H·G·P Horizon Group Properties, Inc.

2003

H·G·P Horizon Group Properties, Inc.

Dear Shareholder:

This past year has been very exciting for Horizon Group Properties, Inc. We continued to build on the strong foundation we laid last year and are focused on enhancing the quality of our assets and investing in new opportunities. I would like to review some of the highlights of the year with you.

Huntley Master Planned Community

In January, six months after our acquisition of the Huntley Master Planned Community land, we sold 240 acres of land to an industrial building developer for over $12 million. This was important to Horizon since it enabled us to pay down $9.8 million of debt owed to Beal Bank. This loan carries a 12% interest rate and comes due in October 2005. The current balance on the loan is approximately $850,000 and is secured by the 411 acres of land that the Company owns after the sale.

In June, the Company broke ground on a 22,200 square foot retail strip center adjacent to a Jewel grocery store in the retail portion of the development. This project will be completed in December and is currently 58% leased. In addition to the anticipated economic benefit that we will receive from owning the center, the property taxes and the one-half percent of the sales tax from the project will be allocated to Tax Increment Financing ("TIF") bonds. Horizon owns the Series C TIF bonds and there are funded reserves of $6.5 million securing the TIF bonds which are available to cover the current shortfall in debt service. The Company benefits from the incremental revenue created by additional sales and property taxes because these revenues flow first to support the Series B bonds, then to replenish any deficiencies in the reserves and finally to the Series C Bonds. In addition, any balance remaining in the funded reserves will be released to the Company upon maturity or refunding of the TIF bonds. The Company will continue to make every possible effort to increase the TIF bond revenues because of the benefit to the Company.

Acquisitions and Development

The Company made two important additions to its portfolio this past year. In April, we acquired the Prime Outlets of Darien from Prime Retail. The Company purchased a 51% interest in the partnership that owns the center. Howard Amster (our largest shareholder and a Company director) and I own the other 49% interest in the partnership. The center is located in Darien, Georgia, midway between Savannah and Jacksonville, Florida. This 306,258 square foot center boasts some of the best brand name tenants in the outlet industry including Polo, Liz Claiborne, Coach, Tommy Hilfiger, Gap and others. These tenants have performed satisfactorily while the balance of the tenants lagged and in many cases left the center. We purchased the center at what we

believe to be a very attractive price and intend to invest in its redevelopment, capitalizing on the high-profile tenants. We changed the name of the center to the Georgia Islands Factory Shoppes and are currently engaged in upgrading the property. This program includes the demolition of approximately 28,000 square feet of space to improve visibility from the highway and allow easier access to parking, the relocation of tenants, repainting the center and replacing major signs. We have committed significant resources to market the center to the large tourist population at Sea Island and other nearby resort communities. We are enthusiastic about the prospects for this rejuvenated project.

In July, the Company acquired an ownership interest in a 400,000 square foot enclosed mall in Laredo, Texas. The Company invested in a partnership with Mr. Amster and myself on a basis similar to that in Darien, Georgia. This partnership in turn owns a 50% interest in the joint venture that owns the center. The center is located directly adjacent to the primary pedestrian bridge to Mexico and a quarter mile from the I-35 bridge. There are nine million annual pedestrian crossings and 14 million annual vehicle crossings over these bridges.

Along with our partner, Morgan Stern Realty Holdings, LLC, we intend to redevelop the center into a factory outlet center. We have commenced the redesign of the center and have started to market it to outlet tenants. The initial reaction to the center has been extremely encouraging. Many tenants like the idea of having the ability to sell into Mexico without opening a store in Mexico. In addition to the 800,000 residents of Laredo and Nuevo Laredo, the mall is only a two-hour drive for the eight million people in Monterrey, Mexico, one of the wealthiest populations in Mexico.

In my letter to you last year, I wrote about the successful completion of Phase II of our center in Tulare, California. The sales generated by tenants in both Phase I and Phase II continue to be strong and we increased the occupancy of Phase I from 88.2% last year to 100% currently. Liz Claiborne opened this year in Phase I, the movie theaters directly adjacent to Phase II are opening this month, and most importantly, we are actively marketing a new Phase III. While our initial plan was to open Phase III in 2004, we now are targeting an opening in 2005. Based on the increasing sales at the center, we are hopeful that Phase III will contain 50,000 square feet rather than the 30,000 we had originally planned. This will help us to accomplish our goal of increasing the critical mass of this center to make it an even more exciting retail destination.

Asset Sales

The Company continues to selectively sell assets that do not fit our ongoing business plans. At the Horizon Outlet in Monroe, Michigan we sold the 103,000 square foot strip center portion of the shopping center for $1.7 million. Horizon retained the village portion of the shopping center which contains 123,000 square feet. We utilized the sales proceeds to partially repay a loan from Beal Bank secured by the center to $1.3 million. The sale also increased net operating income since the strip center had disproportionately lower rents and higher vacancy. We are now focused on increasing the occupancy of the village portion from its current 76% to 100%.

Leasing and Operations

The Company achieved several leasing milestones this past year. As I mentioned earlier, our center in Tulare is now 100% occupied. Similarly, we completed the leasing of our office building in Norton Shores, Michigan. It, too, is 100% occupied.

We continue to make improvements in the performance of our center in Laughlin, Nevada. While occupancy has remained steady at about 89%, we have been working diligently to upgrade the quality of our tenants. We have released space to retailers that are more popular with our shoppers, and more importantly, who pay us better rents. As a result, the net operating income at the center continues to improve.

The Company is committed to redeveloping the Holland Outlet Center in Holland, Michigan. This has proven to be a more difficult task than we anticipated. We are still confident that the center is conducive to redevelopment. The Company has started the construction which will convert a portion of the center to office space and we will soon begin the work required to change the vehicular traffic flow through the center. We are encouraged by the interest being shown by prospective tenants in locating to the center.

The Company is pleased by the sales and traffic at our center in Medford, Minnesota. Last year we started to market more aggressively to the affluent city of Rochester, MN. We are pleased with the results of this effort and have mounted an effort to bring some of the better brand names to the center to provide the critical mass needed to really move the center forward.

Last year I wrote about the improvements that we were making to our center in Warrenton, Missouri outside of St. Louis. The Company felt that these improvements were necessary to help compete with a major value-oriented center being opened in the St. Louis market. Investing in those improvements proved to be wise because the impact of the opening was not insignificant and we believe our efforts helped to minimize the effect on our center. Nonetheless, we need to continue to strive to improve the performance of this center. We have decided to change our primary marketing focus from shoppers in the city of St. Louis and its suburbs to the east of the center to the shoppers in the cities and towns to the west of the center. Early indications are that this strategy will be helpful in improving traffic at our center.

Investor Relations

Last year at this time the Company was in the midst of a share repurchase effort to reduce the number of record shareholders and thus eliminate the costs and administrative burdens of complying with the myriad rules of the Securities and Exchange Commission. I am pleased to report that our efforts were successful and that the Company is reaping the benefits of this change through reduced legal, accounting and administrative costs.

Although we no longer file financial reports with the SEC, we are committed to providing timely and comprehensive financial information to our shareholders. We will continue to post our quarterly and annual financial statements on our website at

http://www.horizongroup.com/investor_relations.htm. In addition, we will post on our website press releases associated with significant events at the Company.

Termination of REIT Status

The accompanying proxy contains a proposal to be voted on which would allow the Company to terminate its REIT status. As you know, REIT status is a tax classification that allows the Company to escape corporate level federal income taxation. In exchange, REIT status imposes numerous limitations on stock ownership and the activities in which the Company is allowed to participate.

Because of the Company's sizeable net operating losses, it is unlikely that the Company will be subject to any federal taxes for the near future, so there is no benefit to remaining a REIT. The Company could choose to re-elect REIT status after a period of five (5) years should taxes become an issue. There is a great benefit to the Company of eliminating the operating restrictions and compliance costs associated with being a REIT.

While eliminating REIT status, we nevertheless want to keep the stock ownership limitations in place. Maintaining these limitations will protect the Company from forfeiting any tax losses that could result if certain ownership changes occur and also facilitate the future re-election of REIT status. I urge you to vote in favor of this proposal.

The Future

The Board and employees share my excitement about the direction in which the Company is headed. We believe that we are well positioned to take advantage of the skills and experience of our team to increase the value of the Company and the value of your investment.

On behalf of everyone at Horizon I want to thank you for your support and confidence.

Very truly yours,

Gary J. Skoien

REPORT OF INDEPENDENT AUDITORS

To the Shareholders and 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, 2003 and 2002, and the related consolidated statements of operations, shareholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Horizon Group Properties, Inc. at December 31, 2003 and 2002, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

Ernst & Young LLP

February 20, 2004

HORIZON GROUP PROPERTIES, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)

	December 31, 2003	December 31, 2002
ASSETS		
Real estate – at cost:		
Land	$ 7,523	$ 7,523
Buildings and improvements	82,405	79,716
Less accumulated depreciation	(15,289)	(12,818)
	74,639	74,421
Land held for investment	30,930	-
Total net real estate	105,569	74,421
Cash and cash equivalents	2,565	1,237
Restricted cash	6,567	2,707
Tenant accounts receivable, net	1,044	1,072
Real estate – discontinued operations	6,056	21,854
Deferred costs (net of accumulated amortization of $1,315 and $793, respectively)	2,005	2,147
Other assets	1,785	1,239
Total assets	$125,591	$104,677
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)		
Liabilities:		
Mortgages and other debt – continuing operations	$ 62,919	$ 57,739
Mortgages and other debt – discontinued operations	5,125	46,013
Accrued interest	291	6,741
Accounts payable and other accrued expenses	5,114	3,292
Prepaid rents and other tenant liabilities	639	1,170
Participation interests and other liabilities	10,535	716
Total liabilities	84,623	115,671
Minority interests	21,635	(2,303)
Shareholders' equity (deficit):		
Common shares ($.01 par value, 50,000 shares authorized, 2,870 and 2,855 issued and outstanding, respectively)	29	29
Additional paid-in capital	37,063	35,788
Accumulated deficit	(17,759)	(44,508)
Total shareholders' equity (deficit)	19,333	(8,691)
Total liabilities and shareholders' equity (deficit)	$125,591	$104,677

See accompanying notes to consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands)

	Year ended December 31, 2003	Year ended December 31, 2002
REVENUE		
Base rent	$13,041	$ 12,600
Percentage rent	177	157
Expense recoveries	2,791	2,701
Other	940	515
Gain on debt restructuring	5,618	-
Total revenue	22,567	15,973
EXPENSES		
Property operating	4,504	4,373
Real estate taxes	1,491	1,415
Land lease and other	697	552
Depreciation and amortization	3,557	3,709
General and administrative	3,936	2,742
Provision for impairment	750	3,474
Interest	7,425	6,912
Total expenses	22,360	23,177
Income/(loss) from continuing operations before minority interests and gain on sale of partnership interests and real estate	207	(7,204)
Minority interests	(2,135)	1,092
Loss from continuing operations	(1,928)	(6,112)
Gain on sale of partnership interests and real estate, net of minority interests	6,858	150
Income/(loss) from discontinued operations, net of minority interests	21,819	(15,701)
Net income/(loss)	$26,749	$(21,663)

See accompanying notes to consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
(In thousands)

	Common Shares		Additional Paid -In	Accumulated	Shareholders'
	Number	Amount	Capital	Earnings/(Deficit)	Equity
Balance, January 1, 2002	2,870	$ 29	$ 34,448	$ (22,845)	$ 11,632
Other	-	-	747	-	747
Units sold to principal shareholder	-	-	593	-	593
Net loss	-	-	-	(21,663)	(21,663)
Balance, December 31, 2002	2,870	29	35,788	(44,508)	(8,691)
Share repurchase	(15)	-	(75)	-	(75)
Units sold to principal shareholder	-	-	1,350	-	1,350
Net income	-	-	-	26,749	26,749
Balance, December 31, 2003	2,855	$ 29	$ 37,063	$ (17,759)	$ 19,333

See acompanying notes to consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year ended December 31, 2003	Year ended December 31, 2002
Cash flows from operating activities:		
Net income/(loss)	$ 26,749	$(21,663)
Net gain on sale of partnership interests and real estate, including amounts in discontinued operations	(23,358)	(177)
Gain on debt restructuring, including amounts in discontinued operations	(32,504)	-
Adjustments to reconcile net income/(loss) to net cash provided by/(used in) operating activities:		
Minority interests, including amounts in gain on sale of partnership interests and real estate and discontinued operations	19,759	(3,900)
Depreciation	3,309	4,616
Amortization, including deferred financing costs	798	1,419
Provision for impairment	2,583	17,027
HGP partnership unit grants	225	120
Changes in assets and liabilities:		
Restricted cash	(997)	799
Tenant accounts receivable	9	198
Deferred costs and other assets	(1,290)	(268)
Accounts payable, accrued expenses and accrued interest	72	4,563
Participation interests and other liabilities	(407)	(53)
Prepaid rents and other tenant liabilities	(483)	(140)
Net cash provided by/(used in) operating activities	(5,535)	2,541
Cash flows from investing activities:		
Acquisition of land	-	(500)
Acquisition of land held for investment	(9,300)	-
Expenditures for buildings and improvements	(5,408)	(416)
Net proceeds from sale of real estate and partnership interests	25,921	634
Net cash provided by/(used in) investing activities	11,213	(282)
Cash flows from financing activities:		
Sale of HGP LP partnership units	1,350	750
Principal payments on mortgages and other debt	(25,732)	(33,883)
Proceeds from borrowings	20,328	32,500
Debt issue costs	(221)	(1,485)
Share repurchase	(75)	-
Net cash used in financing activities	(4,350)	(2,118)
Net increase in cash and cash equivalents	1,328	141
Cash and cash equivalents:		
Beginning of year	1,237	1,096
End of year	$ 2,565	$ 1,237

See accompanying notes to consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS, continued

	Year ended December 31, 2003	Year ended December 31, 2002
Supplemental Information:		
Real estate acquisition:		
Land held for investment	$ 30,250	$ -
Restricted cash	2,060	-
Mortgages and other debt	(10,706)	-
Accounts payable and accrued expenses	(2,174)	-
Other liabilities	(10,130)	-
Cash paid	$ 9,300	$ -
Real estate dispositions:		
Net book value of real estate disposed	$14,769	$457
Restricted cash	(1,074)	-
Tenant accounts receivable	19	-
Other assets	38	-
Mortgage assumed by purchaser	(15,732)	-
Accounts payable and other liabilities	671	-
Gain on sale of real estate	13,848	177
Cash received, net	$12,463	$634
Partnership interest dispositions:		
Minority interests	$ 3,948	$ -
Gain on sale of partnership interests	9,510	-
Cash received, net	$13,458	$ -
Debt extinguishment:		
Mortgage balance forgiven	$25,278	$ -
Accrued interest forgiven	7,514	-
Restricted cash	(271)	-
Accounts payable and accrued expenses	(17)	-
Gain on debt restructure	$ 32,504	$ -

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 self-administered and self-managed Maryland corporation that was established on June 15, 1998. The operations of the Company are primarily conducted through a subsidiary limited partnership, Horizon Group Properties, L.P. ("HGP LP") of which the Company is the sole general partner. As of December 31, 2003, HGPI owned approximately 70.6% 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 the Company's election).

In November and December 2003, the Company sold an aggregate of 48.9% ownership interest in the entities that owned nine outlet centers (one of which was subsequently sold) and its corporate office building to an affiliate of Howard Amster ("Amster"), a director and significant shareholder of HGPI. Amster's interest in the net earnings and the net equity of the applicable property partnerships are included in Minority Interests on the Company's consolidated financial statements. The related gain is included in Gain on Sale of Partnership Interests on the Company's statement of operations (See Note 9).

As of December 31, 2003, HGP's portfolio consisted of eight factory outlet centers located in six states comprising an aggregate of approximately 1.6 million square feet of gross leasable area ("GLA"). In addition, the Company owns its corporate office building located in Norton Shores, Michigan, of which a substantial portion is leased by third party tenants. The Company also purchased approximately 655 acres of land in Huntley, Illinois, from The Prime Group, Inc. ("Prime Group") in June 2003, that is held for investment purposes (See Note 9).

On December 8, 2003, HGPI purchased 15,078 shares of its Common Stock pursuant to an offer to purchase all shares of its common stock held by persons owning 20 or fewer shares as of the close of business on September 26, 2003 for $5.00 per share. At the completion of this transaction, HGPI had fewer than 300 shareholders of record and thus, effective December 11, 2003, de-registered its common stock with the Securities and Exchange Commission and ceased being a reporting company under the Securities and Exchange Act of 1934, as amended. In addition, HGPI's common stock ceased to be listed on the NASDAQ SmallCap Market.

Note 2 - Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and all subsidiaries that the Company controls, including HGP LP. The Company considers itself to control an entity if it is the majority owner of and has voting control over such entity. All significant intercompany balances and transactions have been eliminated in consolidation.

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 accounting principles generally accepted in the United States 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.

Discontinued Operations

In accordance with SFAS 144 "Accounting for the Impairment or Disposal of Long Lived Assets," ("SFAS 144") effective for financial statements issued for fiscal years beginning after December 15, 2001, the results of operations and gain/(loss) on real estate properties sold or held for sale subsequent to December 31, 2001 are reflected in the consolidated statements of operations as "Income from Discontinued Operations" for all periods presented.

Impact of Recently Issued Accounting Standards

In April 2002, the Financial Accounting Standards Board ("FASB") issued Statement 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 1 and Technical Correction" ("SFAS No. 145"). Statement 4, "Reporting Gains and Losses from Extinguishment of Debt" ("SFAS No. 4"), required that gains and losses from the extinguishment of debt that were included in the determination of net income be aggregated and, if material, classified as an extraordinary item. The provisions of SFAS No. 145 related to the rescission of SFAS No. 4 require the Company to reclassify prior period items into continuing operations, including those recorded in the current period, that do not meet the extraordinary classification. Additionally, future gains and losses related to debt extinguishment are required to be classified in income from continuing operations. The provisions of SFAS No. 145 related to the rescission of SFAS No. 4 became effective in fiscal years beginning after May 15, 2002. The Company recorded gains on the extinguishment of debt in the year ended December 31, 2003 which are included in Income from Discontinued Operations and Gain on Debt Restructuring on the Company's statement of operations.

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 year ended December 31, 2003, $60,000 of interest was capitalized related to the construction of Phase II of the outlet center in Tulare, California.

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	10 years or lease term, if less
Furniture, fixtures or equipment	3 - 7 years

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", 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 $469,000 and $101,000 for the years ended December 31, 2003 and 2002, respectively, excluding properties classified as discontinued operations.

Cash Equivalents

The Company considers all liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Restricted Cash

Restricted cash consists of amounts deposited in accounts with (1) the Company's primary lenders in connection with certain loans (see Note 7), (2) in escrow accounts for infrastructure requirements related to land sales in Huntley and future infrastructure expenses and interest payments related to Huntley and (3) with the trustee for the TIF Bonds (as hereinafter defined) until certificates of occupancy are received for previously sold Huntley land parcels which secure the US Bank Mortgage (see Note 7). At December 31, 2003, the escrow accounts related to the Company's primary lenders include approximately $1.0 million in capital improvement and tenant allowance reserves, $521,000 in real estate tax and insurance escrows, and approximately $1.0 million for debt service and operating expenses (including $212,000 in a certificate of deposit related to the Beal Bank Loan I (See Note 9)). The Huntley infrastructure escrow accounts total $2.6 million and the US Bank Mortgage account has a balance of approximately $1.5 million at December 31, 2003.

Tenant Accounts Receivable

Management regularly reviews accounts receivable and estimates the necessary amounts to be recorded as an allowance for uncollectibility. 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.

Total tenant accounts receivable are reflected net of reserves of $183,000 and $314,000 as of December 31, 2003 and 2002, respectively. The provision for doubtful accounts was $202,000 and $109,000 for the years ended December 31, 2003 and 2002, respectively. This charge is included in the line item entitled "Land lease and other" on the statements of operations.

Discontinued Operations

Periodically, in the course of reviewing the performance of its portfolio, management may determine that it is appropriate for the Company to offer certain properties for sale, and accordingly, such properties will be classified as discontinued operations on the Company's balance sheets. In accordance with SFAS 144, assets held for sale are valued at the lower of carrying value or fair value less costs to dispose. For fiscal years beginning after December 15, 2001, SFAS 144 requires that the results of operations and gain/(loss) on real estate properties sold or held for sale subsequent to December 31, 2001 be reflected in the consolidated statements of operations as "Income from Discontinued Operations" for all periods presented. As of December 31, 2003, the Company had entered into contracts to sell the single tenant building in Roseville, Michigan leased to Petsmart, Inc. and the 103,000 square foot strip building at the outlet center in Monroe, Michigan and was actively marketing for sale several parcels of vacant land. Pursuant to the

requirements of SFAS 144, the Company has reclassified the real estate assets and related mortgage notes payable for these properties to Discontinued Operations on the balance sheets and reports the revenue and expenses from the properties as Income from Discontinued Operations on the statements of operations. The Company ceased depreciating the building in Monroe, Michigan at September 30, 2003. In addition, operations from the outlet centers located in Daleville, Indiana and Somerset, Pennsylvania, which were sold in May 2003, the power center located in Norton Shores, Michigan which was sold in August 2003 and the outlet center located in Sealy, Texas which was sold in December 2003 are also included in the discontinued operations line items on the balance sheets and statements of operations. SFAS 144 also requires that prior period financial statements presented are also reclassified for comparability. This reclassification has no effect on the Company's previously reported net income or loss.

Deferred Costs

Deferred leasing costs consist of fees and direct internal costs incurred to initiate and renew operating leases 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 of Financial Instruments

The Company estimates the fair value of its debt to be approximately $69.1 million as of December 31, 2003. This value is estimated using a discounted cash flow analysis, based on the incremental borrowing rates for similar types of borrowing arrangements. The carrying value for this debt is $68.0 million. The carrying value of cash and cash equivalents, receivables and payables approximate their fair values due to their short-term nature.

Income Taxes

The Company has elected to be taxed as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended (the "Code"). A REIT is a legal entity that holds real estate interests and receives a deduction for dividends paid to its shareholders for federal income tax purposes. HGP intends to distribute its REIT taxable income to its shareholders and satisfy certain other requirements as defined in the Code so as to reduce or eliminate federal income tax liability. Based on its taxable loss in the current period and past fiscal years, the Company is not and has not been obligated to make any dividend distributions to maintain its status as a REIT. Accordingly, the consolidated financial statements do not include any federal income tax expense. The Company has federal and state net operating losses to which no value has been attributed due to the uncertainty of the Company's ability to use them in the future.

Minority Interests

Minority interests represent the interests of unitholders of HGP LP, other than HGPI, in the net earnings and net equity of HGP LP and third party interests in other property partnerships that are not wholly owned by the Company (see below). The unitholder minority interest in HGP LP was approximately 29.4% at December 31, 2003. On December 27, 2002, HGPI sold 145,349 units in HGP LP to Amster, for aggregate consideration of $750,000, or $5.16 per unit. On March 13, 2003, HGPI sold an additional 261,268 units in HGP LP to Amster for aggregate consideration of $1.35 million or $5.16 per unit. The second set of units cannot be converted into shares of Common Stock of HGPI. Proceeds in excess of HGPI's carrying value of these units was recognized as an increase in additional paid in capital in both transactions. HGPI may consider additional sale of units in HGP LP to Amster or others in the future. In September 2002, the Company granted 43,695 new units in HGP LP to key employees with a total fair value of $120,000. In April 2003, the Company granted 82,722 new units in HGP LP to key employees with a total fair value of $225,000.

The fair value of these unit grants is included in the line item entitled "General and Administrative" in the statements of operations for the years ended December 31, 2003 and 2002. These units cannot be converted to shares of Common Stock for one year from the date of grant.

In November and December 2003, the Company sold ownership interests representing 48.9% ownership in the entities that owned nine outlet centers (one of which was subsequently sold) and its corporate office building to an affiliate of Amster. The net gain on the sale of the partnership units is included in the line item entitled "Gain on Sale of Partnership Interests" in the Company's statement of operations for the year ended December 31, 2003 (See Note 9).

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 $375,000 and $402,000 as of December 31, 2003 and 2002, 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 only after the 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 interest income, income related to marketing services that is recovered from tenants pursuant to lease agreements and income from tenants with lease terms of less than one year.

Share Options

The Company has elected to follow Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB 25"), in accounting for its options on common shares. Under APB 25, no compensation expense is recognized because the exercise price of the Company's employee share options equals or exceeds the market price of the underlying shares at the date of grant.

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.

Note 3 – Leases

Space in the Company's centers is leased to various tenants under operating leases, which are generally for one to five 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 tenant sales in excess of certain thresholds.

Minimum future rentals to be received under non-cancelable leases are summarized as follows (in thousands):

	Operating Portfolio	Discontinued Operations
2004	$10,461	$ 392
2005	7,393	336
2006	4,827	312
2007	2,850	312
2008	1,786	312
Thereafter	5,333	2,809

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

Note 4 - Impairment

The declining results of operations resulting in the inability to service the JP Morgan Loans, as hereinafter defined, was judged to represent an indicator of possible impairment in the value of the collateral properties. Based on negotiations with the lender and declines in occupancy and revenues, the Company estimated the carrying value of four of the centers exceeded the fair values of those centers and, accordingly, recorded a provision for asset impairment of $17.0 million in 2002, including $13.6 million related to properties which are included in Income from Discontinued Operations.

In 2003 the Company entered into an agreement to sell the 103,000 square foot strip building at the outlet center in Monroe, Michigan. Income from Discontinued Operations also includes a charge for asset impairment of $1.83 million to reduce the carrying value of this building to its estimated sales value, less costs to dispose. In addition, due to declines in occupancy and net operating income, the Company estimated the carrying value of the remaining portion of the outlet center in Monroe, Michigan exceeded its fair value and recorded a provision for asset impairment in 2003 of $750,000 which is reflected on the Company's statement of operations in income from continuing operations.

Note 5 - Long Term Stock Incentive Plan

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 308,500 shares were outstanding at December 31, 2003. The Company uses the intrinsic value method of accounting for it stock – based compensation.

The fair value of options granted for the purpose of presenting pro forma information, in accordance with Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), has been estimated using a Black-Scholes option pricing model with the following weighted-average assumptions:

	For the year ended December 31, 2003	**For the year ended December 31, 2002**
Expected dividend yield	0.00%	0.00%
Expected stock price volatility	.497	.447
Risk free interest rate	4.26%	3.82%
Expected life of options	10 years	10 years

The Black-Scholes option valuation 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.

Net income/(loss) for the years ended December 31, 2003 and 2002, computed on a pro forma basis under requirements of SFAS 123 equals $26,700,000 and $(21,698,000), respectively.

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

	For the year ended December 31, 2003		**For the year ended December 31, 2002**	
	Shares	**Price**	**Shares**	**Price**
Outstanding, beginning of the year	326,000	$3.40 - $6.49	326,000	$3.40 - $6.49
Granted	-	-	-	-
Exercised	-	-	-	-
Canceled	17,500	$3.40 - $6.49	-	-
Outstanding, end of the year	308,500	$3.40 - $6.49	326,000	$3.40 - $6.49

The weighted average fair value of options canceled for the year ended December 31, 2003 was $4.20.

The weighted average exercise price for options outstanding at both December 31, 2003 and 2002 was $5.12. The weighted average contractual life of options outstanding at December 31, 2003 and 2002 was 5.17 years and 5.27 years, respectively.

The Company granted 82,722 units and 43,695 units of HGP LP to key employees in April 2003 and September 2002, respectively (See Note 2, "Minority Interests").

Note 6 – Commitments

The Company has outstanding commitments for capital expenditures on leases signed at December 31, 2003 in the amount of $239,000 for tenant allowances and $39,000 for construction costs. These costs are expected to be paid during 2004 and a portion will be reimbursed from the capital improvement escrows (see Note 2).

Note 7 - Mortgage Debt and Other Liabilities

UBS Loans

The UBS Loans consist of senior loans with a total initial principal balance of $22.0 million (the "UBS Senior Loans") and mezzanine loans with a total initial principal balance of $3.5 million (the "UBS Mezzanine Loans", or collectively, the "UBS Loans") provided by UBS Warburg Real Estate Investments Inc. on July 11, 2002. The UBS Senior Loans and UBS Mezzanine Loans each consist of three loans, each secured by an outlet center. The centers which secure the UBS Loans are in Laughlin, Nevada, Medford, Minnesota and Warrenton, Missouri, each of which was transferred to a new subsidiary of the Company, which is restricted from owning any assets, other than the outlet centers, and may not incur additional

liabilities, other than normal trade payables. The UBS Loans are cross-collateralized and non-recourse to the Company, subject to certain customary exceptions. The UBS Loans require that the Company maintain a Leverage Ratio (as defined in the loan documents) that is no more than 5% greater than the Initial Leverage Ratio (as defined in the loan documents) calculated as of July 11, 2002.

The UBS Senior Loans mature July 11, 2009, require monthly principal payments based on a 25-year amortization schedule and bear interest at a fixed rate of 8.15%. The outstanding balances of these loans totaled $21.6 million and $21.9 million at December 31, 2003 and 2002, respectively. These loans also require the monthly funding of escrow accounts for the payment of future debt service, real estate taxes, insurance, capital and tenant improvements and leasing commissions (see Note 2). Funds in excess of those specified in the loan agreements are disbursed to the new entities at least monthly.

The UBS Mezzanine Loans mature July 11, 2005 and may be prepaid without penalty after July 11, 2004. These loans require monthly payments based on a three-year amortization schedule and bear interest at a fixed rate of 17.0%. The outstanding balances of these loans totaled $2.1 million and $3.1 million at December 31, 2003 and 2002, respectively.

Beal Bank Loans

Beal Bank, S.S.B. ("Beal Bank") provided two loans initially totaling $7.0 million (the "Beal Bank Loans") and consisting of (i) a $3.0 million loan secured by vacant land located in Norton Shores, Michigan and Fruitport Township, Michigan (the "Beal Bank Loan I"), and (ii) a $4.0 million loan secured by the outlet center in Monroe, Michigan (the "Beal Bank Loan II"). These loans are cross-collateralized and are recourse to the Company. The Beal Bank Loans mature July 10, 2005. Principal payments of up to $2.0 million are permitted without penalty at any time and the loans may be prepaid in whole or in part without penalty after July 10, 2004. In connection with the Company's sale of the vacant land in Norton Shores, Michigan in August 2003, $1.0 million was repaid on each of the Beal Bank Loans and the Beal Bank Loans were cross defaulted with the Huntley Beal Loan (as defined below). The Company also granted a second mortgage on the Huntley Land (as defined below) to Beal Bank as security for the Beal Bank Loans. In addition, the Company granted Beal Bank a first priority pledge and security interest in the net proceeds resulting from any future sale of the partnership that owns the outlet center located in Laughlin, Nevada. At December 31, 2003, the balance of the Beal Bank Loan I was $2.0 million and the Beal Bank Loan II was $3.0 million.

The Beal Bank Loans require monthly payments of interest only at rates of (i) the greater of the Wall Street Journal Prime Rate plus 4.5% or 12.0% for the Beal Bank Loan I and (ii) the greater of the Wall Street Journal Prime Rate plus 2.5% or 9.9% for the Beal Bank Loan II, each of which adjusts monthly.

The Beal Bank Loan II is guaranteed by Prime Retail, Inc. ("Prime Retail") up to a maximum amount of $4.0 million (the "Prime-Beal Guaranty"). Mr. Skoien and Mr. Amster, Directors of the Company, were members of the board of Directors of Prime Retail. The Prime-Beal Guaranty was released on August 19, 2003, pursuant to the agreement, when the total outstanding balance of the Beal Bank Loans was reduced to $5.0 million. The Company was obligated to make quarterly payments of $15,000 to Prime Retail as long as this guaranty was in effect.

Republic Bank Loan

On June 29, 2001, the Company completed a $3.5 million refinancing of its outlet center in Holland, Michigan, with Republic Bank. The outstanding balance of this loan was $3.3 million and $3.4 million at December 31, 2003 and 2002, respectively. The loan is for a term of five years, requires monthly debt service payments of $30,000 based on a twenty-year amortization schedule, and bears interest at a fixed rate of 8.21%.

Greenwich Loan

On August 19, 2003, the Company sold its power center and adjacent vacant land located in Norton Shores, Michigan. The power center had been security for a $16.0 million loan provided by Greenwich Capital Financial Products, Inc., which was assumed by the purchaser. The non-recourse loan had a term of ten years, required monthly payments based on a 30-year amortization schedule and bore interest at a fixed rate of 7.647%. The outstanding balance of this loan was $15.8 million at December 31, 2002.

JP Morgan Loans

On July 9, 1999 the Company completed a debt financing totaling $46.7 million with Morgan Guaranty Trust Company of New York (the "JP Morgan Loans"). The JP Morgan Loans initially consisted of (i) loans totaling $22.9 million secured by three factory outlet centers located in Daleville, Indiana, Somerset, Pennsylvania and Tulare, California (the "DST Loans") and (ii) loans totaling $23.8 million secured by three factory outlet centers located in Gretna, Nebraska, Sealy, Texas and Traverse City, Michigan (the "GST Loans"). Within each group, the loans were cross-collateralized and bore interest at a fixed rate of 8.46%, mature on August 1, 2009 and required the monthly payment of interest and principal based on a 25-year amortization schedule. The loans are non-recourse to HGPI, subject to certain customary exceptions.

On October 10, 2001, the Company notified the servicers of the JP Morgan Loans that the net cash flow from the properties securing the loans was insufficient to fully pay the required debt service and began remitting monthly all available cash flow, after a reserve for operating expenses, as partial payment of the debt service. During this Event of Default (as defined in the loan agreements) the interest rate increased to 13.46% and a penalty of 5.0% of each monthly installment not timely made in full was imposed. The default interest and monthly penalty had been accrued in the consolidated financial statements since October 2001.

The declining results of operations resulting in the inability to service the JP Morgan Loans was judged to represent an indicator of possible impairment in the value of the collateral properties. Based on negotiations with the lender and declines in occupancy and revenues, the Company estimated the carrying value of four of the centers exceeded the fair values of those centers and, accordingly, recorded a provision for asset impairment of $17.0 million in 2002, including $13.6 million related to properties which are included in Income from Discontinued Operations.

On May 22, 2003, the Company restructured the DST Loans by (1) the acquiring the loans secured by the outlet centers located in Daleville, Indiana and Somerset, Pennsylvania (the "Daleville and Somerset Loans") which had an aggregate principal balance of $13.2 million, excluding accrued interest and penalties, and (2) reinstating to current status the loan secured by an outlet center in Tulare, California (the "Tulare Loan") for a total payment by the Company of $1.98 million. The funds for this transaction were provided by a $2.0 million loan from an affiliate of Amster. On May 30, 2003 this loan was repaid in connection with the sale of the centers in Daleville, Indiana and Somerset, Pennsylvania to an investment group including Gary J. Skoien, Chairman, Chief Executive Officer and President of the Company and Amster. The independent directors of the Company approved this transaction and the Company believes this transaction reflects market terms. The gain on debt restructuring related to the Daleville and Somerset Loans of $14.5 million is included in Income from Discontinued Operations on the statement of operations because the two properties were sold on May 30, 2003 (See Note 9).

The restructuring of the Tulare Loan resulted in the forgiveness of $1.25 million of accrued penalties and default interest. Pursuant to FASB Statement No. 15 "Accounting by Debtors and Creditors for Troubled Debt Restructurings" ("FASB 15"), the carrying amount and prospective effective interest rate on the Tulare Loan was adjusted for the forgiven interest and penalties applicable to this loan. At December 31, 2003, the

Tulare Loan had an outstanding principal balance of $8.9 million and an unamortized restructuring adjustment of $1.1 million, which will be amortized as a reduction of future interest expense.

On November 4, 2003, the Company began restructuring the GST Loans by purchasing, for $1.25 million, the loan secured by the property in Sealy, Texas (the "Sealy Loan") which had a principal balance of $10.8 million, excluding accrued interest and penalties. The gain on debt restructuring related to the Sealy Loan of $12.4 million is included in Income from Discontinued Operations on the statement of operations because the property was sold on December 4, 2003 (See Note 9). On November 7, 2003, the Company purchased, for $2.75 million, the loan secured by the property in Gretna, Nebraska (the "Gretna Loan" or together with the Sealy Loan, the "Gretna and Sealy Loans") which had a principal balance of $7.2 million, excluding accrued interest and penalties. The gain on debt restructuring related to the Gretna Loan of $5.7 million is included in Gain on Debt Restructuring on the statement of operations. The Company completed the restructuring on December 4, 2003 when the loan secured by the property in Traverse City, Michigan (the "Traverse City Loan") was reinstated to a current status.

The Company's share of the funds for the discounted payoff of the Gretna and Sealy Loans were provided by a $2.04 million loan from an affiliate of Amster. This loan bears interest at a rate of 8.0% and matures on August 3, 2004. HGPI also sold a 49% interest in the entity that owns the three outlet centers subject to the GST Loans to an affiliate of Amster for $1.96 million (See Note 9). The funds from these two transactions were required to be used to complete the restructuring of the GST Loans.

The restructuring of the Traverse City Loan resulted in the forgiveness of $594,000 of accrued penalties and default interest. Pursuant to FASB 15, the carrying amount and prospective effective interest rate on the Traverse City Loan was adjusted for the forgiven interest and penalties applicable to this loan. At December 31, 2003, the Traverse City Loan had an outstanding principal balance of $4.9 million and an unamortized restructuring adjustment of $594,000, which will be amortized as a reduction of future interest expense.

The Tulare Loan and the Traverse City Loan require the monthly funding of escrow accounts for the payment of real estate taxes, insurance and capital improvements. These escrow accounts are classified on the balance sheet as restricted cash (See Note 2).

Huntley Debt

On June 12, 2003 the Company borrowed $9.1 million from Amster Trading Company, an affiliate of Amster, (the "Huntley Amster Loan") which funded the purchase of Huntley Development Limited Partnership and Huntley Meadows Residential Venture (collectively "Huntley") from Prime Group and its affiliates. The Huntley Amster Loan bears interest at a rate of 11.0% per annum, payable monthly, and matures on June 12, 2004, with the option for a one-year extension. A one percent (1.0%) origination fee was paid to Amster Trading Company and a 1.0% prepayment fee is required if the loan is repaid prior to February 1, 2004. Approximately $8.4 million was repaid on the principal balance of this loan from the proceeds of the sale of partnership interests to an affiliate of Mr. Amster in December 2003 (See Note 9). The outstanding principal balance of the Huntley Amster Loan was $690,000 at December 31, 2003. The Huntley Amster Loan is guaranteed by HGPI and HGP LP and is secured by a pledge of the partnership interests in Huntley, subject to any required lender consents. The independent directors of HGPI approved this transaction and the Company believes this transaction reflects market terms.

In connection with the Company's acquisition of Huntley, the Company assumed a loan secured by the land owned by Huntley (the "Huntley Land") provided by Beal Bank, which at December 31, 2003, had an outstanding principal balance of $10.7 million (the "Huntley Beal Loan"). The Huntley Beal Loan requires monthly payments of interest at an annual rate equal to the greater of (i) the Wall Street Journal Prime Rate plus four percent (4%) or (ii) twelve percent (12%). The Huntley Beal Loan may only be prepaid, prior to maturity, from the net proceeds from the sale of the collateral land as approved by the lender in its sole discretion. The Huntley Beal Loan matures on October 31, 2004, and allows for a one-year

extension upon the satisfaction of certain customary conditions. The Huntley Beal Loan is guaranteed by HGPI. In connection with the sale of the power center in Norton Shores, Michigan, the Company granted Beal Bank a first priority pledge and security interest in the net proceeds resulting from the sale of the partnerships that own the outlet center located in Laughlin, Nevada. The Beal Bank Loans and the Huntley Beal Loan are cross-defaulted and Beal Bank has a second mortgage on the Huntley Land as security for the Beal Bank Loans.

Pursuant to the terms of the Amended and Restated Agreement and Assignment of Net Profits Interest dated October 27, 1999, as later amended (the "Beal Net Profits Agreement"), Beal Bank has a 35% interest in the Net Profits of Huntley, subject to certain preferences in their distribution. Net profits generated by Huntley are to be distributed in the following order: first to the owners of Huntley in the amount of the Approved Contributions (which totaled approximately $12.8 million at December 31, 2003 and from which the Huntley Beal Loan is required to be repaid), second to Beal Bank for the Beal Account (which had a balance of approximately $6.7 million at December 31, 2003), third to Huntley for its account (which had a balance of approximately $12.4 million at December 31, 2003) and thereafter, 35% to Beal Bank and 65% to Huntley. The Approved Contributions include operating and development expenditures funded for Huntley (excluding interest on the Huntley Beal Loan). For purposes of determining distribution preferences under the Beal Net Profits Agreement, the Approved Contributions, the Huntley Account and the Beal Account increase per the terms of the Beal Net Profits Agreement. On the maturity date of the Huntley Beal Loan, Huntley is required to pay Beal Bank the fair market value of Beal Bank's Net Profits interest. Pursuant to purchase accounting requirements, the Company has recorded an estimated liability for the Beal Net Profits Agreement in the amount of $9.1 million, reflecting the estimated value of the Beal Bank Net Profits interest liability. Such estimate is subject to change. Some of the factors that could cause a significant revision to the estimate include changes in zoning and changes in the market demand for real estate in the area. The Beal Bank Net Profits interest has been included in Participation Interests and Other Liabilities on the Company's balance sheet and has a balance of $9.4 million, including accrued interest, at December 31, 2003. Certain affiliates of Prime Group have continuing guarantees related to the Beal Net Profits Agreement. The Company has idemnified such guarantors against any liability in connection with their guarantees. Capitalized terms in this paragraph which are not defined herein shall have the meanings given such terms in the Beal Net Profits Agreement, as amended.

Gary J. Skoien, Chairman, Chief Executive Officer and President of the Company, is also the Executive Vice President and Chief Operating Officer of 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 proceeds generated by Huntley, which he retained after the Company's purchase of Huntley. 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 Huntley plus interest per the terms of the agreement). Pursuant to purchase accounting requirements, the Company has recorded a liability for the Skoien Net Profits Interest in the amount of $1.0 million, which represents its estimated fair value and which amount has been included in Participation Interests and Other Liabilities on the Company's balance sheet.

As additional consideration for the partnership interests, the Company granted to Prime Group and certain of its affiliates, a participation interest of 26% of the net cash flow distributed by Huntley (the "Prime Group Participation Interest") with respect to the interests acquired by the Company. No amount is payable to Prime Group until the Company has received distributions from Huntley in excess of its purchase price for Huntley and advances made by the Company to Huntley 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") which is authorized to issue up to $108.0 million of tax-exempt, tax-increment bonds (the "TIF

Bonds") to reimburse Huntley for a portion of the land cost and the cost of infrastructure improvements. In 1995, the Village sold $7.0 million of Series A bonds and $14.0 million of Series B bonds. Huntley owns the Series C bonds with a total principal amount of $25.0 million plus accrued interest. The Series C bonds are subordinate to the Series A and Series B bonds. Currently there is no portion of the tax increment available to the Series C bonds and no value has been ascribed to them by the Company.

The TIF District contains approximately 900 acres of land owned or previously owned by Huntley. The source of repayment for the 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) reserve funds established at the time of issuance of the TIF Bonds. Debt service reserve funds were initially established with $700,000 for the Series A bonds and $3.09 million for the Series B bonds as security for the payment of principal and interest on the TIF Bonds. To the extent the reserve funds are not needed to service the bonds, they will be returned to Huntley. These funds are held in interest bearing accounts under the control of the TIF Bond trustee and totaled approximately $3.4 million at December 31, 2003. There can be no assurance that these funds will be returned to Huntley and, therefore, they are not reflected on the balance sheet of the Company. The repayment of the TIF Bonds is not an obligation of the Company and thus they are not reflected on the Company's balance sheet as a liability.

As additional security for the Series B bonds, Huntley granted a mortgage to U.S. Bank Trust National Association, as trustee for the holders of the Series B bonds, covering approximately 131 acres of land (the "US Bank Mortgage"). Upon the sale of any parcel of land subject to the US Bank Mortgage, such parcel will be released from the US Bank Mortgage provided that Huntley deposits into a collateral account (the "US Bank Collateral Account") an amount equal to the greater of (i) 50% of the July 1997 appraised value of such parcel or (ii) an amount per square foot of the parcel sold as set forth in Exhibit B to the Amended and Restated Intercreditor Agreement. Amounts deposited into the US Bank Collateral Account are released to Huntley upon the issuance of a certificate of occupancy for the subject land parcel. The balance in the US Bank Collateral Account was approximately $1.5 million at December 31, 2003 and is included in Restricted Cash on the Company's balance sheet (see Note 2). Based on a third-party review of the current incremental real estate and sales tax revenue and the available debt service reserve funds, the Company believes that those funds will be sufficient to make the scheduled debt service payments on the Series A and B bonds. Further, Huntley has no continuing legal obligation related to the proceeds received from the TIF Bonds and thus, no liability has been recognized related to this mortgage.

The independent directors of HGPI approved the acquisition of Huntley and the assumption of the related net profits interests and other liabilities. The Company believes this transaction reflects market terms.

Tulare Construction Loan

On April 24, 2003, the Company closed on a $3.1 million loan for the construction of Phase II of its outlet center in Tulare, California (the "Tulare II Loan"). The loan is secured by a first mortgage on the land and improvements and bears interest at the greater of LIBOR plus 300 basis points or 5.5%. The loan was made by an affiliate of Amster. This loan was repaid on December 30, 2003 from the proceeds of the sale of partnership interests to an affiliate of Amster (See Note 9).

Petsmart Loan

On July 20, 2001, the Company acquired the ownership of a triple net leased property in Roseville, Michigan, which is leased to Petsmart, Inc., and assumed a $3.2 million mortgage. The rent payable under the lease is equal to the debt service due under the loan secured by the property (the "Petsmart Loan"). The Petsmart Loan matures on January 8, 2008, bears interest at a fixed rate of 8.77% and requires the monthly payment of principal computed on a 25-year schedule. The loan is non-recourse to HGPI. The balance of the Petsmart Loan was $3.1 million and $3.2 million at December 31, 2003 and 2002, respectively. At

December 31, 2003, the Company had entered into a contract to sell this property and thus, pursuant to SFAS 144, its real estate assets, debt and results of operations are listed as Discontinued Operations on the Company's consolidated financial statements.

UBS Office Loan

On August 19, 2003, the Company refinanced its corporate office building in Norton Shores, Michigan with a $2.25 million loan from UBS Real Estate Investments Inc. ("UBS" and the "UBS Office Loan"). The UBS Office Loan requires an officer of the Company to be personally liable for losses suffered by UBS for environmental damages and the results of certain actions prohibited under the UBS Office Loan documents. Gary J. Skoien personally indemnified UBS for such losses and damages. The Company agreed to indemnify Mr. Skoien for any amounts paid under the UBS indemnification and to pay Mr. Skoien an annual fee of $30,000 related to such indemnification until the loan is repaid (or Mr. Skoien is otherwise released from the UBS indemnification obligations). The outstanding balance of this loan was $2.2 million at December 31, 2003. The loan is for a term of ten years, requires monthly principal payments based on a 30-year amortization schedule, bears interest at a fixed rate of 6.89% and is secured by a first mortgage on the land and building.

Laughlin Land Loan

On June 4, 2002, the Company purchased the land underlying its center in Laughlin, Nevada for $2.5 million pursuant to a purchase option contained in the ground lease. The Company paid approximately $500,000 at closing and a $2.0 million unsecured promissory note was provided by the seller. This note matures in June 2012, bears interest at a rate of 2.0% above the weighted average cost of funds index for the Eleventh District Savings Institutions, adjusted annually and requires amortization based on a ten year schedule. The initial interest rate payable on the loan was 5.074% through February 28, 2003 and is 4.375% through February 29, 2004. The outstanding principal balance on this note was $1.7 million and $1.9 million at December 31, 2003 and 2002, respectively.

Debt Maturities

Debt maturities and principal payments, including debt secured by the assets classified as discontinued operations, due subsequent to December 31, 2003 are as follows (in thousands):

Due in:	Operating Portfolio	Discontinued Operations
2004	$15,475	$ 40
2005	4,705	2,043
2006	3,953	47
2007	883	52
2008	942	2,943
Thereafter	35,255	-
	61,213	$5,125
Tulare Loan restructuring adjustment	1,112	
Traverse City Loan restructuring adjustment	594	
	$62,919	

The Huntley Amster Loan is reflected as a current year maturity, but the loan contains a provision for extension, upon the satisfaction of certain customary conditions (see "Huntley Debt" above).

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.

Note 8 - Related Party Transactions

The Company utilizes Thilman & Filippini as its agent for insurance and risk management programs. E. Thomas Thilman is a Director of the Company and a partner in Thilman & Filippini. The Company paid premiums totaling approximately $1.1 million during each of the years ended December 31, 2003 and 2002 on insurance policies placed by Thilman & Filippini. This includes insurance premiums for the properties classified as discontinued operations.

The Company sub-leased office space on a month to month basis for its senior executives at 77 W. Wacker, Chicago, Illinois from Prime Group. The Company incurred rent expense of $54,000 and $47,000 during the years ended December 31, 2003 and 2002, respectively.

In connection with the sale of approximately 49% interests in the entities that own nine outlet centers (one of which was subsequently sold) (See Note 9) and its corporate office building to an affiliate of Amster, the Company receives a management fee equal to approximately 49% of the general and administrative expenses, excluding the costs of being a public company, to the extent such costs and expenses relate to the respective properties and the operations thereof. During the year ended December 31, 2003, the Company recognized management fee income related to this arrangement of $82,000 which is included in Other Income on the Company's statement of operations.

The Company has several loans from affiliates of Amster on which it paid a total of $613,000 of interest during the year ended December 31, 2003. See Note 7 for the specific terms of the loans.

For additional disclosure of related party transactions, see Notes 2, 7 and 9.

Gary J. Skoien, Chairman, Chief Executive Officer and President of the Company is also Executive Vice President and Chief Operating Officer of Prime Group. Howard Amster ("Amster") is a director and significant shareholder of the Company.

Note 9 – Property Acquisitions and Dispositions

On January 25, 2002, the Company sold 7.1 acres of land ancillary to its center in Warrenton, Missouri. The proceeds from this sale were $235,000 and a loss on sale of $1,000 was recognized.

On February 15, 2002, a tenant exercised its option to purchase the land subject to its ground lease at Lakeshore Marketplace in Norton Shores, Michigan. The proceeds from this sale were $373,000 and a gain on sale of $156,000 was recognized.

In September 2002, the Company sold excess office furniture to a tenant at the Michigan corporate office for $37,000 resulting in a gain of $22,000.

In March 2003, the Company received a condemnation award for land adjacent to the Company's center in Gretna, Nebraska. The land was condemned by Sarpy County in Nebraska in order to widen Highway No. I-80 that runs along the center. The Company recognized a gain of $29,000 as a result of the condemnation.

On May 30, 2003 the Company sold a parcel of land adjacent to its center located in Tulare, California. The proceeds from the sale were $650,000 and a gain of $547,000 was recognized.

On May 31, 2003, the Company sold the partnership that owns two outlet centers located in Daleville, Indiana and Somerset, Pennsylvania for $1.98 million. A net gain on sale of $1.3 million was recognized. The investment group that acquired the partnership includes Gary J. Skoien, Chairman, Chief

Executive Officer and President of the Company and an affiliate of Amster. The independent directors of HGPI approved this transaction and the Company believes this transaction reflects market terms. The investment group has hired the Company to manage and lease the two properties. The leasing and management agreement provides that the Company will receive 50% of the net profit from the subsequent sale of the centers after the owners receive a 12% annual return on their investment. There can be no assurance that the Company will receive any funds from such sales.

In June 2003, the Company purchased controlling interest in Huntley (two partnerships, which own approximately 655 acres of land in Huntley, Illinois) from affiliates of Prime Group. Gary J. Skoien, Chairman, Chief Executive Officer and President of the Company is also the Executive Vice President and Chief Operating Officer of Prime Group. The independent directors of HGPI approved this transaction and the Company believes the transaction reflects market terms. This purchase was accounted for under the purchase method of accounting under which assets acquired and liabilities assumed were recorded at their relative fair values as of the date of the purchase. The initial purchase price allocation estimates are preliminary and will be finalized upon obtaining additional information regarding the liabilities assumed at acquisition. Direct costs incurred for development activities at Huntley are capitalized to Land Held for Investment on the Company's balance sheet, while indirect costs and holding costs are expensed in general and administrative expense on the Company's statement of operations. The Company had previously acquired a 3.25% net profits interest in Huntley in connection with a loan made to Retail Partners in March 2003. The value of this interest is included in Land Held for Investment on the balance sheet (See Note 7 for further details on the debt assumed in the transaction).

The following summarizes the preliminary estimate of the assets acquired and liabilities assumed by the Company on June 13, 2003 pursuant to the purchase of Huntley:

	(In thousands)
Land held for investment	$30,250
Restricted cash	2,060
	$32,310
Mortgages and other debt	$10,706
Accounts payable and accrued expenses	2,174
Other liabilities	10,130
Contributed capital (cash paid)	9,300
	$32,310

On August 19, 2003, the Company sold the power center and adjacent land parcels located in Norton Shores, Michigan for $22.7 million, including the assumption of the mortgage with Greenwich Capital Financial Products, Inc. by the purchaser. A gain of $10.9 million was recognized and is included in Income from Discontinued Operations on the Company's statement of operations. The Company used $2.0 million of the proceeds from the sale to pay $1.0 million each on the Beal Bank Loans. The vacant land parcels were a portion of the security for the Beal Bank Loan I. The reduction of the principal balance on the Beal Bank Loans to $5.0 million released the Prime-Beal Guaranty. In addition, Beal Bank required that $3.0 million be deposited into an escrow account to fund infrastructure and interest payments for Huntley, since the mortgage it provided on that property is cross-collateralized with the Beal Bank Loans.

On September 16, 2003, the Company sold 10 acres of vacant land in Fruitport Township, Michigan. This land was subject to the Beal Bank Loan I. The proceeds from this sale were $226,000 and a gain on sale of $116,000 was recognized. The net proceeds of $213,000 were placed in a certificate of deposit by Beal Bank to be applied to the Beal Bank Loan I principal balance after July 11, 2004, when additional prepayments are allowed. This balance is included on the Company's balance sheets as restricted cash (See Note 2).

On November 3, 2003, HGPI sold a 49% ownership interest in the entity which owned the three outlet centers subject to the GST Loans (one of which was subsequently sold) to an affiliate of Amster for $1.96 million. The proceeds from this sale were required to be used to complete the restructuring of the GST Loans. A gain of $11.2 million was recognized on this transaction. This gain is included, net of minority interests, on the Company's statement of operations on the line item entitled "Gain on Sale of Partnership Interests".

On December 4, 2003, the Company sold 5 acres of vacant land adjacent to the outlet center in Gretna, Nebraska. The proceeds from this sale were $39,000 and a gain on sale of $33,000 was recognized.

On December 5, 2003, the Company sold the outlet center in Sealy, Texas for $1.8 million. A net gain on the sale of $946,000 was recognized.

In December 2003, HGPI sold an aggregate of 48.9% ownership interest in the entities that owned six outlet centers and its corporate office building to an affiliate of Amster for $11.5 million. The Company used $8.4 million of the proceeds from this sale to partially repay the Huntley Amster Loan. A loss of $1.7 million was recognized on this transaction and is included, net of minority interests, on the Company's statement of operations on the line item entitled "Gain on Sale of Partnership Interests".

Note 10 – Discontinued Operations

In accordance with SFAS 144 effective for financial statements issued for fiscal years beginning after December 15, 2001, the results of operations and gain/(loss) on real estate properties sold or held for sale subsequent to December 31, 2001 are reflected in the consolidated statements of operations as "Income from Discontinued Operations" for all periods presented.

The following table is a summary of the results of operations of the properties classified as discontinued operations (in thousands):

	Year ended December 31, 2003	Year ended December 31, 2002
Total revenue	$ 3,408	$ 5,302
Total expenses	5,519	10,285
Provision for impairment	1,833	13,553
Gain on debt restructuring	26,886	-
Income/(loss) before minority interests	22,942	(18,536)
Minority interests	(10,778)	2,835
Gain on sale of real estate, net of minority interests of $4,194	9,655	-
Income/(loss) from discontinued operations	$21,819	$(15,701)

Note 11 – Subsequent Events

On January 2, 2004, the Company sold 235 acres of land in Huntley, Illinois for $11.4 million. A portion of the land was subject to the US Bank Mortgage and thus, $1.7 million of the proceeds were deposited into the US Bank Collateral Account (See Note 7). The Company used $636,000 of the proceeds to acquire water and sewer capacity, a portion of which was included with the land that was sold, together with $686,000 from the Huntley infrastructure escrow account (See Note 2). An escrow account was

established with $300,000 to fund wetland mitigation and sewer line construction required by the contract. The net proceeds of $9.8 million were used to partially repay the Huntley Beal Loan.

On January 22, 2004, the Company executed an agreement to purchase a 303,000 square foot outlet center in Darien, Georgia from Prime Retail and its affiliates for $3.0 million. A $500,000 earnest money deposit was made on January 28, 2004. The transaction is expected to close by the end of the first quarter of 2004.

On January 29, 2004, an affiliate of Amster provided a $3.1 million loan to the Company. The loan is secured by the outlet center in Gretna, Nebraska. The loan matures on August 9, 2004, bears interest at a rate equal to the greater of LIBOR plus 300 basis points or 5.5% and requires monthly principal payments based on a 25-year amortization schedule.

The Company has entered into an agreement to sell its interests in the entities, which own the triple net leased property in Roseville, Michigan, which is leased to Petsmart, Inc. The sales price was $475,000, including the assumption of the Petsmart Loan (See Note 7) by the purchaser. The Company provided the purchaser a $370,000 note as a portion of the purchase price. The note bears interest at a rate of 4.0%, matures on December 30, 2005 and is secured by the partnership interests.

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Howard M. Amster
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Chairman, President and
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Information is also available on the Company's Web site:
http://www.horizongroup.com

STOCK TRADING

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

H·G·P Horizon Group Properties, Inc.

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