

Consolidated Financial Statements

Horizon Group Properties, Inc.

For the years ended December 31, 2007 and 2006

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For the years ended December 31, 2007 and 2006

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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, 2007, and the related consolidated statements of operations, stockholders' equity and cash flows for the year 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 audit. The consolidated financial statements of Horizon Group Properties, Inc. as of and for the year ended December 31, 2006, were audited by other auditors whose report dated June 7, 2007, expressed an unqualified opinion on those statements.

We conducted our audit 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 audit provides a reasonable basis for our opinion.

In our opinion, the 2007 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Horizon Group Properties, Inc. at December 31, 2007, and the results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States.

Cohen & Company

Cleveland, Ohio
August 29, 2008

HORIZON GROUP PROPERTIES, INC.
Consolidated Balance Sheets
(In thousands)

	December 31, 2007	December 31, 2006
ASSETS		
Real estate – at cost:		
Land	\$ 26,619	\$ 7,534
Buildings and improvements	103,849	9,458
Less accumulated depreciation	<u>(5,817)</u>	<u>(2,289)</u>
	124,651	14,703
Construction in progress	1,093	4,205
Land held for investment	<u>19,884</u>	<u>19,884</u>
Total net real estate	145,628	38,792
Investment in joint ventures	3,490	2,880
Cash and cash equivalents	6,743	6,534
Restricted cash	8,104	5,299
Marketable securities	10,253	21,530
Tenant and other accounts receivable, net	3,971	1,441
Real estate – held for sale	-	4,793
Deferred costs (net of accumulated amortization of \$659 and \$433, respectively)	4,160	764
Other assets	<u>4,336</u>	<u>5,851</u>
Total assets	<u>\$186,685</u>	<u>\$87,884</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Mortgages and other debt	\$143,009	\$36,318
Accounts payable and other accrued expenses	6,302	5,763
Prepaid rents and other tenant liabilities	1,152	227
Participation interests and other liabilities	<u>2,655</u>	<u>3,102</u>
Total liabilities	<u>153,118</u>	<u>45,410</u>
Minority interests	<u>12,625</u>	<u>19,845</u>
Commitments and contingencies		
Stockholders' equity:		
Common shares (\$.01 par value, 50,000 shares authorized, 2,913 and 2,879 issued and outstanding, respectively)	29	29
Additional paid-in capital	37,522	37,295
Accumulated deficit	<u>(16,609)</u>	<u>(14,695)</u>
Total stockholders' equity	<u>20,942</u>	<u>22,629</u>
Total liabilities and stockholders' equity	<u>\$186,685</u>	<u>\$87,884</u>

See accompanying notes to consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.
Consolidated Statements of Operations
(In thousands)

	Year ended December 31, 2007	Year ended December 31, 2006
REVENUE		
Base rent	\$ 7,249	\$ 1,238
Percentage rent	104	1
Expense recoveries	2,208	336
Other	1,301	962
Interest	<u>1,229</u>	<u>1,370</u>
Total revenue	<u>12,091</u>	<u>3,907</u>
EXPENSES		
Property operating	3,121	658
Real estate taxes	910	235
Other operating	527	95
Depreciation and amortization	3,850	424
General and administrative	5,366	5,889
Interest	7,710	4,965
Loss on marketable securities	<u>112</u>	<u>117</u>
Total expenses	<u>21,596</u>	<u>12,383</u>
Income/(loss) from investment in joint ventures	<u>5,504</u>	<u>(1,100)</u>
Loss from continuing operations before minority interests, gain on sale of real estate and income from discontinued operations	(4,001)	(9,576)
Minority interests	<u>1,615</u>	<u>3,131</u>
Loss from continuing operations	(2,386)	(6,445)
Gain on sale of real estate, net of minority interests	-	167
Income from discontinued operations, net of minority interests	<u>472</u>	<u>15,266</u>
Net income/(loss)	<u><u>\$ (1,914)</u></u>	<u><u>\$ 8,988</u></u>

See accompanying notes to consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.
Consolidated Statements of Stockholders' Equity
(In thousands)

	<i>Common Shares</i>		<i>Additional</i>	<i>Accumulated</i>	<i>Stockholders'</i>
	<i>Number</i>	<i>Amount</i>	<i>Paid -In</i>	<i>Earnings/(Deficit)</i>	<i>Equity</i>
	<u>Number</u>	<u>Amount</u>	<u>Capital</u>	<u>Earnings/(Deficit)</u>	<u>Equity</u>
Balance, January 1, 2006	2,862	\$ 29	\$ 37,200	\$ (23,683)	\$ 13,546
Stock grant to officers	17	-	95	-	95
Net income	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,988</u>	<u>8,988</u>
Balance, December 31, 2006	2,879	29	37,295	(14,695)	22,629
Stock grant to officers	34	-	227	-	227
Net loss	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1,914)</u>	<u>(1,914)</u>
Balance, December 31, 2007	<u>2,913</u>	<u>\$ 29</u>	<u>\$ 37,522</u>	<u>\$ (16,609)</u>	<u>\$ 20,942</u>

See accompanying notes to consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.
Consolidated Statements of Cash Flows
(In thousands)

	<u>Year ended</u> <u>December 31, 2007</u>	<u>Year ended</u> <u>December 31, 2006</u>
Cash flows from operating activities:		
Net income/(loss)	\$ (1,914)	\$ 8,988
Net gain on sale of real estate	(877)	(46,065)
Adjustments to reconcile net income/(loss) to net cash used in operating activities:		
Minority interests, including amounts in gain on sale of real estate and income from discontinued operations	(1,266)	25,142
(Income)/loss from investment in joint ventures	(5,504)	1,100
Depreciation	3,824	2,261
Amortization, including deferred financing costs	903	665
Loss on marketable securities	112	117
HGPI stock/HGP LP partnership unit grants	227	185
Changes in assets and liabilities:		
Restricted cash	1,703	47
Tenant and other accounts receivable	(3,687)	657
Deferred costs and other assets	(42)	(2,395)
Accounts payable and other accrued expenses	1,030	5,165
Participation interests and other liabilities	-	1,577
Prepaid rents and other tenant liabilities	<u>1,542</u>	<u>(604)</u>
Net cash used in operating activities	<u>(3,949)</u>	<u>(3,160)</u>
Cash flows from investing activities:		
Acquisition of property (See Note 11)	(17,691)	-
Repayment of note receivable	-	1,150
Net marketable securities activity	7,160	(13,021)
(Investment in)/distribution from joint ventures	6,106	(3,177)
Expenditures for land held for investment	-	(235)
Expenditures for buildings and improvements	(44,410)	(4,885)
Cash transferred in connection with sale of subsidiaries	(928)	(447)
Cash transferred in connection with de-consolidation of entities	(1,669)	-
Gross proceeds from sale of real estate	<u>4,029</u>	<u>114,031</u>
Net cash provided by/(used in) investing activities	<u>(47,403)</u>	<u>93,416</u>
Cash flows from financing activities:		
Net distributions to minority interests	(3,989)	(28,254)
Principal payments on mortgages and other debt	(58,130)	(71,297)
Proceeds from borrowings	115,357	15,129
Debt issue costs	<u>(1,677)</u>	<u>(113)</u>
Net cash provided by/(used in) financing activities	<u>51,561</u>	<u>(84,535)</u>
Net increase in cash and cash equivalents	209	5,721
Cash and cash equivalents:		
Beginning of year	<u>6,534</u>	<u>813</u>
End of year	<u><u>\$ 6,743</u></u>	<u><u>\$ 6,534</u></u>

See accompanying notes to consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.
Consolidated Statements of Cash Flows, continued
(In thousands)

Year ended
December 31, 2007 Year ended
December 31, 2006

Supplemental Information -

During the years ended December 31, 2007 and 2006, the Company sold the following real estate assets (See Notes 1 and 11):

Land	\$ -	\$ 9,053
Buildings and improvements	3	80,275
Accumulated depreciation	(57)	(20,532)
Land held for investment	-	(267)
Tenant and other accounts receivable, net	-	326
Real estate-held for sale	3,380	-
Deferred costs	(4)	1,048
Other assets	30	(351)
Mortgages and other debt	-	(1,821)
Accounts payable and accrued expenses	286	(466)
Prepaid rents and other tenant liabilities	(53)	200
Participation interests and other liabilities	-	(30)
Minority interests	<u>(106)</u>	<u>2,108</u>
Net assets sold	3,479	69,543
Gross proceeds from sale of real estate	<u>4,356</u>	<u>115,608</u>
Gain on sale of real estate	<u>\$ 877</u>	<u>\$ 46,065</u>

The following represents supplemental disclosure of significant cash activity from the gross proceeds from the sale of real estate (above) to arrive at the net proceeds from the sale of real estate as shown on the consolidated statements of cash flows for the years ended December 31, 2007 and 2006 (See Notes 1 and 11):

Gross proceeds from the sale of real estate	\$4,356	\$115,608
Release of restricted cash – escrow reserves	-	2,405
Defeasance premium	-	(3,654)
Miscellaneous	<u>(327)</u>	<u>(328)</u>
	<u>\$4,029</u>	<u>\$114,031</u>

The following represents supplemental disclosure of the sale of ownership interests in a subsidiary during the years ended December 31, 2007 and 2006 (See Note 11):

Cash and cash equivalents	\$ 928	\$ 447
Restricted cash	22	-
Marketable securities	4,005	-
Tenant and other accounts receivable, net	(30)	38
Real estate – held for sale	-	36
Other assets	473	1,601
Mortgages and other debt	(3,998)	-
Accounts payable and other accrued expenses	(11)	(15)
Minority interests	<u>(758)</u>	<u>(1,025)</u>
Accounts receivable – net proceeds	<u>\$ 631</u>	<u>\$ 1,082</u>

See accompanying notes to consolidated financial statements.

HORIZON GROUP PROPERTIES, INC.
Consolidated Statements of Cash Flows, continued
(In thousands)

Year Ended
December 31, 2007 Year Ended
December 31, 2006

Supplemental Information (Continued) -

The following represents supplemental disclosure of noncash activity for the consolidation of the assets and liabilities of the El Paso Center as of September 1, 2006 and the subsequent deconsolidation on December 1, 2007 (See Note 1):

Land	\$(4,604)	\$6,508
Buildings and improvements	(2)	-
Construction in progress	(49,162)	1,142
Investment in joint venture	260	(1,849)
Cash and cash equivalents	(1,669)	-
Restricted cash	(27,956)	-
Tenant and other accounts receivable, net	(1,072)	-
Deferred costs	(966)	77
Other assets	1,096	987
Mortgages and other debt	79,500	(3,228)
Accounts payable and other accrued expenses	4,191	(201)
Prepaid rents and other tenant liabilities	(6)	-
Minority interests	<u>390</u>	<u>(3,436)</u>
	<u>\$ -</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, 2007 and 2006:

Buildings and improvements	\$ 189	\$ 250
Deferred costs	<u>379</u>	<u>215</u>
	<u>\$ 568</u>	<u>\$ 465</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, 2007 and 2006, HGPI owned approximately 68.9% and 68.6%, 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 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 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 December 31, 2007, the principal balances of the debt were \$43.2 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 BFO 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 \$52.7 million as of December 31, 2007.

At December 31, 2007 and 2006, the Company owned 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. At December 31, 2007 and 2006, an affiliate of Howard Amster (“Amster”), a director and significant stockholder of the Company, owned 5.9% of the preferred and common interests and Gary Skoien (“Skoien”), Chairman, President and CEO of the Company, owned 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 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 judged to be 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 began to use the equity method of accounting with respect to El Paso Center.

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

HORIZON GROUP PROPERTIES, INC.
Notes to Consolidated Financial Statements

The Company also owns a 22,000 square foot shopping center located in Huntley, Illinois and an office building located in Norton Shores, Michigan, a portion of which it occupies. It also owns approximately 408 acres of land in a master planned community in Huntley, Illinois (the "Huntley Project") and approximately 100 acres of vacant land in Fruitport Township, Michigan, all of which is held for investment purposes.

Prior to July 28, 2006, the Company owned controlling interests in entities which owned nine factory outlet centers located in seven states comprising an aggregate of approximately 1.8 million square feet of GLA. An affiliate of Amster owned approximately 49% of those entities (except the entity that owned the center in Darien, Georgia of which it owned approximately 44% and of which Gary Skoien owned 5.3%). Six of the factory outlet centers containing 1.3 million square feet of GLA were sold on July 28, 2006, one center was sold in November 2006 and another center was sold in June 2007 (See Note 11). The remaining entity owns a shopping center located in Holland, Michigan which contains approximately 194,000 square feet of GLA.

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 consolidated statements of operations and such parties' portion of the net equity in such subsidiaries is reported on the Company's 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 from Joint Ventures on the consolidated statements of operations. For the year ended December 31, 2007, the Company recognized income from distributions in excess of equity investments of \$5.9 million related to distributions of the proceeds of non-recourse debt related to El Paso Center.

Note 2 - Summary of Significant Accounting Policies

Principles of Consolidation

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

Reclassifications

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

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States ("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 Statement of Financial Accounting Standards No. 141, *Business Combinations*. In making estimates of fair values for purposes of allocating purchase price, the Company utilizes a number of sources, including independent appraisals that may be obtained in connection with the acquisition or financing of the respective property and other market data. The Company also considers information obtained about each property as a result of its pre-acquisition due diligence, marketing, and leasing activities, in estimating the fair value of the tangible and intangible assets acquired.

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 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 of the tenant origination costs would be charged to expense.

Real Estate and Depreciation

Costs incurred for the acquisition, development, construction and improvement of properties, as well as significant renovations and betterments to the properties, are capitalized. Pre-development costs are carried in Other Assets until conditions are met that indicate that development is imminent at which point the costs are reclassified to Construction in Progress. In the event a development is no longer deemed to be probable, the costs previously capitalized are expensed. At December 31, 2007, pre-development costs classified as Other Assets and Construction in Progress were \$159,000 and \$861,000, respectively. At December 31, 2006, pre-development costs classified as Other Assets were \$6,000. 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. For the period in which the property was consolidated, during the years ended December 31, 2007 and 2006, \$1,258,000 and \$217,000, respectively, of interest was capitalized related to the construction of the outlet center in El Paso, Texas. During the year ended December 31, 2006, \$241,000 of interest was capitalized related to the construction of Phase III of the outlet center in Tulare, California.

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

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

In accordance with Statement of Financial Accounting Standards, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"), the Company records impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated over their expected holding periods are less than the carrying amounts of those assets. For assets to be held in the portfolio, impairment losses are measured as the difference between carrying value and fair value. For assets to be sold, impairment is measured as the difference between carrying value and fair value, less costs to dispose. Fair value may be based upon estimated cash flows discounted at a risk-adjusted rate of

HORIZON GROUP PROPERTIES, INC.
Notes to Consolidated Financial Statements

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 \$12,000 and \$248,000 for the years ended December 31, 2007 and 2006, respectively, excluding properties classified as discontinued operations.

Cash Equivalents

The Company considers all liquid investments with a maturity of three months or less when purchased to be cash equivalents. 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 9), (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 9). At December 31, 2007, the escrow accounts related to the Company's primary lenders included approximately \$962,000 in capital improvement and tenant allowance reserves, \$804,000 in real estate tax and insurance escrows, and approximately \$2,182,000 for cash collateral accounts. At December 31, 2007, the Huntley infrastructure escrow accounts totaled \$87,000 and the TIF Bond Collateral Account had a balance of approximately \$4,069,000.

Marketable Securities

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

Total tenant accounts receivable are reflected net of reserves of \$352,000 and \$91,000 as of December 31, 2007 and 2006, respectively. The provision for doubtful accounts was \$280,000 and \$191,000 for the years ended December 31, 2007 and 2006, respectively. This charge is included in the line item entitled "Other Operating" in the consolidated statements of operations.

Discontinued Operations

In accordance with Statement of Financial Accounting Standards, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"), assets held for sale are valued at the lower of carrying value or fair value less costs to dispose. SFAS 144 requires that the results of operations and gain/(loss) on real estate properties sold or held for sale be reflected in the consolidated statements of operations as "Income/Loss from Discontinued Operations" for all periods presented. As of December 31, 2007, no assets were classified as held for sale. Results of operations from the six factory outlet centers sold to Prescott Capital Management, LLC ("Prescott") in July

HORIZON GROUP PROPERTIES, INC.
Notes to Consolidated Financial Statements

2006, the outlet center located in Monroe, Michigan sold in November 2006, the vacant land parcel 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 consolidated statements of operations. The six centers sold to Prescott are located in Darien, Georgia; Laughlin, Nevada; Medford, Minnesota; Traverse City, Michigan; Tulare, California and Warrenton, Missouri. SFAS 144 requires that prior period financial statements presented are also reclassified for comparability. This reclassification has no effect on the Company's previously reported net income or loss.

Deferred Costs

Deferred leasing costs consist of fees and direct internal costs incurred to initiate and renew operating leases and are amortized on the straight-line method over the initial lease term or renewal period. Deferred financing costs are amortized as interest expense over the life of the related debt.

Fair Value of Financial Instruments

The Company'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, 2007 and 2006.

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 \$176,000 and \$27,000 as of December 31, 2007 and 2006, 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.

On January 1, 2007, the Company adopted Financial Accounting Standard Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The adoption of FIN 48 did not have any impact on the financial position or results of operations of the Company. As of and for the year ended December 31, 2007, the Company did not have a liability for any unrecognized tax benefits. The Company recognizes interest and penalties, if any, related to unrecognized tax benefits as interest or general and

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administrative expense in the statement of operations. During 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 2004.

Recent Financial Accounting Standards

In September 2006, the Financial Accounting Standards Board 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 for us in the first quarter of 2008, except as it relates to certain nonfinancial assets and liabilities for which the effective date will be first quarter of 2009. The adoption of SFAS 157 is not expected to have a significant impact on the results of operations or financial position of the Company.

In February 2007, the Financial Accounting Standards Board 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 for fiscal years beginning after November 15, 2007. If adopted, SFAS 159 is not expected to have a material effect on the Company's consolidated financial statements.

In December 2007, the Financial Accounting Standards Board 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 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.

HORIZON GROUP PROPERTIES, INC.
Notes to Consolidated Financial Statements

Note 3- Investment in Joint Ventures

The Company owns 51% of Horizon El Portal, LLC (“Horizon El Portal”), an entity of which HGP LP is the managing member and of which the remaining 49% is owned by Gary Skoien and Pleasant Lake Apts. Limited Partnership (“PLA”), an affiliate of Amster. Horizon El Portal owns 50% of a joint venture (“El Portal Center”) that owns a shopping center in Laredo, Texas containing approximately 345,000 square feet of GLA. For its ownership in the El Portal Center joint venture, Horizon El Portal contributed \$3.0 million in cash and assumed the responsibility for the payments on an existing \$3.0 million loan secured by the shopping center owned by El Portal Center. This loan was refinanced in June 2006. 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.

Summary financial information (stated at 100%) of the El Portal Center joint venture as of December 31, 2007 and 2006 and for the years ended December 31, 2007 and 2006 are as follows (in thousands):

	As of <u>December 31, 2007</u>	As of <u>December 31, 2006</u>
Assets		
Real estate	\$11,700	\$11,737
Other assets	<u>287</u>	<u>408</u>
Total assets	<u>\$11,987</u>	<u>\$12,145</u>
Liabilities and members' capital		
Mortgages and other debt	\$ 6,700	\$ 6,163
Other liabilities	195	223
Members' capital	<u>5,092</u>	<u>5,759</u>
Total liabilities and members' capital	<u>\$11,987</u>	<u>\$12,145</u>
	Year Ended <u>December 31, 2007</u>	Year Ended <u>December 31, 2006</u>
Statements of Operations		
Revenue	<u>\$ 563</u>	<u>\$ 933</u>
Operating expenses	932	979
General and administrative expenses	7	1,327
Depreciation and amortization expense	73	56
Interest expense	<u>697</u>	<u>770</u>
Total expenses	<u>1,709</u>	<u>3,132</u>
Net loss	<u>\$(1,146)</u>	<u>\$(2,199)</u>

General and administrative expenses for the year ended December 31, 2006 include the charge-off of development costs of approximately \$1.1 million that were considered impaired as of December 31, 2006. There were no similar charges in 2007. HGPI has guaranteed 50% of the principal and interest due on the mortgage secured by the shopping center in Laredo, Texas.

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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 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 used the equity method to account for its investment in El Paso Center (See Note 1).

Summary financial information (stated at 100%) of El Paso Center as of December 31, 2007 and for the month ended December 31, 2007 is as follows (in thousands):

	As of <u>December 31, 2007</u>
Assets	
Real estate	\$56,536
Restricted cash	16,024
Other assets	<u>2,788</u>
Total assets	<u>\$75,348</u>
Liabilities and members' deficit	
Mortgages and other debt	\$79,500
Other liabilities	5,726
Members' deficit	<u>(9,878)</u>
Total liabilities and members' deficit	<u>\$75,348</u>
	Month Ended <u>December 31, 2007</u>
Statement of Operations	
Revenue	<u>\$ 1,139</u>
Operating expenses	273
General and administrative expenses	89
Interest expense	<u>515</u>
Total expenses	<u>877</u>
Net income	<u>\$ 262</u>

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 (See Note 1).

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Note 4 – 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, 2007 and 2006 consisted of the following:

	<u>2007</u>	<u>2006</u>
	<i>(in thousands)</i>	
Federal	\$ -	\$ -
State	<u>-</u>	<u>-</u>
Net provision (benefit)	<u>\$ -</u>	<u>\$ -</u>

For federal income tax purposes, HGPI had net operating loss carryforwards (“NOLs”) of approximately \$60.5 million and \$54.6 million at December 31, 2007 and 2006, respectively, and accumulated capital loss carryforwards of approximately \$43.1 million and \$40.9 million at December 31, 2007 and 2006, respectively. The NOLs expire from 2014 to 2022 and the accumulated capital loss carryforward expires from 2008 to 2011.

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, 2007 and 2006 (in thousands):

	<u>2007</u>	<u>2006</u>
Deferred Tax Assets:		
NOL carryforwards-federal and state	\$22,004	\$20,460
Capital loss carryforward	15,093	14,323
Tax basis of assets in excess of book basis:		
Fixed/intangible assets	1,048	1,040
Impairment	241	947
Other	105	2,686
Book basis of liabilities in excess of tax basis:		
Prepaid rental revenue	135	26
Profits interests	<u>628</u>	<u>626</u>
Gross deferred tax assets	39,254	40,108
Less: valuation allowance	<u>(36,246)</u>	<u>(36,726)</u>
	3,008	3,382
Deferred Tax Liabilities:		
Book basis of assets in excess of tax basis:		
Fixed/intangible assets	(39)	(1,418)
Other	<u>(2,969)</u>	<u>(1,964)</u>
Gross deferred tax liabilities	<u>(3,008)</u>	<u>(3,382)</u>
Net deferred tax asset	<u>\$ -</u>	<u>\$ -</u>

The valuation allowance related to the net deferred tax asset decreased by \$480 and \$2,448 for the years ended December 31, 2007 and 2006, respectively.

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Note 5 – Leases

Space in the Company’s centers is leased to various tenants under operating leases, which are generally for one to five year periods. Some leases contain renewal options and may also provide for the payment of a tenant’s share of certain operating expenses. Leases may also obligate a tenant to pay rent based on a percentage of tenant sales in excess of certain thresholds. Minimum future rentals to be received under non-cancelable leases are summarized as follows (in thousands):

2008	\$ 10,922
2009	9,361
2010	7,489
2011	3,306
2012	2,328
Thereafter	<u>16,798</u>
	<u>\$50,204</u>

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

Note 6 - 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 323,500 shares were outstanding at December 31, 2007.

The fair value of options granted for the purpose of presenting pro forma information, in accordance with Statement of Financial Accounting Standards No. 123R, “Accounting for Stock-Based Compensation”, has been estimated using a Black-Scholes option pricing model. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company’s employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value 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.

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

	<i>For the year ended</i>		<i>For the year ended</i>	
	<i>December 31, 2007</i>		<i>December 31, 2006</i>	
	<i>Shares</i>	<i>Price</i>	<i>Shares</i>	<i>Price</i>
Outstanding, beginning of the year	323,500	\$3.40 - \$6.49	323,500	\$3.40 - \$6.49
Granted	-	-	-	-
Exercised	-	-	-	-
Canceled	-	-	-	-
Outstanding, end of the year	<u>323,500</u>	\$3.40 - \$6.49	<u>323,500</u>	\$3.40 - \$6.49

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The weighted average exercise price for options outstanding at both December 31, 2007 and 2006 was \$5.12. The weighted average contractual life of options outstanding at December 31, 2007 and 2006 was 1.66 years and 2.66 years, respectively. At December 31, 2007 there were 323,500 options vested and exercisable .

The Company granted a total of 16,367 units of HGP LP to key employees in the year ended December 31, 2006, and 33,610 shares and 17,273 shares of stock in HGPI to board members and key employees in the years ended December 31, 2007 and 2006, respectively, and recognized compensation expense based on the fair market value of the units or stock granted. There were no unit grants in 2007. Total compensation expense recognized related to these awards equaled \$227,000 and \$185,000 in 2007 and 2006, respectively.

Note 7 – Marketable Securities

The estimated fair values of securities held by the Company at December 31, 2007 based on quoted market prices are as follows (in thousands):

	<u>Face Value</u>	<u>Cost</u>	<u>Fair Market Value</u>
Debt Securities:			
FNMA Note, 6.0%, maturing November 2036	\$ 9,600	\$ 9,258	\$ 8,653
FHLD Note, 4.3%, maturing January 2008	<u>1,600</u>	<u>1,550</u>	<u>1,600</u>
	<u>\$11,200</u>	<u>\$10,808</u>	<u>\$10,253</u>

These securities serve as collateral under repurchase agreements as disclosed in Note 9.

Note 8 – Commitments

The Company has outstanding commitments for capital expenditures on leases signed at December 31, 2007 in the amount of \$1.7 million for tenant allowances and \$447,000 for other capital expenditures and construction costs, which are not reflected on the consolidated balance sheet as of December 31, 2007. These costs are expected to be paid during 2008 and are anticipated to be funded from capital improvement escrow accounts (See Note 2), construction financing, equity contributions and additional borrowings.

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Note 9 - Mortgage Debt and Other Liabilities

	Principal Balance as of:	
	<u>December 31, 2007</u>	<u>December 31, 2006</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 (the "UBS Office Loan"), secured by the corporate office building in Muskegon, Michigan and indemnified against certain losses by Gary Skoien (See Note 10)	\$2,147	\$2,174
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	950	1,144
Mortgage loan to Village Green Associates, LLC, as borrower, from Interstate Bank, as lender, dated as of November 17, 2005, in the original principal amount of \$2.9 million, bearing interest at 7.875%, due November 17, 2009, and secured by the shopping center in Huntley, Illinois and guaranteed by the Company.	2,847	2,869
Mortgage loan to Huntley Development Limited Partnership, ("HDLP") as borrower, from First Midwest Bank, as lender, dated as of March 30, 2005, in the original principal amount of \$15.6 million, bearing interest at the Wall Street Journal Prime Rate plus 0.5%, due March 30, 2007, secured by 380 acres of land owned by HDLP and a pledge of the Series C TIF bonds related to the Huntley TIF District. This loan was repaid during 2007 (See below).	-	10,000
Repurchase agreement between Magnolia Bluff Factory Shops LP, as borrower, and Wachovia Securities, LLC, as lender, dated December 28, 2007, in the original principal amount of \$8.2 million, bearing interest at a rate of 4.82%, due on January 28, 2008 and secured by a pledge of FNMA Notes having a face value of \$9.6 million as of December 31, 2007, a repurchase agreement dated December 18, 2007, in the original principal amount of \$1.55 million, bearing interest at a rate of 4.75%, due on January 4, 2008 and secured by a pledge of FNMA Notes having a face value of \$1.6 million as of December 31, 2007 and a repurchase agreement dated December 18, 2006, in the original principal amount of \$9.2 million, bearing interest at a rate of 5.37%, due on January 18, 2007 and secured by a pledge of FNMA Notes having a face value of \$9.6 million as of December 31, 2006. In the normal course of business these notes are repurchased at maturity. This debt is guaranteed by Amster.	9,760	9,239
Mortgage loan to El Paso Outlet Center LLC, as borrower, from Cathay Bank, as lender, dated April 12, 2006, in the amount of \$3.45 million, bearing interest at the Wall Street Journal Prime Rate plus 1.0% with a floor of 7.5%, due May 1, 2007 and guaranteed up to 50% by HGPI. This loan requires payments of interest only. This loan was repaid during 2007.	-	3,330

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Mortgage loan to Horizon Group Properties, L.P., 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 31, 2009 and secured by approximately 100 acres of vacant land in Norton Shores, Michigan and Fruitport Township, Michigan. Initial loan funding of \$3.8 million with \$1.3 million available to be drawn to pay interest on the loan. This loan and the land securing it were transferred from Monroe Outlet Center, LLC to Horizon Group Properties, L.P. on April 30, 2007.	3,707	3,800
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 and secured by The Outlet Shoppes at Gettysburg. (See below)	43,236	-
Mezzanine loan to Gettysburg Outlet Center Holding, LLC, as borrower, and CW Capital LLC, as lender, in the original principal amount of \$6.0 million, bearing interest at an initial rate of LIBOR plus 4.5%, due February 11, 2016, and 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 and guaranteed by the Company. (See below)	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. (See below)	52,668	-
Mortgage loan to Huntley Development Limited Partnership, as borrower, from US Bank, in the maximum principal amount of \$23.4 million, bearing interest at LIBOR plus 3.0%, maturing September 30, 2009, secured by approximately 379 acres of vacant land in Huntley, Illinois and guaranteed by the Company. (See below)	20,906	-
Loan to Horizon Group Properties, L.P., as borrower, from Prime Retail, L.P., as lender, dated August 15, 2007, in the original principal amount of \$927,966, bearing interest at 12.0%, due August 15, 2009 and guaranteed by Horizon Group Properties, Inc.	788	-
Margin account between Monroe Outlet Center, LLC, as borrower, and Bear, Stearns Securities Corp., as lender, dated as of December 18, 2006, bearing interest at a rate of 5.75%, secured by a pledge of FNMA notes having a face value of \$4.1 million. This debt is guaranteed by an affiliate of Amster and was included as part of the sale of the ownership interest in Monroe Outlet Center, LLC. (See below)	-	3,762
	<u>\$143,009</u>	<u>\$36,318</u>

In 2007 and 2006, the Company acquired a portfolio of marketable securities (as defined in Note 2 and listed in Note 7) with the proceeds from repurchase agreements and partner contributions. The margin account for Monroe Outlet Center LLC is guaranteed solely by Amster and, therefore, all income statement impact from this account is allocated to minority interest. This entity is considered a variable interest entity and the Company has been judged the primary beneficiary. The margin account repurchase agreements are included in Mortgages and Other Debt on

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the consolidated balance sheets. These notes are expected to be repurchased at maturity in the normal course of business. The Company sold its ownership interest in Monroe Outlet Center LLC to an affiliate of Amster as of June 30, 2007.

In February 2007, El Paso Center obtained a construction loan from IXIS Real Estate Capital (the "IXIS Loan") for the construction of the outlet shopping center in El Paso, Texas (See Note 1). The Company received fees from its joint venture partner with respect to guarantees it made in connection with the IXIS Loan. The balance of the IXIS Loan was \$42.4 million at November 28, 2007, when it was repaid with the proceeds from a loan originated by NATIXIS Commercial Mortgage Funding, LLC (the "NATIXIS Loan"). The NATIXIS Loan had an original principal balance of \$70.0 million, bears interest at 7.06%, requires principal payments over a 30 year schedule, and is due December 5, 2017. The terms of the NATIXIS Loan required that reserves be established related to tenants who had signed leases but not yet taken occupancy, for the completion of construction and for the payment of tenant improvement allowances. Amounts in those reserves are to be released upon tenants taking occupancy, for the payment of construction costs and tenant improvement allowances. These reserves were funded at closing with a total of \$15.5 million along with a reserve for the net proceeds from the loan of \$9.5 million, which was released upon obtaining certain levels of tenant estoppels in December. These balances were still in place at December 1, 2007 when El Paso was deconsolidated and accounted for under the equity method of accounting. December 31, 2007 balances in these accounts are included in Restricted Cash on the balance sheet of El Paso Outlet Center LLC (See Note 3).

In February 2007, El Paso Center entered into a mezzanine loan agreement with an affiliate of Dominion Capital Management (the "Dominion Mezzanine Loan") in connection with the construction of the outlet shopping center in El Paso. The loan had a balance of \$9.5 million at November 28, 2007, when it was repaid with the proceeds a preferred equity investment made to El Paso Outlet Center Holding, LLC ("El Paso Holding") by Dominion Capital Asset Company A, LLC (the "Dominion Preferred Equity") in the amount of \$9.5 million, bearing interest at 15%, and due October 27, 2010. A preferred return reserve was established for the purpose of paying the monthly preferred return on the Dominion Preferred Equity. A default in the repayment of the Dominion Preferred Equity entitles Dominion to acquire the common ownership interests of El Paso Holdings at 10% of fair market value (as defined in the Operating Agreement of El Paso Holding). The Dominion Preferred Equity is considered to be debt on the balance sheet of El Paso Holding and the related distributions of preferred return are included in interest expense on El Paso Holding's statement of operations. The Company uses the equity method to account for its investment in El Paso Holding.

In March 2007, the Company entered into a loan agreement with US Bank (the "US Bank Loan") secured by approximately 379 acres of vacant land owned by the Company in Huntley, Illinois (See Note 1 and below). The agreement provides for advances up to a total of \$23.4 million (and not more than 65% of the appraised value of the mortgaged land), bears interest at the rate of LIBOR plus 3.0% and matures on September 30, 2009, with an option to extend the loan for one year subject to the satisfaction of certain conditions, including the repayment of at least \$10.0 million of the principal of the loan. Of the total amount, \$3.4 million is designated for the payment of interest and is drawn as needed. US Bank obtained an appraisal valuing the land securing the loan at \$36.0 million in December 2006. The initial loan disbursement was \$10.5 million, \$9.9 million of which was used to repay existing indebtedness secured by the property. During 2007, proceeds from the US Bank Loan were used for the acquisition of the shopping center in Gettysburg, Pennsylvania and the BFO Centers (See Note 1). At December 31, 2007, the outstanding principal balance of the loan was \$20.9 million and the undisbursed loan proceeds are solely designated for the payment of interest. The Company entered into a guaranty in connection with the obligations under the US Bank Loan. The guaranty contains covenants (the "Guaranty Covenants") requiring that the Company maintain net worth of at least \$35.0 million and liquidity of \$5.0 million, each of which to be reasonably determined by US Bank. Although an uncertainty exists as US Bank 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 that it is not in compliance with the Guaranty Covenants.

In connection with the acquisition of the outlet shopping center in Gettysburg, Pennsylvania on July 18, 2007, Gettysburg Outlet Center LP assumed an existing first mortgage loan originated by Column Financial, Inc. which is

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secured by the property (See Note 1). The loan matures on February 11, 2016, bears interest at a fixed rate of 5.87% and requires principal payments calculated on a 30-year schedule. The loan is non-recourse to the Company with certain exceptions for environmental issues, misrepresentations and prohibited acts. The Company paid a 1.0% fee in connection with the assumption of the loan.

The Company also obtained a \$6.0 million mezzanine loan from CW Capital LLC in connection with the acquisition of the Gettysburg center. The loan matures in February 2016 and initially bears interest at LIBOR plus 4.5%, increasing to LIBOR plus 9.5% upon the fourth anniversary of the loan. The loan is interest only for the first two years with principal payments due computed on a 25-year schedule thereafter. 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. The loan documents contain covenants that require the Company to maintain a minimum net worth of \$25.0 million and liquidity of at least \$5.0 million (each of which term is defined in the loan agreement). By the fourth anniversary of the loan, a deposit of \$2.8 million is required as collateral for such guaranty. The loan requires an annual minimum debt service coverage ratio ("DSCR") of 1.05, 1.075, 1.10, and 1.15 in years 1, 2, 3, and 4, respectively, and 1.5 thereafter. The Company is required to make principal payments on the loan (if required) to achieve the applicable minimum DSCR on a proforma basis. The loan is secured by a pledge of the ownership interests in the entity that effectively owns the Gettysburg center as well as a first mortgage on approximately 37 acres of vacant land adjacent to the center. Upon repayment of loan principal amounts, an exit fee of 1.0% is due (subject to a 50% reduction if the proceeds are repaid with the proceeds of a loan from CW Capital or its affiliates). A deferred origination fee of .50% of the outstanding principal as of December 31, 2009 is payable on that date.

In connection with the acquisition of the BFO Centers on August 9, 2007, BFO Factory Shoppes LLC assumed an existing first mortgage loan originated by Wachovia Bank, National Association which is secured by three outlet centers (See Note 1). The loan matures January 11, 2016, bears interest at a fixed rate of 5.58% and requires principal payments calculated on a 30-year schedule. The loan is non-recourse to the Company with certain exceptions for environmental issues, misrepresentations and prohibited acts. The Company paid a .25% fee in connection with the assumption of the loan.

Cash paid for interest, including on the properties classified as discontinued operations, for the years ended December 31, 2007 and 2006, was \$3,571,000 and \$9,824,000, respectively. Interest advanced on loans or reserve accounts tied to loans was \$4,339,000 and \$1,642,000 for the years ended December 31, 2007 and 2006, respectively. The Company capitalized interest totaling \$1,258,000 and \$458,000 for the years ended December 31, 2007 and 2006, 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 proceeds 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 December 31, 2007 and 2006, 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 2006 change in estimated fair value of the Skoien Net Profits Interest is reflected as interest expense in the consolidated statement of operations.

The Company granted to Prime Group and certain of its affiliates, a participation interest of 26% of the net cash flow distributed by the Huntley 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

HORIZON GROUP PROPERTIES, INC.
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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") 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 \$2.0 million at December 31, 2007. 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 sheet of the Company. The repayment of the TIF Bonds is not an obligation of the Company and thus they are not reflected on the Company's consolidated balance sheet 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 December 31, 2007, the mortgage covers approximately 17 acres of land owned by HDLP (the "TIF Bond Mortgage"). Upon the sale of land subject to the TIF Bond Mortgage, such land will be released from the TIF Bond Mortgage provided that HDLP deposits into a collateral account (the "TIF Bond Collateral Account") an amount equal to the greater of (i) 50% of the July 1997 appraised value of such parcel or (ii) an amount per square foot of the parcel sold as set forth in Exhibit B to the Amended and Restated Intercreditor Agreement. Amounts deposited into the TIF Bond Collateral Account are released to HDLP upon the issuance of a certificate of occupancy for the subject land parcel. The balance in the TIF Bond Collateral Account was approximately \$4.1 million at December 31, 2007 and \$3.9 million at December 31, 2006 and is included in Restricted Cash on the Company's consolidated balance sheets (see Note 2). Based on management's review of the current incremental real estate and sales tax revenue and the available debt service reserve funds, the Company believes that the tax revenues and debt service reserve funds will be sufficient to make the scheduled debt service payments on the Series A and B bonds. Further, HDLP has no continuing legal obligation related to the proceeds received from the TIF Bonds and thus, no liability has been recognized related to this mortgage.

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Debt Maturities

Debt maturities and principal payments due subsequent to December 31, 2007 are as follows (in thousands):

<u>Due in:</u>	
2008	\$ 11,770
2009	29,374
2010	1,761
2011	5,903
2012	1,735
Thereafter	<u>92,466</u>
	<u>\$143,009</u>

The Company's ability to secure new loans is limited by the fact that most of the Company's real estate assets are currently pledged as collateral for its current loans. The Company anticipates refinancing the obligations due in 2008 in the normal course of business.

Note 10 - Related Party Transactions

Howard Amster ("Amster") is a director and significant stockholder of HGPI. At December 31, 2007, an affiliate of Amster owns approximately 44% of the entity that owned the center in Darien, Georgia 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 operation of the entities that he owns. Certain expenses related to the general operation of the Company are not subject to reimbursement under the agreement. The Company recognized income related to this arrangement of \$550,000 and \$1.0 million during the years ended December 31, 2007 and 2006, 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. The Company had several loans from affiliates of Amster on which it paid a total of \$481,000 of interest during the year ended December 31, 2006. All of these loans were repaid during 2006. Included in Other Assets on the consolidated balance sheets at December 31, 2007 and 2006 is an unsecured note receivable from Amster which had 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 is \$1.8 million and \$1.1 million at December 31, 2007 and 2006, respectively, 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. The Company recognized compensation expense for the El Paso Net Profits Interests of \$328,000 during the year ended December 31, 2007.

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 related to such

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indemnifications until such loans are repaid (or Mr. Skoien is otherwise released from the indemnification obligations).

The Company utilizes Thilman Filippini LLC as its agent for insurance and risk management programs. E. Thomas Thilman is a Director of the Company and President of Thilman Filippini LLC. The Company paid premiums totaling approximately \$604,000 and \$791,000 during the years ended December 31, 2007 and 2006, respectively, on insurance policies placed by Thilman Filippini LLC.

Note 11 – Recent Developments

In January 2007, the Company sold a one-acre parcel of land located in Fruitport Township, Michigan for \$506,000. Approximately \$437,000 of the proceeds was used to partially repay the mortgage loan from First Bank of Beverly Hills. A gain of approximately \$446,000, before minority interests, was recognized on the transaction.

The Company sold the 191,500 square foot outlet shopping center located in Gretna, Nebraska in June 2007. The gross sales price was \$3.85 million. The Company owned approximately 51% and an affiliate of Amster owned approximately 49% of the entity that owned the center. A gain of approximately \$325,000, before minority interests, was recognized on the transaction.

In June 2007, the Company sold its ownership interest in the entity that formerly owned the outlet center located in Monroe, Michigan. This interest was sold to an affiliate of Amster for \$631,000, 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. A gain of approximately \$106,000 was recognized in connection with this sale transaction. A receivable for the sale of this interest is included in Tenant and Other Accounts Receivable, Net on the consolidated balance sheet at December 31, 2007.

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed of the entity that owns the Gettysburg shopping center in addition to the mezzanine financing entered into at the date of acquisition. Such estimates are subject to refinement as additional valuation information is received.

	<i>(In thousands)</i>
Land	\$15,900
Buildings and improvements	43,729
Construction in progress	153
Restricted cash	884
Other assets	<u>2,411</u>
	<u>\$63,077</u>
Mortgages and other debt assumed	\$49,447
Accounts payable and other accrued expenses	183
Prepaid rents and other tenant liabilities	26
Cash paid (including 2006 payments)	<u>13,421</u>
	<u>\$63,077</u>

The amount shown above for Buildings and Improvements includes \$4,562,000 for tenant origination costs, representing the value of in-place leases at acquisition, and Other Assets includes \$2,222,000 for lease intangibles, representing the net above/below-market lease values at acquisition.

The Company acquired three outlet shopping centers located in Burlington, Washington; Fremont, Indiana and Oshkosh, Wisconsin on August 9, 2007. The centers contain a total of approximately 674,000 square feet of retail space. The price was \$59.1 million, subject to customary prorations. The centers are subject to existing debt of \$53.0 million as of the date of closing which was assumed by the Company.

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The following table summarizes the estimated fair value of the assets acquired and liabilities assumed by the Company pursuant to the acquisition of the shopping centers in Washington, Indiana and Wisconsin at the date of acquisition. Such estimates are subject to refinement as additional valuation information is received.

	<i>(In thousands)</i>
Land	\$ 9,300
Buildings and improvements	50,125
Restricted cash	1,922
Deferred costs	<u>322</u>
	<u>\$61,669</u>
Mortgages and other debt assumed	\$53,834
Accounts payable and other accrued expenses	1,552
Prepaid rents and other tenant liabilities	13
Cash paid	<u>6,270</u>
	<u>\$61,669</u>

The amount shown above for Buildings and Improvements includes \$9,159,000 for tenant origination costs, representing the value of in-place leases at acquisition, and Deferred Costs includes \$109,000 for lease intangibles, representing the net above/below-market values at acquisition.

The results of operations of these four properties have been included from the date of their acquisition forward. The Company acquired these properties in an effort to enhance the value and size of its portfolio by capitalizing on their occupancy levels, tenant rosters, and the opportunity to expand the centers.

Note 12 – Discontinued Operations

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

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

	Year ended <u>December 31, 2007</u>	Year ended <u>December 31, 2006</u>
	<i>(in thousands)</i>	
Total revenue	<u>\$278</u>	<u>\$10,891</u>
Operating expenses	280	5,068
General and administrative expenses	(13)	52
Depreciation and amortization expense	68	2,168
Interest expense	<u>-</u>	<u>5,962</u>
Total expenses	<u>335</u>	<u>13,250</u>
Loss before minority interests and gain on sale of real estate	(57)	(2,359)
Minority interests	37	1,529
Gain on sale of real estate, net of minority interests	<u>492</u>	<u>16,096</u>
Income from discontinued operations, net of minority interests	<u>\$472</u>	<u>\$15,266</u>

In 2007, the Company reclassified the vacant land parcels owned in Norton Shores and Fruitport Township, Michigan from Real Estate Held for Sale to Other Assets on the consolidated balance sheet as they no longer met the criteria for this classification.

Note 13 – Subsequent Events

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 (See Note 9). The Company will recognize a net gain on the transaction in the third quarter of 2008.