



J. CREW



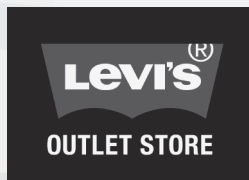
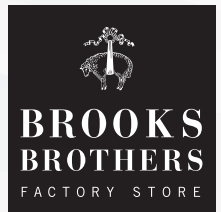
NIKE FACTORY STORE

GUESS

BANANA REPUBLIC
FACTORY STORE

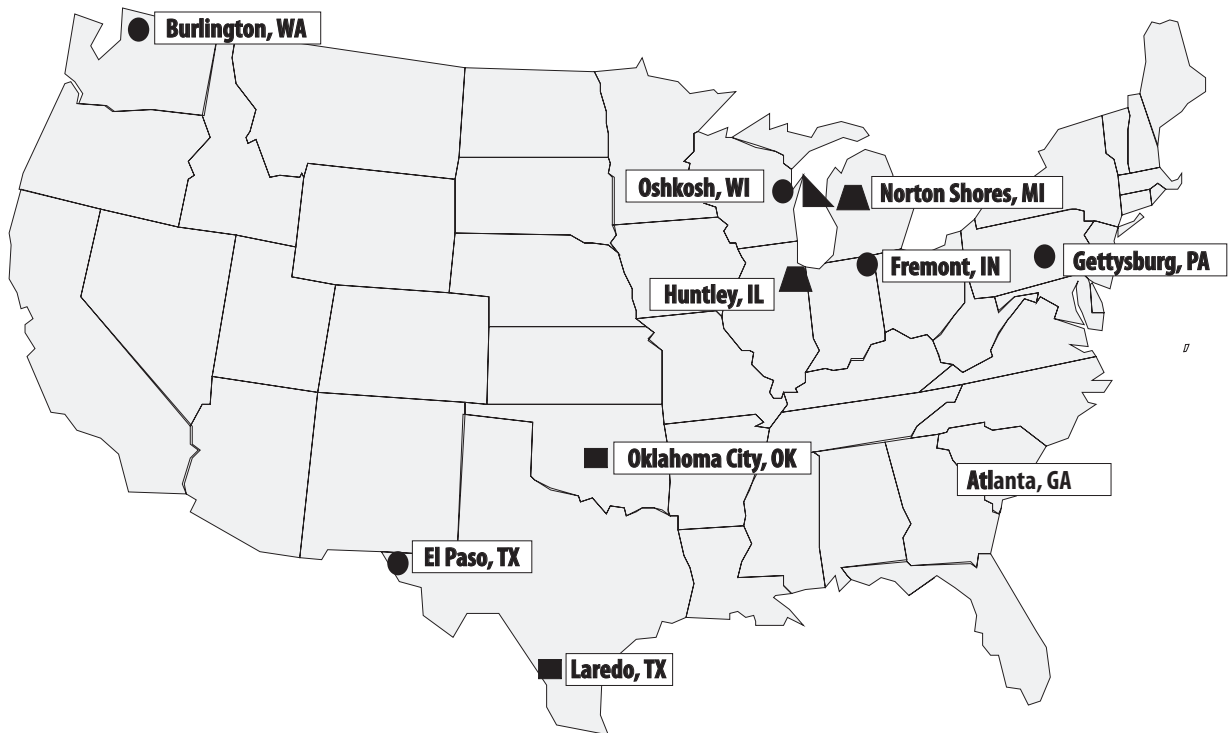


UNDER ARMOUR



TOMMY HILFIGER
COMPANY STORES

Portfolio



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

Company Profile

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

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

Dear Stockholder,

The difficult national economy and its impact on the real estate industry have not changed very much from when I wrote to you last year. Unemployment remains high and growth of the national economy is anemic. The most notable macroeconomic change over the past year that affects our business is an increase in the availability of credit, although not to the levels that existed prior to the recession. The market for securitized commercial debt, which had completely ceased to exist, is coming back albeit slowly. This development is important since this market was the source of a majority of the pre-recession real estate debt capital, yet there still is a long way to go.

As an owner and developer of outlet shopping centers, Horizon is fortunate to be in one of the most resilient sectors of the real estate industry. In fact, in the retail real estate sector, the outlet business is the one really bright spot. Customers continue to seek and find brand names at deep discounts at outlet centers. Many retailers have recognized this and shifted their business focus from wholesale and full-price retail to outlet retail. As a result of these phenomena, sales have increased significantly at our centers since 2008 and we continue to see great opportunities for the development of new outlet centers and the opportunity to improve returns at our existing shopping centers.

Oklahoma City

The most exciting activity at the Company over the last year is the progress we have made in developing The Outlet Shoppes at Oklahoma City. As you may recall from past letters, this exciting project has gone through a number of iterations. These related to the lack of available financing rather than any fundamental issue with the project. We began working on this project in 2006 and by the fall of 2008, Horizon had leased over 70% of the space in the center, arranged financing, and taken construction bids. As we were about to begin to build the project, the financial sector collapsed, causing our financing to be terminated. The resulting delay and the expiration of delivery dates for spaces to our tenants meant that our leasing team was required to amend or sign all new leases for the center with a significantly later opening date.

Our new leasing efforts were successful and, in the spring of this year, we were again ready to commence construction. Meanwhile our partner, Cousins Properties, was dealing with the impact of the real estate downturn on its company and needed to focus on improving its balance sheet and stabilizing its core assets. At that point, Cousins determined that new development was not in its best interest and decided not to invest in the project. Horizon began looking for another means to finance the project—a difficult task given the still-troubled capital markets.

In mid-June of this year, we decided to start construction on the project in light of the fact that over 75% of the space at the center was leased, the knowledge that failure to move forward on the development of the project at that time would likely mean it would never be built and our conviction that this center would be quite successful. After an aggressive effort to find a new capital source, we formed a joint venture in mid-October with CBL Properties, a REIT with a solid reputation that owns interests in over 150 retail properties. Pursuant to our agreement with

CBL, we will oversee construction, provide leasing services and manage the center once it is opened in addition to our equity stake.

Construction on the \$66 million, 323,000 square foot center is progressing well with a scheduled opening on August 5, 2011. It is located on Interstate 40, about seven miles from downtown Oklahoma City. Tenants at the center include Coach, Saks Off 5th, Banana Republic, Nike, GAP, Brooks Brothers, J. Crew and many other great retail brands. The land on which the center is being built is large enough to allow 80,000 square feet of additional retail and contains out-lots we will sell or lease. As of this writing, The Outlet Shoppes at Oklahoma City is the only outlet shopping center scheduled to open in 2011 in the entire country.

New Development

The Company is continuing to work on the development of The Outlet Shoppes at Atlanta located on Interstate 575 northwest of the city. This center is being developed in partnership with Cousins Properties. Retailers are responding very positively to this proposed development and our goal is to open the center in 2012.

We continue to work on the development of an outlet in Laredo, TX and are in the process of negotiating a development package with the City of Laredo. We continue to believe that Laredo has the potential to be a very strong outlet location.

Finally, as I indicated above, we are convinced of the long-term viability of the outlet business and the fact that there are great potential outlet sites remaining to be developed in the US. We are currently evaluating sites as we look to the future for our next potential development.

Leasing and Property Operations

The most significant statistic regarding our portfolio of properties is the increase in sales since the end of 2008. Since that time, we have increased sales at our properties by 17.6% and have generated increases in sales at every center we own. Occupancy at our centers was slightly up over the same period. Given the retail environment, we were pleased that we did not lose a significant number of tenants to bankruptcy. In fact, excluding tenants lost to bankruptcy, occupancy at our centers was up by 3.5%.

A number of great things are happening at our centers. In El Paso, we have encountered a few tenant move-outs particularly among mature fashion retailers. We have replaced those tenants with some great fashion forward tenants including Vans, Guess? Accessories and P.S. from Aeropostale. We also added Ripley's Marvelous Mirror, an entertainment concept for kids and a Mexican restaurant at the food court to appeal to the large number of Mexican National shoppers. These activities have produced double-digit increases in sales and traffic at the center over the past 18 months.

Similarly, we have generated increases in traffic and sales at The Outlet Shoppes at Oshkosh and we have added strong tenants to the center including Under Armour, Brooks Brothers and Levi's. After sitting vacant for over seven years, a former restaurant building is now the home to The Blue Agave Southwest Grill. Providing a quality restaurant cures the most significant deficiency at this center.

We have also leased space to Brooks Brothers and Levi's at The Outlet Shoppes at Gettysburg this year and Tommy Hilfiger was added to the center last year. Despite high regional unemployment, this center remains strong. We continue to promote it as a tax-free shopping venue for customers from Maryland and a great destination for traditional Christmas shopping.

We have increased sales at The Outlet Shoppes at Burlington with the help of the performance of several great tenants we brought to the center and the strength of the Canadian dollar. Nike will open for business at the center in early November, another great addition. We think that Burlington will continue to be a solid center for Horizon.

Debt

Most real estate companies are facing the issue of impending debt maturities in a debt market that is not fully functional. This year we were able to obtain an extension until February 2011 of a \$2.8 million loan that had expired last November. That loan is secured by a strip shopping center we own in Huntley.

The Company is currently negotiating with the servicer of the non-recourse loan secured by our corporate office building in Muskegon, MI. The difficult market for office space has resulted in income that is insufficient to meet the debt service obligations. This is in spite of the fact that we were able to sign a five-year lease with the US Department of Veteran Affairs for 8,595 square feet of space increasing occupancy from 51% to 81%.

The Company has a \$20 million loan from US Bank secured by a mortgage on land we own in Huntley. Last year, I reported that Horizon and US Bank had signed an agreement to extend the maturity of the loan for one year to October 1, 2010. This summer we were able to extend the loan by an additional four months to January 2011. The loan balance reflects our recent pay-down of the loan by \$1.7 million with the proceeds from the sale of 8.4 acres of land to an RV dealership. We continue to be focused on the sale of land in Huntley in one of the most difficult environments for land sales in many years.

China

In 2009, the Company was approached by several Chinese firms to participate in developing outlet projects in China. The Chinese retail market is vast, complex and evolving rapidly. It is clear that outlet centers will be successful in China and that they are being planned or discussed in dozens of locations around the country. Several years ago we explored the possibility of developing outlets in China but concluded that we did not have the resources and were too risk adverse to undertake a development there even though we believed that outlets would be quite successful.

Late last year, we entered into a joint venture agreement to develop outlets centers in China with one of the firms that approached us. This firm is an experienced Chinese real estate company with an interest in a significant outlet presence in China. Our role in this joint venture is to assist with development, provide leasing services for the projects and manage the properties upon completion. We will earn fees for our services and receive an equity participation in the

operating company managing the centers. This arrangement gives us an opportunity to participate in the growth of outlets in China without taking equity risk and with a partner knowledgeable in real estate development there.

Conclusion

Our two greatest achievements this year are arranging the financing for and beginning construction of The Outlet Shoppes at Oklahoma City and improving the operating performance of our portfolio of outlet centers. For the former, I extend my thanks to Tom Rumptz for moving the construction of the project forward, to Andrew Pelmoter and his leasing team for a great job leasing the project in difficult times and to David Tinkham and Terri Springstead for their efforts that enabled us to close on our joint venture agreement. For the latter I would like to thank James Harris and his property team for operating our properties efficiently with a keen eye on keeping costs in line. As with all great successes, there are many more dedicated individuals at Horizon to thank including:

Charles Aaronson	David Lemke
Robert Ackors	Henry Lemke
Efren Aleman	Thomas Logan
Kris Arnson	Jorge Loya
Jaime Arroyo	Elizabeth Maciag Lankerd
Sarah Barnes	Jesus Maldonado
Matthew Baumann	Dora Meza
Carlos Bruan	Beth Parkinson
Cecilia Camarillo	Dawn Perkins
Abraham Capote	Kyle Rathburn
Norma Cazares	Rochelle Richard
Jennifer Chartrand	Jesus Rincon
Jeffrey Collins	Julian Rivera
Tisha Colpo	Charles Rosien V
Camilo Coronel	John Sabino
Douglas Emig	Charles Sander
Amy Fairchild	Dawn Saucedo
Darlene Fenner	Robert Schaub
Melanie Galarneau	Michael Schmidt
Armando Garcia	Debra Schutter-Jellema
Debbie Griesinger	Regina Slechta
Michelle Hamby	Jonathan Sokolowski
Jim Helsel	David Spring
Luz Hernandez	David Stringer
Mario Hernandez	Michael Tanis
Anita Hickman	Denise Thomas
Thomas Hill	George Torres
Keith Holschbach	Phillip Waters
Tammi Lanore	Kylee Woerner
Edgar Lara	

Over the coming year, all of us will be focused on completing The Outlet Shoppes at Oklahoma City on time and on budget, improving the occupancy, sales and income at our existing centers, selling vacant land and working on our next outlet projects. Thank you for your confidence in our team.

Sincerely,

A handwritten signature in black ink, appearing to read "G. Skoien", with a long horizontal flourish extending to the right.

Gary J. Skoien

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Horizon Group Properties, Inc.

We have audited the accompanying consolidated balance sheets of Horizon Group Properties, Inc. (the "Company") as of December 31, 2009 and 2008, and the related consolidated statements of operations, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Horizon Group Properties, Inc. as of December 31, 2009 and 2008, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

Cohen & Company

Cleveland, Ohio
June 15, 2010

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

	December 31, 2009	December 31, 2008
ASSETS		
Real estate – at cost:		
Land	\$ 34,965	\$ 34,965
Buildings and improvements	103,136	103,591
Less accumulated depreciation	<u>(15,249)</u>	<u>(10,370)</u>
	122,852	128,186
Construction in progress	3,544	3,051
Land held for investment	<u>20,295</u>	<u>20,646</u>
Total net real estate	146,691	151,883
Investment in joint ventures	1,967	1,968
Cash and cash equivalents	1,406	755
Restricted cash	3,108	7,693
Marketable securities	11,392	10,174
Tenant and other accounts receivable, net	1,471	2,169
Real estate held for sale	-	2,825
Deferred costs (net of accumulated amortization of \$2,265 and \$1,465, respectively)	3,646	3,859
Other assets	<u>3,070</u>	<u>3,097</u>
Total assets	<u><u>\$172,751</u></u>	<u><u>\$184,423</u></u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Mortgages and other debt	\$143,026	\$145,267
Accounts payable and other accrued expenses	3,346	5,481
Prepaid rents and other tenant liabilities	740	819
Participation interests and other liabilities	<u>1,100</u>	<u>2,300</u>
Total liabilities	<u>148,212</u>	<u>153,867</u>
Commitments and contingencies		
Stockholders' equity:		
Common shares (\$.01 par value, 50,000 shares authorized, 2,843 and 2,895 issued and outstanding, respectively)	28	29
Additional paid-in capital	36,008	37,514
Accumulated deficit	<u>(24,284)</u>	<u>(19,953)</u>
Total stockholders' equity attributable to the controlling interest	11,752	17,590
Noncontrolling interests in consolidated subsidiaries	<u>12,787</u>	<u>12,966</u>
Total stockholders' equity	<u>24,539</u>	<u>30,556</u>
Total liabilities and stockholders' equity	<u><u>\$172,751</u></u>	<u><u>\$184,423</u></u>

See accompanying notes to consolidated financial statements.

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

	Year ended December 31, 2009	Year ended December 31, 2008
REVENUE		
Base rent	\$11,987	\$12,432
Percentage rent	276	250
Expense recoveries	3,239	3,474
Other	1,811	1,620
Interest	<u>376</u>	<u>677</u>
Total revenue	<u>17,689</u>	<u>18,453</u>
EXPENSES		
Property operating	4,750	4,676
Real estate taxes	1,680	1,419
Other operating	459	656
Depreciation and amortization	6,541	8,134
General and administrative	4,045	4,369
Interest	7,380	8,447
Gain on marketable securities	<u>(162)</u>	<u>(75)</u>
Total expenses	<u>24,693</u>	<u>27,626</u>
Income from investment in joint ventures	<u>677</u>	<u>1,700</u>
Consolidated net loss from continuing operations	(6,327)	(7,473)
Loss from discontinued operations	<u>(399)</u>	<u>(389)</u>
Consolidated net loss before gain on sale of real estate	(6,726)	(7,862)
Gain on sale of real estate	<u>17</u>	<u>2,864</u>
Consolidated net loss	(6,709)	(4,998)
Less net loss attributable to the noncontrolling interests	<u>2,378</u>	<u>1,654</u>
Net loss attributable to the Company	<u><u>\$(4,331)</u></u>	<u><u>\$(3,344)</u></u>

See accompanying notes to consolidated financial statements.

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

	Common Shares	Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Equity Attributable to the Controlling Interest	Noncontrolling Interests in Consolidated Subsidiaries	Total Stockholders' Equity
Balance, January 1, 2009	\$29	\$37,514	\$(19,953)	\$17,590	\$12,966	\$30,556
Net loss	-	-	(4,331)	(4,331)	(2,378)	(6,709)
Stock grant to officers	-	29	-	29	-	29
Stock buyback and retirement	(1)	(80)	-	(81)	-	(81)
Sale of interests in consolidated subsidiaries (See Notes 3 and 13)	-	(1,455)	-	(1,455)	2,774	1,319
Net distributions to noncontrolling interests	-	-	-	-	(575)	(575)
Balance, December 31, 2009	<u>\$28</u>	<u>\$36,008</u>	<u>\$(24,284)</u>	<u>\$11,752</u>	<u>\$12,787</u>	<u>\$24,539</u>

	Common Shares	Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Equity Attributable to the Controlling Interest	Noncontrolling Interests in Consolidated Subsidiaries	Total Stockholders' Equity
Balance, January 1, 2008	\$29	\$37,522	\$(16,609)	\$20,942	\$12,625	\$33,567
Net loss	-	-	(3,344)	(3,344)	(1,654)	(4,998)
Stock grant to officers	1	291	-	292	-	292
Stock buyback and retirement	(1)	(299)	-	(300)	-	(300)
Consolidation of El Portal Center (See Note 4)	-	-	-	-	1,643	1,643
Net contributions from noncontrolling interests	-	-	-	-	352	352
Balance, December 31, 2008	<u>\$29</u>	<u>\$37,514</u>	<u>\$(19,953)</u>	<u>\$17,590</u>	<u>\$12,966</u>	<u>\$30,556</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>2009</u>	<u>2008</u>
Cash flows from operating activities:		
Net loss attributable to the Company	\$(4,331)	\$(3,344)
(Gain)/loss on sale of real estate, including amounts in discontinued operations	121	(2,864)
Adjustments to reconcile net loss attributable to the Company to net cash used in operating activities:		
Net loss attributable to the noncontrolling interests	(2,378)	(1,654)
Income from investment in joint ventures	(677)	(1,700)
Depreciation	6,423	8,124
Amortization, including deferred financing costs	1,241	975
Gain on marketable securities	(162)	(75)
HGPI stock grants	(25)	292
Changes in assets and liabilities:		
Restricted cash	585	833
Tenant and other accounts receivable	725	1,807
Real estate held for sale	90	-
Deferred costs and other assets	(587)	(1,558)
Accounts payable and other accrued expenses	(2,064)	(1,005)
Participation interests and other liabilities	(678)	(355)
Prepaid rents and other tenant liabilities	<u>(51)</u>	<u>(339)</u>
Net cash used in operating activities	<u>(1,768)</u>	<u>(863)</u>
Cash flows from investing activities:		
Net marketable securities activity	(1,056)	154
Net distribution from joint ventures	678	384
Repayment of notes receivable	96	-
Expenditures for buildings and improvements	(1,585)	(5,030)
Expenditures for land held for investment	(7)	-
Cash transferred in connection with consolidation/ (de-consolidation) of entities	(44)	50
TIF Bond Collateral Account proceeds (see Note 10)	4,000	-
Net proceeds from sale of real estate	<u>2,536</u>	<u>3,707</u>
Net cash provided by/(used in) investing activities	<u>4,618</u>	<u>(735)</u>
Cash flows from financing activities:		
Net contributions from/(distributions to) noncontrolling interests	(575)	352
Net proceeds from sale of ownership interests	1,350	-
Principal payments on mortgages and other debt	(13,890)	(8,544)
Proceeds from borrowings	11,649	4,102
Debt issue costs	(542)	-
HGPI stock buyback and retirement	(27)	(300)
Payment of participation interests	<u>(164)</u>	<u>-</u>
Net cash used in financing activities	<u>(2,199)</u>	<u>(4,390)</u>
Net increase/(decrease) in cash and cash equivalents	651	(5,988)
Cash and cash equivalents:		
Beginning of year	<u>755</u>	<u>6,743</u>
End of year	<u>\$ 1,406</u>	<u>\$ 755</u>

See accompanying notes to consolidated financial statements.

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

2009

2008

Supplemental Information

During the years ended December 31, 2009 and 2008, the Company sold assets that affected the following accounts:

Accumulated depreciation	\$ (72)	\$ -
Real estate held for sale	2,825	-
Land held for investment	-	854
Deferred costs	(18)	-
Accounts payable and other accrued expenses	<u>203</u>	<u>292</u>
Net assets sold	2,938	1,146
Gross proceeds from sale of real estate	<u>2,817</u>	<u>4,010</u>
Gain/(loss) on sale of real estate	<u>\$ (121)</u>	<u>\$2,864</u>

The following represents the 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 consolidated statements of cash flows for the years ended December 31, 2009 and 2008:

Gross proceeds from sale of real estate	\$2,817	\$4,010
Accounts payable and other accrued expenses – closing costs	(257)	(303)
Prepaid rents and other tenant liabilities	<u>(24)</u>	<u>-</u>
Net proceeds from sale of real estate	<u>\$2,536</u>	<u>\$3,707</u>

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

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

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

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

See accompanying notes to consolidated financial statements.

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

Supplemental Information (Continued)	<u>2009</u>	<u>2008</u>
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The following represents supplemental disclosure of noncash activity for the consolidation of the assets and liabilities of El Portal Center on October 1, 2008 (See Note 4):

Land		\$ 8,878
Buildings and improvements		2,855
Construction in progress		111
Accumulated depreciation		(293)
Investment in joint venture		(2,842)
Cash and cash equivalents		50
Restricted cash		422
Tenant and other accounts receivable, net		9
Deferred costs		73
Other assets		(722)
Mortgages and other debt		(6,700)
Accounts payable and other accrued expenses		(195)
Prepaid rents and other tenant liabilities		(7)
Noncontrolling interests in consolidated subsidiaries		<u>(1,639)</u>
		<u>\$ -</u>

The following represents supplemental disclosure of noncash activity for the disposal of fully depreciated/amortized assets during the years ended December 31, 2009 and 2008:

Buildings and improvements	\$ 934	\$1,040
Deferred costs	<u>300</u>	<u>50</u>
	<u>\$1,234</u>	<u>\$1,090</u>

See accompanying notes to consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Organization and Principles of Consolidation

Horizon Group Properties, Inc. (“HGPI” or, together with its subsidiaries, “HGP” or the “Company”) is a Maryland corporation that was established on June 15, 1998. The operations of the Company are conducted primarily through a subsidiary limited partnership, Horizon Group Properties, L.P. (“HGP LP”) of which HGPI is the sole general partner. As of December 31, 2009 and 2008, HGPI owned approximately 68.3% and 68.8%, respectively, of the partnership interests (the “Common Units”) of HGP LP. In general, Common Units are exchangeable for shares of Common Stock on a one-for-one basis (or for an equivalent cash amount at HGPI’s election).

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

Note 2 - Summary of Significant Accounting Policies

Principles of Consolidation

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

Reclassifications

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

Use of Estimates

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

Investment in Real Estate

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

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company allocates a portion of the purchase price to above-market and below-market lease values for acquired properties based on the present value (using an interest rate which reflects the risks associated with the leases acquired) of the difference between: (i) the contractual amounts to be paid pursuant to the in-place leases and (ii) management's estimate of fair market lease rates for the corresponding in-place leases, measured over the remaining non-cancelable term of the lease. In the case of below market leases, the Company considers the remaining contractual lease period and renewal periods, taking into consideration the likelihood of the tenant exercising its renewal options. The capitalized above/below-market lease values (included in Deferred Costs or Prepaid Rents and Other Tenant Liabilities on the consolidated balance sheets) are amortized as either a reduction of, or addition to, rental income over the remaining noncancelable terms of the respective leases. Should a tenant terminate its lease prior to its scheduled expiration, the unamortized portion of the lease intangibles would be charged to expense. The net book value of capitalized above/below-market lease values was \$1.2 million and \$1.7 million at December 31, 2009 and 2008, respectively.

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

The value of in-place leases (included in Buildings and Improvements on the consolidated balance sheets) is amortized to expense over the remaining initial term of the respective leases. Should a tenant terminate its lease prior to its scheduled expiration, the unamortized portion would be charged to expense. The net book value of in-place leases was \$3.3 million and \$6.4 million at December 31, 2009 and 2008, respectively.

Real Estate and Depreciation

Costs incurred for the acquisition, development, construction and improvement of properties, as well as significant renovations and betterments to the properties, are capitalized. Maintenance and repairs are charged to expense as incurred. Interest costs incurred with respect to qualified expenditures relating to the construction of assets are capitalized during the construction period. During the years ended December 31, 2009 and 2008, \$206,000 and \$182,000, respectively, of interest was capitalized related to the acquisition of land in Oklahoma City, Oklahoma.

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

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

In accordance with GAAP, the Company records impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Depreciation and amortization expense includes charges for unamortized capitalized costs related to unscheduled tenant move-outs totaling \$124,000 and \$951,000 for the years ended December 31, 2009 and 2008, respectively.

Pre-Development Costs

The pre-development stage of a project involves certain costs to ascertain the viability of a potential project and to secure the necessary land. Direct costs to acquire the assets are capitalized once the acquisition becomes probable. These costs are carried in Other Assets until conditions are met that indicate that development is forthcoming, at which point the costs are reclassified to Construction in Progress. In the event a development is no longer deemed probable, the costs previously capitalized are expensed when the project is abandoned. At December 31, 2009, pre-development costs classified as Other Assets and Construction in Progress were \$700,000 and \$3.5 million, respectively. At December 31, 2008, pre-development costs classified as Other Assets and Construction in Progress were \$687,000 and \$2.8 million, respectively.

Cash Equivalents

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

Restricted Cash

Restricted Cash consists of amounts deposited (i) in accounts with the Company's primary lenders in connection with certain loans (see Note 10), (ii) in escrow accounts for infrastructure requirements related to land sales in Huntley and future infrastructure expenses and interest payments related to Huntley and (iii) 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, 2009 and 2008, the escrow accounts related to the Company's primary lenders included approximately \$916,000 and \$993,000 in capital improvement and tenant allowance reserves, respectively, \$230,000 and \$735,000 in real estate tax and insurance escrows, respectively, and approximately \$1.9 million for cash collateral accounts at both dates. At December 31, 2009 and 2008, the Huntley infrastructure and expense escrow accounts totaled \$63,000 and \$64,000, respectively. The TIF Bond Collateral Account had a balance of approximately \$4.0 million at December 31, 2008.

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Marketable Securities

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

Tenant Accounts Receivable

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

At December 31, 2009 and 2008, total tenant accounts receivable include balances greater than 90 days totaling \$246,000 and \$678,000, respectively, and are reflected net of reserves of \$112,000 and \$626,000, respectively. The provision/(credit) for doubtful accounts was \$(58,000) and \$354,000 for the years ended December 31, 2009 and 2008, respectively. This charge is included in the line item entitled "Other Operating" in the consolidated statements of operations.

Discontinued Operations

In accordance with GAAP, assets held for sale are valued at the lower of carrying value or fair value less costs to dispose. GAAP requires that the results of operations and gain/(loss) on real estate properties sold or held for sale be reflected in the consolidated statements of operations as "Income/(Loss) from Discontinued Operations" for all periods presented. As of December 31, 2008, the carrying value of the shopping center located in Holland, Michigan, which was sold on July 20, 2009, is included in real estate held for sale on the consolidated balance sheet. Results of operations from the shopping center located in Holland, Michigan are included in the discontinued operations line items on the consolidated statements of operations. GAAP also requires that prior period financial statements presented are 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, as well as allocated purchase price related to above market lease values, and are amortized on the straight-line method over the initial lease term or renewal period. Deferred financing costs are amortized as interest expense over the life of the related debt.

Fair Value of Financial Instruments

The Company's financial instruments consist of cash and cash equivalents, restricted cash, tenant and other receivables, notes payable, accounts payable and accrued expenses. Management believes that the carrying value of the Company's financial instruments approximate their respective fair market values at December 31, 2009 and 2008.

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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 \$602,000 and \$313,000 as of December 31, 2009 and 2008, respectively, which is expected to be collected over the remaining lives of the leases. Rents which represent basic occupancy costs, including fixed amounts and amounts computed as a function of sales, are classified as base rent. Amounts which may become payable in addition to base rent and which are computed as a function of sales in excess of certain thresholds are classified as percentage rents and are accrued after the reported tenant sales exceed the applicable thresholds. Expense recoveries based on common area maintenance expenses and certain other expenses are accrued in the period in which the related expense is incurred.

Other Revenue

Other Revenue consists primarily of income from management 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.

As of December 31, 2009 and 2008 and for the years then ended, the Company did not have a net liability for any unrecognized tax benefits. The Company recognizes interest and penalties, if any, related to unrecognized tax benefits as interest or general and administrative expense in the statement of operations. During 2009 and 2008, the Company did not incur any interest or penalties. The Company is not subject to examination by U.S. federal tax authorities for tax years before 2006.

Recent Financial Accounting Standards

The Company adopted the provisions of FASB Accounting Standards Codification (“ASC”) 820, “Fair Value Measurements and Disclosures” for nonfinancial assets and liabilities effective January 1, 2009. ASC 820 establishes a framework for measuring fair value and expands disclosure about fair value measurements in financial statements. The various inputs that may be used to determine the fair value of the Company’s assets are summarized in three broad levels:

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

At December 31, 2009 and 2008, the Company held marketable securities that total approximately \$11.4 million and \$10.2 million, respectively, and are considered to have Level 2 fair

HORIZON GROUP PROPERTIES, INC.

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value inputs. The Company did not hold any Level 3 assets during the years ended December 31, 2009 and 2008.

The Company adopted a section of ASC 810 “Consolidation” requiring noncontrolling interests (previously referred to as minority interests) to be treated as a separate component of equity, not as a liability or other item outside of permanent equity. In addition, this section applies to the accounting for noncontrolling interests and transactions with noncontrolling interest holders in consolidated financial statements. This section of ASC 810 is effective for periods beginning on or after December 15, 2008. The Company adopted this section of ASC 810 effective January 1, 2009 and has applied it retrospectively, for all periods presented.

In 2009, the Company adopted ASC 855 “Subsequent Events”. ASC 855 provides guidance for disclosing events that occur after the balance sheet date, but before the financial statements are issued or available to be issued. The adoption of ASC 855 did not have an impact on the Company’s consolidated financial statements. The Company has evaluated subsequent events through June 15, 2010, the date the consolidated financial statements were available to be issued, and determined that there have been no significant events that have occurred through that date that have not been reflected in the consolidated financial statements and/or disclosed on the notes to the consolidated financial statements.

ASC 810 also contains guidance modifying how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. These provisions of ASC 810 clarify that the determination of whether a company is required to consolidate an entity is based on, among other things, an entity’s purpose and design and a company’s ability to direct the activities of the entity that most significantly impact the entity’s performance. These provisions of ASC 810 require an ongoing reassessment of whether a company is the primary beneficiary of a variable interest entity (“VIE”), and also require additional disclosures about a company’s involvement in VIEs, including any significant changes in risk exposure due to that involvement. These provisions of ASC 810 are effective for fiscal years beginning after November 15, 2009 and the Company is currently evaluating the effect these provisions of ASC 810 will have on the 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.

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Note 3 - Investment in Real Estate

The following table contains information on the operating properties and land held for investment owned by the Company and for which the Company consolidates the results of operations and the assets and liabilities as of December 31, 2009.

<u>Property Name</u>	<u>Location</u>	<u>Property Type</u>	<u>Gross Leasable Area (Sq. Ft.)</u>	<u>Net Carrying Value</u>	<u>Ownership Percentage</u>
The Outlet Shoppes at Burlington	Burlington, WA	Outlet Retail	174,260	\$ 11,244,000	77.5%
El Portal Center	Laredo, TX	Retail	345,106	11,327,000	38.0%
The Outlet Shoppes at Fremont	Fremont, IN	Outlet Retail	228,925	11,850,000	77.5%
The Outlet Shoppes at Gettysburg	Gettysburg, PA	Outlet Retail/ Adjacent Land	249,927	54,669,000	77.5%
The Outlet Shoppes at Oshkosh	Oshkosh, WI	Outlet Retail	270,512	29,025,000	77.5%
Village Green Shopping Center	Huntley, IL	Retail	22,204	2,899,000	100.0%
5000 Hakes Drive	Norton Shores, MI	Office	28,863	1,768,000	51.1%
Corporate Assets	Norton Shores, MI	Miscellaneous	<u>-</u>	<u>70,000</u>	100.0%
Total			<u>1,319,797</u>	<u>\$122,852,000</u>	
			<u>Acres</u>		
Land Held for Investment	Fruitport Township, MI	Land	46	\$ 769,000	100.0%
Land Held for Investment	Huntley, IL	Land	<u>408</u>	<u>19,526,000</u>	100.0%
Total			<u>454</u>	<u>\$ 20,295,000</u>	

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

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

reported on the Company's consolidated balance sheets as Noncontrolling Interests in Consolidated Subsidiaries.

The Holland Town Center located in Holland, Michigan was classified as held for sale as of December 31, 2008 and was sold on July 20, 2009 (see Notes 2 and 13).

In December 2009, the Company sold noncontrolling interests in the entities that own five of its outlet centers to Bright Horizons of South Florida, LLC ("Bright Horizons"). The centers subject to the transaction are located in Burlington, Washington; El Paso, Texas; Fremont, Indiana; Gettysburg, Pennsylvania and Oshkosh, Wisconsin. Bright Horizons acquired a 22.5% interest in the entities that own the outlet centers (excluding the entity that owns the center in El Paso, in which it acquired a 19.6% preferred interest and a 17.8% common interest). The total price for the acquired ownership interests was \$1.35 million. No gain or loss was recognized on this transaction. See the Consolidated Statements of Stockholders' Equity for the effect of this transaction on the equity accounts of the Company. In May 2010, Bright Horizons acquired an additional 26.5% interest in the entities that own the outlet centers (excluding the entity that owns the center in El Paso, in which it acquired an additional 23.6% preferred interest and an additional 21.8% common interest) for additional consideration of \$1.35 million (see Notes 13 and 15). Bright Horizons is controlled by Somerset Outlet Center, L.P., of which Howard Amster, a director and significant stockholder of the Company ("Howard Amster") owns a controlling interest and Gary Skoien, Chairman, President and CEO of the Company ("Gary Skoien") owns a non-controlling interest.

Pre-Development Projects

On July 8, 2008, the Company formed Winding Brook Center, LLC, a joint venture for the development of an outlet center in Richmond, VA. The Company's partner will contribute land and the Company will contribute cash in an amount equal to the land value, when and as needed for the construction of the center. At December 31, 2009 and 2008, the Company had incurred predevelopment costs of \$700,000 and \$685,000, respectively, for the project which are classified in Other Assets on the consolidated balance sheet (See Note 2) and at December 31, 2009 had outstanding commitments for capital expenditures on leases signed (which amounts become payable when the spaces are delivered to the tenants) in the amount of \$1.95 million.

On November 18, 2008, the Company entered into a Preformation Agreement with Cousins Properties, Inc. ("Cousins") for the development of the Outlet Shoppes at Oklahoma City, a planned 341,000 square foot outlet shopping center in Oklahoma City, Oklahoma. The center is planned for the intersection of Interstate 40 and Council Road. Construction is scheduled to begin in the first half of 2010. The Company currently has an option on the land which expires on July 31, 2010. The Company is overseeing the development, management and leasing of the project. At December 31, 2009 and 2008, the Company had incurred pre-development costs of \$2.8 million and \$2.7 million, respectively, for this project, which are classified as Construction Progress on the consolidated balance sheet (See Note 2) and at December 31, 2009 had outstanding commitments for capital expenditures on leases signed (which amounts become payable when the spaces are delivered to the tenants) in the amount of \$8.1 million. The Company will receive reimbursement for pre-development costs in excess of \$2.0 million together with substantial leasing and development fees if and when the joint venture is formed.

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Note 4- Investment in Joint Ventures

El Portal Entities

As of December 31, 2009 and 2008, the Company owned a 60.8% interest in Horizon El Portal LLC, an entity of which HGP LP is the managing member and of which the remaining 39.2% is owned by Gary Skoien and Pleasant Lake Apts. Limited Partnership (“PLA”), an affiliate of Howard Amster. Horizon El Portal owns 62.5% of El Portal Center LLC (“El Portal Center”), a joint venture that owns a shopping center in Laredo, Texas containing approximately 345,000 square feet of GLA (See Note 3). Through the third quarter of 2008, Horizon El Portal reported the results of operations and the assets and liabilities of El Portal Center using the equity method of accounting.

On September 26, 2008, Horizon El Portal purchased a 12.5% interest in El Portal Center from its joint venture partner for \$375,000. HGP LP made a capital contribution to Horizon El Portal to acquire the interest and increased its ownership in that entity to 60.8%. The Company also acquired an option to purchase the remaining 37.5% interest in El Portal Center for \$2.1 million from the joint venture partner at any time prior to September 26, 2010. Horizon El Portal acts as a sole manager of El Portal Center with full authority with respect to the activities of the venture, excluding the authority to amend the operating agreement and enter into agreements with affiliates of the Company. Horizon El Portal has the obligation to advance, as loans to El Portal Center bearing interest at a rate of 15.0%, all reasonably necessary funds. The Company has agreed to fund 75.5% of such amounts. In the event that the Company does not exercise the purchase option, the property will be marketed for sale and each joint venture partner will have the obligation to fund its proportionate share of any required funds, also as loans to El Portal Center bearing interest at a rate of 15.0%.

The Company began consolidating the results of operations and the assets and liabilities of El Portal Center in the fourth quarter of 2008. The Company consolidates the results of operations and the assets and liabilities of Horizon El Portal. Summary financial information (stated at 100%) of the El Portal Center joint venture for the nine months ended September 30, 2008 are as follows (in thousands):

	Nine Months Ended September 30, 2008
Statements of Operations	
Revenue	<u>\$ 375</u>
Operating expenses	567
Depreciation and amortization expense	54
General and administrative expenses	24
Interest expense	<u>466</u>
Total expenses	<u>1,111</u>
Net loss	<u>\$ (736)</u>

The shopping center owned by El Portal Center secures a loan from Cathay Bank which had a principal balance of \$6.2 million and \$6.7 million at December 31, 2009 and 2008, respectively, bears interest at Prime plus 1.0% (with a minimum rate of 7.5%) and matures on March 1, 2010. HGPI has guaranteed 50% of the principal and interest due on the loan from Cathay Bank. Subsequent to year end,

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the Company exercised its option to extend the maturity of the loan to September 1, 2010. This extension required a \$250,000 principal repayment to be paid in five monthly installments of \$50,000 beginning April 2010. The Company will engage in negotiations with Cathay Bank with respect to a further extension of the loan beyond September 1, 2010.

The Company received management fees pursuant to a management agreement that totaled \$11,000 during the nine months ended September 30, 2008, while El Portal Center was accounted for using the equity method.

El Paso Entities

As of December 31, 2009 and 2008, the Company owned 68.6% and 88.2%, respectively, of the preferred interests and 63.0% and 80.7%, respectively, of the common interests in Horizon El Paso LLC ("Horizon El Paso"), which owns 50% of El Paso Outlet Center Holding, LLC, (together with its subsidiaries, "El Paso Center"), a joint venture that developed an outlet shopping center in El Paso, Texas, which opened on October 11, 2007 containing approximately 380,000 square feet of GLA and owns several outparcels adjacent to the shopping center. Horizon El Paso also owns a 50% interest in TOSEP Land Company, LLC ("TOSEP"), an entity that owns approximately 45 acres of undeveloped land adjacent to the outlet center. An affiliate of Howard Amster directly owns 5.9% of the preferred and common interests and Gary Skoien directly owns 5.9% of the preferred interests and 7.2% of the common interests of Horizon El Paso. As of December 31, 2009, Bright Horizons owns 19.6% of the preferred interests and 17.8% of the common interests of Horizon El Paso (see Note 12). Bright Horizons purchased an additional 23.6% of the preferred interests and 21.8% of the common interests in Horizon El Paso in May 2010 (see Note 15). The Company maintains control over Horizon El Paso with a 50.1% voting unit ownership position after the May 2010 transaction. The Company consolidates the results of operations and the assets and liabilities of Horizon El Paso. The Company uses the equity method to account for its investment in El Paso Center and TOSEP.

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Summary financial information (stated at 100%) of El Paso Center and TOSEP as of December 31, 2009 and 2008 and for the years ended December 31, 2009 and 2008 are as follows (in thousands):

	<u>As of</u> <u>December 31, 2009</u>	<u>As of</u> <u>December 31, 2008</u>
Assets		
Real estate - net	\$55,111	\$58,241
Cash and cash equivalents	1,007	3,022
Restricted cash	5,177	3,970
Other assets	<u>4,622</u>	<u>5,513</u>
Total assets	<u>\$65,917</u>	<u>\$70,746</u>
Liabilities and members' deficit		
Mortgages and other debt	\$78,204	\$78,882
Other liabilities	2,992	3,362
Members' deficit	<u>(15,279)</u>	<u>(11,498)</u>
Total liabilities and members' deficit	<u>\$65,917</u>	<u>\$70,746</u>
	<u>Year Ended</u> <u>December 31, 2009</u>	<u>Year Ended</u> <u>December 31, 2008</u>
Statements of Operations		
Revenue	<u>\$12,775</u>	<u>\$12,764</u>
Operating expenses	3,296	4,188
Depreciation and amortization expense	4,337	2,791
General and administrative expenses	1,239	859
Interest expense	<u>6,741</u>	<u>6,667</u>
Total expenses	<u>15,613</u>	<u>14,505</u>
Gain on sale of real estate	<u>415</u>	<u>320</u>
Net loss	<u>\$(2,423)</u>	<u>\$(1,421)</u>

The shopping center owned by El Paso Center secures a loan originated by NATIXIS Commercial Mortgage Funding, LLC which had a principal balance of \$68.7 million and \$69.4 million at December 31, 2009 and 2008, respectively, bears interest at 7.06%, requires principal payments over a 30-year amortization schedule and is due December 5, 2017. In November 2007, Dominion Capital Asset Company A, LLC made a preferred equity investment in El Paso Center in the amount of \$9.5 million, bearing interest at 15.0% and due October 27, 2010. In the event of a default, the preferred equity partner has an option to purchase the ownership interest of for an amount equal to 10% of the amount that the Company would receive if the property were sold at its fair market value. The Company is currently in negotiations with the holder of the preferred equity interest with respect to an extension of the maturity date of the preferred equity. The preferred equity investment is classified as debt on the balance sheet of El Paso Center.

The Company received management and similar fees from El Paso Center that totaled \$1.1 million and \$932,000 during the years ended December 31, 2009 and 2008, respectively. In May 2009, the Company and its partner in El Paso Center reached an agreement which clarified the reimbursement to

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

the Company for administrative fees and certain corporate expenses and resulted in a reduction of operating expenses for El Paso Center.

There was no significant operating activity for TOSEP for the years ended December 31, 2009 and 2008.

Distributions in excess of the Company's net investments in entities accounted for using the equity method are recognized as income if the Company is not obligated to make future contributions to those entities or budgeted capital contributions that would require the return of such excess distributions. Such distributions are included in Income from Investment in Joint Ventures on the consolidated statements of operations. The Company recognized income from distributions in excess of equity investments of \$679,000 and \$2.1 million for the years ended December 31, 2009 and 2008, respectively, related to El Paso Center.

In September 2008, El Paso Center sold an outparcel, comprised of approximately one acre of unimproved land, for \$600,000. A gain of approximately \$320,000 was recognized on the transaction. In June 2009, El Paso Center sold an outparcel, comprised of approximately one acre of unimproved land, for \$725,000. A gain of approximately \$415,000 was recognized on the transaction.

Note 5 – Income Taxes

HGPI is taxable as a corporation under the provisions of Subchapter C of the Internal Revenue Code. The net provision for income taxes after the change in the valuation reserve for the years ended December 31, 2009 and 2008 consisted of the following (in thousands):

	<u>2009</u>	<u>2008</u>
Federal	\$ -	\$ -
State	<u>-</u>	<u>-</u>
Net provision (benefit)	<u>\$ -</u>	<u>\$ -</u>

For federal income tax purposes, HGPI had net operating loss carryforwards ("NOLs") of approximately \$62.5 million and \$55.9 million at December 31, 2009 and 2008, respectively, and accumulated capital loss carryforwards of approximately \$4.3 million and \$1.5 million at December 31, 2009 and 2008, respectively. The NOLs expire from 2019 to 2028 and the accumulated capital loss carryforward expires in 2013.

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Deferred income tax liabilities and assets are determined based on the differences between the financial statement and tax basis of assets and liabilities. The components of the Company's gross deferred tax assets and liabilities are as follows as of December 31, 2009 and 2008 (in thousands):

	<u>2009</u>	<u>2008</u>
Deferred Tax Assets:		
NOL carryforwards - federal and state	\$23,689	\$21,165
Capital loss carryforward	1,496	529
Tax basis of assets in excess of book basis:		
Fixed/intangible assets	2,247	1,479
Impairment	-	242
Other	129	129
Book basis of liabilities in excess of tax basis:		
Prepaid rental revenue	207	217
Profits interests	<u>264</u>	<u>555</u>
Gross deferred tax assets	28,032	24,316
Less: valuation allowance	<u>(26,285)</u>	<u>(23,134)</u>
	<u>1,747</u>	<u>1,182</u>
Deferred Tax Liabilities:		
Book basis of assets in excess of tax basis:		
Fixed/intangible assets	(704)	(142)
Other	<u>(1,043)</u>	<u>(1,040)</u>
Gross deferred tax liabilities	<u>(1,747)</u>	<u>(1,182)</u>
Net deferred tax asset	<u>\$ -</u>	<u>\$ -</u>

The valuation allowance related to the net deferred tax asset increased by \$3.2 million and decreased by \$13.1 million for the years ended December 31, 2009 and 2008, respectively.

Note 6 – 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):

2010	\$9,977
2011	5,999
2012	4,590
2013	3,885
2014	2,948
Thereafter	<u>14,859</u>
	<u>\$42,258</u>

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

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

The Company has adopted the HGP 1998 Long Term Stock Incentive Plan (the “HGP Stock Plan”) to advance the interests of the Company by encouraging and enabling the acquisition of a financial interest in the Company by key employees and directors of the Company and its subsidiaries through equity awards. The Company reserved 338,900 common shares for issuance pursuant to the HGP Stock Plan and options covering 140,500 shares were outstanding at December 31, 2009.

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

The HGP Stock Plan provided for the issuance of shares over the ten-year period ended June 15, 2008. Accordingly, as of December 31, 2009, no additional equity awards may be made pursuant to the HGP Stock Plan.

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

	For the year ended December 31, 2009		For the year ended December 31, 2008	
	<u>Shares</u>	<u>Price</u>	<u>Shares</u>	<u>Price</u>
Outstanding, beginning of the year	170,500	\$3.40 - \$5.04	323,500	\$3.40 - \$6.49
Granted	-	-	-	-
Exercised	-	-	-	-
Expired	<u>(30,000)</u>	\$5.00	<u>(153,000)</u>	\$6.49
Outstanding, end of the year	<u>140,500</u>	\$3.40 - \$5.04	<u>170,500</u>	\$3.40 - \$5.04

The weighted average exercise price for options outstanding was \$3.65 and \$3.89 at December 31, 2009 and 2008, respectively. The weighted average contractual life of options outstanding at December 31, 2009 and 2008 was 1.02 years and 1.74 years, respectively. At December 31, 2009 and 2008 there were 140,500 and 170,500 options vested and exercisable, respectively.

The Company granted 20,307 and 48,769 shares of stock in HGPI to key employees in 2009 and 2008, respectively, and recognized compensation expense based on the fair market value of the stock granted. Total compensation expense recognized related to these awards equaled \$29,000 and \$292,000 in 2009 and 2008, respectively.

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Note 8 – Marketable Securities

The estimated fair values of securities held by the Company at December 31, 2009 and 2008 based on quoted market prices are as follows (in thousands):

	<u>Face Value</u>	<u>Cost</u>	<u>Fair Market Value</u>
December 31, 2009:			
Equity Security -			
1,000 Shares Wells Fargo Company stock	n/a	\$ 25	\$ 27
Debt Securities:			
FHLM Notes, ranging from 4.0% to 5.5%, maturing from June 2020 to April 2038	\$ 1,598	1,052	1,055
FNMA Notes, ranging from 4.0% to 5.5%, maturing from August 2019 to December 2037	18,224	8,184	8,069
GNMA Notes, ranging from 3.75% to 4.0%, maturing from April 2033 to December 2034	<u>27,391</u>	<u>2,222</u>	<u>2,241</u>
	<u>\$47,213</u>	<u>\$11,483</u>	<u>\$11,392</u>
December 31, 2008:			
Debt Securities:			
FNMA Note, 6.0%, maturing November 2036	\$ 9,600	\$ 7,519	\$ 7,568
FNMA Note, 6.0%, maturing November 2036	<u>3,200</u>	<u>2,581</u>	<u>2,606</u>
	<u>\$12,800</u>	<u>\$10,100</u>	<u>\$10,174</u>

These securities serve as collateral on margin accounts and under repurchase agreements as disclosed in Note 10.

Note 9 – Commitments

The Company has outstanding commitments for capital expenditures on leases signed (which amounts become payable when the spaces are delivered to the tenants) at December 31, 2009 in the amount of \$10.2 million for tenant allowances, which are not reflected on the consolidated balance sheet as of December 31, 2009. These amounts include the commitments for the pre-development projects (See Note 3). These capital expenditures are expected to be paid during 2010 and 2011 and are anticipated to be funded from capital improvement escrows, construction financing, equity contributions and additional borrowings.

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 10 – Mortgages and Other Debt

	Principal Balance as of:	
	<u>December 31,</u>	<u>December 31,</u>
	<u>2009</u>	<u>2008</u>
	<i>(in thousands)</i>	
Mortgage loan to 5000 Hakes Drive LLC, as borrower, from UBS, as lender, dated as of August 19, 2003, in the original principal amount of \$2.25 million, bearing interest at 6.89%, due September 11, 2013, secured by the corporate office building in Muskegon, Michigan and indemnified against certain losses by Gary Skoien (See below)	\$2,089	\$2,119
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	615	744
Mortgage loan to Village Green Associates, LLC, as borrower, from MB Financial, as lender, dated as of November 17, 2005, in the original principal amount of \$2.9 million, bearing interest at 7.875%, due May 15, 2010, secured by the shopping center in Huntley, Illinois and guaranteed by the Company (See below)	2,763	2,806
Margin account between Magnolia Bluff Factory Shops LP, as borrower, and Ramat Securities Ltd, as lender (see Notes 8 and 12), bearing interest at a rate of 1.14% at December 31, 2009 (the “Ramat Margin Account”); and a repurchase agreement between Magnolia Bluff Factory Shops LP, as borrower, and Wachovia Securities, LLC, as lender, dated December 18, 2008, in the original principal amount of \$7.1 million, bearing interest at a rate of 1.82%, due on January 6, 2009 and secured by a pledge of FNMA Notes having a face value of \$9.6 million as of December 31, 2008, and a repurchase agreement dated December 18, 2008, in the original principal amount of \$2.4 million, bearing interest at a rate of 1.82%, due on January 6, 2009 and secured by a pledge of FNMA Notes having a face value of \$3.2 million as of December 31, 2008. This debt is guaranteed by HGP LP, Amster and Gary Skoien.	10,140	9,472
Mortgage loan to HGP LP, as substituted 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 1, 2009 and secured by approximately 46 acres of vacant land in Fruitport Township, Michigan. Initial loan funding of \$3.8 million with \$1.3 million available to be drawn to pay interest on the loan. This loan was repaid in 2009.	-	250

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Mortgage loan to HGP LP, as borrower, from Somerset Outlet Center, L.P., as lender, dated as of September 28, 2009, in the original principal amount of \$300,000, bearing interest at 5.0%, due December 1, 2013 and secured by approximately 46 acres of vacant land in Fruitport Township, Michigan and a 50% interest in the net profits from the sale of the land over certain thresholds. Loan is interest only, with principal due upon the earlier of the sale of the property or maturity (See Note 12 and below).	300	-
Mortgage loan to Gettysburg Outlet Center, LP, as assuming borrower, from Column Financial, Inc., as lender, in the original principal amount of \$43.75 million, bearing interest at 5.87%, due February 11, 2016, secured by The Outlet Shoppes at Gettysburg and subject to certain debt service coverage ratios	42,119	42,698
Mezzanine loan to Gettysburg Outlet Center Holding, LLC, as borrower, from CW Capital LLC, as lender, in the original principal amount of \$6.0 million, bearing interest at an initial rate of LIBOR (LIBOR was 0.23% and 1.08% as of December 31, 2009 and 2008, respectively) plus 4.5%, increasing to LIBOR plus 9.5% upon the fourth anniversary of the loan (July 2011), due February 11, 2016, secured by pledges of the ownership interests in Gettysburg Outlet Center GP, Inc. and Gettysburg Outlet Center, LP, and a first mortgage on approximately 37 acres of vacant land. The loan is recourse to the Company which has also guaranteed the payment of interest on the loan and \$2.8 million of the loan principal and is subject to certain debt coverage ratios. By the fourth anniversary of the loan, a deposit of \$2.8 million is required as collateral for such guaranty.	6,000	6,000
Mortgage loan to BFO Factory Shoppes LLC, as assuming borrower, from Wachovia Bank, National Association, as lender, in the original principal amount of \$54.0 million, bearing interest at 5.58%, due January 11, 2016 and secured by The Outlet Shoppes at Burlington, The Outlet Shoppes at Fremont, and The Outlet Shoppes at Oshkosh	51,131	51,925
Mortgage loan to Huntley Development Limited Partnership, as borrower, from US Bank, as lender, in the maximum principal amount of \$23.4 million, bearing interest at LIBOR plus 4.5% with a floor of 5.5%, due September 30, 2010, secured by approximately 404 acres of vacant land in Huntley, Illinois and guaranteed by the Company (See below)	21,606	22,219
Loan to HGP LP, as borrower, from Prime Retail, L.P., as lender, dated August 15, 2007, in the original principal amount of \$928,000, bearing interest at 12.0%, due October 1, 2009 and guaranteed by HGPI. This loan was repaid in 2009.	-	334

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Mortgage loan to El Portal Center LLC, as borrower, from Cathay Bank, as lender, in the original principal amount of \$6.7 million, bearing interest at Prime plus 1.0% with a 7.5% floor, due September 1, 2010, secured by El Portal Center and guaranteed to 50% of principal and interest due by HGPI (See Note 4 and below)	6,200	6,700
Capital lease agreement between BFO Factory Shoppes LLC and Banner Bank, dated as of October 29, 2009, bearing interest at 9.0%, due November 1, 2014, secured by an LED sign at The Outlet Shoppes at Oshkosh and guaranteed by HGPI and HGPLP.	<u>63</u>	<u>-</u>
	<u>\$143,026</u>	<u>\$145,267</u>

In 2009 and 2008, the Company held a portfolio of marketable securities (as defined in Note 2 and listed in Note 8) with the proceeds from repurchase agreements, margin accounts and partner contributions. The margin account and repurchase agreements are included in Mortgages and Other Debt on the consolidated balance sheets.

In July 2008, the Company sold approximately 53 acres of unimproved land in Muskegon, Michigan for \$4.0 million. The net proceeds of approximately \$3.7 million were used to pay down the principal balance of the mortgage loan from First Bank of Beverly Hills. A gain of approximately \$2.9 million before noncontrolling interests was recognized on the transaction.

In December 2008, the Company amended the note and other loan documents related to the US Bank Loan to provide for the current payment of interest starting with the payment due February 1, 2009. The interest had previously been paid from an interest reserve established at the closing of the loan. The amendment also reduced the net worth covenant contained in the guaranty executed by the Company to \$20.0 million. The Company also granted US Bank a mortgage on the outlet center in Holland, Michigan, 48.9% of which is owned by an affiliate of Howard Amster, and agreed to apply 51.1% of any sales proceeds from the Holland property as repayment of the US Bank Loan. The amendment also revised the option to extend the maturity of the loan to September 30, 2010 to provide that the required \$10.0 million principal paydown due on or before September 30, 2009 will be reduced by any interest payments made by the Company and any proceeds from the sale of the Holland property. The Company agreed to indemnify Amster's affiliate for losses arising from the sale of the Holland property, but only if the property is sold pursuant to a judicial foreclosure sale. The indemnification obligation is limited to the affiliate's ownership share in Holland multiplied by the difference, if any, between \$3.8 million and the net amount received from such sale.

At December 31, 2008, the outstanding principal balance of the US Bank Loan was \$22.2 million and the undisbursed loan proceeds were designated solely for the payment of interest due through February 1, 2009.

In June 2009, US Bank amended the terms of its loan to the Company. The maturity date of the loan was extended to September 30, 2010 without a principal paydown and the interest rate was increased to the 30-day LIBOR rate plus 4.5% with a floor of 5.5%. In connection with the Loan extension, the Company pledged as additional collateral 25 acres of vacant land in Huntley, Illinois and funded an interest reserve with \$900,000. A portion of the net proceeds from the Company's sale of its shopping center in Holland, Michigan in July 2009 (See Note 13) were used to fund an additional \$600,000 for the

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

interest reserve and a \$691,000 principal pay down on the loan. In April 2010, US Bank amended the loan to waive an additional six months of interest that were previously required to be added to the reserve and instead required the Company to begin the payment of interest out of pocket commencing with interest for April 2010. In June 2010, the Company secured a commitment from US Bank to extend the maturity of the loan to January 31, 2011. The commitment requires the Company to pledge its interest in the Huntley Series C TIF bonds (see below) to US Bank as additional collateral and make principal payments of \$10,000 each in August and September 2010 and \$20,000 per month beginning in October 2010.

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

In September 2009, the Company paid off a loan from First Bank of Beverly Hills ("FBBH") which had an outstanding balance of \$250,000 at December 31, 2008 and was secured by approximately 46 acres of land that the Company holds for investment purposes (the "FBBH Loan"). The FBBH Loan was repaid from the proceeds of a \$300,000 loan from Somerset Outlet Center, L.P. which is secured by the same 46 acres of land held for investment purposes (the "Somerset Loan"). The Somerset Loan matures on December 1, 2013, bears interest at a rate of 5.0% and gives the lender a 50% interest in the net profits from the sale of the land over certain thresholds. Howard Amster owns a controlling interest and Gary Skoien owns a non-controlling interest in Somerset Outlet Center, L.P.

The Company is currently negotiating with the servicer of the mortgage loan to 5000 Hakes Drive LLC with respect to modifying the terms of that loan. The Company has requested that a portion of the funds in the loan's releasing reserve be utilized to pay a portion of the monthly debt service starting with the payment due February 1, 2010. The Company has not yet reached an agreement with the servicer and has not paid its monthly debt service payment since January 2010.

MB Financial, the lender on the mortgage loan to Village Green Associates, LLC with a maturity date of May 15, 2010, has expressed an interest to further extend the maturity to February 15, 2011 pending receipt of a satisfactory updated appraisal of the property.

The Company has exercised its option to extend the maturity of the loan from Cathay Bank to El Portal Center, LLC to September 1, 2010. This extension required a \$250,000 principal repayment to be paid in five monthly installments of \$50,000 beginning April 2010. The Company will engage in negotiations with Cathay Bank with respect to a further extension of the loan beyond September 1, 2010.

Cash interest payments, including amounts paid on loans associated with properties classified as discontinued operations, for the years ended December 31, 2009 and 2008, totaled \$6.6 million and \$6.9 million, respectively. Interest advanced on loans and reserve accounts associated with loans totaled \$1.2 million and \$1.6 million for the years ended December 31, 2009 and 2008, respectively. The Company capitalized interest totaling \$206,000 and \$182,000 for the years ended December 31, 2009 and 2008, respectively.

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Huntley Net Profits Interests and TIF Bonds

Gary J. Skoien was formerly the Executive Vice President and Chief Operating Officer of The Prime Group, Inc. (“Prime Group”). In connection with his employment with Prime Group, Mr. Skoien was previously granted an interest (the “Skoien Net Profits Interest”) in the net profits generated by Huntley Development Limited Partnership (“HDLP”), an entity which owns approximately 408 acres of land in a master planned community in Huntley, Illinois (the “Huntley Project”), which obligation the Company assumed in connection with the purchase of the Huntley Project from Prime Group. The Skoien Net Profits Interest consists of a 9.675% participation in the Net Cash Flow (as defined in Mr. Skoien’s Net Profits Agreement) distributed to the Company (excluding distributions of all amounts contributed or advanced by the Company to the Huntley Project plus interest per the terms of the agreement) from the Huntley Project. The Company has recorded a liability for the Skoien Net Profits Interest in the amount of \$1.1 million and \$2.3 million as of December 31, 2009 and 2008, respectively, which represents its estimated fair value as of such dates and which amount is included in Participation Interests and Other Liabilities on the Company’s consolidated balance sheets. The change in the estimated fair value of the Skoien Net Profits Interests is reflected as a reduction of interest expense in the amount of \$1.0 million and \$300,000 for the years ended December 31, 2009 and 2008, respectively. A payment of \$164,000 was made to Mr. Skoien in June 2009 on the Skoien Net Profits Interest.

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

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

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

The TIF District contains approximately 900 acres of land currently or previously owned by HDLP or Huntley Meadows Residential Venture. The source of repayment for the Series 2009 TIF Bonds and Series C TIF bonds is (a) 100% of the increase in real estate taxes on the land in the TIF

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

District above the taxes in place when the TIF District was created, (b) one-half of the Village's one percent (1%) sales tax collected on retail sales occurring within the TIF District and (c) reserves associated with the Series 2009 TIF Bonds. The repayment of the Series 2009 TIF Bonds is not an obligation of the Company and thus is not reflected on the Company's consolidated balance sheet as a liability.

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

Debt Maturities

Debt maturities and principal payments due subsequent to December 31, 2009 are as follows (in thousands):

<u>Due in:</u>	
2010	\$ 44,595
2011	6,111
2012	2,064
2013	2,469
2014	2,323
Thereafter	<u>85,464</u>
	<u>\$143,026</u>

The Company's ability to secure new loans is limited by the fact that most of the Company's real estate assets are currently pledged as collateral for its current loans. The Company will pay the scheduled principal amortization in the normal course of business during 2010 and is in the process of or anticipates refinancing or extending the maturities of the remainder of the \$44.6 million of obligations due in 2010.

Note 11- Stock Repurchases

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

On April 21, 2008, the Company purchased 65,860 shares of Horizon Group Properties, Inc. stock from a stockholder for \$4.55 per share. After acquisition, the shares were retired.

Note 12 - Related Party Transactions

At December 31, 2009 and 2008, an affiliate of Howard Amster owns approximately 44% of the entity that owns a portfolio of marketable securities and 49% of the entity that owns the office building in Norton Shores, Michigan. His affiliate also owns 31.3% of Horizon El Portal LLC and 5.9% of the preferred and common interests in Horizon El Paso, LLC. Included in Other Assets on the consolidated

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

balance sheets at December 31, 2009 and 2008 is an unsecured note receivable from Amster which has a balance of \$1.42 million and bears interest at 5.0%. Included in Tenant and Other Accounts Receivable, Net on the consolidated balance sheets are \$33,000 and \$404,000 at December 31, 2009 and 2008, respectively, due from Amster for the Company's pro rata share of the net assets of the entities sold to Amster in November 2006, June 2007 and October 2009.

At December 31, 2009 and 2008, Gary Skoien owns 7.8% of Horizon El Portal LLC, 5.3% of an entity that owns a portfolio of marketable securities and 5.9% of the preferred interests and 7.2% of the common interests in Horizon El Paso, LLC.

Common interests in Horizon El Paso (the "El Paso Net Profits Interests") were granted in May 2007 to certain officers of the Company, Gary Skoien, Thomas Rumpitz and Andrew Pelmoter, representing 1.3%, 2.6% and 3.5%, respectively, of the total common interests in Horizon El Paso, LLC. Holders of the El Paso Net Profits Interests are not entitled to any distributions until the holders of the preferred interests have received a return of their capital plus interest thereon calculated at an annual rate of 12%, compounded quarterly. The El Paso Net Profits Interests are accounted for as a profit sharing arrangement with compensation expense being recognized for payments related to such interests. The Company recognized compensation expense for the El Paso Net Profits Interests of \$33,000 during the year ended December 31, 2009. There was no similar expense for 2008.

Certain loans of the Company require an officer of the Company to be personally liable for losses suffered by the lender for environmental damages and certain actions prohibited under the loan documents. Gary Skoien personally indemnified certain lenders for such losses and damages. The Company agreed to indemnify Gary Skoien for any amounts paid under the indemnifications and to pay Gary Skoien total annual fees of \$50,000 (\$44,475 for annual periods after August 19, 2008) related to such indemnifications until such loans are repaid (or Gary Skoien is otherwise released from the indemnification obligations).

The Company incurred interest expense on the Ramat Margin Account in the amount of \$11,000 for the year ended December 31, 2009. Ramat Securities Ltd is an affiliate of Howard Amster.

The Company incurred interest expense on the Somerset Loan (See Note 10) in the amount of \$5,000 for the year ended December 31, 2009. Howard Amster owns a controlling interest and Gary Skoien owns a non-controlling interest in the lender, Somerset Outlet Center, L.P.

In December 2009, the Company sold noncontrolling interests in the entities that own five of its outlet centers to Bright Horizons. The centers subject to the transaction are located in Burlington, Washington; El Paso, Texas; Fremont, Indiana; Gettysburg, Pennsylvania and Oshkosh, Wisconsin. Bright Horizons acquired a 22.5% interest in the entities that own the outlet centers (excluding the entity that owns the center in El Paso, in which it acquired a 19.6% preferred interest and a 17.8% common interest). In May 2010, Bright Horizons acquired an additional 26.5% interest in the entities that own the outlet centers (excluding the entity that owns the center in El Paso, in which it acquired an additional 23.6% preferred interest and an additional 21.8% common interest) for additional consideration of \$1.35 million. Bright Horizons is controlled by Somerset Outlet Center, L.P., of which Howard Amster owns a controlling interest and Gary Skoien owns a non-controlling interest.

The Company utilizes entities affiliated with a Director of the Company as its agent for insurance and risk management programs. The Company paid premiums totaling approximately \$562,000 and

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

\$462,000 during the years ended December 31, 2009 and 2008, respectively, on insurance policies placed by consolidated entities.

Note 13 – Recent Developments

In July 2008, the Company sold approximately 53 acres of unimproved land in Muskegon, Michigan for \$4.0 million. The net proceeds of approximately \$3.7 million were used to pay down the principal balance of the mortgage loan from First Bank of Beverly Hills. A gain of approximately \$2.9 million, before noncontrolling interests, was recognized on the transaction.

On September 26, 2008, Horizon El Portal purchased an additional 12.5% interest for \$375,000 in El Portal Center from its joint venture partner. HGP LP made a capital contribution to Horizon El Paso to acquire the interest and increased its ownership in that entity to 60.8%. The Company also acquired an option to purchase the remaining 37.5% interest in El Portal Center for \$2.1 million from the joint venture partner at any time prior to September 26, 2010. The Company began consolidating the results of operations and the assets and liabilities of El Portal Center in the fourth quarter of 2008.

In July 2009, the Company sold the 194,000 square foot shopping center located in Holland, Michigan. The gross sales price was \$2.8 million. The Company owned approximately 51% and an affiliate of Amster owned approximately 49% of the entity that owned the center. A loss of approximately \$138,000 was recognized on the transaction. The carrying value and results of operations for this center are classified as real estate held for sale at December 31, 2008, and loss from discontinued operations, for the years ended December 31, 2009 and 2008, on the Company's balance sheets and statements of operations, respectively.

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

In December 2009, the Company sold noncontrolling interests in the entities that own five of its outlet centers to Bright Horizons. The total price for the acquired ownership interests was \$1.35 million. No gain or loss was recognized on this transaction (See Notes 3 and 15).

Note 14 – Discontinued Operations

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

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

	<u>Year ended December 31, 2009</u>	<u>Year ended December 31, 2008</u>
Total revenue	<u>\$ 284</u>	<u>\$728</u>
Operating expenses	444	919
General and administrative expenses	10	5
Depreciation and amortization expense	<u>91</u>	<u>193</u>
Total expense	<u>545</u>	<u>1,117</u>
Loss on sale of real estate	<u>138</u>	<u>-</u>
Loss from discontinued operations	<u>\$(399)</u>	<u>\$(389)</u>
Loss from discontinued operations attributable to the noncontrolling interests	<u>\$(259)</u>	<u>\$(252)</u>
Loss from discontinued operations attributable to the Company	<u>\$(140)</u>	<u>\$(137)</u>

Note 15 – Subsequent Events

In January 2010, the Company formed a joint venture with a partner from the People's Republic of China that will lease, manage and provide development services with respect to the design, construction and operation of outlet shopping centers in mainland China. The Company's partner is an affiliate of a publicly traded real estate firm that is working on the development of eight outlet shopping centers in China.

In May 2010, the Company sold additional noncontrolling interests in the entities that own five of its outlet centers to Bright Horizons for \$1.35 million. No gain or loss will be recognized on this transaction (see Notes 3 and 13).

Note 16 – Business Operations

The consolidated financial statements have been prepared on a going concern basis, which contemplate continuation of the Company as a going concern. The Company has sustained operating losses and has increased its accumulated deficit. In addition, the Company has \$44.6 million of debt obligations coming due in 2010. The Company is aggressively pursuing financing solutions and new revenue sources and has obtained a commitment from US Bank with respect to extending its loan of \$21.6 million to January 2011.

In view of these matters, realization of a major portion of the Company's assets in the accompanying consolidated financial statements is dependent upon continuing operations of the Company which, in turn, is dependent upon the Company's ability to meet its financing requirements and the

HORIZON GROUP PROPERTIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

success of its future operations. The Company anticipates refinancing or extending the maturities of the obligations due in 2010. Management believes the operations of the Company and the support from its shareholders will continue to generate sufficient cash flow for its working capital and financing requirements. Management believes the actions presently being taken provides the opportunity for the Company to continue as a going concern

BOARD OF DIRECTORS**Howard M. Amster**

President
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Gov. Jim Edgar

Distinguished Fellow
University of Illinois Institute of
Government and Public Affairs

Margaret A. Gilliam

President
Gilliam & Co.

Gary J. Skoien

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

E. Thomas Thilman

Chairman
Willis of Illinois, Inc.

CORPORATE OFFICERS**Gary J. Skoien**

Chairman, President and
Chief Executive Officer

David R. Tinkham

Chief Financial Officer
and Secretary

Andrew F. Pelmoter

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

STOCK TRADING

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

