HIGHWOODS PROPERTIES INC
Form S-11
April 17, 2007
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As filed with the Securities and Exchange Commission on April 17, 2007

Registration No. 333-

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM S-11

REGISTRATION STATEMENT UNDER

THE SECURITIES ACT OF 1933

HIGHWOODS PROPERTIES, INC.

(Exact name of registrant as specified in its charter)

Maryland	**6798**	**56-1871668**
(State or other jurisdiction of incorporation or organization)	*(Primary Standard Industrial Classification Code Number)*	*(I.R.S. employer identification number)*

3100 Smoketree Court, Suite 600

Raleigh, North Carolina 27604

(919) 872-4924

(Address, including zip code, and telephone number, including area code, of the registrant s principal executive offices)

Jeffrey D. Miller *Copy to:*

Vice President, General Counsel and Secretary

Highwoods Properties, Inc.

3100 Smoketree Court, Suite 600

Raleigh, NC 27604

Phone: (919) 872-4924

(Name, address, including zip code, and telephone number, including area code,

of agent for service)

Robert H. Bergdolt, Esq.

DLA Piper US LLP

4141 Parklake Avenue, Suite 300

Raleigh, NC 27612

Phone: (919) 786-2000

Facsimile: (919) 786-2200

Approximate date of commencement of proposed sale to the public: As soon as practicable after the effectiveness of the registration statement.

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act of 1933, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration number of the earlier effective registration statement for the same offering. ¨

If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration number of the earlier effective registration statement for the same offering. ¨

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. ¨

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount To Be Registered	Proposed Maximum Offering Price Per Note (1)	Proposed Maximum Aggregate Offering Price (1)	Amount of Registration Fee
Common Stock, $.01 par value per share	4,139,943	$ 40.38	$ 167,170,898.34	$ 5,132.15

(1) Estimated solely for purposes of determining the registration fee pursuant to Rule 457(f) under the Securities Act.

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

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The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the SEC is effective. This prospectus is not an offer to sell these securities and we are not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED APRIL 17, 2007

4,139,943 Shares

Common Stock

This prospectus relates to up to 4,139,943 shares of Common Stock of Highwoods Properties, Inc. that the selling stockholders named in this prospectus may offer for sale from time to time. The selling stockholders named in this prospectus may acquire these shares by exercising warrants or by redeeming units of limited partnership in Highwoods Realty Limited Partnership, which is the operating partnership through which we conduct substantially all of our business, for shares of our Common Stock. All of the Common Units and warrants were issued in transactions that were consummated more than five years ago.

The purchase price of any shares offered by the selling stockholders will be the market price of a share of Common Stock at that time unless otherwise indicated in an accompanying prospectus supplement. We will not receive any proceeds from the sale of any of the shares offered by the selling stockholders. See Selling Stockholders.

Our Common Stock is listed on the New York Stock Exchange under the symbol HIW. On April 16, 2007, the last reported sale price of our Common Stock was $41.47 per share.

The selling stockholders and any agents or broker-dealers that participate with the selling stockholders in the distribution of Common Stock may be deemed to be underwriters under the Securities Act of 1933. See Plan of Distribution.

Investing in our Common Stock involves risks. You should carefully read and consider the risk factors beginning on page 8 of this prospectus for a discussion of these risks before buying our securities.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of our Common Stock or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is , 2007.

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You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with different or additional information. This prospectus does not constitute an offer to sell, or a solicitation of an offer to purchase, the securities offered by this prospectus in any jurisdiction to or from any person to whom or from whom it is unlawful to make such offer or solicitation of an offer in such jurisdiction. You should not assume that the information contained in this prospectus is accurate as of any date other than the date on the front cover of this prospectus. Neither the delivery of this prospectus nor any distribution of securities pursuant to this prospectus shall, under any circumstances, create any implication that there has been no change in the information set forth in this prospectus or in our affairs since the date of this prospectus.

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SUMMARY

This is only a summary and does not contain all of the information that you should consider before investing in shares of our Common Stock. You should read this entire prospectus, including Risk Factors, our financial statements and related notes appearing elsewhere in this prospectus, before deciding to invest in shares of our Common Stock. We refer to (1) Highwoods Properties, Inc. as the Company, (2) Highwoods Realty Limited Partnership as the Operating Partnership, (3) the Company s common stock as Common Stock, (4) the Company s preferred stock as Preferred Stock, (5) the Operating Partnership s common partnership interests as Common Units, (6) the Operating Partnership s preferred partnership interests as Preferred Units and (7) in-service properties (excluding rental residential units) to which the Company and/or the Operating Partnership have title and 100.0% ownership rights as the Wholly Owned Properties.

Overview

The Company is a fully integrated, self-administered and self-managed equity real estate investment trust (REIT) that began operations through a predecessor in 1978. The Company completed its initial public offering in 1994 and its Common Stock is traded on the New York Stock Exchange (NYSE) under the symbol HIW. We are one of the largest owners and operators of suburban office, industrial and retail properties in the southeastern and midwestern United States. At December 31, 2006, we:

- wholly owned 322 in-service office, industrial and retail properties, encompassing approximately 26.9 million rentable square feet, and 109 rental residential units;
- owned an interest (50.0% or less) in 70 in-service office and industrial properties, encompassing approximately 7.4 million rentable square feet, and 418 rental residential units. Five of these in-service office properties are consolidated at December 31, 2006 as more fully described in Notes 1 and 3 to the Consolidated Financial Statements;
- wholly owned 719 acres of undeveloped land, approximately 435 acres of which are considered core holdings and which are suitable to develop approximately 5.3 million rentable square feet of office and industrial space;
- were developing or re-developing 16 wholly owned properties comprising approximately 2.7 million square feet and 139 for-sale condominiums that were under construction or were completed but had not achieved 95% stabilized occupancy; and
- were developing through 50.0% owned joint ventures (a) an office property of approximately 31,000 square feet that was completed in 2006 but had not achieved 95% stabilized occupancy and (b) a for-rent residential project comprising 332 units in three buildings.

The Company conducts substantially all of its activities through the Operating Partnership. Other than 22.4 acres of undeveloped land, 13 rental residential units and the Company s interest in the Kessinger/Hunter, LLC and 4600 Madison Associates, LLC joint ventures (see Note 2 to the Consolidated Financial Statements), all of the Company s assets are owned directly or indirectly by the Operating Partnership. The Company is the sole general partner of the Operating Partnership. At December 31, 2006, the Company owned all of the Preferred Units and 92.2% of the Common Units in the Operating Partnership. Limited partners (including certain officers and directors of the Company) own the remaining Common Units. Generally, the Operating Partnership is obligated to redeem each Common Unit at the request of the holder thereof for cash equal to the value of one share of Common Stock based on the average of the market price for the 10 trading days immediately preceding the notice date of such redemption provided that the Company at its option may elect to acquire any such Common Units presented for redemption for cash or one share of Common Stock. The Common Units owned by the Company are not redeemable. Preferred Units in the Operating Partnership were issued to the Company in connection with the Company s Preferred Stock offerings that occurred in 1997 and 1998.

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The Company was incorporated in Maryland in 1994. The Operating Partnership was formed in North Carolina in 1994. Our executive offices are located at 3100 Smoketree Court, Suite 600, Raleigh, North Carolina 27604 and our telephone number is (919) 872-4924. We maintain offices in each of our primary markets.

Our business is the acquisition, development and operation of rental real estate properties. We operate office, industrial, retail and residential properties. There are no material inter-segment transactions. See Note 17 to the Consolidated Financial Statements for a summary of the rental income, net operating income and assets for each reportable segment.

In addition to this prospectus, we file or furnish quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (SEC). All documents that we file or furnish with the SEC are made available as soon as reasonably practicable free of charge on our corporate website, which is http://www.highwoods.com. The information on this website is not and should not be considered part of this prospectus and is not incorporated by reference in this document. This website is only intended to be an inactive textual reference. You may also read and copy any document that we file or furnish at the public reference facilities of the SEC at 100 F. Street, N.E., Room 1580, Washington, D.C. 20549. Please call the SEC at (800) 732-0330 for further information about the public reference facilities. These documents also may be accessed through the SEC s electronic data gathering, analysis and retrieval system (EDGAR) via electronic means, including the SEC s home page on the Internet (http://www.sec.gov). In addition, since some of our securities are listed on the NYSE, you can read similar information about us at the offices of the NYSE at 20 Broad Street, New York, New York 10005.

Operating Strategy

Efficient, Customer Service-Oriented Organization. We provide a complete line of real estate services to our customers and third parties. We believe that our in-house development, acquisition, construction management, leasing and property management services allow us to respond to the many demands of our existing and potential customer base. We provide our customers with cost-effective services such as build-to-suit construction and space modification, including tenant improvements and expansions. In addition, the breadth of our capabilities and resources provides us with market information not generally available. We believe that the operating efficiencies achieved through our fully integrated organization also provide a competitive advantage in setting our lease rates and pricing other services.

Capital Recycling Program. Our strategy has been to focus our real estate activities in markets where we believe our extensive local knowledge gives us a competitive advantage over other real estate developers and operators. Through our capital recycling program, we generally seek to:

- selectively dispose of non-core properties in order to use the net proceeds to improve our balance sheet by reducing outstanding debt and Preferred Stock balances, to make new investments or for other purposes;
- engage in the development of office and industrial projects in our existing geographic markets, primarily in suburban in-fill business parks; and
- acquire selective suburban office and industrial properties in our existing geographic markets at prices below replacement cost that offer attractive returns.

Our capital recycling activities benefit from our local market presence and knowledge. Because our division officers have significant real estate experience in their respective markets, we believe that we are in a better position to evaluate capital recycling opportunities than many of our competitors. In addition, our relationships with our customers and those tenants at properties for which we conduct third-party fee-based services may lead to development projects when these tenants seek new space.

Conservative and Flexible Balance Sheet. We are committed to maintaining a conservative and flexible balance sheet that allows us to capitalize on favorable development and acquisition opportunities as they arise. We expect to meet our short- and long-term liquidity requirements through a combination of any one or more of:

cash flow from operating activities;

borrowings under our credit facilities;

the issuance of unsecured debt;

the issuance of secured debt;

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

the selective disposition of non-core land and other assets; and

private equity capital raised from unrelated joint venture partners involving the sale or contribution of our Wholly Owned Properties, development projects or development land.

Geographic Diversification. We do not believe that our operations are significantly dependent upon any particular geographic market. Today, including our various joint ventures, our portfolio consists primarily of office and industrial properties throughout the Southeast, retail and office properties in Kansas City, Missouri, including one significant mixed retail and office property, and office properties in Des Moines, Iowa.

Summary Risk Factors

You should carefully consider the matters discussed in the Risk Factors section beginning on page 8 prior to deciding to invest in shares of our Common Stock. These risks include:

The market price and trading volume of our Common Stock may be volatile.

Future offerings of debt securities, which would be senior to our Common Stock upon liquidation, or equity securities, which would dilute the holdings of our existing stockholders and may be senior to our Common Stock for the purposes of dividend distributions or distributions upon liquidation, may adversely affect the market price of our Common Stock.

We have not established a minimum dividend payment level and there are no assurances of our ability to pay dividends in the future.

Our performance is subject to risks associated with real estate investment.

Future acquisitions and development properties may fail to perform in accordance with our expectations and may require renovation and development costs exceeding our estimates.

Illiquidity of real estate investments and the tax effect of dispositions could significantly impede our ability to sell assets or to respond to favorable or adverse changes in the performance of our properties.

Because holders of our Common Units may suffer adverse tax consequences upon the sale of some of our properties, the ownership of Common Units by our officers and directors could compromise their independent judgment, which could result in actions that are not in the best interests of our common stockholders.

The success of our joint venture activity depends upon our ability to work effectively with financially sound partners.

Our insurance coverage on our properties may be inadequate.

Our use of debt to finance our operations could have a material adverse effect on our cash flow and ability to make distributions.

We may be subject to taxation as a regular corporation if we fail to maintain our REIT status.

Because provisions contained in Maryland law, our charter and our bylaws may have an anti-takeover effect, investors may be prevented from receiving a control premium for their shares.

Material weaknesses in our internal control over financial reporting could directly or indirectly cause a material misstatement of our financial statements.

Tax Status

The Company has elected to be treated as a REIT for federal income tax purposes. To qualify as a REIT, the Company must meet various tax law requirements, including, among others, requirements relating to the nature of our assets, the sources of our income, the timing and amount of distributions that we make and the composition of the Company s stockholders. As a REIT, the Company is generally not subject to federal income tax on income that it distributes to stockholders. If the Company fails to qualify as a REIT in any taxable year, it will be subject to federal income tax at regular corporate rates, and may be precluded from qualifying as a REIT for the subsequent four taxable years during which it lost its qualification. Further, even to the extent that the Company qualifies as a REIT, it will be subject to tax at normal corporate rates on net income or capital gains not distributed to the its stockholders, and may be subject to other taxes, including payroll taxes, and state and local income, franchise, property, sales and other taxes. Moreover, we may have subsidiary entities that are subject to federal income taxation and to various other taxes. Any dividends received from us will generally, with limited exceptions, not be eligible for taxation at the preferred capital gain rates that currently apply to dividends received by individuals from taxable corporations. See Material Federal Income Tax Considerations.

Restrictions on Ownership of Stock

In order for the Company to maintain its qualification as a REIT under the Internal Revenue Code, not more than 50% (by value) of the Company s outstanding shares of capital stock may be owned, directly, or indirectly, by five or fewer individuals (as defined in the Internal Revenue Code to include certain entities). For the purpose of preserving the Company s REIT qualification, its charter generally prohibits direct or indirect ownership of more than 9.8% of the outstanding shares of capital stock by any person or entity. The Company s Board of Directors may, however, in its discretion, exempt a person from this ownership limitation, and, as a condition to such exemption, may require a satisfactory ruling from the Internal Revenue Service, or IRS, an opinion of counsel (as to our continued REIT status) and/or certain representations and undertakings from such person.

Distribution Policy

To maintain the Company s qualification as a REIT, we must distribute to stockholders at least 90.0% of our REIT taxable income, excluding capital gains. REIT taxable income, the calculation of which is determined by the federal tax laws, does not equal net income under GAAP. We generally expect to use our cash flow from operating activities for dividends to stockholders and for payment of recurring capital expenditures. Future dividends and distributions will be at the discretion of the Board of Directors and will depend on our actual funds from operations, our financial condition, capital requirements, the annual dividend requirements under the REIT provisions of the Internal Revenue Code and such other factors as the Board of Directors deems relevant. See Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Stockholder Dividends.

During 2006, cash dividends on Common Stock totaled $1.70 per share, $0.97 of which represented return of capital for income tax purposes. The minimum dividend per share of Common Stock required for the Company to maintain its REIT status (excluding any net capital gains) was $0.24 per share in 2005. Aggregate dividends paid on Preferred Stock exceeded REIT taxable income (excluding capital gains) in 2006, which resulted in no required dividend on Common Stock in 2006 for REIT qualification purposes.

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Selling Stockholders

This prospectus relates to up to 4,139,943 shares of Common Stock that the selling stockholders named in this prospectus may offer for sale from time to time.

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THE OFFERING

Common Stock offered	The selling stockholders may, from time to time, sell 4,139,943 shares of our Common Stock.
Offering price	The selling stockholders are offering, from time to time, the shares of Common Stock being offered by this prospectus at the then current market price.
Use of proceeds	We will not receive any of the proceeds from the sale of Common Stock offered by the selling stockholders named in this prospectus. In connection with the issuance of the shares offered by us through this prospectus, we will receive one warrant or one Common Unit for each of the shares issuable upon exercise or redemption of the same number of outstanding warrants or units.
Risk factors	Investing in our Common Stock involves a high degree of risk. See Risk Factors beginning on page 8 and other information in this prospectus for a discussion of factors you should consider carefully before investing in our Common Stock.
New York Stock Exchange Symbol	HIW

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SUMMARY SELECTED FINANCIAL DATA

The following summary selected financial data as of December 31, 2006 and 2005 and for each of the three years in the period ended December 31, 2006 is derived from the Company s audited Consolidated Financial Statements included elsewhere herein. The selected financial data as of December 31, 2004, 2003 and 2002 and for each of the two years in the period ended December 31, 2003 is derived from previously issued financial statements and, as required by SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, (SFAS No. 144), results and balance sheet data for the years ended December 31, 2005, 2004, 2003 and 2002 were reclassified from previously reported amounts to reflect in discontinued operations the operations for those properties sold or held for sale in 2006 which qualified for discontinued operations presentation. The information in the following table should be read in conjunction with the Company s audited Consolidated Financial Statements and related notes included herein ($ in thousands, except per share data):

	Years Ended December 31,				
	2006	**2005**	**2004**	**2003**	**2002**
Rental and other revenues	$ 416,798	$ 396,075	$ 389,587	$ 414,745	$ 424,354
Income from continuing operations	$ 36,465	$ 27,728	$ 21,044	$ 7,906	$ 32,780
Income/(loss) from continuing operations available for common stockholders	$ 17,599	$ (3,782)	$ (9,808)	$ (22,946)	$ 1,928
Net income	$ 53,744	$ 62,458	$ 41,577	$ 42,649	$ 80,052
Net income available for common stockholders	$ 34,878	$ 30,948	$ 10,725	$ 11,797	$ 49,200
Net income per common share basic:					
Income/(loss) from continuing operations	$ 0.32	$ (0.07)	$ (0.18)	$ (0.43)	$ 0.04
Net income	$ 0.64	$ 0.58	$ 0.20	$ 0.22	$ 0.93
Net income per common share diluted:					
Income/(loss) from continuing operations	$ 0.31	$ (0.07)	$ (0.18)	$ (0.43)	$ 0.04
Net income	$ 0.62	$ 0.58	$ 0.20	$ 0.22	$ 0.93
Dividends declared per common share	$ 1.70	$ 1.70	$ 1.70	$ 1.86	$ 2.34

	December 31,				
	2006	**2005**	**2004**	**2003**	**2002**
Balance Sheet Data:					
Total assets	$ 2,844,853	$ 2,908,978	$ 3,239,658	$ 3,513,224	$ 3,745,269
Total mortgages and notes payable	$ 1,465,129	$ 1,471,616	$ 1,572,574	$ 1,718,274	$ 1,796,167
Financing obligations	$ 35,530	$ 34,154	$ 65,309	$ 125,777	$ 122,666
Co-venture obligation	$	$	$	$	$ 43,511

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RISK FACTORS

An investment in our Common Stock involves various risks. All investors should carefully consider the following risk factors in conjunction with the other information contained in this prospectus before trading in our securities. If any of these risks actually occur, our business, operating results, prospects and financial condition could be harmed.

Risks Related to the Sale of Common Stock by the Selling Stockholders

The market price and trading volume of our Common Stock may be volatile. In 1994, we completed an initial public offering of our Common Stock, which is listed on the New York Stock Exchange. Although there has been active trading in our Common Stock since the initial public offering, we cannot assure you that an active trading market in our Common Stock will be sustained. Even if active trading of our Common Stock continues, the market price of our Common Stock may be highly volatile and be subject to wide fluctuations. In addition, you may be unable to resell shares of our Common Stock at or above the purchase price you paid to acquire them. We cannot assure you that the market price of our common shares will not fluctuate or decline significantly in the future.

Future offerings of debt securities, which would be senior to our Common Stock upon liquidation, or equity securities, which would dilute the holdings of our existing stockholders and may be senior to our Common Stock for the purposes of dividend distributions or distributions upon liquidation, may adversely affect the market price of our Common Stock. In the future we may attempt to increase our capital resources by making additional offerings of debt or equity securities. Upon liquidation, holders of our debt securities and shares of Preferred Stock and lenders with respect to other borrowings will receive a distribution of our available assets prior to the holders of our Common Stock. Additional equity offerings may dilute the holdings of our existing stockholders or reduce the market price of our Common Stock, or both. If we decide to issue additional Preferred Stock, it could have a preference on liquidating distributions or a preference on dividend payments that could limit our ability to make a dividend distribution to the holders of our Common Stock. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus, our stockholders bear the risk of our future offerings reducing the market price of our Common Stock and diluting their stock holdings in us.

We have not established a minimum dividend payment level and there are no assurances of our ability to pay dividends in the future. We intend to pay quarterly dividends and to make distributions to our stockholders in an amount such that all or substantially all of our taxable income in each year, subject to certain adjustments, is distributed. We have not established a minimum dividend payment level and our ability to pay dividends may be adversely affected by the risk factors described in this prospectus. All distributions will be made at the discretion of our Board of Directors and will depend on our earnings, our financial condition, maintenance of our REIT status and such other factors as our Board of Directors may deem relevant from time to time. There are no assurances of our ability to pay dividends in the future. In addition, some of our distributions may include a return of capital.

General Real Estate Risks

Our performance is subject to risks associated with real estate investment. We are a real estate company that derives most of our income from the ownership and operation of our properties. There are a number of factors that may adversely affect the income that our properties generate, including the following:

Economic Downturns. Downturns in the national economy, particularly in the Southeast, generally will negatively impact the demand and rental rates for our properties.

Oversupply of Space. An oversupply of space in our markets would typically cause rental rates and occupancies to decline, making it more difficult for us to lease space at attractive rental rates.

Competitive Properties. If our properties are not as attractive to tenants (in terms of rent, services, condition or location) as properties owned by our competitors, we could lose tenants to those properties or receive lower rental rates.

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Renovation Costs. In order to maintain the quality of our properties and successfully compete against other properties, we periodically must spend money to maintain, repair and renovate our properties.

Customer Risk. Our performance depends on our ability to collect rent from our customers. Our financial condition could be adversely affected by financial difficulties experienced by a major customer, or by a number of smaller customers, including bankruptcies, insolvencies or general downturns in business.

Reletting Costs. As leases expire, we try to either relet the space to the existing customer or attract a new customer to occupy the space. In either case, we likely will incur significant costs in the process, including potentially substantial tenant improvement expense or lease incentives. In addition, if market rents have declined since the time the expiring lease was executed, the terms of any new lease likely will not be as favorable to us as the terms of the expiring lease, thereby reducing the rental revenue earned from that space.

Regulatory Costs. There are a number of government regulations, including zoning, tax and accessibility laws, that apply to the ownership and operation of our properties. Compliance with existing and newly adopted regulations may require us to incur significant costs on our properties.

Rising Operating Costs. Costs of operating our properties, such as real estate taxes, utilities, insurance, maintenance and other costs, can rise faster than our ability to increase rental income. While we do receive some additional rent from our tenants that is based on recovering a portion of operating expenses, generally increased operating expenses will negatively impact our net operating income. Our revenues and expense recoveries are subject to longer term leases and may not be quickly increased sufficient to recover an increase in operating costs and expenses.

Fixed Nature of Costs. Most of the costs associated with owning and operating a property are not necessarily reduced when circumstances such as market factors and competition cause a reduction in rental revenues from the property. Increases in such fixed operating expenses, such as increased real estate taxes or insurance costs, would reduce our net income.

Environmental Problems. Federal, state and local laws and regulations relating to the protection of the environment may require a current or previous owner or operator of real property to investigate and clean up hazardous or toxic substances or petroleum product releases at the property. The clean up can be costly. The presence of or failure to clean up contamination may adversely affect our ability to sell or lease a property or to borrow funds using a property as collateral.

Competition. A number of other major real estate investors with significant capital compete with us. These competitors include publicly-traded REITs, private REITs, private real estate investors and private institutional investment funds.

Future acquisitions and development properties may fail to perform in accordance with our expectations and may require renovation and development costs exceeding our estimates. In the normal course of business, we typically evaluate potential acquisitions, enter into non-binding letters of intent, and may, at any time, enter into contracts to acquire additional properties. Our acquisition investments may fail to perform in accordance with our expectations due to lease up risk, renovation cost risks and other factors. In addition, the renovation and improvement costs we incur in bringing an acquired property up to market standards may exceed our estimates. We may not have the financial resources to make suitable acquisitions or renovations on favorable terms or at all.

In addition to acquisitions, we periodically consider developing and constructing properties. Risks associated with development and construction activities include:

- the unavailability of favorable financing;

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construction costs exceeding original estimates;

construction and lease-up delays resulting in increased debt service expense and construction costs; and

lower than anticipated occupancy rates and rents at a newly completed property causing a property to be unprofitable.

If new developments are financed through construction loans, there is a risk that, upon completion of construction, permanent financing for newly developed properties will not be available or will be available only on disadvantageous terms. Development activities are also subject to risks relating to our ability to obtain, or delays in obtaining, all necessary zoning, land-use, building, occupancy and other required governmental and utility company authorizations.

Illiquidity of real estate investments and the tax effect of dispositions could significantly impede our ability to sell assets or to respond to favorable or adverse changes in the performance of our properties. Because real estate investments are relatively illiquid, our ability to promptly sell one or more properties in our portfolio in response to changing economic, financial and investment conditions is limited. In addition, we have a significant amount of mortgage debt under which we could incur significant prepayment penalties if such loans were paid off in connection with the sale of the underlying real estate assets. Such loans, even if assumed by a buyer rather than being paid off, could reduce the sale proceeds we receive if we sold such assets.

We intend to continue to sell some of our properties in the future. However, we cannot predict whether we will be able to sell any property for the price or on the terms set by us, or whether the price or other terms offered by a prospective purchaser would be acceptable to us. We also cannot predict the length of time needed to find a willing purchaser and to close the sale of a property.

Certain of our properties have low tax bases relative to their fair value, and accordingly, the sale of such assets would generate significant taxable gains unless we sold such properties in a tax-free exchange under Section 1031 of the Internal Revenue Code or another tax-free or tax-deferred transaction. For an exchange to qualify for tax-deferred treatment under Section 1031, the net proceeds from the sale of a property must be held by an escrow agent until applied toward the purchase of real estate qualifying for gain deferral. Given the competition for properties meeting our investment criteria, there could be a delay in reinvesting such proceeds. Any delay in using the reinvestment proceeds to acquire additional income producing assets would reduce our income from operations.

In addition, the sale of certain properties acquired in the J.C. Nichols Company merger in July 1998, including assets acquired in connection with Section 1031 exchanges with properties originally acquired in the J.C. Nichols Company merger, would require us to pay corporate-level tax under Section 1374 of the Internal Revenue Code on the built-in gain relating to such properties unless we sold such properties in a tax-free exchange under Section 1031 of the Internal Revenue Code or another tax-free or tax-deferred transaction. This tax will no longer apply after July 2008 because we will have owned the assets for 10 years or more. As a result, we may choose not to sell these properties even if management determines that such a sale would otherwise be in the best interests of our stockholders. We have no current plans to dispose of any properties in a manner that would require us to pay corporate-level tax under Section 1374. However, we would consider doing so if our management determines that a sale of a property would be in our best interests based on consideration of a number of factors, including the price being offered for the property, the operating performance of the property, the tax consequences of the sale and other factors and circumstances surrounding the proposed sale.

Because holders of our Common Units may suffer adverse tax consequences upon the sale of some of our properties, the ownership of Common Units by our officers and directors could compromise their independent judgment, which could result in actions that are not in the best interests of our common stockholders. Holders of Common Units may suffer adverse tax consequences upon our sale of certain properties. Therefore, holders of Common Units, including certain of our officers and directors, may have different objectives than our stockholders regarding the appropriate pricing and timing of a property s sale. The ownership of Common Units by our officers and directors could compromise their independent judgment, which could result in actions that are not in the best interests of our common stockholders.

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The success of our joint venture activity depends upon our ability to work effectively with financially sound partners. Instead of owning properties directly, we have in some cases invested, and may continue to invest, as a partner or a co-venturer with one or more third parties. Under certain circumstances, this type of investment may involve risks not otherwise present, including the possibility that a partner or co-venturer might become bankrupt or that a partner or co-venturer might have business interests or goals inconsistent with ours. Also, such a partner or co-venturer may take action contrary to our instructions or requests or contrary to provisions in our joint venture agreements that could harm us.

Our insurance coverage on our properties may be inadequate. We carry comprehensive insurance on all of our properties, including insurance for liability, fire, windstorms, flood and business interruption. Insurance companies, however, limit coverage against certain types of losses, such as losses due to terrorist acts, named windstorms and toxic mold. Thus, we may not have insurance coverage, or sufficient insurance coverage, against certain types of losses and/or there may be decreases in the insurance coverage available. Should an uninsured loss or a loss in excess of our insured limits occur, we could lose all or a portion of the capital we have invested in a property or properties, as well as the anticipated future revenue from the property or properties. If any of our properties were to experience a catastrophic loss, it could disrupt our operations, delay revenue and result in large expenses to repair or rebuild the property. Such events could adversely affect our financial condition. Our existing property, casualty and liability insurance policies are scheduled to expire on June 30, 2007.

Financing Risks

Our use of debt to finance our operations could have a material adverse effect on our cash flow and ability to make distributions. We are subject to risks normally associated with debt financing, such as the sufficiency of cash flow to meet required payment obligations, difficulty in complying with financial ratios and other covenants and the ability to refinance existing indebtedness. Increases in interest rates on our variable rate debt would increase our interest expense. If we fail to comply with the financial ratios and other covenants under our credit facilities, we would likely not be able to borrow any further amounts under such facilities, which could adversely affect our ability to fund our operations, and our lenders could accelerate outstanding debt.

We generally do not intend to reserve funds to retire existing secured or unsecured debt upon maturity. We may not be able to repay, refinance or extend any or all of our debt at maturity or upon any acceleration. If any refinancing is done at higher interest rates, the increased interest expense could adversely affect our cash flow and ability to pay dividends to stockholders. Any such refinancing could also impose tighter financial ratios and other covenants that restrict our ability to take actions that could otherwise be in our stockholders best interest, such as funding new development activity, making opportunistic acquisitions, repurchasing our securities or paying distributions. If we do not meet our mortgage financing obligations, any properties securing such indebtedness could be foreclosed on, which would have a material adverse effect on our cash flow and ability to make distributions.

Tax and Other Risks

We may be subject to taxation as a regular corporation if we fail to maintain our REIT status. Our failure to qualify as a REIT for income tax purposes would have serious adverse consequences to our stockholders. Many of the requirements for taxation as a REIT are highly technical and complex and depend upon various factual matters and circumstances that may not be entirely within our control. For example, to qualify as a REIT, at least 95.0% of our gross income must come from certain sources that are itemized in the REIT tax laws. We are also required to distribute to stockholders at least 90.0% of our REIT taxable income, excluding capital gains. The fact that we hold substantially all of our assets through the Operating Partnership and its subsidiaries further complicates the application of the REIT requirements. Even a technical or inadvertent mistake could jeopardize our REIT status. Furthermore, Congress and the Internal Revenue Service (IRS) might change the tax laws and regulations and the courts might issue new rulings that make it more difficult, or impossible, for us to remain qualified as a REIT. If we fail to qualify as a REIT, we would be subject to federal income tax at regular corporate rates. Also, unless the IRS granted us relief under certain statutory provisions, we would remain disqualified as a REIT for four years following the year we first failed to qualify. If we failed to qualify as a REIT, we would have to pay significant income taxes and would, therefore, have less cash available for investments or to pay dividends to stockholders. This would likely have a significant adverse effect on the value of our securities. In addition, if we lost our REIT status, we would no longer be required to pay dividends to stockholders.

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Because provisions contained in Maryland law, our charter and our bylaws may have an anti-takeover effect, investors may be prevented from receiving a control premium for their shares. Provisions contained in our charter and bylaws as well as Maryland general corporation law may have anti-takeover effects that delay, defer or prevent a takeover attempt, and thereby prevent stockholders from receiving a control premium for their shares. For example, these provisions may defer or prevent tender offers for our Common Stock or purchases of large blocks of our Common Stock, thus limiting the opportunities for our stockholders to receive a premium for their Common Stock over then-prevailing market prices. These provisions include the following:

Ownership limit. Our charter prohibits direct, indirect or constructive ownership by any person or entity of more than 9.8% of our outstanding capital stock. Any attempt to own or transfer shares of our capital stock in excess of the ownership limit without the consent of our Board of Directors will be void.

Preferred Stock. Our charter authorizes our Board of Directors to issue Preferred Stock in one or more classes and to establish the preferences and rights of any class of Preferred Stock issued. These actions can be taken without stockholder approval. The issuance of Preferred Stock could have the effect of delaying or preventing someone from taking control of us, even if a change in control were in our stockholders best interest.

Staggered board. Our Board of Directors is divided into three classes. As a result, each director generally serves for a three-year term. This staggering of our Board may discourage offers for us or make an acquisition of us more difficult, even when an acquisition is in the best interest of our stockholders.

Maryland control share acquisition statute. Maryland s control share acquisition statute applies to us, which means that persons, entities or related groups that acquire more than 20% of our Common Stock may not be able to vote such excess shares under certain circumstances if such shares were acquired in one or more transactions not approved by at least two-thirds of our outstanding Common Stock held by disinterested stockholders.

Maryland unsolicited takeover statute. Under Maryland law, our Board of Directors could adopt various anti-takeover provisions without the consent of stockholders. The adoption of such measures could discourage offers for us or make an acquisition of us more difficult, even when an acquisition is in the best interest of our stockholders.

Anti-takeover protections of Operating Partnership agreement. Upon a change in control of the Company, the limited partnership agreement of the Operating Partnership requires certain acquirers to maintain an umbrella partnership real estate investment trust (UPREIT) structure with terms at least as favorable to the limited partners as are currently in place. For instance, the acquirer would be required to preserve the limited partner s right to continue to hold tax-deferred partnership interests that are redeemable for capital stock of the acquirer. Some change of control transactions involving the Company could require the approval of two-thirds of the limited partners of the Operating Partnership (other than the Company). These provisions may make a change of control transaction involving the Company more complicated and therefore might decrease the likelihood of such a transaction occurring, even if such a transaction would be in the best interest of the Company s stockholders.

Dilutive effect of stockholder rights plan. We have a stockholder rights plan, which is currently scheduled to expire on October 6, 2007, pursuant to which our existing stockholders would have the ability to acquire additional Common Stock at a significant discount in the event a person or group attempts to acquire us on terms that our Board of Directors does not approve. These rights are designed to deter a hostile takeover by increasing the takeover cost. As a result, such rights could discourage offers for us or make an acquisition of us more difficult, even when an acquisition is in the best interest of our stockholders. The rights plan should not interfere with any merger or other business combination the Board of Directors approves since we may generally terminate the plan at any time at nominal cost.

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Material weaknesses in our internal control over financial reporting could directly or indirectly cause a material misstatement of our financial statements. Additionally, no assurance can be provided that we will be able to prevent or detect material misstatements to our financial statements in the future. Material weaknesses in our internal control over financial reporting could cause a material misstatement of our financial statements. Our internal control over financial reporting was not effective at December 31, 2006 due to material weaknesses as of such date in the internal control environment associated with accounting for real estate assets. For a discussion of these material weaknesses that existed as of December 31, 2006, see Control and Procedures. A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. Although we have taken various measures to improve our internal control over financial reporting, we have not yet completed all of our planned remediation activities nor been required to undertake an evaluation of our internal control over financial reporting since December 31, 2006. Therefore, we cannot provide any assurances that the material weaknesses described above have been sufficiently remediated as of the date of this prospectus. In addition, no assurance can be provided that we will be able to prevent or detect material misstatements to our financial statements in the future.

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DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

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

- speculative development activity by our competitors in our existing markets could result in an excessive supply of office, industrial and retail properties relative to tenant demand;
- the financial condition of our tenants could deteriorate;
- we may not be able to complete development, acquisition, reinvestment, disposition or joint venture projects as quickly or on as favorable terms as anticipated;
- we may not be able to lease or release space quickly or on as favorable terms as old leases;
- increases in interest rates would increase our debt service costs;
- we may not be able to meet our liquidity requirements or obtain capital on favorable terms to fund our working capital needs and growth initiatives or to repay or refinance outstanding debt upon maturity;
- we could lose key executive officers; and
- our southeastern and midwestern markets may suffer unexpected declines in economic growth.

This list of risks and uncertainties, however, is not intended to be exhaustive. You should also review the other cautionary statements we make in Risk Factors set forth elsewhere in this prospectus.

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

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USE OF PROCEEDS

We will not receive any of the proceeds from the sale of Common Stock offered by the selling stockholders named in this prospectus. In connection with the issuance of the shares offered by us through this prospectus, we will receive one warrant or Common Unit for each of the shares issuable upon exercise or redemption of the same number of outstanding warrants or units.

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MARKET PRICE OF AND DIVIDENDS ON THE REGISTRANT S COMMON EQUITY

AND RELATED STOCKHOLDER MATTERS

Our Common Stock is traded on the NYSE under the symbol HIW. The following table sets forth the quarterly high and low stock prices per share reported on the NYSE for the quarters indicated and the dividends paid per share during such quarter.

	2006			2005		
Quarter Ended	High	Low	Dividend	High	Low	Dividend
March 31	$ 34.77	$ 29.20	$ .425	$ 27.82	$ 24.27	$ .425
June 30	36.18	29.56	.425	30.54	26.15	.425
September 30	38.15	35.39	.425	31.86	28.43	.425
December 31	41.31	36.40	.425	29.91	26.72	.425

On April 16, 2007, the last reported stock price of our Common Stock on the NYSE was $41.47 per share and we had 1,528 common stockholders of record.

We intend to continue to pay quarterly dividends to holders of shares of Common Stock and make distributions to holders of Common Units. Future dividends and distributions will be at the discretion of the Board of Directors and will depend on our actual funds from operations, our financial condition, capital requirements, the annual dividend requirements under the REIT provisions of the Internal Revenue Code and such other factors as the Board of Directors deems relevant. See Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Stockholder Dividends.

During 2006, cash dividends on Common Stock totaled $1.70 per share, $0.97 of which represented return of capital for income tax purposes. The minimum dividend per share of Common Stock required for the Company to maintain its REIT status (excluding any net capital gains) was $0.24 per share in 2005. Aggregate dividends paid on Preferred Stock exceeded REIT taxable income (excluding capital gains) in 2006, which resulted in no required dividend on Common Stock in 2006 for REIT qualification purposes.

During the fourth quarter of 2006, we did not issue any Common Stock that was not registered under the Securities Act of 1933 nor did we repurchase any Common Stock or Preferred Stock.

The Company has a Dividend Reinvestment and Stock Purchase Plan under which holders of Common Stock may elect to automatically reinvest their dividends in additional shares of Common Stock and may make optional cash payments for additional shares of Common Stock. The administrator of the Dividend Reinvestment and Stock Purchase Plan has been instructed by the Company to purchase Common Stock in the open market for purposes of satisfying the Company s obligations thereunder. However, the Company may in the future elect to satisfy such obligations by issuing additional shares of Common Stock.

The Company has an Employee Stock Purchase Plan for all active employees, under which participants may contribute up to 25.0% of their compensation for the purchase of Common Stock. Generally, at the end of each three-month offering period, each participant s account balance is applied to acquire newly issued shares of Common Stock at a cost that is calculated at 85.0% of the lower of the average closing price on the NYSE on the five consecutive days preceding the first day of the quarter or the five days preceding the last day of the quarter.

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SELECTED FINANCIAL DATA

The following selected financial data as of December 31, 2006 and 2005 and for each of the three years in the period ended December 31, 2006 is derived from the Company s audited Consolidated Financial Statements included elsewhere herein. The selected financial data as of December 31, 2004, 2003 and 2002 and for each of the two years in the period ended December 31, 2003 is derived from previously issued financial statements and, as required by SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, (SFAS No. 144), results and balance sheet data for the years ended December 31, 2005, 2004, 2003 and 2002 were reclassified from previously reported amounts to reflect in discontinued operations the operations for those properties sold or held for sale in 2006 which qualified for discontinued operations presentation. The information in the following table should be read in conjunction with the Company s audited Consolidated Financial Statements and related notes included herein ($ in thousands, except per share data):

	Years Ended December 31,				
	2006	2005	2004	2003	2002
Rental and other revenues	$ 416,798	$ 396,075	$ 389,587	$ 414,745	$ 424,354
Income from continuing operations	$ 36,465	$ 27,728	$ 21,044	$ 7,906	$ 32,780
Income/(loss) from continuing operations available for common stockholders	$ 17,599	$ (3,782)	$ (9,808)	$ (22,946)	$ 1,928
Net income	$ 53,744	$ 62,458	$ 41,577	$ 42,649	$ 80,052
Net income available for common stockholders	$ 34,878	$ 30,948	$ 10,725	$ 11,797	$ 49,200
Net income per common share basic:					
Income/(loss) from continuing operations	$ 0.32	$ (0.07)	$ (0.18)	$ (0.43)	$ 0.04
Net income	$ 0.64	$ 0.58	$ 0.20	$ 0.22	$ 0.93
Net income per common share diluted:					
Income/(loss) from continuing operations	$ 0.31	$ (0.07)	$ (0.18)	$ (0.43)	$ 0.04
Net income	$ 0.62	$ 0.58	$ 0.20	$ 0.22	$ 0.93
Dividends declared per common share	$ 1.70	$ 1.70	$ 1.70	$ 1.86	$ 2.34

	December 31,				
	2006	2005	2004	2003	2002
Balance Sheet Data:					
Total assets	$ 2,844,853	$ 2,908,978	$ 3,239,658	$ 3,513,224	$ 3,745,269
Total mortgages and notes payable	$ 1,465,129	$ 1,471,616	$ 1,572,574	$ 1,718,274	$ 1,796,167
Financing obligations	$ 35,530	$ 34,154	$ 65,309	$ 125,777	$ 122,666
Co-venture obligation	$	$	$	$	$ 43,511

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

Overview

We are a fully integrated, self-administered and self-managed equity REIT that provides leasing, management, development, construction and other customer-related services for our properties and for third parties. As of December 31, 2006, we owned or had an interest in 392 in-service office, industrial and retail properties, encompassing approximately 34.3 million square feet, which includes seven in-service office and industrial development properties that had not yet reached 95% stabilized occupancy aggregating approximately 953,000 square feet, and 527 rental residential units. As of that date, we also owned development land and other properties under development as described under Business below. We are based in Raleigh, North Carolina, and our properties and development land are located in Florida, Georgia, Iowa, Kansas, Maryland, Missouri, North Carolina, South Carolina, Tennessee and Virginia.

Results of Operations

Approximately 82% of our rental and other revenue from continuing operations in 2006 was derived from our office properties. As a result, while we own and operate a limited number of industrial, retail and residential properties, our operating results depend heavily on successfully leasing our office properties. Furthermore, since approximately 65% of our annualized revenues from office properties come from properties located in Florida, Georgia, North Carolina and Tennessee, economic growth in those states is and will continue to be an important determinative factor in predicting our future operating results.

The key components affecting our rental revenue stream are dispositions, acquisitions, new developments placed in service, average occupancy and rental rates. Average occupancy generally increases during times of improving economic growth, as our ability to lease space outpaces vacancies that occur upon the expirations of existing leases. Average occupancy generally declines during times of slower economic growth, when new vacancies tend to outpace our ability to lease space. Asset acquisitions, dispositions and new developments placed in service directly impact our rental revenues and could impact our average occupancy, depending upon the occupancy rate of the properties that are acquired, sold or placed in service. A further indicator of the predictability of future revenues is the expected lease expirations of our portfolio. As a result, in addition to seeking to increase our average occupancy by leasing current vacant space, we also must concentrate our leasing efforts on renewing leases on expiring space. For more information regarding our lease expirations, see Properties Lease Expirations.

Whether or not our rental revenue tracks average occupancy proportionally depends upon whether rents under new leases signed are higher or lower than the rents under the previous leases. The average rental rate per square foot on second generation and renewal leases signed in our Wholly Owned Properties compared to the rent under the previous leases (based on straight line rental rates) was 2.5% higher in 2006, 2.2% lower in 2005 and 1.5% lower in 2004. The annualized rental revenues from second generation leases signed during any particular year is generally less than 15% of our total annual rental revenues.

Our expenses primarily consist of rental property expenses, depreciation and amortization, general and administrative expenses and interest expense. Rental property expenses are expenses associated with our ownership and operation of rental properties and include expenses that vary somewhat proportionately to occupancy levels, such as common area maintenance and utilities, and expenses that do not vary based on occupancy, such as property taxes and insurance. Depreciation and amortization is a non-cash expense associated with the ownership of real property and generally remains relatively consistent each year, unless we buy or sell assets, since we depreciate our properties and related building and tenant improvement assets on a straight-line basis over a fixed life. General and administrative expenses, net of amounts capitalized, consist primarily of management and employee salaries and other personnel costs, corporate overhead and long-term incentive compensation. Interest expense depends upon the amount of our borrowings, the weighted average interest rates on our debt and the amount of interest capitalized on development projects.

Liquidity and Capital Resources

We incur capital expenditures to lease space to our customers and to maintain the quality of our properties to successfully compete against other properties. Tenant improvements are the costs required to customize the space for the specific needs of the customer. Lease commissions are costs incurred to find the customer for the space. Lease incentives are costs paid to or on behalf of tenants to induce them to enter into leases and that do not relate to customizing the space for the tenant s specific needs. Building improvements are recurring capital costs not related to a customer to maintain the buildings. As leases expire, we either attempt to relet the space to an existing customer or attract a new customer to occupy the space. Generally, customer renewals require lower leasing capital expenditures than reletting to new customers. However, market conditions such as supply of available space on the market, as well as demand for space, drive not only customer rental rates but also tenant improvement costs. Leasing capital expenditures are amortized over the term of the lease and building improvements are depreciated over the appropriate useful life of the assets acquired. Both are included in depreciation and amortization in results of operations.

Because we are a REIT, we are required under the federal tax laws to distribute at least 90.0% of our REIT taxable income, excluding capital gains, to our stockholders. We generally use rents received from customers and proceeds from sales of non-core development land to fund our operating expenses, recurring capital expenditures and stockholder dividends. To fund property acquisitions, development activity or building renovations, we may sell other assets and may incur debt from time to time. As of December 31, 2006, we had $741.6 million of secured debt outstanding and $723.5 million of unsecured debt outstanding. Our debt generally consists of mortgage debt, unsecured debt securities and borrowings under our credit facilities.

As of December 31, 2006 and March 31, 2007, we had approximately $113.0 million and $396.3 million, respectively, of additional combined borrowing availability under our existing unsecured credit facility and under our secured revolving construction credit facility.

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

To generate additional capital to fund our growth and other strategic initiatives and to lessen the ownership risks typically associated with owning 100.0% of a property, we may sell some of our properties or contribute them to joint ventures. When we create a joint venture with a strategic partner, we usually contribute one or more properties that we own and/or vacant land to a newly formed entity in which we retain an interest of 50.0% or less. In exchange for our equal or minority interest in the joint venture, we generally receive cash from the partner and retain some or all of the management income relating to the properties in the joint venture. The joint venture itself will frequently borrow money on its own behalf to finance the acquisition of, and/or leverage the return upon, the properties being acquired by the joint venture or to build or acquire additional buildings. Such borrowings are typically on a non-recourse or limited recourse basis. We generally are not liable for the debts of our joint ventures, except to the extent of our equity investment, unless we have directly guaranteed any of that debt. In most cases, we and/or our strategic partners are required to guarantee customary exceptions to non-recourse liability in non-recourse loans. See Note 15 to the Consolidated Financial Statements for additional information on certain debt guarantees. We have historically also sold additional Common Stock or Preferred Stock or issued Common Units to fund additional growth or to reduce our debt, but we have limited those efforts since 1998 because funds generated from our capital recycling program in recent years have provided sufficient funds to satisfy our liquidity needs. In addition, we have recently used funds from our capital recycling program to redeem Common Units and Preferred Stock for cash.

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RESULTS OF OPERATIONS

Comparison of 2006 to 2005

The following table sets forth information regarding our results of operations for the years ended December 31, 2006 and 2005 ($ in millions). As noted above and as more fully described in Note 1 to the Consolidated Financial Statements, as required by SFAS No. 144, results for the year ended December 31, 2005 were reclassified from previously reported amounts to reflect in discontinued operations the operations for those properties sold or held for sale in 2006 which qualified for discontinued operations presentation.

	Years Ended December 31,		2006 to 2005	
	2006	2005	$ Change	% Change
Rental and other revenues	$ 416.8	$ 396.1	$ 20.7	5.2%
Operating expenses:				
Rental property and other expenses	153.5	141.6	11.9	8.4
Depreciation and amortization	115.0	109.6	5.4	4.9
Impairment of assets held for use	2.6	7.6	(5.0)	(65.8)
General and administrative	37.3	33.0	4.3	13.0
Total operating expenses	308.4	291.8	16.6	5.7
Interest expense:				
Contractual	94.2	98.7	(4.5)	(4.6)
Amortization of deferred financing costs	2.4	3.4	(1.0)	(29.4)
Financing obligations	4.2	5.0	(0.8)	(16.0)
	100.8	107.1	(6.3)	(5.9)
Other income/(expense):				
Interest and other income	7.0	7.1	(0.1)	(1.4)
Settlement of bankruptcy claim	1.6		1.6	100.0
Loss on debt extinguishments	(0.5)	(0.5)		
	8.1	6.6	1.5	22.7
Income/(loss) before disposition of property, minority interest and equity in earnings of unconsolidated affiliates	15.7	3.8	11.9	313.2
Gains on disposition of property, net	16.2	14.1	2.1	14.9
Minority interest	(2.2)	0.5	(2.7)	(540.0)
Equity in earnings of unconsolidated affiliates	6.8	9.3	(2.5)	(26.9)
Income from continuing operations	36.5	27.7	8.8	31.8
Discontinued operations:				
Income from discontinued operations, net of minority interest	3.4	11.5	(8.1)	(70.4)
Gains, net of impairments, on sales of discontinued operations, net of minority interest	13.9	23.2	(9.3)	(40.1)
	17.3	34.7	(17.4)	(50.2)
Net income	53.8	62.4	(8.6)	(13.8)
Dividends on preferred stock	(17.1)	(27.2)	10.1	37.1
Excess of preferred stock redemption cost over carrying value	(1.8)	(4.3)	2.5	58.1
Net income available for common stockholders	$ 34.9	$ 30.9	$ 4.0	12.9%

Rental and Other Revenues

The increase in rental and other revenues from continuing operations was primarily the result of higher average occupancy in 2006 as compared to 2005, the contribution from developed properties placed in service in the latter part of 2005 and in 2006 and the consolidation of the Markel joint venture effective January 1, 2006, as discussed in Note 1 to the Consolidated Financial Statements. These increases were partly offset by a decrease in lease termination fees from 2005 to 2006 and the recognition of Eastshore as a completed sale which occurred in the third quarter of 2005.

As of the date of this filing, we continue to see modest improvements in employment trends in most of our markets and an improving economic climate in the Southeast. There has been modest but steady positive absorption of office space in most of our markets during the past year. Also, we expect to deliver approximately 1.1 million

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square feet of new office and industrial development properties by the end of 2007, which are 38% pre-leased (weighted based on investment) as of December 31, 2006. We have sold and expect to sell additional non-core properties in 2007 that will probably be classified as discontinued operations.

Rental Property and Other Expenses

The increase in rental and other operating expenses primarily was a result of general inflationary increases in certain operating expenses, such as salaries, benefits, utility costs and real estate taxes, expenses of developed properties placed in service in the latter part of 2005 and 2006 and the consolidation of the Markel joint venture effective January 1, 2006, as discussed in Note 1 to the Consolidated Financial Statements. These increases were partly offset by a decrease in operating expenses as a result of the recognition of Eastshore as a completed sale which occurred in the third quarter of 2005.

Operating margin, defined as rental and other revenue less rental property and other expenses expressed as a percentage of rental and other revenues, decreased from 64.3% in 2005 to 63.2% in 2006. This decrease in margin was primarily caused by operating expenses increasing from inflationary pressures at a higher rate than our rental revenues and operating cost recoveries.

We expect rental and other operating expenses to increase in 2007 as compared to 2006 from anticipated inflationary increases in certain fixed operating expenses, particularly higher utility costs, and by operating expenses of the development properties placed in service during 2006 and 2007.

The increase in depreciation and amortization is primarily a result of the contribution from developed properties placed in service in the latter part of 2005 and in 2006 and the consolidation of the Markel joint venture effective January 1, 2006, as discussed in Note 1 to the Consolidated Financial Statements. These increases were partly offset by a decrease related to the recognition of Eastshore as a completed sale which occurred in the third quarter of 2005.

For 2006, one office property had indicators of impairment where the carrying value exceeded the sum of the estimated undiscounted future cash flows. Therefore, an impairment of assets held for use of $2.6 million was recorded in the year ended December 31, 2006. For 2005, one land parcel and one office property had indicators of impairment where the carrying value exceeded the sum of estimated undiscounted future cash flows. Therefore, impairments of assets held for use aggregating $7.6 million were recorded in the year ended December 31, 2005.

The increase in general and administrative expenses was primarily related to higher annual and long-term incentive compensation costs and from deferred compensation, a portion of which is recognized based on increases in the total return on our Common Stock, which was 50.6% in 2006, higher salary and fringe benefit costs from annual employee wage and salary increases, inflationary effects on other general and administrative expenses and costs related to the retirement of a certain officer at June 30, 2006.

In 2007, general and administrative expenses are expected to decrease slightly as the total return-based equity incentive compensation and deferred compensation costs are expected to be lower than in 2006, partly offset by anticipated inflationary increases in non-equity compensation, benefits and other costs.

Interest Expense

The decrease in contractual interest was primarily due to a decrease in average borrowings from $1,511 million in the year ended December 31, 2005 to $1,441 million in the year ended December 31, 2006, partially offset by an increase in weighted average interest rates on outstanding debt from 6.80% in the year ended December 31, 2005 to 6.92% in the year ended December 31, 2006. In addition, capitalized interest in 2006 was approximately $2.1 million higher compared to 2005 due to increased development activity and higher average construction and development costs. Interest allocated to discontinued operations was $1.2 million in 2005 compared to $0.6 million in 2006.

The decrease in amortization of deferred financing costs was primarily related to obtaining the new revolving credit facility in May 2006, as discussed further in the Note 5 to the Consolidated Financial Statements, resulting in a reduction of amortization of deferred financing costs of approximately $1.0 million from 2005 to 2006.

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The decrease in interest from financing obligations was primarily a result of the completed sale of three buildings in Richmond, Virginia (the Eastshore transaction) in the third quarter of 2005 and the elimination of the related financing obligation. Partly offsetting this decrease was an increase in 2006 related to SF-HIW Harborview Plaza LP primarily from amortization of the option discount, as described in Note 3 to the Consolidated Financial Statements.

Total interest expense is expected to decline in 2007 primarily from lower average interest rates as a result of completed and planned debt refinancings in late 2006 and early 2007 at rates that are lower than the prior debt and higher capitalized interest from increased development project costs in 2007 compared to 2006. Average debt balances are not expected to vary materially from 2006 in 2007 since we generally expect to fund costs associated with our development activity in 2007 with proceeds from property dispositions.

Settlement of Bankruptcy Claim

In 2006, we received a settlement of a bankruptcy claim in the amount of $1.6 million related to leases with a former tenant that were terminated in 2003. See Note 18 to the Consolidated Financial Statements for further discussion.

Loss on Debt Extinguishments

In 2006, we had $0.5 million from losses on early extinguishments of debt, including our old revolving credit facility and bank term loan, which were paid off in the second quarter of 2006 upon the closing of our new revolving credit facility. The $0.5 million of loss in 2005 relates to loans that were paid off early in 2005 from proceeds raised from disposition activities.

Gains on Disposition of Property; Minority Interest; Equity in Earnings of Unconsolidated Affiliates

Net gains on dispositions of properties not classified as discontinued operations were $16.2 million in the year ended December 31, 2006 compared to $14.1 million for the year ended December 31, 2005; the components of net gains are described in Note 4 to the Consolidated Financial Statements. Gains are dependent on the specific assets sold, their historical cost basis and other factors, and can vary significantly from period to period.

Minority interest changed from $0.5 million of income in the year ended December 31, 2005 to $2.2 million of expense in the year ended December 31, 2006. In 2005, the Operating Partnership had a loss from continuing operations after Preferred Unit distributions which caused minority interest income. In 2006, the Operating Partnership had income from continuing operations after Preferred Unit distributions, resulting in minority interest expense related to the Operating Partnership. In addition, minority interest in 2006 includes $0.6 million from the consolidation of the Markel joint venture, the accounting for which changed from equity method to consolidation effective January 1, 2006, as described in Note 1 to the Consolidated Financial Statements.

The decrease in equity in earnings of unconsolidated affiliates primarily resulted from the consolidation of the Markel joint venture in 2006, and from $0.7 million of our share of a loss on early debt extinguishment from refinancing of loans in the Des Moines joint ventures in the third quarter of 2006. The Markel joint venture contributed $0.8 million to equity in earnings of unconsolidated affiliates during the year ended December 31, 2005. In addition, capitalization of interest ceased and full depreciation commenced beginning December 2005 for the office property in the Plaza Colonnade, LLC joint venture which caused an approximate $0.6 million reduction in equity in earnings of unconsolidated affiliates in 2006 compared to 2005.

Discontinued Operations

In accordance with SFAS No. 144, we classified net income of $17.3 million and $34.7 million as discontinued operations for the year ended December 31, 2006 and 2005, respectively. These amounts relate to 7.6 million square feet of office and industrial properties and 202 residential units sold during 2005 and 2006 and 0.3 million square feet of property held for sale at December 31, 2006. These amounts include net gains on the sale of these properties of $13.9 million and $23.2 million in the year ended December 31, 2006 and 2005, respectively.

Preferred Stock Dividends and Excess of Preferred Stock Redemption Costs in Excess of Carrying Value

The decreases in Preferred Stock dividends and excess of Preferred Stock redemption costs over carrying value were due to the redemptions of $130.0 million of Preferred Stock in the third quarter of 2005 and $50.0 million of Preferred Stock in the first quarter of 2006.

Net Income and Net Income Allocable to Common Stockholders

We recorded net income of $53.8 million in 2006 compared to $62.4 million in 2005, and net income allocable to common stockholders of $34.9 million in 2006 compared to $30.9 million in 2005; these changes resulted from the various factors described above.

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Comparison of 2005 to 2004

The following table sets forth information regarding our results of operations for the years ended December 31, 2005 and 2004 ($ in millions). As noted above and as more fully described in Note 1 to the Consolidated Financial Statements, as required by SFAS No. 144, results for the years ended December 31, 2005 and 2004 were reclassified from previously reported amounts to reflect in discontinued operations the operations for those properties sold or held for sale in 2006 which qualified for discontinued operations presentation.

	Years Ended December 31,		2005 to 2004	
	2005	2004	$ Change	% Change
Rental and other revenues	$ 396.1	$ 389.6	$ 6.5	1.7%
Operating expenses:				
Rental property and other expenses	141.6	137.9	3.7	2.7
Depreciation and amortization	109.6	108.8	0.8	0.7
Impairment of assets held for use	7.6		7.6	100.0
General and administrative	33.0	41.5	(8.5)	(20.5)
Total operating expenses	291.8	288.2	3.6	1.2
Interest expense:				
Contractual	98.7	104.8	(6.1)	(5.8)
Amortization of deferred financing costs	3.4	3.7	(0.3)	(8.1)
Financing obligations	5.0	10.0	(5.0)	(50.0)
	107.1	118.5	(11.4)	(9.6)
Other income/(expense):				
Interest and other income	7.1	6.1	1.0	16.4
Settlement of bankruptcy claim		14.4	(14.4)	(100.0)
Loss on debt extinguishments	(0.5)	(12.4)	11.9	96.0
	6.6	8.1	(1.5)	(18.5)
Income/(loss) before disposition of property, minority interest and equity in earnings of unconsolidated affiliates	3.8	(9.0)	12.8	142.2
Gains on disposition of property, net	14.1	21.6	(7.5)	(34.7)
Minority interest	0.5	1.0	(0.5)	(50.0)
Equity in earnings of unconsolidated affiliates	9.3	7.4	1.9	25.7
Income from continuing operations	27.7	21.0	6.7	31.9
Discontinued operations:				
Income from discontinued operations, net of minority interest	11.5	17.7	(6.2)	(35.0)
Gains, net of impairments, on sales of discontinued operations, net of minority interest	23.2	2.8	20.4	728.6
	34.7	20.5	14.2	69.3
Net income	62.4	41.5	20.9	50.4
Dividends on preferred stock	(27.2)	(30.8)	3.6	11.7
Excess of preferred stock redemption cost over carrying value	(4.3)		(4.3)	(100.0)
Net income available for common stockholders	$ 30.9	$ 10.7	$ 20.2	188.8%

Rental and Other Revenues

The $6.5 million increase in rental and other revenues from continuing operations was primarily the result of higher average occupancy in 2005 compared to 2004, revenues contributed from new development properties placed in service during the second half of 2005, and higher termination fee income in 2005. These positive increases were partially offset by a reduction in revenues from sold properties that were not classified as discontinued operations.

Operating Expenses

Rental and other operating expenses from continuing operations (real estate taxes, utilities, insurance, repairs and maintenance and other property-related expenses) increased $3.7 million in 2005 compared to 2004, primarily as a result of higher average occupancy in 2005 and general inflationary increases in certain operating expenses, such as salaries, benefits, utility costs and real estate taxes. These increases were partially offset by a reduction in operating expenses from sold properties that were not classified as discontinued operations.

Operating margin, defined as rental and other revenue less rental property and other expenses expressed as a percentage of rental and other revenues, decreased from 64.7% in 2004 to 64.3% in 2005. This decrease in margin was primarily caused by operating expenses increasing from inflationary pressures at a higher rate than our rental revenues and operating cost recoveries.

Depreciation and amortization from continuing operations increased slightly in 2005. This slight increase primarily resulted from a relatively higher proportion in 2005 of leasing assets (tenant improvements and deferred leasing costs) which have shorter lives compared to buildings which are depreciated over 40 years. This was partially offset by a reduction in depreciation and amortization from sold properties that were not classified as discontinued operations.

Impairments on assets held for use were $7.6 million in 2005 compared to none in 2004. In 2005 one land parcel and one office property, which are classified as held for use, had indicators of impairment where the carrying value exceeded the sum of projected undiscounted future cash flows. Accordingly, we recognized impairment losses of $7.6 million during the year ended December 31, 2005.

The $8.5 million decrease in general and administrative expenses in 2005 as compared to 2004 primarily relates to (1) $4.6 million recognized in 2004 in connection with a retirement package for our former chief executive officer (see Note 18 to the Consolidated Financial Statements) and (2) a $5.4 million decrease in 2005 compared to 2004 primarily relating to costs of personnel, consultants and our independent auditors in connection with (a) the initial implementation of Section 404 of the Sarbanes-Oxley Act in 2004, (b) evaluation of a strategic transaction in 2004, and (c) the preparation and audit of the restated Consolidated Financial Statements included in our 2004 Annual Report on Form 10-K. These decreases were partially offset by $1.6 million net increase primarily related to higher long-term incentive compensation costs, salary and fringe benefit costs and other costs.

Interest Expense

The $6.1 million decrease in contractual interest was primarily due to a decrease in average borrowings from $1,657 million in 2004 to $1,508 million in 2005, partially offset by an increase in weighted average interest rates on outstanding debt from 6.46% in 2004 to 6.76% in 2005. The decrease in average debt balances outstanding in 2005 was primarily due to the debt reductions made during 2005 as described in Note 5 to the Consolidated Financial Statements. In addition, capitalized interest in 2005 was approximately $1.9 million higher compared to 2004 due to increased development activity and higher average construction and development costs.

The $5.0 million decrease in interest expense on financing obligations was primarily a result of the purchase of our partner s interest in the Orlando City Group properties in MG-HIW, LLC on March 2, 2004 which eliminated the requirement to record financing obligation interest expense with respect to the Orlando City Group properties after that date (see Note 3 to the Consolidated Financial Statements).

Other Income/Expense

In 2004, we received net proceeds of $14.4 million as a result of the settlement of the bankruptcy of WorldCom (See Note 18 to our Consolidated Financial Statements for further discussion on this settlement).

Loss on debt extinguishments decreased $11.9 million from $12.4 million in 2004 to $0.5 million in 2005. In 2004, a $12.3 million loss was recorded related to the retirement of the Exercisable Put Option Notes described in Note 5 to the Consolidated Financial Statements. The $0.5 million of loss in 2005 relates to certain of our loans that were paid off early in 2005 from proceeds raised from disposition activities.

Gains on Disposition of Property; Minority Interest; Equity in Earnings of Unconsolidated Affiliates

Net gains on dispositions of properties not classified as discontinued operations were $14.1 million in 2005 compared to $21.6 million in 2004; the components of net gains are described in Note 4 to the Consolidated Financial Statements. Gains and impairments are dependent on the specific assets sold, their historical cost basis and other factors, and can vary significantly from period to period.

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Minority interest decreased from $1.0 million of income in the year ended December 31, 2004 to $0.5 million of income in the year ended December 31, 2005 due to a corresponding decrease in the Operating Partnership s loss from continuing operations after Preferred Unit distributions.

The $1.9 million increase in equity in earnings from continuing operations of unconsolidated affiliates was primarily a result of an increase related to the formation of the HIW-KC Orlando, LLC joint venture in late June 2004, which contributed approximately $1.4 million of additional equity in earnings from continuing operations of unconsolidated affiliates in 2005. In addition, the Plaza Colonnade, LLC joint venture, which was placed in service in the fourth quarter of 2004, contributed approximately $0.3 million more to equity in earnings in 2005 compared to 2004.

Discontinued Operations

In accordance with SFAS No. 144, we classified net income of $34.7 million and $20.5 million, net of minority interest, as discontinued operations for the years ended December 31, 2005 and 2004, respectively. These assets classified as discontinued operations comprise 8.9 million square feet of office and industrial properties and 290 residential units sold during 2006, 2005 and 2004 and 0.3 million square feet of property held for sale at December 31, 2006. These amounts include gains, net of impairments, of discontinued operations of $23.2 million and $2.8 million, net of minority interest, in the years ended December 31, 2005 and 2004, respectively; the components of net gains are set out in Note 4 to the Consolidated Financial Statements.

Preferred Stock Dividends and Excess of Preferred Stock Redemption Costs in Excess of Carrying Value

We recorded $27.2 million and $30.8 million in Preferred Stock dividends in 2005 and 2004, respectively. The reduction was due to the redemption of $130.0 million of Preferred Stock in the third quarter of 2005. In connection with the redemption of Preferred Stock, the $4.3 million excess of the redemption cost over the net carrying amount of the redeemed shares was recorded as a reduction to net income available for common shareholders in 2005 in accordance with EITF Topic D-42.

Net Income and Net Income Allocable to Common Stockholders

We recorded net income of $62.4 million in 2005 compared to $41.5 million in 2004, and net income allocable to common stockholders of $30.9 million in 2005 compared to $10.7 million in 2004; these changes resulted from the various factors described above.

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LIQUIDITY AND CAPITAL RESOURCES

Statement of Cash Flows

As required by GAAP, we report and analyze our cash flows based on operating activities, investing activities and financing activities. The following table sets forth the changes in our cash flows from 2005 to 2006 ($ in thousands):

	Years Ended December 31, 2006	2005	Change
Cash Provided by Operating Activities	$ 145,525	$ 154,133	$ (8,608)
Cash Provided by Investing Activities	64,734	200,925	(136,191)
Cash Used in Financing Activities	(194,781)	(378,328)	183,547
Total Cash Flows	$ 15,478	$ (23,270)	$ 38,748

In calculating cash flow from operating activities, depreciation and amortization, which are non-cash expenses, are added back to net income. As a result, we have historically generated a significant positive amount of cash from operating activities. From period to period, cash flow from operations depends primarily upon changes in our net income, as discussed more fully above under Results of Operations, changes in receivables and payables, and net additions or decreases in our overall portfolio, which affect the amount of depreciation and amortization expense.

Cash provided by or used in investing activities generally relates to capitalized costs incurred for leasing and major building improvements and our acquisition, development, disposition and joint venture activity. During periods of significant net acquisition and/or development activity, our cash used in such investing activities will generally exceed cash provided by investing activities, which typically consists of cash received upon the sale of properties and distributions of capital from our joint ventures.

Cash used in financing activities generally relates to stockholder dividends, distributions on Common Units, incurrence and repayment of debt and sales, repurchases or redemptions of Common Stock, Common Units and Preferred Stock. As discussed previously, we use a significant amount of our cash to fund stockholder dividends and Common Unit distributions. Whether or not we have increases in the outstanding balances of debt during a period depends generally upon the net effect of our acquisition, disposition, development and joint venture activity. We use our revolving credit facility for working capital purposes, which means that during any given period, in order to minimize interest expense, we will likely record significant repayments and borrowings under our revolving credit facility.

The decrease of $8.6 million in cash provided by operating activities in the year ended December 31, 2006 compared to the same period in 2005 was primarily the result of lower cash flows from net income adjusted for changes in depreciation and gains and impairments, partially offset by a $1.8 million increase from net changes in operating assets and liabilities.

The decrease of $136.2 million in cash provided by investing activities in the year ended December 31, 2006 compared to the same period in 2005 was primarily a result of a $110.7 million decrease in proceeds from dispositions of real estate assets and a $54.3 million increase in additions to real estate assets and deferred leasing costs. Partly offsetting these decreases was an increase of $24.2 million in other investing activities that resulted from a collateral substitution on a secured note pursuant to which the lender refunded $11.8 million in restricted cash in 2006, which had been paid in 2005, and an increase of $7.1 million in distributions of capital from unconsolidated affiliates as a result of a refinancing of debt in 2006, as described in Note 2 to the Consolidated Financial Statements.

The decrease of $183.5 million in cash used in financing activities in the year ended December 31, 2006 was primarily a result of a decrease of $80.0 million in redemptions of Preferred Stock from 2005 to 2006, a $70.7 million reduction in net paydowns on our revolving credit facility and mortgages and notes payable, a decrease of $10.2 million in Preferred Stock dividends resulting from our Preferred Stock redemptions, and an increase of $41.2 million in net proceeds from the sale of Common Stock due to the exercise of stock options during 2006, as described in Note 6 to the Consolidated Financial Statements.

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During 2007, we expect to have positive cash flows from operating activities. The net cash flows from investing activities in 2007 are expected to be negative as cash inflows from property dispositions and joint ventures are expected to be less than cash used for development, capitalized leasing and tenant improvement costs. Net cash flows from operating and investing activities combined in 2007 are expected to be positive and, together with positive financing cash flows from new debt borrowings or other sources, will be used to pay stockholder and unitholder distributions, scheduled debt maturities, principal amortization payments and any other reductions of debt and Preferred Stock balances (see Note 9 to the Consolidated Financial Statements).

Capitalization

The following table sets forth our capitalization as of December 31, 2006 and December 31, 2005 (in thousands, except per share amounts):

	December 31, 2006	December 31, 2005
Mortgages and notes payable, at recorded book value	$ 1,465,129	$ 1,471,616
Financing obligations	$ 35,530	$ 34,154
Preferred Stock, at liquidation value	$ 197,445	$ 247,445
Common Stock and Common Units outstanding	60,944	59,479
Per share stock price at period end	$ 40.76	$ 28.45
Market value of Common Stock and Common Units	$ 2,484,077	$ 1,692,178
Total market capitalization with debt	$ 4,182,181	$ 3,445,393

Based on our total market capitalization of approximately $4.2 billion at December 31, 2006 (at the December 31, 2006 per share stock price of $40.76 and assuming the redemption for shares of Common Stock of the approximate 4.7 million Common Units not owned by the Company), our mortgages and notes payable represented 35.0% of our total market capitalization. Mortgages and notes payable at December 31, 2006 was comprised of $741.6 million of secured indebtedness with a weighted average interest rate of 6.78% and $723.5 million of unsecured indebtedness with a weighted average interest rate of 6.79%. As of December 31, 2006, our outstanding mortgages and notes payable and financing obligations were secured by real estate assets with an aggregate undepreciated book value of approximately $1.2 billion.

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

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Contractual Obligations

The following table sets forth a summary regarding our known contractual obligations, including required interest payments for those items that are interest bearing, at December 31, 2006 ($ in thousands):

		Amounts due during years ending December 31,					
	Total	2007	2008	2009	2010	2011	Thereafter
Mortgages and Notes Payable (1)							
Principal payments	$ 1,465,129	$ 86,709	$ 110,341	$ 564,656	$ 9,057	$ 9,811	$ 684,555
Interest payments (2)	461,179	93,503	85,908	66,045	46,599	45,845	123,279
Financing Obligations:							
SF-HIW Harborview Plaza, LP financing obligation (3) (9)	20,005						20,005
Tax Increment Financing obligation (4) (9)	28,365	2,182	2,182	2,182	2,182	2,182	17,455
Capitalized ground lease obligation (9)	2,003	52	52	52	52	52	1,743
Capitalized lease obligations (5)	481	252	188	41			
Purchase Obligations:							
Completion contracts (10)	133,862	104,902	28,960				
Operating Lease Obligations:							
Land leases (6)	51,191	1,063	1,079	1,119	1,137	1,157	45,636
Other Long Term Liabilities Reflected on the Balance Sheet:							
Plaza Colonnade lease guarantee (6)	37			37			
Highwoods DLF 97/26 DLF 99/32 LP lease guarantee (6)	419		419				
RRHWoods and Dallas County Partners lease guarantee (6)	49						49
RRHWoods, LLC (6)	28			28			
Industrial environmental guarantee (6)	125						125
Eastshore lease guarantee (7)	4,084	4,084					
DLF payable (8)	3,551	526	536	546	556	567	820
KC Orlando, LLC lease guarantee (6)	420	97	97	97	97	32	
KC Orlando, LLC accrued lease commissions, tenant improvements and building improvements (6)	356						356
RRHWoods, LLC (6)	403				403		
Total	$ 2,171,687	$ 293,370	$ 229,762	$ 634,803	$ 60,083	$ 59,646	$ 894,023

(1) See Note 5 to the Consolidated Financial Statements for further discussion.

(2) These amounts represent interest payments due on mortgage and notes payable, based on the stated rates for the fixed rate debt and on the December 31, 2006 rates for the variable rate debt. The weighted average interest rate on the variable rate debt as of December 31, 2006 was 6.15%.

(3) This liability represents a financing obligation to our joint venture partner as a result of accounting for this transaction as a financing arrangement. See Note 3 to the Consolidated Financial Statements for further discussion.

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

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

(6) See Note 15 to the Consolidated Financial Statements for further discussion.

(7) This represents our maximum exposure to contingent loss under our Eastshore guarantee. See Notes 3 and 15 to the Consolidated Financial Statements for further discussion.

(8)

Represents a fixed obligation we owe our partner in Highwoods DLF 98/29, LP. This obligation arose from an excess contribution from our partner at the formation of the joint venture, and the net present value of the fixed obligation discounted at 9.62% which represents the interest rate derived from the agreement, is recorded in other liabilities. See Note 2 to the Consolidated Financial Statements for further discussion.

(9) Interest components of the contractual obligations are based on the stated fixed rates in the instruments. For floating rate debt, interest is computed using the current rate in effect at December 31, 2006.

(10) This amount represents our estimate of contractual obligations as of December 31, 2006 related to various construction projects.

Refinancings and Preferred Stock Redemptions in 2005 and 2006

During 2005, 2006 and through February 15, 2007, we paid off $490 million of outstanding loans, excluding any normal debt amortization, which included $260 million of secured debt with a weighted average interest rate of 7.27% and $230 million of unsecured floating rate debt with a weighted average interest rate of 6.13%. Approximately $531 million of real estate assets (based on undepreciated cost basis) became unencumbered after paying off the secured debt. We also used some of the proceeds from our disposition activity to redeem, in August 2005 and February 2006, all of our outstanding Series D Preferred Shares and 3.2 million of our outstanding Series B Preferred Shares, aggregating $180 million plus accrued dividends. These reductions in outstanding debt and Preferred Stock balances were made primarily from proceeds from property dispositions that closed in 2005, 2006 and early 2007, a $270 million increase in outstanding borrowings under our revolving and non-revolving credit facilities and by approximately $57 million of additional loan proceeds on an existing secured loan. In connection with the redemption of Preferred Stock, the excess of the redemption cost over the net carrying amount of the redeemed shares was recorded as a reduction to net income available for common shareholders. These reductions amounted to $4.3 million and $1.8 million for the third quarter 2005 and first quarter 2006, respectively.

Unsecured Indebtedness

On May 1, 2006, we obtained a new $350 million, three-year unsecured revolving credit facility from Bank of America, N.A. We used $273 million of proceeds from the new revolving credit facility, together with available cash, to pay off the remaining outstanding balance of $178 million under our previous revolving credit facility and a $100 million bank term loan. In connection with these payoffs, we wrote off approximately $0.5 million in unamortized deferred financing costs in the second quarter of 2006 as a loss on debt extinguishment.

On August 8, 2006, this revolving credit facility was amended and restated as part of a syndication with a group of 15 banks. The revolving credit facility was also upsized from $350 million to $450 million. Our revolving credit facility is initially scheduled to mature on May 1, 2009. Assuming no default exists, we have an option to extend the maturity date by one additional year and, at any time prior to May 1, 2008, may request increases in the borrowing availability under the credit facility by up to an additional $50 million. The interest rate is LIBOR plus 80 basis points and the annual base facility fee is 20 basis points. As of December 31, 2006 and March 31, 2007, we had $373.5 million and $65.0 million, respectively, borrowed on this revolving credit facility.

On March 22, 2007, the Operating Partnership sold $400,000,000 aggregate principal amount of 5.85% Notes due March 15, 2017. The notes were issued under the indenture, dated as of December 1, 1996, among the Operating Partnership, the Company, and U.S. Bank National Association (as successor in interest to Wachovia Bank, N.A.), the trustee, and pursuant to resolutions of the Company s Board of Directors and an officers certificate dated as of March 22, 2007 establishing the terms of the notes. We used the net proceeds from the sale of the notes to repay borrowings outstanding under an unsecured non-revolving credit facility that we obtained on January 31, 2007 (which was subsequently terminated) and our $450 million unsecured revolving credit facility. In connection with the completion of the offering, we entered into a registration rights agreement dated as of March 22, 2007 with the initial purchasers of the notes. The registration rights agreement requires the Operating Partnership to file, within 90 days after the closing date of the sale of the notes, a registration statement with respect to an offer to exchange the notes for other freely tradable notes that are registered under the Securities Act of 1933 and to cause such exchange offer registration statement to become effective within 180 days after the closing date. The Operating Partnership is required to complete the exchange offer within 210 days after the closing date. If we fail to comply with the provisions of the registration rights agreement, the interest rate will be increased by 0.25% per annum during the 90-day period immediately following the default and will increase by 0.25% per annum at the end of each subsequent 90-day period, but in no event shall such increase exceed 0.50% per annum.

Our credit facilities and the indenture that governs our outstanding notes require us to comply with customary operating covenants and various financial and operating ratios. We are currently in compliance with all such requirements. Although we expect to remain in compliance with these covenants and ratios for at least the next year, depending upon our future operating performance, property and financing transactions and general economic conditions, we cannot assure you that we will continue to be in compliance.

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

In May, July, August and September 2005 and February 2006, we obtained waivers from the lenders under our previous revolving credit facility and our previous bank term loans related to timely reporting to the lenders of annual and quarterly financial statements and to covenant violations that could arise from future redemptions of Preferred Stock due to the reclassification of Preferred Stock from equity to a liability during the period of time from the announcement of the redemption until the redemption is completed. The aforementioned modifications did not change the economic terms of the loans. In connection with these modifications, we incurred certain loan costs that are capitalized and amortized over the remaining terms of the loans. In November 2005, we amended the $100.0 million bank term loan to extend the maturity date to July 17, 2006 and reduce the spread over the LIBOR interest rate from 130 basis points to 100 basis points. These loans were paid off in May 2006 in connection with the closing of our new revolving credit facility, as described above.

Current and Future Cash Needs

Rental and other revenues are our principal source of funds to meet our short-term liquidity requirements, which primarily consist of operating expenses, debt service, stockholder dividends, any guarantee obligations and recurring capital expenditures. In addition, we could incur tenant improvement costs and lease commissions related to any releasing of vacant space.

As of March 31, 2007, other than principal amortization on certain secured loans, we have no outstanding debt that matures prior to the end of 2007. We expect to fund our short-term liquidity needs through a combination of available working capital, cash flows from operations and the following:

- the selective disposition of non-core land and other assets;
- borrowings under our unsecured credit facility and under our existing $50.0 million secured revolving construction loan;
- the sale or contribution of some of our Wholly Owned Properties, development projects and development land to strategic joint ventures to be formed with unrelated investors, which would have the net effect of generating additional capital through such sale or contributions;
- the issuance of secured debt; and
- the issuance of unsecured debt.

Our long-term liquidity needs generally include the funding of capital expenditures to lease space to our customers, maintain the quality of our existing properties and build new properties. Capital expenditures include tenant improvements, building improvements, new building completion costs and land infrastructure costs. Tenant improvements are the costs required to customize space for the specific needs of first-generation and second-generation customers. Building improvements are recurring capital costs not related to a specific customer to maintain existing buildings. New building completion costs are expenses for the construction of new buildings. Land infrastructure costs are expenses to prepare development land for future development activity that is not specifically related to a single building. Excluding recurring capital expenditures for leasing costs and tenant improvements and for normal building improvements, our expected future capital expenditures for started and/or committed new development projects were approximately $260 million at December 31, 2006 and were approximately $250 million at February 15, 2007. A significant portion of these future expenditures are currently subject to binding contractual arrangements.

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Our long-term liquidity needs also include the funding of development commitments, selective asset acquisitions and the retirement of mortgage debt, amounts outstanding under our credit facilities and long-term unsecured debt. Our goal is to maintain a conservative and flexible balance sheet. Accordingly, we expect to meet our long-term liquidity needs through a combination of (1) the issuance by the Operating Partnership of additional unsecured debt securities, (2) the issuance of additional equity securities by the Company and the Operating Partnership, (3) borrowings under other secured construction loans that we may enter into, as well as (4) the sources described above with respect to our short-term liquidity. We expect to use such sources to meet our long-term liquidity requirements either through direct payments or repayments of borrowings under our revolving credit facility. As mentioned above, we do not intend to reserve funds to retire existing secured or unsecured indebtedness upon maturity. Instead, we will seek to refinance such debt at maturity or retire such debt through the issuance of equity or debt securities or from proceeds from sales of properties.

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

Stockholder Dividends

To maintain our qualification as a REIT, we must distribute to stockholders at least 90.0% of our REIT taxable income, excluding capital gains. REIT taxable income, the calculation of which is determined by the federal tax laws, does not equal net income under GAAP. The minimum dividend per share of Common Stock required for the Company to maintain its REIT status (excluding any net capital gains) was $0.24 per share in 2005. Aggregate dividends paid on Preferred Stock exceeded REIT taxable income (excluding capital gains) in 2006, which resulted in no required dividend on Common Stock in 2006 for REIT qualification purposes. We generally expect to use our cash flow from operating activities for dividends to stockholders and for payment of recurring capital expenditures. Future dividends will be made at the discretion of our Board of Directors. The following factors will affect our cash flows and, accordingly, influence decisions of the Board of Directors regarding dividends:

- debt service requirements after taking into account debt covenants and the repayment and restructuring of certain indebtedness;
- scheduled increases in base rents of existing leases;
- changes in rents attributable to the renewal of existing leases or replacement leases;
- changes in occupancy rates at existing properties and execution of leases for newly acquired or developed properties;
- operating expenses and capital replacement needs, including tenant improvements and leasing costs; and
- sales of properties and non-core land.

Off Balance Sheet Arrangements

We have several off balance sheet joint venture and guarantee arrangements. The joint ventures were formed with unrelated investors to generate additional capital to fund property acquisitions, repay outstanding debt, fund other strategic initiatives and lessen the risks typically associated with owning 100.0% of a property. When we create a joint venture with a strategic partner, we usually contribute one or more properties that we own to a newly formed entity in which we retain an equal or minority interest. In exchange for an equal or minority interest in the joint venture, we generally receive cash from the partner and frequently retain the management income relating to the properties in the joint venture. For financial reporting purposes, certain assets we sold have been accounted for as financing arrangements. See Notes 1, 2 and 3 to the Consolidated Financial Statements.

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As discussed in Note 1, we generally account for our investments in less than majority owned joint ventures, partnerships and limited liability companies under the equity method of accounting. As a result, the assets and liabilities of these joint ventures are not included on our balance sheet and the results of operations of these joint ventures are not included on our income statement, other than as equity in earnings of unconsolidated affiliates. Generally, we are not liable for the debts of our joint ventures, except to the extent of our equity investment, unless we have directly guaranteed any of that debt. In most cases, we and/or our strategic partners are required to guarantee customary limited exceptions to non-recourse liability in non-recourse loans.

As of December 31, 2006, our unconsolidated joint ventures had $776.8 million of total assets and $604.9 million of total liabilities as reflected in their financial statements. At December 31, 2006, our weighted average equity interest based on the total assets of these unconsolidated joint ventures was 40.5%. During 2006, these unconsolidated joint ventures earned $14.7 million of total net income, of which our share, after appropriate purchase accounting and other adjustments, was $6.8 million. For additional information about our unconsolidated joint venture activity, see Note 2 to the Consolidated Financial Statements.

As of December 31, 2006, our unconsolidated joint ventures had $575.5 million of outstanding mortgage debt. All of this joint venture debt is non-recourse to us except (1) in the case of customary exceptions pertaining to such matters as misuse of funds, environmental conditions and material misrepresentations and (2) those guarantees and loans described in the following paragraphs. The following table sets forth the scheduled maturities of our proportionate share of the outstanding debt of our unconsolidated joint ventures as of December 31, 2006 ($ in thousands):

2007	$ 3,817
2008	4,717
2009	8,342
2010	23,517
2011	6,117
Thereafter	198,465
	$ 244,975

In connection with our Des Moines joint ventures, we guaranteed certain debt. The maximum potential amount of future payments that we could be required to make under the guarantees is $8.6 million at December 31, 2006. This amount relates to housing revenue bonds that require credit enhancements in addition to the real estate mortgages. The bonds bear a floating interest rate, which at December 31, 2006 averaged 3.65%, and mature in 2015. If the joint ventures are unable to repay the outstanding balance under these housing revenue bonds, we will be required to repay our maximum exposure under these loans. Recourse provisions exist that enable us to recover some or all of such payments from the joint ventures assets. The joint venture currently generates sufficient cash flow to cover the debt service required by the loan. On July 31, 2006, $6.0 million in other loans related to four office buildings that had been previously guaranteed by us were refinanced with no guarantee. An additional guarantee of $5.4 million expired upon an industrial building becoming 95% leased prior to the end of 2006.

In connection with the RRHWoods, LLC joint venture, we guaranteed $3.1 million relating to a letter of credit and corresponding master lease, which expires in August 2010. The guarantee requires us to pay under a contingent master lease if the cash flows from the building securing the letter of credit do not cover at least 50% of the minimum debt service. The letter of credit along with the building secure the industrial revenue bonds used to finance the property. These bonds mature in 2015. Recourse provisions exist such that we could recover some or all of the payments made under the letter of credit guarantee from the joint venture s assets. At December 31, 2006, we recorded a $0.4 million deferred charge included in other assets and liabilities on our Consolidated Balance Sheet with respect to this guarantee. Our maximum potential exposure under this guarantee was $3.1 million at December 31, 2006.

The Plaza Colonnade, LLC joint venture has a $50 million non-recourse mortgage that bears a fixed interest rate of 5.7%, requires monthly principal and interest payments and matures on January 31, 2017. We and our joint venture partner have signed a contingent master lease limited to 30,772 square feet, which expires in December 2009. Our maximum exposure under this master lease was $1.3 million at December 31, 2006. However, the current occupancy level of the building is sufficient to cover all debt service requirements.

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 on June 30, 2008. The tenant also leases space in other buildings owned by us. In conjunction with an overall restructuring of the tenant s leases with us and with this joint venture, we agreed to certain changes to the lease with the joint venture in September 2003. The modifications included allowing the tenant to vacate the premises 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 at that time. In turn, we agreed to compensate the joint venture for any economic losses incurred as a result of these lease modifications. As of December 31, 2006, we have approximately $0.4 million in other liabilities and $0.4 million as a deferred charge in other assets recorded on our Consolidated Balance Sheet to account for the lease guarantee. However, should new tenants occupy the vacated space prior to the end of the guarantee period, in June 2008, our liability under the guarantee would diminish. Our maximum potential amount of future payments with regard to this guarantee as of December 31, 2006 was $0.7 million. No recourse provisions exist to enable us to recover any amounts paid to the joint venture under this lease guarantee arrangement. During 2006, we expensed $0.1 million related to the lease guarantee.

RRHWOODS, LLC and Dallas County Partners financed the construction of two buildings with a $7.4 million ten-year loan. As an inducement to make the loan at a 6.3% long-term rate, we and our partner agreed to master lease the vacant space and each guaranteed $0.8 million of the debt with limited recourse. As leasing improves, the guarantee obligations under the loan agreement diminish. As of December 31, 2006, no master lease payments were necessary. We currently have recorded $0.05 million in other liabilities and $0.05 million as a deferred charge included in other assets on our Consolidated Balance Sheet with respect to this guarantee. The maximum potential amount of future payments that we could be required to make based on the current leases in place was approximately $2.2 million as of December 31, 2006. The likelihood of us paying on our $0.8 million guarantee is remote since the joint venture currently satisfies the minimum debt coverage ratio and should we have to pay our portion of the guarantee, we would be entitled to recover the $0.8 million from other joint venture assets.

On June 28, 2004, Kapital-Consult, a European investment firm, bought a 60.0% interest in HIW-KC Orlando, LLC. We own the remaining 40.0% interest. HIW-KC Orlando, LLC owns five in-service office properties, encompassing 1.3 million rentable square feet, located in the central business district of Orlando, Florida, which were valued under the joint venture agreement at $212.0 million. The joint venture borrowed $143.0 million under a ten-year fixed rate mortgage loan from a third party lender at the time of its formation. In connection with this transaction, we agreed to guarantee rent to the joint venture for 3,248 rentable square feet commencing in August 2004 and expiring in April 2011. In connection with this guarantee, as of June 30, 2004, we included $0.6 million in other liabilities and reduced the total amount of gain to be recognized by the same amount. Additionally, we agreed to guarantee re-tenanting costs for approximately 11% of the joint venture s total square footage. We recorded a $4.1 million contingent liability with respect to such guarantee as of June 30, 2004 and reduced the total amount of gain to be recognized by the same amount. In the three year period ended December 31, 2006, we paid $3.7 million in re-tenanting costs related to this guarantee. The contribution was accounted for as a partial sale as defined by SFAS No. 66 and we recognized a $16.3 million gain in June 2004. Since we have an ongoing 40.0% financial interest in the joint venture and since we are engaged by the joint venture to provide management and leasing services for the joint venture, for which we receive customary management fees and leasing commissions, the operations of these properties were not reflected as discontinued operations consistent with SFAS No. 144 and the related gain on sale was included in continuing operations in the second quarter of 2004.

On September 27, 2004, we and an affiliate of Crosland, Inc. (Crosland) formed Weston Lakeside, LLC, in which we have a 50.0% ownership interest. On June 29, 2005, we contributed 22.4 acres of land at an agreed upon value of $3.9 million to this joint venture, and Crosland contributed approximately $2.0 million in cash. Immediately thereafter, the joint venture distributed approximately $1.9 million to us and we recorded a gain of $0.5 million. Crosland managed and operated this joint venture, which constructed approximately 332 rental residential units in three buildings, at a total estimated cost of approximately $33 million. Crosland received 3.25% of all project costs other than land as a development fee and 3.5% of the gross revenue of the joint venture in management fees. The joint venture financed the development with a $28.4 million construction loan guaranteed by Crosland. We provided certain development services for the project and received a fee equal to 1.0% of all project costs excluding land. We have accounted for this joint venture using the equity method of accounting. On February 22, 2007, the joint venture sold the 332 rental residential units to a third party for gross proceeds of $45.0 million. Mortgage debt in the amount of $27.1 million was paid off and various development related costs were paid. We received a net distribution of $6.1 million and may receive a further small and final distribution. A gain of approximately $5 million will be recognized by us in the first quarter of 2007 related to this sale. As of February 28, 2007, the joint venture is dormant pending the final distribution to the partners.

On December 22, 2004, we and Easlan Investment Group, Inc. (Easlan) formed The Vinings at University Center, LLC. We contributed 7.8 acres of land at an agreed upon value of $1.6 million to the joint venture in December 2004 in return for a 50.0% equity interest. Easlan contributed $1.1 million in the form of non-interest bearing promissory notes for a 50.0% equity interest in the joint venture. Upon formation, the joint venture entered into a $9.7 million secured construction loan to complete the construction of 156 rental residential units on the 7.8 acres of land. Easlan guaranteed this construction loan. The construction of the residential units was completed in the first quarter of 2006. Easlan was the manager and leasing agent for these residential units and received customary management fees and leasing commissions. We received development fees throughout the construction project. We consolidated this joint venture from inception under the provisions of FASB Interpretation No. 46 (revised December 2003) Consolidation of Variable Interest Entities (FIN 46(R)) because Easlan had no at-risk equity and we would absorb the majority of the joint venture s expected losses. On November 1, 2006, the joint venture sold the residential units to a third party for gross proceeds of $14.3 million, paid off the construction note payable and made cash distributions to the partners. We received a distribution of $2.9 million and recorded a gain of $1.4 million during the fourth quarter of 2006.

Financing Arrangements

The following summarizes significant sale transactions in 2000 and 2002 that were or continue to be accounted for as financing arrangements under paragraphs 25 through 29 of SFAS No. 66 during the years ended December 31, 2006, 2005 and 2004.

SF-HIW Harborview Plaza, LP

On September 11, 2002, we 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 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, we entered into a master lease agreement with Harborview LP for five years on the then vacant space in the building (approximately 20% of the building); occupancy was 99.6% at December 31, 2006. We also guaranteed to Harborview LP the payment of tenant improvements and lease commissions of $1.2 million. Our maximum exposure to loss under the master lease agreement was $2.1 million at September 11, 2002 and was $0.3 million at December 31, 2006. Additionally, our partner in Harborview LP was granted the right to put its 80.0% equity interest in Harborview LP to us in exchange for cash at any time during the one-year period commencing September 11, 2014. The value of the 80.0% equity interest will be determined at the time that such partner elects to exercise its put right, if ever, based upon the then fair market value of Harborview LP s assets and liabilities, less 3.0%, which amount was intended to cover the normal costs of a sale transaction.

Because of the put option and the master lease agreement, this transaction is accounted for as a financing transaction, as described in Note 1 to the Consolidated Financial Statements. Accordingly, the assets, liabilities and operations related to Harborview Plaza, the property owned by Harborview LP, including any new financing by the partnership, remain on our consolidated financial statements. As a result, we have established a financing obligation equal to the net equity contributed by the other partner. At the end of each reporting period, the balance of the financing obligation is adjusted to equal the greater of the original financing obligation or the current fair value of the put option discussed above. The value of the put option was $20.0 million at December 31, 2006. This amount is offset by a related discount account, which is being amortized prospectively through September 2014 as interest expense on financing obligation. The amount of the financing obligation, net of the discount amount, related to Harborview LP was $16.2 million at December 31, 2006. 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. We continue to depreciate the property and record all of the depreciation on our consolidated financial statements. Any payments made under the master lease agreement were expensed as incurred ($0.1 million was expensed during each of the years ended December 31, 2006, 2005 and 2004) 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 is otherwise terminated, we will record the transaction as a sale and recognize gain on sale.

Eastshore

On November 26, 2002, we sold three buildings located in Richmond, Virginia (the Eastshore transaction) for a total price of $28.5 million in cash, which was paid in full by the buyer at closing. Each of the sold properties was 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, we entered into a rental guarantee agreement for each building for the benefit of the buyer to guarantee any shortfalls that 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). Our maximum exposure to loss under the rental guarantee agreements was $18.7 million at the date of sale and was $4.1 million as of December 31, 2006. No payments were made during 2003 or 2002 in respect of these rent guarantees. However, in June 2004, we 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. We began making additional payments in June 2006 of approximately $0.1 million per month due to the tenant vacating space in one of the three buildings as of May 31, 2006. These payments will continue until the earlier of the end of the guarantee period or until replacement tenants are in place and paying amounts equal to or more than the current tenant.

These rent guarantees are a form of continuing involvement as discussed in paragraph 28 of SFAS No. 66. Because the guarantees cover the entire space occupied by a single tenant under a triple-net lease arrangement, our guarantees were considered a guaranteed return on the buyer s investment for an extended period of time. Therefore, the transaction had been accounted for as a financing transaction following the accounting method described in Note 1 to the Consolidated Financial Statements through July 2005. Accordingly, through July 2005, the assets, liabilities and operations were included in the Consolidated Financial Statements, and a financing obligation of $28.8 million was recorded, which represented the amount received from the buyer, adjusted for subsequent activity. The income from the operations of the properties, other than depreciation, was allocated 100.0% to the owner as interest expense on financing obligations. Payments made under the rent guarantees were charged to expense as incurred. This transaction was recorded as a completed sale transaction in July 2005 when the maximum exposure to loss under the guarantees became less than the related deferred gain; accordingly, $1.7 million in gain was recognized in the last six months of 2005, $3.6 million in gain was recognized in 2006 and additional gain will be recognized in 2007 as the maximum exposure under the guarantees is reduced. Payments made under rent guarantees after July 2005 are recorded as a reduction of the deferred gain.

Interest Rate Hedging Activities

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

The interest rate on all of our variable rate debt is adjusted at one and three month intervals, subject to settlements under these interest rate hedge contracts. We also enter into treasury lock agreements from time to time in order to limit our exposure to an increase in interest rates with respect to future debt offerings. We currently have no outstanding interest rate hedge contracts.

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Critical Accounting Estimates

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the reporting period. Actual results could differ from our estimates.

The policies and estimates used in the preparation of our Consolidated Financial Statements are described in Note 1 to our Consolidated Financial Statements for the year ended December 31, 2006. However, certain of our significant accounting policies contain an increased level of assumptions used or estimates made in determining their impact on our Consolidated Financial Statements. Management has reviewed our critical accounting policies and estimates with the audit committee of the Company s Board of Directors and the Company s independent auditors.

We consider our critical accounting estimates to be those used in the determination of the reported amounts and disclosure related to the following:

- Real estate and related assets;
- Sales of real estate;
- Allowance for doubtful accounts; and
- Property operating expense recoveries.

Real Estate and Related Assets

Real estate and related assets are recorded at cost and stated at cost less accumulated depreciation. Renovations, replacements and other expenditures that improve or extend the life of an asset are capitalized and depreciated over their estimated useful lives. Expenditures for ordinary maintenance and repairs are charged to operating expense as incurred. Depreciation is computed using the straight-line method over the estimated useful life of 40 years for buildings and depreciable land infrastructure costs, 15 years for building improvements and five to seven years for furniture, fixtures and equipment. Tenant improvements are amortized using the straight-line method over initial fixed terms of the respective leases, which generally are from three to 10 years.

Expenditures directly related to the development and construction of real estate assets are included in net real estate assets and are stated at cost in the Consolidated Balance Sheets. Our capitalization policy on development properties is in accordance with SFAS No. 67, Accounting for Costs and the Initial Rental Operations of Real Estate Properties, SFAS No. 34, Capitalization of Interest Costs, and SFAS No. 58, Capitalization of Interest Cost in Financial Statements That Include Investments Accounted for by the Equity Method. Development expenditures include pre-construction costs essential to the development of properties, development and construction costs, interest costs, real estate taxes, salaries and related costs and other costs incurred during the period of development. Interest and other carrying costs are capitalized until the building is ready for its intended use. We consider a construction project as substantially completed and held available for occupancy upon the completion of tenant improvements, but no later than one year from cessation of major construction activity. We cease capitalization on the portion substantially completed and occupied or held available for occupancy, and capitalize only those costs associated with the portion under construction.

Expenditures directly related to the leasing of properties are included in deferred leasing costs and are stated at cost in the Consolidated Balance Sheets. We capitalize initial direct costs related to our leasing efforts in accordance with SFAS No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases. All leasing commissions paid to third parties for new leases or lease renewals are capitalized. Internal leasing costs include primarily compensation, benefits and other costs such as legal fees related to leasing activities that are incurred in connection with successfully securing leases on the properties. Capitalized leasing costs are amortized on a straight-line basis over initial fixed terms of the respective leases, which generally

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are from three to 10 years. Estimated costs related to unsuccessful activities are expensed as incurred. If our assumptions regarding the successful efforts of leasing are incorrect, the resulting adjustments could impact earnings.

We record liabilities under FASB Interpretation No. 47 Accounting for Conditional Asset Retirement Obligations, an interpretation of SFAS No. 143, (FIN 47) for the performance of asset retirement activities when the obligation to perform such activities is unconditional, whether or not the timing or method of settlement of the obligation may be conditional on a future event.

Upon the acquisition of real estate, we assess the fair value of acquired tangible assets such as land, buildings and tenant improvements, intangible assets such as above and below market leases, acquired in-place leases and other identified intangible assets and assumed liabilities in accordance with SFAS No. 141, Business Combinations. We allocate the purchase price to the acquired assets and assumed liabilities based on their relative fair values. We assess and consider fair value based on estimated cash flow projections that utilize appropriate discount and/or capitalization rates as well as available market information. The fair value of the tangible assets of an acquired property considers the value of the property as if it were vacant.

Above and below market leases acquired are recorded in other assets at their fair value. Fair value is calculated as the present value of the difference between (1) the contractual amounts to be paid pursuant to each in-place lease and (2) management s estimate of fair market lease rates for each corresponding in-place lease, using a discount rate that reflects the risks associated with the leases acquired and measured over a period equal to the remaining term of the lease for above-market leases and the initial term plus the term of any below-market fixed rate renewal options for below-market leases. The capitalized above-market lease values are amortized as a reduction of base rental revenue over the remaining term of the respective leases and the capitalized below-market lease values are amortized as an increase to base rental revenue over the remaining term of the respective leases and any below market option periods. If a tenant vacates its space prior to its contractual expiration date, any unamortized balance is adjusted through rental revenue.

In-place leases acquired are recorded at their fair value in real estate and related assets and are amortized to depreciation and amortization expense over the remaining term of the respective lease. The value of in-place leases is based on our evaluation of the specific characteristics of each tenant s lease. Factors considered include estimates of carrying costs during hypothetical expected lease-up periods, current market conditions and costs to execute similar leases. In estimating carrying costs, we include real estate taxes, insurance and other operating expenses and estimates of lost rentals at market rates during the expected lease-up periods, depending on local market conditions. In estimating costs to execute similar leases, we consider tenant improvements, leasing commissions and legal and other related expenses. The value of in-place leases is amortized to depreciation and amortization expense over the remaining term of the respective leases. If a tenant vacates its space prior to its contractual expiration date, any unamortized balance of its related asset is expensed.

The value of a tenant relationship is based on our overall relationship with the respective tenant. Factors considered include the tenant s credit quality and expectations of lease renewals. The value of a tenant relationship is amortized to depreciation and amortization expense over the initial term and any renewal periods defined in the respective leases. Based on our acquisitions since the adoption of SFAS No. 141 and SFAS No. 142, we have deemed tenant relationships to be immaterial and have not allocated any amounts to this intangible asset. We will evaluate these items in future transactions.

Real estate and leasehold improvements are classified as long-lived assets held for sale or as long-lived assets to be held for use. Real estate is classified as held for sale when the criteria set forth in SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, are satisfied; this determination requires management to make estimates and assumptions, including assessing the probability that potential sales transactions may or may not occur. Actual results could differ from those assumptions. In accordance with SFAS No. 144, we record assets held for sale at the lower of the carrying amount or estimated fair value. Fair value of assets held for sale is equal to the estimated or contracted sales price with a potential buyer less costs to sell. The impairment loss is the amount by which the carrying amount exceeds the estimated fair value. With respect to assets classified as held for use, if events or changes in circumstances, such as a significant decline in occupancy and change in use, indicate that the carrying value may be impaired, an impairment analysis is performed. Such analysis consists of determining whether the asset s carrying amount will be recovered from its undiscounted estimated future operating cash flows, including estimated residual cash flows. These cash flows are estimated based on a number of assumptions that are subject to economic and market uncertainties including, among others, demand for space, competition for tenants, changes in market rental rates and costs to operate each property. If the carrying amount of a held for use asset exceeds the sum of its undiscounted future operating and residual cash flows, an impairment loss is recorded for the difference between estimated fair value of the asset and the net carrying amount. We generally estimate the fair value of assets held for use by using discounted cash flow analysis; in some instances, appraisal information may be available and is used in addition to the discounted cash flow analysis. As the factors used in generating these cash flows are difficult to predict and are subject to future events that may alter our assumptions, the discounted and/or undiscounted future operating and residual cash flows estimated by us in our impairment analyses or those established by appraisal may not be achieved and we may be required to recognize future impairment losses on our properties held for sale and held for use.

Sales of Real Estate

We account for sales of real estate in accordance with SFAS No. 66. For sales transactions meeting the requirements of SFAS No. 66 for full profit recognition, the related assets and liabilities are removed from the balance sheet and the resultant gain or loss is recorded in the period the transaction closes. For sales transactions that do not meet the criteria for full profit recognition, we account for the transactions in accordance with the methods specified in SFAS No. 66. For sales transactions with continuing involvement after the sale, if the continuing involvement with the property is limited by the terms of the sales contract, profit is recognized at the time of sale and is reduced by the maximum exposure to loss related to the nature of the continuing involvement. Sales to entities in which we have or receive an interest are accounted for in accordance with partial sale accounting provisions as set forth in SFAS No. 66.

For sales transactions that do not meet sale criteria as set forth in SFAS No. 66, we evaluate the nature of the continuing involvement, including put and call provisions, if present, and account for the transaction as a financing arrangement, profit-sharing arrangement, leasing arrangement or other alternate method of accounting rather than as a sale, based on the nature and extent of the continuing involvement. Some transactions may have numerous forms of continuing involvement. In those cases, we determine which method is most appropriate based on the substance of the transaction.

If we have an obligation to repurchase the property at a higher price or at a future indeterminable value (such as fair market value), or we guarantee the return of the buyer s investment or a return on that investment for an extended period, we account for such transaction as a financing transaction. If we have an option to repurchase the property at a higher price and it is likely we will exercise this option, the transaction is accounted for as a financing transaction. For transactions treated as financings, we record the amounts received from the buyer as a financing obligation and continue to keep the property and related accounts recorded on our consolidated financial statements. The results of operations of the property, net of expenses other than depreciation (net operating income), will be reflected as interest expense on the financing obligation. If the transaction includes an obligation or option to repurchase the asset at a higher price, additional interest is recorded to accrete the liability to the repurchase price. For options or obligations to repurchase the asset at fair market value at the end of each reporting period, the balance of the liability is adjusted to equal the current fair value to the extent fair value exceeds the original financing obligation. The corresponding debit or credit will be recorded to a related discount account and the revised debt discount is amortized over the expected term until termination of the option or obligation. If it is unlikely such option will be exercised, the transaction is accounted for under the deposit method or profit-sharing method. If we have an obligation or option to repurchase at a lower price, the transaction is accounted for as a leasing arrangement. At such time as these repurchase obligations expire, a sale will be recorded and gain recognized.

If we retain an interest in the buyer and provide certain rent guarantees or other forms of support where the maximum exposure to loss exceeds the gain, we account for such transaction as a profit-sharing arrangement. For transactions treated as profit-sharing arrangements, we record a profit-sharing obligation for the amount of equity contributed by the other partner and continue to keep the property and related accounts recorded on our consolidated financial statements. The results of operations of the property, net of expenses other than depreciation (net operating income), will be allocated to the other partner for their percentage interest and reflected as co-venture expense in our Consolidated Financial Statements. In future periods, a sale is recorded and profit is recognized when the remaining maximum exposure to loss is reduced below the amount of gain deferred.

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Properties that are sold or classified as held for sale are classified as discontinued operations in accordance with SFAS No. 144 and EITF Issue No. 03-13, Applying the Conditions of Paragraph 42 of FASB Statement No. 144 in Determining Whether to Report Discontinued Operations, (effective beginning in 2005) provided that (1) the operations and cash flows of the property will be eliminated from our ongoing operations and (2) we will not have any significant continuing involvement in the operations of the property after it is sold. Interest expense is included in discontinued operations if the related loan securing the sold property is paid off or assumed by the buyer in connection with the sale. If the property is sold to a joint venture in which we retain an interest, the property will not be accounted for as discontinued operations due to our significant ongoing interest in the operations through our joint venture interest. If we are retained to provide property management, leasing and/or other services for the property owner after the sale, the property generally will be accounted for as discontinued operations because the expected cash flows related to these management and leasing activities will generally not be significant in comparison to the cash flows from the property prior to sale.

Allowance for Doubtful Accounts

Accounts receivable are reduced by an allowance for amounts that may become uncollectible in the future. Our receivable balance is comprised primarily of rents and operating cost recoveries due from tenants as well as accrued straight-line rents receivable. We regularly evaluate the adequacy of our allowance for doubtful accounts. The evaluation primarily consists of reviewing past due account balances and considering such factors as the credit quality of our tenant, historical trends of the tenant and/or other debtor, current economic conditions and changes in customer payment terms. Additionally, with respect to tenants in bankruptcy, we estimate the expected recovery through bankruptcy claims and increase the allowance for amounts deemed uncollectible. If our assumptions regarding the collectibility of accounts receivable and accrued straight-line rents receivable prove incorrect, we could experience write-offs of accounts receivable or accrued straight-line rents receivable in excess of our allowance for doubtful accounts.

Property Operating Expense Recoveries

We receive additional rent from tenants in the form of property operating cost recoveries (or cost reimbursements) which are determined on a lease-by-lease basis. The most common types of cost reimbursements in our leases are common area maintenance (CAM) and real estate taxes, where the tenant pays its pro rata share of operating and administrative expenses and real estate taxes, as determined in each lease.

The computation of such additional rent due from tenants is complex and involves numerous judgments, including the interpretation of terms and other tenant lease provisions. Leases are not uniform in dealing with such cost reimbursements and there are many variations in the computations. Many tenants make monthly fixed payments of CAM, real estate taxes and other cost reimbursement items. We record these payments as income each month. We also make adjustments, positive or negative, to cost recovery income to adjust the recorded amounts to our best estimate of the final amounts to be billed and collected with respect to the cost reimbursements. After the end of the calendar year, we compute each tenant s final cost reimbursements and, after considering amounts paid by the tenant during the year, issue a bill or credit for the appropriate amount to the tenant. The differences between the amounts billed less previously received payments and the accrual adjustment are recorded as increases or decreases to cost recovery income when the final bills are prepared, usually beginning in March and completed by mid-year.

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Funds From Operations

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

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

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

- Net income (loss) computed in accordance with GAAP;
- Less dividends to holders of Preferred Stock and less excess of Preferred Stock redemption cost over carrying value;
- Plus depreciation and amortization of assets uniquely significant to the real estate industry;
- Less gains, or plus losses, from sales of depreciable operating properties (but excluding impairment losses) and excluding items that are classified as extraordinary items under GAAP;
- Plus or minus adjustments for unconsolidated partnerships and joint ventures (to reflect funds from operations on the same basis); and
- Plus or minus adjustments for depreciation and amortization and gains/(losses) on sales and minority interest related to discontinued operations.

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

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

FFO and FFO per share for the years ended December 31, 2006, 2005 and 2004 are summarized in the following table ($ in thousands, except per share amounts):

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	2006		2005		2004	
	Amount	Per Share	Amount	Per Share	Amount	Per Share
Funds from operations:						
Net income	$ 53,744		$ 62,458		$ 41,577	
Dividends to preferred stockholders	(17,063)		(27,238)		(30,852)	
Excess of Preferred Stock redemption cost over carrying value	(1,803)		(4,272)			
Net income applicable to common stockholders	34,878	$ 0.62	30,948	$ 0.58	10,725	$ 0.20
Add/(Deduct):						
Depreciation and amortization of real estate assets	111,848	1.82	106,982	1.77	105,967	1.77
(Gains) on disposition of depreciable properties	(4,114)	(0.06)	(7,692)	(0.13)	(18,880)	(0.31)
Minority interest from the Operating Partnership in income/(loss) from operations	1,621		(475)		(1,026)	
Unconsolidated affiliates:						
Depreciation and amortization of real estate assets	11,191	0.18	10,989	0.18	9,044	0.15
Discontinued operations:						
Depreciation and amortization of real estate assets	3,386	0.06	16,841	0.28	25,339	0.42
(Gains) on disposition of depreciable properties	(15,082)	(0.25)	(34,128)	(0.57)	(9,380)	(0.16)
Minority interest from the Operating Partnership in income from discontinued operations	1,557		3,756		2,371	
Funds from operations	$ 145,285	$ 2.37	$ 127,221	$ 2.11	$ 124,160	$ 2.07
Weighted average shares outstanding (1)	61,362		60,301			60,024

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

Quantitative and Qualitative Disclosures About Market Risk

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

To meet in part our long-term liquidity requirements, we borrow funds at a combination of fixed and variable rates. Borrowings under our revolving credit facility bear interest at variable rates. Our long-term debt, which consists of secured and unsecured long-term financings and the issuance of unsecured debt securities, typically bears interest at fixed rates although some loans bear interest at variable rates. Our interest rate risk management objectives are to limit the impact of interest rate changes on earnings and cash flows and to lower our overall borrowing costs. To achieve these objectives, from time to time we enter into interest rate hedge contracts such as collars, swaps, caps and treasury lock agreements in order to mitigate our interest rate risk with respect to various debt instruments. We do not hold or issue these derivative contracts for trading or speculative purposes. We had no interest rate hedge contracts in effect at December 31, 2006.

As of December 31, 2006, we had $1,080.7 million of fixed rate debt outstanding. The estimated aggregate fair market value of this debt at December 31, 2006 was $1,122.3 million. If interest rates increase by 100 basis points, the aggregate fair market value of our fixed rate debt as of December 31, 2006 would decrease by approximately $46.2 million. If interest rates decrease by 100 basis points, the aggregate fair market value of our fixed rate debt as of December 31, 2006 would increase by approximately $49.7 million.

As of December 31, 2006, we had $384.4 million of variable rate debt outstanding. If the weighted average interest rate on this variable rate debt is 100 basis points higher or lower during the 12 months ended December 31, 2007, our interest expense would be increased or decreased approximately $3.8 million.

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Controls And Procedures

General

The purpose of this section is to discuss the effectiveness of our disclosure controls and procedures and our internal control over financial reporting. The statements in this section represent the conclusions of Edward J. Fritsch, our President and Chief Executive Officer, and Terry L. Stevens, our Vice President and Chief Financial Officer.

The CEO and CFO evaluations of our disclosure controls and procedures and our internal control over financial reporting include a review of the objectives, design and operation of the controls and the effect of the controls on the information generated for use in this prospectus. We seek to identify data errors, control problems or acts of fraud and confirm that appropriate corrective action, including process improvements, is undertaken. Our disclosure controls and procedures and our internal control over financial reporting are also evaluated on an ongoing basis by or through the following:

- activities undertaken and reports issued by employees in our internal audit department;
- quarterly sub-certifications by representatives from appropriate business and accounting functions to support the evaluations of our controls and procedures;
- other personnel in our finance and accounting organization;
- members of our internal disclosure committee; and
- members of the audit committee of our Board of Directors.

Our management, including our CEO and CFO, do not expect that our disclosure controls and procedures and our internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of disclosure controls and procedures and internal control over financial reporting must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Management s Annual Report On Internal Control Over Financial Reporting

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

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

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

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

Under the supervision of our CEO and CFO, in connection with the filing on March 1, 2007 of our 2006 Annual Report, our management conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2006 based on the criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

In management s report included in the 2006 Annual Report filed on March 1, 2007, our management determined that material weaknesses existed as of December 31, 2006 in the internal control environment associated with accounting for real estate assets. Specifically, the following material weaknesses were identified as of December 31, 2006:

First, the design and operation of our controls were not effective to reasonably assure compliance with generally accepting accounting principles related to the proper accrual of in-process tenant improvements, building improvements and new development completion costs that were incurred as of the reporting date but for which the related invoices were received after the reporting date. This could result in material errors in balance sheet accounts in our consolidated financial statements such as understatements of building and tenant improvements, development in process, accounts payable, accrued expenses and other liabilities.

Second, the design and operation of our controls were not effective to reasonably assure compliance with generally accepting accounting principles related to the proper accrual of tenant improvements that were constructed by tenants but for which we are required to reimburse such tenants upon submission of proper documentation under the terms of the lease. This could result in material errors in our consolidated financial statements, such as understatements of building and tenant improvements, accounts payable, accrued expenses, other liabilities and depreciation expense.

Third, the controls related to the consistent preparation and timely review of real estate asset account reconciliations were not operating effectively to reasonably assure the discovery of potential errors. This could result in material errors in real estate assets and depreciation and amortization expense in our consolidated financial statements.

As a result of these identified material weaknesses, our management concluded that, as of December 31, 2006, our internal control over financial reporting was not effective. Deloitte & Touche LLP, our independent registered public accounting firm, issued their attestation report, which was included in the 2006 Annual Report filed on March 1, 2007 and is set forth below, on management s assessment of our internal control over financial reporting and the effectiveness of our internal control over financial reporting as of December 31, 2006.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of

Highwoods Properties, Inc.

Raleigh, North Carolina

We have audited management s assessment, included in the accompanying Management s Annual Report on Internal Control Over Financial Reporting, that Highwoods Properties, Inc. and subsidiaries (the Company) did not maintain effective internal control over financial reporting as of December 31, 2006, because of the effect of the material weaknesses identified in management s assessment based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed by, or under the supervision of, the company s principal executive and principal financial officers, or persons performing similar functions, and effected by the company s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

Management has determined that material weaknesses existed as of December 31, 2006 in the internal control environment associated with accounting for real estate assets. Specifically, the following material weaknesses were identified as of such date:

First, the design and operation of the Company s controls were not effective to reasonably assure compliance with generally accepted accounting principles related to the proper accrual of in-process tenant improvements, building improvements and new development completion costs that were incurred as of the reporting date but for which the related invoices were received after the reporting date. This could result in material errors in balance sheet accounts in the Company s consolidated financial statements such as understatements of building and tenant improvements, development in process, accounts payable, accrued expenses and other liabilities.

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Second, the design and execution of the Company s controls were not effective to reasonably assure compliance with generally accepted accounting principles related to the proper accrual of tenant improvements that were constructed by tenants but for which the Company is required to reimburse such tenants upon submission of proper documentation under the terms of the lease. This could result in material errors in the Company s consolidated financial statements, such as understatements of building and tenant improvements, accounts payable, accrued expenses, other liabilities and depreciation expense.

Third, the controls related to the consistent preparation and timely review of real estate asset account reconciliations were not operating effectively to reasonably assure the discovery of potential errors. This could result in material errors in real estate assets and depreciation and amortization expense in the Company s consolidated financial statements.

These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the consolidated financial statements and financial statement schedules as of and for the year ended December 31, 2006, of the Company and this report does not affect our report on such financial statements and financial statement schedules.

In our opinion, management s assessment that the Company did not maintain effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2006, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedules as of and for the year ended December 31, 2006, of the Company and our report dated March 1, 2007 expressed an unqualified opinion on those financial statements and financial statement schedules and includes an explanatory paragraph relating to the Company s change in its method of accounting for share-based payments, effective January 1, 2006, to conform to Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment,* and the Company s change in its method of accounting for joint ventures, effective January 1, 2006, to conform to Emerging Issues Task Force Issue No. 04-5, *Determining Whether a General Partner or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights*.

/s/ Deloitte & Touche LLP

Raleigh, North Carolina
March 1, 2007

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Changes in Internal Control Over Financial Reporting

In our Annual Report on Form 10-K for the year ended December 31, 2005, we reported the existence of material weaknesses as of December 31, 2005 in the design of our real estate fixed asset and lease incentive accounting processes, the design of our journal entry approval process and relating to our use of and dependence upon manually prepared spreadsheets in accumulating and consolidating our prior restatement adjustments. In our Quarterly Report on Form 10-Q for the three months ended September 30, 2006, we reported the discovery of an additional control deficiency relating to the proper classification of assets held for sale under SFAS No. 144 that existed at September 30, 2006 that could have resulted in a material misstatement of our financial statements had it not been discovered prior to the filing of such Quarterly Report. Although we were not required to, nor did we, undertake the procedures necessary to include a management s report on the effectiveness of our internal control over financial reporting as of September 30, 2006, we reported that management believed that such a control deficiency constituted a material weakness.

We implemented various changes and improvements to our internal control over financial reporting in 2006. We designed and implemented a quarterly process to reasonably assure that amounts spent on completed tenant improvement jobs are accrued, classified and closed at the lease start date. Additionally, we improved our written policies by including a more detailed and formal description of which tenant-related costs should be accounted for as lease incentives and educated relevant accounting and division personnel to reasonably assure the proper identification and classification of lease incentive costs. We also eliminated our use of and dependence upon manually prepared spreadsheets in accumulating and consolidating restatement adjustments recorded in connection with our historical financial statements by recording in our general ledger all of the restatement adjustments related to our amended 2003 Annual Report and our 2004 Annual Report on Form 10-K (including ongoing effects of such adjustments to balances subsequent to December 31, 2004), which eliminated the likelihood of errors in our consolidated financial statements that resulted from our reliance upon such manually prepared spreadsheets in the financial statement close process. We also implemented improvements to our journal entry review and approval processes and enhanced controls over the recording and deleting of journal entries in our general ledger system to reduce the likelihood of potential material errors in our financial statements. We also implemented revised approval procedures over signing of construction contracts and change orders to provide reasonable assurance that such matters are approved by management at appropriate levels in the Company. We also developed and implemented additional procedures to ensure the proper classification of assets held for sale under SFAS No. 144 prior to the completion of our fourth quarter financial statement close process.

We determined that, as a result of the foregoing activities, we have remediated as of December 31, 2006 the following material weaknesses that existed as of December 31, 2005: (a) material weaknesses in the design of our fixed asset accounting processes with regard to completed tenant improvement jobs and our lease incentive accounting processes; (b) material weaknesses relating to our use of and dependence upon manually prepared spreadsheets in accumulating and consolidating our prior restatement adjustments, (c) material weaknesses in the design of our journal entry approval process; and (d) material weaknesses in controls to ensure the signing of construction contracts and change orders by management at appropriate levels. Additionally, we determined that we have remediated as of December 31, 2006 the control deficiency that management believed constituted a material weakness as of September 30, 2006 relating to the proper classification of assets held for sale under SFAS No. 144.

During 2007, we plan to undertake additional activities to improve the internal control environment associated with accounting for real estate assets and remediate the remaining material weaknesses described above that existed as of December 31, 2006. First, we are currently converting from a supplemental software package used to calculate depreciation to the depreciation module contained within our general ledger package. This conversion will eliminate the need to reconcile the supplemental system to the general ledger and enhance the effectiveness of our fixed asset account reconciliations. Second, we plan to use our centralized lease approval software to identify and properly account for all tenant improvements undertaken by tenants. Third, we plan to use our centralized invoice approval software to process all invoices related to in-process building improvements, tenant improvements and new development completion costs to reasonably assure that such expenses are identified and properly accrued in our consolidated financial statements on a timely basis. Fourth, we are developing and implementing a Company-wide policy and procedures manual for use by our divisional and accounting staff, intended to reasonably assure consistent and appropriate assessment and application of generally accepting accounting principles. Fifth, we are continuing our search to fill our newly created Chief Accounting Officer position. Our management is working closely with the audit committee to monitor our ongoing efforts to improve our internal control over financial reporting.

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Disclosure Controls And Procedures

SEC rules also require us to maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our annual and periodic reports filed with the SEC is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms. As defined in Rule 13a-15(e) under the Exchange Act, disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us is accumulated and communicated to our management, including our CEO and CFO, to allow timely decisions regarding required disclosure. As described above, since our internal control over financial reporting was not effective at December 31, 2006, our CEO and CFO do not believe that our disclosure controls and procedures were effective as of December 31, 2006.

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BUSINESS

General

The Company is a fully integrated, self-administered and self-managed equity real estate investment trust (REIT) that began operations through a predecessor in 1978. The Company completed its initial public offering in 1994 and its Common Stock is traded on the New York Stock Exchange (NYSE) under the symbol HIW. We are one of the largest owners and operators of suburban office, industrial and retail properties in the southeastern and midwestern United States. At December 31, 2006, we:

- wholly owned 322 in-service office, industrial and retail properties, encompassing approximately 26.9 million rentable square feet, and 109 rental residential units;
- owned an interest (50.0% or less) in 70 in-service office and industrial properties, encompassing approximately 7.4 million rentable square feet, and 418 rental residential units. Five of these in-service office properties are consolidated at December 31, 2006 as more fully described in Notes 1 and 3 to the Consolidated Financial Statements;
- wholly owned 719 acres of undeveloped land, approximately 435 acres of which are considered core holdings and which are suitable to develop approximately 5.3 million rentable square feet of office and industrial space;
- were developing or re-developing 16 wholly owned properties comprising approximately 2.7 million square feet and 139 for-sale condominiums that were under construction or were completed but had not achieved 95% stabilized occupancy; and
- were developing through 50.0% owned joint ventures (a) an office property of approximately 31,000 square feet that was completed in 2006 but had not achieved 95% stabilized occupancy and (b) a for-rent residential project comprising 332 units in three buildings.

The Company conducts substantially all of its activities through the Operating Partnership. Other than 22.4 acres of undeveloped land, 13 rental residential units and the Company s interest in the Kessinger/Hunter, LLC and 4600 Madison Associates, LLC joint ventures (see Note 2 to the Consolidated Financial Statements), all of the Company s assets are owned directly or indirectly by the Operating Partnership. The Company is the sole general partner of the Operating Partnership. At December 31, 2006, the Company owned all of the Preferred Units and 92.2% of the Common Units in the Operating Partnership. Limited partners (including certain officers and directors of the Company) own the remaining Common Units. Generally, the Operating Partnership is obligated to redeem each Common Unit at the request of the holder thereof for cash equal to the value of one share of Common Stock based on the average of the market price for the 10 trading days immediately preceding the notice date of such redemption provided that the Company at its option may elect to acquire any such Common Units presented for redemption for cash or one share of Common Stock. The Common Units owned by the Company are not redeemable. Preferred Units in the Operating Partnership were issued to the Company in connection with the Company s Preferred Stock offerings that occurred in 1997 and 1998.

The Company was incorporated in Maryland in 1994. The Operating Partnership was formed in North Carolina in 1994. Our executive offices are located at 3100 Smoketree Court, Suite 600, Raleigh, North Carolina 27604 and our telephone number is (919) 872-4924. We maintain offices in each of our primary markets.

Our business is the acquisition, development and operation of rental real estate properties. We operate office, industrial, retail and residential properties. There are no material inter-segment transactions. See Note 17 to the Consolidated Financial Statements for a summary of the rental income, net operating income and assets for each reportable segment.

In addition to this prospectus, we file or furnish quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (SEC). All documents that we file or furnish with the

SEC are made available as soon as reasonably practicable free of charge on our corporate website, which is http://www.highwoods.com. The information on this website is not and should not be considered part of this prospectus and is not incorporated by reference in this document. This website is only intended to be an inactive textual reference. You may also read and copy any document that we file or furnish at the public reference facilities of the SEC at 100 F. Street, N.E., Room 1580, Washington, D.C. 20549. Please call the SEC at (800) 732-0330 for further information about the public reference facilities. These documents also may be accessed through the SEC s electronic data gathering, analysis and retrieval system (EDGAR) via electronic means, including the SEC s home page on the Internet (http://www.sec.gov). In addition, since some of our securities are listed on the NYSE, you can read similar information about us at the offices of the NYSE at 20 Broad Street, New York, New York 10005.

Customers

The following table sets forth information concerning the 20 largest customers of our Wholly Owned Properties (including properties classified as held for sale) as of December 31, 2006:

Customer	Rental Square Feet	Annualized Cash Rental Revenue (1) (in thousands)	Percent of Total Annualized Cash Rental Revenue (1)	Weighted Average Remaining Lease Term in Years
Federal Government	1,532,005	$ 26,486	6.79%	8.1
AT&T	672,986	12,701	3.25	2.1
PricewaterhouseCoopers	332,931	8,475	2.17	3.3
State of Georgia	360,683	7,252	1.86	3.2
T-Mobile USA	205,855	5,287	1.36	7.0
Syniverse Technologies, Inc.	198,750	4,581	1.17	9.8
US Airways	293,007	3,995	1.02	0.8
Volvo	278,940	3,974	1.02	3.3
Lockton Companies	151,076	3,713	0.95	8.2
Northern Telecom	246,000	3,651	0.94	1.2
SCI Services, Inc.	162,784	3,499	0.90	10.6
Metropolitan Life Insurance	174,944	3,437	0.88	7.0
BB&T	209,237	3,131	0.80	5.6
Fluor Enterprises, Inc.	147,041	2,658	0.68	4.8
Jacob s Engineering Group, Inc.	181,794	2,535	0.65	9.0
Vanderbilt University	126,617	2,386	0.61	8.8
Lifepoint Corporate Services	122,703	2,351	0.60	4.5
Wachovia	97,792	2,109	0.54	3.3
Icon Clinical Research	101,249	2,066	0.53	6.1
The Martin Agency	118,518	2,038	0.52	10.3
Total (2)	**5,714,912**	**$ 106,325**	**27.24%**	**5.8**

(1) Annualized Cash Rental Revenue is cash rental revenue (base rent plus additional rent based on the level of operating expenses, excluding straight-line rent) for the month of December 2006 multiplied by 12.

(2) Excludes customers that may lease space in joint venture properties that are consolidated but are not Wholly Owned Properties.

Operating Strategy

Efficient, Customer Service-Oriented Organization. We provide a complete line of real estate services to our customers and third parties. We believe that our in-house development, acquisition, construction management, leasing and property management services allow us to respond to the many demands of our existing and potential customer base. We provide our customers with cost-effective services such as build-to-suit construction and space modification, including tenant improvements and expansions. In addition, the breadth of our capabilities and resources provides us with market information not generally available. We believe that the operating efficiencies achieved through our fully integrated organization also provide a competitive advantage in setting our lease rates and pricing other services.

Capital Recycling Program. Our strategy has been to focus our real estate activities in markets where we believe our extensive local knowledge gives us a competitive advantage over other real estate developers and operators. Through our capital recycling program, we generally seek to:

selectively dispose of non-core properties in order to use the net proceeds to improve our balance sheet by reducing outstanding debt and Preferred Stock balances, to make new investments or for other purposes;

engage in the development of office and industrial projects in our existing geographic markets, primarily in suburban in-fill business parks; and

acquire selective suburban office and industrial properties in our existing geographic markets at prices below replacement cost that offer attractive returns.

Our capital recycling activities benefit from our local market presence and knowledge. Because our division officers have significant real estate experience in their respective markets, we believe that we are in a better position to evaluate capital recycling opportunities than many of our competitors. In addition, our relationships with our customers and those tenants at properties for which we conduct third-party fee-based services may lead to development projects when these tenants seek new space.

The following table summarizes the changes in square footage in our in-service Wholly Owned Properties during the past three years:

	2006	2005	2004
	(rentable square feet in thousands)		
Office, Industrial and Retail Properties:			
Dispositions	(2,982)	(4,641)	(1,263)
Contributions to Joint Ventures			(1,270)(1)
Developments Placed In-Service **(2)**	33	713	141
Redevelopment/Other	(74)	(133)	(21)
Acquisitions	70		1,357(1)
Net Change of In-Service Wholly Owned Properties	(2,953)	(4,061)	(1,056)

(1) Includes 1,270,000 square feet of properties in Orlando, Florida acquired from MG-HIW, LLC in March 2004 and contributed to HIW-KC Orlando, LLC in June 2004.

(2) We consider a development project to be stabilized upon the earlier of the original projected stabilization date or the date such project is at least 95% occupied.

Conservative and Flexible Balance Sheet. We are committed to maintaining a conservative and flexible balance sheet that allows us to capitalize on favorable development and acquisition opportunities as they arise. We expect to meet our short- and long-term liquidity requirements through a combination of any one or more of:

cash flow from operating activities;

borrowings under our credit facilities;

the issuance of unsecured debt;

the issuance of secured debt;

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

- the selective disposition of non-core land and other assets; and

- private equity capital raised from unrelated joint venture partners involving the sale or contribution of our Wholly Owned Properties, development projects or development land.

Geographic Diversification. We do not believe that our operations are significantly dependent upon any particular geographic market. Today, including our various joint ventures, our portfolio consists primarily of office and industrial properties throughout the Southeast, retail and office properties in Kansas City, Missouri, including one significant mixed retail and office property, and office properties in Des Moines, Iowa.

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Competition

Our properties compete for tenants with similar properties located in our markets primarily on the basis of location, rent, services provided and the design and condition of the facilities. We also compete with other REITs, financial institutions, pension funds, partnerships, individual investors and others when attempting to acquire, develop and operate properties.

Insurance

Our properties are generally covered by comprehensive liability, casualty, flood and rental loss insurance with policy specifications and insured limits are appropriate given the relative risk of loss, the cost of coverage and industry practice.

Employees

As of December 31, 2006, the Company had 476 employees.

Legal Proceedings

We are from time to time a party to a variety of legal proceedings, claims and assessments arising in the ordinary course of our business. We regularly assess the liabilities and contingencies in connection with these matters based on the latest information available. For those matters where it is probable that we have incurred or will incur a loss and the loss or range of loss can be reasonably estimated, reserves are recorded in the Consolidated Financial Statements. In other instances, because of the uncertainties related to both the probable outcome and amount or range of loss, a reasonable estimate of liability, if any, cannot be made. Based on the current expected outcome of such matters, none of these proceedings, claims or assessments is expected to have a material adverse effect on our business, financial condition and results of operations.

In June, August, September and October 2006, we received assessments for state excise taxes and related interest amounting to approximately $4.5 million, related to periods 2002 through 2004. We believe that we are not subject to such taxes and have vigorously disputed the assessment. Based on the advice of counsel concerning the status of settlement discussions and on our own analysis, we currently believe it is probable that all excise tax assessments, including potential assessments for 2005 and 2006, can be settled by the payment of franchise taxes of approximately $0.5 million, and in the fourth quarter of 2006 such amount was accrued and charged to operating expenses. Legal fees related to this matter were nominal and were charged to operating expenses as incurred in 2006.

As previously disclosed, the SEC s Division of Enforcement issued a confidential formal order of investigation in connection with the Company s previous restatement of its financial results. In November 2006, the Company was informed that the SEC s Division of Enforcement had closed its investigation and was not taking any action with respect to this matter.

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OUR PROPERTIES

Wholly Owned Properties

As of December 31, 2006, we owned all of the ownership interests in 322 in-service office, industrial and retail properties, encompassing approximately 26.9 million rentable square feet, and 109 rental residential units, including 0.3 million rentable square feet with a net book value of $19.8 million that was classified as held for sale. The following table sets forth information about our Wholly Owned Properties (including properties classified as held for sale) and our development properties as of December 31, 2006 and 2005:

	December 31, 2006		December 31, 2005	
	Rentable Square Feet	Percent Leased/ Pre-Leased	Rentable Square Feet	Percent Leased/ Pre-Leased
In-Service:				
Office **(1)**	19,244,000	89.0%	21,412,000	87.5%
Industrial	6,281,000	91.7	6,977,000	92.4
Retail **(2)**	1,327,000	95.7	1,416,000	97.5
Total or Weighted Average	**26,852,000(3)**	**90.0%**	**29,805,000(3)**	**89.1%**
Development:				
Completed Not Stabilized (4)				
Office **(1)**	504,000	62.8%		
Industrial	418,000	44.0		
Retail			9,600	87.0%
Total or Weighted Average	**922,000**	**54.3%**	**9,600**	**87.0%**
In Process (5)				
Office **(1)**	1,357,000	55.3%	533,000	37.2%
Industrial	383,000			
Retail				
For Sale Residential **(6)**	139 units			
Total or Weighted Average (3)	**1,740,000**	**43.1%**	**533,000**	**37.2%**
Total:				
Office **(1)**	21,105,000		21,945,000	
Industrial	7,082,000		6,977,000	
Retail **(2)**	1,327,000		1,425,600	
Total or Weighted Average (3) (5) (7)	**29,514,000**		**30,347,600**	

(1) Substantially all of our office properties are located in suburban markets.
(2) Excludes 430,000 square feet of basement space in the Country Club Plaza and other Kansas City retail properties.
(3) Rentable square feet excludes the 109 residential units.
(4) We consider a development project to be stabilized upon the earlier of the original projected stabilization date or the date such project is at least 95% occupied.
(5) December 31, 2005 excludes a 156-unit multi-family residential property under development that was 50.0% owned and which was consolidated (see Notes 1, 2 and 4 to the Consolidated Financial Statements). This development commenced in late 2004 and was sold in

late 2006.

(6) In January 2007, we executed a joint venture agreement for this development. We now have a 93% interest and will consolidate this joint venture. As of March 31, 2007, there were approximately 300 reservations for the 139 units. Reservations are fully refundable until mid 2007 at which time binding sales contracts will be accepted and non-refundable deposits will be retained. Residential units and reservation numbers are not part of the In-Process total or weighted average for square feet and pre-leasing percentage.

(7) Excludes the following joint venture properties that are consolidated but are not Wholly Owned Properties: (1) one office property that was sold to SF-HIW Harborview Plaza, LP, a 20% owned joint venture, but which is accounted for as a financing under SFAS No. 66 and thus remains consolidated as described in Note 3 to the Consolidated Financial Statements, and (2) four office properties owned by Highwoods-Markel Associates, LLC, a 50% owned joint venture, which is consolidated beginning January 1, 2006, as described in Notes 1 and 2 to the Consolidated Financial Statements.

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The following table sets forth geographic information about our in service Wholly Owned properties (including properties classified as held for sale) at December 31, 2006

	Rentable		Percentage of Annualized Cash Rental Revenue (1)			
Market	**Square Feet**	**Occupancy**	**Office**	**Industrial**	**Retail**	**Total**
Raleigh, NC **(2)**	3,810,000	86.1%	14.6%			14.6%
Atlanta, GA	5,515,000	94.0	10.3	4.0%		14.3
Kansas City, MO	2,225,000 (3)	90.1	4.3		9.7%	14.0
Tampa, FL	2,332,000	97.7	13.2			13.2
Nashville, TN	2,876,000	91.6	13.0			13.0
Piedmont Triad, NC **(4)**	5,195,000	88.7	7.0	3.7		10.7
Richmond, VA	2,024,000	89.8	8.9			8.9
Memphis, TN	1,197,000	91.8	5.6			5.6
Greenville, SC	1,108,000	75.3	3.4	0.1		3.5
Orlando, FL	218,000	100.0	1.2			1.2
Columbia, SC	252,000	48.7	0.5			0.5
Other	100,000	73.6	0.5			0.5
Total (5)	**26,852,000**	**90.0%**	**82.5%**	**7.8%**	**9.7%**	**100.0%**

(1) Annualized Cash Rental Revenue is cash rental revenue (base rent plus additional rent based on the level of operating expenses, excluding straight-line rent) for the month of December 2006 multiplied by 12.
(2) The Raleigh market encompasses the Raleigh, Durham, Cary and Research Triangle metropolitan area.
(3) Excludes 430,000 square feet of basement space in the Country Club Plaza and other Kansas City retail properties.
(4) The Piedmont Triad market encompasses the Greensboro and Winston-Salem metropolitan area.
(5) Excludes the following joint venture properties that are consolidated but are not Wholly Owned Properties: (1) one office property that was sold to SF-HIW Harborview Plaza, LP, a 20% owned joint venture, but which is accounted for as a financing under SFAS No. 66 and thus remains consolidated as described in Note 3 to the Consolidated Financial Statements, and (2) four office properties owned by Highwoods-Markel Associates, LLC, a 50% owned joint venture, which is consolidated beginning January 1, 2006, as described in Notes 1 and 2 to the Consolidated Financial Statements.

Development Land

We wholly owned 719 acres of development land as of December 31, 2006. We estimate that we can develop approximately 5.3 million square feet of office and industrial space on the approximately 435 acres that we consider core long term holdings for our future development needs. Our development land is zoned and available for office and industrial development, and nearly all of the land has utility infrastructure in place. We believe that our commercially zoned and unencumbered land in existing business parks gives us a development advantage over other commercial real estate development companies in many of our markets. Any future development, however, is dependent on the demand for office and industrial space in the area, the availability of favorable financing and other factors, and no assurance can be given that any construction will take place on the development land. In addition, if construction is undertaken on the development land, we will be subject to the risks associated with construction activities, including the risks that occupancy rates and rents at a newly completed property may not be sufficient to make the property profitable, construction costs may exceed original estimates and construction and lease-up may not be completed on schedule, resulting in increased debt service expense and construction expense. We may also develop properties other than office and industrial on certain parcels with unrelated joint venture partners. We consider approximately 284 acres of our development land at December 31, 2006 to be non-core assets because this land is not necessary for our foreseeable future development needs. We are actively working to dispose of such non-core development land through sales to other parties or contributions to joint ventures. Approximately 108 acres with a net book value of $14.4 million are under contract to be sold and are included in Real estate and other assets, net, held for sale in our Consolidated Balance Sheet at December 31, 2006.

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Other Properties

As of December 31, 2006, we owned an interest (50.0% or less) in 70 in-service properties. These properties include primarily office and industrial buildings encompassing approximately 7.4 million rentable square feet and 418 rental residential units. The following table sets forth information about the stabilized in-service joint venture properties by segment and by geographic location at December 31, 2006:

			Percentage of Annualized Cash Rental Revenue (1)				
Market	**Rentable Square Feet**	**Occupancy**	**Office**	**Industrial**	**Retail**	**Multi-Family**	**Total**
Des Moines, Iowa	2,475,000**(2)**	93.6%**(3)**	28.4%	4.2%	1.0%	3.4%	37.0%
Orlando, Florida	1,686,000	94.7	27.2				27.2
Atlanta, Georgia	835,000	95.0	11.4				11.4
Kansas City, Missouri	721,000	82.2	8.8				8.8
Richmond, Virginia **(4)**	413,000	100.0	5.0				5.0
Raleigh, North Carolina **(5)**	455,000	99.6	3.7				3.7
Piedmont Triad, North Carolina **(6)**	364,000	100.0	3.6				3.6
Tampa, Florida **(7)**	205,000	100.0	2.0				2.0
Charlotte, North Carolina	148,000	100.0	0.8				0.8
Other	110,000	100.0	0.5				0.5
Total	**7,412,000**	**94.3%**	**91.4%**	**4.2%**	**1.0%**	**3.4%**	**100.0%**

(1) Annualized Cash Rental Revenue is cash rental revenue (base rent plus additional rent based on the level of operating expenses, excluding straight-line rent) for the month of December 2006 multiplied by 12.
(2) Excludes 418 residential units.
(3) Excludes residential occupancy percentage of 95.9%.
(4) We own a 50.0% interest in this joint venture (Highwoods-Markel Associates, LLC) which is consolidated (see Notes 1 and 2 to the Consolidated Financial Statements).
(5) The Raleigh market encompasses the Raleigh, Durham, Cary and Research Triangle metropolitan area.
(6) The Piedmont Triad market encompasses the Greensboro and Winston-Salem metropolitan area.
(7) We own a 20.0% interest in this joint venture (SF-HIW Harborview Plaza, LP) which is consolidated (see Notes 1 and 3 to the Consolidated Financial Statements).

In addition to the properties described above, as of December 31, 2006, two joint ventures in which we hold 50.0% interests were developing a 332-unit residential property and had developed a 31,000 square foot office building that was completed but had not yet achieved stabilized occupancy. The following table sets forth information about these properties at December 31, 2006 ($ in thousands):

Property	**% Ownership**	**Market**	**Rentable Square Feet**	**Anticipated Total Investment**	**Investment at 12/31/2006**	**Pre-leasing**	**Actual or Estimated Completion Date**	**Estimated Stabilization Date**
Brickstone	50.0%	Des Moines	31,000	$ 5,149	$ 4,343	35%	4Q06	4Q07
Weston Lakeside	50.0%	Raleigh	332 units	33,200	31,104	43%	1Q07**(1)**	1Q08
Total			**31,000**	**$ 38,349**	**$ 35,447**			

(1) Estimated Completion Date is the date the last unit is expected to be delivered; currently there are 136 units leased. In 2006, the Weston Lakeside joint venture entered into a contract to sell to a third party all of the assets, which sale occurred in February 2007, as described in more detail in Note 2 to the Consolidated Financial Statements.

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Lease Expirations

The following tables set forth scheduled lease expirations for existing leases at our Wholly Owned Properties (including properties classified as held for sale but excluding residential units) as of December 31, 2006. The tables include (1) expirations of leases in properties that are completed but not yet stabilized and (2) the effects of any early renewals exercised by tenants as of December 31, 2006.

Office Properties (1):

Lease Expiring	Rentable Square Feet Subject to Expiring Leases	Percentage of Leased Square Footage Represented by Expiring Leases	Annualized Cash Rental Revenue Under Expiring Leases (2) ($ in thousands)	Average Annual Rental Rate Per Square Foot for Expirations	Percent of Annualized Cash Rental Revenue Represented by Expiring Leases (2)
2007 **(3)**	1,554,029	9.0%	$ 28,027	$ 18.04	8.7%
2008	2,145,074	12.4	39,793	18.55	12.4
2009	2,799,327	16.1	53,375	19.07	16.5
2010	2,323,591	13.4	46,889	20.18	14.6
2011	2,804,723	16.2	51,220	18.26	15.9
2012	1,731,147	10.0	30,337	17.52	9.4
2013	838,925	4.8	15,145	18.05	4.7
2014	550,008	3.2	10,668	19.40	3.3
2015	667,412	3.8	13,427	20.12	4.2
2016	729,111	4.2	13,882	19.04	4.3
Thereafter	1,198,962	6.9	19,253	16.06	6.0
	17,342,309	**100.0%**	**$ 322,016**	**$ 18.57**	**100.0%**

Industrial Properties:

Lease Expiring	Rentable Square Feet Subject to Expiring Leases	Percentage of Leased Square Footage Represented by Expiring Leases	Annualized Cash Rental Revenue Under Expiring Leases (2) ($ in thousands)	Average Annual Rental Rate Per Square Foot for Expirations	Percent of Annualized Cash Rental Revenue Represented by Expiring Leases (2)
2007 **(4)**	1,011,155	17.0%	$ 5,807	$ 5.74	19.1%
2008	1,214,386	20.3	5,589	4.60	18.3
2009	961,855	16.2	5,226	5.43	17.1
2010	558,583	9.4	3,004	5.38	9.8
2011	639,024	10.8	3,123	4.89	10.2
2012	257,895	4.3	1,287	4.99	4.2
2013	166,289	2.8	1,032	6.21	3.4
2014	212,965	3.6	1,151	5.40	3.8
2015	169,882	2.9	695	4.09	2.3
2016	264,597	4.5	883	3.34	2.9
Thereafter	486,150	8.2	2,724	5.60	8.9

	5,942,781	**100.0%**	**$ 30,521**	**$ 5.14**	**100.0%**

(1) Excludes the following joint venture properties that are consolidated but are not Wholly Owned Properties: (1) one office property that was sold to SF-HIW Harborview Plaza, LP, a 20% owned joint venture, but which is accounted for as a financing under SFAS No. 66 and thus remains consolidated as described in Note 3 to the Consolidated Financial Statements and (2) four office properties owned by Highwoods-Markel Associates, LLC, a 50% owned joint venture, which is consolidated beginning January 1, 2006, as described in Notes 1 and 2 to the Consolidated Financial Statements.

(2) Annualized Cash Rental Revenue is cash rental revenue (base rent plus additional rent based on the level of operating expenses, excluding straight-line rent) for the month of December 2006 multiplied by 12.

(3) Includes 68,000 square feet of leases that are on a month-to-month basis, which represent 0.2% of total annualized cash rental revenue.

(4) Includes 86,000 square feet of leases that are on a month-to-month basis, which represent 0.1% of total annualized cash rental revenue.

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Retail Properties:

Lease Expiring	Rentable Square Feet Subject to Expiring Leases	Percentage of Leased Square Footage Represented by Expiring Leases	Annualized Cash Rental Revenue Under Expiring Leases (1) ($ in thousands)	Average Annual Rental Rate Per Square Foot for Expirations	Percent of Annualized Cash Rental Revenue Represented by Expiring Leases (1)
2007 **(2)**	65,255	5.1%	$ 1,771	$ 27.14	4.7%
2008	126,550	10.0	3,658	28.91	9.7
2009	142,868	11.3	4,032	28.22	10.7
2010	98,944	7.8	3,438	34.75	9.1
2011	71,009	5.6	2,075	29.22	5.5
2012	143,793	11.3	4,322	30.06	11.5
2013	55,903	4.4	2,174	38.89	5.8
2014	86,274	6.8	1,673	19.39	4.4
2015	130,127	10.2	4,232	32.52	11.2
2016	67,224	5.3	2,639	39.26	7.0
Thereafter	281,837	22.2	7,653	27.15	20.4
	1,269,784	**100.0%**	**$ 37,667**	**$ 29.66**	**100.0%**

Total (3):

Lease Expiring	Rentable Square Feet Subject to Expiring Leases	Percentage of Leased Square Footage Represented by Expiring Leases	Annualized Cash Rental Revenue Under Expiring Leases (1) ($ in thousands)	Average Annual Rental Rate Per Square Foot for Expirations	Percent of Annualized Cash Rental Revenue Represented by Expiring Leases (1)
2007 **(4)**	2,630,439	10.7%	$ 35,605	$ 13.54	9.1%
2008	3,486,010	14.2	49,040	14.07	12.6
2009	3,904,050	16.0	62,633	16.04	16.0
2010	2,981,118	12.1	53,331	17.89	13.7
2011	3,514,756	14.3	56,418	16.05	14.4
2012	2,132,835	8.7	35,946	16.85	9.2
2013	1,061,117	4.3	18,351	17.29	4.7
2014	849,247	3.5	13,492	15.89	3.5
2015	967,421	3.9	18,354	18.97	4.7
2016	1,060,932	4.3	17,404	16.40	4.5
Thereafter	1,966,949	8.0	29,630	15.06	7.6
	24,554,874	**100.0%**	**$ 390,204**	**$ 15.89**	**100.0%**

(1) Annualized Cash Rental Revenue is cash rental revenue (base rent plus additional rent based on the level of operating expenses, excluding straight-line rent) for the month of December 2006 multiplied by 12.

(2) Includes 3,000 square feet of leases that are on a month-to-month basis or less than 0.1% of total annualized cash rental revenue.

(3) Excludes the following joint venture properties that are consolidated but are not Wholly Owned Properties: (1) one office property that was sold to SF-HIW Harborview Plaza, LP, a 20% owned joint venture, but which is accounted for as a financing under SFAS No. 66 and thus remains consolidated as described in Note 3 to the Consolidated Financial Statements and (2) four office properties owned by Highwoods-Markel Associates, LLC, a 50% owned joint venture, which is consolidated beginning January 1, 2006, as described in Notes 1 and 2 to the Consolidated Financial Statements.

(4) Includes 157,000 square feet of leases that are on a month-to-month basis, which represent 0.3% of total annualized cash rental revenue.

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MANAGEMENT

Our Directors and Executive Officers

Our directors are divided into three classes, with approximately one-third of the directors elected by the stockholders annually. The Board of Directors currently consists of nine members. The terms of office for Edward J. Fritsch, Lawrence S. Kaplan and F. William Vandiver, Jr. will expire at the annual meeting to be held May 18, 2007. Effective as of the date of the meeting, Mr. Vandiver will retire from the Board of Directors and the size of the Board will be reduced from nine to eight. Messrs. Fritsch and Kaplan have been nominated for election at the meeting as directors to hold office until the 2010 annual meeting of stockholders and until their successors are elected and qualified. Sherry A. Kellett, whose term is currently scheduled to expire at the 2008 annual meeting, has been nominated for election at the meeting as a director to hold office until the 2010 annual meeting of stockholders and until her successor is elected and qualified. The three-year term of office for Thomas A. Adler and Kay N. Callison will expire at the annual meeting in 2008. The three-year term of office for Gene H. Anderson, L. Glenn Orr, Jr. and O. Temple Sloan, Jr. will expire at the annual meeting in 2009.

The following table sets forth information about our directors and executive officers.

NAME	AGE	POSITION
Edward J. Fritsch	48	President, Chief Executive Officer and Director
Terry L. Stevens	58	Vice President and Chief Financial Officer
Michael E. Harris	57	Executive Vice President and Chief Operating Officer
Jeffrey D. Miller	36	Vice President, General Counsel and Secretary
Gene H. Anderson	61	Senior Vice President and Director
Michael F. Beale	53	Senior Vice President and Regional Manager
W. Brian Reames	43	Senior Vice President and Regional Manager
O. Temple Sloan, Jr.	68	Chairman of the Board of Directors
Thomas W. Adler	66	Independent Director
Kay N. Callison	63	Independent Director
Lawrence S. Kaplan	64	Independent Director
Sherry A. Kellett	62	Independent Director
L. Glenn Orr, Jr.	66	Independent Director
F. William Vandiver, Jr.	65	Independent Director

Information for each of our executive officers and directors is set forth below.

Edward J. Fritsch, 48, has been a director since January 2001. Mr. Fritsch became our Chief Executive Officer in July 2004 and our president in December 2003. Prior to that, Mr. Fritsch was our chief operating officer from January 1998 to July 2004 and was a vice president and secretary from June 1994 to January 1998. Mr. Fritsch joined our predecessor in 1982 and was a partner of that entity at the time of our initial public offering in June 1994. Mr. Fritsch is Chairman of the University of North Carolina s Board of Visitors and also serves on the Board of Trustees of St. Timothy s Episcopal School and the Board of Directors of the Triangle Chapter of the YMCA.

Terry L. Stevens, 58, has been our Vice President and Chief Financial Officer since December 2003. Prior to joining us in December 2003, Mr. Stevens was executive vice president, chief financial officer and trustee for Crown American Realty Trust, a public REIT. Before joining Crown American Realty Trust, Mr. Stevens was director of financial systems development at AlliedSignal, Inc., a large multi-national manufacturer. Mr. Stevens was also an audit partner with Price Waterhouse for approximately seven years. Mr. Stevens currently serves as trustee, chairman of the Audit Committee and member of the Investment and Finance Committee of First Potomac Realty Trust, a public REIT. Mr. Stevens is a member of the American and the Pennsylvania Institutes of Certified Public Accountants.

Michael E. Harris, 57, has been our Executive Vice President and Chief Operating Officer since July 2004. Prior to that, Mr. Harris was a senior vice president and was responsible for our operations in Memphis, Nashville, Kansas City and Charlotte. Mr. Harris was executive vice president of Crocker Realty Trust prior to its merger with us in 1996. Before joining Crocker Realty Trust, Mr. Harris served as senior vice president, general counsel and chief financial officer of Towermarc Corporation, a privately owned real estate development firm. Mr. Harris is a member of the Advisory Board of Directors of SouthTrust Bank of Memphis and Allen & Hoshall, Inc.

Jeffrey D. Miller, 36, has been our Vice President, General Counsel and Secretary since March 2007. Mr. Miller was a partner with the law firm of DLA Piper US LLP, where he has practiced since 2005. Previously, he was a partner with the law firm of Alston & Bird LLP, where he practiced from 1997. Mr. Miller received a B.A. from Pennsylvania State University and a J.D. and M.B.A. from Wake Forest University. He is admitted to practice in North Carolina.

Gene H. Anderson, 61, has been a director and senior vice president since our combination with Anderson Properties, Inc. in February 1997, and in July 2006 became Executive Vice President of Highwoods Development, LLC, a taxable subsidiary formed to pursue the development of office and industrial properties for existing customers, such as the GSA, in core and non-core markets. Additionally, Mr. Anderson oversees our Atlanta and Triad operations. Mr. Anderson served as president of Anderson Properties, Inc. from 1978 to February 1997. Mr. Anderson was past president of the Georgia chapter of the National Association of Industrial and Office Properties and is a national board member of the National Association of Industrial and Office Properties.

Michael F. Beale, 53, has been our Senior Vice President and Regional Manager since 2000. Mr. Beale manages our Orlando and oversees our Tampa operations. Prior to joining us in 2000, Mr. Beale served as vice president of Koger Equity, Inc., where he was responsible for Koger s acquisitions and developments throughout the Southeast. Mr. Beale is currently the president of the Central Florida Chapter of the National Association of Industrial and Office Properties and also serves on various committees for the Mid-Florida Economic Development Commission.

W. Brian Reames, 43, has been our Senior Vice President and Regional Manager since August 2004. Mr. Reames manages our Nashville and oversees our Memphis, Greenville and Columbia operations. Prior to that, Mr. Reames was vice president responsible for the Nashville division, a position he held since 1999. Mr. Reames was a partner and owner at Eakin & Smith, Inc., a Nashville-based office real estate firm, from 1989 until its merger with us in 1996. Mr. Reames is a past Nashville chapter President of the National Association of Industrial and Office Properties. He is currently serving on the Board of Directors of H.G. Hill Realty and the Nashville Zoo and as President of the Board of Trustees at Harding Academy in Nashville, Tennessee.

O. Temple Sloan, Jr., 68, is chairman of the Board of Directors, a position he has held since March 1994. Mr. Sloan is chairman and chief executive officer of General Parts International, Inc. He is also the lead outside director of Bank of America Corporation and is a director of Lowe s Companies, Inc.

Thomas W. Adler, 66, has been a director since June 1994. Mr. Adler is chairman of PSF Management Co. in Cleveland, Ohio. Mr. Adler formerly served on the board of directors of the National Association of Realtors and the boards of governors of the American Society of Real Estate Counselors and the National Association of Real Estate Investment Trusts. He is a past national president of the Society of Industrial and Office Realtors. Mr. Adler is currently active in the Urban Land Institute.

Kay N. Callison, 63, has been a director since our merger with J.C. Nichols Company in July 1998. Ms. Callison had served as a director of J.C. Nichols Company since 1982. Ms. Callison is active in charitable activities in the Kansas City metropolitan area.

Lawrence S. Kaplan, 64, has been a director since November 2000. Mr. Kaplan is a certified public accountant and retired in 2000 as a partner from Ernst & Young LLP where he was the national director of that firm s REIT Advisory Services group. Mr. Kaplan has served on the board of governors of the National Association of Real

Estate Investment Trusts and has been actively involved in REIT legislative and regulatory matters for over 20 years. Mr. Kaplan is a director of Maguire Properties, Inc., a publicly traded office REIT based in California, and Feldman Mall Properties, Inc., a publicly traded mall REIT based in Arizona.

Sherry A. Kellett, 62, has been a director since November 2005. Ms. Kellett is a certified public accountant. Ms. Kellett served as corporate controller of BB&T Corporation from 1995 until her retirement in August 2003. Ms. Kellett had served as corporate controller of Southern National Corporation from 1991 until 1995 when it merged with BB&T Corporation. Ms. Kellett previously served in several positions at Arthur Andersen & Co. Ms. Kellett is a director of Medical Properties Trust, Inc., a publicly traded medical office REIT based in Alabama, and MidCountry Financial Corp., a private financial services holding company based in Macon, GA. Ms. Kellett s term is currently scheduled to expire at the 2008 annual meeting, but the Board of Directors, upon the recommendation of our compensation and governance committee, has nominated Ms. Kellett for election at the meeting as a director to hold office until the 2010 annual meeting of stockholders and until her successor is elected and qualified.

L. Glenn Orr, Jr., 66, has been a director since February 1995. Mr. Orr has been president and chief executive officer of Orr Holdings since 2006. Mr. Orr had served as president and chief executive officer of The Orr Group from 1995 to 2006. Mr. Orr was chairman of the board of directors, president and chief executive officer of Southern National Corporation from 1990 until its merger with BB&T Corporation in 1995. He previously served as president and chief executive officer of Forsyth Bank and Trust Co., president of Community Bank in Greenville, S.C. and president of the North Carolina Bankers Association. Mr. Orr is a member of the boards of directors of Medical Properties Trust, Inc., a publicly traded medical office REIT based in Alabama, General Parts International, Inc., Village Tavern, Inc. and Broyhill Management Fund, and he is chairman of the Wake Forest University board of trustees.

F. William Vandiver, Jr., 65, has been a director since July 2002. Mr. Vandiver served as corporate risk management executive at Bank of America Corporation from 1998 until his retirement in 2002. Mr. Vandiver is Chairman of the Board of Trustees of Queens University of Charlotte. He also serves on the President s Advisory Council of Clemson University, the Board of Trustees of Presbyterian Hospital in Charlotte and the Board of Directors of General Parts International, Inc. and as a Senior Advisor to McColl Partners. Mr. Vandiver will retire from the Board of Directors effective as of the date of the 2007 annual meeting of stockholders.

CORPORATE GOVERNANCE

Director Independence

Under New York Stock Exchange rules, at least a majority of our directors and all of the members of the audit committee and the compensation and governance committee must be independent. The New York Stock Exchange standards provide that to qualify as an independent director, in addition to satisfying certain bright-line criteria, the Board of Directors must affirmatively determine that a director has no material relationship with us (either directly or as a partner, shareholder or officer of an organization that has a relationship with us). The Board of Directors has determined that Messrs. Adler, Kaplan, Orr, Sloan and Vandiver and Mses. Callison and Kellett each satisfies the bright-line criteria and that none has a relationship with us that would interfere with such person s ability to exercise independent judgment as a member of the Board. In addition, none of these directors has ever served as (or is related to) an employee of our Company or any of our predecessors or acquired companies or received any compensation from us or any such other entities except for compensation directly related to service as a director. Therefore, we believe that all of these directors, or more than three-fourths of the Board, are independent.

Compensation and Governance Committee

Our compensation and governance committee currently consists of Messrs. Orr and Sloan and Ms. Callison. Mr. Orr serves as chairman of the compensation and governance committee. Each member is an independent director.

The compensation and governance committee determines compensation for our executive officers and implements our non-equity and equity incentive plans. The committee also makes recommendations concerning board member qualification standards, director nominees, board responsibilities and compensation, board access to management and independent advisors and management succession. On an annual basis, the compensation and governance committee assesses the appropriate skills and characteristics of existing and new board members. This assessment includes consideration as to the members independence, diversity, age, skills and experience in the context of the needs of the Board. The same criteria are used by the compensation and governance committee in evaluating nominees for directorship. The Investor Relations/Governance Documents section of our website includes an online version of our compensation and governance committee charter. Our website is located at www.highwoods.com.

Compensation and Governance Committee Interlocks and Insider Participation. None of the members of our compensation and governance committee is a current or past employee of our Company or any of our predecessors or acquired companies and each was and is an independent director. None of our executive officers currently serves, or in the past three years has served, as a member of the board of directors or compensation committee of another entity that has one or more executive officers serving on our Board of Directors or compensation and governance committee.

Audit Committee

Our audit committee currently consists of Messrs. Kaplan and Vandiver and Ms. Kellett. Upon Mr. Vandiver s retirement as a director effective as of the date of the meeting, Mr. Orr will join the audit committee. Mr. Kaplan serves as chairman of the audit committee. Each of the foregoing directors is an independent director and none has accepted any consulting, advisory or other compensatory fee from us other than as set forth below under Compensation of Directors and Executive Officers Director Compensation in 2006. Further, the Board has determined that each of the foregoing directors is financially literate and at least two members, Mr. Kaplan and Ms. Kellett, both of whom are certified public accountants, are financial experts.

The audit committee approves the engagement of our independent registered public accounting firm, reviews the plans and results of the audit engagement with such firm, approves professional services provided by such firm, reviews the independence of such firm, approves audit and non-audit fees and reviews the adequacy of our internal control over financing reporting. The Investor Relations/Governance Documents section of our website includes an online version of the audit committee charter.

Investment Committee

Our investment committee currently consists of Messrs. Adler, Anderson, Fritsch and Sloan. The investment committee oversees the acquisition, new development, redevelopment and asset disposition process. The investment committee, which held 28 conference calls in 2006, generally meets on call to review new opportunities and to make recommendations to the Board of Directors concerning such opportunities.

Executive Committee

Our executive committee currently consists of Messrs. Adler, Orr, Sloan and Vandiver. Mr. Fritsch, as our Chief Executive Officer, serves as an ex-officio member of the committee. Upon Mr. Vandiver s retirement as a director effective as of the date of the meeting, the size of the executive committee will be reduced from five to four (including the ex-officio member of the committee). The executive committee meets on call by the Chairman of the Board of Directors and may exercise all of the powers of the Board of Directors, subject to the limitations imposed by applicable law, the bylaws or the Board of Directors. Each member (other than the Chief Executive Officer) is independent. During 2006, the executive committee held four in-person meetings and 19 conference calls.

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COMPENSATION OF DIRECTORS AND EXECUTIVE OFFICERS

Compensation Discussion and Analysis

The following sets forth a discussion and analysis of the compensation of our principal executive officer, our principal financial officer and the next three most highly compensated executive officers during 2006, which we collectively refer to as the Named Executive Officers :

Edward J. Fritsch	President and Chief Executive Officer
Michael E. Harris	Executive Vice President and Chief Operating Officer
Terry L. Stevens	Vice President and Chief Financial Officer
Mack D. Pridgen, III (1)	Vice President, General Counsel and Secretary
Gene H. Anderson	Senior Vice President

(1) Mr. Pridgen s last day of employment with us was March 16, 2007.

Compensation Decision-Making. Our compensation and governance committee generally sets our compensation philosophy and makes specific compensation decisions with respect to our Named Executive Officers. Our compensation and governance committee currently consists of Messrs. Orr and Sloan and Ms. Callison. Mr. Orr serves as chairman of the committee. Each member is an independent director. For additional information about our compensation and governance committee, see Corporate Governance Compensation and Governance Committee. Actual compensation decisions with respect to Mr. Fritsch are made solely by the committee. Actual compensation decisions with respect to our other Named Executive Officers are made by the committee after receiving input from Mr. Fritsch. Named Executive Officers do not recommend or determine any element or component of their own pay package or total compensation amount.

Our current executive compensation program is based upon extensive input from Mercer Human Resource Consulting, which the compensation and governance committee retained in 1999, 2004 and 2007 to review our existing compensation philosophy and suggest design changes based on recent trends and developments impacting executive officer compensation and its best practices knowledge. Based on a review recently conducted by Mercer, we believe that overall compensation in 2006 for our Named Executive Officers was in the 25^{th} to 50^{th} percentile of our peer group (which is described below).

Amounts earned in 2006 from incentive awards granted prior to 2006 generally were not considered in setting compensation elements for 2006.

Other than Mr. Harris, none of our Named Executive Officers has an employment agreement with us. We entered into a three-year employment contract with Mr. Harris on July 1, 2004. The contract is thereafter extended automatically for additional three-year periods unless we give notice to Mr. Harris during the 60-day period ending one year prior to expiration of the contract. Mr. Harris may terminate the contract at any time upon 30 days prior written notice to us. The contract provides for a minimum annual base salary of $305,000 for Mr. Harris, which may be increased by the Board of Directors.

Notwithstanding the foregoing, we have entered into new change in control contracts effective as of April 13, 2007 with Messrs. Fritsch, Harris, Stevens and Anderson that provide for payments and benefits to such officers upon certain terminations of employment or diminishing of responsibilities within 36 months from the date of a change in control. For additional information about these arrangements, see Change in Control Arrangements in this Compensation Discussion and Analysis and Post-Employment Compensation.

Section 162(m) of the Internal Revenue Code generally denies a deduction for compensation in excess of $1 million paid to certain executive officers, unless certain performance, disclosure and stockholder approval requirements are met. Option grants and certain other awards are intended to qualify as performance-based compensation not subject to the Section 162(m) deduction limitation. The committee believes that a substantial portion of compensation earned under our compensation program would be exempted from the $1 million deduction limitation. The committee s intention is to qualify, to the extent reasonable, a substantial portion of each executive officer s compensation for deductibility under applicable tax laws.

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Compensation Objectives and Components. Compensation for Named Executive Officers is based largely on the following principles:

- variable compensation is a significant part of compensation with the percentage at-risk increasing at higher levels of responsibility;
- employee stock ownership aligns the interests of Named Executive Officers and stockholders and results in Named Executive Officers sharing financially in the successes and shortcomings of our Company based in part upon their position responsibility, overall impact and assessed contribution;
- performance-based compensation focuses Named Executive Officers on critical business objectives as reflected in our Strategic Plan, controls fixed costs and aligns pay with performance through performance-leveraged incentive opportunities;
- compensation must be competitive with that offered by other companies that compete with us to attract and retain the best possible executive talent; and
- differences in executive compensation should reflect differing levels of responsibility and performance with our organization.

A key factor in determining levels of compensation remains the pay practices of public equity REITs with comparable revenues. As of January 1, 2007, our peer group included the following public equity REITs:

- Brandywine Realty Trust;
- Corporate Office Properties Trust;
- Duke Realty Corp.;
- Kilroy Realty Corp.;
- Liberty Property Trust;
- Mack-Cali Realty Corp.; and
- Parkway Properties, Inc.

Publicly available data from the peer group was considered in determining the proportions of base salary, bonuses, annual non-equity incentive compensation and equity incentive compensation, as well as targeted total compensation. The data from our peer group is adjusted to take into account differences in market capitalization between the peer group companies and our Company. Overall compensation is intended to be at, above or below competitive levels depending upon our performance relative to our targeted performance and the performance of our peer group.

Base Salary. Base salaries for all of our employees are determined by position, which takes into consideration the scope of job responsibilities and competitive market compensation paid by other companies for similar positions. Base salaries are also driven by market competition to attract and retain high-quality employees. Our overall approach to setting base salaries is to create and sustain stockholder value by balancing our need to retain high-quality employees while controlling the annual growth of our general and administrative expenses. The base salaries earned by our Named Executive Officers were 3.5% higher in 2006 as compared to 2005, similar to the average increases for all of our salaried employees. In determining to increase base salaries, the compensation and governance committee considered, among other things, our planned operating budget for 2006, cost of living increases in our various divisional markets and publicly available data regarding the pay practices of other public REITs and similarly situated public companies. Base salaries are reviewed for adjustment annually and adjustments, if any, are effective in April. Individual base salaries for Messrs. Fritsch, Harris, Stevens and Anderson are 3.5% higher in 2007 as compared to 2006.

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Annual Non-Equity Incentive Program. In 2006, our Named Executive Officers participated in our annual non-equity incentive program pursuant to which they were eligible to earn cash payments (which were paid in March 2007) based on a percentage of their annual base salary in effect for December 2006. Under this component of our executive compensation program, our Named Executive Officers are eligible to earn additional cash compensation to the extent specific performance-based metrics are achieved during the most recently completed year. The position held by each Named Executive Officer has a target annual incentive percentage, which has generally remained consistent since 2000, ranging from 65% to 85% of base salary depending on the executive s position. For 2006, the target annual incentive percentage was 85% for Mr. Fritsch, 75% for Messrs. Harris, Stevens and Pridgen and 65% for Mr. Anderson. In addition to considering the pay practices of our peer group in determining each Named Executive Officer s annual incentive percentage, the committee also considers the individual officer s ability to influence our overall performance. The more senior the position within the Company, the greater the portion of compensation that varies with performance.

The actual amount a Named Executive Officer may earn under the annual non-equity incentive compensation program is the product of the target annual incentive percentage times an actual performance factor, which can range from zero to 200%. The actual performance factor depends upon the relationship between how various performance criteria compare with predetermined goals. For Messrs. Fritsch, Harris, Stevens and Pridgen, who served as corporate executives during 2006, the actual performance factor was based on the same goals and criteria applied to our performance as a whole. For Mr. Anderson, who serves as a corporate executive and is responsible for our Atlanta division, his actual performance factor is equally weighted between the performance of the Atlanta division and our performance as a whole. Participants in our annual non-equity incentive program receive quarterly statements throughout the year that illustrate our to-date performance under the varying criteria, which we believe is an important tool in keeping our employees focused on achieving these goals and delivering measurable results that create stockholder value.

The components and weighting of each year s metrics, which are set by the compensation and governance committee prior to or near the beginning of each year as part of our budgeting and strategic planning process, are intended to closely match the operating and financial goals of our Strategic Plan and to provide our Named Executive Officers with direct line of sight to focus their individual efforts to the achievement of the metrics. The performance criteria for Named Executive Officers during 2006, which were equally weighted, were the following:

- average occupancy rates relative to budgeted rates;
- net operating income relative to budgeted amounts;
- average payback on leases relative to a fixed goal; and
- the dollar value weighted average lease term relative to a fixed goal.

The compensation and governance committee set threshold, target and maximum levels with respect to each of the four factors. The following table sets forth information about the metrics and actual performance factors under our annual non-equity incentive program for 2006:

Factor	Threshold (50%)	Target (100%)	Maximum (200%)
Average Occupancy	99.6% of Budgeted Average Occupancy	100.1% of Budgeted Average Occupancy	101.5% of Budgeted Average Occupancy
Net Operating Income	97% of Budgeted Net Operating Income	103% of Budgeted Net Operating Income	110% of Budgeted Net Operating Income
Average Payback on Leases (1)	60 Basis Points Worse Than the Prior 3-Year Average	100.0% of Prior 3-Year Average	150 Basis Points Better Than the Prior 3-Year Average
Dollar Value Weighted	Prior 3-Year Average	Prior 3-Year Average Plus 0.5 Years	Prior 3-Year Average Plus 1.5 Years

Average Lease Term

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(1) Average payback on leases means the ratio of the investment we make in a particular lease divided by the total cash rent receivable under the fixed term of the lease. For this factor, a lower number means improved operating performance. For purposes of calculating this actual performance factor, the compensation and governance committee from time to time approves the exclusion of leases that are executed for important business purposes but the payback of which is not representative of the leasing efforts of our personnel nor appropriate upon which to base compensation decisions.

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If the threshold level is not satisfied with respect to a particular factor, the actual performance factor would be zero with respect to that factor. If performance exceeds the threshold level but does not satisfy the target level, the actual performance factor would range on a sliding scale between 50% and 100% with respect to that factor. If performance is between the target level and the maximum level, the actual performance factor would range on a sliding scale between 100% and 200% with respect to that factor. The performance factor used to determine the amount an executive could earn in 2006 under the annual non-equity incentive program was the equally weighted average of the four factors. Notwithstanding the formulas described above, our compensation and governance committee has retained the discretion and flexibility to increase or decrease the actual performance factor with respect to any particular year and/or any particular officer to more appropriately reflect, in the committee s sole judgment, actual performance, market conditions, unanticipated circumstances and other factors. The compensation and governance committee did not exercise its right to modify the actual performance factor for any of the Named Executive Officers in 2006. For 2006, the actual performance factor under the non-equity incentive program was approximately 108% for Messrs. Fritsch, Harris, Stevens and Pridgen and approximately 100% for Mr. Anderson. As a result, under the non-equity incentive program for 2006, Mr. Fritsch earned $397,089, Mr. Harris earned $264,836, Mr. Stevens earned $209,737, Mr. Pridgen earned $196,768 and Mr. Anderson earned $156,378.

The committee has adopted the following performance criteria for officers during 2007:

growth in core funds from operations (FFO) (36% weighting for corporate executives and 24% weighting for divisional officers);

net operating income relative to budgeted amounts (20% weighting for corporate executives and 30% weighting for divisional officers);

cash available for distribution (CAD) payout ratio (24% weighting for corporate executives and 16% weighting for divisional officers);

average occupancy rates relative to budgeted rates (12% weighting for corporate executives and 18% weighting for divisional officers); and

average payback on leases relative to a fixed goal (8% weighting for corporate executives and 12% weighting for divisional officers).

The compensation and governance committee has set threshold, target and maximum levels with respect to each of the five factors. The following table sets forth information about the metrics and actual performance factors under our annual non-equity incentive program for 2007:

Factor	**Threshold (50%)**	**Target (100%)**	**Maximum (200%)**
Core FFO Growth	Projected Threshold Increase over Prior Year	Projected Target Increase over Prior Year	Projected Maximum Increase over Prior Year
Net Operating Income	97% of Budgeted Net Operating Income	103% of Budgeted Net Operating Income	110% of Budgeted Net Operating Income
CAD Payout Ratio	Projected Threshold Decrease over Prior Year	Projected Target Decrease over Prior Year	Projected Maximum Decrease over Prior Year
Average Occupancy	99.6% of Budgeted Average Occupancy	100.1% of Budgeted Average Occupancy	101.5% of Budgeted Average Occupancy
Average Payback on Leases (1)	60 Basis Points Worse Than the Prior 3-Year Average	100.0% of Prior 3-Year Average	150 Basis Points Better Than the Prior 3-Year Average

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(1) Average payback on leases means the ratio of the investment we make in a particular lease divided by the total cash rent receivable under the fixed term of the lease. For this factor, a lower number means improved operating performance. For purposes of calculating this actual performance factor, the compensation and governance committee from time to time approves the exclusion of leases that are executed for important business purposes but the payback of which is not representative of the leasing efforts of our personnel nor appropriate upon which to base compensation decisions.

It is the annual expectation of the compensation and governance committee that the estimated probability of achievement of the threshold levels is 80%, the estimated probability of achievement of the target levels is 60% and the estimated probability of achievement of the maximum levels is 20%.

Amounts Earned in 2006 for Grants in 2004 under the 1999 Shareholder Value Plan. The 1999 Shareholder Value Plan is intended to reward our executive officers when the total shareholder returns measured by increases in the market value of Common Stock plus dividends exceeds a comparable index of our peers over a three-year period. A payout for this program, which is in cash or shares of Common Stock at the election of the officer, is determined by the percentage change in our shareholder return index compared to the composite index of our peer group. If our performance is not at least 100% of the peer group, no payout is earned. As with our annual non-equity incentive program, notwithstanding the specific payout criteria described above, our compensation and governance committee has retained the discretion and flexibility to increase or decrease the payout, if any, under the 1999 Shareholder Value Plan to more appropriately reflect, in the committee s sole judgment, actual performance, market conditions, unanticipated circumstances, absolute performance of our Common Stock and other factors. No new grants have been made under the 1999 Shareholder Value Plan since 2004. Prior to 2006, no payouts had been earned for grants under this plan.

The closing price of our Common Stock as reported on the New York Stock Exchange increased from $25.40 per share on January 1, 2004 to a 30-day trailing average of $40.02 per share as of December 31, 2006, which resulted in an 88.6% total stockholder return over that period assuming the reinvestment of dividends. Because the total return index of our Common Stock over the applicable period was 106% of a comparable index of our peers, Named Executive Officers were entitled to earn an aggregate of $350,835 in payouts for awards granted in 2004 under the 1999 Shareholder Value Plan (including the value of the discount attributable to the issuance of Common Stock to Messrs. Pridgen and Stevens, who elected at the beginning of the three-year period to receive shares of Common Stock at a 10% discount in lieu of a cash payout, if any, with respect to grants in 2004 under the 1999 Shareholder Value Plan). In recognition of the significant absolute total stockholder return over the three-year period, the compensation and governance committee increased the payout ratio from 106% to 130%, which resulted in our Named Executive Officers earning an additional $323,889 in the aggregate, including the value of the discount attributable to the issuance of Common Stock to Messrs. Pridgen and Stevens.

Equity Incentive Compensation Overview. Our officers, including our Named Executive Officers, are eligible to receive equity incentive compensation that promotes our long-term success by aligning their interests with the interests of our stockholders. The equity incentive awards provide the executive officers with an ownership interest in our Company and a direct and demonstrable stake in our success to the extent of their position, responsibility, overall impact and assessed contribution. We have adopted stock ownership guidelines for our Named Executive Officers. For additional information, see Corporate Governance Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Our compensation and governance committee authorizes a mix of stock options and restricted stock awards to our Named Executive Officers valued at amounts ranging in the aggregate from 100% to 295% of their annual base salary depending upon level of responsibility within our Company. For the grant date fair value of such awards in 2006 calculated in accordance with FAS 123(R), see the Grant Date Fair Value of Stock and Option Awards column in the table under Grants of Plan-Based Awards in 2006. The compensation and governance committee retains the ability to alter the equity incentive percentage or the mix of equity incentive awards from year to year. Equity incentive awards in 2006 were allocated as follows:

Type of Grant	**Percentage of Total**
Stock Options	20%
Time-Based Restricted Stock	40%
Performance-Based Restricted Stock	20%
Total Return-Based Restricted Stock	20%

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Dividends are paid on all restricted stock, whether or not vested, at the same rate and on the same date as on shares of Common Stock, and such dividends are non-forfeitable.

Equity Incentive Compensation Stock Options. The compensation and governance committee believes that stock option awards are an important and useful component of our equity incentive compensation program. Like restricted stock, stock options offer the potential to realize additional compensation in the future upon increases in the price of our Common Stock. Stock options differ from restricted stock in several key areas. First, the receipt of stock options is generally not taxable to holders until exercise, at which time there is typically cash available to the holder as a result of the sale of shares acquired upon exercise to pay the tax. Second, unless we elect, in our sole discretion, to net share settle an option upon exercise by issuing an amount of shares equal to the in-the-money value of the option, stock option exercises have a positive impact on our cash flows from financing activities. Third, holders of stock options, unlike restricted stock, are not entitled to receive dividends except upon exercise. Stock options issued in 2006 vest ratably on an annual basis over four years and remain outstanding for seven years. The value of such options as of the date of grant was calculated using the Black-Scholes option-pricing model.

Equity Incentive Compensation Time-Based Restricted Stock. The compensation and governance committee believes that the issuance of time-based restricted stock is an important retention device and serves to deter our Named Executive Officers from seeking other employment opportunities. Shares of time-based restricted stock represented half of the total number of shares of restricted stock issued to our Named Executive Officers in 2006. Time-based restricted stock issued in 2006 will vest ratably on an annual basis over a four-year term. If a Named Executive Officer leaves our employ at any time before the fourth anniversary of the date of grant, unvested shares generally are forfeited except as otherwise provided under our retirement plan.

In addition to the ordinary grant in 2007 of time-based restricted stock in amounts consistent with past practice, our compensation and governance committee wanted to reward Messrs. Fritsch, Harris and Anderson for individual excellent performance over the past several years. Accordingly, the committee in 2007 authorized an additional grant of time-based restricted stock in 2007 of 100,000 shares for Mr. Fritsch, 31,000 shares for Mr. Harris and 12,500 shares for Mr. Anderson. Such shares issued to Messrs. Harris and Anderson will vest ratably over three years. Such shares issued to Mr. Fritsch will vest ratably over four years. If any such officer leaves our employ at any time during the vesting period, unvested shares will be forfeited regardless of whether such officer is eligible for benefits under our retirement plan.

Equity Incentive Compensation Total Return-Based Restricted Stock. The compensation and governance committee believes the issuance of total return-based restricted stock directly aligns the interests of our Named Executive Officers with stockholder interests. One of our principal goals is to provide our stockholders with attractive risk-adjusted returns on their investment through the consistent payment of quarterly dividends and stock price appreciation. Shares of total return-based restricted stock generally vest only to the extent our total return index over a three-year period is at least 100% of our peer group. Total return is defined as the sum of stock price appreciation plus reinvested dividends over the stock value at the beginning of the applicable period. The peer companies with the highest and lowest total return are eliminated from the calculation to avoid any one outlier from distorting the overall comparison. In addition, the total return of each company in the peer group is weighted to reflect the relative market capitalization of each company. The 2005 Shareholder Value Plan sets forth more information about the amounts and vesting schedules with respect to shares of total return-based restricted stock issued in 2006.

Our compensation and governance committee selected a three-year cycle to match the grants of total return-based restricted stock in 2006 generally with the three-year goals set during the budgeting process for our Strategic Plan. The three-year performance period begins on January 1 of the year of the grant. The percentage of total return-based restricted stock that vests at December 31, 2008 will be equal to the sum of 50% plus 2.5% for each percentage point that our total return index exceeds 100% of the peer group index. Accordingly, if our total return index is not at least 100% of the peer group index, all of the total return-based restricted stock issued in 2006 will be forfeited on December 31, 2008, except as otherwise described below. If our total return index ranges between 100% and 120% of the peer group index, the percentage of total return-based restricted stock issued in 2006 that vests on December 31, 2008 will range between 50% and 100%. If our total return index ranges between 120% and 160% of the peer group index, we will issue on December 31, 2008 an amount of additional shares up to 100% of

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the original total return-based restricted stock award. These additional shares, if any, would be fully vested when issued. If a Named Executive Officer leaves our employ at any time before the end of the three-year cycle, all of the total return-based restricted stock issued in 2006 generally will be forfeited except to the extent vested as set forth in the next paragraph.

Notwithstanding the foregoing, even if our total return index over the three-year period is less than 100% of the peer group index, one-sixth of the total return-based restricted stock issued in 2006 will nonetheless vest at the end of each year during the three-year cycle if our total return index exceeds 9% during such applicable year. The purpose of this additional vesting criteria is to reward Named Executive Officers when we deliver in any particular year what the compensation and governance committee believes is an attractive absolute level of return to our stockholders. Assuming the reinvestment of dividends, long-term holders of our Common Stock realized a 50.6% total stockholder return during 2006. As a result, one-sixth of the total return-based restricted stock issued in 2006 vested as of December 31, 2006.

Equity Incentive Compensation Performance-Based Restricted Stock. The compensation and governance committee believes the issuance of performance-based restricted stock is an important motivational tool designed to reward our Named Executive Officers with additional equity incentive compensation to the extent specific performance-based metrics are achieved over a three-year period. The components and weighting of the metrics for the grants of performance-based restricted stock in 2006, which are set by the compensation and governance committee prior to or near the beginning of each year as part of our Company s budgeting process, are intended to closely match certain three-year goals of our Strategic Plan. The company-wide performance criteria for performance-based restricted stock issued during 2006, which are equally weighted, are the following financial and operating measures as of and for the year ended December 31, 2008:

- overall occupancy;
- ratio of debt plus Preferred Stock to adjusted assets;
- cumulative three-year FFO per diluted share (adjusted to eliminate certain debits and credits in the discretion of the compensation and governance committee); and
- cash available for distribution payout ratio.

At the beginning of 2006, the compensation and governance committee set the following threshold, target and maximum levels with respect to each of the four factors:

Factor	Threshold (50%)	Target (100%)	Maximum (150%)
Overall Occupancy at December 31, 2008	98.9% of internal strategic goal	100.0 % of internal strategic goal	101.1% of internal strategic goal
Ratio of Debt plus Preferred Stock to Adjusted Assets at December 31, 2008	95.7% of internal strategic goal	100.0% of internal strategic goal	103.2% of internal strategic goal
Cumulative Three-Year FFO Per Share	98.7% of internal strategic goal	100.0% of internal strategic goal	101.3% of internal strategic goal
Cash Available for Distribution Payout Ratio for 2008	92.0% of internal strategic goal	100.0% of internal strategic goal	105.7% of internal strategic goal

It is the expectation of the compensation and governance committee that the estimated probability of achievement of the threshold levels is 80%, estimated probability of achievement of the target levels is 60% and estimated probability of achievement of the maximum levels is 20%. If the threshold level is not satisfied as of December 31, 2008 with respect to a particular factor, the vesting percentage would be zero with respect to that factor. If performance is between the threshold level and the target level, the vesting percentage would range on a sliding scale between 50% and 100% with respect to that factor. If performance is between the target level and the

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maximum level, the vesting percentage would range on a sliding scale between 100% and 150% with respect to that factor. The number of shares of performance-based restricted stock that vests at December 31, 2008 will be based on the overall average of these vesting percentages. Unvested shares of performance-based restricted stock would be forfeited at December 31, 2008. We will issue an amount of additional shares up to 50% of the original total performance-based restricted stock award to the extent the overall average of the vesting percentages exceeds 100%. These additional shares, if any, would be fully vested when issued. If a Named Executive Officer leaves our employ at any time before the end of the three-year cycle, all of the performance-based restricted stock issued in 2006 generally will be forfeited.

Named Executive Officers receive quarterly statements throughout the three-year period that specifically illustrate our to-date performance under the varying criteria. We believe this is an important tool in keeping our officers focused on attaining the higher levels of the criteria and delivering tangible and concrete results that create long-term, sustainable stockholder value.

The company-wide performance criteria for performance-based restricted stock issued during 2007, which are equally weighted, are the following financial and operating measures as of and for the year ended December 31, 2009:

- overall occupancy;
- cumulative three-year FFO per diluted share (adjusted to eliminate certain debits and credits in the discretion of the compensation and governance committee);
- cumulative three-year free cash flow; and
- average three-year operating expense ratio.

At the beginning of 2007, the compensation and governance committee set the following threshold, target and maximum levels with respect to each of the four factors:

Factor	Threshold (50%)	Target (100%)	Maximum (150%)
Overall Occupancy at December 31, 2009	98.4% of internal strategic goal	100.0% of internal strategic goal	101.1% of internal strategic goal
Cumulative Three-Year FFO Per Share	98.1% of internal strategic goal	100.0% of internal strategic goal	105.1% of internal strategic goal
Cumulative Three-Year Free Cash Flow	77.8% of internal strategic goal	100.0% of internal strategic goal	133.3% of internal strategic goal
Average Three-Year Operating Expense Ratio	95.6% of internal strategic goal	100.0% of internal strategic goal	103.8% of internal strategic goal

Employee Benefits and Perquisites. Each Named Executive Officer receives the same company-wide benefits as are generally available to all other salaried employees, such as short- and long-term disability insurance, basic life insurance and eligibility for supplemental health and life insurance, flexible health care reimbursement accounts and 401(k) matching. Named Executive Officers participate in the same company-wide health insurance program, except that we pay a Named Executive Officer s family premium. Additionally, Named Executive Officers are entitled to receive a nominal amount of additional annual perquisites not widely available to all salaried employees, including a car allowance and, subject to limitations, reimbursement for personal financial consulting services and the costs of a physical exam not otherwise covered by our health insurance. We also paid the life insurance premiums for additional coverage on behalf of Messrs. Fritsch and Pridgen during 2006. Named Executive Officers may also elect to defer a portion of their bas