



Darien, GA

Annual

2004



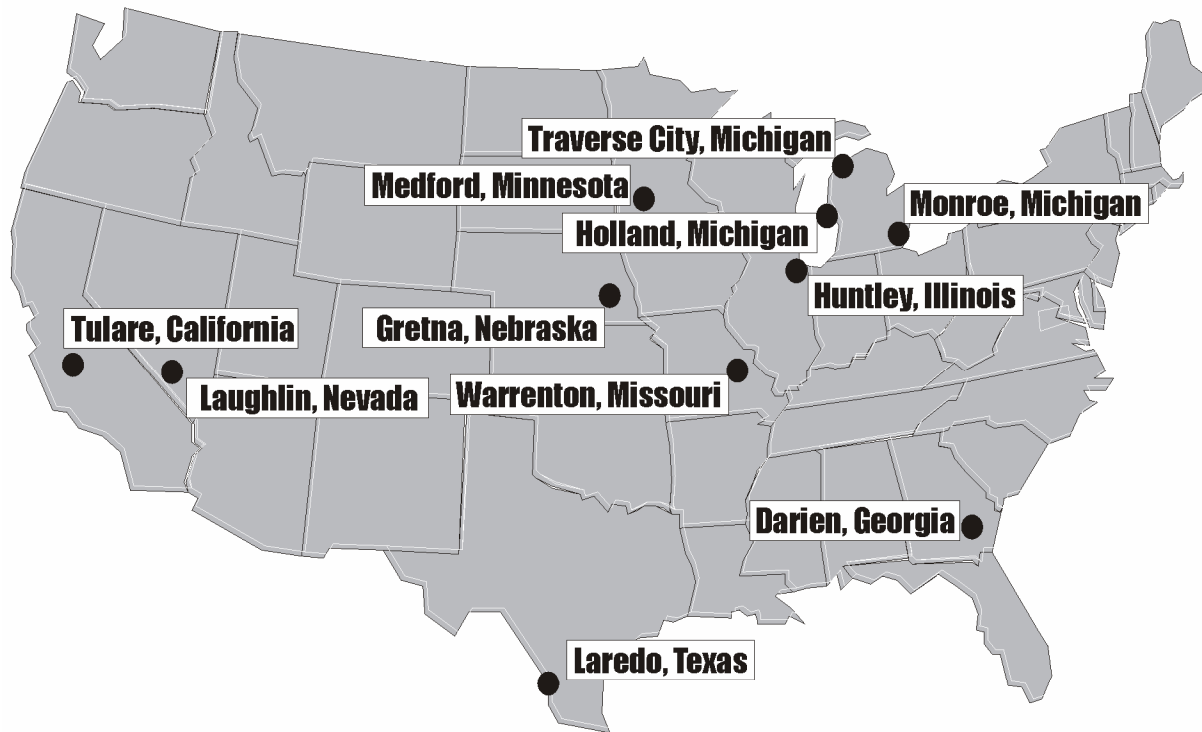
Tulare, CA



Laredo, TX

Report

Portfolio



Company Profile

Based in Rosemont, Illinois, Horizon Group Properties, Inc. has interests in ten factory outlet centers in eight states totaling approximately 2.2 million square feet and is the developer of a master planned community in suburban Chicago. The tenants in its outlet portfolio include premier brand names including Polo Ralph Lauren, Gap Outlet, Liz Claiborne, Tommy Hilfinger, Nike, Mikasa and Carter's Childrenswear.

BOARD OF DIRECTORS

Gov. Jim Edgar

Distinguished Fellow
University of Illinois Institute of
Government and Public Affairs

Margaret A. Gilliam

President
Gilliam & Co.

Howard M. Amster

President
Pleasant Lake Apts. Corp.

Gary J. Skoien

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

E. Thomas Thilman

Partner
Thilman & Filippini

CORPORATE OFFICERS

Gary J. Skoien

Chairman, President and
Chief Executive Officer

David R. Tinkham

Chief Financial Officer and Secretary

Andrew F. Pelmoter

Senior Vice President, Leasing

Thomas A. Rumpitz

Senior Vice President,
Asset Management

CORPORATE EXECUTIVE OFFICES

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) 921-8380

INDEPENDENT AUDITORS

Ernst & Young LLP
233 South Wacker Drive
Chicago, IL 60606

SHAREHOLDER INQUIRIES

Information about Horizon Group
Properties, Inc. is available upon request
from Melanie Galarneau with the Company's
Accounting Department:

Horizon Group Properties, Inc.
P. O. Box 0510, Muskegon, MI 49443
(231) 798-9191

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".

Dear Stockholder:

In my letter last November, I updated you on the exciting events that had occurred at Horizon Group Properties, Inc. over the prior 18 months. This year, the Board of Directors has decided to hold the Annual Meeting in June so that it occurs closer to the end of the prior fiscal year, thus allowing stockholders to receive more current information. I hope that you will find this useful. We intent to adhere to a late spring or early summer schedule in the future. This letter is more brief than in the past having been written so soon after the last, but it is still full of significant accomplishments of which we are quite proud.

Huntley Master Planned Community

In March, the Company closed on a loan for \$15.6 million secured by 380 acres of land that are part of the Huntley Master Planned Community. The loan has a term of two years and carries interest at the prime rate plus $\frac{1}{2}$ %. The loan allowed the Company to retire an approximately \$857,000 loan from Beal Bank and buy out Beal's 35% net profits interest in the development for \$8.5 million. Management believes the purchase of the net profits interest will be beneficial to the Company. In addition, the loan provided the Company with cash that will allow us to pursue new opportunities as described below.

Late last year, the Company successfully completed the construction of the small strip shopping center in Huntley that I described in my last letter. It is now fully leased. We achieved higher rents than originally projected and, as a result, are seeking favorable replacement financing for the center. The Company is now pursuing the development of additional retail space adjacent to this center.

Acquisitions and Development

We are rapidly approaching the groundbreaking for Phase III at our center in Tulare, California. This 56,000 square foot addition will include several premium tenants including Calvin Klein and Casual Corner. We plan to complete this addition in time for stores to be open for the Christmas shopping season. Phases I and II of the center are 100% occupied and sales are strong and rising. If the trends continue, and Phase III opens as successfully as we project, we will start to plan and lease Phase IV on land we are purchasing to accommodate Phase III.

Last April, we purchased what we subsequently renamed the Georgia Islands Factory Shoppes in Darien, Georgia. Since acquiring the property, we have completed its reconfiguration and completely repainted it. The tenants who relocated or who were the beneficiaries of increased visibility and access as a result of the reconfiguration of the center have reported solid sales increases in the past few months. We continue to focus our attention on marketing the center which will be key to our overall success.

Last July, we purchased an interest in a failed enclosed mall in Laredo, Texas immediately adjacent to pedestrian and vehicle bridges into Mexico. Since acquiring our interest in the mall, we have completed plans for the redesign and conversion of the center into the Laredo Outlet Stores. We have begun to sign leases for the center and are aggressively working to lease space to several premium tenants. We are convinced that the volume of border crossings and the proximity to Mexico make this a very exciting location for tenants to open a store. We are currently in the process of negotiating the terms for a loan that will provide the \$35 million required for the complete renovation and conversion of the property. We hope to close on the loan and commence construction later this year.

The Company, with our mall partners, is also actively working with the City of Laredo on a mixed-use trade, convention and hotel facility adjacent to the mall. The synergy between our mall, this project and a major Visitors' Center funded by the City and currently under construction should greatly enhance our likelihood of success with the outlet project.

The Company has launched an effort to acquire underperforming outlet centers that have value-add opportunities. We are also studying several greenfield sites for new outlet center development. Horizon has a proven track record of repositioning existing troubled outlet centers and has a leasing, management and marketing team that is well regarded in the industry. It is my belief that acquisitions or new development play to these core strengths.

Leasing and Operations

I discussed above the great success that we have had at our center in Tulare. We are having similar success at our center in Laughlin, Nevada. While we are unable to add space to the center, we have been able to lease space that has never been occupied since the center's completion in 1996. Sales continue to rise at the center and we are continuing to replace underperforming tenants with tenants that will add to the overall shopping experience. Most importantly, our efforts have resulted in continued improvements in net operating income at the center.

We are pleased with tenant interest in our center in Medford, Minnesota. We are formalizing leases with Old Navy and Haggar which should be terrific additions to the retail mix and help increase traffic to the center. As a result of the center's continued strength, we are working with several premium tenants to whom we hope to lease space.

We continue to reposition the Company's center in Holland, Michigan from outlet-only shopping to a town center concept with a mix of retail, office and dining. At the end of the year, new drive lanes and parking configurations were completed at the center. The conversion of one of the center's buildings from retail to office use is underway. It should be completed in June. This project has proven more difficult than we anticipated, but we continue to be diligently focused on making this effort a success.

Investor Relations

As a reminder, although we no longer file financial reports with the SEC, we are committed to providing timely and comprehensive financial information to our stockholders. 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. I would encourage you to visit this site if you seek information regarding our activities.

Thanks

The Company has achieved a great deal over the past few years, especially in light of its uncertain prospects at its inception. We are fortunate to have a terrific Board, which includes Howard Amster, Governor Jim Edgar, Maggie Gilliam and Tom Thilman, helping us to achieve our goals. I thank them for their service, support and insight into our business. I encourage you to vote for Mr. Amster, Ms. Gilliam and Mr. Thilman in the accompanying proxy.

Of course, these achievements could never have been attained were it not for a dedicated and talented group of employees. Each and every one has performed his or her job admirably, demonstrating professionalism, dedication, skill and knowledge.

I would specifically like to recognize Andy Pelmoter who so ably leads our leasing efforts, Tom Rumptz who is a jack of all trades, working on development, property management and asset disposition, Gina Slechta, our marketing guru, and David Tinkham, our CFO and the guy who keeps us honest and our numbers straight. Each one provides a great service to the Company and stockholders and allow me to sleep at night. Thanks Team.

Finally, thank you for your continual confidence and interest in Horizon Group Properties.

Very Truly yours,

A handwritten signature in black ink, appearing to read 'GJS', with a horizontal line extending to the right.

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, 2004 and 2003, 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. We were not engaged to perform an audit of the Company’s internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and 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, 2004 and 2003, 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

March 18, 2005, except for
Note 13, as to which the date
is March 30, 2005

HORIZON GROUP PROPERTIES, INC.

CONSOLIDATED BALANCE SHEETS
(In thousands)

	<u>December 31, 2004</u>	<u>December 31, 2003</u>
ASSETS		
Real estate – at cost:		
Land	\$ 8,641	\$ 7,335
Buildings and improvements	88,574	82,405
Less accumulated depreciation	<u>(19,142)</u>	<u>(15,289)</u>
	78,073	74,451
Land held for investment	<u>20,070</u>	<u>30,930</u>
Total net real estate	98,143	105,381
Investment in joint venture	2,860	-
Cash and cash equivalents	466	2,565
Restricted cash	6,462	6,567
Tenant accounts receivable, net	1,069	1,044
Real estate – held for sale	1,443	6,244
Deferred costs (net of accumulated amortization of \$1,992 and \$1,315, respectively)	1,873	2,005
Other assets	<u>3,167</u>	<u>1,785</u>
Total assets	<u>\$115,483</u>	<u>\$125,591</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Mortgages and other debt	\$ 60,070	\$ 68,044
Accounts payable and other accrued expenses	4,054	5,405
Prepaid rents and other tenant liabilities	1,111	639
Participation interests and other liabilities	<u>10,563</u>	<u>10,535</u>
Total liabilities	<u>75,798</u>	<u>84,623</u>
Minority interests	<u>22,155</u>	<u>21,635</u>
Shareholders' equity:		
Common shares (\$.01 par value, 50,000 shares authorized, 2,859 and 2,870 issued and outstanding, respectively)	29	29
Additional paid-in capital	37,174	37,063
Accumulated deficit	<u>(19,673)</u>	<u>(17,759)</u>
Total shareholders' equity	<u>17,530</u>	<u>19,333</u>
Total liabilities and shareholders' equity	<u>\$115,483</u>	<u>\$125,591</u>

See accompanying notes to consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands)

	<u>Year ended December 31, 2004</u>	<u>Year ended December 31, 2003</u>
REVENUE		
Base rent	\$14,333	\$13,041
Percentage rent	204	177
Expense recoveries	2,869	2,791
Other	1,765	912
Gain on debt restructuring	<u>-</u>	<u>5,618</u>
Total revenue	<u>19,171</u>	<u>22,539</u>
EXPENSES		
Property operating	5,328	4,504
Real estate taxes	1,361	1,491
Land lease and other	1,084	697
Depreciation and amortization	4,396	3,557
General and administrative	4,175	3,847
Provision for impairment	-	750
Interest	<u>4,954</u>	<u>7,210</u>
Total expenses	21,298	22,056
Loss from investment in joint venture	<u>(133)</u>	<u>-</u>
Income/(loss) from continuing operations before minority interests and gain/(loss) on sale of partnership interests and real estate	(2,260)	483
Minority interests	<u>341</u>	<u>(3,752)</u>
Loss from continuing operations	(1,919)	(3,269)
Gain/(loss) on sale of partnership interests and real estate, net of minority interests	(22)	6,858
Income from discontinued operations, net of minority interests	<u>27</u>	<u>23,160</u>
Net income/(loss)	<u>\$(1,914)</u>	<u>\$26,749</u>

See accompanying notes to consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(In thousands)

	<u>Common Shares</u>		<u>Additional</u>	<u>Accumulated</u>	<u>Shareholders'</u>
	<u>Number</u>	<u>Amount</u>	<u>Paid -In</u>	<u>Earnings/</u>	<u>Equity</u>
			<u>Capital</u>	<u>(Deficit)</u>	
Balance, January 1, 2003	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	<u>-</u>	<u>-</u>	<u>-</u>	<u>26,749</u>	<u>26,749</u>
Balance, December 31, 2003	2,855	29	37,063	(17,759)	19,333
Contribution	-	-	87	-	87
Units converted to shares	4	-	24	-	24
Net loss	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1,914)</u>	<u>(1,914)</u>
Balance, December 31, 2004	<u>2,859</u>	<u>\$ 29</u>	<u>\$37,174</u>	<u>\$ (19,673)</u>	<u>\$ 17,530</u>

See accompanying notes to consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Year ended December 31, *(In thousands)*

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:		
Net income/(loss)	\$(1,914)	\$26,749
Net gain on sale of partnership interests and real estate, including amounts in discontinued operations	(307)	(23,358)
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 net gain/(loss) on sale of partnership interests and real estate and discontinued operations	(365)	19,759
Loss from investment in joint venture	133	-
Depreciation	3,973	3,309
Amortization, including deferred financing costs	697	798
Provision for impairment	-	2,583
HGP partnership unit grants	265	225
Changes in assets and liabilities:		
Restricted cash	105	(997)
Tenant accounts receivable	(132)	9
Deferred costs and other assets	(184)	(1,290)
Accounts payable and other accrued expenses	(1,515)	72
Participation interests and other liabilities	28	(407)
Prepaid rents and other tenant liabilities	<u>114</u>	<u>(483)</u>
Net cash provided by/(used in) operating activities	<u>898</u>	<u>(5,535)</u>
Cash flows from investing activities:		
Acquisition of property	(4,367)	(9,300)
Investment in joint venture	(2,992)	-
Expenditures for buildings and improvements	(3,786)	(5,408)
Net proceeds from sale of real estate and partnership interests	<u>14,030</u>	<u>25,921</u>
Net cash provided by investing activities	<u>2,885</u>	<u>11,213</u>
Cash flows from financing activities:		
Sale of HGP LP partnership units	-	1,350
Net contributions primarily by minority interests	730	-
Principal payments on mortgages and other debt	(14,138)	(25,732)
Proceeds from borrowings	7,688	20,328
Debt issue costs	(162)	(221)
Share repurchase	<u>-</u>	<u>(75)</u>
Net cash used in financing activities	<u>(5,882)</u>	<u>(4,350)</u>
Net increase/(decrease) in cash and cash equivalents	(2,099)	1,328
Cash and cash equivalents:		
Beginning of year	<u>2,565</u>	<u>1,237</u>
End of year	<u>\$ 466</u>	<u>\$ 2,565</u>

See accompanying notes to consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS, continued
For the Year ended December 31, *(In thousands)*

	<u>2004</u>	<u>2003</u>
Supplemental Information:		
Real estate disposition and transfer of debt:		
Real estate – held for sale	\$ 3,242	
Other assets	(344)	
Mortgages and other debt transferred	(3,122)	
Accounts payable and accrued expenses	(65)	
Gain on sale of real estate	<u>329</u>	
Cash received, net	<u>\$ 40</u>	
Debt extinguishment:		
Mortgage balance forgiven		\$25,278
Accrued interest forgiven		7,514
Restricted cash		(271)
Accounts payable and accrued expenses		<u>(17)</u>
Gain on debt restructure		<u>\$32,504</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 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 HGPI is the sole general partner. As of December 31, 2004, HGPI owned approximately 69.2% 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 majority of the assets of HGP LP are its investments in subsidiary partnerships that own real estate. HGPI consolidates the results of operations and the balance sheets of those partnerships in which HGPI and HGP LP (or their wholly owned subsidiaries) collectively own the majority interest or for variable interest entities formed after December 31, 2003 of which they are the primary beneficiaries. For a partnership in which HGPI and HGP LP do not meet these criteria, the Company reflects its net investment in such partnership and reports such partnership’s results of operations using the equity method of accounting.

As of December 31, 2004, HGP’s portfolio consisted of nine factory outlet centers located in seven states comprising an aggregate of approximately 1.8 million square feet of gross leasable area (“GLA”). In addition, the Company owns its corporate office building located in Norton Shores, Michigan, a substantial portion of which is leased to third party tenants. In November and December 2003, the Company sold an aggregate of 48.9% ownership interest in the entities that own the outlet centers and its corporate office building to an affiliate of Howard Amster (“Amster”), a director and significant shareholder of HGPI. In April 2004, HGPI and HGP LP collectively acquired a 51% controlling interest in the entity that controls the outlet center in Darien, Georgia. Amster and Gary J. Skoien, President, Chairman, and Chief Executive Officer of the Company, acquired the remaining 49% limited partner interest in this entity. HGPI consolidates the results of operations and the assets and liabilities of these entities in its financial statements.

The Company owns 51% of Horizon El Portal, LLC (“Horizon El Portal”), which owns 50% of a joint venture (“El Portal Center”) that owns a shopping center in Laredo, Texas containing approximately 345,000 square feet of GLA. Horizon El Portal reports the results of operations and the assets and liabilities of El Portal Center using the equity method of accounting. HGPI consolidates the results of operations and the assets and liabilities of Horizon El Portal.

The Company also owns approximately 411 acres of land in Huntley, Illinois that is held for investment purposes (“Huntley”).

The portion of the net earnings of HGPI’s subsidiaries owned by parties other than HGPI is reported as Minority Interests on the Company’s statements of operations and such parties’ portion of the net equity in such subsidiaries is reported on the Company’s balance sheets as Minority Interests.

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

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

fewer than 300 stockholders 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 de-listed its common stock from the NASDAQ SmallCap Market after which the common stock began trading in the over-the-counter 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. In accordance with Financial Accounting Standards Board Interpretation No. 46, "Consolidation of Variable Interest Entities," the Company consolidates variable interest entities created subsequent to December 31, 2003 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 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.

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.

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Investment in Real Estate

The Company allocates the purchase price of properties to net tangible and identifiable assets acquired based on their fair values in accordance with the provisions of Statement of Financial Accounting Standards No. 141, *Business Combinations*. 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 other tenant liabilities on the balance sheet) 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 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 balance sheet) 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 of the tenant origination costs would be charged to expense.

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. During the year ended December 31, 2004, \$23,000 of interest was capitalized related to the construction of the shopping center in Huntley, Illinois.

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"), 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 retreating 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 \$55,000 and \$113,000 for the years ended December 31, 2004 and 2003, 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 (1) in accounts with the Company's primary lenders in connection with certain loans (see Note 9), (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 9). At December 31, 2004, the escrow accounts related to the Company's primary lenders included approximately \$1.3 million in capital improvement and tenant allowance reserves, \$609,000 in real estate tax and insurance escrows, and approximately \$613,000 for debt service and operating expenses. At December 31, 2004, the Huntley infrastructure escrow accounts totaled \$427,000 and the US Bank Mortgage account had a balance of approximately \$3.5 million.

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 \$277,000 and \$183,000 as of December 31, 2004 and 2003, respectively. The provision for doubtful accounts was \$304,000 and \$202,000 for the years ended December 31, 2004 and 2003, respectively. This charge is included in the line item entitled "Land lease and other" in 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, 2004, the Company 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 to Real Estate-Held for Sale on the balance sheets and reports the revenue and expenses from the properties as Income from Discontinued Operations on the statements of operations. In addition, results of 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, the outlet center located in Sealy, Texas which was sold in December 2003, the single tenant building in Roseville, Michigan leased to Petsmart, Inc. which was sold in February 2004 and the 103,000 square foot strip building at the outlet center in Monroe, Michigan which was sold in May 2004 are also included in the discontinued operations line items in the statements of operations and the real estate assets are included in Real Estate-Held for Sale on the balance sheets at periods prior to their sale. 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 \$60.7 million as of December 31, 2004. This value is estimated using a discounted cash flow analysis, based on the

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incremental borrowing rates for similar types of borrowing arrangements. The carrying value for this debt is \$60.1 million. The carrying value of cash and cash equivalents, receivables and payables approximate their fair values due to their short-term nature.

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 \$191,000 and \$375,000 as of December 31, 2004 and 2003, 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 interest income, fees related to marketing services that are paid by tenants pursuant to lease agreements and income from tenants with lease terms of less than one year.

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.

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.

HORIZON GROUP PROPERTIES, INC.

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Note 3- Investment in Joint Venture

On July 14, 2004, the Company acquired a 51% ownership interest in Horizon El Portal, an entity of which HGP LP is the managing member and of which the remaining 49% is owned by Pleasant Lake Apts. Limited Partnership ("PLA"), an affiliate of Amster, and Gary Skoien. For its ownership in the El Portal Center joint venture, Horizon El Portal contributed \$3.0 million in cash and assumed the responsibility for the payments on an existing \$3.0 million loan secured by the shopping center owned by El Portal Center.

Summary financial information (stated at 100%) of the El Portal Center joint venture at December 31, 2004 and for the period from July 14, 2004 (inception) through December 31, 2004, follows:

	<i>(In thousands)</i>
Assets	
Real estate	\$12,034
Other assets	<u>351</u>
Total assets	<u>\$12,385</u>
Liabilities and members' capital	
Mortgages and other debt	\$ 3,450
Other liabilities	198
Members' capital	<u>8,737</u>
Total liabilities and members' capital	<u>\$12,385</u>
Statement of Operations	
Revenue	\$ 632
Operating expenses	563
General and administrative expenses	34
Depreciation and amortization expense	176
Interest expense	<u>122</u>
Total expenses	<u>895</u>
Net loss	<u>\$ (263)</u>

Note 4 – Income Taxes

The Company elected to be taxed as a REIT under Sections 856 through 860 of the Internal Revenue Code of 1986, as amended (the "Code") from its inception through calendar year 2003. 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. Based on its taxable loss in 2003 and past fiscal years, the Company was not and has not been obligated to make any dividend distribution to maintain its status as a REIT. Accordingly, the consolidated financial statements for 2003 do not include any federal income tax expense.

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Effective for calendar year 2004, the Company did not qualify as a REIT and is taxable as a corporation under the provisions of Subchapter C of the Internal Revenue Code. The Company adopted the provisions of Financial Accounts Standards Board Statement No. 109 (“FASB 109”) “Accounting for Income Taxes” effective for the year ended December 31, 2004. The provision for income taxes for the year ended December 31, 2004 consisted of the following (in thousands):

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

For federal income tax purposes, the Company had accumulated operating loss carryforwards (“NOLs”) of approximately \$33.9 million and accumulated capital loss carryforwards or approximately \$42.2 million at December 31, 2004. The NOLs expire from 2014 to 2019 and the accumulated capital loss carryforwards expire in 2008.

Deferred income tax liabilities or assets are determined based on the differences between the financial statement and tax basis of assets and liabilities. The components of the Company’s deferred tax assets and liabilities are as follows as of December 31, 2003 and 2004 (in thousands):

	<u>2004</u>	<u>2003</u>
Deferred Tax Assets:		
NOL carryforwards-federal and state	\$12,525	\$11,350
Capital loss carryforward	14,787	16,108
Tax basis of assets in excess of book basis:		
Fixed/intangible assets	9,299	9,516
Impairment	825	868
Other	1,191	1,144
Book basis of liabilities in excess of tax basis:		
Prepaid rental revenue	76	56
Debt restructure	173	216
Profits interests	<u>2,563</u>	<u>2,633</u>
	41,439	41,891
Less valuation allowance	<u>(36,927)</u>	<u>(33,955)</u>
	4,512	7,936
Deferred Tax Liabilities:		
Book basis of assets in excess of tax basis:		
Fixed/intangible assets	(2,168)	(4,329)
Other	<u>(2,344)</u>	<u>(3,607)</u>
	<u>(4,512)</u>	<u>(7,936)</u>
Net deferred tax asset	<u>\$ -</u>	<u>\$ -</u>

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Note 5 – 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):

2005	\$11,144
2006	7,791
2007	4,960
2008	3,268
2009	1,947
Thereafter	6,302

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

The Company also leases office space under an operating lease. Future minimum rent payments under the lease approximate \$40,000 per year through July 2009. The lease also requires payment of a pro rata share of property taxes and operating expenses.

Note 6 - Impairment

In May 2004 the Company sold the 103,000 square foot strip building at the outlet center located in Monroe, Michigan. Income from Discontinued Operations for the year ended December 31, 2003 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. There were no similar charges incurred in 2004.

Note 7 - 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 323,500 shares were outstanding at December 31, 2004. The Company uses the intrinsic value method of accounting for its stock – based compensation.

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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:

	<i>For the year ended December 31, 2004</i>	<i>For the year ended December 31, 2003</i>
Expected dividend yield	0.00%	0.00%
Expected stock price volatility	.175	.497
Risk free interest rate	4.22%	4.26%
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, 2004 and 2003, computed on a pro forma basis under requirements of SFAS 123 equals \$(1.9) million and \$26.7 million, respectively.

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

	<i>For the year ended December 31, 2004</i>		<i>For the year ended December 31, 2003</i>	
	<i>Shares</i>	<i>Price</i>	<i>Shares</i>	<i>Price</i>
Outstanding, beginning of the year	308,500	\$3.40-\$6.49	326,000	\$3.40 - \$6.49
Granted	15,000	\$5.04	-	-
Exercised	-	-	-	-
Canceled	-	-	<u>(17,500)</u>	\$3.40 - \$6.49
Outstanding, end of the year	<u>323,500</u>	\$3.40-\$6.49	<u>308,500</u>	\$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, 2004 and 2003 was \$5.12. The weighted average contractual life of options outstanding at December 31, 2004 and 2003 was 5.23 years and 6.03 years, respectively.

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The Company granted 55,791 units and 82,722 units of HGP LP to key employees in August 2004 and April 2003, respectively and recognized compensation expense based on the fair market value of the units granted.

Note 8 – Commitments

The Company has outstanding commitments for capital expenditures on leases signed at December 31, 2004 in the amount of \$398,000 for tenant allowances and \$816,000 for other capital expenditures construction costs, which are not reflected on the balance sheet as of December 31, 2004. These costs are expected to be paid during 2005 and a portion will be reimbursed from the capital improvement escrows (see Note 2).

Note 9 - Mortgage Debt and Other Liabilities

	Principal Balance as of December 31,	
	<u>2004</u>	<u>2003</u>
	<i>(in thousands)</i>	
Senior mortgage loan to Laughlin Outlet Center LLC, as borrower, from UBS Warburg Real Estate Investments Inc. (“UBS”), as lender, dated as of July 11, 2002, in the original principal amount of \$11.0 million, bearing interest at 8.15%, due July 11, 2009, secured by the outlet center in Laughlin, Nevada and cross-collateralized with the other UBS senior mortgage loans	\$10,677	\$10,818
Mezzanine loan to Laughlin Holdings LLC, as borrower, from UBS, as lender, dated as of July 11, 2002, in the original principal amount of \$1.75 million, bearing interest at 17.0%, due July 11, 2005, secured by a pledge of the ownership interests in Laughlin Outlet Center LLC and cross-collateralized with the other UBS mezzanine loans	423	1,040
Senior mortgage loan to Medford Outlet Center LLC, as borrower, from UBS, as lender, dated as of July 11, 2002, in the original principal amount of \$6.5 million, bearing interest at 8.15%, due July 11, 2009, secured by the outlet center in Medford, Minnesota and cross-collateralized with the other UBS senior mortgage loans	6,309	6,393
Mezzanine loan to Medford Holdings LLC, as borrower, from UBS, as lender, dated as of July 11, 2002, in the original principal amount of \$1.0 million, bearing interest at 17.0%, due July 11, 2005, secured by a pledge of the ownership interests in Medford Outlet Center LLC and cross-collateralized with the other UBS mezzanine loans	242	594
Senior mortgage loan to Warrenton Outlet Center LLC, as borrower, from UBS, as lender, dated as of July 11, 2002, in the original principal amount of \$4.5 million, bearing interest at 8.15%, due July 11, 2009, secured by the outlet center in Warrenton, Missouri and cross-collateralized with the other UBS senior mortgage loans	4,368	4,426

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Mezzanine loan to Warrenton Holdings LLC, as borrower, from UBS, as lender, dated as of July 11, 2002, in the original principal amount of \$750,000, bearing interest at 17.0%, due July 11, 2005, secured by a pledge of the ownership interests in Warrenton Outlet Center LLC and cross-collateralized with the other UBS mezzanine loans	181	446
Mortgage loan to Monroe Outlet Center LLC, as borrower, from Beal Bank, S.S.B. (“Beal Bank”), as lender, dated as of July 11, 2002, in the original principal amount of \$3.0 million, bearing interest at the greater of the Wall Street Journal Prime Rate plus 4.5% or 12.0%, due July 10, 2005 (the “Beal Bank Loan I”), secured by vacant land located in Norton Shores, Michigan and Fruitport Township, Michigan, cross-collateralized with Beal Bank Loan II and Huntley Beal Loan (both as defined below), secured by a first priority pledge and security interest in the net proceeds from any future sale of the partnership that owns the outlet center in Laughlin, Nevada and recourse to the Company (See Note 13)	2,000	2,000
Mortgage loan to Monroe Outlet Center LLC, as borrower, from Beal Bank, as lender, dated as of July 11, 2002, in the original principal amount of \$4.0 million, bearing interest at the greater of the Wall Street Journal Prime Rate plus 2.5% or 9.9%, due July 10, 2005 (the “Beal Bank Loan II”), secured by the outlet center in Monroe, Michigan, cross-collateralized with Beal Bank Loan I and Huntley Beal Loan (as defined below), secured by a first priority pledge and security interest in the net proceeds from any future sale of the partnership that owns the outlet center in Laughlin, Nevada and recourse to the Company (See Note 13)	1,296	3,000
Mortgage loan to Holland Outlet Center LLC, as borrower, from Republic Bank, as lender, dated as of June 28, 2001, in the original principal amount of \$3.5 million, bearing interest at 8.21%, due June 28, 2006, secured by the outlet center in Holland, Michigan	3,226	3,314
Promissory note to HGP LP, as borrower, from PLA, an affiliate of Amster, as lender, dated as of November 3, 2003, bearing interest at 8.0%, due February 3, 2006 (the “PLA Loan”)	2,040	2,040
Mortgage loan to Traverse City Outlet Center LLC, as borrower, from Morgan Guaranty Trust Company of New York (“JP Morgan”), as lender, dated as of July 9, 1999, in the original principal amount of \$5.2 million, with a debt restructuring adjustment for forgiven interest of \$601,000 in December 2003, bearing interest at 8.46%, due August 1, 2009 (the “Traverse City Loan”), secured by the outlet center in Traverse City, Michigan	5,316	5,509
Mortgage loan to Tulare Outlet Center LLC, as borrower, from JP Morgan, as lender, dated as of July 9, 1999, in the original principal amount of \$9.3 million, with a debt restructuring adjustment for forgiven interest of \$1,246,000 in June 2003, bearing interest at 8.46%, due August 1, 2009 (the “Tulare Loan”), secured by the outlet center in Tulare, California	9,677	10,000

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Mortgage loan to Huntley Development Limited Partnership, as borrower, from Beal Bank, as lender, dated as of June 13, 2003, in the original principal amount of \$10.7 million, bearing interest at the greater of the Wall Street Journal Prime Rate plus 4.0% or 12.0%, due October 31, 2005 (the "Huntley Beal Loan"), secured by the land owned by Huntley Development Limited Partnership ("HDLP"), cross-collateralized with Beal Bank Loan I and Beal Bank Loan II, secured by a first priority pledge and security interest in the net proceeds from any future sale of the partnership that owns the outlet center in Laughlin, Nevada and guaranteed by HGPI (See Note 13)	857	10,706
Mortgage loan to Horizon Huntley LLC, as borrower, from Amster Trading Company, as lender, in the original principal amount of \$9.09 million, dated as of June 12, 2003, bearing interest at 11.0%, due December 12, 2005 (the "Huntley Amster Loan"), secured by a pledge of the partnership interests in HDLP and guaranteed by HGPI and HGP LP	690	690
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 8.21%, due September 11, 2013 (the "UBS Office Loan"), secured by the corporate office building in Muskegon, Michigan and indemnified against certain losses by Gary Skoien (See Note 9)	2,224	2,245
Unsecured promissory note to HGP LP, as borrower, from James Slayback, Sr., as lender, dated as of March 25, 2002, in the original principal amount of \$2.0 million, bearing interest at 2.0% above the weighted average cost of funds index for the Eleventh District Savings Institutions, due February 25, 2012	1,518	1,698
Promissory note to Gretna, Sealy, Traverse City Outlet Centers, L.L.C., as borrower, from Amster Trading Company, an affiliate of Amster, as lender, dated as of January 29, 2004, in the original principal amount of \$3.1 million, bearing interest at the greater of the LIBOR rate plus 300 basis points or 5.5%, due August 1, 2009, secured by the shopping center in Gretna, Nebraska and guaranteed by HGPI	3,054	-
Mortgage loan to Cricpets Roseville Trust, as borrower, from First Union, as lender, dated as of December 19, 1997, in the original principal amount of \$3.3 million, bearing interest at 8.77%, due January 11, 2008 (the "Petsmart Loan"), secured by a property in Roseville, Michigan leased to Petsmart, Inc.	-	3,125
Capitalized land lease between Magnolia Bluff Factory Shops Limited Partnership, as lessee, and McIntosh County Industrial Development Authority, as lessor, dated as of February 1, 1995, in the original amount of \$2.9 million bearing interest at 8.90%, due February 1, 2008, secured by a pledge of the rights, title and interest in and to the ground lease for the outlet center in Darien, Georgia	1,384	-

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Mortgage loan to Horizon El Portal LLC, as borrower, from Amster Trading Company, as lender, dated as of July 12, 2004, in the original principal amount of \$2.4 million, bearing interest at a rate equal to the greater of LIBOR plus 3.0% or 6.0%, due July 12, 2006 (“Amster Horizon El Portal Loan”), secured by the outlet center in Darien, Georgia	2,400	-
Line of credit to Horizon El Portal LLC, as borrower, from Amster Trading Company, as lender, dated as of July 14, 2004, with a limit of \$3.0 million, bearing interest at a rate of 10.0%, due July 12, 2006 (“Amster Horizon El Portal Line”), secured by the second phase of the outlet center in Tulare, California	450	-
Construction loan to Village Green Associates, LLC, as borrower, from Interstate Bank, as lender, dated as of August 18, 2004, with a limit of \$2.9 million, bearing interest at a rate equal to the Wall Street Journal prime rate plus 2.75%, due 48 months after conversion to a mortgage loan, secured by the shopping center under construction in Huntley, Illinois	1,738	-
	<u>\$60,070</u>	<u>\$68,044</u>

The Huntley Beal Loan was repaid from the net proceeds from refinancing on March 30, 2005 (See Note 13).

On January 29, 2004, the Company borrowed \$3.1 million from Amster Trading Company, an affiliate of Amster, a director and significant shareholder of HGPI. The loan is secured by the Company’s shopping center in Gretna, Nebraska and is guaranteed by HGPI. The loan requires monthly principal payments based on a 25-year amortization schedule and bears interest at a rate equal to the greater of LIBOR plus 3.0% or 5.5%. The loan matures on August 1, 2009 and may be prepaid at any time without penalty.

On February 10, 2004, the Company sold its interests in the entities which own the triple net leased property in Roseville, Michigan, which is leased to Petsmart, Inc. The Petsmart Loan was assumed by the purchaser in this transaction (See Note 11).

On July 12, 2004, Horizon El Portal borrowed \$2.4 million from Amster Trading Company, an affiliate of Amster, to fund a portion of the purchase price of a 50% joint venture interest in El Portal Center which owns a shopping center in Laredo, Texas (see Note 3). The Amster Horizon El Portal Loan is secured by the outlet center in Darien, Georgia, which is jointly owned by the Company, PLA and Gary Skoien. The loan matures on July 12, 2006 and requires monthly interest payments at a rate equal to the greater of LIBOR plus 3.0% or 6.0%.

On July 14, 2004, Horizon El Portal obtained a \$3.0 million line of credit from Amster Trading Company, an affiliate of Amster. The Amster Horizon El Portal Line is secured by the second phase of the Company’s outlet center in Tulare, California (which is jointly owned with an affiliate of Amster). The line matures on July 12, 2006 and requires monthly payments of interest at an annual interest rate of 10.0%. This line of credit was obtained to fund a \$3.0 million line of credit Horizon El Portal has provided to El Portal Center (the “El Portal Center Line”) to fund renovation and operating expenses.

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The El Portal Center Line matures on July 8, 2006, requires monthly payments of interest at an annual rate of 12.0% and is secured by a second mortgage on the center owned by El Portal Center.

On August 18, 2004, the Company obtained a \$2.9 million construction loan which is secured by a shopping center being built in Huntley, Illinois. The construction loan requires monthly payments of interest at an annual rate of the Wall Street Journal prime rate plus 2.75%. After a maximum one-year construction period, the loan converts to a mortgage loan, due 48 months after the conversion. The mortgage loan bears interest at a fixed rate of the Wall Street Journal prime rate as of the conversion date plus 2.75% and requires monthly debt service payments based on a 25-year amortization period. The mortgage loan will also require the monthly funding of escrow accounts for real estate taxes and insurance.

Huntley Net Profits Interests and TIF Bonds

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 Development Limited Partnership ("HDLP") and Huntley Meadows Residential Venture (collectively, the "Huntley Partnerships"), subject to certain preferences in their distribution. Net profits generated by the Huntley Partnerships are to be distributed in the following order: first to HDLP in the amount of the Approved Contributions (which totaled approximately \$5.6 million at December 31, 2004 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 \$7.0 million at December 31, 2004), third to HDLP for its account (which had a balance of approximately \$13.1 million at December 31, 2004) and thereafter, 35% to Beal Bank and 65% to HDLP. 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 HDLP Account and the Beal Account each increase per the terms of the Beal Net Profits Agreement. On the maturity date of the Huntley Beal Loan, HDLP is required to pay Beal Bank the fair market value of Beal Bank's Net Profits interest. The Company has recorded the estimated value of the Beal Bank Net Profits interest which is included in Participation Interests and Other Liabilities on the Company's balance sheet and had a balance of \$9.5 million, including accrued interest, at December 31, 2004. Certain affiliates of The Prime Group, Inc. ("Prime Group") have continuing guarantees related to the Beal Net Profits Agreement. The Company has indemnified such guarantors against any liability in connection with their guarantees. (See Note 13)

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 the Huntley Partnerships, which he retained after the Company's purchase of the Huntley Partnerships. 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 Partnerships plus interest per the terms of the agreement). The Company has recorded a liability for the Skoien Net Profits Interest in the amount of \$1.0 million as of December 31, 2004, which represents its estimated fair value and which amount has been included in Participation Interests and Other Liabilities on the Company's balance sheet.

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The Company granted to Prime Group and certain of its affiliates, a participation interest of 26% of the net cash flow distributed by the Huntley Partnerships (the “Prime Group Participation Interest”) as additional consideration for the purchase of the Huntley Partnerships from Prime Group. 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 Partnerships 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 HDLP 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. HDLP owns the Series C bonds with a principal amount of \$24.4 million plus accrued interest. The Series C bonds are subordinate to the Series A and Series B bonds. Currently no portion of the tax increment is 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 the Huntley Partnerships. 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 HDLP. These funds are held in interest bearing accounts under the control of the TIF Bond trustee and totaled approximately \$3.3 million at December 31, 2004. There can be no assurance that these funds will be returned to HDLP 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, HDLP 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 HDLP 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 HDLP upon the issuance of a certificate of occupancy for the subject land parcel. The balance in the US Bank Collateral Account was approximately \$3.5 million at December 31, 2004 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 the tax revenues and debt service reserve funds will be sufficient to make the scheduled debt service payments on the Series A and B bonds.

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Further, HDLP 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 the Huntley Partnerships and the assumption of the related net profits interests and other liabilities. The Company believes this transaction reflects market terms.

Debt Maturities

Debt maturities and principal payments, including debt secured by the assets classified as discontinued operations, due subsequent to December 31, 2004 are as follows (in thousands):

<u>Due in:</u>	
2005	\$ 6,974
2006	9,330
2007	1,440
2008	1,117
2009	37,191
Thereafter	<u>2,601</u>
	58,653
Tulare Loan restructuring adjustment	928
Traverse City Loan restructuring adjustment	<u>489</u>
	<u>\$60,070</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.

Note 10 - 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 \$931,000 and \$1.1 million during the years ended December 31, 2004 and 2003, respectively, on insurance policies placed by Thilman & Filippini, including insurance premiums for properties classified as discontinued operations.

Prior to March 2004, the Company sub-leased office space on a month to month basis for its senior executives in Chicago, Illinois from Prime Group. The Company incurred rent expense of \$7,000 and \$54,000 during the years ended December 31, 2004 and 2003, respectively.

Pursuant to an expense reimbursement agreement signed in December 2003, an affiliate of Amster reimburses the Company for approximately 49% of the general and administrative expenses related to the operation of the outlet centers and corporate office building in which the affiliate of Amster owns a partnership interest. Certain expenses related to the general operation of the Company are not subject to reimbursement under the agreement. The Company recognized income related to this arrangement of \$726,000 and \$82,000 during the years ended December 31, 2004 and 2003, respectively.

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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 Company has several loans from affiliates of Amster on which it paid a total of \$497,000 and \$613,000 of interest during the years ended December 31, 2004 and 2003, respectively. See Note 9 for the specific terms of the loans.

For additional disclosure of related party transactions, see Notes 2, 9 and 11.

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 11 – Recent Developments

On January 21, 2004, the Company sold a total of approximately 240 acres of land in Huntley, Illinois for a total of \$12.1 million. A portion of the land was subject to a mortgage provided by U.S. Bank Trust National Association, as trustees for the holders of the Series B bonds of the tax-exempt, tax-increment bonds created by the Village of Huntley (the “US Bank Mortgage”) and, accordingly \$1.7 million was deposited into a collateral account related to the US Bank Mortgage. The Company used \$636,000 from a previously established infrastructure escrow account to acquire additional water and sewer capacity, a portion of which was sold with the land. A new escrow account was established with \$300,000 of the net proceeds to fund wetland mitigation and sewer line construction, as required by the contract. The net proceeds of \$9.8 million were used to partially repay the Huntley Beal Loan (See Note 9). No gain or loss was recorded as a result of this sale.

On February 10, 2004, the Company sold 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, and the assumption of the Petsmart Loan (See Note 9) by the purchaser. The Company received a \$370,000 note from the purchaser as a portion of the purchase price. The note bears interest at 4.0%, matures on December 30, 2005 and is secured by the entities that own the property leased to Petsmart. The Company recognized a gain of \$327,000 on the sale.

On April 1, 2004, the Company acquired a 51.0% ownership interest in the entities that operate an outlet shopping center in Darien, Georgia pursuant to a ground lease (which contains a lessee purchase option for a nominal fee). The remaining ownership interests were purchased by PLA, an affiliate of Amster, and Gary Skoien, the Chairman, Chief Executive Officer and President of the Company. The total purchase price of \$3.0 million for the entities was paid in cash at closing. The acquisition was accounted for under the purchase method.

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The following table summarizes the estimated fair value of the assets acquired and liabilities of the entities that own the Darien shopping center assumed at the date of acquisition. Such estimates are subject to refinement as additional valuation information is received.

	<i>(In thousands)</i>
Land	\$ 942
Buildings and improvements	2,571
Other assets	<u>1,598</u>
	<u>\$5,111</u>
Mortgages and other debt	\$1,598
Accounts payable and other accrued expenses	24
Prepaid rents and other tenant liabilities	636
Contributed capital (minority interests)	1,398
Contributed capital (cash paid)	<u>1,455</u>
	<u>\$5,111</u>

On May 7, 2004, the Company sold the 103,000 square foot strip building at the shopping center in Monroe, Michigan for \$1.75 million. The net proceeds of approximately \$1.7 million were deposited into an escrow account with Beal Bank. On July 12, 2004, the funds were applied to the outstanding principal balance on the Beal Bank Loan II. A net loss of \$51,000 was recognized.

On May 13, 2004, the Company exercised a purchase option and acquired approximately 40 acres of vacant land in Fruitport Township, Michigan. Pursuant to terms of the option and after-purchase credits, the net cash settlement of \$182,000 was paid from a portion of an escrow account related to the Beal Bank Loan II. The land is classified as held for sale on the Company's balance sheet as of December 31, 2004.

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 \$548,000 was recognized.

On May 31, 2003, the Company sold its ownership interests in the partnership that owned 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 interests includes Gary Skoien and an affiliate of Amster. The independent directors of HGPI approved this transaction and the Company believes this transaction reflects market terms.

In June 2003, the Company purchased controlling interest in the Huntley Partnerships 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. Direct costs incurred for development activities of the Huntley Partnerships 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

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Company had previously acquired a 3.25% net profits interest in HDLP 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 8 for further details on the debt assumed in the transaction).

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

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

On June 18, 2004, the Company sold 1.74 acres of vacant land adjacent to its shopping center in Gretna, Nebraska for \$152,000. A net gain of \$113,000 was recognized.

On June 21, 2004, the Company sold approximately 19 acres of vacant land in Daleville, Indiana, adjacent to an outlet center formerly owned by the Company, for \$154,000. A net loss of \$49,000 was recognized.

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 by the purchaser of a \$15.7 million mortgage note. A gain of \$10.9 million was recognized on the transaction. The Company used \$2.0 million of the proceeds from the sale to repay \$1.0 million on each of Beal Bank Loan I and Beal Bank Loan II. The vacant land parcels were a portion of the security for the Beal Bank Loan I. In addition, Beal Bank required that \$3.0 million be deposited into an escrow account to fund infrastructure and interest payments for the Huntley Beal Loan which is cross-collateralized with the other loans from Beal Bank. (See Note 13)

On September 16, 2003, the Company sold 10 acres of vacant land in Fruitport Township, Michigan. The proceeds from this sale were \$226,000 and a gain on sale of \$116,000 was recognized.

On October 4, 2004, the Company sold approximately 3.3 acres of land held for investment located in Huntley, Illinois for \$438,000 to an unrelated third party. The consideration consisted of \$317,000 in cash from the purchaser and a note for \$121,000 from an affiliate of Prime Group, a party to a transaction related to the land sale. The note matures on October 4, 2005 and bears interest at a rate of 7.0%, payable upon maturity. Approximately \$268,000 of the net proceeds was deposited into a collateral account related to the US Bank Mortgage. A loss of \$33,000 was recognized in the transaction and is included, net of minority interests, in the Company's statement of operations in the line item entitled "Gain/(Loss) on Sale of Partnership Interests and Real Estate".

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On November 3, 2003, the Company 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 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, in the Company's statement of operations in the line item entitled "Gain/(Loss) on Sale of Partnership Interests and Real Estate".

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, the Company 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, in the Company's statement of operations in the line item entitled "Gain/(Loss) on Sale of Partnership Interests and Real Estate".

Note 12 – Discontinued Operations

In accordance with SFAS 144, the results of operations and gain/(loss) on real estate properties sold or held for sale are reflected in the consolidated statements of operations as "Income from Discontinued Operations".

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

	<u>Year ended</u> <u>December 31, 2004</u>	<u>Year ended</u> <u>December 31, 2003</u>
Total revenue	\$ 96	\$ 3,436
Total expenses	(422)	(5,823)
Provision for impairment	-	(1,833)
Gain on debt restructuring	<u>-</u>	<u>26,886</u>
Income/(loss) before minority interests	(326)	22,666
Minority interests	99	(9,193)
Gain on sale of real estate, net of minority interests	<u>254</u>	<u>9,687</u>
Income from discontinued operations	<u>\$ 27</u>	<u>\$23,160</u>

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Mortgages and Other Debt on the Company's balance sheet includes \$2.0 million and \$5.1 million of outstanding debt as of December 31, 2004 and 2003, respectively, related to assets classified as held for sale.

Note 13 – Subsequent Events

On March 30, 2005 HDLP obtained a \$15.6 million loan from First Midwest Bank ("FMB") secured by 380 acres of land in Huntley, Illinois. The Company repaid the Huntley Beal Loan and Beal Bank's net profits interest in the Huntley Partnerships (see Note 9) and received net proceeds of \$3.5 million after the repayment.

The FMB loan matures March 30, 2007 and bears interest at the Prime Rate plus 0.5%. The loan agreement provides for a 12-month extension of the maturity date provided certain conditions are met, including the repayment of at least \$5.6 million by August 30, 2006. In addition to the 380 acres of land, the FMB loan is also secured by a pledge of the Series C TIF bonds related to the Huntley TIF District (see Note 9). The initial funding under the loan was \$13.9 million with an additional \$1.7 million available to be drawn to pay interest on the FMB loan.

The Huntley Beal Loan had a balance of \$857,000 as of March 30, 2005. Beal Bank's net profits interest was valued by the agreement of the Company and Beal Bank at \$8.5 million. HDLP will recognize a gain of approximately \$900,000 related to the retirement of the net profits interest. The land in Huntley was also collateral for Beal Bank Loan I and Beal Bank Loan II. In conjunction with the Huntley refinancing, the maturity dates on those loans were extended from July 10, 2005 to July 10, 2006 and both loans are closed to repayment prior to March 31, 2006.