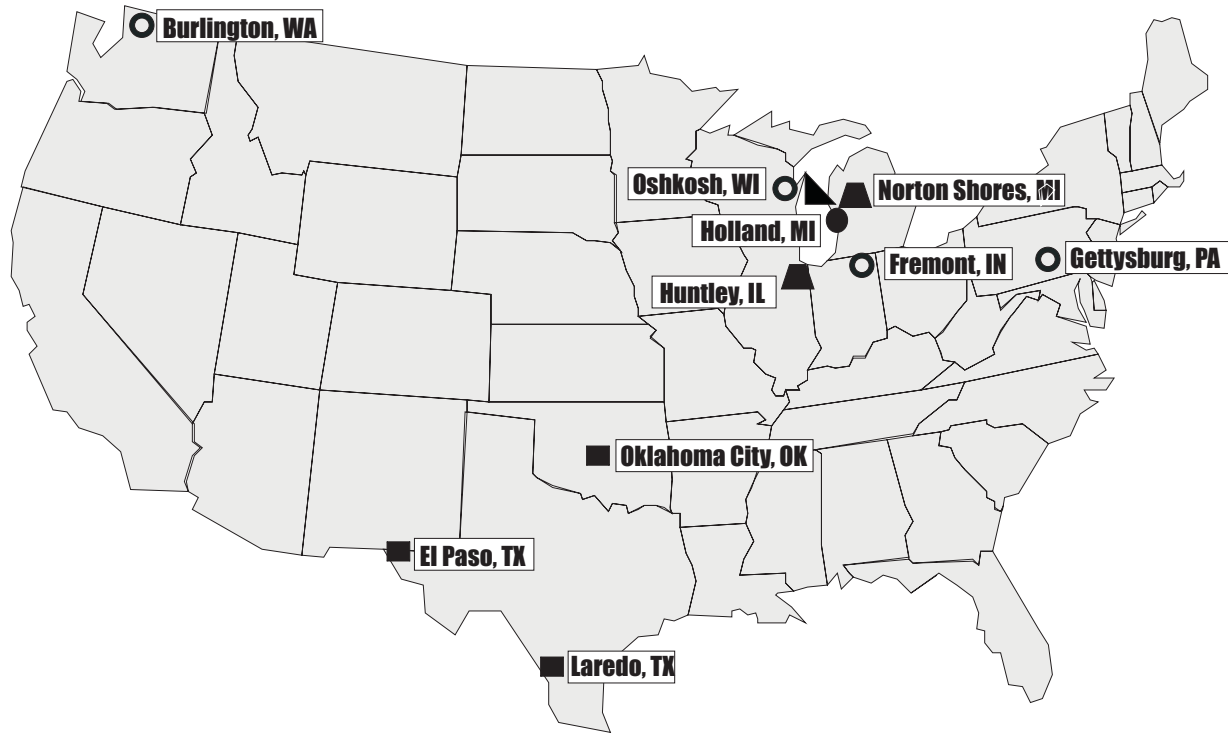




2006 Annual Report

HGP 
Horizon Group Properties

Portfolio



- Outlet Center
- Outlet Center under development
- ▲ Office Building
- ▲ Land Development
- Under Contract for purchase

Company Profile

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

Our shopping centers feature favorite name brand stores such as Polo Ralph Lauren, Calvin Klein, Liz Claiborne, Coach, Gap Outlet, Nike, Carter's and PacSun, just to name a few.

Cover - El Paso, Texas

Dear Stockholder:

2006 was a seminal year for Horizon Group Properties. We completed a portfolio sale of six of our properties, culminating eight years of hard effort redeveloping, repositioning and maximizing the value of those assets. We have embarked on a strategy of redeploying the capital from the sale into the factory outlet sector, both in the development of new centers and the acquisition of existing centers where we can increase value through expansion, redevelopment, and enhanced marketing. We believe this strategy will generate attractive returns on both our financial and human capital.

Portfolio Sale

In my letter to you last year, I reported on the stalemate we had reached with the potential buyer of our outlet shopping center portfolio. Since that time, we participated in nonbinding mediation and reached a favorable settlement with the buyer. The revised agreement provided for the sale of six of the nine properties originally under contract for the same price we originally agreed to for the nine properties. In July 2006, we closed on the sale for a total purchase price of \$113.8 million which provided the Company with \$27.8 million of proceeds after the repayment of debt and distributions to our minority partners in the properties. The sale provided the Company with liquidity that had been lacking over the course of the prior eight years.

Retained Properties

Pursuant to the settlement with the portfolio buyer, the Company retained the shopping centers in Gretna, Nebraska; Monroe, Michigan; and Holland, Michigan. Our plan was to sell Gretna and Monroe and redevelop Holland. In November 2006, we sold the Monroe property for \$1.9 million and in June 2007, we sold Gretna for \$3.85 million.

The redevelopment of our property in Holland involves renovating a portion of the center into office condominiums which we would sell. The remainder of the center will be rented to a combination of outlet and community retail tenants. While we believe in the efficacy of the plan, its implementation is proving to be a challenge. In the event that the returns are too meager and the distraction too great, we will consider other options. But for now, we are proceeding with the redevelopment plans.

New Development

As I reported last year, we entered into a joint venture to develop a factory outlet center in El Paso, Texas. In April 2006, the venture acquired 100 acres of land and construction of the center began in September. Named The Outlet Shoppes at El Paso, the initial phase of the development will contain 385,000 square feet of retail space. As of the end of June 2007, tenants had signed leases for 84% of the space in the center and we have commitments for 95% of the space. The center is scheduled to open October 11, 2007.

We believe that this center will draw substantial traffic from Mexico. Other border outlet centers have been very attractive to brand-name starved Mexican consumers. El Paso is a growing and vibrant community and the center is located on well traveled Interstate 10. In combination, these factors bode well for the center's success. We expect to announce our plans for a second phase at the center in the near future.

The construction of the center is being financed by a \$60 million construction loan from IXIS Real Estate Capital Inc. and a \$9.5 million mezzanine loan provided by an affiliate of Dominion Capital Management, LLC.

We obtained a rebate of sales taxes from both the City and County of El Paso to reimburse the Company for the cost of water and sewer related infrastructure and for the cost of marketing the center to Mexico. The rebates will total \$1.9 million and will be reimbursed based on our expenditures. We estimate that the joint venture will receive these reimbursements over the next three to four years.

In 2006, we identified the greater Oklahoma City market for the development of a new factory outlet center. Oklahoma City is roughly the size of El Paso and is experiencing an exciting level of redevelopment and growth. There are no other outlet shopping centers in Oklahoma. The center, to be named The Outlet Shoppes at Oklahoma City, is planned to contain 340,000 square feet of retail space. Early tenant response has been encouraging. If all proceeds as planned, the center will open in the fall of 2008. As in El Paso, securing incentives from the local government will be a key element in our decision to undertake the project. We are hopeful that the local officials will recognize the significant tax revenue that this type of destination retail will bring to the local units of government and provide us with incentives commensurate with the scale of the planned project.

Last year, I wrote regarding the challenges we faced in redeveloping the enclosed mall in Laredo, Texas in which we own an interest. Our plans to renovate the mall for factory outlet tenants were suddenly and unexpectedly stymied by an extraordinary and widely reported surge in drug violence across the border in Nuevo Laredo, Mexico. While the violence was contained to Mexico, and in spite of the fact retail sales continued to increase in Laredo, our tenants were deterred from locating at the project. While the violence across the border has not completely ended, it has diminished and it appears that the new Mexican president is committed to halting it.

Several changed conditions have caused us to reevaluate our plans for the center. We remain convinced of the strength of the location and the extraordinary demand of the Mexican consumer. Last December, the City of Laredo completed a new customs, reception and security center adjacent to our mall and is working on a plan to widen the Rio Grande River and beautify the land directly in front of our mall. Accordingly, we have decided to jettison our original scheme to renovate the existing mall and instead intend to demolish the structure and construct a completely new shopping center, one that will truly complement this unique site and provide an exciting platform for our retail tenants. The preliminary schematics for the project are complete and we recently launched our marketing to the outlet

industry. We are very excited by this opportunity and hope we can instill the same excitement among retailers.

Acquisitions

The Company has spent considerable time over the past year evaluating the acquisition of existing outlet centers. We analyzed a larger number of properties and identified four outlet centers with an aggregate 969,162 square feet of retail space as being attractive acquisitions; those four centers are currently under contract to purchase.

The first is Gettysburg Village Shopping Center in Gettysburg, Pennsylvania, to be renamed The Outlet Shoppes at Gettysburg. The center contains 252,075 square feet of existing outlet retail plus a 35,000 square foot movie theater and a small amount of office space. It is 98% occupied. The purchase includes 23 acres of additional land on which we can build at least 200,000 square feet of additional retail. We are currently designing the first of several expansions containing approximately 50,000 square feet of retail space which we plan to open in the fall of 2008. We believe that this property is in need of more critical mass, which the expansion will create. In addition, the center requires a new marketing focus. It currently is marketed primarily to the local communities but requires more concentration on the visitors and the growing areas of Maryland to the south.

In connection with the acquisition, we are assuming a ten year securitized loan with a balance of \$43.8 million carrying a 5.87% interest rate. We have also arranged for a \$10.0 million mezzanine loan from CW Capital. This purchase is scheduled to be completed in mid-July.

The other three properties we have under contract to purchase are located in Burlington, Washington (north of Seattle); Oshkosh, Wisconsin; and Fremont, Indiana (at the intersection of I-90 and I-69).

Oshkosh contains 270,607 square feet of retail space and is approximately 90% occupied with good sales and a quality tenant roster. Our efforts with respect to this center will focus on maintaining the existing tenants and improving store sales.

Burlington and Fremont are more challenging properties. Burlington contains 174,055 square feet of retail, is 74% occupied and has sales that have been negatively affected by a new center located between it and Seattle. Despite the new competition, the center is well positioned in a good retail market, continues to have good tenants and is closer to Vancouver, British Columbia than the competing center. The Center appears worn and outdated and we are currently working on a long overdue makeover, an expansion to create more critical mass and a new marketing plan.

Fremont contains 228,925 square feet of retail and is approximately 72% occupied. The center has two phases; the newer one, which is closer to the interstate, contains the better tenants and has superior sales. Our first priority after acquiring the center will be to improve

the performance of the weak phase. As with Gettysburg and Burlington, marketing will be a key element of repositioning this center.

In connection with the acquisition of these three centers, we are assuming a non-recourse loan with a principal balance of approximately \$53.5 million. The loan carries an attractive 5.58% interest rate and has approximately nine more years remaining on its term. All three properties secure the loan. We expect to close this transaction during the third quarter of 2007.

Marketing to create awareness and interest in our shopping centers is a key element of our business. To assist this effort, each center we are acquiring as well as those being developed will be named as part of a corporate strategy to consistently name our centers. The names of the centers will all begin with "The Outlet Shoppes at..." followed by the location of the center, e.g. "The Outlet Shoppes at Gettysburg." We want the consumer to clearly understand that the shopping center is an outlet center and identify it by its location.

Huntley Master Planned Community

Last year I wrote regarding the hurdles we have faced because of the failure of the Huntley Village leaders to honor their obligations pursuant to our annexation and redevelopment agreements. This situation persists despite the fact that the Company has exceeded the obligations contained in these agreements. Nevertheless, we continue to work diligently to maximize the value of the 408 acres of land that we own, as well as the tax increment financing bonds we hold. We remain convinced that the Company will receive a superior risk adjusted return on this investment.

Transactions

During 2006 the Company sold a parcel of land in Huntley for a gross sales price of \$760,000. We sold an outlot in Muskegon this past January for a gross sales price of \$506,000. We are aggressively marketing our land in Michigan. We intend to list our office building in Norton Shores, Michigan for sale after we renew leases with several key tenants.

Our Staff

Our decision to continue our focus on developing, buying, and owning factory outlet centers results from the improvements we see in this asset class and our belief that we can create substantial value through these activities. However, we would not be in a position to capitalize on these opportunities if we did not have a capable and dedicated staff with experience working in these arenas. We are fortunate to have some of the most talented individuals in the industry at every level of our company. The Board and I are indebted to all of them for their hard work and dedication.

Several deserve special recognition. Andrew Pelmoter leads our leasing efforts and does a terrific job working with our clients and partners - the retailers. He has done a great

job in the very successful leasing of The Outlet Shoppes at El Paso. Tom Rumptz oversees development and is responsible for finishing El Paso on time and under budget. His efforts to date on this and other projects have been outstanding. Finally, our CFO, David Tinkham, works with our lenders to secure the financing for our new developments and acquisitions, provides analysis and input regarding our acquisitions, and does a splendid job guarding the Company's assets and managing our cash. I wish to publicly thank these individuals and all of the dedicated employees of the Company. It is a privilege to be able to work with such a great team.

In May, we hired James Harris to oversee business development for the Company. Given our growth plans, the Company required assistance with site development and new acquisitions. James brings two decades of outlet experience to the Company. We are delighted to have him as part of our team.

At the beginning of this letter I said that 2006 was a seminal year. I believe the same will be said for 2007 after its completion. 2006 closed one chapter in our Company's history and 2007 is opening a new chapter. The Board and management are very excited by what the future holds. We believe we are well positioned to take on new challenges and appreciate your continued trust and support as we move forward.

Sincerely,

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

Gary J. Skoien

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REPORT OF INDEPENDENT AUDITORS

To the Board of Directors
Horizon Group Properties, Inc.

We have audited the accompanying consolidated balance sheets of Horizon Group Properties, Inc. (the "Company") as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' 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 audits 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, 2006 and 2005, 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

Chicago, Illinois
June 7, 2007

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

	December 31, 2006	December 31, 2005
ASSETS		
Real estate – at cost:		
Land	\$ 7,776	\$ 598
Buildings and improvements	17,617	13,006
Less accumulated depreciation	<u>(2,832)</u>	<u>(2,452)</u>
	22,561	11,152
Land held for investment	<u>19,884</u>	<u>20,070</u>
Total net real estate	42,445	31,222
Investment in joint ventures	2,880	2,651
Cash and cash equivalents	6,534	813
Restricted cash	5,299	7,751
Marketable securities	21,530	8,626
Tenant and other accounts receivable, net	1,441	1,239
Real estate – held for sale	1,413	74,798
Deferred costs (net of accumulated amortization of \$554 and \$23, respectively)	491	316
Other assets	<u>5,851</u>	<u>3,128</u>
Total assets	<u>\$87,884</u>	<u>\$130,544</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Mortgages and other debt	\$36,318	\$ 44,085
Mortgages and other debt – real estate held for sale	-	46,995
Accounts payable and other accrued expenses	5,763	5,288
Prepaid rents and other tenant liabilities	227	719
Participation interests and other liabilities	<u>3,102</u>	<u>1,565</u>
Total liabilities	<u>45,410</u>	<u>98,652</u>
Minority interests	<u>19,845</u>	<u>18,346</u>
Stockholders' equity:		
Common shares (\$.01 par value, 50,000 shares authorized, 2,879 and 2,862 issued and outstanding, respectively)	29	29
Additional paid-in capital	37,295	37,200
Accumulated deficit	<u>(14,695)</u>	<u>(23,683)</u>
Total stockholders' equity	<u>22,629</u>	<u>13,546</u>
Total liabilities and stockholders' equity	<u>\$87,884</u>	<u>\$130,544</u>

See accompanying notes to consolidated financial statements.

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

	Year ended December 31, 2006	Year ended December 31, 2005
REVENUE		
Base rent	\$1,950	\$ 1,984
Percentage rent	19	4
Expense recoveries	375	366
Other	1,075	1,267
Interest	<u>1,370</u>	<u>260</u>
Total revenue	<u>4,789</u>	<u>3,881</u>
EXPENSES		
Property operating	1,145	822
Real estate taxes	291	279
Other operating	168	333
Depreciation and amortization	611	487
General and administrative	5,815	4,670
Provision for impairment	-	2,000
Interest	4,747	2,826
Loss on marketable securities	117	3
Gain on debt extinguishment	<u>-</u>	<u>(929)</u>
Total expenses	12,894	10,491
Loss from investment in joint venture	<u>(1,100)</u>	<u>(217)</u>
Loss from continuing operations before minority interests, gain on sale of real estate and income/(loss) from discontinued operations	(9,205)	(6,827)
Minority interests	<u>2,980</u>	<u>3,163</u>
Loss from continuing operations	(6,225)	(3,664)
Gain on sale of real estate, net of minority interests	167	-
Income/(loss) from discontinued operations, net of minority interests	<u>15,046</u>	<u>(346)</u>
Net income/(loss)	<u>\$8,988</u>	<u>\$(4,010)</u>

See accompanying notes to consolidated financial statements.

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

	<u>Common Shares</u>		<u>Additional</u>	<u>Accumulated</u>	<u>Stockholders'</u>
	<u>Number</u>	<u>Amount</u>	<u>Paid -In</u>	<u>Earnings/</u>	
			<u>Capital</u>	<u>(Deficit)</u>	<u>Equity</u>
Balance, January 1, 2005	2,859	\$ 29	\$37,174	\$ (19,673)	\$ 17,530
Contribution	-	-	8	-	8
Units converted to shares	3	-	18	-	18
Net loss	<u>-</u>	<u>-</u>	<u>-</u>	<u>(4,010)</u>	<u>(4,010)</u>
Balance, December 31, 2005	2,862	29	37,200	(23,683)	13,546
Stock grant to officers	17	-	95	-	95
Net income	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,988</u>	<u>8,988</u>
Balance, December 31, 2006	<u>2,879</u>	<u>\$ 29</u>	<u>\$ 37,295</u>	<u>\$ (14,695)</u>	<u>\$ 22,629</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>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Net income/(loss)	\$ 8,988	\$ (4,010)
Net gain on sale of real estate	(46,065)	(97)
Gain on debt extinguishment	-	(929)
Adjustments to reconcile net income/(loss) to net cash used in operating activities:		
Minority interests, including amounts in net gain on sale of real estate and discontinued operations	25,142	(3,586)
Loss from investment in joint venture	1,100	217
Depreciation	2,261	3,926
Amortization, including deferred financing costs	665	766
Provision for impairment	-	5,000
HGP partnership unit grants	90	114
HGPI stock grants	95	-
Changes in assets and liabilities:		
Restricted cash	47	(1,289)
Tenant accounts receivable	657	(389)
Deferred costs and other assets	(2,395)	(1,549)
Accounts payable and other accrued expenses	5,165	1,237
Participation interests and other liabilities	1,577	431
Prepaid rents and other tenant liabilities	<u>(604)</u>	<u>(28)</u>
Net cash (used in) operating activities	<u>(3,277)</u>	<u>(186)</u>
Cash flows from investing activities:		
Acquisition of property	-	(2,634)
Repayment of note receivable	1,150	-
Purchase of marketable securities	(12,904)	(8,626)
Investment in joint venture	(3,177)	-
Expenditures for land held for investment	(235)	-
Expenditures for buildings and improvements	(4,885)	(9,967)
Cash transferred in connection with sale of subsidiaries	(447)	-
Net proceeds from sale of real estate	<u>65,826</u>	<u>106</u>
Net cash provided by/(used in) investing activities	<u>45,328</u>	<u>(21,121)</u>
Cash flows from financing activities:		
Net distributions to minority interests	(28,254)	(319)
Principal payments on mortgages and other debt	(23,092)	(6,168)
Proceeds from borrowings	15,129	37,178
Payment of participation interests	-	(8,500)
Debt issue costs	<u>(113)</u>	<u>(537)</u>
Net cash (used in)/provided by financing activities	<u>(36,330)</u>	<u>21,654</u>
Net increase in cash and cash equivalents	5,721	347
Cash and cash equivalents:		
Beginning of year	<u>813</u>	<u>466</u>
End of year	<u>\$ 6,534</u>	<u>\$ 813</u>

HORIZON GROUP PROPERTIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS, continued
For the Year ended December 31, *(In thousands)*

	<u>2006</u>	<u>2005</u>
Supplemental Information -		
During the year ended December 31, 2006, the Company sold the following net assets:		
Land	\$ 9,053	
Buildings and improvements	80,275	
Accumulated depreciation	(20,532)	
Tenant and other accounts receivable, net	326	
Investment land	(267)	
Deferred costs	1,048	
Other assets	(351)	
Mortgages and other debt	(1,821)	
Accounts payable and accrued expenses	(467)	
Prepaid rents and other tenant liabilities	200	
Participation interests and other liabilities	(30)	
Minority interests	<u>2,108</u>	
Net assets sold	69,542	
Gross proceeds from sale of real estate	<u>115,608</u>	
Gain on sale of real estate	<u>\$ 46,066</u>	

The following represents supplemental disclosure of significant cash activity from the gross proceeds from the sale of real estate (above) to arrive at the net proceeds from the sale of real estate as shown on the statement of cash flows for the year ended December 31, 2006:

Gross proceeds from the sale of real estate	\$115,608
Release of restricted cash – escrow reserves	2,405
Mortgages and other debt	(48,205)
Defeasance premium	(3,654)
Miscellaneous	<u>(328)</u>
	<u>\$ 65,826</u>

The following represents the supplemental disclosure of noncash activity for the consolidation of the assets and liabilities of the El Paso Center as of September 1, 2006 (see Note 1):

Land	6,508
Buildings and improvements	1,142
Investment in joint venture	(1,849)
Deferred costs	77
Other assets	987
Mortgages and other debt	(3,228)
Accounts payable and accrued expenses	(201)
Minority interests	<u>(3,436)</u>
	<u>\$ -</u>

The following represents the supplemental disclosure of noncash activity for the disposal of fully depreciated/amortized assets during the years ended December 31, 2006 and 2005:

Buildings and improvements	\$ 250	\$1,230
Deferred costs	<u>215</u>	<u>1,027</u>
	<u>\$ 465</u>	<u>\$2,257</u>

See accompanying notes to consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Organization and Principles of Consolidation

Horizon Group Properties, Inc. (“HGPI” or, together with its subsidiaries “HGP” or the “Company”) is a Maryland corporation that was established on June 15, 1998. The operations of the Company are 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, 2006, HGPI owned approximately 68.6% 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 HGPI’s election).

HGP LP’s primary assets 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 or HGP LP (or their wholly owned subsidiaries) collectively own the majority interest, and of variable interest entities 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 reflecting its significant influence but not control over the partnership.

Prior to July 28, 2006, HGP owned nine factory outlet centers located in seven states comprising an aggregate of approximately 1.8 million square feet of gross leasable area (“GLA”). Six of the factory outlet centers containing 1.3 million square feet of GLA were sold on July 28, 2006 (see Notes 2 and 12). The Company sold the outlet center located in Monroe, Michigan containing approximately 122,000 square feet on November 15, 2006. The Company also owns a 22,000 square foot shopping center located in Huntley, Illinois and an office building located in Norton Shores, Michigan, a portion of which it occupies. HGPI consolidates the results of operations and the assets and liabilities of these entities in its financial statements. All references to GLA or acreage in these financial statements are unaudited.

An affiliate of Howard Amster (“Amster”), a director and significant stockholder of HGPI, owned approximately 49% of the entities that sold the six outlet shopping centers (except the entity that owned the center in Darien, Georgia of which he owned approximately 43.7% and of which Gary Skoien owned 5.3%). An affiliate of Amster owns approximately 49% of the entities that own the other outlet shopping centers and the office building in Norton Shores, Michigan (see Note 11).

The Company also 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.

As of December 31, 2006, the Company also owned 88.2% of Horizon El Paso, LLC (“Horizon El Paso”), which owns 50% of El Paso Outlet Center, LLC, (“El Paso Center”), a joint venture that acquired approximately 100 acres of unimproved land in El Paso, Texas in April 2006. The remaining 11.8% is owned by an affiliate of Amster and Gary Skoien, equally. The joint venture has begun construction of a factory outlet center on the site. Horizon El Paso reported the results of operations and the assets and liabilities of El Paso Center, using the equity method of accounting through August 31, 2006. As of September 1, 2006, Horizon El Paso began to consolidate the results of operations and the assets and liabilities of El Paso Center as a result of certain loans made to the joint venture partner by the

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Company. Effective September 1, 2006, El Paso Center was judged to be a variable interest entity. When these loans are repaid, the equity method of accounting may again be applicable to Horizon El Paso's investment in El Paso Center. HGPI consolidates the results of operations and the assets and liabilities of Horizon El Paso.

The Company also owns approximately 408 acres of land in Huntley, Illinois that is held for investment purposes ("Huntley").

The portion of the net income or loss 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.

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 also consolidates variable interest entities if it is that entity's primary beneficiary.

Reclassifications

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

Use of Estimates

The preparation of financial statements in conformity with 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.

Investment in Real Estate

The Company allocates the purchase price of properties to net tangible and intangible assets acquired based on their fair values in accordance with the provisions of 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

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, 2006, \$296,000 of interest was capitalized related to the construction of the outlet center in El Paso, Texas. Construction in progress, excluding the land component, at El Paso Center, is approximately \$4.1 million and is included with buildings and improvements on the consolidated balance sheet. During the years ended December 31, 2006 and 2005, \$241,000 and \$180,000, respectively, of interest was capitalized related to the construction of Phase III of the outlet center in Tulare, California. During the year ended December 31, 2005, \$68,000 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, "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 \$248,000 and \$91,000 for the years ended December 31, 2006 and 2005, 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 10), (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 TIF Bond Mortgage (see Note 10). At December 31, 2006, the escrow accounts related to the Company's primary lenders included approximately \$266,000 in capital improvement and tenant allowance reserves, \$137,000 in real estate tax and insurance escrows, and approximately \$826,000 for cash collateral accounts. At December 31, 2006, the Huntley infrastructure escrow accounts totaled \$106,000 and the TIF Bond Mortgage account had a balance of approximately \$3.9 million.

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Marketable Securities

The Company classifies its marketable securities as trading securities in accordance with the provisions of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities". These securities are carried at fair market value, with unrealized gains and losses, if any, reported in the statement of operations.

Tenant Accounts Receivable

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

Total tenant accounts receivable are reflected net of reserves of \$91,000 and \$128,000 as of December 31, 2006 and 2005, respectively. The provision for doubtful accounts was \$191,000 and \$4,000 for the years ended December 31, 2006 and 2005, respectively. This charge is included in the line item entitled "Other operating" in the statements of operations.

Discontinued Operations

In accordance with Statement of Financial Accounting Standards, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"), assets held for sale are valued at the lower of carrying value or fair value less costs to dispose. SFAS 144 requires that the results of operations and gain/(loss) on real estate properties sold or held for sale be reflected in the consolidated statements of operations as "Income/Loss from Discontinued Operations" for all periods presented. As of December 31, 2006, certain land parcels the Company owns were classified as held for sale. 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 parcels as Income/(Loss) from Discontinued Operations on the statements of operations. In addition, results of operations from the six factory outlet centers sold to Prescott Capital Management, LLC ("Prescott") in July 2006 and the outlet center located in Monroe, Michigan sold in November 2006 are also included in the discontinued operations line items on the balance sheets and the statements of operations. The six centers sold to Prescott are located in Darien, Georgia; Laughlin, Nevada; Medford, Minnesota; Traverse City, Michigan; Tulare, California and Warrenton, Missouri. 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.

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Fair Value of Financial Instruments

The Company estimates the fair value of its debt to be approximately \$36.3 million as of December 31, 2006. 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 \$36.3 million. The carrying value of cash and cash equivalents, receivables and payables approximate their fair values due to their short-term nature.

Derivatives and Hedging Instruments

The Company accounts for derivatives in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), as amended, which requires that all derivatives be recognized as assets and liabilities on the balance sheet and be measured at fair value. SFAS 133 also requires changes in fair value of the derivatives to be recorded each period in current earnings (other income or other expense) or other comprehensive income depending on the intended use and effectiveness of the derivatives.

Asset Retirement Obligations

SFAS No. 143 "Accounting for Asset Retirement Obligations", requires that the fair value of a liability related to an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of the fair value can be made. During 2005, Interpretation No. 47 was issued, clarifying the required accounting and measurement process for an asset retirement obligation for which settlement is subject to uncertainties that may or may not be within the control of an entity (a "conditional" asset retirement obligation). In connection with the issuance of this Interpretation, the Company evaluated any potential asset retirement obligations including those related to the disposal of asbestos containing materials. Based on this review, the Company did not identify any conditional asset retirement obligations.

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 \$27,000 and \$236,000 as of December 31, 2006 and 2005, 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.

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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.

In June 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). The interpretation clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. Specifically, the pronouncement prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on the related derecognition, classification, interest and penalties, accounting for interim periods, disclosure and transition of uncertain tax positions. The interpretation is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact of this pronouncement on its consolidated financial statements.

Share Options

The Company has historically 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 was 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.

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment" ("SFAS No. 123(R)"), which is a revision to SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"). SFAS No. 123 (R) supersedes Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB Opinion No. 25"). Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123 except that SFAS No. 123(R) requires all share-based awards to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative under SFAS No. 123(R). We adopted SFAS No. 123(R) on January 1, 2006 using the modified prospective method. The impact on net income of adopting SFAS No. 123(R) in 2006 was insignificant (see Note 7).

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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- Investment in Joint Venture

In July 2004, the Company acquired a 51% interest in Horizon El Portal, an entity of which HGP LP is the managing member and of which the remaining 49% is owned by Gary Skoien and Pleasant Lake Apts. Limited Partnership (“PLA”), an affiliate of Amster. 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. This loan was refinanced in June 2006 (see Note 12).

Summary financial information (stated at 100%) of the El Portal Center joint venture at December 31, 2006 and 2005 and for the years ended December 31, 2006 and 2005 follows (in thousands):

	As of <u>December 31, 2006</u>	As of <u>December 31, 2005</u>
Assets		
Real estate	\$11,737	\$12,573
Other assets	<u>408</u>	<u>405</u>
Total assets	<u>\$12,145</u>	<u>\$12,978</u>
Liabilities and members’ capital		
Mortgages and other debt	\$ 6,163	\$ 4,500
Other liabilities	223	175
Members’ capital	<u>5,759</u>	<u>8,303</u>
Total liabilities and members’ capital	<u>\$12,145</u>	<u>\$12,978</u>
	Year Ended <u>December 31, 2006</u>	Year Ended <u>December 31, 2005</u>
Statements of Operations		
Revenue	<u>\$ 933</u>	<u>\$1,288</u>
Operating expenses	979	882
General and administrative expenses	1,327	232
Depreciation and amortization expense	56	178
Interest expense	<u>770</u>	<u>430</u>
Total expenses	<u>3,132</u>	<u>1,723</u>
Net loss	<u>\$(2,199)</u>	<u>\$(434)</u>

General and administrative expenses include the charge-off of approximately \$1.1 million in development costs that were considered impaired in 2006.

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 – Income Taxes

HGPI 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” first effective for the Company for the year ended December 31, 2004.

The net provision for income taxes after the change in the valuation reserve for the years ended December 31, 2006 and 2005 consisted of the following:

	<u>2006</u>	<u>2005</u>
	<i>(in thousands)</i>	
Federal	\$ -	\$ -
State	<u>-</u>	<u>-</u>
Net provision (benefit)	<u>\$ -</u>	<u>\$ -</u>

For federal income tax purposes, HGPI had net operating loss carryforwards (“NOLs”) of approximately \$54.6 million and \$47.9 million at December 31, 2006 and 2005, respectively, and accumulated capital loss carryforwards of approximately \$40.9 million and \$42.2 million at December 31, 2006 and 2005, respectively. The NOLs expire from 2014 to 2021 and the accumulated capital loss carryforward expires in 2008.

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Deferred income tax liabilities and assets are determined based on the differences between the financial statement and tax basis of assets and liabilities. The components of the Company's deferred tax assets and liabilities are as follows as of December 31, 2006 and 2005 (in thousands):

	<u>2006</u>	<u>2005</u>
Deferred Tax Assets:		
NOL carryforwards-federal and state	\$20,460	\$17,972
Capital loss carryforward	14,323	14,787
Tax basis of assets in excess of book basis:		
Fixed/intangible assets	1,040	6,937
Impairment	947	1,413
Other	2,686	2,126
Book basis of liabilities in excess of tax basis:		
Prepaid rental revenue	26	84
Debt restructure	-	137
Profits interests	<u>626</u>	<u>248</u>
	40,108	43,704
Less valuation allowance	<u>(36,726)</u>	<u>(39,174)</u>
	3,382	4,530
Deferred Tax Liabilities:		
Book basis of assets in excess of tax basis:		
Fixed/intangible assets	(1,418)	(2,362)
Other	<u>(1,964)</u>	<u>(2,168)</u>
	<u>(3,382)</u>	<u>(4,530)</u>
Net deferred tax asset	<u>\$ -</u>	<u>\$ -</u>

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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):

2007	\$ 2,313
2008	4,644
2009	4,382
2010	4,047
2011	3,972
Thereafter	<u>7,124</u>
	<u>\$26,482</u>

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 \$42,650 per year through July 2009. The lease also requires payment of a pro rata share of property taxes and operating expenses.

Note 6 - Impairment

Due to declines in occupancy and net operating income, the Company concluded that the carrying value of certain of its shopping centers exceeded the estimated undiscounted cash flows expected over their investment holding period. Based on this, a provision for asset impairment was recorded in the amount of \$5.0 million in 2005 to record such facilities at their estimated fair value. There was no similar charge recorded in 2006.

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, 2006.

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. 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

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 loss for the year ended December 31, 2005, computed on a pro forma basis under requirements of SFAS 123(R) equals \$(4.0) million.

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

	<i>For the year ended December 31, 2006</i>		<i>For the year ended December 31, 2005</i>	
	<i>Shares</i>	<i>Price</i>	<i>Shares</i>	<i>Price</i>
Outstanding, beginning of the year	323,500	\$3.40 - \$6.49	323,500	\$3.40 - \$6.49
Granted	-	-	-	-
Exercised	-	-	-	-
Canceled	-	-	-	-
Outstanding, end of the year	<u>323,500</u>	\$3.40 - \$6.49	<u>323,500</u>	\$3.40 - \$6.49

The weighted average exercise price for options outstanding at both December 31, 2006 and 2005 was \$5.12. The weighted average contractual life of options outstanding at December 31, 2006 and 2005 was 3.23 years and 4.23 years, respectively. At December 31, 2006 there were 318,100 options vested and exercisable with the remaining 5,400 becoming vested and exercisable in 2007. The Company will recognize approximately \$10,000 in compensation expense in 2007 related to these options.

The Company granted a total of 16,367 units and 21,667 units of HGP LP to key employees in the years ended December 31, 2006 and 2005, respectively and 17,273 shares of stock in HGPI to key employees in the year ended December 31, 2006, and recognized compensation expense based on the fair market value of the units or stock granted. Total compensation expense recognized related to these awards equaled \$185,000 and \$114,000 in 2006 and 2005, respectively. There were no similar grants of shares of HGPI stock in 2005.

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 8 – Marketable Securities

The estimated fair values of securities held by the Company at December 31, 2006 based on quoted market prices are as follows (in thousands):

	<u>Face Value</u>	<u>Cost</u>	<u>Fair Market Value</u>
Debt Securities:			
FNMA Note, 6.0%, maturing November 2036	\$ 9,600	\$ 9,258	\$ 9,650
U.S. Treasury Note, 4.703%, maturing January 2007	7,726	7,698	7,702
FNMA Note, 6.0%, maturing November 2036	<u>4,150</u>	<u>4,163</u>	<u>4,178</u>
	<u>\$21,476</u>	<u>\$21,119</u>	<u>\$21,530</u>

The \$9.6 million and \$4.15 million FNMA Notes serve as collateral under repurchase agreements as disclosed in Note 10.

Note 9 – Commitments

The Company has outstanding commitments for capital expenditures on leases signed at December 31, 2006 in the amount of \$6.2 million for tenant allowances and \$34.7 million for other capital expenditures and construction costs, including the construction of the outlet center in El Paso, Texas, all of which are not reflected on the balance sheet as of December 31, 2006. These costs are expected to be paid during 2007 and are anticipated to be funded from capital improvement escrows, construction financing, equity contributions and additional borrowings (see Notes 2 and 14).

Note 10 - Mortgage Debt and Other Liabilities

	Principal Balance as of December 31, <u>2006</u> <u>2005</u> (in thousands)
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. Defeased in July 2006 (see Note 12).	- \$10,522

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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. Defeased in July 2006 (see Note 12).	-	6,218
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. Defeased in July 2006 (see Note 12).	-	4,304
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, 2006 (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 (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. Refinanced in July 2006 (see Note 12)	-	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, 2006 (the “Beal Bank Loan II”), secured by the outlet center in Monroe, Michigan, cross-collateralized with Beal Bank Loan I, 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. Refinanced in July 2006 (see Note 12)	-	1,296
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 (“Republic Bank Loan”), secured by the outlet center in Holland, Michigan and guaranteed by HGPI. Repaid in July 2006 (see Note 12).	-	3,137
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, 2007 (the “PLA Loan”) and guaranteed by HGPI. Repaid in July 2006 (see Note 12).	-	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. Defeased in July 2006 (see Note 12).	-	5,125

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Mortgage loan to Tulare Outlet Center LP, 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 Phase I of the outlet center in Tulare, California. Defeased in July 2006 (see Note 12).	-	9,333
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, 2006 (the “Huntley Amster Loan”), secured by a pledge of the partnership interests in HDLP and guaranteed by HGPI and HGP LP. Repaid in July 2006 (see Note 12).	-	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 6.89%, 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 11)	2,174	2,201
Unsecured promissory note to HGP LP, as borrower, from James Slayback, Sr., as lender, dated as of February 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 24, 2012	1,144	1,332
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. Repaid in July 2006 (see Note 12).	-	3,001
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. Assumed by a third party in July 2006 (see Note 12).	-	1,018
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 4.0% or 6.0%, due July 12, 2006 (“Amster Horizon El Portal Loan”), secured by the outlet center in Darien, Georgia and guaranteed by HGPLP, PLA and Gary Skoien. Repaid in July 2006 (see Note 12).	-	2,400

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 and guaranteed by HGP LP, PLA and Gary Skoien. Repaid in June 2006 (see Note 12).	-	1,500
Mortgage loan to Village Green Associates, LLC, as borrower, from Interstate Bank, as lender, dated as of November 17, 2005, in the original principal amount of \$2.9 million, bearing interest at 9.75%, due November 17, 2009 secured by the shopping center in Huntley, Illinois. This was the conversion of the construction loan provided on August 17, 2004	2,869	2,898
Mortgage loan to Huntley Development Limited Partnership, (“HDLP”) as borrower, from First Midwest Bank, as lender, dated as of March 30, 2005, in the original principal amount of \$15.6 million, bearing interest at the Wall Street Journal Prime Rate plus 0.5%, due March 30, 2007, secured by 380 acres of land owned by HDLP and a pledge of the Series C TIF bonds related to the Huntley TIF District. Initial loan funding of \$13.9 million with \$1.7 million available to be drawn to pay interest on the loan (see Note 14)	10,000	14,636
Construction loan to Tulare III, LLC, as borrower, from IXIS Real Estate Capital, Inc. (“IXIS”), as lender, dated as of September 16, 2005, with a limit of \$11.9 million, bearing interest at a rate of LIBOR plus 3.25%, with a decrease to LIBOR plus 2.5% after certain additional collateral is added to the deed of trust. The Company entered into an agreement capping the LIBOR rate at 5.0% for the term of the loan, maturing October 9, 2006, secured by Phases II and III of the Tulare, CA outlet center and a pledge of excess cash flow from Phase I of the center and guaranteed by HGPI. The fair value of the interest rate cap was judged to be approximately equal to its carrying cost of \$10,000 at December 31, 2005. Repaid in July 2006 (see Note 12).	-	9,179
Repurchase agreement between Magnolia Bluff Factory Shops LP, as borrower, and Wachovia Securities, LLC, as lender, dated December 18, 2006, in the original principal amount of \$9.2 million, bearing interest at a rate of 5.37%, due on January 18, 2007 and secured by a pledge of FNMA Notes having a face value of \$9.6 million as of December 31, 2006 and a repurchase agreement dated December 30, 2005 in the original principal amount of \$8.25 million, bearing interest at the rate of 4.18%, due on January 18, 2006 and secured by a pledge of US Treasury Notes having a face value of \$8.4 million as of December 31, 2005. In the normal course of business these notes are repurchased at maturity. This debt is guaranteed by Amster.	9,239	8,250

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Promissory note to HGP LP, as borrower, from Phillip Waters, as lender, dated as of April 24, 2006, in the amount of \$100,000, bearing interest at 12.0%, plus a 1.0% origination fee, due October 24, 2006 and guaranteed by HGPI. Mr. Waters is an employee of HGPI (see Note 12). Repaid in August 2006.	-	-
Promissory note to HGP LP, as borrower, from E. Thomas Thilman, as lender, dated as of April 28, 2006, in the amount of \$70,000, bearing interest at 12.0%, plus a 1.0% origination fee, due October 28, 2006 and guaranteed by HGPI. Mr. Thilman is a Director of HGPI (see Note 12). Repaid in August 2006.	-	-
Promissory note to HGP LP, as borrower, from Thomas Filippini, as lender, dated as of April 25, 2006, in the amount of \$70,000, bearing interest at 12.0%, plus a 1.0% origination fee, due October 25, 2006 and guaranteed by HGPI. Mr. Filippini is an affiliate of a Director of HGPI (see Note 12). Repaid in August 2006.	-	-
Promissory note to HGP LP, as borrower, from Shirley Skoien, as lender, dated as of April 11, 2006, in the amount of \$775,000, bearing interest at 12.0%, plus a 1.0% origination fee, due October 11, 2006 and guaranteed by HGPI. Ms. Skoien is the mother of Gary Skoien (see Note 12). Repaid in August 2006.	-	-
Promissory note to HGP LP, as borrower, from Gould Trading Company, as lender, dated as of April 11, 2006, in the amount of \$500,000, bearing interest at 12.0%, plus a 1.0% origination fee, due October 11, 2006 and guaranteed by HGPI. Gould Trading Company is an affiliate of Amster (see Note 12). Repaid in August 2006.	-	-
Mortgage loan to El Paso Outlet Center LLC, as borrower, from Cathay Bank, as lender, dated April 12, 2006, in the amount of \$3.45 million, bearing interest at the Wall Street Journal Prime Rate plus 1.0%, due May 1, 2007 and guaranteed up to 50% by HGPI. This loan requires payments of interest only. Initial funding of \$3.1 million with \$310,500 available to be drawn to pay interest on the loan.	3,330	-
Mortgage loan to Monroe Outlet Center LLC, as borrower, from First Bank of Beverly Hills, as lender, dated as of July 25, 2006, in the original principal amount of \$5.1 million, bearing interest at 9.5%, due on August 31, 2009 and secured by approximately 100 acres of vacant land in Norton Shores, Michigan and Fruitport Township, Michigan. Initial loan funding of \$3.8 million with \$1.3 million available to be drawn to pay interest on the loan (see below).	3,800	-
Margin account between Monroe Outlet Center, LLC, as borrower, and Bear, Stearns Securities Corp., as lender, dated as of December 18, 2006, bearing interest at a rate of 5.75%, secured by a pledge of FNMA notes having a face value of \$4.1 million. This debt is guaranteed by an affiliate of Amster.	<u>3,762</u>	<u>-</u>
	<u>\$36,318</u>	<u>\$91,080</u>

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

On March 30, 2005, the Company obtained a \$15.6 million loan from First Midwest Bank (the “FMB Loan”) and used a portion of the proceeds to repay the Huntley Beal Loan and Beal Bank’s net profits interest in the Huntley Partnerships. Pursuant to requirements of the loan, the Company repaid the FMB Loan to a principal balance of \$10.0 million at September 28, 2006. The Company granted a mortgage on 380 acres of land in Huntley, Illinois in connection with the FMB Loan. This loan was repaid in March 2007 with the proceeds of the loan from US Bank (see Note 14).

The Huntley Beal Loan had a balance of \$857,000 as of March 30, 2005, just prior to repayment. Beal Bank’s net profits interest was valued by the agreement of the Company and Beal Bank at \$8.5 million in the first quarter of 2005. HDLP recognized a gain of approximately \$929,000 related to the retirement of the net profits interest and the debt refinancing.

In December 2005, the Company entered into an agreement for the sale for its center in Darien, Georgia. The agreement provided for the sale of the center as of December 31, 2005 for a total price of \$8.0 million. The Company received a purchase money note for \$5.6 million and the purchaser assumed the Amster Horizon El Portal Loan with a balance of \$2.4 million. The purchaser held a put option that allowed it to sell the center back to the Company on or before June 15, 2006. Due to the put option, the Company recorded this transaction as a sale for accounting purposes on July 28, 2006, upon the expiration of the put option. Accordingly, all assets and liabilities of the center are reflected on the balance sheet of the Company as of December 31, 2005 and all results of operations are included on the statement of operations through July 28, 2006.

In 2005 and 2006, the Company acquired a portfolio of marketable securities (as defined in Note 2 and listed in Note 8) with the proceeds from repurchase agreements (see Note 10) and partner advances of \$495,000 reflected in participation interests and other liabilities on the consolidated balance sheet from Amster and Gary Skoien. The margin account for Monroe Outlet Center LLC is guaranteed solely by Amster and, therefore, all income statement impact from this account is allocated to minority interest. This entity is considered a variable interest entity and the Company has been judged the primary beneficiary. The margin account repurchase agreements are included in mortgages and other debt on the balance sheet. These notes are expected to be repurchased at maturity in the normal course of business.

On July 25, 2006, the Company obtained a \$5.1 million loan from First Bank of Beverly Hills (the “FBBH Loan”), \$3.3 million of which was used to repay Beal Bank Loan I and Beal Bank Loan II (see above) and \$1.3 million was available to be drawn to pay interest on the loan. The Company granted a mortgage to the lender on approximately 100 acres of vacant land in Norton Shores, Michigan and Fruitport Township, Michigan.

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 was granted a 35% interest in the Net Profits of Huntley Development Limited Partnership (“HDLP”) and Huntley Meadows Residential Venture (collectively, the “Huntley Partnerships”). The estimated value of the Beal Bank Net Profits interest is included in Participation Interests and Other Liabilities on the Company’s balance sheet. The Company repaid the Huntley Beal Loan and Beal Bank’s net profits interest on March 30, 2005 and HDLP recognized a gain of approximately \$929,000 related to the retirement of the net profits interest and the debt refinancing.

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Gary J. Skoien, Chairman, Chief Executive Officer and President of the Company, was also formerly the Executive Vice President and Chief Operating Officer of The Prime Group, Inc. ("Prime Group"). In connection with his employment with Prime Group, Mr. Skoien was previously granted an interest (the "Skoien Net Profits Interest") in the net 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 \$2.6 million and \$1.0 million as of December 31, 2006 and 2005, respectively which represent its estimated fair value and which amounts have been included in Participation Interests and Other Liabilities on the Company's balance sheets. The change in estimated fair value of the Skoien Net Profits Interest is reflected as interest expense in the statement of operations.

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. The Prime Group Participation Interest does not entitle Prime Group to participate in decision making or otherwise control the activities of the Huntley Partnerships. 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 currently 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 of \$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 \$2.4 million at December 31, 2006. 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.

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As additional security for the Series B bonds, HDLP granted U.S. Bank Trust National Association, as trustee for the holders of the Series B bonds, a mortgage on certain land in the TIF District. As of December 31, 2006, the mortgage covers approximately 17 acres of land owned by HDLP (the "TIF Bond Mortgage"). Upon the sale of land subject to the TIF Bond Mortgage, such land will be released from the TIF Bond Mortgage provided that HDLP deposits into a collateral account (the "TIF Bond 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 TIF Bond Collateral Account are released to HDLP upon the issuance of a certificate of occupancy for the subject land parcel. The balance in the TIF Bond Collateral Account was approximately \$3.9 million at December 31, 2006 and is included in Restricted Cash on the Company's balance sheet (see Note 2). Based on management's 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. 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.

Debt Maturities

Debt maturities and principal payments due subsequent to December 31, 2006 are as follows (in thousands):

<u>Due in:</u>	
2007	\$26,582
2008	265
2009	6,852
2010	267
2011	287
Thereafter	<u>2,065</u>
	<u>\$36,318</u>

The Company's ability to secure new loans is limited by the fact that most of the Company's real estate assets are currently pledged as collateral for its current loans. The Company anticipates refinancing the obligations due in 2007 in the normal course of business. See Note 14 with respect to the refinancing of certain loans subsequent to December 31, 2006.

Note 11 - Related Party Transactions

Howard Amster ("Amster") is a director and significant stockholder of HGPI. An affiliate of Amster owns approximately 49% of the entities that own or owned a total of nine outlet shopping centers (except the center in Darien, Georgia of which he owns approximately 44%) and the office building in Norton Shores, Michigan. His affiliate also owns 39.2% of Horizon El Portal, LLC and 5.9% of Horizon El Paso, LLC. In connection with his ownership, Amster's affiliate entered into an agreement to reimburse the Company for approximately 49% (adjusted to 35.3% in the fourth quarter of 2006 due to the sale of the properties to Prescott - see Note 12) of the general and administrative expenses related to the operation of the entities that own the outlet centers and the corporate office building in which the affiliate of Amster owns a partnership interest. Certain expenses related to the general operation of the

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Company are not subject to reimbursement under the agreement. The Company recognized income related to this arrangement of \$1.0 million and \$848,000 during the years ended December 31, 2006 and 2005, respectively, which is reflected in other income on the statement of operations. The Company had several loans from affiliates of Amster on which it paid a total of \$481,000 and \$549,000 of interest during the years ended December 31, 2006 and 2005, respectively. See Note 10 for the terms of the loans. All of these loans were repaid during 2006. Included in other assets in the consolidated balance sheet at December 31, 2006 is a note receivable from Amster for approximately \$1.42 million which bears interest at 5.0%.

Gary J. Skoien is Chairman, Chief Executive Officer and President of the Company. Mr. Skoien owns 9.8% of Horizon El Portal, LLC, 5.9% of Horizon El Paso, LLC and 5.3% of the entity that formerly owned the outlet center in Darien, Georgia. He was also formerly Executive Vice President and Chief Operating Officer of Prime Group and while in that capacity was granted and still owns a net profits interest in Huntley Development Limited Partnership (see the discussion of *Huntley Net Profits Interests and TIF Bonds* in Note 10). The UBS Office Loan and FBBH Loan require an officer of the Company to be personally liable for losses by the lender for environmental damages and certain actions prohibited under the loan documents. Mr. Skoien personally indemnified the lenders for such losses and damages. The Company agreed to indemnify Mr. Skoien for any amounts paid under the indemnifications and to pay Mr. Skoien fees of \$30,000 and \$20,000, respectively, related to such indemnifications until such loans are repaid (or Mr. Skoien is otherwise released from the indemnification obligation).

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 \$791,000 and \$986,000 during the years ended December 31, 2006 and 2005, respectively, on insurance policies placed by Thilman & Filippini, including insurance premiums for properties classified as discontinued operations.

Note 12 – Recent Developments

In April 2006, El Paso Outlet Center, LLC acquired 100 acres of unimproved land in El Paso County, Texas with the intent to develop a factory outlet center on the site. The site was acquired with the proceeds from a \$3.45 million loan from Cathay Bank and \$3.4 million of capital contributions from the partners of El Paso Outlet Center, LLC, of which Horizon El Paso, LLC owns 50% (see Note 1).

In April 2006, the Company sold a one-acre parcel of land held for investment located in Huntley, Illinois for \$760,000. Approximately \$150,000 of the net proceeds was deposited into a collateral account related to the TIF Bond Mortgage and approximately \$53,000 was used to partially repay the FMB Loan (see Note 10). A net gain of approximately \$245,000 before minority interests was recognized on the transaction.

In June 2006, El Portal Center, LLC obtained a \$6.7 million loan secured by the shopping center in Laredo, Texas from Cathay Bank. El Portal Center, LLC used a portion of the proceeds to repay the loan from Horizon El Portal, LLC (see Note 3) and the remaining net proceeds were distributed to the partners. Horizon El Portal, LLC used its share of the distributed loan proceeds and the proceeds from the repayment of its loan to El Portal Center, LLC to repay the \$3.0 million loan previously secured by the shopping center owned by El Portal Center, LLC (see Note 3) and to repay \$900,000 under the line of credit from an affiliate of Amster (see Note 10).

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company obtained loans from related parties in April 2006 in connection with the acquisition of the vacant land for the El Paso Center. The Company recognized interest expense to each of the lenders as follows in year ended December 31, 2006, respectively: Phillip Waters, employee of HGPI, \$4,300; E. Thomas Thilman, Director of HGPI, \$3,000; Thomas Filippini, affiliate of a Director of HGPI, \$3,000; Shirley Skoien, mother of Gary Skoien, \$37,200; and Gould Trading Company, affiliate of Amster, \$23,800. All of these loans were repaid in August 2006.

In July 2006, the Company completed the sale of six factory outlet centers to Prescott Capital Management, LLC ("Prescott") pursuant to an agreement entered into in 2005 and as subsequently amended (see Note 2). The centers are located in Darien, Georgia; Laughlin, Nevada; Medford, Minnesota; Traverse City, Michigan; Tulare, California and Warrenton, Missouri. The net sales price was approximately \$61.5 million after the repayment of approximately \$48.7 million of the debt owed to third parties and secured by the properties sold to Prescott and \$3.7 million of loan defeasance costs related to loans previously secured by certain of the centers sold to Prescott. The loans collateralized by the six properties sold in this transaction were defeased via special purpose entities outside the control of HGPI through the contribution by the Company of marketable securities sufficient in size to satisfy scheduled payments under the debt. For accounting purposes, this was treated as a debt extinguishment. The defeasance costs are recorded as interest expense in Discontinued Operations (See Note 13). In addition, a portion of the sales proceeds was used to repay the \$3.1 million loan on the outlet center in Holland, Michigan and loans totaling approximately \$5.1 million secured by the center in Gretna, Nebraska. Distributions of sales proceeds totaling \$25.4 million were made to the other owners of the entities that owned the properties sold to Prescott (see Note 11). HGP LP used \$690,000 to repay the Huntley Amster Loan (see Note 10) and \$1.3 million to acquire the Amster Horizon El Portal Line from Amster Trading Company (see Note 10 and the discussion of the Cathay Bank Loan to El Portal Center, LLC above). The defeasance premiums were included in the price paid by the purchaser for the properties and, thus, adjusted the gain realized on the transaction. In connection with the transaction, Amster paid the Company a brokerage commission, from his distribution, of \$650,000, which is included as a component of the gain on the transaction. A gain of approximately \$16.0 million, net of minority interests, was recognized on the transaction and is included in Income/(Loss) from Discontinued Operations.

In November 2006, the Company sold its ownership interests in the entities that formerly owned the six outlet shopping centers that were sold to Prescott. Each was sold to an affiliate of Amster for its net book value pursuant to the terms of an agreement entered into in 2003 in which the Company had agreed to sell the entities to Amster after the entity had sold its real estate assets. No gain or loss was recognized on the sales. A receivable for the Company's prorata share of the net assets of the entities is included in tenant and other accounts receivable on the balance sheet at December 31, 2006.

In November 2006, the Company sold the 122,000 square foot outlet shopping center located in Monroe, Michigan. The gross sales price was \$1.9 million. A gain of approximately \$157,000, before minority interests, was recognized on the transaction.

Note 13 – 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/(Loss) from Discontinued Operations".

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table is a summary of the results of operations of the properties classified as discontinued operations (see Note 2):

	Year ended <u>December 31, 2006</u>	Year ended <u>December 31, 2005</u>
	<i>(in thousands)</i>	
Total revenue	<u>\$10,009</u>	<u>\$16,548</u>
Operating expenses	4,452	6,959
General and administrative expenses	126	144
Depreciation and amortization expense	1,981	3,873
Provision for impairment	-	3,000
Interest expense	<u>6,180</u>	<u>3,439</u>
Total expenses	<u>12,739</u>	<u>17,415</u>
Loss before minority interests	(2,730)	(867)
Minority interest	1,680	453
Gain on sale of real estate, net of minority interests of \$29,726 and \$30, respectively	<u>16,096</u>	<u>68</u>
Income/(loss) from discontinued operations	<u>\$15,046</u>	<u>\$ (346)</u>

Note 14 – Subsequent Events

The Company has entered into a purchase agreement to acquire the entity that owns the outlet shopping center known as Gettysburg Village in Gettysburg, Pennsylvania. The center contains a total of approximately 252,000 square feet of retail space, a 35,000 square foot movie theater and ground leases to the Carlson County Inn and TGI Friday's. The contract price is \$61.0 million and is subject to customary prorations. The center is subject to existing debt of \$43.75 million (as of January 1, 2007). The assumption of the existing loan by the Company is a condition of closing. The Company has also obtained a proposal for a total of \$10.0 million of mezzanine and first mortgage land financing in connection with the acquisition. Closing on the acquisition is expected to occur in the third quarter of 2007.

El Paso Center is currently constructing a 380,000 square foot outlet shopping center in El Paso, Texas (see Note 1) which is expected to open in the fourth quarter of 2007. The total construction cost of the center is estimated to be approximately \$70.0 million. El Paso Center closed on a construction loan in February 2007 which provides for an initial loan of up to \$55.0 million, increasing to \$60.0 million if certain leasing thresholds are met. The loan contains net worth and liquidity minimums for the Company as well as other covenants and is fully guaranteed by the Company until certain leasing conditions at the center are met. An affiliate of El Paso Center also closed on a \$9.5 million mezzanine loan in February 2007 in connection with the construction of the project. The Company is acting as the leasing and construction manager for the project and receives fees from El Paso Center for such services.

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In March 2007, the Company entered into a \$23.4 million revolving credit agreement with US Bank which is secured by a mortgage on approximately 380 acres of land owned by the Company in Huntley, Illinois. The initial funding of \$10.5 million was used to repay the FMB Loan (see Note 10). The terms of the loan from US Bank require \$3.4 million to be used for the payment of interest with the remainder available to be used by the Company to fund additional investments.

The Company has entered into a purchase agreement to acquire three outlet shopping centers located in Burlington, Washington; Fremont, Indiana and Oshkosh, Wisconsin. The centers contain a total of approximately 674,000 square feet of retail space. The contract price is \$59.1 million and is subject to customary prorations. The centers are subject to existing debt of \$53.4 million (as of January 1, 2007). The assumption of the existing loan by the Company is a condition of closing. The Company has requested that the servicer of the existing loan consent to its assumption by the Company. Closing on the acquisition is expected to occur in the third quarter of 2007.

In June 2007, the Company sold the 191,500 square foot shopping center located in Gretna, Nebraska. The gross sales price was \$3.85 million.

BOARD OF DIRECTORS**Howard M. Amster**

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Gov. Jim Edgar

Distinguished Fellow
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Gary J. Skoien

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

E. Thomas Thilman

President
Thilman Filippini LLC.

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Chairman, President and
Chief Executive Officer

David R. Tinkham

Chief Financial Officer and Secretary

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STOCK TRADING

The Company's common stock trades in the
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