

Condensed Consolidated Financial Statements

Horizon Group Properties, Inc.

For the nine months ended September 30, 2008 and 2007

Horizon Group Properties, Inc.
Condensed Consolidated Financial Statements
(Unaudited)

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HORIZON GROUP PROPERTIES, INC.
Condensed Consolidated Balance Sheets
(unaudited)

| | September 30, 2008 | December 31, 2007 |
|---|-----------------------|-------------------|
| | <i>(In thousands)</i> | |
| ASSETS | | |
| Real estate – at cost: | | |
| Land | \$ 26,687 | \$ 26,619 |
| Buildings and improvements | 104,040 | 103,849 |
| Less accumulated depreciation | <u>(10,249)</u> | <u>(5,817)</u> |
| | 120,478 | 124,651 |
| Construction in progress | 3,112 | 1,093 |
| Land held for investment | <u>19,884</u> | <u>19,884</u> |
| Total net real estate | 143,474 | 145,628 |
| Investment in joint ventures | 4,648 | 3,490 |
| Cash and cash equivalents | 635 | 6,743 |
| Restricted cash | 7,909 | 8,104 |
| Marketable securities | 7,663 | 10,253 |
| Tenant and other accounts receivable, net | 2,362 | 3,971 |
| Deferred costs (net of accumulated amortization of \$1,298 and \$659, respectively) | 4,030 | 4,160 |
| Other assets | <u>5,327</u> | <u>4,336</u> |
| Total assets | <u>\$176,048</u> | <u>\$186,685</u> |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Liabilities: | | |
| Mortgages and other debt | \$136,272 | \$143,009 |
| Accounts payable and other accrued expenses | 5,203 | 6,302 |
| Prepaid rents and other tenant liabilities | 1,577 | 1,152 |
| Participation interests and other liabilities | <u>2,607</u> | <u>2,655</u> |
| Total liabilities | <u>145,659</u> | <u>153,118</u> |
| Minority interests | <u>11,878</u> | <u>12,625</u> |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Common shares (\$.01 par value, 50,000 shares authorized, 2,895 and 2,913 issued and outstanding, respectively) | 29 | 29 |
| Additional paid-in capital | 37,514 | 37,522 |
| Accumulated deficit | <u>(19,032)</u> | <u>(16,609)</u> |
| Total stockholders' equity | <u>18,511</u> | <u>20,942</u> |
| Total liabilities and stockholders' equity | <u>\$176,048</u> | <u>\$186,685</u> |

See accompanying notes to condensed consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.
Condensed Consolidated Statements of Operations
(unaudited)

| | Three months ended September 30, 2008 | Three months ended September 30, 2007 |
|--|--|--|
| <i>(In thousands)</i> | | |
| REVENUE | | |
| Base rent | \$3,265 | \$ 2,280 |
| Percentage rent | 41 | 8 |
| Expense recoveries | 872 | 718 |
| Other | 333 | 137 |
| Interest | <u>157</u> | <u>286</u> |
| Total revenue | <u>4,668</u> | <u>3,429</u> |
| EXPENSES | | |
| Property operating | 1,181 | 759 |
| Real estate taxes | 400 | 351 |
| Other operating | 30 | 47 |
| Depreciation and amortization | 1,814 | 1,432 |
| General and administrative | 1,069 | 1,301 |
| Interest | 2,100 | 2,372 |
| Gain on marketable securities | <u>(16)</u> | <u>(71)</u> |
| Total expenses | <u>6,578</u> | <u>6,191</u> |
| Income/(loss) from investment in joint ventures | <u>730</u> | <u>(152)</u> |
| Loss from continuing operations before minority interests, gain on sale of real estate and loss from discontinued operations | (1,180) | (2,914) |
| Minority interests | <u>322</u> | <u>1,118</u> |
| Loss from continuing operations | (858) | (1,796) |
| Gain on sale of real estate, net of minority interests | 1,963 | - |
| Loss from discontinued operations, net of minority interests | <u>-</u> | <u>(1)</u> |
| Net income/(loss) | <u>\$1,105</u> | <u>\$(1,797)</u> |

See accompanying notes to condensed consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.
Condensed Consolidated Statements of Operations
(unaudited)

| | Nine months ended September 30, 2008 | Nine months ended September 30, 2007 |
|--|---|---|
| <i>(In thousands)</i> | | |
| REVENUE | | |
| Base rent | \$ 9,669 | \$ 2,837 |
| Percentage rent | 87 | 14 |
| Expense recoveries | 2,617 | 919 |
| Other | 1,373 | 969 |
| Interest | <u>500</u> | <u>1,026</u> |
| Total revenue | <u>14,246</u> | <u>5,765</u> |
| EXPENSES | | |
| Property operating | 3,669 | 1,272 |
| Real estate taxes | 1,139 | 510 |
| Other operating | 821 | 190 |
| Depreciation and amortization | 5,814 | 1,659 |
| General and administrative | 3,770 | 4,323 |
| Interest | 6,505 | 4,239 |
| Loss on marketable securities | <u>28</u> | <u>234</u> |
| Total expenses | <u>21,746</u> | <u>12,427</u> |
| Income/(loss) from investment in joint ventures | <u>1,083</u> | <u>(446)</u> |
| Loss from continuing operations before minority interests, gain on sale of real estate and income from discontinued operations | (6,417) | (7,108) |
| Minority interests | <u>2,026</u> | <u>2,964</u> |
| Loss from continuing operations | (4,391) | (4,144) |
| Gain on sale of real estate, net of minority interests | 1,968 | - |
| Income from discontinued operations, net of minority interests | <u>-</u> | <u>461</u> |
| Net loss | <u><u>\$(2,423)</u></u> | <u><u>\$(3,683)</u></u> |

See accompanying notes to condensed consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.
Condensed Consolidated Statements of Cash Flows
(unaudited)

| | <u>Nine months ended</u> <u>September 30, 2008</u> | <u>Nine months ended</u> <u>September 30, 2007</u> |
|--|---|---|
| | <i>(In thousands)</i> | |
| Cash flows from operating activities: | | |
| Net loss | \$(2,423) | \$(3,683) |
| Net gain on sale of assets, including amounts in discontinued operations | (2,853) | (877) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Minority interests, including amounts in gain on sale of real estate and income from discontinued operations | (1,140) | (2,622) |
| (Income)/loss from investment in joint ventures | (1,083) | 446 |
| Depreciation | 5,753 | 1,655 |
| Amortization, including deferred financing costs | 609 | 395 |
| Loss on marketable securities | 28 | 234 |
| HGPI stock grants | 292 | 227 |
| Changes in assets and liabilities: | | |
| Restricted cash | 195 | (1,479) |
| Tenant and other accounts receivable | 1,609 | (1,714) |
| Deferred costs and other assets | (479) | (254) |
| Accounts payable and other accrued expenses | (1,136) | 358 |
| Prepaid rents and other tenant liabilities | <u>(1,421)</u> | <u>2,016</u> |
| Net cash used in operating activities | <u>(2,049)</u> | <u>(5,298)</u> |
| Cash flows from investing activities: | | |
| Net marketable securities activity | 2,562 | 8,576 |
| Investment in joint venture | (75) | (357) |
| Cash transferred in connection with sale of subsidiary | - | (822) |
| Deposits for acquisition of properties | - | (17,691) |
| Expenditures for buildings and improvements | (3,599) | (36,803) |
| Net proceeds from sale of real estate | <u>3,697</u> | <u>4,029</u> |
| Net cash provided by/(used in) investing activities | <u>2,585</u> | <u>(43,068)</u> |
| Cash flows from financing activities: | | |
| Net contributions from/(distributions to) minority interests | 393 | (3,564) |
| Principal payments on mortgages and other debt | (7,961) | (15,187) |
| Proceeds from borrowings | 1,224 | 64,729 |
| HGPI stock buy back and retirement | (300) | - |
| Debt issue costs | <u>-</u> | <u>(724)</u> |
| Net cash provided by/(used in) financing activities | <u>(6,644)</u> | <u>45,254</u> |
| Net decrease in cash and cash equivalents | (6,108) | (3,112) |
| Cash and cash equivalents: | | |
| Beginning of period | <u>6,743</u> | <u>6,534</u> |
| End of period | <u>\$ 635</u> | <u>\$ 3,422</u> |

See accompanying notes to condensed consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.
Condensed Consolidated Statements of Cash Flows, continued
(unaudited)

| | Nine Months Ended <u>September 30, 2008</u> | Nine Months Ended <u>September 30, 2007</u> |
|--|---|---|
|--|---|---|

Supplemental Information -

During the nine months ended September 30, 2008 and 2007, the Company sold the following assets:

| | | |
|---|----------------|---------------|
| Land | \$ - | \$ 243 |
| Buildings and improvements | - | 3,667 |
| Accumulated depreciation | - | (600) |
| Deferred costs | - | 12 |
| Other assets | 855 | 30 |
| Accounts payable and other accrued expenses | 292 | 286 |
| Prepaid rents and other liabilities | - | (53) |
| Minority interests | - | (106) |
| Net assets sold | <u>1,147</u> | <u>3,479</u> |
| Gross proceeds from sale of real estate | <u>4,000</u> | <u>4,356</u> |
| Gain on sale of real estate | <u>\$2,853</u> | <u>\$ 877</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 condensed consolidated statements of cash flows for the nine months ended September 30, 2008 and 2007:

| | | |
|---|----------------|----------------|
| Gross proceeds from sale of real estate | \$4,000 | \$4,356 |
| Accounts payable and other accrued expenses – closing costs | (303) | (321) |
| Prepaid rents and other tenant liabilities | - | (6) |
| Net proceeds from sale of real estate | <u>\$3,697</u> | <u>\$4,029</u> |

The following represents the supplemental disclosure of the sale of ownership interests in a subsidiary during the nine months ended September 30, 2007:

| | | |
|---|--|---------------|
| Cash and cash equivalents | | \$ 822 |
| Restricted cash | | 22 |
| Marketable securities | | 4,005 |
| Other assets | | 473 |
| Mortgages and other debt | | (3,892) |
| Accounts payable and other accrued expenses | | (11) |
| Minority interests | | (758) |
| Accounts receivable – net proceeds | | <u>\$ 661</u> |

The following represents the supplemental disclosure of noncash activity for the disposal of fully depreciated/amortized assets disposed of during the nine months ended September 30, 2008 and 2007:

| | | |
|----------------------------|--------------|--------------|
| Buildings and improvements | \$916 | \$133 |
| Deferred costs | <u>15</u> | <u>331</u> |
| | <u>\$931</u> | <u>\$464</u> |

See accompanying notes to condensed consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.
Condensed Notes to Consolidated Financial Statements
(unaudited)

Note 1 – Organization and Basis of Presentation

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 September 30, 2008, HGPI owned approximately 68.8% 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 accompanying unaudited condensed consolidated financial statements include the accounts of all majority-owned subsidiaries, and all significant inter-company amounts have been eliminated. Due to the seasonal nature of certain operational activities, among other factors, the results for the interim period ended September 30, 2008 are not necessarily indicative of the results that may be obtained for the full fiscal year.

These condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) and include selected information and disclosures for the interim periods. Accordingly, they do not include all of the disclosures required by GAAP for complete financial statements. In the opinion of management, all adjustments necessary for fair presentation (including normal recurring accruals) have been included. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes contained in our 2007 Annual Report.

The Company’s primary assets are its investments in subsidiary partnerships that own real estate. HGPI consolidates the results of operations and the balance sheets of those partnerships 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 partnerships which do not meet these criteria using the equity method.

The Company acquired the entity that owns an outlet shopping center located in Gettysburg, Pennsylvania on July 18, 2007. The center contains a total of approximately 252,000 square feet of gross leasable area (“GLA”), a 35,000 square foot movie theater and ground leases to the Carlson Country Inn and TGI Friday’s. The contract price was \$61.0 million, subject to customary prorations. The Company assumed existing debt secured by the property which had a principal balance of \$43.5 million as of the date of closing. The Company has also obtained a \$6.0 million mezzanine loan in connection with the acquisition. As of September 30, 2008, the principal balances of the debt were \$42.8 million and \$6.0 million, respectively.

On August 9, 2007, the Company acquired three outlet shopping centers located in Burlington, Washington; Fremont, Indiana; and Oshkosh, Wisconsin (the “BFO Centers”). The centers contain approximately 174,000, 229,000 and 271,000 square feet of GLA, respectively. The aggregate acquisition price was \$59.1 million, subject to customary prorations. The centers collectively secure debt which the Company assumed at closing. The principal balance of the debt was \$53.0 million as of the date of acquisition and \$52.1 million as of September 30, 2008.

The Company owns 88.2% of the preferred interests and 80.7% 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 and contains approximately 380,000 square feet of GLA. 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 (“Amster”), a director and significant stockholder of the Company owns 5.9% of the preferred and common interests and Gary Skoien (“Skoien”), Chairman, President and CEO of the Company owns 5.9% of the preferred interests and 7.2% of the common interests of Horizon El Paso. Horizon El Paso reported the results of operations and the assets and liabilities of El Paso Center using the equity

HORIZON GROUP PROPERTIES, INC.
Condensed Notes to Consolidated Financial Statements
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method of accounting through August 31, 2006. As a result of certain loans made to the joint venture partner by the Company, El Paso Center was judged to be a variable interest entity and Horizon El Paso was the primary beneficiary. Therefore the Company began to consolidate the results of operations and the assets and liabilities of El Paso Center effective September 1, 2006. The loans to the joint venture partner have been repaid and, effective December 1, 2007, the Company was no longer judged to be the primary beneficiary of El Paso Center. Accordingly, starting December 1, 2007, Horizon El Paso again began to use the equity method of accounting with respect to El Paso Center.

The Company owns the majority interest in Horizon El Portal, LLC (“Horizon El Portal”), which owns 50% (62.5% after September 26, 2008) of a joint venture (“El Portal Center”) that owns a shopping center in Laredo, Texas containing approximately 345,000 square feet of GLA. Horizon El Portal reports the results of operations and assets and liabilities of El Portal Center using the equity method of accounting. HGPI consolidates the results of operations and assets and liabilities of Horizon El Portal. On September 26, 2008, Horizon El Portal purchased a 12.5% interest in El Portal Center from its joint venture partner. HGP LP made a capital contribution to acquire the interest and increased its ownership in Horizon El Portal to 60.8%. The Company expects to consolidate the results of operations and the assets and liabilities of El Portal Center starting in the fourth quarter of 2008 (See Note 3).

The Company also owns 51% of an office building located in Norton Shores, Michigan, a portion of which it occupies, and a 194,000 square foot shopping center located in Holland, Michigan. The remaining 49% is owned by an affiliate of Amster. It also owns approximately 408 acres of land in a master planned community in Huntley, Illinois (the “Huntley Project”), which is held for investment purposes, approximately 100 acres of vacant land in Fruitport Township, Michigan and a 22,000 square foot shopping center located in Huntley, Illinois.

The portion of the net income or loss of HGPI’s subsidiaries owned by parties other than HGPI is reported as Minority Interests on the Company’s condensed consolidated statements of operations and such parties’ portion of the net equity in such subsidiaries is reported on the Company’s condensed consolidated balance sheets as Minority Interests. Distributions in excess of the Company’s net investments in entities accounted for using the equity method are recognized as income when the Company is not obligated to make additional contributions to those entities and are included in Income from Investment in Joint Ventures on the condensed consolidated statements of operations. For the nine months ended September 30, 2008, the Company recognized income from distributions in excess of equity investments of \$1,457,000.

Note 2 - Summary of Significant Accounting Policies

The condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States, which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities (including disclosure of contingent assets and liabilities) at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

In the opinion of management, all adjustments necessary for a fair statement of the financial position and results of operations for the interim periods presented have been included in these condensed consolidated financial statements and are of a normal and recurring nature.

Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and all subsidiaries that the Company controls, including HGP LP. The Company considers itself to control an entity if it is the majority owner of and has voting control over such entity. All significant intercompany balances and transactions have been eliminated in consolidation. In accordance with Financial Accounting Standards Board Interpretation No. 46R, “Consolidation of Variable Interest Entities,” the Company consolidates variable interest entities if it is that entity’s primary beneficiary.

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Reclassifications

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

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 September 30, 2008, pre-development costs classified as Other Assets and Construction in Progress were \$283,000 and \$1,877,000, respectively. At December 31, 2007, pre-development costs classified as Other Assets and Construction in Progress were \$159,000 and \$861,000, respectively.

Discontinued Operations

In accordance with Statement of Financial Accounting Standards, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"), assets held for sale are valued at the lower of carrying value or fair value less costs to dispose. SFAS 144 requires that the results of operations and gain/(loss) on real estate properties sold or held for sale be reflected in the consolidated statements of operations as "Income/(Loss) from Discontinued Operations" for all periods presented. As of September 30, 2008, no assets were classified as held for sale. Results of operations from the vacant land parcels in Michigan sold in January 2007 and the outlet center located in Gretna, Nebraska sold in June 2007 are included in the discontinued operations line items on the statements of operations.

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. 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.

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 September 30, 2008 and December 31, 2007, 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. For the periods ending September 30, 2008 and 2007, 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 2005.

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Recent Financial Accounting Standards

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, “Fair Value Measurements” (“SFAS 157”). SFAS 157 is definitional and disclosure oriented and addresses how companies should approach measuring fair value when required by GAAP; it does not create or modify any current GAAP requirements to apply fair value accounting. The Standard provides a single definition for fair value that is to be applied consistently for all accounting applications, and also generally describes and prioritizes according to reliability the methods and inputs used in valuations. SFAS 157 prescribes various disclosures about financial statement categories and amounts which are measured at fair value, if such disclosures are not already specified elsewhere in GAAP. The new measurement and disclosure requirements of SFAS 157 are effective January 1, 2008, except as it relates to certain nonfinancial assets and liabilities for which the effective date will be first quarter of 2009. At September 30, 2008, the Company holds marketable securities that total approximately \$7,663,000 and are considered to have Level 1 fair value inputs.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159 “The Fair Value Option for Financial Assets and Financial Liabilities” (“SFAS 159”). SFAS 159 allows entities to voluntarily choose, at specified election dates to measure many financial assets and financial liabilities (as well as certain non-financial instruments that are similar to financial instruments) at fair value. The election is made on an instrument-by-instrument basis and is irrevocable. If the fair value option is elected for an instrument, SFAS 159 specifies that all subsequent changes in fair value for that instrument shall be reported in earnings. SFAS 159 is effective January 1, 2008. The Company has not elected the fair value option for any of its existing financial instruments on the effective date and has not determined whether or not it will elect this option for any eligible financial instruments acquired in the future.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160 “Noncontrolling Interests in Consolidated Financial Statements” (“SFAS 160”). SFAS 160 will require 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, the statement applies to the accounting for noncontrolling interests and transactions with noncontrolling interest holders in consolidated financial statements. SFAS 160 is effective for periods beginning on or after December 15, 2008. The Company is currently evaluating the effect of SFAS 160 on the condensed consolidated financial statements.

Note 3- Investment in Joint Ventures

El Portal Entities

The Company owns a majority interest in of Horizon El Portal, LLC (“Horizon El Portal”), an entity of which HGP LP is the managing member and of which the remaining 49% (39.2% after September 26, 2008) is owned by Gary Skoien and Pleasant Lake Apts. Limited Partnership (“PLA”), an affiliate of Amster. Horizon El Portal owns 50% (62.5% after September 26, 2008) of a joint venture (“El Portal Center”) that owns a shopping center in Laredo, Texas containing approximately 345,000 square feet of GLA. Horizon El Portal reports the results of operations and the assets and liabilities of El Portal Center using the equity method of accounting. The Company consolidates the results of operations and the assets and liabilities of Horizon El Portal.

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Summary financial information (stated at 100%) of the El Portal Center joint venture as of September 30, 2008 and December 31, 2007 and for the three and nine months ended September 30, 2008 and 2007, respectively are as follows (in thousands):

| | <u>As of</u> <u>September 30, 2008</u> | <u>As of</u> <u>December 31, 2007</u> | | |
|---|--|--|---|---|
| Assets | | | | |
| Real estate | \$12,014 | \$11,700 | | |
| Other assets | <u>432</u> | <u>287</u> | | |
| Total assets | <u>\$12,446</u> | <u>\$11,987</u> | | |
| Liabilities and members' capital | | | | |
| Mortgages and other debt | \$ 6,700 | \$ 6,700 | | |
| Other liabilities | 1,100 | 195 | | |
| Members' capital | <u>4,646</u> | <u>5,092</u> | | |
| Total liabilities and members' capital | <u>\$12,446</u> | <u>\$11,987</u> | | |
| | | | | |
| | <u>Three months</u> <u>ended</u> <u>September 30,</u> <u>2008</u> | <u>Three months</u> <u>ended</u> <u>September 30,</u> <u>2007</u> | <u>Nine months</u> <u>ended</u> <u>September 30,</u> <u>2008</u> | <u>Nine months</u> <u>ended</u> <u>September 30,</u> <u>2007</u> |
| Revenue | <u>\$ 124</u> | <u>\$ 104</u> | <u>\$ 375</u> | <u>\$ 426</u> |
| Operating expenses | 189 | 241 | 567 | 722 |
| General and administrative expenses | 19 | (15) | 24 | 2 |
| Depreciation and amortization expense | 18 | 18 | 54 | 55 |
| Interest expense | <u>168</u> | <u>163</u> | <u>466</u> | <u>541</u> |
| Total expenses | <u>394</u> | <u>407</u> | <u>1,111</u> | <u>1,320</u> |
| Net loss | <u>\$(270)</u> | <u>\$(303)</u> | <u>\$(736)</u> | <u>\$(894)</u> |

The shopping center owned by El Portal Center secures a loan from Cathay Bank which had a principal balance of \$6.7 million at September 30, 2008 and December 31 2007, bears interest at Prime plus 1.0% (with a minimum rate of 7.5%) and matures on March 1, 2009. HGPI has guaranteed 50% of the principal and interest due on the loan from Cathay Bank.

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 acquire the interest and increased its ownership in Horizon El Portal to 60.8%. Horizon El Portal has an option to purchase the remaining 37.5% interest in El Portal Center for \$2,125,000 from the joint venture partner within a 24-month period. The Company expects to consolidate the results of operations and the assets and liabilities of El Portal Center starting in the fourth quarter of 2008.

El Paso Entities

The Company owns 88.2% of the preferred interests and 80.7% of the common interests in Horizon El Paso, which owns 50% of El Paso Center, a joint venture that developed an outlet shopping center in El Paso, Texas, which opened on October 11, 2007 and contains approximately 380,000 square feet of GLA (See Note 1). From inception

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through August 31, 2006, Horizon El Paso used the equity method to account for its investment in El Paso Center. From September 1, 2006 through November 30, 2007, Horizon El Paso consolidated the results of operations and the assets and liabilities of El Paso Center. Effective December 1, 2007, Horizon El Paso again began using the equity method to account for its investment in El Paso Center (See Note 1).

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 (See Note 1).

Summary financial information (stated at 100%) of El Paso Center and TOSEP as of September 30, 2008 and December 31, 2007 and for the three and nine months ended September 30, 2008 are as follows (in thousands):

| | <u>As of</u> <u>September 30, 2008</u> | <u>As of</u> <u>December 31, 2007</u> |
|---|--|---|
| Assets | | |
| Real estate | \$58,812 | \$58,441 |
| Cash | 3,701 | 494 |
| Restricted cash | 4,571 | 16,027 |
| Other assets | <u>5,377</u> | <u>2,289</u> |
| Total assets | <u>\$72,461</u> | <u>\$77,251</u> |
| Liabilities and members' deficit | | |
| Mortgages and other debt | \$79,047 | \$79,500 |
| Other liabilities | 3,354 | 5,729 |
| Members' deficit | <u>(9,940)</u> | <u>(7,978)</u> |
| Total liabilities and members' deficit | <u>\$72,461</u> | <u>\$77,251</u> |
| | | |
| | <u>Three Months</u> <u>Ended</u> <u>September 30, 2008</u> | <u>Nine Months</u> <u>Ended</u> <u>September 30, 2008</u> |
| Statements of Operations | | |
| Revenue | <u>\$3,311</u> | <u>\$9,409</u> |
| Operating expenses | 1,136 | 3,132 |
| General and administrative expenses | 264 | 640 |
| Depreciation and amortization | 1,001 | 1,773 |
| Interest expense | <u>1,709</u> | <u>4,961</u> |
| Total expenses | <u>4,110</u> | <u>10,506</u> |
| Gain on sale of real estate | <u>320</u> | <u>320</u> |
| Net loss | <u>\$ (479)</u> | <u>\$ (777)</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 \$69.5 million and \$70.0 million at September 30, 2008 and December 31, 2007, 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 Outlet Center Holding, LLC in the amount of \$9.5 million, bearing interest at 15.0% and due October 27, 2010. The preferred equity investment is classified as debt on the balance sheet of El Paso Outlet Center Holding, LLC.

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In November 2007, El Paso Center distributed approximately 45 acres of undeveloped land with a carrying value of \$1.9 million to its members who then contributed that land to TOSEP. In September 2008, El Paso Outlet Center distributed site improvements with a carrying value of approximately \$1.7 million to its members, who then contributed them to TOSEP. There was no significant operating activity for TOSEP for the nine months ended September 30, 2008.

In September 2008, El Paso Center sold approximately one acre of unimproved land in El Paso, Texas for \$600,000. A gain of approximately \$320,000 was recognized on the transaction.

Note 4 – Commitments

The Company has outstanding commitments for capital expenditures on leases signed at September 30, 2008 in the amount of \$1.8 million for tenant allowances and \$33,000 for other capital expenditures and construction costs, which are not reflected on the balance sheet as of September 30, 2008. These costs are expected to be paid during 2008 and 2009 and are anticipated to be funded from capital improvement escrows, construction financing, equity contributions and additional borrowings.

Note 5 – Secured Debt

Total secured indebtedness was \$135.0 million and \$141.3 million at September 30, 2008 and December 31, 2007, respectively. Cash paid for interest, including on the properties classified as discontinued operations, for the three months ended September 30, 2008 and 2007 was \$1,644,000 and \$998,000, respectively and for the nine months ended September 30, 2008 and 2007 was \$5,074,000 and \$1,613,000, respectively. Interest advanced on loans or reserve accounts tied to loans for the three months ended September 30, 2008 and 2007 was \$354,000 and \$1,379,000, respectively, and for the nine months ended September 30, 2008 and 2007 was \$1,224,000 and \$2,755,000, respectively. The Company capitalized interest totaling \$91,000 and \$587,000 for the three months ended September 30, 2008 and 2007, respectively, and \$122,000 and \$964,000 for the nine months ended September 30, 2008 and 2007, respectively.

Huntley Net Profits Interests and TIF Bonds

Gary J. Skoien, Chairman, Chief Executive Officer and President of the Company, was also formerly the Executive Vice President and Chief Operating Officer of The Prime Group, Inc. (“Prime Group”). In connection with his employment with Prime Group, Mr. Skoien was previously granted an interest (the “Skoien Net Profits Interest”) in the net profits generated by the Huntley Project (See Note 1), which obligation the Company assumed in connection with the purchase of the Huntley Project from Prime Group (See Note 1). 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). The Company has recorded a liability for the Skoien Net Profits Interest in the amount of \$2.6 million as of September 30, 2008 and December 31, 2007, 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 condensed consolidated balance sheets.

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

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liability has been recorded by the Company for the Prime Group Participation Interest as its current fair value is estimated to be zero.

In 1993, the Village of Huntley (the "Village") created a Tax Increment Financing District (the "TIF District") which is authorized to issue up to \$108.0 million of tax-exempt, tax-increment bonds (the "TIF Bonds") to reimburse Huntley Development Limited Partnership ("HDLP") for a portion of the land cost and the cost of infrastructure improvements. In 1995, the Village sold \$7.0 million of Series A bonds and \$14.0 million of Series B bonds. HDLP owns the Series C bonds with a principal amount of \$24.4 million plus accrued interest. The Series C bonds are subordinate to the Series A and Series B bonds. Currently no portion of the tax increment is available to the Series C bonds and no value has been ascribed to them by the Company.

The TIF District contains approximately 900 acres of land currently or previously owned by HDLP or Huntley Meadows Residential Venture. The source of repayment for the TIF Bonds is (a) 100% of the increase in real estate taxes on the land in the TIF District above the taxes in place when the TIF District was created, (b) one-half of the Village's one percent (1%) sales tax collected on retail sales occurring within the TIF District and (c) reserves established at the time of issuance of the TIF Bonds (the "Initial TIF Reserves"). To the extent the Initial TIF Reserves are not needed to service the bonds, they will be returned to HDLP. The Initial TIF Reserves are held in interest bearing accounts under the control of the TIF Bond trustee and totaled approximately \$1.9 million at September 30, 2008. There can be no assurance that the Initial TIF Reserves will be returned to HDLP and, therefore, they are not reflected on the consolidated balance sheets of the Company. The repayment of the TIF Bonds is not an obligation of the Company, HDLP has no continuing legal obligation related to the proceeds received from the TIF Bonds, and thus they are not reflected on the Company's consolidated balance sheets as a liability.

As additional security for the Series B bonds, HDLP granted U.S. Bank Trust National Association, as trustee for the holders of the Series B bonds, a mortgage on certain land in the TIF District. As of September 30, 2008, the mortgage covers approximately 17 acres of land owned by HDLP (the "TIF Bond Mortgage"). Upon the sale of land subject to the TIF Bond Mortgage, such parcel will be released from the TIF Bond Mortgage provided that HDLP deposits into a collateral account (the "TIF Bond Collateral Account") an amount equal to the greater of (i) 50% of the July 1997 appraised value of such parcel or (ii) an amount per square foot of the parcel sold as set forth in Exhibit B to the Amended and Restated Intercreditor Agreement. Amounts deposited into the TIF Bond Collateral Account are released to HDLP upon the issuance of a certificate of occupancy for the subject land parcel. The balance in the TIF Bond Collateral Account was approximately \$4.1 million at September 30, 2008 and December 31, 2007. Based on management's review of the projected incremental real estate and sales tax revenue and the available debt service reserve funds, the Company believes that the tax revenues and debt service reserve funds will be sufficient to make the scheduled debt service payments on the Series A and B bonds. Thus, no liability has been recognized related to TIF Bond Mortgage and the funds held in the TIF Bond Collateral Account are included in Restricted Cash on the Company's condensed consolidated balance sheets

Note 6 – Stock Repurchase

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 7 - Related Party Transactions

Howard Amster ("Amster") is a director and significant stockholder of HGPI. At September 30, 2008 an affiliate of Amster owns approximately 44% of the entity that owned the center in Darien, Georgia (which currently owns a portfolio of marketable securities) and 49% of the entities that own the office building in Norton Shores, Michigan and a shopping center. His affiliate also owns 39.2% of Horizon El Portal, LLC and 5.9% of the preferred and common interests in Horizon El Paso, LLC. In connection with his ownership, Amster's affiliate entered into an agreement to reimburse the Company for a portion of the general and administrative expenses related to the

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operation of the entities that he owns. Certain expenses related to the general operation of the Company are not subject to the reimbursement agreement. The Company recognized income and a corresponding receivable related to this arrangement of \$700 during the three months ended September 30, 2008 and 2007, and \$2,100 and \$550,000 during the nine months ended September 30, 2008 and 2007, respectively. Starting July 1, 2007 the fee payable by Amster's affiliate was reduced to \$700 per quarter reflecting the sale of the majority of the jointly owned entities. Included in Other Assets in the consolidated balance sheets at September 30, 2008 and December 31, 2007 is an unsecured note receivable from Amster which had a balance of \$1.42 million which bears interest at 5.0%. Included in Tenant and Other Accounts Receivable, Net on the consolidated balance sheets is \$384,000 and \$1.8 million at September 30, 2008 and December 31, 2007, respectively, due from Amster for the Company's pro rata share of the net assets of the entities sold to Amster in November 2006 and June 2007.

Mr. Skoien owns 9.8% of Horizon El Portal, LLC, 5.3% of the entity that formerly owned the outlet center in Darien, Georgia 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 Mr. Skoien, Thomas Rumpitz and Andrew Pelmoter, officers of the Company, 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.

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. Mr. Skoien personally indemnified certain lenders for such losses and damages. The Company agreed to indemnify Mr. Skoien for any amounts paid under the indemnifications and to pay Mr. Skoien 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 Mr. Skoien is otherwise released from the indemnification obligations). In July 2008, The Company sold a portion of the land that is pledged to secure one of the loans related to Mr. Skoien's indemnifications, and the proceeds from the sale were used to partially repay the loan. (See Note 8). In connection with the reduction in the principal amount of the loan, the indemnification fee payable to Mr. Skoien was reduced.

The Company utilizes Willis HRH as its agent for insurance and risk management programs. E. Thomas Thilman is a Director of the Company and Chairman of Willis HRH of Illinois. The Company paid premiums totaling approximately \$456,000 and \$377,000 during the three months ended September 30, 2008 and 2007, respectively, and \$541,000 and \$426,000 during the nine months ended September 30, 2008 and 2007, respectively, related to insurance policies placed by Willis HRH, including insurance premiums for properties classified as discontinued operations.

Note 8 – 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 \$2,853,000, before minority 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 acquire the interest and increased its ownership in Horizon El Portal to 60.8%. Horizon El Portal has an option to purchase the remaining 37.5% interest in El Portal Center for \$2,125,000 from the joint venture partner within a 24-month period. The Company expects to consolidate the results of operations and the assets and liabilities of El Portal Center starting in the fourth quarter of 2008.

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Note 9 – Discontinued Operations

In accordance with SFAS 144, the results of operations and gain on real estate sold or held for sale are reflected in the condensed consolidated statements of operations as “Income/(Loss) from Discontinued Operations, net of minority interests”.

There were no assets classified as discontinued operations in 2008 (See Note 2). The following table is a summary of the results of operations of the properties classified as discontinued operations for the three and nine months ended September 30, 2007 (in thousands):

| | Three months ended September 30, 2007 | Nine months ended September 30, 2007 |
|--|--|---|
| | <u> </u> | <u> </u> |
| Total revenue | <u>\$(10)</u> | <u>\$278</u> |
| Operating expenses | (6) | 302 |
| General and administrative expenses | - | (17) |
| Depreciation and amortization expense | <u>-</u> | <u>68</u> |
| Total expenses | <u>(6)</u> | <u>353</u> |
| Loss before minority interests | (4) | (75) |
| Minority interests | 3 | 49 |
| Gain on sale of real estate, net of minority interests | <u>-</u> | <u>487</u> |
| Income/(loss) from discontinued operations, net of minority interests | <u>\$ (1)</u> | <u>\$461</u> |

Note 10 – Subsequent Events

On November 18, 2008, the Company announced that it will form a joint venture with Cousins Properties, Inc. to pursue the development of The Outlet Shoppes at Oklahoma City, a planned 341,400 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 spring of 2009 with a July 2010 opening. Horizon is overseeing the development, management and leasing of the project.