HIGHWOODS PROPERTIES INC
Form 10-Q
April 30, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2013

HIGHWOODS PROPERTIES, INC.
(Exact name of registrant as specified in its charter)

Maryland	001-13100	56-1871668
(State or other jurisdiction of incorporation or organization)	(Commission File Number)	(I.R.S. Employer Identification Number)

HIGHWOODS REALTY LIMITED PARTNERSHIP
(Exact name of registrant as specified in its charter)

North Carolina	000-21731	56-1869557
(State or other jurisdiction of incorporation or organization)	(Commission File Number)	(I.R.S. Employer Identification Number)

3100 Smoketree Court, Suite 600
Raleigh, NC 27604
(Address of principal executive offices) (Zip Code)
919-872-4924
(Registrants' 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.
Highwoods Properties, Inc. Yes S No £ Highwoods Realty Limited Partnership Yes S No £

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Highwoods Properties, Inc. Yes S No £ Highwoods Realty Limited Partnership Yes S No £

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of 'large accelerated filer,' 'accelerated filer' and 'smaller reporting company' in Rule 12b-2 of the Securities Exchange Act.
Highwoods Properties, Inc.
Large accelerated filer S Accelerated filer £ Non-accelerated filer £ Smaller reporting company £

Highwoods Realty Limited Partnership
Large accelerated filer £   Accelerated filer £   Non-accelerated filer S   Smaller reporting company £

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act).
Highwoods Properties, Inc. Yes £ No S   Highwoods Realty Limited Partnership Yes £ No S

The Company had 82,142,340 shares of Common Stock outstanding as of April 19, 2013.

HIGHWOODS PROPERTIES, INC.
HIGHWOODS REALTY LIMITED PARTNERSHIP

QUARTERLY REPORT FOR THE PERIOD ENDED MARCH 31, 2013

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

We refer to Highwoods Properties, Inc. as the “Company,” Highwoods Realty Limited Partnership as the “Operating Partnership,” the Company’s common stock as “Common Stock” or “Common Shares,” the Company’s preferred stock as “Preferred Stock” or “Preferred Shares,” the Operating Partnership’s common partnership interests as “Common Units,” the Operating Partnership’s preferred partnership interests as “Preferred Units” and in-service properties (excluding for-sale residential condominiums) to which the Company and/or the Operating Partnership have title and 100.0% ownership rights as the “Wholly Owned Properties.” References to “we” and “our” mean the Company and the Operating Partnership, collectively, unless the context indicates otherwise.

The partnership agreement provides that the Operating Partnership will assume and pay when due, or reimburse the Company for payment of, all costs and expenses relating to the ownership and operations of, or for the benefit of, the Operating Partnership. The partnership agreement further provides that all expenses of the Company are deemed to be incurred for the benefit of the Operating Partnership.

Certain information contained herein is presented as of April 19, 2013, the latest practicable date for financial information prior to the filing of this Quarterly Report.

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HIGHWOODS PROPERTIES, INC.
Consolidated Balance Sheets
(Unaudited and in thousands, except share and per share data)

	March 31, 2013	December 31, 2012
Assets:		
Real estate assets, at cost:		
Land	$380,932	$ 371,730
Buildings and tenant improvements	3,365,154	3,281,362
Development in process	29,209	21,198
Land held for development	122,825	117,784
	3,898,120	3,792,074
Less-accumulated depreciation	(966,448)	(939,550)
Net real estate assets	2,931,672	2,852,524
Real estate and other assets, net, held for sale	4,394	18,938
Cash and cash equivalents	12,170	13,783
Restricted cash	14,790	19,702
Accounts receivable, net of allowance of $1,923 and $2,848, respectively	25,067	23,073
Mortgages and notes receivable, net of allowance of $437 and $182, respectively	25,472	25,472
Accrued straight-line rents receivable, net of allowance of $1,034 and $880, respectively	122,098	116,584
Investments in and advances to unconsolidated affiliates	66,142	66,800
Deferred financing and leasing costs, net of accumulated amortization of $82,472 and $77,219, respectively	176,816	169,094
Prepaid expenses and other assets, net of accumulated amortization of $12,587 and $12,318, respectively	41,972	44,458
Total Assets	$3,420,593	$ 3,350,428
Liabilities, Noncontrolling Interests in the Operating Partnership and Equity:		
Mortgages and notes payable	$1,896,300	$ 1,859,162
Accounts payable, accrued expenses and other liabilities	167,553	172,146
Financing obligations	29,251	29,358
Total Liabilities	2,093,104	2,060,666
Commitments and contingencies		
Noncontrolling interests in the Operating Partnership	147,317	124,869
Equity:		
Preferred Stock, $.01 par value, 50,000,000 authorized shares;		
8.625% Series A Cumulative Redeemable Preferred Shares (liquidation preference $1,000 per share), 29,077 shares issued and outstanding	29,077	29,077
Common Stock, $.01 par value, 200,000,000 authorized shares;		
82,130,593 and 80,311,437 shares issued and outstanding, respectively	821	803
Additional paid-in capital	2,076,081	2,040,306
Distributions in excess of net income available for common stockholders	(919,328)	(897,418)
Accumulated other comprehensive loss	(11,170)	(12,628)
Total Stockholders' Equity	1,175,481	1,160,140
Noncontrolling interests in consolidated affiliates	4,691	4,753
Total Equity	1,180,172	1,164,893
Total Liabilities, Noncontrolling Interests in the Operating Partnership and Equity	$3,420,593	$ 3,350,428

See accompanying notes to consolidated financial statements.

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HIGHWOODS PROPERTIES, INC.
Consolidated Statements of Income
(Unaudited and in thousands, except per share amounts)

	Three Months Ended March 31,	
	2013	2012
Rental and other revenues	$137,030	$124,894
Operating expenses:		
Rental property and other expenses	48,941	44,378
Depreciation and amortization	42,144	36,983
Impairments of real estate assets	415	—
General and administrative	10,582	9,673
Total operating expenses	102,082	91,034
Interest expense:		
Contractual	22,798	23,851
Amortization of deferred financing costs	949	902
Financing obligations	121	(76)
	23,868	24,677
Other income:		
Interest and other income	1,783	2,230
Losses on debt extinguishment	(164)	—
	1,619	2,230
Income from continuing operations before disposition of condominiums and equity in earnings/(losses) of unconsolidated affiliates	12,699	11,413
Gains on for-sale residential condominiums	—	65
Equity in earnings/(losses) of unconsolidated affiliates	436	(162)
Income from continuing operations	13,135	11,316
Discontinued operations:		
Income from discontinued operations	94	1,882
Impairments of real estate assets held for sale	(713)	—
Net gains on disposition of discontinued operations	1,244	5,134
	625	7,016
Net income	13,760	18,332
Net (income) attributable to noncontrolling interests in the Operating Partnership	(581)	(827)
Net (income) attributable to noncontrolling interests in consolidated affiliates	(203)	(184)
Dividends on Preferred Stock	(627)	(627)
Net income available for common stockholders	$12,349	$16,694
Earnings per Common Share – basic:		
Income from continuing operations available for common stockholders	$0.14	$0.14
Income from discontinued operations available for common stockholders	0.01	0.09
Net income available for common stockholders	$0.15	$0.23
Weighted average Common Shares outstanding – basic	81,029	72,836
Earnings per Common Share – diluted:		
Income from continuing operations available for common stockholders	$0.14	$0.14
Income from discontinued operations available for common stockholders	0.01	0.09
Net income available for common stockholders	$0.15	$0.23
Weighted average Common Shares outstanding – diluted	84,862	76,696
Dividends declared per Common Share	$0.425	$0.425

Net income available for common stockholders:		
Income from continuing operations available for common stockholders	$11,752	$10,022
Income from discontinued operations available for common stockholders	597	6,672
Net income available for common stockholders	$12,349	$16,694

See accompanying notes to consolidated financial statements.

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HIGHWOODS PROPERTIES, INC.
Consolidated Statements of Comprehensive Income
(Unaudited and in thousands)

	Three Months Ended March 31,	
	2013	2012
Comprehensive income:		
Net income	$13,760	$18,332
Other comprehensive income:		
Unrealized gains on tax increment financing bond	390	287
Unrealized gains on cash flow hedges	280	1,104
Amortization of cash flow hedges	788	(33)
Total other comprehensive income	1,458	1,358
Total comprehensive income	15,218	19,690
Less-comprehensive (income) attributable to noncontrolling interests	(784)	(1,011)
Comprehensive income attributable to common stockholders	$14,434	$18,679

See accompanying notes to consolidated financial statements.

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HIGHWOODS PROPERTIES, INC.
Consolidated Statements of Equity
(Unaudited and in thousands, except share amounts)

	Number of Common Shares	Common Stock	Series A Cumulative Redeemable Preferred Shares	Additional Paid-In Capital	Accumulated Other Compre-hensive Loss	Non-controlling Interests in Consolidated Affiliates	Distributions in Excess of Net Income Available for Common Stockholders	Total
Balance at December 31, 2012	80,311,437	$ 803	$ 29,077	$ 2,040,306	$ (12,628)	$ 4,753	$ (897,418)	$ 1,164,893
Issuances of Common Stock, net	1,664,519	17	—	55,787	—	—	—	55,804
Conversions of Common Units to Common Stock	10,071	—	—	351	—	—	—	351
Dividends on Common Stock		—	—	—	—	—	(34,259)	(34,259)
Dividends on Preferred Stock		—	—	—	—	—	(627)	(627)
Adjustment of noncontrolling interests in the Operating Partnership to fair value		—	—	(23,802)	—	—	—	(23,802)
Distributions to noncontrolling interests in consolidated affiliates		—	—	—	—	(265)	—	(265)
Issuances of restricted stock	144,566	—	—	—	—	—	—	—
Share-based compensation expense		1	—	3,439	—	—	—	3,440
Net (income) attributable to noncontrolling interests in the Operating Partnership		—	—	—	—	—	(581)	(581)
Net (income) attributable to noncontrolling interests in consolidated affiliates		—	—	—	—	203	(203)	—
Comprehensive income:								
Net income		—	—	—	—	—	13,760	13,760

Other comprehensive income		—	—	—	1,458	—	—	1,458
Total comprehensive income								15,218
Balance at March 31, 2013	82,130,593	$ 821	$ 29,077	$ 2,076,081	$ (11,170)	$ 4,691	$ (919,328)	$ 1,180,172

	Number of Common Shares	Common Stock	Series A Cumulative Redeemable Preferred Shares	Additional Paid-In Capital	Accumulated Other Compre-hensive Loss	Non-controlling Interests in Consolidated Affiliates	Distributions in Excess of Net Income Available for Common Stockholders	Total
Balance at December 31, 2011	72,647,697	$ 726	$ 29,077	$ 1,803,997	$ (5,734)	$ 4,646	$ (845,853)	$ 986,859
Issuances of Common Stock, net	807,483	8	—	26,636	—	—	—	26,644
Conversions of Common Units to Common Stock	2,000	—	—	63	—	—	—	63
Dividends on Common Stock		—	—	—	—	—	(30,961)	(30,961)
Dividends on Preferred Stock		—	—	—	—	—	(627)	(627)
Adjustment of noncontrolling interests in the Operating Partnership to fair value		—	—	(14,366)	—	—	—	(14,366)
Distributions to noncontrolling interests in consolidated affiliates		—	—	—	—	(291)	—	(291)
Issuances of restricted stock	151,391	—	—	—	—	—	—	—
Share-based compensation expense		2	—	2,420	—	—	—	2,422
Net (income) attributable to noncontrolling interests in the Operating Partnership		—	—	—	—	—	(827)	(827)
Net (income) attributable to noncontrolling interests in consolidated affiliates		—	—	—	—	184	(184)	—
Comprehensive income:								

Net income		—	—	—	—	—	18,332	18,332
Other comprehensive income		—	—	—	1,358	—	—	1,358
Total comprehensive income								19,690
Balance at March 31, 2012	73,608,571	$ 736	$ 29,077	$ 1,818,750	$ (4,376)	$ 4,539	$ (860,120)	$ 988,606

See accompanying notes to consolidated financial statements.

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HIGHWOODS PROPERTIES, INC.
Consolidated Statements of Cash Flows
(Unaudited and in thousands)

	Three Months Ended March 31,	
	2013	2012
Operating activities:		
Net income	$13,760	$18,332
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	42,292	38,515
Amortization of lease incentives and acquisition-related intangible assets and liabilities	(136)	69
Share-based compensation expense	3,440	2,422
Allowance for losses on accounts and accrued straight-line rents receivable	426	579
Amortization of deferred financing costs	949	902
Amortization of cash flow hedges	788	(33)
Impairments of real estate assets	415	—
Impairments of real estate assets held for sale	713	—
Losses on debt extinguishment	164	—
Net gains on disposition of property	(1,244)	(5,134)
Gains on for-sale residential condominiums	—	(65)
Equity in (earnings)/losses of unconsolidated affiliates	(436)	162
Changes in financing obligations	(105)	(334)
Distributions of earnings from unconsolidated affiliates	1,145	1,388
Changes in operating assets and liabilities:		
Accounts receivable	(1,479)	2,470
Prepaid expenses and other assets	(2,533)	(4,497)
Accrued straight-line rents receivable	(5,788)	(5,382)
Accounts payable, accrued expenses and other liabilities	(10,252)	(27,344)
Net cash provided by operating activities	42,119	22,050
Investing activities:		
Investments in acquired real estate and related intangible assets, net of cash acquired	(88,332)	—
Investments in development in process	(4,978)	—
Investments in tenant improvements and deferred leasing costs	(18,004)	(22,671)
Investments in building improvements	(13,107)	(8,483)
Net proceeds from disposition of real estate assets	14,971	10,941
Net proceeds from disposition of for-sale residential condominiums	—	1,008
Distributions of capital from unconsolidated affiliates	363	901
Repayments of mortgages and notes receivable	—	1,481
Investments in and advances/repayments to/from unconsolidated affiliates	(429)	(1,197)
Changes in restricted cash and other investing activities	10,262	5,124
Net cash used in investing activities	(99,254)	(12,896)
Financing activities:		
Dividends on Common Stock	(34,259)	(30,961)
Dividends on Preferred Stock	(627)	(627)
Distributions to noncontrolling interests in the Operating Partnership	(1,584)	(1,584)
Distributions to noncontrolling interests in consolidated affiliates	(265)	(291)
Proceeds from the issuance of Common Stock	59,019	28,392
Costs paid for the issuance of Common Stock	(701)	—
Repurchase of shares related to tax withholdings	(2,514)	(1,748)

Borrowings on revolving credit facility	135,900	61,000
Repayments of revolving credit facility	(61,400)	(282,000)
Borrowings on mortgages and notes payable	—	225,000
Repayments of mortgages and notes payable	(37,214)	(3,067)
Additions to deferred financing costs and other financing activities	(833)	(2,241)
Net cash provided by/(used in) financing activities	55,522	(8,127)
Net increase/(decrease) in cash and cash equivalents	$(1,613)	$1,027

See accompanying notes to consolidated financial statements.

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HIGHWOODS PROPERTIES, INC.
Consolidated Statements of Cash Flows – Continued
(Unaudited and in thousands)

	Three Months Ended March 31,	
	2013	2012
Net increase/(decrease) in cash and cash equivalents	$(1,613)	$1,027
Cash and cash equivalents at beginning of the period	13,783	11,188
Cash and cash equivalents at end of the period	$12,170	$12,215

Supplemental disclosure of cash flow information:

	Three Months Ended March 31,	
	2013	2012
Cash paid for interest, net of amounts capitalized	$21,887	$25,970

Supplemental disclosure of non-cash investing and financing activities:

	Three Months Ended March 31,	
	2013	2012
Unrealized gains on cash flow hedges	$280	$1,104
Conversions of Common Units to Common Stock	351	63
Changes in accrued capital expenditures	5,158	975
Write-off of fully depreciated real estate assets	6,467	15,841
Write-off of fully amortized deferred financing and leasing costs	4,872	3,320
Unrealized gains on marketable securities of non-qualified deferred compensation plan	283	334
Adjustment of noncontrolling interests in the Operating Partnership to fair value	23,802	14,366
Unrealized gains on tax increment financing bond	390	287

See accompanying notes to consolidated financial statements.

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HIGHWOODS PROPERTIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2013
(tabular dollar amounts in thousands, except per share data)
(Unaudited)

1. Description of Business and Significant Accounting Policies

Description of Business

Highwoods Properties, Inc., together with its consolidated subsidiaries (the “Company”), is a fully-integrated, self-administered and self-managed equity real estate investment trust (“REIT”) that provides leasing, management, development, construction and other customer-related services for its properties and for third parties. The Company conducts virtually all of its activities through Highwoods Realty Limited Partnership (the “Operating Partnership”). At March 31, 2013, the Company and/or the Operating Partnership wholly owned: 303 in-service office, industrial and retail properties, comprising 30.1 million square feet; 649 acres of undeveloped land suitable for future development, of which 566 acres are considered core assets; and two office development properties. In addition, we owned interests (50.0% or less) in 31 in-service office properties, a rental residential development property and 11 acres of undeveloped land suitable for future development, which includes a 12.5% interest in a 261,000 square foot office property directly owned by the Company (not included in the Operating Partnership’s Consolidated Financial Statements).

The Company is the sole general partner of the Operating Partnership. At March 31, 2013, the Company owned all of the Preferred Units and 81.7 million, or 95.7%, of the Common Units in the Operating Partnership. Limited partners, including two directors of the Company, own the remaining 3.7 million Common Units. In the event the Company issues shares of Common Stock, the net proceeds of the issuance are contributed to the Operating Partnership in exchange for additional Common Units. Generally, the Operating Partnership is required to redeem each Common Unit at the request of the holder thereof for cash equal to the value of one share of the Company’s Common Stock, $0.01 par value, based on the average of the market price for the 10 trading days immediately preceding the notice date of such redemption, provided that the Company at its option may elect to acquire any such Common Units presented for redemption for cash or one share of Common Stock. The Common Units owned by the Company are not redeemable. During the three months ended March 31, 2013, the Company redeemed 10,071 Common Units for a like number of shares of Common Stock. As a result of this activity, the percentage of Common Units owned by the Company increased from 95.6% at December 31, 2012 to 95.7% at March 31, 2013.

Common Stock Offerings

The Company has entered into equity sales agreements with various financial institutions to offer and sell, from time to time, shares of its Common Stock by means of ordinary brokers' transactions on the New York Stock Exchange or otherwise at market prices prevailing at the time of sale, at prices related to prevailing market prices or at negotiated prices or as otherwise agreed with any of the institutions. During the three months ended March 31, 2013, the Company issued 1,299,791 shares of Common Stock under these agreements at an average gross sales price of $35.95 per share and received net proceeds, after sales commissions, of $46.0 million.

Basis of Presentation

Our Consolidated Financial Statements are prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”). Our Consolidated Balance Sheet at December 31, 2012 was retrospectively revised from previously reported amounts to reflect in real estate and other assets, net, held for sale those properties which qualified as held for sale during the three months ended March 31, 2013. Our Consolidated Statements of Income for the three months ended March 31, 2012 were retrospectively revised from previously reported amounts to reflect in discontinued operations the operations for those properties that qualified for discontinued operations.

Our Consolidated Financial Statements include the Operating Partnership, wholly owned subsidiaries and those entities in which we have the controlling financial interest. All intercompany transactions and accounts have been eliminated. At March 31, 2013 and December 31, 2012, we had involvement with, but are not the primary beneficiary in, an entity that we concluded to be a variable interest entity (see Note 3).

1. Description of Business and Significant Accounting Policies – Continued

The unaudited interim consolidated financial statements and accompanying unaudited consolidated financial information, in the opinion of management, contain all adjustments (including normal recurring accruals) necessary for a fair presentation of our financial position, results of operations and cash flows. We have omitted certain notes and other information from the interim consolidated financial statements presented in this Quarterly Report as permitted by SEC rules and regulations. These Consolidated Financial Statements should be read in conjunction with our 2012 Annual Report on Form 10-K.

Use of Estimates

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

2. Real Estate Assets

Acquisitions

During the first quarter of 2013, we acquired:

- two office properties in Tampa, FL encompassing 372,000 square feet for a purchase price of $52.5 million,

- two office properties in Greensboro, NC encompassing 195,000 square feet for a purchase price of $30.8 million, and

- five acres of development land in Memphis, TN for a purchase price of $4.8 million.

We expensed $0.5 million of acquisition costs (included in general and administrative expenses) related to these acquisitions. The assets acquired and liabilities assumed were recorded at fair value as determined by management based on information available at the acquisition date and on current assumptions as to future operations.

Dispositions

During the first quarter of 2013, we sold two office properties in Orlando, FL for a sale price of $14.6 million (before $0.8 million in closing credits to buyer for unfunded tenant improvements) and recorded a loss on disposition of discontinued operations of $0.3 million.

In connection with the disposition of an office property in Jackson, MS in the third quarter of 2012, we had the right to receive additional cash consideration of up to $1.5 million upon the satisfaction of a certain post-closing requirement. The post-closing requirement was satisfied and the cash consideration was received during the first quarter of 2013. Accordingly, we recognized $1.5 million in additional gain on disposition of discontinued operations in the first quarter of 2013.

Impairments

During the first quarter of 2013, we recorded impairments of real estate assets of $0.4 million on two industrial properties located in Atlanta, GA and recorded impairments of real estate assets held for sale of $0.7 million on five industrial properties in Atlanta, GA. These impairments were due to a change in the assumed timing of future dispositions and leasing assumptions, which reduced the future expected cash flows from the properties.

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HIGHWOODS PROPERTIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(tabular dollar amounts in thousands, except per share data)

3. Mortgages and Notes Receivable

The following table sets forth our mortgages and notes receivable:

	March 31, 2013	December 31, 2012
Seller financing (first mortgages)	$15,853	$ 15,853
Less allowance	—	—
	15,853	15,853
Mortgage receivable	8,648	8,648
Less allowance	—	—
	8,648	8,648
Promissory notes	1,408	1,153
Less allowance	(437)	(182)
	971	971
Mortgages and notes receivable, net	$25,472	$ 25,472

Our mortgages and notes receivable consist primarily of seller financing issued in conjunction with two disposition transactions in 2010 and acquisition financing provided to a third party buyer of adjacent development land in Nashville, TN.

The seller financing is evidenced by first mortgages secured by the assignment of rents and the underlying real estate assets. We evaluate the collectability of the receivables by monitoring the leasing statistics and market fundamentals of these assets. As of March 31, 2013, the payments on both mortgages receivable were current and there were no other indicators of impairment on the receivables. We may be required to take impairment charges in the future if and to the extent the underlying collateral diminishes in value.

During 2012, we provided an $8.6 million loan to a third party, which was used by such third party to fund a portion of the purchase price to acquire 77 acres of mixed-use development land adjacent to our 68-acre office development parcel in Nashville, TN. Initially, the loan is scheduled to mature in December 2015 and bears interest at 5.0% per year. The loan can be extended by the third party for up to three additional years, subject to applicable increases in the interest rate. We also agreed to loan such third party approximately $8.4 million to fund future infrastructure development on its 77-acre development parcel. Both loans are or will be secured by the 77-acre development parcel. As of March 31, 2013, less than $0.1 million has been funded to the third party for infrastructure development. We concluded this arrangement to be an interest in a variable interest entity. However, since we do not have the power to direct matters that most significantly impact the activities of the entity, we do not qualify as the primary beneficiary. Accordingly, the entity is not consolidated and the arrangement is accounted for in mortgages and notes receivable in our Consolidated Balance Sheet at March 31, 2013. Our risk of loss with respect to this arrangement is limited to the carrying value of the mortgage receivable and the future infrastructure development funding commitment.

The following table sets forth our notes receivable allowance, which relates only to promissory notes:

	Three Months Ended March 31,

	2013	2012
Beginning notes receivable allowance	$182	$61
Recoveries/write-offs/other	255	61
Total notes receivable allowance	$437	$122

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HIGHWOODS PROPERTIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(tabular dollar amounts in thousands, except per share data)

4. Investments in and Advances to Affiliates

Unconsolidated Affiliates

We have equity interests of up to 50.0% in various joint ventures with unrelated third parties that are accounted for using the equity method of accounting because we have the ability to exercise significant influence over their operating and financing policies. The following table sets forth combined summarized financial information for our unconsolidated affiliates:

	Three Months Ended March 31,	
	2013	2012
Income Statements:		
Rental and other revenues	$23,516	$24,820
Expenses:		
Rental property and other expenses	11,209	11,416
Depreciation and amortization	6,146	6,565
Impairments of real estate assets	4,790	7,180
Interest expense	4,739	5,830
Total expenses	26,884	30,991
Loss before disposition of properties	(3,368)	(6,171)
Gains on disposition of properties	24	—
Net loss	$(3,344)	$(6,171)
Our share of:		
Depreciation and amortization	$2,015	$2,098
Impairments of real estate assets	$1,020	$1,002
Interest expense	$1,752	$1,980
Gains on disposition of depreciable properties	$421	$—
Net income/(loss)	$4	$(795)
Our share of net income/(loss)	$4	$(795)
Adjustments for management and other fees	432	633
Equity in earnings/(losses) of unconsolidated affiliates	$436	$(162)

During the first quarter of 2013, our DLF II joint venture sold an office property to unrelated third parties for a sale price of $10.1 million (after $0.3 million in closing credits to buyer for free rent) and recorded a gain on disposition of property of less than $0.1 million. As our cost basis is different from the basis reflected at the joint venture level, we recorded $0.4 million of gain through equity in earnings of unconsolidated affiliates.

During the first quarter of 2013, our DLF I joint venture recorded impairments of real estate assets of $4.8 million on an office property located in Atlanta, GA and an office property located in Charlotte, NC. We recorded $1.0 million as our share of this impairment charge through equity in earnings of unconsolidated affiliates. These impairments were due to a change in the assumed timing of future dispositions and leasing assumptions, which reduced the future expected cash flows from the properties.

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

5. Intangible Assets and Below Market Lease Liabilities

The following table sets forth total intangible assets and acquisition-related below market lease liabilities, net of accumulated amortization:

	March 31, 2013	December 31, 2012
Assets:		
Deferred financing costs	$21,426	$21,759
Less accumulated amortization	(8,648)	(7,862)
	12,778	13,897
Deferred leasing costs (including lease incentives and above market lease and in-place lease acquisition-related intangible assets)	237,862	224,554
Less accumulated amortization	(73,824)	(69,357)
	164,038	155,197
Deferred financing and leasing costs, net	$176,816	$169,094
Liabilities (in accounts payable, accrued expenses and other liabilities):		
Acquisition-related below market lease liabilities	$37,538	$37,019
Less accumulated amortization	(4,319)	(3,383)
	$33,219	$33,636

The following table sets forth amortization of intangible assets and acquisition-related below market lease liabilities:

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Amortization of deferred financing costs	$949	$902
Amortization of deferred leasing costs and acquisition-related intangible assets (in depreciation and amortization)	$8,359	$6,440
Amortization of lease incentives (in rental and other revenues)	$383	$343
Amortization of acquisition-related intangible assets (in rental and other revenues)	$466	$270
Amortization of acquisition-related intangible assets (in rental property and other expenses)	$137	$—
Amortization of acquisition-related below market lease liabilities (in rental and other revenues)	$(1,122)	$(544)

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5. Intangible Assets and Below Market Lease Liabilities - Continued

The following table sets forth scheduled future amortization of intangible assets and below market lease liabilities:

	Amortization of Deferred Financing Costs	Amortization of Deferred Leasing Costs and Acquisition-Related Intangible Assets (in Depreciation and Amortization)	Amortization of Lease Incentives (in Rental and Other Revenues)	Amortization of Acquisition-Related Intangible Assets (in Rental and Other Revenues)	Amortization of Acquisition-Related Intangible Assets (in Rental Property and Other Expenses)	Amortization of Acquisition-Related Below Market Lease Liabilities (in Rental and Other Revenues)
April 1 through December 31, 2013	$2,768	$ 24,305	$965	$ 1,372	$ 416	$ (3,087)
2014	3,249	28,125	1,154	1,537	553	(4,009)
2015	2,614	22,845	926	1,252	553	(3,746)
2016	1,515	18,485	734	1,023	553	(3,443)
2017	1,226	15,591	660	908	553	(3,208)
Thereafter	1,406	36,617	2,105	1,164	1,642	(15,726)
	$12,778	$ 145,968	$6,544	$ 7,256	$ 4,270	$ (33,219)
Weighted average remaining amortization periods as of March 31, 2013 (in years)	5.0	6.6	7.6	5.4	7.7	9.8

The following table sets forth the intangible assets acquired and below market lease liabilities assumed as a result of 2013 acquisition activity:

	Acquisition-Related Intangible Assets (amortized in Rental and Other Revenues)	Acquisition-Related Intangible Assets (amortized in Depreciation and Amortization)	Acquisition-Related Below Market Lease Liabilities (amortized in Rental and Other Revenues)
Amount recorded from acquisition activity	$ 2,777	$ 11,561	$ (1,329)
Weighted average remaining amortization periods (in years)	4.9	4.8	9.3

6. Mortgages and Notes Payable

The following table sets forth our mortgages and notes payable:

	March 31, 2013	December 31, 2012

Secured indebtedness	$ 547,150	$ 549,607
Unsecured indebtedness	1,349,150	1,309,555
Total mortgages and notes payable	$ 1,896,300	$ 1,859,162

At March 31, 2013, our secured mortgage loans were collateralized by real estate assets with an aggregate undepreciated book value of $967.3 million.

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6. Mortgages and Notes Payable - Continued

Our $475.0 million unsecured revolving credit facility is scheduled to mature in July 2015 and includes an accordion feature that allows for an additional $75.0 million of borrowing capacity subject to additional lender commitments. Assuming no defaults have occurred, we have an option to extend the maturity for an additional year. The interest rate at our current credit ratings is LIBOR plus 150 basis points and the annual facility fee is 35 basis points. The interest rate and facility fee are based on the higher of the publicly announced ratings from Moody's Investors Service or Standard & Poor's Ratings Services. We use our revolving credit facility for working capital purposes and for the short-term funding of our development and acquisition activity and, in certain instances, the repayment of other debt. The continued ability to borrow under the revolving credit facility allows us to quickly capitalize on strategic opportunities at short-term interest rates. There was $97.5 million and $94.5 million outstanding under our revolving credit facility at March 31, 2013 and April 19, 2013, respectively. At both March 31, 2013 and April 19, 2013, we had $0.1 million of outstanding letters of credit, which reduces the availability on our revolving credit facility. As a result, the unused capacity of our revolving credit facility at March 31, 2013 and April 19, 2013 was $377.4 million and $380.4 million, respectively.

During the first quarter of 2013, we prepaid the remaining $35.0 million balance on a $200.0 million bank term loan that was originally scheduled to mature in February 2016. We recorded $0.2 million of loss on debt extinguishment related to this repayment.

We are currently in compliance with the debt covenants and other requirements with respect to our debt.

7. Derivative Financial Instruments

We have six floating-to-fixed interest rate swaps through January 2019 with respect to an aggregate of $225.0 million LIBOR-based borrowings. These swaps effectively fix the underlying LIBOR rate at a weighted average of 1.678%. The counterparties under the swaps are major financial institutions. These swaps have been designated as and are being accounted for as cash flow hedges with changes in fair value recorded in other comprehensive income each reporting period. No gain or loss was recognized related to hedge ineffectiveness or to amounts excluded from effectiveness testing on our cash flow hedges during the three months ended March 31, 2013. We have no collateral requirements related to our interest rate swaps.

Amounts reported in accumulated other comprehensive loss ("AOCL") related to derivatives will be reclassified to interest expense as interest payments are made on our variable-rate debt. During the period from April 1, 2013 through March 31, 2014, we estimate that $3.3 million will be reclassified to interest expense.

For the periods ending March 31, 2013 and December 31, 2012, all of our derivatives were in a liability position. The following table sets forth the fair value of our liability derivatives:

	March 31, 2013	December 31, 2012
Liability Derivatives:		
Derivatives designated as cash flow hedges in accounts payable, accrued expenses and other liabilities:		
Interest rate swaps	$8,261	$ 9,369

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

7. Derivative Financial Instruments - Continued

The following table sets forth the effect of our cash flow hedges on AOCL and interest expense:

	Three Months Ended March 31,	
	2013	2012
Derivatives Designated as Cash Flow Hedges:		
Amount of unrealized gains recognized in AOCL on derivatives (effective portion):		
Interest rate swaps	$280	$1,104
Amount of (gains)/losses reclassified out of AOCL into contractual interest expense (effective portion):		
Interest rate swaps	$788	$(33)

8. Noncontrolling Interests

Noncontrolling Interests in the Operating Partnership

Noncontrolling interests in the Operating Partnership relate to the ownership of Common Units by various individuals and entities other than the Company. Net income attributable to noncontrolling interests in the Operating Partnership is computed by applying the weighted average percentage of Common Units not owned by the Company during the period, as a percent of the total number of outstanding Common Units, to the Operating Partnership’s net income for the period after deducting distributions on Preferred Units. When a noncontrolling unitholder redeems a Common Unit for a share of Common Stock or cash, the noncontrolling interests in the Operating Partnership are reduced and the Company's share in the Operating Partnership is increased by the fair value of each security at the time of redemption.

The following table sets forth noncontrolling interests in the Operating Partnership:

	Three Months Ended March 31,	
	2013	2012
Beginning noncontrolling interests in the Operating Partnership	$124,869	$110,655
Adjustment of noncontrolling interests in the Operating Partnership to fair value	23,802	14,366
Conversions of Common Units to Common Stock	(351)	(63)
Net income attributable to noncontrolling interests in the Operating Partnership	581	827
Distributions to noncontrolling interests in the Operating Partnership	(1,584)	(1,584)
Total noncontrolling interests in the Operating Partnership	$147,317	$124,201

The following table sets forth net income available for common stockholders and transfers from noncontrolling interests in the Operating Partnership:

	Three Months Ended March 31,	
	2013	2012

Net income available for common stockholders	$12,349	$16,694
Increase in additional paid in capital from conversions of Common Units to Common Stock	351	63
Change from net income available for common stockholders and transfers from noncontrolling interests	$12,700	$16,757

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8. Noncontrolling Interests - Continued

Noncontrolling Interests in Consolidated Affiliates

At March 31, 2013, noncontrolling interests in consolidated affiliates relates to our joint venture partner's 50.0% interest in office properties located in Richmond, VA. Our joint venture partner is an unrelated third party.

9. Disclosure About Fair Value of Financial Instruments

The following summarizes the three levels of inputs that we use to measure fair value, as well as the assets, noncontrolling interests in the Operating Partnership and liabilities that we recognize at fair value using those levels of inputs.

Level 1. Quoted prices in active markets for identical assets or liabilities.

Our Level 1 assets are investments in marketable securities that we use to pay benefits under our non-qualified deferred compensation plan. Our Level 1 noncontrolling interests in the Operating Partnership relate to the ownership of Common Units by various individuals and entities other than the Company. Our Level 1 liability is our non-qualified deferred compensation obligation.

Level 2. Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the related assets or liabilities.

Our Level 2 asset is the fair value of certain of our mortgages and notes receivable, which was estimated by the income approach utilizing contractual cash flows and market-based interest rates to approximate the price that would be paid in an orderly transaction between market participants.

Our Level 2 liabilities include (1) the fair value of our mortgages and notes payable, which was estimated by the income approach utilizing contractual cash flows and market-based interest rates to approximate the price that would be paid in an orderly transaction between market participants and (2) interest rate swaps whose fair value is determined using the market standard methodology of netting the discounted future fixed cash receipts and the discounted expected variable cash payments. The variable cash payments of our interest rate swaps are based on the expectation of future LIBOR interest rates (forward curves) derived from observed market LIBOR interest rate curves. In addition, credit valuation adjustments are incorporated in the fair values to account for potential nonperformance risk, but were concluded to not be significant inputs to the calculation for the periods presented.

Level 3. Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Our Level 3 assets include (1) certain of our mortgages and notes receivable, which were estimated by the income approach utilizing internal cash flow projections and market interest rates to estimate the price that would be paid in an orderly transaction between market participants, (2) our tax increment financing bond, which is not routinely traded but whose fair value is determined by the income approach utilizing contractual cash flows and market-based interest rates to estimate the projected redemption value based on quoted bid/ask prices for similar unrated municipal bonds, and (3) any real estate assets recorded at fair value on a non-recurring basis as a result of our quarterly impairment analysis, which were valued using the terms of definitive sales contracts or the sales comparison approach and substantiated with internal cash flow projections.

Our Level 3 liabilities include the fair value of our contingent consideration to acquire real estate assets and financing obligations, which were estimated by the income approach to approximate the price that would be paid in an orderly transaction between market participants, utilizing: (1) contractual cash flows; (2) market-based interest rates; and (3) a number of other assumptions including demand for space, competition for customers, changes in market rental rates, costs of operation and expected ownership periods.

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9. Disclosure About Fair Value of Financial Instruments - Continued

The following tables set forth the assets, noncontrolling interests in the Operating Partnership and liabilities that we measure at fair value by level within the fair value hierarchy. We determine the level based on the lowest level of substantive input used to determine fair value.

	March 31, 2013	Level 1 Quoted Prices in Active Markets for Identical Assets or Liabilities	Level 2 Significant Observable Inputs	Level 3 Significant Unobservable Inputs
Assets:				
Mortgages and notes receivable, at fair value (1)	$25,638	$—	$16,990	$ 8,648
Marketable securities of non-qualified deferred compensation plan (in prepaid expenses and other assets)	3,529	3,529	—	—
Impaired real estate assets	9,002	—	—	9,002
Tax increment financing bond (in prepaid expenses and other assets)	14,324	—	—	14,324
Total Assets	$52,493	$3,529	$16,990	$ 31,974
Noncontrolling Interests in the Operating Partnership	$147,317	$147,317	$—	$ —
Liabilities:				
Mortgages and notes payable, at fair value (1)	$2,024,509	$—	$2,024,509	$ —
Interest rate swaps (in accounts payable, accrued expenses and other liabilities)	8,261	—	8,261	—
Non-qualified deferred compensation obligation (in accounts payable, accrued expenses and other liabilities)	3,529	3,529	—	—
Contingent consideration to acquire real estate assets (in accounts payable, accrued expenses and other liabilities)	375	—	—	375
Financing obligations, at fair value (1)	23,986	—	—	23,986
Total Liabilities	$2,060,660	$3,529	$2,032,770	$ 24,361

	December 31, 2012	Level 1 Quoted Prices in Active Markets for Identical Assets or Liabilities	Level 2 Significant Observable Inputs	Level 3 Significant Unobservable Inputs
Assets:				
Mortgages and notes receivable, at fair value (1)	$ 24,725	$—	$16,077	$ 8,648
	3,354	3,354	—	—

Marketable securities of non-qualified deferred compensation plan (in prepaid expenses and other assets)				
Tax increment financing bond (in prepaid expenses and other assets)	14,496	—	—	14,496
Total Assets	$ 42,575	$ 3,354	$ 16,077	$ 23,144
Noncontrolling Interests in the Operating Partnership	$ 124,869	$ 124,869	$ —	$ —
Liabilities:				
Mortgages and notes payable, at fair value (1)	$ 1,987,364	$ —	$ 1,987,364	$ —
Interest rate swaps (in accounts payable, accrued expenses and other liabilities)	9,369	—	9,369	—
Non-qualified deferred compensation obligation (in accounts payable, accrued expenses and other liabilities)	3,354	3,354	—	—
Contingent consideration to acquire real estate assets (in accounts payable, accrued expenses and other liabilities)	563	—	—	563
Financing obligations, at fair value (1)	23,252	—	—	23,252
Total Liabilities	$ 2,023,902	$ 3,354	$ 1,996,733	$ 23,815

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9. Disclosure About Fair Value of Financial Instruments - Continued

(1) Amounts recorded at historical cost on our Consolidated Balance Sheets at March 31, 2013 and December 31, 2012.

The following table sets forth the changes in our Level 3 asset and liability, which are recorded at fair value on our Consolidated Balance Sheets:

	Three Months Ended March 31, 2013	2012
Asset:		
Tax Increment Financing Bond:		
Beginning balance	$14,496	$14,788
Principal repayment	(562)	—
Unrealized gains (in AOCL)	390	287
Ending balance	$14,324	$15,075
Liability:		
Contingent Consideration to Acquire Real Estate Assets:		
Beginning balance	$563	$—
Unrealized gains (in general and administrative expenses)	(188)	—
Ending balance	$375	$—

During 2007, we acquired a tax increment financing bond associated with a parking garage developed by us. This bond amortizes to maturity in 2020. The estimated fair value at March 31, 2013 was $1.5 million below the outstanding principal due on the bond. If the discount rate used to fair value this bond was 100 basis points higher or lower, the fair value of the bond would have been $0.5 million lower or $0.5 million higher, respectively, as of March 31, 2013. We intend to hold this bond and have concluded that we will not be required to sell this bond before recovery of the bond principal. Payment of the principal and interest for the bond is guaranteed by us. We have recorded no credit losses related to the bond during the three months ended March 31, 2013 and 2012. There is no legal right of offset with the liability, which we report as a financing obligation, related to this tax increment financing bond.

The impaired real estate assets that were measured in the first quarter of 2013 at fair value and deemed to be Level 3 assets were valued based primarily on market-based inputs and our assumptions about the use of the assets, as observable inputs were not available. In the absence of observable inputs, we estimate the fair value of real estate using unobservable data such as estimated discount and capitalization rates. We also utilize local and national industry market data such as comparable sales, sales contracts and appraisals to assist us in our estimation of fair value. Significant increases or decreases in any valuation inputs in isolation would result in a significantly lower or higher fair value measurement.

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9. Disclosure About Fair Value of Financial Instruments - Continued

The following table sets forth quantitative information about the unobservable inputs of our Level 3 assets and liability, which are recorded at fair value on our Consolidated Balance Sheets:

	Fair Value at March 31, 2013	Valuation Technique	Unobservable Input	Rate/ Percentage
Assets:				
Tax increment financing bond	$14,324	Income approach	Discount rate	10.4%
Impaired real estate assets	$9,002	Income approach	Capitalization rate	8.5%-9.5%
			Discount rate	9.0%-10.0%
Liability:				
Contingent consideration to acquire real estate assets	$375	Income approach	Payout percentage	50.0%

10. Share-based Payments

During the three months ended March 31, 2013, we granted 168,700 stock options with an exercise price equal to the closing market price of a share of our Common Stock on the date of grant. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model, which resulted in a weighted average grant date fair value per share of $6.50. During the three months ended March 31, 2013, we also granted 79,080 shares of time-based restricted stock and 65,486 shares of total return-based restricted stock with weighted average grant date fair values per share of $36.35 and $31.73, respectively. We recorded stock-based compensation expense of $3.4 million and $2.4 million during the three months ended March 31, 2013 and 2012, respectively. At March 31, 2013, there was $7.2 million of total unrecognized stock-based compensation costs, which will be recognized over a weighted average remaining contractual term of 2.7 years.

11. Accumulated Other Comprehensive Loss

The following table sets forth the components of AOCL:

	Three Months Ended March 31,	
	2013	2012
Tax increment financing bond:		
Beginning balance	$(1,898)	$(2,309)
Unrealized gains on tax increment financing bond	390	287
Ending balance	(1,508)	(2,022)
Cash flow hedges:		
Beginning balance	(10,730)	(3,425)
Unrealized gains on cash flow hedges	280	1,104
Amortization of cash flow hedges (1)	788	(33)
Ending balance	(9,662)	(2,354)
Total accumulated other comprehensive loss	$(11,170)	$(4,376)

(1) Amounts reclassified out of AOCL into contractual interest expense.

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12. Discontinued Operations

The following table sets forth our operations which required classification as discontinued operations:

	Three Months Ended March 31,	
	2013	2012
Rental and other revenues	$345	$5,478
Operating expenses:		
Rental property and other expenses	103	1,939
Depreciation and amortization	148	1,532
Total operating expenses	251	3,471
Interest expense	—	125
Income from discontinued operations	94	1,882
Impairments of real estate assets held for sale	(713)	—
Net gains on disposition of discontinued operations	1,244	5,134
Total discontinued operations	$625	$7,016

The following table sets forth the major classes of assets of our real estate and other assets, net, held for sale:

	March 31, 2013	December 31, 2012
Assets:		
Land	$658	$ 2,482
Buildings and tenant improvements	6,690	23,106
Less-accumulated depreciation	(2,991)	(8,017)
Net real estate assets	4,357	17,571
Accrued straight-line rents receivable, net	26	408
Deferred leasing costs, net	11	929
Prepaid expenses and other assets	—	30
Real estate and other assets, net, held for sale	$4,394	$ 18,938

As of March 31, 2013, real estate and other assets, net, held for sale included five industrial properties in Atlanta, GA. As of December 31, 2012, real estate and other assets, net, held for sale included two office properties in Orlando, FL and five industrial properties in Atlanta, GA. All of these properties qualified for discontinued operations in the first quarter of 2013.