Total Liabilities	1,875,438	75,819	1,951,257	1,670,530		1,670,530	272,906	1,943,436
Minority interest in the Operating Partnership	161,884	(37,983)	123,901	165,250		165,250	(37,474)	127,776
Total Stockholders Equity	1,471,201	(21,669)	1,449,532	1,491,029		1,491,029	(19,218)	1,471,811
	$ 3,508,523	$ 16,167	$ 3,524,690	$ 3,326,809	$	$ 3,326,809	$ 216,214	$ 3,543,023

Total Liabilities and Stockholders Equity								

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HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. Restated Financial Data - Continued

Statement of Operations

	For the Three Months Ended March 31, 2004			For the Three Months Ended March 31, 2003				
	As Reported	Restatement Adjustments	Restated	As Reported In March 31, 2003 Filing	Discontinued Operations	As Reported with Discontinued Operations In March 31, 2004 Filing	Restatement Adjustments	Restated
Rental and other revenues	$ 108,622	$ 12,302	$ 120,924	$ 109,020	$ (5,096)	$ 103,924	$ 23,508	$ 127,432
Operating expenses:								
Rental property and other expenses	39,165	5,496	44,661	37,319	(1,379)	35,940	7,542	43,482
Depreciation and amortization	34,316	1,688	36,004	33,294	(1,264)	32,030	4,456	36,486
General and administrative	12,167	(1,500)	10,667	5,344		5,344	(672)	4,672
Interest expense:								
Contractual	26,057	1,158	27,215	27,674		27,674	2,485	30,159
Amortization of deferred financing costs	855	289	1,144	626		626	271	897
Financing obligations		4,693	4,693				4,877	4,877
Other income/expense:								
Interest and other income	3,346	(1,588)	1,758	2,890	(31)	2,859	(1,682)	1,177
Loss on debt extinguishments							(14,653)	(14,653)
Gain on disposition of property, net	1,083	(13)	1,070	883		883	(79)	804
Co-venture expense							(2,086)	(2,086)
Minority interest	(231)	920	689	(1,221)	283	(938)	2,544	1,606
Equity in earnings of unconsolidated affiliates	1,402	(118)	1,284	1,761		1,761	(612)	1,149
Income/(loss) from continuing operations	1,662	(321)	1,341	9,076	(2,201)	6,875	(12,019)	(5,144)
Discontinued operations:								
Income, net of minority interest	667	(498)	169	2,266	2,201	4,467	(3,418)	1,049

Gain on sale, net of minority interest	3,555	(119)	3,436	(170)		(170)	176	6
Net income/(loss)	5,884	(938)	4,946	11,172		11,172	(15,261)	(4,089)
Dividends on preferred stock	(7,713)		(7,713)	(7,713)		(7,713)		(7,713)
Net loss attributable to common stockholders	$ (1,829)	$ (938)	$ (2,767)	$ 3,459	$	$ 3,459	$ (15,261)	$ (11,802)
Net loss per share basic:								
Loss from continuing operations	$ (0.11)	$ (0.01)	$ (0.12)	$ 0.02	$ (0.04)	$ (0.02)	$ (0.22)	$ (0.24)
Discontinued operations	0.08	(0.01)	0.07	0.04	0.04	0.08	(0.06)	0.02
Net loss **(1)**	$ (0.03)	$ (0.02)	$ (0.05)	$ 0.06	$	$ 0.06	$ (0.28)	$ (0.22)
Net loss per share diluted:								
Loss from continuing operations	$ (0.11)	$ (0.01)	$ (0.12)	$ 0.02	$ (0.04)	$ (0.02)	$ (0.22)	$ (0.24)
Discontinued operations	0.08	(0.01)	0.07	0.04	0.04	0.08	(0.06)	0.02
Net loss **(1)**	$ (0.03)	$ (0.02)	$ (0.05)	$ 0.06	$	$ 0.06	$ (0.28)	$ (0.22)

(1) Amounts represent net income available to common stockholder per share, which is after deducting preferred dividends.

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HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. Other Events

Retirement of Chief Executive Officer

As previously announced, the Company s Chief Executive Officer retired June 30, 2004. In connection with his retirement, the Company s Board of Directors approved a retirement package for him that included a lump sum cash payment, accelerated vesting of stock options and restricted stock, extended lives of stock options and continued coverage under the Company s health and life insurance plan for three years at the Company s expense. Under GAAP, the changes to existing stock options and restricted stock give rise to new measurement dates and revised compensation computations. The total cost recognized for the six months ended June 30, 2004 was $4.6 million, comprised of a $2.2 million cash payment, $0.6 million related to stock options, $1.7 million related to restricted shares and about $0.1 million for continued insurance coverage. The total expense is $1.7 million lower than the amount previously disclosed by the Company in connection with its first quarter 2004 earnings due to an adjustment to the method of valuing the accelerated vesting and extension of the lives of the stock options under SFAS No. 123 and No. 148. Previously, the Company had recorded the intrinsic value of the options as of the date of the Board s approval. However, the Company has subsequently determined that these changes to the options should be accounted for using other valuation techniques, as set forth in SFAS No. 123 and No. 148. Certain components of this retirement package were required to be recognized as of the Board s approval date, which was in the first quarter, while other components were required to be amortized from that date until his June 30, 2004 retirement date. Accordingly, $3.2 million was expensed in the first quarter and the remaining $1.4 million was expensed in the second quarter.

Revolving Loan

In March 2004, the Company amended its Revolving Loan and two bank term loans. The changes modified certain definitions used in all three loans to determine amounts that are used to compute financial covenants and also adjusted one of the financial ratio covenants. The amendments did not change any economic terms of the loans, although the Company paid fees to the lenders that were capitalized and that will be amortized over the remaining terms of the loans. See Note 13 for information regarding additional amendments in June, August and October 2004 to the Company s Revolving Loan and two bank term loans and a waiver obtained in October 2004 for certain covenant violations on these loans.

13. Subsequent Events

Dispositions

On June 28, 2004, Kapital-Consult, a European investment firm, bought an interest in HIW-KC Orlando, LLC, an entity formed by the Company. HIW-KC Orlando, LLC owns the Orlando City Group assets which were valued under the joint venture agreement at $212.0 million, including amounts related to the Company s guarantees described below, and which were subject to a $136.2 million secured mortgage loan.

Kapital-Consult contributed $41.4 million in cash and received a 60.0% equity interest in return. The joint venture borrowed $143.0 million under a ten-year fixed rate mortgage loan from a third party lender and repaid the $136.2 million loan. The Company retained a 40.0% equity interest in the joint venture and received net cash proceeds of approximately $46.6 million, of which $33.0 million was used to pay down the Company s Revolving Loan and $13.6 million was used to pay down another loan of the Company. In connection with this transaction, the Company agreed to guarantee rent to the joint venture for 3,248 rentable square feet commencing in August 2004 and expiring in April 2011. Additionally, the Company agreed to guarantee re-tenanting costs for approximately 11% of the joint venture s total square footage. The Company recorded a $4.1 million liability with respect to such guarantee as of June 30, 2004 and reduced the total amount of gain recognized by the same amount. The Company believes its estimate related to the re-tenanting costs guarantee is accurate. However, if its assumptions prove to be incorrect, future losses may occur. The contribution was accounted for as a partial sale as defined by SFAS No. 66, and the Company recognized a $15.9 million gain in June 2004. Since the Company has an ongoing 40.0% financial interest in the joint venture and since the Company is engaged by the joint venture to provide management and leasing services for the joint venture, for which it receives customary management fees and leasing commissions, the operations of these properties will not be reflected as discontinued operations consistent with SFAS No. 144 and the related gain on sale will be included in continuing operations in the second quarter 2004.

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HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

13. SUBSEQUENT EVENTS Continued

On June 16, 2004, the Company sold a 177,000 square foot building (the network operations center) located in the Highwoods Preserve Office Park in Tampa, Florida. Highwoods Preserve is a 816,000 square foot office park that has not been occupied since WorldCom vacated the space as of December 31, 2002. Net proceeds from the sale were approximately $18.6 million. The asset had a net book value of approximately $22.4 million. The Company recognized an impairment loss of approximately $3.7 million in April 2004 when the planned sale met the criteria to be classified as held for sale. In connection with the sale of the network operations center, the buyer also agreed to purchase a 3.3 acre tract of development land located in the office park for approximately $1.4 million, which is subject to the Company securing certain development rights for the land from the local municipality. The net book value of the land is approximately $0.6 million and was classified as held for sale in accordance with SFAS No. 144 in April 2004. This land sale is subject to customary closing conditions and no assurances can be provided that the disposition will occur. The remaining assets in the office park were classified as held for use as of March 31, 2004 and continue to be so classified in accordance with SFAS No. 144.

In May 2004, the Company executed two agreements to sell approximately 30.0 acres of land in suburban Baltimore, Maryland. The agreements provide for estimated net proceeds of approximately $6.1 million and the net book value of the land is $7.9 million. Accordingly, an impairment loss of approximately $1.8 million was recorded in May 2004 when the land was reclassified from held for use to held for sale. On September 30, 2004, one sale of 27.0 acres was consummated. The Company received $5.5 million in net proceeds. Sale of the remaining 3.0 acres is subject to customary closing conditions and no assurances can be provided that the disposition will occur.

Mortgages and Notes Payable

In 1997, the Operating Partnership sold $100.0 million of Exercisable Put Option Notes due June 15, 2011 (the Put Option Notes). The Put Option Notes bore an interest rate of 7.19% from the date of issuance through June 15, 2004. After June 15, 2004, the interest rate to maturity on the Put Option Notes was required to be 6.39% plus the applicable spread determined as of June 10, 2004. In connection with the initial issuance of the Put Option Notes, a counter party was granted an option to purchase the Put Option Notes on June 15, 2004 at 100.0% of the principal amount. The counter party exercised this option and acquired the Put Option Notes on June 15, 2004. On that same date, the Company exercised its option to acquire the Put Option Notes from the counter party for a purchase price equal to the sum of the present value of the remaining scheduled payments of principal and interest (assuming an interest rate of 6.39%) on the Put Option Notes, or $112.3 million. The difference between the $112.3 million and the $100.0 million was charged to loss on extinguishment of debt in the quarter ended June 30, 2004. The Company borrowed funds from its Revolving Loan to make the $112.3 million payment.

In June 2004, the Company amended its Revolving Loan and two bank term loans. The changes excluded the $12.3 million charge taken related to the refinancing of the Put Option Notes from the calculations used to compute financial covenants.

In August 2004, the Company further amended its Revolving Loan and two bank term loans. The changes excluded the effects of accounting for three sales transactions as financing and/or profit-sharing arrangements under SFAS No. 66, as described in Note 11, from the calculations used

to compute financial covenants, adjusted one financial covenant and temporarily adjusted a second financial covenant until the earlier of December 31, 2004 or the period when the Company can record income from the anticipated settlement of a claim against WorldCom - see below.

In early October 2004, the Company obtained a waiver from the lenders of the Company s Revolving Loan and two bank term loans for certain covenant violations caused by the effects of the loss on debt extinguishment from the MOPPRS transaction in early 2003, as described in Note 11.

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HIGHWOODS PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

13. SUBSEQUENT EVENTS - Continued

The aforementioned modifications did not change the economic terms of the loans. In connection with these modifications, the Company incurred certain loan costs that are capitalized and amortized over the remaining term of the loans.

WorldCom Settlement

On July 21, 2002, WorldCom filed a voluntary petition with the United States Bankruptcy Court seeking relief under Chapter 11 of the United States Bankruptcy Code. In connection with the bankruptcy filing, WorldCom rejected leases with the Company encompassing 819,653 square feet including the entire 816,000 square foot Highwoods Preserve office campus in Tampa, Florida. The Company submitted bankruptcy claims against WorldCom aggregating $21.2 million related to these rejected leases and other matters. WorldCom emerged from bankruptcy (now MCI, Inc.) on April 20, 2004. On August 27, 2004, the Company and various MCI subsidiaries and affiliates (the MCI Entities) executed a settlement agreement. The agreement provided that the MCI Entities will pay the Company approximately $8.6 million in cash and also transfer to it approximately 340,000 shares of new MCI, Inc. stock. The Company received the $8.6 million cash payment and the MCI, Inc. stock in September 2004. The Company sold the stock for net proceeds of approximately $5.8 million, and will record the full settlement of approximately $14.4 million as Other Income in the third quarter of 2004.

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

The following discussion should be read in conjunction with all of the financial statements appearing elsewhere in the report and is based primarily on the Consolidated Financial Statements of the Company.

Disclosure Regarding Forward-looking Statements

Some of the information in this amended Quarterly Report on Form 10-Q 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 s 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;