

HGP

Horizon Group Properties

2010 Annual Report



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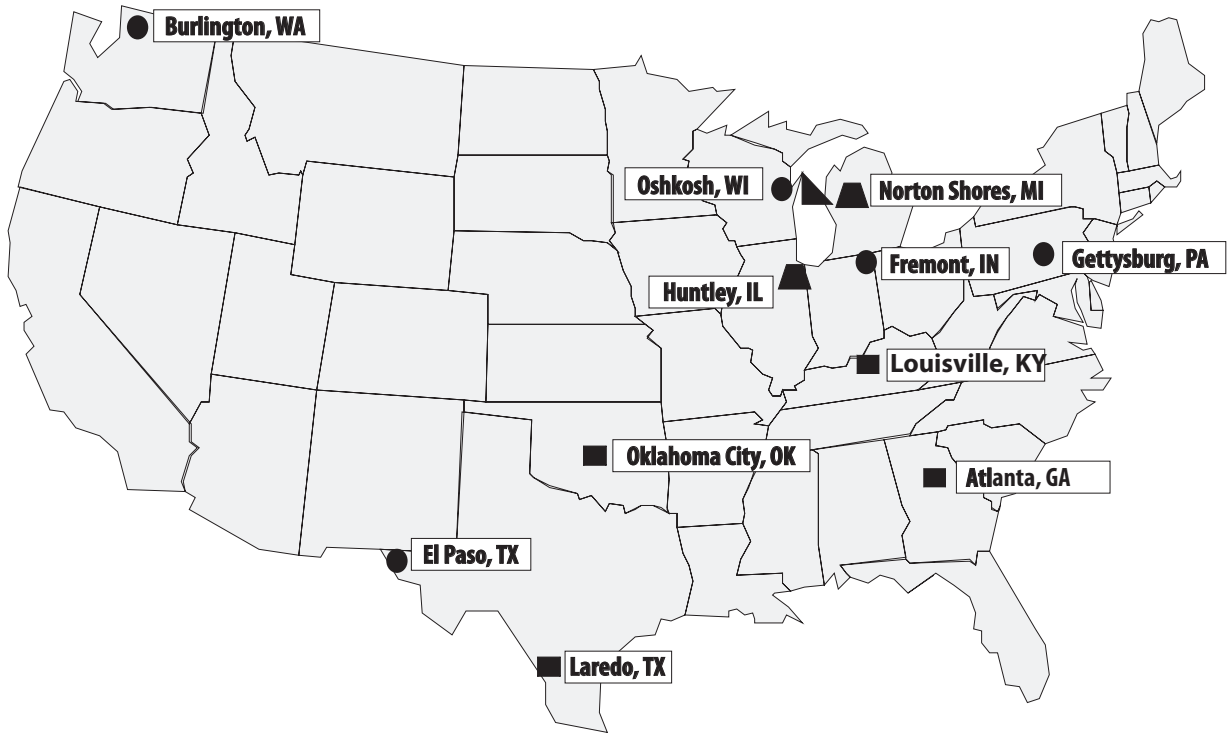
TOMMY HILFIFGER
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Portfolio



- Outlet Center
- Outlet Center under development
- ▲ Office Building
- ▲ Land Development

Company Profile

Based in Norton Shores, Michigan, Horizon Group Properties, Inc. is an owner and developer of factory outlet shopping centers and the developer of a master planned community in suburban Chicago.

Our shopping centers feature favorite name brand stores such as Polo Ralph Lauren, Coach, Kenneth Cole, Banana Republic, Gap Outlet, Nike, Carter's and PacSun, just to name a few.

Cover - The Outlet Shoppes at Oklahoma City

Dear Stockholder,

I am pleased to report that the state of the outlet shopping center industry is strong, perhaps the strongest it's been since the industry began. The health of the industry comes despite the fact that the national economy has improved little since my letter last year. In fact, there is reason to believe that the country may be in for a prolonged period of slow or little growth similar to what occurred during the seventies.

There is no doubt that the bad economy has actually helped the outlet industry, but there is far more at play than simply hard-pressed consumers trying to save money while still purchasing branded goods. At the recent International Council of Shopping Center Convention held in May, which is the largest real estate convention in the US and perhaps the world, the retail sector garnering the most attention was the outlet sector. Three major mall players have announced plans to enter the outlet business this year. Retailers continue to increase their presence in the sector and additional retailers seek to enter the industry. Sales at outlet centers continue to rise.

This is all good news for Horizon Group Properties. The Company is positioned to take advantage of the growth in this sector. We have a pipeline of new developments in hand and a strong, experienced team prepared to take on the challenges of competing in this sector. On August 5th, we will open The Outlet Shoppes at Oklahoma City, the only new outlet center to be opened in 2011 in the US. We also see opportunities to improve the performance of the properties in our portfolio through the addition of new tenants and the expansion of several of our existing centers.

The Outlet Shoppes at Oklahoma City

Our newest development, The Outlet Shoppes at Oklahoma City, at the intersection of Interstate 40 and Council Road, is nearing completion. It is poised to open with more than 96 percent of the space leased, significantly above the level at which most centers are opened. In fact, the leasing of the center has been so strong that rather than the 323,000 square foot center I wrote of last year, the center will open with 348,000 square feet of leasable area. The quality and mix of the tenants at the center is strong and includes Saks Off 5th, Nike, Coach, Gap, Banana Republic, Ralph Lauren Polo, DKNY, Guess, and Brooks Brothers to name just a few.

The total cost for the project is \$69 million and, as of this writing, will be completed within budget and on schedule. We believe that this center will be a strong performer given the fact that it will have some great name tenants that are new to the Oklahoma City market. In addition, the market is not over retailled and the local economy is far stronger than the national average. If the performance of the tenants at the center is as strong as we believe it will be, we will begin planning for expansion of the center next year.

The Outlet Shoppes at Atlanta

The next project in Horizon's pipeline is The Outlet Shoppes at Atlanta to be located on Interstate 575 at a new four way interchange currently being constructed at Ridgewalk Parkway in Woodstock, GA. The site, which we have under contract to acquire, is comprised of 50 acres

with good visibility from the Interstate and easy access from Ridgewalk Parkway. The population surrounding the site is large and the median income levels are well above average. This center will be far closer to the city of Atlanta than the existing outlet centers in the market and therefore has very strong demographics. It is also well positioned to garner a significant share of the tourist population looking to shop at outlets.

The project will be built in two phases with the first being approximately 380,000 square feet; the second will be approximately 35,000 square feet. Tenant interest in the site has been strong. We have already secured commitments from tenants for approximately half of the leasable space. Construction on the project is projected to commence in early 2012 with completion scheduled for summer 2013.

The Outlet Shoppes at Louisville

At the ICSC Convention in May, we announced the next development in our pipeline, The Outlet Shoppes at Louisville, which was received very favorably. The site, located on Interstate 64 east of Louisville, will serve the more than two million people in the Louisville and Lexington market. It will be the only true outlet mall in the entire State of Kentucky. The site has great visibility and access from the Interstate. Our preliminary plan is for the center to contain about 350,000 square feet of retail space with construction to commence in the late summer of 2012 and open in the fall of 2013.

Leasing and Property Operations

Our activity is not solely focused on new development. We continue to strive to improve occupancy and sales in the five operating outlet centers in our portfolio. Our center in El Paso, Texas has produced strong growth in sales each year since opening in 2007. We have replaced some weaker tenants that featured apparel for mature women with stronger tenants that appeal to a more youthful audience. We believe this has created a merchandise mix superior to the mix that existed when the center opened. In recent months, we have added tenants including Guess Accessories, Chico's, Soma and Clarke's Shoes. A Ralph Lauren Polo store will open during the first week of July.

We are working to expand this center by adding 35,000 square feet of leasable space to the existing 385,000 square feet. We are engaged in discussions with some terrific tenants for the expansion and will commence construction when we have signed the tenants required to make the expansion work. Because some of the costs associated with the expansion were included in the cost of the original project, the cash-on-cash return on the cost of the expansion should be 30% above average.

Similar to El Paso, The Outlet Shoppes at Burlington has experienced several years of significant sales growth. In fact, gross sales at the center are up almost 75% in the past two years. Three years ago we signed a temporary lease with Lululemon for its first US outlet store. Because of the high sales volume at the store, we recently converted that lease into a long-term lease. We added a Nike store to the center last fall which is performing well, are in the process of moving Coach to a larger space, and recently added Vanity Fair in a temporary space as an experiment to see how they perform in this market. The center occupancy is still only 70%, but

sales are in excess of \$300 per square foot and we think the elements are in place to permit us to fully lease the center and to substantially increase its net operating income.

The Outlet Shoppes at Oshkosh is another success story; 33% of the space is occupied by tenants that we have added to the center since we acquired it in 2007. In addition to bringing Nike, Under Armour, Levi's and Brooks Brothers, amongst others, to the center over the last few years, this past year we added Coach, Christopher and Banks, and Yankee Candle. We have produced sales increases at the center since we purchased it. We have started a marketing campaign to inform the shoppers in the market about all of the new tenants and changes at the center to further drive up sales.

We have also added key tenants to The Outlet Shoppes at Gettysburg in the past year including Brooks Brothers, Levi's, Under Armour and Kahn Lucas. We are exploring the economics of adding additional space to the center to increase its critical mass. This center is designed in the colonial style and is located in a region that is conducive to traditional Christmas decorations. Over the last several years, we have devoted additional funds to reach our goal of making this a must see place for families to come during the holiday season and a true Christmas season destination.

I have written in the past about the outlet development we have planned for Laredo, TX. The plans for this site have been fraught with difficulty; first it was the violence across the border, next was the emergence of three competing sites and finally, the flooding by the adjacent Rio Grande River. Last summer the river rose to a level that flooded the center with four feet of water. To date we have received \$3.1 million from insurance proceeds, \$2 million of which was used to pay down the existing loan secured by the property and the balance to preserve and clean up the property. We are millions of dollars apart on the balance of our claim with the CNA, the insurance carrier on the property. While we wish to resolve the matter amicably, it seems likely that this issue will need to be settled by the courts. In the meantime, we continue to review our options for developing an outlet shopping center in Laredo.

Debt

We have made significant progress in dealing with maturing debt on several of our real estate assets. In February 2011, we extended the maturity of the loan secured by a strip center in Huntley, IL that originally matured in February. This \$2.7 million loan now matures in February 2014.

We have an approximately \$20 million loan from US Bank secured by a mortgage on land we own in Huntley, IL. The loan originally matured in May 2011. We successfully extended this loan; the new maturity date is May 2013. No area of real estate has been more negatively affected than undeveloped land. Sales activity has been at a standstill but we hope we will have sold land to pay down additional principal on the loan before its maturity. The bank agrees with us that when the markets recover, this land will have significant value above the balance of the loan.

Preferred equity in the amount of \$9.5 million on The Outlet Shoppes at El Paso came due in October of last year. We had been working with the holder of the preferred equity on an

extension of the maturity prior to its maturity only to be informed that the lender was unwilling to extend and wanted to be repaid. We have secured a commitment for replacement financing and are currently awaiting approval of that financing by the servicer of the senior debt on the property. We are confident that such approval will be obtained. The new preferred equity will have a maturity in 2017 which is concurrent with the maturity of the senior loan. The replacement preferred equity has an interest rate that is 200 basis points below the rate on the existing preferred equity.

A \$6 million mezzanine loan secured by a pledge of our partnership interests in The Outlet Shoppes at Gettysburg and a mortgage on vacant land at the center requires a pay down of \$4 million in July. We are negotiating with the lender to waive the pay down or to sell us the note at discount to the current principle balance. We have signed a pre-negotiation letter with the lender and expect to begin discussions on this issue shortly.

China and Asia

Last year I reported on the joint venture we formed with Richly Fields, a Chinese real estate development firm. Horizon will provide its development expertise as well as leasing and management services in connection with the development of outlet centers in China. In September, the first center will open in Changsha. The next center to be developed will be in Guangzhou adjacent to the Guangzhou International Convention and Exhibition Center, one of the largest such facilities in the world and which is surrounded by a large population. The biggest challenge to successfully developing in China is having enough international brands to make the projects exciting for consumers. More and more international brands are entering the market and as they do, the prospects will increase for the development of additional outlets.

We recently began due diligence on projects in Kuala Lumpur, Malaysia and a northern Island of Indonesia, a resort destination that is a 30 minute ferry ride from Singapore. Both projects would be undertaken with large domestic firms in each country. Based on the full price retailing in both places, the prospects for outlets seem very exciting.

While the opportunities in Asia are good for Horizon, I do not want them to overshadow the projects we are doing in the US. Our main focus will continue to be in the US where there are many terrific opportunities. So that our work in Asia is not a distraction to our US efforts, in February we hired Maggie Xu as Vice President for Asia to oversee our activities there. Maggie is fluent in Mandarin Chinese and brings development expertise and cultural knowledge to our Asian ventures.

Growth Strategy

Horizon has a strong franchise but in the past has been capital constrained requiring the Company to be nimble to be able to finance development activity and acquisitions. Like most corporations, we did not foresee the sharp downturn in the economy and the breakdown in the capital markets that began in late 2007. It delayed and added costs to our development activity which in turn strained our cash flow.

Today, the strength of the outlet sector coupled with the lack of good real estate investment options, our pipeline of projects and our ever improving reputation have lead us to conclude that it is an ideal time to identify a growth partner. We are actively working to find a partner that will allow us to leverage our existing assets and provide capital to propel us forward. A transaction of this type coupled with the completion of our new outlet projects should leave the Company in a far better position from a cash flow perspective.

In May, we hired David Nelson to be our Chief Investment Officer to spearhead the effort to identify new capital. David most recently worked in capital markets and acquisitions for Cousin Properties. He will be critical to the success of our efforts in this area.

Our development pipeline as described above is very important to our growth strategy. We are actively identifying the two sites that will follow The Outlet Shoppes at Louisville. We receive information on proposed sites weekly from landowners and local municipalities. Most of these do not work. We spend extensive time, effort and due diligence to make sure that any site on which we proceed has a high likelihood of being the site for a successful outlet center.

On the acquisition side, we have found the opportunities to be rather limited or at prices that are far higher than we are willing to pay. While we continue to review assets as they come on the market, I do not see this as a significant part of our growth strategy.

Conclusion

Last year, in my letter, I listed the names of all of our staff that have been instrumental in our success over the past few years. They continue to be critical to all of our efforts. This year I want to single out a few key individuals who have been involved in development of The Outlet Shoppes of Oklahoma City. Andy Pelmoter heads our leasing team that includes John Lane and Paul Schaffer. They are responsible for the fact that The Outlet Shoppes at Oklahoma City will be opened at least 96% leased with some of the finest brands in the outlet business. We anticipate that the center will be opened on time and within budget. Tom Rumptz and his team of Jack Barrett, Dave Spring, Ed Anderson and Jennifer Chartrand have made this happen. I thank them and all of the employees of Horizon who contributed to this exciting project.

These are exciting times for Horizon and we clearly have our work cut out for us. We intend to take advantage of the strength of our organization and the growth in the outlet sector. As always we remain committed to improving the return on the investment that you have made in the Company.

Sincerely,



Gary J. Skoien

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Consolidated Financial Statements

Horizon Group Properties, Inc.

For the years ended December 31, 2010 and 2009

Horizon Group Properties, Inc.
Consolidated Financial Statements
For the years ended December 31, 2010 and 2009

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Horizon Group Properties, Inc.

We have audited the accompanying consolidated balance sheets of Horizon Group Properties, Inc. (the "Company") as of December 31, 2010 and 2009, and the related consolidated statements of operations, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Horizon Group Properties, Inc. as of December 31, 2010 and 2009, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

Cohen & Company

Cleveland, Ohio
June 30, 2011

HORIZON GROUP PROPERTIES, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands)

	December 31, 2010	December 31, 2009
ASSETS		
Real estate – at cost:		
Land	\$ 34,965	\$ 34,965
Buildings and improvements	100,859	103,136
Less accumulated depreciation	<u>(17,324)</u>	<u>(15,249)</u>
	118,500	122,852
Construction in progress	731	3,544
Land held for investment	<u>19,453</u>	<u>20,295</u>
Total net real estate	138,684	146,691
Investment in and advances to joint ventures	11,126	1,967
Cash and cash equivalents	463	1,406
Restricted cash	4,113	3,108
Marketable securities	4,433	11,392
Tenant and other accounts receivable, net	1,387	1,471
Deferred costs (net of accumulated amortization of \$2,465 and \$2,265, respectively)	2,522	3,646
Other assets	<u>2,057</u>	<u>3,070</u>
Total assets	<u>\$164,785</u>	<u>\$172,751</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Mortgages and other debt	\$133,744	\$143,026
Accounts payable and other accrued expenses	3,363	3,346
Prepaid rents and other tenant liabilities	812	740
Participation interests and other liabilities	<u>525</u>	<u>1,100</u>
Total liabilities	<u>138,444</u>	<u>148,212</u>
Commitments and contingencies		
Stockholders' equity:		
Common shares (\$.01 par value, 50,000 shares authorized, 2,859 and 2,843 issued and outstanding, respectively)	29	28
Additional paid-in capital	34,685	36,008
Accumulated deficit	<u>(26,484)</u>	<u>(24,284)</u>
Total stockholders' equity attributable to the controlling interest	8,230	11,752
Noncontrolling interests in consolidated subsidiaries	<u>18,111</u>	<u>12,787</u>
Total stockholders' equity	<u>26,341</u>	<u>24,539</u>
Total liabilities and stockholders' equity	<u>\$164,785</u>	<u>\$172,751</u>

See accompanying notes to consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands)

	Year ended December 31, 2010	Year ended December 31, 2009
REVENUE		
Base rent	\$11,699	\$11,987
Percentage rent	301	276
Expense recoveries	3,009	3,239
Other	4,993	1,811
Interest	<u>413</u>	<u>376</u>
Total revenue	<u>20,415</u>	<u>17,689</u>
EXPENSES		
Property operating	4,233	4,750
Real estate taxes	1,813	1,680
Other operating	182	459
Depreciation and amortization	5,658	6,541
General and administrative	5,082	4,045
Interest	7,971	7,380
Gain on marketable securities	<u>(105)</u>	<u>(162)</u>
Total expenses	<u>24,834</u>	<u>24,693</u>
Income from investment in joint ventures	<u>466</u>	<u>677</u>
Consolidated net loss from continuing operations	(3,953)	(6,327)
Loss from discontinued operations	<u>-</u>	<u>(399)</u>
Consolidated net loss before gain on sale of real estate	(3,953)	(6,726)
Gain on sale of real estate	<u>844</u>	<u>17</u>
Consolidated net loss	(3,109)	(6,709)
Less net loss attributable to the noncontrolling interests	<u>909</u>	<u>2,378</u>
Net loss attributable to the Company	<u><u>\$(2,200)</u></u>	<u><u>\$(4,331)</u></u>

See accompanying notes to consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands)

	Common Shares	Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Equity Attributable to the Controlling Interest	Noncontrolling Interests in Consolidated Subsidiaries	Total Stockholders' Equity
Balance, January 1, 2010	\$28	\$36,008	\$(24,284)	\$11,752	\$12,787	\$24,539
Net loss	-	-	(2,200)	(2,200)	(909)	(3,109)
Stock grant to officers	1	8	-	9	-	9
Sale of interests in consolidated subsidiaries (See Note 3)	-	(1,331)	-	(1,331)	2,955	1,624
Net contributions from noncontrolling interests	-	-	-	-	3,278	3,278
Balance, December 31, 2010	<u>\$29</u>	<u>\$34,685</u>	<u>\$(26,484)</u>	<u>\$ 8,230</u>	<u>\$18,111</u>	<u>\$26,341</u>

	Common Shares	Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Equity Attributable to the Controlling Interest	Noncontrolling Interests in Consolidated Subsidiaries	Total Stockholders' Equity
Balance, January 1, 2009	\$29	\$37,514	\$(19,953)	\$17,590	\$12,966	\$30,556
Net loss	-	-	(4,331)	(4,331)	(2,378)	(6,709)
Stock grant to officers	-	29	-	29	-	29
Stock buyback and retirement	(1)	(80)	-	(81)	-	(81)
Sale of interests in consolidated subsidiaries (See Note 3)	-	(1,455)	-	(1,455)	2,774	1,319
Net distributions to noncontrolling interests	-	-	-	-	(575)	(575)
Balance, December 31, 2009	<u>\$28</u>	<u>\$36,008</u>	<u>\$(24,284)</u>	<u>\$11,752</u>	<u>\$12,787</u>	<u>\$24,539</u>

See accompanying notes to consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	<u>Year ended</u> <u>December 31, 2010</u>	<u>Year ended</u> <u>December 31, 2009</u>
Cash flows from operating activities:		
Net loss attributable to the Company	\$(2,200)	\$(4,331)
(Gain)/loss on sale of real estate, including amounts in discontinued operations	(844)	121
Adjustments to reconcile net loss attributable to the Company to net cash used in operating activities:		
Net loss attributable to the noncontrolling interests	(909)	(2,378)
Income from investment in joint ventures	(466)	(677)
Depreciation	5,475	6,423
Amortization, including deferred financing costs	1,363	1,241
Gain on marketable securities	(105)	(162)
HGPI stock grants	9	(25)
Changes in assets and liabilities:		
Restricted cash	(1,005)	585
Tenant and other accounts receivable	84	725
Real estate held for sale	-	90
Deferred costs and other assets	(337)	(587)
Accounts payable and other accrued expenses	918	(2,064)
Participation interests and other liabilities	(575)	(678)
Prepaid rents and other tenant liabilities	<u>72</u>	<u>(51)</u>
Net cash provided by/(used in) operating activities	<u>1,480</u>	<u>(1,768)</u>
Cash flows from investing activities:		
Net marketable securities activity	7,064	(1,056)
Net (contribution to)/distribution from joint ventures	(4,645)	678
Repayment on notes receivable	-	96
Expenditures for buildings and improvements	(5,887)	(1,585)
Expenditures for land held for investment	-	(7)
Cash transferred in connection with the formation/(de-consolidation) of entities	4,006	(44)
TIF Bond Collateral Account proceeds (see Note 10)	-	4,000
Net proceeds from sale of real estate	<u>1,688</u>	<u>2,536</u>
Net cash provided by investing activities	<u>2,226</u>	<u>4,618</u>
Cash flows from financing activities:		
Net contributions from/(distributions to) noncontrolling interests	3,278	(575)
Net proceeds from sale of ownership interests	1,624	1,350
Principal payments on mortgages and other debt	(13,887)	(13,890)
Proceeds from borrowings	4,605	11,649
Debt issue costs	(269)	(542)
HGPI stock buyback and retirement	-	(27)
Payment of participation interests	<u>-</u>	<u>(164)</u>
Net cash used in financing activities	<u>(4,649)</u>	<u>(2,199)</u>
Net increase/(decrease) in cash and cash equivalents	(943)	651
Cash and cash equivalents:		
Beginning of year	<u>1,406</u>	<u>755</u>
End of year	<u>\$ 463</u>	<u>\$ 1,406</u>

See accompanying notes to consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS, **continued**
(In thousands)

	<u>Year ended</u> <u>December 31, 2010</u>	<u>Year ended</u> <u>December 31, 2009</u>
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Supplemental Information

During the years ended December 31, 2010 and 2009, the Company sold the following assets:

Land held for investment	\$ 842	\$ -
Accumulated depreciation	-	(72)
Real estate held for sale	-	2,825
Deferred costs	-	(18)
Accounts payable and other accrued expenses	<u>156</u>	<u>203</u>
Net assets sold	998	2,938
Gross proceeds from sale of real estate	<u>1,842</u>	<u>2,817</u>
Gain/(loss) on sale of real estate	<u>\$ 844</u>	<u>\$ (121)</u>

The following represents the supplemental disclosure of significant cash activity from the gross proceeds from sale of real estate (above) to arrive at the net proceeds from sale of real estate as shown on the consolidated statements of cash flows for the years ended December 31, 2010 and 2009:

Gross proceeds from sale of real estate	\$1,842	\$2,817
Accounts payable and other accrued expenses – closing costs	(154)	(257)
Prepaid rents and other tenant liabilities	<u>-</u>	<u>(24)</u>
Net proceeds from sale of real estate	<u>\$1,688</u>	<u>\$2,536</u>

The following represents supplemental disclosure of the sale of ownership interests in subsidiaries to Bright Horizons (See Note 3) during the year ended December 31, 2010 and 2009:

Noncontrolling interests in consolidated subsidiaries	\$2,955	\$2,805
Additional paid-in capital	<u>(1,331)</u>	<u>(1,455)</u>
Net proceeds from sale of ownership interests	<u>\$1,624</u>	<u>\$1,350</u>

The following represents supplemental disclosure of the sale of ownership interests in a subsidiary that formerly owned the outlet center located in Holland, Michigan (See Note 13) during the year ended December 31, 2009:

Cash and cash equivalents		\$ 44
Tenant and other accounts receivable, net		(27)
Other assets		24
Accounts payable and other accrued expenses		(6)
Participation interests and other liabilities		(4)
Noncontrolling interests in consolidated subsidiaries		<u>(31)</u>
Net proceeds		<u>\$ -</u>

The following represents supplemental disclosure of noncash activity for the contribution of the assets and liabilities in connection with the formation of the OKC Joint Venture on October 15, 2010 (see Note 4):

Cash and cash equivalents	\$ 4,006	
Construction in progress	(7,564)	
Investment in joint ventures	4,046	
Other assets	(1,380)	
Accounts payable and other accrued liabilities	<u>892</u>	
	<u>\$ -</u>	

See accompanying notes to consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS, **continued**
(In thousands)

	<u>Year Ended</u> <u>December 31, 2010</u>	<u>Year Ended</u> <u>December 31, 2009</u>
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Supplemental Information (Continued)

The following represents supplemental disclosure of noncash activity for the disposal of fully depreciated/amortized assets during the years ended December 31, 2010 and 2009:

Buildings and improvements	\$2,510	\$ 934
Deferred costs	<u>1,262</u>	<u>300</u>
	<u>\$3,772</u>	<u>\$1,234</u>

See accompanying notes to consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Organization and Principles of Consolidation

Horizon Group Properties, Inc. (“HGPI” or, together with its subsidiaries, “HGP” or the “Company”) is a Maryland corporation that was established on June 15, 1998. The operations of the Company are conducted primarily through a subsidiary limited partnership, Horizon Group Properties, L.P. (“HGP LP”) of which HGPI is the sole general partner. As of December 31, 2010 and 2009, HGPI owned approximately 68.4% and 68.3%, respectively, of the partnership interests (the “Common Units”) of HGP LP. In general, Common Units are exchangeable for shares of Common Stock on a one-for-one basis (or for an equivalent cash amount at HGPI’s election).

The Company’s primary assets are its investments in subsidiary entities that own real estate. HGPI consolidates the results of operations and the balance sheets of those entities of which the Company owns the majority interest and of those variable interest entities of which the Company is the primary beneficiary. The Company accounts for its investments in entities which do not meet these criteria using the cost or equity methods. The entities referred to herein are consolidated subsidiaries of the Company, unless they are discussed in Note 4; those entities are accounted for using the equity method of accounting or the cost method, as indentified.

Note 2 - Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of HGPI and all subsidiaries that HGPI controls, including HGP LP. The Company considers itself to control an entity if it is the majority owner of or has voting control over such entity. All significant intercompany balances and transactions have been eliminated in consolidation. In accordance with generally accepted accounting principles (“GAAP”), the Company also consolidates variable interest entities if it is that entity’s primary beneficiary.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year presentation.

Use of Estimates

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

Investment in Real Estate

The Company allocates the purchase price of properties to net tangible and intangible assets acquired based on their fair values in accordance with the provisions of GAAP. In making estimates of fair values for purposes of allocating purchase price, the Company utilizes a number of sources, including independent appraisals that may be obtained in connection with the acquisition or financing of the respective property and other market data. The Company also considers information obtained about each property as a result of its pre-acquisition due diligence, marketing, and leasing activities, in estimating the fair value of the tangible and intangible assets acquired.

The Company allocates a portion of the purchase price to above-market and below-market lease values for acquired properties based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between: (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) management’s estimate of fair market lease rates for the corresponding in-place leases, measured over the remaining non-cancelable term of the lease. In the case of below market leases, the Company considers the remaining contractual lease period and renewal periods, taking into consideration the likelihood of the tenant exercising its renewal options. The capitalized above/below-market lease values (included in Deferred Costs or Prepaid Rents and

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Other Tenant Liabilities on the consolidated balance sheets) are amortized as either a reduction of, or addition to, rental income over the remaining noncancelable terms of the respective leases. Should a tenant terminate its lease prior to its scheduled expiration, the unamortized portion of the lease intangibles would be charged to expense. The net book value of capitalized above/below-market lease values was \$715,000 and \$1.2 million at December 31, 2010 and 2009, respectively.

The Company allocates a portion of the purchase price to the value of leases acquired based on the difference between: (i) the property valued with existing in-place leases adjusted to market rental rates and (ii) the property valued as if vacant. The Company utilizes independent appraisals or its internally developed estimates to determine the respective in-place lease values. The Company's estimates of value are made using methods similar to those used by independent appraisers. Factors management considers in its analysis include an estimate of carrying costs during the expected lease-up periods considering current market conditions and costs to execute similar leases including leasing commissions, legal and other related expenses.

The value of in-place leases (included in Buildings and Improvements on the consolidated balance sheets) is amortized to expense over the remaining initial term of the respective leases. Should a tenant terminate its lease prior to its scheduled expiration, the unamortized portion would be charged to expense. The net book value of in-place leases was \$1.3 million and \$3.3 million at December 31, 2010 and 2009, respectively.

Real Estate and Depreciation

Costs incurred for the acquisition, development, construction and improvement of properties, as well as significant renovations and betterments to the properties, are capitalized. Maintenance and repairs are charged to expense as incurred. Interest costs incurred with respect to qualified expenditures relating to the construction of assets are capitalized during the construction period. During the years ended December 31, 2010 and 2009, \$175,000 and \$206,000, respectively, of interest was capitalized related to the acquisition of land in Oklahoma City, Oklahoma.

Amounts included under Buildings and Improvements on the consolidated balance sheets include the following types of assets and are depreciated on the straight-line method over estimated useful lives, which are:

Buildings and improvements	31.5 years
Tenant improvements/origination costs	10 years or lease term, if less
Furniture, fixtures or equipment	3 - 7 years

In accordance with GAAP, the Company records impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated over their expected holding periods are less than the carrying amounts of those assets. For assets to be held in the portfolio, impairment losses are measured as the difference between carrying value and fair value. For assets to be sold, impairment is measured as the difference between carrying value and fair value, less costs to dispose. Fair value may be based upon estimated cash flows discounted at a risk-adjusted rate of interest, comparable or anticipated sales in the marketplace, or estimated replacement cost, as adjusted to consider the costs of retenanting and repositioning those properties which have significant vacancy issues, depending on the facts and circumstances of each property.

Depreciation and amortization expense includes charges for unamortized capitalized costs related to unscheduled tenant move-outs totaling \$27,000 and \$124,000 for the years ended December 31, 2010 and 2009, respectively.

Pre-Development Costs

The pre-development stage of a project involves certain costs to ascertain the viability of a potential project and to secure the necessary land. Direct costs to acquire the assets are capitalized once the acquisition becomes probable. These costs are carried in Other Assets until conditions are met that indicate that development is forthcoming, at

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which point the costs are reclassified to Construction in Progress. In the event a development is no longer deemed probable and costs are deemed to be non-recoverable, the applicable costs previously capitalized are expensed when the project is abandoned or these costs are determined to be non-recoverable. At December 31, 2010, pre-development costs classified as Other Assets and Construction in Progress were \$360,000 and \$685,000, respectively. At December 31, 2009, pre-development costs classified as Other Assets and Construction in Progress was \$700,000 and \$3.5 million, respectively. In October 2010, the Company's assets and liabilities related to the construction project in Oklahoma City, Oklahoma were contributed to the joint venture with CBL & Associates, Inc. (see Note 4).

Cash Equivalents

The Company considers all liquid investments with a maturity of three months or less when purchased to be cash equivalents. The Company's cash is held in accounts with balances, which at times, exceed federally insured limits. The Company has not experienced any losses on such accounts and believes it is not exposed to any significant credit risk on Cash and Cash Equivalents.

Restricted Cash

Restricted Cash consists of amounts deposited (i) in accounts with the Company's primary lenders in connection with certain loans (see Note 10), (ii) in escrow accounts for infrastructure requirements related to land sales in Huntley and future infrastructure expenses and interest payments related to Huntley. At December 31, 2010 and 2009, the escrow accounts related to the Company's primary lenders included approximately \$228,000 and \$916,000 in capital improvement and tenant allowance reserves, respectively, \$459,000 and \$230,000 in real estate tax and insurance escrows, respectively, and approximately \$648,000 and \$905,000 for cash collateral accounts, respectively. At December 31, 2010 and 2009, the Huntley interest, infrastructure and expense escrow accounts totaled \$653,000 and \$1,057,000, respectively. At December 31, 2010, restricted cash also included the El Portal Center escrow account and totaled \$2,125,000 in flood insurance proceeds which were primarily used to pay down the related loan and fund an interest reserve in January 2011 (see Note 13).

Marketable Securities

The Company classifies its marketable securities as trading securities in accordance with GAAP. These securities are carried at fair market value, with unrealized gains and losses, if any, reported in the consolidated statements of operations.

Tenant Accounts Receivable

Management regularly reviews accounts receivable and estimates the necessary amounts to be recorded as an allowance for uncollectability. These reserves are established on a tenant-specific basis and are based upon, among other factors, the period of time an amount is past due and the financial condition of the obligor.

At December 31, 2010 and 2009, total tenant accounts receivable include balances greater than 90 days totaling \$(31,000) and \$246,000, respectively, which are reflected net of reserves of \$146,000 and \$112,000, respectively. The provision/(credit) for doubtful accounts was \$34,000 and \$(58,000) for the years ended December 31, 2010 and 2009, respectively. This charge is included in the line items entitled "Other operating" and "General and administrative" in the consolidated statements of operations.

Discontinued Operations

In accordance with GAAP, assets held for sale are valued at the lower of carrying value or fair value less costs to dispose. GAAP requires that the results of operations and gain/(loss) on real estate properties sold or held for sale be reflected in the consolidated statements of operations as "Income/(Loss) from Discontinued Operations" for all

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periods presented. As of December 31, 2010 and 2009 no assets were classified as held for sale. Results of operations of the shopping center located in Holland, Michigan, which was sold on July 20, 2009, are included in the discontinued operations line items on the consolidated statements of operations.

Deferred Costs

Deferred leasing costs consist of fees and direct internal costs incurred to initiate and renew operating leases, as well as allocated purchase price related to above and below market lease values, and are amortized on the straight-line method over the initial lease term or renewal period. Deferred financing costs are amortized as interest expense over the life of the related debt.

Fair Value Measurements

The various inputs that may be used to determine fair value of the Company's assets are summarized in three broad levels:

- Level 1 - Quoted prices in active markets for identical securities
- Level 2 - Other significant observable inputs (including quoted prices for similar securities, interest rates, credit risks, etc).
- Level 3 - Significant unobservable inputs (including the Company's own assumptions used to determine value)

At December 31, 2010 and 2009, the Company held marketable securities that totaled approximately \$4.4 million and \$11.4 million, respectively, which are considered to have Level 2 fair value inputs. The Company did not hold any Level 3 assets during the years ended December 31, 2010 or 2009.

Revenue Recognition

Leases with tenants are accounted for as operating leases. Minimum annual rentals are recognized on a straight-line basis over the terms of the respective leases. As a result of recording rental revenue on a straight-line basis, tenant accounts receivable include \$751,000 and \$602,000 as of December 31, 2010 and 2009, respectively, which is expected to be collected over the remaining lives of the leases. Rents which represent basic occupancy costs, including fixed amounts and amounts computed as a function of sales, are classified as base rent. Amounts which may become payable in addition to base rent and which are computed as a function of sales in excess of certain thresholds are classified as percentage rents and are accrued after the reported tenant sales exceed the applicable thresholds. Expense recoveries based on common area maintenance expenses and certain other expenses are accrued in the period in which the related expense is incurred.

Other Revenue

Other revenue consists primarily of income from management, leasing and development agreements and income from tenants with lease terms of less than one year. Other revenue for the year ended December 31, 2010, includes \$1.9 million in net insurance proceeds related to the flood at the center in Laredo, Texas (see Note 13).

Income Taxes

Deferred income taxes are recorded based on enacted statutory rates to reflect the tax consequences in future years of the differences between the tax bases of assets and liabilities and their financial reporting amounts. Deferred tax assets, such as net operating loss carryforwards which will generate future tax benefits, are recognized to the extent that realization of such benefits through future taxable earnings or alternative tax strategies in the foreseeable future is more likely than not.

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As of December 31, 2010 and 2009 and for the years then ended, the Company did not have a net liability for any unrecognized tax benefits. The Company recognizes interest and penalties, if any, related to unrecognized tax benefits as interest or general and administrative expense in the statement of operations. During 2010 and 2009, the Company did not incur any interest or penalties. The Company is not subject to examination by U.S. federal tax authorities for tax years before 2007.

Legal Proceedings

In the ordinary course of business the Company is subject to certain legal actions. While any litigation contains an element of uncertainty, management believes the losses, if any; resulting from such matters will not have a material adverse effect on the consolidated financial statements of the Company.

Subsequent Events

Management has evaluated events through June 30, 2011, the date of the consolidated financial statements were available to be issued.

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Note 3 - Investment in Real Estate

The following table contains information on the operating properties and land held for investment owned by the Company and for which the Company consolidates the results of operations and the assets and liabilities as of December 31, 2010.

<u>Property Name</u>	<u>Location</u>	<u>Property Type</u>	<u>Gross Leasable Area (Sq. Ft.)</u>	<u>Net Carrying Value</u>	<u>Ownership Percentage</u>
The Outlet Shoppes at Burlington	Burlington, WA	Outlet Retail	174,260	\$ 11,547,000	51.0%
El Portal Center	Laredo, TX	Retail	345,106	11,230,000	38.0%
The Outlet Shoppes at Fremont	Fremont, IN	Outlet Retail	228,925	11,176,000	51.0%
The Outlet Shoppes at Gettysburg	Gettysburg, PA	Outlet Retail/ Adjacent Land	249,937	52,480,000	51.0%
The Outlet Shoppes at Oshkosh	Oshkosh, WI	Outlet Retail	270,512	27,552,000	51.0%
Village Green Shopping Center	Huntley, IL	Retail	22,204	2,792,000	100.0%
5000 Hakes Drive	Norton Shores, MI	Office	28,863	1,680,000	51.1%
Corporate Assets	Norton Shores, MI	Miscellaneous	<u>-</u>	<u>43,000</u>	100.0%
Total			<u>1,319,807</u>	<u>\$118,500,000</u>	
			<u>Acres</u>		
Land Held for Investment	Fruitport Township, MI	Land	46	\$ 769,000	100.0%
Land Held for Investment	Huntley, IL	Land	<u>400</u>	<u>18,684,000</u>	100.0%
Total			<u>446</u>	<u>\$ 19,453,000</u>	

The portion of the net income or loss of HGPI's subsidiaries owned by parties other than HGPI is reported as Net Income or Loss Attributable to the Noncontrolling Interests on the Company's consolidated statements of operations and such parties' portion of the net equity in such subsidiaries is reported on the Company's consolidated balance sheets as Noncontrolling Interests in Consolidated Subsidiaries.

In December 2009, the Company sold noncontrolling interests in the entities that own five of its outlet centers to Bright Horizons of South Florida, LLC ("Bright Horizons"). The centers subject to the transaction are located in Burlington, Washington; El Paso, Texas; Fremont, Indiana; Gettysburg, Pennsylvania and Oshkosh, Wisconsin. Bright Horizons acquired a 22.5% interest in the entities that own the outlet centers (excluding the entity that owns the center in El Paso, Texas, in which it acquired a 19.6% preferred interest and a 17.8% common interest). The

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total price for the acquired ownership interests was \$1.35 million. In May 2010, Bright Horizons acquired an additional 26.5% interest in the entities that own the outlet centers (excluding the entity that owns the center in El Paso, Texas, in which it acquired an additional 23.6% preferred interest and an additional 21.8% common interest) for additional consideration of \$1.624 million which consists of \$1.35 million paid at closing and preferential distributions totaling \$274,000 from future positive cash flow distributions made from these entities. No gain or loss was recognized on these transactions. Bright Horizons is controlled by Somerset Outlet Center, L.P., (“Somerset, L.P.”) of which Howard Amster, a director and significant stockholder of the Company (“Howard Amster”) owns a controlling interest and Gary Skoien, Chairman, President and CEO of the Company (“Gary Skoien”) owns a non-controlling interest.

Pre-Development Projects

On July 8, 2008, the Company formed Winding Brook Center, LLC, a joint venture for the development of an outlet center in Richmond, VA. At December 31, 2010 and 2009, the Company’s consolidated balance sheets included pre-development costs of \$350,000 (after a \$350,000 reserve was recorded in 2010 and is included in General and Administrative Expense on the consolidated statement of operations) and \$700,000, respectively, in the line item titled Other Assets (see Note 2).

In December 2010, the Company entered into an agreement to acquire approximately 50 acres of vacant land in suburban Atlanta, Georgia, which is intended to be the site of an outlet center. The site is adjacent to Interstate 575 in Woodstock, Georgia. The Company’s obligation to purchase the property is subject to the satisfactory completion of due diligence, the achievement of certain pre-leasing of the project and other conditions. In connection with the contract, the Company made a \$3.0 million loan to the entity that controls the land for the outlet center as well as an additional 123 acres adjacent to the outlet center site. The loan receivable bears interest at 3%, matures in December 2012, and is secured by a pledge of the ownership interests in the land-owning entity. In addition, as an inducement to make the loan, the Company was granted a 15% economic interest in the land-owning entity. The Company uses the cost method to account for its investment in the entity which owns the vacant land (see Note 4).

Note 4- Investment in Joint Ventures

El Paso Entities

As of December 31, 2010 and 2009, the Company owned 45.0% and 68.6%, respectively, of the preferred interests and 41.2% and 63.0%, respectively, of the common interests in Horizon El Paso LLC (“Horizon El Paso”), which owns 50% of El Paso Outlet Center Holding, LLC, (together with its subsidiaries, “El Paso Center”), a joint venture that developed and owns an outlet shopping center in El Paso, Texas, which opened on October 11, 2007 containing approximately 380,000 square feet of GLA and owns several outparcels adjacent to the shopping center. Horizon El Paso also owns a 50% interest in TOSEP Land Company, LLC (“TOSEP”), an entity that owns approximately 45 acres of undeveloped land adjacent to the outlet center. An affiliate of Howard Amster directly owns 5.9% of the preferred and common interests and Gary Skoien directly owns 5.9% of the preferred interests and 7.2% of the common interests of Horizon El Paso. As of December 31, 2010 and 2009, Bright Horizons owned 43.2% and 19.6%, respectively, of the preferred interests and 39.6% and 17.8%, respectively, of the common interests of Horizon El Paso (see Note 12). The Company controls Horizon El Paso with a 50.1% voting unit ownership position at December 31, 2010. The Company consolidates the results of operations and the assets and liabilities of Horizon El Paso. The Company uses the equity method to account for its investment in El Paso Center and TOSEP.

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Summary financial information (stated at 100%) of El Paso Center and TOSEP as of December 31, 2010 and 2009 and for the years ended December 31, 2010 and 2009 are as follows (in thousands):

	<u>As of</u> <u>December 31, 2010</u>	<u>As of</u> <u>December 31, 2009</u>
Assets		
Real estate - net	\$52,013	\$55,111
Cash and cash equivalents	1,183	1,007
Restricted cash	4,959	5,177
Other assets	<u>4,116</u>	<u>4,622</u>
Total assets	<u>\$62,271</u>	<u>\$65,917</u>
Liabilities and members' deficit		
Mortgages and other debt	\$77,476	\$78,204
Other liabilities	3,237	2,992
Members' deficit	<u>(18,442)</u>	<u>(15,279)</u>
Total liabilities and members' deficit	<u>\$62,271</u>	<u>\$65,917</u>
	<u>Year Ended</u> <u>December 31, 2010</u>	<u>Year Ended</u> <u>December 31, 2009</u>
Statements of Operations		
Revenue	<u>\$12,861</u>	<u>\$12,775</u>
Operating expenses	3,709	3,296
Depreciation and amortization expense	4,395	4,337
General and administrative expenses	941	1,239
Interest expense	<u>6,679</u>	<u>6,741</u>
Total expenses	<u>15,724</u>	<u>15,613</u>
Gain on sale of real estate	<u>-</u>	<u>415</u>
Net loss	<u>\$(2,863)</u>	<u>\$(2,423)</u>

The shopping center owned by El Paso Center secures a loan originated by NATIXIS Commercial Mortgage Funding, LLC which had a principal balance of \$68.0 million and \$68.7 million at December 31, 2010 and 2009, respectively, bears interest at 7.06%, requires principal payments over a 30-year amortization schedule and is due December 5, 2017. In November 2007, Dominion Capital Asset Company A, LLC made a preferred equity investment in El Paso Center in the amount of \$9.5 million, bearing interest at 15.0% and due October 27, 2010, which has not been repaid. In the event of a default, the preferred equity partner has an option to purchase the ownership interest of for an amount equal to 10% of the amount that the Company would receive if the property were sold at its fair market value. The preferred equity member has asserted the maturity of the obligation and the Company is currently in negotiations with the holder of the preferred equity interest with respect to an extension of the maturity date of the preferred equity. The Company is also pursuing options to secure a replacement preferred equity partner. The preferred equity investment is classified as debt on the balance sheet of El Paso Center.

The Company received management and similar fees from El Paso Center that totaled \$892,000 and \$1.1 million during the years ended December 31, 2010 and 2009, respectively.

There was no significant operating activity for TOSEP for the years ended December 31, 2010 and 2009.

Distributions in excess of the Company's net investments in entities accounted for using the equity method are recognized as income if the Company is not obligated to make future contributions to those entities or budgeted

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capital contributions that would require the return of such excess distributions. Such distributions are included in Income from Investment in Joint Ventures on the consolidated statements of operations. The Company recognized income from distributions in excess of equity investments of \$468,000 and \$679,000 for the years ended December 31, 2010 and 2009, respectively, related to El Paso Center.

In June 2009, El Paso Center sold an outparcel, comprised of approximately one acre of unimproved land, for \$725,000. A gain of approximately \$415,000 was recognized on the transaction.

Oklahoma City

In October 2010, the Company formed a joint venture (the "OKC Joint Venture") with an affiliate of CBL & Associates, Inc. ("CBL") to develop The Outlet Shoppes at Oklahoma City. The Company contributed all of its rights and interests in leases, contracts and construction in progress related to the project. The Company formed a subsidiary entity ("Horizon OKC") to be CBL's partner in the OKC Joint Venture. The total equity commitment from CBL and Horizon OKC is \$20.9 million, of which Horizon OKC is obligated for \$5.23 million. Horizon OKC will own 25% of the OKC Joint Venture and CBL will own 75%. At formation, the OKC Joint Venture purchased the land for the project and made other payments, resulting in an initial equity capitalization of \$16.2 million of which Horizon OKC's 25% share was \$4.05 million. As of the date of formation of the OKC Joint Venture, the Company had incurred \$8.05 million of costs, \$3.35 million of which had been funded with the proceeds of loans from affiliates (see Note 12). The Company received a distribution of \$4.0 million representing excess capital contributions at closing and used a portion of this distribution to repay a portion of the loans from affiliates. The Company was obligated to fund an additional \$1.2 million of future capital contributions, which were made in the fourth quarter of 2010.

In November 2010, the OKC Joint Venture received a \$48.85 million construction loan from US Bank for the project. The loan bears interest at LIBOR plus 3.0% and matures on November 30, 2013. At December 31, 2010, the principal balance of the construction loan was \$2.4 million. CBL has guaranteed the loan and will receive an annual fee of 1.0% of the maximum loan amount for providing such guarantee. The Company will lease and manage The Outlet Shoppes at Oklahoma City and will act as the co-developer of the project, which is scheduled to open in August 2011.

The Company has voting control over Horizon OKC and will own, directly and indirectly, approximately 34% of the preferred interests in Horizon OKC. The other preferred members include Somerset, L.P. (see Note 12) and Andrew Pelmoter. The Company also granted common interests in Horizon OKC (the "OKC Net Profits Interests") to Gary Skoien, Thomas Rumptz and Andrew Pelmoter, all officers of the Company. Holders of the OKC Net Profits Interests are not entitled to any distributions until the holders of the preferred interests have received a return of their capital plus interest thereon calculated at an annual rate of 12.0%, compounded quarterly. The Company consolidates the results of operations and the assets and liabilities of Horizon OKC and uses the equity method to account for its investment in the OKC Joint Venture.

At December 31, 2010, the OKC Joint Venture had incurred construction costs of \$16.0 million. At December 31, 2010, the OKC Joint Venture had outstanding commitments for construction costs and capital expenditures on leases signed (which amounts become payable when the spaces are delivered to the tenants) in the amount of \$20.6 million and \$11.8 million, respectively. The Company received development and consulting fees from the OKC Joint Venture that totaled \$696,000 during the year ended December 31, 2010. There was no significant operating activity for the OKC Joint Venture for the year ended December 31, 2010.

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Summary financial information (stated at 100%) of the OKC Joint Venture as of December 31, 2010 is as follows (in thousands):

	As of <u>December 31, 2010</u>
Assets	
Real estate - net	\$24,417
Restricted cash	7
Other assets	<u>17</u>
Total assets	<u>\$24,441</u>
Liabilities and members' equity	
Mortgages and other debt	\$2,413
Other liabilities	1,095
Members' equity	<u>20,933</u>
Total liabilities and members' equity	<u>\$24,441</u>

Woodstock

The Company is a joint venture partner in Ridgewalk Property Investments, LLC ("RPI") and accounts for its joint venture interest using the cost method. The Company acquired its joint venture interest in connection with a \$3.0 million loan it made to RPI in December 2010. The joint venture agreement provides that the Company will receive a 15.0% economic interest in Ridgewalk Holding, LLC ("Holding") which is currently 100% owned by RPI. Holding owns approximately 173 acres of land in Woodstock, Georgia, 50 acres of which comprise the site for an outlet center to be developed by the Company. The Company has a contract to purchase the 50-acre site for \$11.0 million. The 173-acre parcel is subject to a \$19.0 million loan from an affiliate of Wrightwood Capital. The loan bears interest at 6.0% (accruing until maturity), is due on June 1, 2012 and provides for a discounted payoff prior to maturity for \$11.4 million plus interest accruing subsequent to December 30, 2010. Upon repayment of the loan, Wrightwood Capital's affiliate will obtain a 25% interest in Holding.

Note 5 – Income Taxes

HGPI is taxable as a corporation under the provisions of Subchapter C of the Internal Revenue Code. The net provision for income taxes after the change in the valuation reserve for the years ended December 31, 2010 and 2009 consisted of the following (in thousands):

	<u>2010</u>	<u>2009</u>
Federal	\$ -	\$ -
State	<u>-</u>	<u>-</u>
Net provision (benefit)	<u>\$ -</u>	<u>\$ -</u>

For federal income tax purposes, HGPI had net operating loss carryforwards ("NOLs") of approximately \$78.0 million and \$62.5 million at December 31, 2010 and 2009, respectively, and accumulated capital loss carryforwards of approximately \$4.3 million at December 31, 2009. The NOLs expire from 2019 to 2030.

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Deferred income tax liabilities and assets are determined based on the differences between the financial statement and tax basis of assets and liabilities. The components of the Company's gross deferred tax assets and liabilities are as follows as of December 31, 2010 and 2009 (in thousands):

	<u>2010</u>	<u>2009</u>
Deferred Tax Assets:		
NOL carryforwards - federal and state	\$29,209	\$23,689
Capital loss carryforward	-	1,496
Tax basis of assets in excess of book basis:		
Fixed/intangible assets	1,339	2,247
Other	35	129
Book basis of liabilities in excess of tax basis:		
Prepaid rental revenue	194	207
Profits interests	<u>126</u>	<u>264</u>
Gross deferred tax assets	30,903	28,032
Less: valuation allowance	<u>(30,078)</u>	<u>(26,285)</u>
	<u>825</u>	<u>1,747</u>
Deferred Tax Liabilities:		
Book basis of assets in excess of tax basis:		
Fixed/intangible assets	(818)	(704)
Other	<u>(7)</u>	<u>(1,043)</u>
Gross deferred tax liabilities	<u>(825)</u>	<u>(1,747)</u>
Net deferred tax asset	<u>\$ -</u>	<u>\$ -</u>

The valuation allowance related to the net deferred tax asset increased by \$3.8 million and increased by \$3.2 million for the years ended December 31, 2010 and 2009, respectively.

Note 6 – Leases

Space in the Company's centers is leased to various tenants under operating leases, which are generally for one to ten year periods. Some leases contain renewal options and may also provide for the payment of a tenant's share of certain operating expenses. Leases may also obligate a tenant to pay rent based on a percentage of sales in excess of certain thresholds. Minimum future rentals to be received under non-cancelable leases are summarized as follows (in thousands):

2011	\$ 9,343
2012	7,792
2013	6,388
2014	5,006
2015	3,890
<i>Thereafter</i>	<u>13,025</u>
	<u>\$45,444</u>

The above scheduled rentals are subject to the usual business risks associated with collection.

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Note 7 - Long Term Stock Incentive Plan and Grants of Common Units

The Company has adopted the HGP 1998 Long Term Stock Incentive Plan (the “HGP Stock Plan”) to advance the interests of the Company by encouraging and enabling the acquisition of a financial interest in the Company by key employees and directors of the Company and its subsidiaries through equity awards. The Company reserved 338,900 common shares for issuance pursuant to the HGP Stock Plan and options covering 15,000 shares were outstanding at December 31, 2010.

The Company estimated the fair value of options granted using a Black-Scholes option pricing model for the purpose of presenting pro forma information, in accordance with GAAP. The Black-Scholes model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company’s employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management’s opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

The HGP Stock Plan provided for the issuance of shares over the ten-year period ended June 15, 2008. Accordingly, as of December 31, 2010, no additional equity awards may be made pursuant to the HGP Stock Plan.

Options granted, exercised and expired under the Long-term Stock Incentive Plan are summarized below:

	For the year ended December 31, 2010		For the year ended December 31, 2009	
	<u>Shares</u>	<u>Price</u>	<u>Shares</u>	<u>Price</u>
Outstanding, beginning of the year	140,500	\$3.40 - \$5.04	170,500	\$3.40 - \$5.04
Granted	-	-	-	-
Exercised	-	-	-	-
Expired	<u>(125,500)</u>	\$3.40 - \$4.49	<u>(30,000)</u>	\$5.00
Outstanding, end of the year	<u>15,000</u>	\$5.04	<u>140,500</u>	\$3.40 - \$5.04

The weighted average exercise price for options outstanding was \$5.04 and \$3.65 at December 31, 2010 and 2009, respectively. The weighted average contractual life of options outstanding at December 31, 2010 and 2009 was 3.25 years and 1.02 years, respectively. At December 31, 2010 and 2009 there were 15,000 and 140,500 options vested and exercisable, respectively.

The Company granted 15,692 and 20,307 shares of stock in HGPI to key employees in 2010 and 2009, respectively, and recognized compensation expense based on the fair market value of the stock granted. Total compensation expense recognized related to these awards equaled \$7,800 and \$29,000 in 2010 and 2009, respectively.

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 8 – Marketable Securities

The estimated fair values of securities held by the Company at December 31, 2010 and 2009 based on quoted market prices are as follows (in thousands):

	<u>Face Value</u>	<u>Cost</u>	<u>Fair Market Value</u>
December 31, 2010:			
Debt Securities:			
FHLM Notes, ranging from 3.5% to 5.5%, maturing from June 2020 to April 2038	\$ 2,498	\$ 1,591	\$ 1,601
FNMA Notes, ranging from 4.0% to 5.5%, maturing from August 2019 to February 2037	<u>7,497</u>	<u>2,855</u>	<u>2,832</u>
	<u>\$ 9,995</u>	<u>\$ 4,446</u>	<u>\$ 4,433</u>
December 31, 2009:			
Equity Security -			
1,000 Shares Wells Fargo Company stock	n/a	\$ 25	\$ 27
Debt Securities:			
FHLM Notes, ranging from 4.0% to 5.5%, maturing from June 2020 to April 2038	\$ 1,598	1,052	1,055
FNMA Notes, ranging from 4.0% to 5.5%, maturing from August 2019 to December 2037	18,224	8,184	8,069
GNMA Notes, ranging from 3.75% to 4.0%, maturing from April 2033 to December 2034	<u>27,391</u>	<u>2,222</u>	<u>2,241</u>
	<u>\$47,213</u>	<u>\$11,483</u>	<u>\$11,392</u>

These securities serve as collateral on a margin account as disclosed in Note 10.

Note 9 – Commitments

The Company has outstanding commitments for construction costs and tenant allowances on leases signed (which amounts become payable when the spaces are delivered to the tenants) at December 31, 2010 in the amount of \$25,000 and \$1.0 million, respectively, which are not reflected on the consolidated balance sheet as of December 31, 2010. These amounts include the commitments for the pre-development projects (see Note 3). These capital expenditures are expected to be paid during 2011 and 2012 and are anticipated to be funded from capital improvement escrows, construction financing, equity contributions and additional borrowings.

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 10 – Mortgages and Other Debt

	Principal Balance as of:	
	<u>December 31, 2010</u>	<u>December 31, 2009</u>
	<i>(in thousands)</i>	
Mortgage loan to 5000 Hakes Drive LLC, as borrower, from UBS, as lender, dated as of August 19, 2003, in the original principal amount of \$2.25 million, bearing interest at 6.89%, due September 11, 2013, secured by the corporate office building in Muskegon, Michigan and indemnified against certain losses by Gary Skoien (See below)	\$1,834	\$2,089
Unsecured promissory note to HGP LP, as borrower, from The James T. Slayback, Sr. Family Trust, as lender, dated as of February 25, 2002, in the original principal amount of \$2.0 million, bearing interest at 3.904%, due October 1, 2012 (the “Slayback Loan”)	591	615
Mortgage loan to Village Green Associates, LLC, as borrower, from MB Financial, as lender, dated as of November 17, 2005, in the original principal amount of \$2.9 million, bearing interest at 7.5%, due February 15, 2014, secured by the shopping center in Huntley, Illinois and guaranteed by the Company (See below)	2,695	2,763
Margin account between Magnolia Bluff Factory Shops LP, as borrower, and Ramat Securities Ltd, as lender (see Notes 8 and 12), bearing interest at a rate of 1.21% and 1.14% at December 31, 2010 and 2009, respectively (the “Ramat Margin Account”). This debt is guaranteed by Howard Amster and Gary Skoien.	3,793	10,140
Mortgage loan to HGP LP, as borrower, from Somerset, L.P., as lender, dated as of September 28, 2009, in the original principal amount of \$300,000, bearing interest at 5.0%, due December 1, 2013 and secured by approximately 46 acres of vacant land in Fruitport Township, Michigan and a 50% interest in the net profits from the sale of the land over certain thresholds. Loan is interest only, with principal due upon the earlier of the sale of the property or maturity (See Notes 12, 15 and below).	300	300
Mortgage loan to Gettysburg Outlet Center, LP, as assuming borrower, from Column Financial, Inc., as lender, in the original principal amount of \$43.75 million, bearing interest at 5.87%, due February 11, 2016, secured by The Outlet Shoppes at Gettysburg and subject to certain debt service coverage ratios	41,505	42,119
Mezzanine loan to Gettysburg Outlet Center Holding, LLC, as borrower, from CW Capital LLC, as lender, in the original principal amount of \$6.0 million, bearing interest at an initial rate of LIBOR (LIBOR was 0.26% and 0.23% as of December 31, 2010 and 2009, respectively) plus 4.5%, increasing to LIBOR plus 9.5% upon the fourth anniversary of the loan (July 2011), due February 11, 2016, secured by pledges of the ownership interests in Gettysburg Outlet Center GP, Inc. and Gettysburg Outlet Center, LP, and a first mortgage on approximately 37 acres of vacant land. A portion of the loan is recourse to the Company which has guaranteed the payment of interest on the loan and \$2.8 million of the loan principal and is subject to certain debt coverage ratios. By the fourth anniversary of the loan, a deposit (or pay-down) of \$2.8 million as collateral for such guaranty and a principal payment of \$1.2 million are required.	5,949	6,000

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Mortgage loan to BFO Factory Shoppes LLC, as assuming borrower, from Wachovia Bank, National Association, as lender, in the original principal amount of \$54.0 million, bearing interest at 5.58%, due January 11, 2016 and secured by The Outlet Shoppes at Burlington, The Outlet Shoppes at Fremont, and The Outlet Shoppes at Oshkosh	50,289	51,131
Mortgage loan to Huntley Development Limited Partnership, as borrower, from US Bank, as lender, in the maximum principal amount of \$23.4 million, bearing interest at LIBOR plus 4.5% with a floor of 5.5%, due May 1, 2013, secured by approximately 400 acres of vacant land in Huntley, Illinois and the Huntley Series C TIF bonds and guaranteed by the Company (See below)	19,937	21,606
Mortgage loan to El Portal Center LLC, as borrower, from Cathay Bank, as lender, in the original principal amount of \$6.7 million, bearing interest at Prime plus 1.0% with a 7.5% floor, due September 1, 2011, secured by El Portal Center and guaranteed to 50% of principal and interest due by HGPI (See Note 13 and below)	5,900	6,200
Capital lease agreement between BFO Factory Shoppes LLC and Banner Bank, dated as of October 29, 2009, bearing interest at 9.0%, due November 1, 2014, secured by an LED sign at The Outlet Shoppes at Oshkosh and guaranteed by HGPI and HGPLP.	51	63
Unsecured promissory note to HGP LP, as borrower, from Somerset, L.P., as lender, dated as of December 31, 2010, in the amount of \$300,000, bearing interest at 25.0% with 15.0% payable currently and 10.0% deferred to maturity, due December 30, 2013	300	-
Unsecured promissory note to HGP LP, as borrower, from Somerset, L.P., as lender, dated as of December 31, 2010, in the amount of \$600,000, bearing interest at 9.0%, due May 31, 2013	600	-
	<u>\$133,744</u>	<u>\$ 143,026</u>

The Company is currently negotiating with the servicer of the mortgage loan to 5000 Hakes Drive LLC with respect to modifying the terms of that loan. The Company has not yet reached an agreement with the servicer and has not paid its monthly scheduled debt service payment since January 2010. The Company is remitting the monthly net operating income generated by the property to the servicer of the loan and continues to manage the property. The servicer has applied the funds in the escrow accounts toward payments due on the loan.

In December 2010, the Company entered into an agreement with a representative of The James T. Slayback, Sr. Family Trust to amend the terms of the Slayback Loan. The loan now calls for monthly payments of \$30,000, bears interest at 3.904% and is due on October 1, 2012.

MB Financial, the lender on the mortgage loan to Village Green Associates, LLC with a maturity date of February 15, 2011, has extended the maturity to February 15, 2014. The loan bears interest at a rate of 7.5% and is guaranteed by the Company.

In 2010 and 2009, the Company held a portfolio of marketable securities (as defined in Note 2 and listed in Note 8) with the proceeds from a margin account and partner contributions. The margin account is included in Mortgages and Other Debt on the consolidated balance sheets.

In September 2009, the Company fully repaid a loan from First Bank of Beverly Hills ("FBBH") which had an outstanding balance of \$250,000 at December 31, 2008 and was secured by approximately 46 acres of land that the Company holds for investment purposes (the "FBBH Loan"). The FBBH Loan was repaid from the proceeds of a \$300,000 loan from Somerset, L.P., which is secured by the same 46 acres of land held for investment purposes (the

HORIZON GROUP PROPERTIES, INC.

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“Somerset Loan”). The Somerset Loan bears interest at a rate of 5.0% and matures on December 1, 2013 and provides for Somerset, L.P. to receive 50% of net profits from the sale of land over certain thresholds. Howard Amster and Gary Skoien and other unrelated parties own Somerset, L.P.

In July 2007, the Company entered into a guaranty agreement in connection with the \$6.0 million mezzanine loan to Gettysburg Outlet Center Holding, LLC, as borrower, from CW Capital LLC, as lender. The guaranty contains covenants (the “Guaranty Covenants”) requiring the Company to maintain net worth of at least \$25 million and liquidity of \$5.0 million, each of which is to be reasonably determined by CW Capital. Although an uncertainty exists as CW Capital has not provided definitions with respect to the terms contained in the Guaranty Covenants, the Company believes it is in compliance with the Guaranty Covenants and has received no notice of default with respect to its compliance with the Guaranty Covenants. The Company is currently negotiating various options related to the required \$4.0 million of principal payments and/or deposits due in 2011.

In June 2009, US Bank amended the terms of its loan to the Company by extending the maturity date to September 30, 2010 and increasing the interest rate to the 30-day LIBOR rate plus 4.5% with a floor of 5.5%. The Company also pledged 25 acres of vacant land in Huntley, Illinois as additional collateral and deposited \$900,000 into an interest reserve. In July 2009, the Company utilized a portion of the net proceeds from the sale of its center in Holland, Michigan (see Note 13) to repay \$691,000 of principal and deposit an additional \$600,000 into the interest reserve. In April 2010, US Bank amended the loan by requiring the Company to begin the payment of interest out of pocket commencing with the payment due for April 2010. In July 2010, US Bank amended the terms of the loan by extending the maturity of the loan to January 31, 2011 and requiring the Company to pledge its interest in the Huntley Series C TIF bonds (see below) as additional collateral. The Company also agreed to make principal payments of \$10,000 each in August and September 2010 and \$20,000 each month thereafter. In September 2010, the Company sold 8.4 acres of investment land in Huntley (see Note 13) and utilized \$1.6 million of the proceeds to pay down the loan from US Bank. In February 2011, US Bank extended the maturity of the loan to May 1, 2011.

In June 2011, US Bank again amended the terms of its loan to the Company by extending the maturity date to May 1, 2013 and requiring the Company to make principal payments in amounts equal to 50.0% of the positive net cash flow distributed to the Company from the shopping center located in Oklahoma City, Oklahoma. As additional collateral, the Company was also required to pledge its interest in Horizon OKC (See Note 4).

The Company previously exercised its option to extend the maturity of the loan from Cathay Bank to El Portal Center, LLC to March 1, 2011. The Company has also exercised its additional option to extend the maturity of the loan to September 1, 2011. In January 2011, a principal payment of \$1.65 million was made and an interest reserve was funded with \$80,000 from the flood insurance proceeds (see Note 13).

In December 2010, Somerset, L.P. made an unsecured loan to the Company in the amount of \$300,000. This loan bears interest at a rate of 25.0% (15.0% is payable currently and 10.0% is deferred until maturity) and matures on December 30, 2013. Howard Amster and Gary Skoien and other unrelated parties own Somerset, L.P.

In December 2010, Somerset, L.P. made an unsecured loan to the Company in the amount of \$600,000. This loan bears interest at a rate of 9.0% and matures on May 31, 2013. Howard Amster and Gary Skoien and other unrelated parties own Somerset, L.P.

Cash interest payments for the years ended December 31, 2010 and 2009, totaled \$7.2 million and \$6.6 million, respectively. Interest advanced on loans and reserve accounts associated with loans totaled \$747,000 and \$1.2 million for the years ended December 31, 2010 and 2009, respectively. The Company capitalized interest totaling \$175,000 and \$206,000 for the years ended December 31, 2010 and 2009, respectively.

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Huntley Net Profits Interests and TIF Bonds

Gary J. Skoien was formerly the Executive Vice President and Chief Operating Officer of The Prime Group, Inc. (“Prime Group”). In connection with his employment with Prime Group, Mr. Skoien was previously granted an interest (the “Skoien Net Profits Interest”) in the net profits generated by Huntley Development Limited Partnership (“HDLP”), an entity which owns approximately 400 acres of land in a master planned community in Huntley, Illinois (the “Huntley Project”), which obligation the Company assumed in connection with the purchase of the Huntley Project from Prime Group. The Skoien Net Profits Interest consists of a 9.675% participation in the Net Cash Flow (as defined in Mr. Skoien’s Net Profits Agreement) distributed to the Company (excluding distributions of all amounts contributed or advanced by the Company to the Huntley Project plus interest per the terms of the agreement) from the Huntley Project. The Company has recorded a liability for the Skoien Net Profits Interest in the amount of \$525,000 million and \$1.1 million as of December 31, 2010 and 2009, respectively, which represents its estimated fair value as of such dates and which amount is included in Participation Interests and Other Liabilities on the Company’s consolidated balance sheets. The change in the estimated fair value of the Skoien Net Profits Interests is reflected as a reduction of interest expense in the amount of \$575,000 and \$1.0 million for the years ended December 31, 2010 and 2009, respectively. A payment of \$164,000 was made to Mr. Skoien in June 2009 on the Skoien Net Profits Interest.

The Company granted to Prime Group and certain of its affiliates, a participation interest of 26% of the net cash flow distributed from the Huntley Project (the “Prime Group Participation Interest”) as additional consideration for the purchase of the Huntley Project from Prime Group. The Prime Group Participation Interest does not entitle Prime Group to participate in decision making or otherwise control the activities of the Huntley Project. No amount is payable to Prime Group until the Company has received distributions in excess of its purchase price and advances made by the Company to the Huntley Project plus a 40% return on such amounts, compounded quarterly. Aggregate amounts payable pursuant to the Prime Group Participation Interest are limited to \$5.0 million. No liability has been recorded by the Company for the Prime Group Participation Interest as its current fair value is estimated to be zero.

In 1993, the Village of Huntley (the “Village”) created a Tax Increment Financing District (the “TIF District”). In 1995, the Village sold \$7.0 million of Series A TIF bonds and \$14.0 million of Series B TIF bonds and issued to HDLP Series C TIF bonds with a principal amount of \$24.4 million. In May 2009, the Village sold \$14.3 million of Series 2009 TIF Bonds (the “Series 2009 TIF Bonds”), the proceeds of which were used to retire the Series A and B TIF bonds.

In connection with the issuance of the Series 2009 TIF Bonds, HDLP assigned a portion of the tax increment allocable to the Series C TIF bonds to the Village. The assignment agreement provides that payments made with respect to the Series C TIF bonds will be distributed in the following order of priority: (i) HDLP will receive the first \$204,285 annually until it has received a total of \$1.43 million; (ii) the next \$3.04 million will be allocated 75% to HDLP and 25% to the Village; and (iii) amounts in excess of those in (i) and (ii) will be allocated 25% to HDLP and 75% to the Village. The Series C bonds are subordinate to the Series 2009 TIF Bonds. Currently, no portion of the tax increment is available to the Series C TIF bonds and no value has been ascribed to them by the Company.

The TIF District contains approximately 900 acres of land currently or previously owned by HDLP or Huntley Meadows Residential Venture. The source of repayment for the Series 2009 TIF Bonds and Series C TIF bonds is (a) 100% of the increase in real estate taxes on the land in the TIF District above the taxes in place when the TIF District was created, (b) one-half of the Village’s one percent (1%) sales tax collected on retail sales occurring within the TIF District and (c) reserves associated with the Series 2009 TIF Bonds. The repayment of the Series 2009 TIF Bonds is not an obligation of the Company and thus is not reflected on the Company’s consolidated balance sheet as a liability.

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Prior to the issuance of the Series 2009 TIF Bonds, a portion of the proceeds from the sale of certain land parcels in the TIF District was held in a collateral account (the "TIF Bond Collateral Account") for the benefit of the Series B TIF bonds until those parcels were improved. The balance in the TIF Bond Collateral Account was approximately \$4.0 million at December 31, 2008, and was included in Restricted Cash on the Company's consolidated balance sheet as of that date. HDLP received \$1.1 million from the TIF Bond Collateral Account in February 2009 after development criteria were met by a particular land owner. In connection with the issuance of the Series 2009 TIF Bonds the balance of the TIF Bond Collateral Account (approximately \$2.9 million) was released to HDLP in May 2009.

Debt Maturities

Debt maturities and principal payments due subsequent to December 31, 2010 are as follows (in thousands):

<u>Due in:</u>	
2011	\$ 17,745
2012	2,264
2013	22,525
2014	4,347
2015	1,987
Thereafter	<u>84,876</u>
	<u>\$133,744</u>

The Company's ability to secure new loans is limited by the fact that most of the Company's real estate assets are currently pledged as collateral for its current loans. The Company will pay the scheduled principal amortization in the normal course of business during 2011 and is in the process of or anticipates refinancing or extending the maturities of the remainder of the \$17.7 million of obligations due in 2011.

Note 11- Stock Repurchases

On June 22, 2009, the Company purchased 72,750 shares of Horizon Group Properties, Inc. stock from a stockholder for \$0.37 per share. After acquisition, the shares were retired.

Note 12 - Related Party Transactions

At December 31, 2010 and 2009, an affiliate of Howard Amster owns approximately 44% of Magnolia Bluff Factory Shops Limited Partnership ("Magnolia Bluff"), an entity that owns a portfolio of marketable securities and 49% of the entity that owns the office building in Norton Shores, Michigan. His affiliate also owns 31.3% of Horizon El Portal LLC and 5.9% of the preferred and common interests in Horizon El Paso, LLC. Another affiliate of Howard Amster, Bright Horizons, owns 49% of the interests in the entities that own the outlet centers and related assets in Burlington, WA; Fremont, IN; Gettysburg, PA and Oshkosh, WI. Bright Horizons also owns 43.2% of Horizon El Paso, LLC. Included in Other Assets on the consolidated balance sheets at December 31, 2010 and 2009 is an unsecured note receivable from Howard Amster which has a balance of \$1.42 million and bears interest at 5.0%.

At December 31, 2010 and 2009, Gary Skoien owns 7.8% of Horizon El Portal LLC, 5.3% of Magnolia Bluff and 5.9% of the preferred interests and 7.2% of the common interests in Horizon El Paso, LLC; Gary Skoien also indirectly owns 9.3% of Bright Horizons.

Common interests in Horizon El Paso (the "El Paso Net Profits Interests") were granted in May 2007 to certain officers of the Company, Gary Skoien, Thomas Rumpitz and Andrew Pelmoter, representing 1.3%, 2.6% and 3.5%, respectively, of the total common interests in Horizon El Paso, LLC. Holders of the El Paso Net Profits Interests are not entitled to any distributions until the holders of the preferred interests have received a return of their capital plus

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interest thereon calculated at an annual rate of 12%, compounded quarterly. The El Paso Net Profits Interests are accounted for as a profit sharing arrangement with compensation expense being recognized for payments related to such interests. The Company recognized compensation expense for the El Paso Net Profits Interests of \$11,000 and \$33,000 during the years ended December 31, 2010 and 2009, respectively.

The mortgage loan which is secured by the Company's office building located in Norton Shores, Michigan requires an officer of the Company to be personally liable for losses suffered by the lender for environmental damages and certain actions prohibited under the loan documents. Gary Skoien personally indemnified this lender for such losses and damages. The Company agreed to indemnify Gary Skoien for any amounts paid under the indemnification and to pay Gary Skoien an annual fee of \$30,000, related to such indemnification until such loan is repaid (or Gary Skoien is otherwise released from the indemnification obligation).

The Company incurred interest expense on the margin account between Magnolia Bluff and Ramat Securities Ltd in the amount of \$77,000 and \$11,000, respectively, for the years ended December 31, 2010 and 2009. Ramat Securities Ltd is an affiliate of Howard Amster.

The Company incurred interest expense on the Somerset Loan, which is secured by approximately 46 acres of vacant land in Fruitport Township, Michigan in the amount of \$18,000 and \$5,000 for the years ended December 31, 2010 and 2009, respectively. The Somerset Loan matures in December 2013, has a balance of \$300,000 and bears interest at a rate of 5.0%, payable monthly. Somerset, L.P. also has a 50% interest in the net profits from the sale of the land over certain thresholds. Howard Amster owns a controlling interest and Gary Skoien owns a non-controlling interest in Somerset, L.P.

During 2010, Magnolia Bluff made a loan to the Company in connection with the development of the outlet center in Oklahoma City, Oklahoma (the "Magnolia Bluff Loan"). The loan was in the amount of \$1.0 million with an annual interest rate of 6.5%. The loan was advanced in the third quarter of 2010 and was repaid in October 2010 in connection with the formation of Horizon OKC (see Note 4). The Company owns the majority interest in Magnolia Bluff and consolidates its balance sheets and results of operations. Accordingly, the Magnolia Bluff Loan and the related interest expense incurred during 2010 are eliminated in the consolidated financial statements of the Company.

During the year ended December 31, 2010, the Company incurred interest expense of \$31,000 related to loans from Somerset, L.P. to the Company to fund development costs for the construction of an outlet center in Oklahoma City, Oklahoma. The loans were for a total of \$3.35 million with an annual interest rate of 6.5%. The loans were advanced in September 2010 and were repaid in October 2010 in connection with the formation of Horizon OKC (see Note 4).

In December 2009, the Company sold noncontrolling interests in the entities that own five of its outlet centers to Bright Horizons. The centers subject to the transaction are located in Burlington, Washington; El Paso, Texas; Fremont, Indiana; Gettysburg, Pennsylvania and Oshkosh, Wisconsin. Bright Horizons acquired a 22.5% interest in the entities that own the outlet centers (excluding the entity that owns the center in El Paso, Texas in which it acquired a 19.6% preferred interest and a 17.8% common interest). The total price for the acquired ownership interests was \$1.35 million. In May 2010, Bright Horizons acquired an additional 26.5% interest in the entities that own the outlet centers (excluding the entity that owns the center in El Paso, Texas, in which it acquired an additional 23.6% preferred interest and an additional 21.8% common interest) for additional consideration of \$1.35 million. The Company is also entitled to preferential distributions totaling \$201,000 from future positive cash flow distributions made from these entities. These additional proceeds will be recorded when they are received. No gain or loss was recognized on these transactions. Bright Horizons is controlled by Somerset, L.P.

The Company utilizes entities affiliated with a Director of the Company as its agent for insurance and risk management programs. The Company paid premiums totaling approximately \$485,000 and \$562,000 during the years ended December 31, 2010 and 2009, respectively, on insurance policies placed by consolidated entities.

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Note 13 – Recent Developments

In July 2009, the Company sold the 194,000 square foot shopping center located in Holland, Michigan. The gross sales price was \$2.8 million. The Company owned approximately 51% and an affiliate of Howard Amster owned approximately 49% of the entity that owned the center. A loss of approximately \$138,000 was recognized on the transaction. The results of operations for this center are included in loss from discontinued operations for the year ended December 31, 2009, on the Company's statements of operations.

In October 2009, the Company sold its ownership interest in the entity that formerly owned the outlet center located in Holland, Michigan. This interest was sold to an affiliate of Howard Amster for \$34,000, its net book value, pursuant to the terms of an agreement entered into in 2003 in which the Company had agreed to sell the entity to Howard Amster after the entity had sold its real estate assets. No gain or loss was recorded on this transaction. A receivable for the sale of this interest is included in Tenant and Other Accounts Receivable, Net with a balance of \$34,000 at December 31, 2009.

In December 2009, the Company sold noncontrolling interests in the entities that own five of its outlet centers to Bright Horizons. The total price for the acquired ownership interests was \$1.35 million. The Company is also entitled to preferential distributions totaling \$201,000 from future positive cash flow distributions made from these entities. These additional proceeds will be recorded when they are received. No gain or loss was recognized on this transaction (See Note 3).

In January 2010, the Company formed a joint venture with a partner from the People's Republic of China, whereby it will lease, manage and provide development services with respect to the design, construction and operation of outlet shopping centers in mainland China. The Company's partner is an affiliate of a publicly traded real estate firm that is working on the development of eight outlet shopping centers in China. The Company recognized income from this agreement totaling \$260,000 for the year ended December 31, 2010.

In May 2010, the Company sold additional noncontrolling interests in the entities that own five of its outlet centers to Bright Horizons for \$1.35 million. No gain or loss was recorded on this transaction (See Note 3).

In July 2010, the El Portal Center in Laredo, Texas was damaged as a result of Hurricane Alex. The majority of the damage was caused by the water entering the buildings from the Rio Grande River. The Company has two flood insurance policies in place on this property. It has agreed to a settlement with one insurer for a total claim of \$2.5 million (the policy limit). The second insurer has asserted that the settlement with the first carrier exceeds the value of the damage for which it is liable. The Company is contesting this assertion. The Company incurred cleaning costs of approximately \$600,000 in connection with the flooding and the remaining \$1.9 million of insurance proceeds were utilized in 2011 to partially repay the loan from Cathay Bank and fund an interest reserve and closing costs for an extension on the maturity date. Any additional insurance proceeds which the Company may receive are required to be applied to the principal balance of the Cathay Bank Loan. There can be no assurance that any additional proceeds will be received. The net insurance proceeds of \$1.9 million are reflected in the consolidated statements of operations for the year ended December 31, 2010 as Other Income and the receivable for the final payments from the insurer are included in Other Assets on the consolidated balance sheet at December 31, 2010.

In September 2010, the Company sold approximately 8.4 acres of unimproved land in Huntley, Illinois for \$1.84 million. Approximately \$1.6 million of the net proceeds was used to pay down the principal balance of the mortgage loan from US Bank. A gain of approximately \$842,000 was recognized on the transaction.

Note 14 – Discontinued Operations

In accordance with GAAP, the results of operations on real estate held for sale are reflected on the consolidated statements of operations as "Loss from discontinued operations" and the net carrying values are reflected on the consolidated balance sheets as "Real estate held for sale".

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The following table is a summary of the results of operations of the property classified as discontinued operations and sold in July 2009, in thousands (See Note 2):

	Year ended <u>December 31, 2009</u>
Total revenue	<u>\$ 284</u>
Operating expenses	444
General and administrative expenses	10
Depreciation and amortization expense	<u>91</u>
Total expense	<u>545</u>
Loss on sale of real estate	<u>138</u>
Loss from discontinued operations	<u>\$(399)</u>
Loss from discontinued operations attributable to the noncontrolling interests	<u>\$(259)</u>
Loss from discontinued operations attributable to the Company	<u>\$(140)</u>

Note 15 – Subsequent Events

In April 2011, the Company sold a 32-acre parcel of land located in Fruitport Township, Michigan for \$317,000. The Company used \$100,000 of the proceeds to partially repay the mortgage loan from Somerset, L.P. The sales proceeds approximated book value.

Note 16 – Business Operations

The consolidated financial statements have been prepared on a going concern basis, which contemplate continuation of the Company as a going concern. The Company has sustained operating losses and has increased its accumulated deficit. In addition, the Company has \$17.7 million of debt obligations coming due in 2011. The Company has begun negotiations with the holder of the mezzanine loan related to The Outlet Shoppes at Gettysburg with respect to a modification of the terms of that loan.

In view of these matters, realization of a major portion of the Company's assets in the accompanying consolidated financial statements is dependent upon continuing operations of the Company which, in turn, is dependent upon the Company's ability to meet its financing requirements and the success of its future operations. The Company anticipates refinancing or extending the maturities of the obligations due in 2011. Management believes the operations of the Company and the support from its shareholders will continue to generate sufficient cash flow for its working capital and financing requirements. Management believes the actions presently being taken provides the opportunity for the Company to continue as a going concern

BOARD OF DIRECTORS**Howard M. Amster**

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Pleasant Lake Apts. Corp.

Gov. Jim Edgar

Distinguished Fellow
University of Illinois Institute of
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Margaret A. Gilliam

President
Gilliam & Co.

Gary J. Skoien

Chairman, President and
Chief Executive Officer
Horizon Group Properties, Inc.

E. Thomas Thilman

Consultant to and former Chairman
Willis of Illinois, Inc.

CORPORATE OFFICERS**Gary J. Skoien**

Chairman, President and
Chief Executive Officer

David R. Tinkham

Chief Financial Officer
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(231) 798-5100, Fax

EXECUTIVE OFFICE

Horizon Group Properties, Inc.
6250 N. River Road
Suite 10-400
Rosemont, IL 60018
(847) 292-1870, Phone
(847) 292-1879, Fax

TRANSFER AGENT AND REGISTRAR

American Stock Transfer & Trust Company
59 Maiden Lane
New York, NY 10038
(718) 921-8124

INDEPENDENT AUDITORS

Cohen & Company, Ltd.
1350 Euclid Avenue, Suite 800
Cleveland, OH 44115

SHAREHOLDER INQUIRIES

Information is available upon request:
Horizon Group Properties, Inc.
5000 Hakes Drive
Suite 500
Norton Shores, MI 49441
(231) 798-9276

Information is also available on the
Company's web site:
www.horizongroup.com

STOCK TRADING

The Company's common stock trades in the
over the counter market under the symbol
"HGPI.PK".

