Section 1: 10-K (10-K)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)
☑ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2018

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 000-55580

HIGHLANDS REIT, INC.

(Exact Name of Registrant as Specified in Its Charter)

Maryland	**81-0862795**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
332 S Michigan Avenue, Ninth Floor Chicago, Illinois	**60604**
(Address of Principal Executive Offices)	**(Zip Code)**

(312) 583-7990
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, par value $0.01 per share
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ☐ Yes ☑ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. ☐ Yes ☑ No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ☑ Yes ☐ No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). ☑ Yes ☐ No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☑

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definition of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller reporting company	Emerging growth company
☐	☐	☑	☑	☑

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to section 13(a) of the Exchange Act. ☑

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
☐ Yes ☑ No

There is no established market for the registrant's shares of common stock. The aggregate market value of the registrant's common stock held by non-affiliates of the registrant as of June 29, 2018 (the last business day of the registrant's most recently completed second quarter) was approximately $287.6 million, based on the estimated per share value of $0.33 as established by the registrant on December 31, 2017.

As of March 21, 2019 there were 875,589,393 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Annual Report on Form 10-K incorporates by reference portions of the registrant's Proxy Statement for its 2019 Annual Meeting of Stockholders to be held on May 9, 2019.

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Part I

Disclosure Regarding Forward-Looking Statements.

Certain statements in this Annual Report on Form 10-K, other than purely historical information, are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These statements include statements about Highlands' plans, objectives, strategies, financial performance and outlook, trends, the amount and timing of future cash distributions, prospects or future events and involve known and unknown risks that are difficult to predict. As a result, our actual financial results, performance, achievements or prospects may differ materially from those expressed or implied by these forward-looking statements. In some cases, you can identify forward-looking statements by the use of words such as "may," "could," "expect," "intend," "plan," "seek," "anticipate," "believe," "estimate," "guidance," "predict," "potential," "continue," "likely," "will," "would," "illustrative" and variations of these terms and similar expressions, or the negative of these terms or similar expressions. Such forward-looking statements are necessarily based upon estimates and assumptions that, while considered reasonable by Highlands and its management based on their knowledge and understanding of the business and industry, are inherently uncertain. These statements are not guarantees of future performance, and stockholders should not place undue reliance on forward-looking statements. There are a number of risks, uncertainties and other important factors, many of which are beyond our control, that could cause our actual results to differ materially from the forward-looking statements contained in this Annual Report on Form 10-K. Such risks, uncertainties and other important factors include, among others: the risks, uncertainties and factors set forth under "Part I-Item IA. Risk Factors" and "Part II-Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations," and the risks and uncertainties related to the following: business, financial and operating risks inherent to real estate investments and the industry; our ability to renew leases, lease vacant space, or re-let space as leases expire; our ability to repay or refinance our debt as it comes due; the nature of our properties may make them more difficult to sell or re-lease due to their specific characteristics as described elsewhere in this report; the business, financial and operating risks inherent to real estate investments; contraction in the global economy or low levels of economic growth; our ability to sell our assets at a price and on a timeline consistent with our investment objectives, or at all; our ability to service our debt; changes in interest rates and operating costs; compliance with regulatory regimes and local laws; uninsured or underinsured losses, including those relating to natural disasters or terrorism; our status as an emerging growth company; the amount of debt that we currently have or may incur in the future; provisions in our debt agreements that may restrict the operation of our business; our organizational and governance structure; our status as a REIT; the cost of compliance with and liabilities under environmental, health and safety laws; adverse litigation judgments or settlements; the outcomes and projected length of any foreclosure proceedings relating to our assets; changes in real estate and zoning laws and increase in real property tax rates; changes in federal, state or local tax law, including legislative, administrative, regulatory or other actions affecting REITs; the impact of the changes in the tax code as a result of recent U.S. federal income tax reform and uncertainty as to how some of those changes may be applied; changes in governmental regulations or interpretations thereof; and estimates relating to our ability to make distributions to our stockholders in the future.

These factors are not necessarily all of the important factors that could cause our actual financial results, performance, achievements or prospects to differ materially from those expressed in or implied by any of our forward-looking statements. Other unknown or unpredictable factors also could harm our results. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements set forth above.

Forward-looking statements speak only as of the date they are made, and we do not undertake or assume any obligation to update publicly any of these forward-looking statements to reflect actual results, new information or future events, changes in assumptions or changes in other factors affecting forward-looking statements, except to the extent required by applicable laws. If we update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect to those or other forward-looking statements.

Item 1. Business

Overview

We are a self-advised and self-administered real estate investment trust ("REIT") created to own and manage substantially all of the "non-core" assets previously owned and managed by our former parent, InvenTrust Properties Corp., a Maryland corporation ("InvenTrust"). On April 28, 2016, we were spun-off from InvenTrust through a pro rata distribution (the "Distribution") by InvenTrust of 100% of the outstanding shares of our common stock to holders of InvenTrust's common stock. Prior to or concurrent with the separation, we and InvenTrust engaged in certain reorganization transactions that were designed to consolidate substantially all of InvenTrust's remaining "non-core" assets in Highlands.

This portfolio of "non-core" assets, which were acquired by InvenTrust between 2005 and 2008, included assets that are special use, single tenant or build to suit; face unresolved legal issues; are in undesirable locations or in weak markets or submarkets; are aging or functionally obsolete; and/or have sub-optimal leasing metrics. A number of our assets are retail properties located in tertiary markets, which are particularly susceptible to the negative trends affecting retail real estate. As a result of these characteristics, such assets are difficult to lease, finance and refinance and are relatively illiquid compared to other types of real estate assets. These factors also significantly limit our asset disposition options, impact the timing of such dispositions and restrict the viable options available to the Company for a future potential liquidity event.

Our strategy is focused on preserving, protecting and maximizing the total value of our portfolio with the long-term objective of providing stockholders with a return of their investment. We engage in rigorous asset management, and seek to sustain and enhance our portfolio, and improve the quality and income-producing ability of our portfolio, by engaging in selective dispositions, acquisitions, capital expenditures, financing, refinancing and enhanced leasing. We are also focused on cost containment efforts across our portfolio, improving our overall capital structure and making select investments in our existing "non-core" assets to maximize their disposition value. To the extent we are able to generate cash flows from operations or dispositions of assets, in addition to the cash uses outlined above, our board of directors has determined that it is in the best interests of the Company to seek to reinvest in assets that are more likely to generate more reliable and stable cash flows, such as multi-family assets, as part of the Company's overall strategy to optimize the value of the portfolio, enhance our options for a future potential liquidity event and maximize shareholder value. Given the nature and quality of the "non-core" assets in our portfolio as well as current market conditions, we expect this strategy will take multiple years to develop and execute.

As of December 31, 2018, our portfolio consisted of one office asset, two industrial assets, five retail assets, five multi-family assets, one correctional facility, two parcels of unimproved land and one bank branch. All of our assets are located in the United States, with little geographic concentration. We currently have four business segments, consisting of (i) net lease, (ii) retail, (iii) multi-tenant office and (iv) multi-family. Our unimproved land assets are presented in other assets (see Note 12 to the consolidated financial statements for additional information regarding segment reporting). We may have additional or fewer segments in the future to the extent we enter into additional real property sectors, dispose of property sectors, or change the character of assets. Highlands was incorporated in December 2015 as a Maryland corporation and operates in a manner that allows us to continue to qualify as a REIT for U.S. federal tax purposes.

2018 Highlights

- In April 2018, the Company completed the transition of its transfer agent from DST Systems to Computershare.

- Effective April 23, 2018, the Company hired Paul Melkus as its Chief Financial Officer ("CFO"). Mr. Melkus previously served as Director of Highlands. Prior to joining the Company, Mr. Melkus served as Global Head of Capital Markets - Real Estate and Infrastructure Department for Abu Dhabi Investment Authority. As CFO of Highlands, Mr. Melkus is charged with developing, implementing and managing all financial related aspects of the Company's strategic plans.

- On May 15, 2018, the Company acquired The Lafayette, a 41-unit multi-family asset located in Denver, Colorado, for a purchase price of $9.5 million.

- During the second quarter of 2018, the Company completed construction on an outpad development at its Lincoln Mall property, adding approximately 10,000 square feet of retail space for additional tenants.

- On July 31, 2018, the Company leased approximately 50% of its multi-tenant office asset located in San Jose, California, to Alta Devices, Inc., a maker of flexible solar panels and subsidiary of Hanergy Holdings Group.

- On August 7, 2018, we completed the sale of our vacant and unleased correctional facility located in Haskell, Texas, for a sale price of $3.6 million.

- On August 22, 2018, the Company acquired 1620 Central Street, a 47-unit multi-family asset located in Evanston, Illinois, for a purchase price of $20.5 million.

- On September 12, 2018, the Company acquired Kenilworth Court, a 30-unit multi-family asset located in Denver, Colorado, for a purchase price of $5.8 million.

- On September 24, 2018, we sold our retail assets located in Longview, Washington, for a sale price of $38.3 million. We paid off the mortgage debt of $19.5 million with the proceeds from the sale, which was scheduled to mature on May 1, 2021.

- On December 28, 2018, we completed the sale of our multi-tenant office asset located in Pittsburgh, Pennsylvania, for a sale price of $38.5 million.

Recent Developments

- On January 8, 2019, the Company acquired The Detroit Apartments and Detroit Terraces, two adjacent apartment buildings with 80 units, located in Denver, Colorado, for a purchase price of $19.0 million.

- On February 13, 2019, we entered into an agreement to sell our Lincoln Mall asset, a retail asset located in Lincoln, Rhode Island, for a gross sale price of $57.0 million. The sale of Lincoln Mall is expected to be completed in the second quarter of 2019.

- On February 15, 2019, we entered into a credit agreement (the "Credit Agreement") with Huntington National Bank that provides for a revolving credit facility of up to $50.0 million and a term loan facility of up to $50.0 million with an accordion feature for an additional $100.0 million in potential financing.

References to "Highlands," "the Company," "we" or "us" are to Highlands REIT, Inc., as well as all of Highlands' wholly-owned subsidiaries. For the complete presentation of our reportable segments, see Note 11 to our Consolidated Financial Statements for the years ended December 31, 2018 and 2017.

Business Strategy

Our investment objectives are to preserve, protect and maximize the total value of our portfolio. Given the quality and nature of the assets in our legacy "non-core" portfolio, which are generally disjointed, non-institutional grade, relatively illiquid, require substantial time and investment to bring to market and are not positioned to protect capital or deliver an acceptable risk-adjusted return, as well as current market conditions, we expect that this strategy will take multiple years to develop and execute. In order to meet our investment objectives, we intend to continue to engage in rigorous asset management, seek to sustain and enhance our portfolio, and improve the quality and income-producing ability of our portfolio, by engaging in selective dispositions, acquisitions, capital expenditures, financing, refinancing and enhanced leasing. We are also focused on cost containment efforts across our portfolio, improving its overall capital structure and making select investments in our existing "non-core" assets to maximize their value. To the extent we are able to generate cash flows from operations or dispositions of assets, in addition to the cash uses outlined above, our board of directors has determined that it is in the best interests of the Company to seek to reinvest in assets that are more likely to generate more reliable and stable cash flows, such as multi-family assets, as part of the Company's overall strategy to optimize the value of the portfolio, enhance our options for a future liquidity event and maximize shareholder value. We are currently exploring appropriate markets and evaluating potential acquisitions to add to our multi-family portfolio.

Disposition Policy

We evaluate each of our assets on a rigorous and ongoing basis in an effort to optimize and enhance the total value of our portfolio. In furtherance of this strategy, for the foreseeable future, we anticipate disposing of select “non-core” assets that are not generating income or have unfavorable risk-adjusted returns and generally, using the proceeds from such sales to prepare other “non-core” assets for sale or invest in assets that are more likely to generate more reliable and stable cash flows, such as multi-family assets.

The determination of when a particular asset should be sold or otherwise disposed of will be made after consideration of all of the relevant factors, including whether such disposition will better position the portfolio for a potential future liquidity event, prevailing and projected economic and market conditions, the cash flow being generated by a particular asset, tax implications of a disposition, investment opportunities for any cash proceeds, debt characteristics of the asset, and whether the value of the asset is anticipated to decline or increase. The timing of any disposition will depend upon then-prevailing economic and market conditions and the factors described above, which could result in differing holding periods among the assets. There can be no assurance that dispositions will occur as planned, on acceptable terms, or within our desired timing.

Foreclosure Proceedings

Our Dulles Executive Plaza, AT&T-Hoffman Estates and AT&T-St. Louis assets have all been conveyed to their respective lenders through various cooperative foreclosure proceedings. Such foreclosures have adversely impacted our revenues and cash flows from operations. See also “Risk Factors-Risks Related to Debt Financing-If we are unable to repay or refinance our existing debt as it comes due, we may need to sell the underlying asset sooner than anticipated or the lender may foreclose, in which case our financial condition, cash flows and results of operations could be materially adversely affected.”

Financing Strategy

Certain of our existing assets are currently encumbered by debt, and debt financing may be used from time to time for property improvements, tenant improvements, acquisition financing, leasing commissions, general corporate purposes and other working capital needs. The form of our indebtedness may vary and could be long-term or short-term, secured or unsecured, or fixed-rate or floating rate. We will not enter into interest rate swaps or caps, or similar hedging transactions or derivative arrangements for speculative purposes, but may do so in order to manage or mitigate our interest rate risk on variable rate debt. For additional information regarding our existing debt, including our credit facility, please refer to “Management's Discussion and Analysis - Borrowings.”

As of December 31, 2018 and December 31, 2017, no debt was recourse to the Company, although the Company or its subsidiaries may act as guarantor under customary, non-recourse carve-out clauses in our wholly-owned property-owning subsidiaries' mortgage loans. On February 15, 2019, we entered into the Credit Agreement which provides for a secured revolving credit facility of up to $50.0 million and a secured term loan facility of up to $50.0 million with an accordion feature for an additional $100.0 million in potential financing. See Note 16 to the consolidated financial statements for additional information regarding subsequent events.

Customers

Approximately 23.0% of our current revenue derives from a net lease with The GEO Group, Inc. on our Hudson correctional facility asset. The lease on this property expires in January of 2020 and if we are unable to re-lease the property, or re-lease on similar terms, our financial condition, cash flows and results of operations would be adversely affected. A significant portion of our revenue has historically been generated by AT&T, Inc. (“AT&T”). For the year ended December 31, 2017, approximately 19% of our total annualized rental income was generated by single-tenant assets leased to affiliates of AT&T. One of those leases expired in 2017, with the underlying asset being foreclosed upon. The loss of revenue historically generated by those properties leased to AT&T has had an adverse impact on our future revenues.

Conflict of Interest Policy

We maintain policies designed to reduce or eliminate potential conflicts of interest. Any transaction between us and any director, officer or 5% stockholder must be approved pursuant to our related party transaction policy. In addition, we have adopted a code of business conduct and ethics that seeks to identify and mitigate conflicts of interest between our employees, directors and officers and our company. However, we cannot assure you that these policies or provisions of law will always be successful in eliminating or minimizing the influence of such conflicts, and if they are not successful, decisions could be made that might fail to reflect fully the interests of stockholders.

Certain Other Policies

We intend to engage in future investment activities in a manner that is consistent with the requirements applicable to REITs for U.S. federal income tax purposes, unless the board of directors determines that it is no longer in our best interest to so qualify as a REIT.

We may issue senior securities, purchase and sell investments, offer securities in exchange for property and repurchase or reacquire shares or other securities in the future. To the extent we engage in these activities, we will comply with applicable law.

We do not currently have policies in place with respect to making loans to other persons (other than our conflict of interest policies described above) or investing in securities.

Competition

We are subject to significant competition in seeking tenants for the leasing of our assets, buyers for the sale of assets and sellers for the acquisition of assets. We compete with many third parties engaged in real estate investment activities, including other REITs, specialty finance companies, savings and loan associations, banks, mortgage bankers, insurance companies, mutual funds, institutional investors, investing banking firms, lenders, hedge funds, governmental bodies and other entities. Many of our competitors have substantially greater financial and other resources than we have and may have substantially more operating experience than us. We also face competition from other real estate investment programs for buyers, sellers and tenants that may be suitable for us. We perceive there to be a lower level of competition for certain assets in our portfolio based on, among other things, the characteristics of such assets, the number of willing buyers and the volume of transactions in their respective markets, which may make it challenging for us to sell these assets or attract tenants. Many of our retail tenants face intense competition from online retailers, which impacts demand for our brick-and-mortar retail real estate. A shift to e-commerce sales may adversely impact our retail tenants' sales thus causing those retailers to reduce the number of their retail locations in the future.

Regulations

Our assets are subject to various U.S. federal, state and local laws, ordinances and regulations, including, among other things, zoning regulations, land use controls, environmental controls relating to air and water quality, noise pollution and indirect environmental impacts such as increased motor vehicle activity. We believe that we have all permits and approvals necessary under current law to operate our assets.

Environmental

As an owner of real estate, we are subject to various environmental laws of U.S. federal, state and local governments. Compliance with existing laws has not had a material adverse effect on our financial condition or results of operations, and management does not believe it will have such an impact in the future. However, we cannot predict the impact of unforeseen environmental contingencies or new or changed laws or regulations on assets in which we hold an interest, or on assets that may be acquired directly or indirectly in the future.

Employees

At December 31, 2018, we had nine full-time employees, not including consultants and part-time workers. Due to the nature of our portfolio and our business strategy, we rely on consultants, professional firms and third parties, under our supervision, to perform many routine operations for us.

Insurance

We have insurance coverage for our properties which includes the type of coverage and limits we believe to be appropriate for each property and our business operations. Such coverage typically includes commercial general liability and property insurance which, includes property damage and loss of rental income resulting from such perils as fire, windstorm, flood and extended coverage. Our management believes our insurance coverage contains policy terms and conditions and insured limits that are customary for similar properties and operations.

Principal Executive Offices

Our principal executive offices are located at 332 S Michigan Avenue, Ninth Floor, Chicago, Illinois, 60604, and our telephone number is (312)-583-7990. We maintain a website at www.highlandsreit.com.

Available Information

Stockholders may obtain copies of our filings with the Securities and Exchange Commission ("SEC"), free of charge, from the website maintained by the SEC at www.sec.gov or from our website at www.highlandsreit.com. These include our annual report on Form 10-K, quarterly reports on form 10-Q, and our current reports on Form 8-K. Our filings will be available on our website as soon as reasonably practicable after we electronically file such materials with the SEC. However, the information from our website is not incorporated by reference into this report.

Item 1A. Risk Factors

You should carefully consider each of the following risks described below and all of the other information in this Annual Report on Form 10-K in evaluating us. Our business, financial condition, cash flows, results of operations and/or ability to pay distributions to our stockholders could be materially adversely affected by any of these risks. This Annual Report on Form 10-K also contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including the risks faced by us described below and elsewhere in this Annual Report on Form 10-K. See "Disclosure Regarding Forward-Looking Statements."

Risks Related to Our Business and Industry

Short-term multi-family community leases associated with any multi-family residential properties we acquire may expose us to the effects of declining market rent and could adversely impact our ability to make cash distributions to our stockholders.

We expect that, to the extent that we invest in any multi-family residential properties, substantially all of our multi-family community leases will be for a term of one year or less. Because these leases generally permit the residents to leave at the end of the lease term without penalty, our rental revenues may be impacted by declines in market rents more quickly than if our leases were for longer terms.

The costs of compliance with laws and regulations relating to our residential properties may adversely affect our income and the cash available for any distributions.

Various laws, ordinances, and regulations affect multi-family residential properties, including regulations relating to recreational facilities, such as activity centers and other common areas. In addition, rent control laws may be applicable to any of our residential properties.

Some of these laws and regulations have been amended so as to require compliance with new or more stringent standards as of future dates. Compliance with new or more stringent laws or regulations, stricter interpretation of existing laws or the future discovery of environmental contamination may require material expenditures by us. Future laws, ordinances or regulations may impose material environmental liabilities, and the current environmental condition of our properties might be affected by the operations of the tenants, by the existing condition of the land, by operations in the vicinity of the properties, such as the presence of underground storage tanks, or by the activities of unrelated third parties.

These laws typically allow liens to be placed on the affected property. In addition, there are various local, state and federal fire, health, life-safety and similar regulations which we may be required to comply with, and which may subject us to liability in the form of fines or damages for noncompliance.

Any newly acquired or developed multi-family residential properties must comply with Title II of the Americans with Disabilities Act (the "ADA") to the extent that such properties are "public accommodations" and/or "commercial facilities" as defined by the ADA. Compliance with the ADA requires removal of structural barriers to handicapped access in certain public areas of the properties where such removal is "readily achievable." Our properties may not comply in all material respects with all present requirements under the ADA and applicable state laws. When acquiring properties, we may not succeed in placing the burden on the seller to ensure compliance with the ADA. Noncompliance with the ADA could result in the imposition of injunctive relief, monetary penalties or, in some cases, an award of damages to private litigants. The cost of defending against any claims of liability under the ADA or the payment of any fines or damages could adversely affect our financial condition and affect cash available to return capital and the amount of distributions to you.

Increased competition and increased affordability of residential homes could limit our ability to retain tenants, lease multi-family homes or increase or maintain rents.

The multi-family sector is highly competitive. This competition could reduce occupancy levels and revenues at our multi-family communities, which would adversely affect our operations. We face competition from many sources. We face competition from other multi-family communities both in the immediate vicinity and in the larger geographic market where our multi-family communities are located. These competitors may have greater experience and financial resources than us giving them an advantage in attracting tenants to their properties. For example, our competitors may be willing to offer multi-family homes at rental rates below our rates, causing us to lose existing or potential tenants and pressuring us to reduce our rental rates to retain existing tenants or convince new tenants to lease space at our property. Overbuilding of multi-family communities may also occur. If so, this will increase the number of multi-family homes available and may decrease occupancy and multi-family rental rates. In addition, increases in operating costs due to inflation may not be offset by increased multi-family rental rates. Furthermore, multi-family communities we acquire most likely compete, or will compete, with numerous housing alternatives in attracting tenants, including owner occupied single- and multi-family homes available to rent or purchase. Competitive housing in a particular area and the increasing affordability of owner occupied single and multi-family homes available to rent or buy caused by low mortgage interest rates and government programs to promote home ownership could adversely affect our ability to retain our tenants, lease multi-family homes and increase or maintain rental rates.

We could be negatively impacted by the condition of Fannie Mae or Freddie Mac and by changes in government support for multi-family housing.

Fannie Mae and Freddie Mac are a major source of financing for multi-family real estate in the United States. In the future, we may utilize loan programs sponsored by these entities as a source of capital to finance our growth and our operations. In September 2008, the U.S. government assumed control of Fannie Mae and Freddie Mac and placed both companies into a government conservatorship under the Federal Housing Finance Agency. In December 2009, the U.S. Treasury increased its financial support for these conservatorships. In February 2011, the Obama administration released its blueprint for winding down Fannie Mae and Freddie Mac and for reforming the system of housing finance. Since that time, members of Congress have introduced and Congressional committees have considered a substantial number of bills that include comprehensive or incremental approaches to winding down Fannie Mae and Freddie Mac or changing their purposes, businesses, or operations. A decision by the U.S. government to eliminate or downscale Fannie Mae or Freddie Mac or to reduce government support for multi-family housing more generally may adversely affect interest rates, capital availability, development of multi-family communities and the value of multi-family assets and, as a result, may adversely affect our future growth and operations.

We may be unable to renew leases, lease vacant space or re-let space as leases expire, thereby increasing or prolonging vacancies, which could adversely affect our financial condition, cash flows and results of operations.

As of December 31, 2018, the current lease term for leases representing approximately 6.0% of the rentable square feet and approximately 5.5% of the annualized base rent of the assets in our portfolio will expire in 2019 (not taking into account any renewal options), and an additional 8.4% of the rentable square feet of the assets in our portfolio was vacant. In addition, approximately 23.0% of our current revenue derives from a net lease with The GEO Group, Inc. on our Hudson correctional facility asset. The lease on this property expires in January of 2020 and if we are unable to re-lease the property, or re-lease on similar terms, our financial condition, cash flows and results of operations would be adversely affected. We cannot assure you that leases will be renewed or that our assets will be re-leased on terms equal to or better than the current terms, or at all. We also may not be able to lease space which is currently not occupied on acceptable terms and conditions, if at all. Certain of our assets are special use, single-tenant or build-to-suit; are in undesirable locations or weak markets or sub-markets; and/or are aging or functionally obsolete. As a result, these properties may be very difficult to lease. In addition, some of our tenants have leases that include early termination provisions that permit the lessee to terminate all or a portion of its lease with us after a specified date or upon the occurrence of certain events with little or no liability to us. We may be required to offer substantial rent abatements, tenant improvements, early termination rights or below-market renewal options to retain these tenants or attract new ones. It is possible that, in order to lease currently vacant space, or space that may become vacant, we will be required to make rent or other concessions to tenants, accommodate requests for renovations, make tenant improvements or and other improvements or provide additional services to our tenants. As a result, we may have to make significant capital or other expenditures in order to retain tenants whose leases expire or to attract new tenants. Portions of our assets may remain vacant for extended periods of time. If the rental rates for our assets decrease, our existing tenants do not renew their leases or we do not re-lease a significant portion of our available space and space for which leases will expire, our financial condition, cash flows and results of operations could be adversely affected.

We depend on tenants for our revenue, and accordingly, lease terminations, vacancies, tenant defaults and bankruptcies could adversely affect the income produced by our assets.

Our business and financial condition depends on the financial stability of our tenants. Certain economic conditions may adversely affect one or more of our tenants. For example, business failures and downsizings can affect the tenants of our office and industrial assets. As a result, our tenants may delay lease commencements, decline to extend or renew their leases upon expiration, fail to make rental payments, or declare bankruptcy. Individual tenants may lease more than one asset or space at more than one asset. As a result, the financial failure of one tenant could increase vacancy at more than one asset or cause more than one lease to become non-performing. Any of these actions could result in the termination of the tenants' leases, the expiration of existing leases without renewal or the loss of rental income attributable to the terminated or expired leases, any of which could make our assets difficult to sell and could have a material adverse effect on our financial condition, cash flows and results of operations.

In the event of a tenant default or bankruptcy, we may experience delays in enforcing our rights as a landlord and may incur substantial costs in protecting our investment and re-leasing our asset. Specifically, a bankruptcy filing by, or relating to, one of our tenants or a lease guarantor would bar efforts by us to collect pre-bankruptcy debts from that tenant or lease guarantor, or its assets, unless we receive an order permitting us to do so from the bankruptcy court. In addition, we cannot evict a tenant solely because of bankruptcy. The bankruptcy of a tenant or lease guarantor could delay our efforts to collect past-due balances under the relevant leases, and could ultimately preclude collection of these sums. If a lease is rejected by a tenant in bankruptcy, we would have only a general, unsecured claim for damages. An unsecured claim would only be paid to the extent that funds are available and only in the same percentage as is paid to all other holders of general, unsecured claims. Restrictions under the bankruptcy laws further limit the amount of any other claims that we can make if a lease is rejected. As a result, it is likely that we would recover substantially less than the full value of the remaining rent during the term, and may not recover any balances at all.

Our portfolio includes assets that are special use, single-tenant and/or build-to-suit; face unresolved legal issues; are aging or functionally obsolete; or have sub-optimal leasing metrics, which may make them difficult to lease, finance or sell.

Our portfolio includes assets that are special use, single-tenant and/or build-to-suit; face unresolved legal issues; are aging or functionally obsolete; or have sub-optimal leasing metrics, which may make them relatively illiquid compared to other types of real estate assets. With these assets, if the current lease is terminated or not renewed, we may be required to make significant capital expenditures to reposition the asset or make rent concessions in order to lease the asset to another tenant, finance the asset or sell the asset.

Many of our properties are located in weak markets or submarkets, which may adversely affect our ability to rent such properties, increase rental rates and/or sell such properties.

Certain of our properties are located in weak markets or submarkets. These markets may be experiencing economic slowdowns, little or no job growth, and/or high numbers of vacancies. Additionally, demand for certain types of assets, such as office assets, may have shifted from suburban areas to city centers, or vice versa. Also, with respect to our retail assets, a shift toward increased e-commerce sales could adversely impact the demand for our retail assets if retail tenants reduce the number of their brick-and-mortar locations. The weakness of an asset's market or submarket may adversely affect our ability to rent such properties, increase rental rates and/or sell such properties, which could have a material adverse effect on our financial condition, cash flows or results of operations.

Economic and market conditions could negatively impact our business, results of operations and financial condition.

Our business may be affected by market and economic challenges experienced by the U.S. or global economies or the real estate industry as a whole or by the local economic conditions in the markets in which our assets are located, including any dislocations in the credit markets. These conditions may materially affect our tenants, the value and performance of our assets and our ability to sell assets, as well as our ability to make principal and interest payments on, or refinance, any outstanding debt when due. Challenging economic conditions may also impact the ability of certain of our tenants to enter into new leasing transactions or satisfy rental payments under existing leases. Specifically, these conditions may have the following consequences:

- the financial condition of our tenants may be adversely affected, which may result in us having to increase concessions, reduce rental rates or make capital improvements in order to maintain occupancy levels or to negotiate for reduced space needs, which may result in a decrease in our occupancy levels;

- significant job loss may occur, which may decrease demand for space and result in lower occupancy levels, which will result in decreased revenues and which could diminish the value of assets, which depend, in part, upon the cash flow generated by our assets;

- an increase in the number of bankruptcies or insolvency proceedings of our tenants and lease guarantors, which could delay our efforts to collect rent and any past due balances under the relevant leases and ultimately could preclude collection of these sums;
- our ability to borrow on terms and conditions that we find acceptable may be limited;
- the amount of capital that is available to finance assets could diminish, which, in turn, could lead to a decline in asset values generally, slow asset transaction activity, and reduce the loan to value ratio upon which lenders are willing to lend; and
- the value of certain of our assets may decrease below the amounts we paid for them, which would limit our ability to dispose of assets at attractive prices or for potential buyers to obtain debt financing secured by these assets and could reduce our ability to finance our business.

Our ongoing business strategy involves the selling of assets; however, we may be unable to sell an asset at acceptable terms and conditions, if at all.

We intend to hold our assets until such time as we determine that a sale or other disposition appears to be advantageous to achieve our investment objectives. The determination of when a particular asset should be sold or otherwise disposed of will be made after consideration of all of the relevant factors, including whether such disposition will better position the portfolio for a potential future liquidity event, prevailing and projected economic and market conditions, the cash flow being generated by a particular asset, tax implications of a disposition, debt characteristics of the asset, and whether the value of the asset or other investment is anticipated to decline or increase investment opportunities for any proceeds. Even if we do determine to sell an asset, market conditions or individual asset characteristics may negatively affect the value of our assets and therefore reduce our return on the investment or prevent us from selling the asset on acceptable terms or at all. Some of our leases contain provisions giving the tenant a right to purchase the asset, such as a right of first offer or right of first refusal, which may lessen our ability to freely control the sale of the asset. Debt levels may exceed the value of our assets in the future, making it more difficult for us to rent, refinance or sell the assets. In addition, real estate investments are relatively illiquid and often cannot be sold quickly, limiting our ability to sell our assets when we decide to do so, or in response to such changing economic or asset-specific issues. Further, economic conditions may prevent potential purchasers from obtaining financing on acceptable terms, if at all, thereby delaying or preventing our ability to sell our assets.

We may not successfully implement our strategy, in which case you may have to hold your investment for an indefinite period.

We are under no obligation to complete our strategy within a specified time period, and market and economic conditions and other factors beyond our control could delay the execution of our strategy. Our investment objectives are to preserve, protect and maximize the total value of our portfolio with the long term objective of providing stockholders with a return of their investment. Given the nature of the assets in our portfolio, we expect that this strategy will take multiple years to develop and execute. We may not be able to control the timing of the sale of our assets, and there can be no assurance that we will be able to sell our assets so as to return any portion of our stockholders’ invested capital, particularly our "non-core" assets, or fully satisfy our debt obligations. Our ability to sell our assets may also be limited by our need to avoid a 100% penalty tax that is imposed on gain recognized by a REIT from the sale of assets characterized as dealer property, which may cause us to forego or defer sales of assets that otherwise would be in our best interests.

If we are not successful in implementing our strategy in a timely manner, your shares may continue to be illiquid and you may, for an indefinite period of time, be unable to convert your investment into cash easily, if at all, and could suffer losses on your investment.

Real estate is a competitive business.

We compete with numerous developers, owners and operators of commercial real estate assets in the leasing market, many of which own assets similar to, and in the same market areas as, our assets. In addition, some of these competitors may be willing to accept lower returns on their investments than we are, and many have greater resources than we have and may enjoy significant competitive advantages that result from, among other things, a lower cost of capital and enhanced operating efficiencies. Principal factors of competition include rents charged, attractiveness of location, the quality of the asset and breadth and quality of services provided. Our success depends upon, among other factors, trends affecting national and local economies, the financial condition and operating results of current and prospective tenants and customers, availability and cost of capital, construction and renovation costs, taxes, governmental regulations, legislation, job creation and population trends.

We also face competition from other real estate investment programs for buyers. We perceive there to be a smaller universe of potential buyers for many of the types of assets that comprise our portfolio in comparison to assets in more core real estate sectors, which will likely make it challenging for us to sell our assets.

Any difficulties in obtaining capital necessary to make tenant improvements, pay leasing commissions and make capital improvements at our assets could materially and adversely affect our financial condition and results of operations.

Ownership of real estate is a capital intensive business that requires significant capital expenditures to operate, maintain and renovate assets. Access to the capital that we need to lease, maintain and renovate existing assets is critical to the success of our business. We may not be able to fund tenant improvements, pay leasing commissions or fund capital improvements at our existing assets solely from cash provided from our operating activities. As a result, our ability to fund tenant improvements, pay leasing commissions or fund capital improvements through retained earnings may be restricted. Consequently, we may have to rely upon the availability of debt, net proceeds from the dispositions of our assets or equity capital to fund tenant improvements, pay leasing commissions or fund capital improvements. Our ability to obtain debt on favorable terms or at all may be further limited by the fact that certain properties previously owned by the Company were foreclosed upon. The inability to access capital could impair our ability to compete effectively and harm our business.

There are inherent risks with investments in real estate, including the relative illiquidity of such investments.

Investments in real estate are subject to varying degrees of risk. For example, an investment in real estate cannot generally be quickly sold, and we cannot predict whether we will be able to sell any asset we desire to on the terms set by us or acceptable to us, or the length of time needed to find a willing purchaser and to close the sale of such asset. Moreover, the Internal Revenue Code of 1986, amended (the “Code”) imposes restrictions on a REIT’s ability to dispose of assets that are not applicable to other types of real estate companies. In particular, the tax laws applicable to REITs require that we hold our assets for investment, rather than primarily for sale in the ordinary course of business, which may cause us to forego or defer sales of assets that otherwise would be in our best interests. Therefore, we may not be able to vary our portfolio promptly in response to changing economic, financial, investment and market conditions and dispose of assets at opportune times, on favorable terms or at all, which may adversely affect our cash flows and our ability to make distributions to stockholders.

Investments in real estate are also subject to adverse changes in general economic conditions. Among the factors that could impact our assets and the value of an investment in us are:

- risks associated with the possibility that cost increases will outpace revenue increases and that in the event of an economic slowdown, the high proportion of fixed costs will make it difficult to reduce costs to the extent required to offset declining revenues;
- changes in tax laws and property taxes, or an increase in the assessed valuation of an asset for real estate tax purposes;
- adverse changes in the U.S. federal, state or local laws and regulations applicable to us, including those affecting zoning, fuel and energy consumption, water and environmental restrictions, and the related costs of compliance;
- changing market demographics;
- an inability to finance real estate assets on favorable terms, if at all;
- the ongoing need for owner-funded capital improvements and expenditures to maintain or upgrade assets;
- fluctuations in real estate values or potential impairments in the value of our assets;

- natural disasters, such as earthquakes, floods or other insured or uninsured losses;
- war, political conditions or civil unrest, terrorist activities or threats heightened travel security measures instituted in response to these events; and
- changes in interest rates and availability, cost and terms of financing.

Our assets may be subject to impairment charges that may materially affect our financial results.

Economic and other conditions may adversely impact the valuation of our assets, resulting in impairment charges that could have a material adverse effect on our results of operations and earnings. On a regular basis, we evaluate our assets for impairments based on various triggers, including changes in the projected cash flows of such assets and market conditions. If we determine that an impairment has occurred, then we would be required to make an adjustment to the net carrying value of the asset, which could have a material adverse effect on our results of operations in the accounting period in which the adjustment is made. During 2018, we determined that impairment with respect to two of our properties had occurred, resulting in reductions in net carrying value of those assets by an aggregate of $4.7 million. Furthermore, changes in estimated future cash flows due to a change in our plans, policies, or views of market and economic conditions could result in the recognition of additional impairment losses for already impaired assets, which, under the applicable accounting guidance, could be substantial.

Many real estate costs and certain operating costs are fixed, even if revenue from our assets decreases.

Many real estate costs, such as real estate taxes, insurance premiums, maintenance costs and certain operating costs generally are more fixed than variable and, as a result, are not reduced even when an asset is not fully occupied, rents decrease or other circumstances cause a reduction in revenues. If we are unable to offset these fixed costs with sufficient revenues across our portfolio, it could materially and adversely affect our results of operations and profitability. This risk is particularly acute at our net lease assets.

Operating and other expenses may increase in the future, which may cause our cash flow and our operating results to decrease.

Certain operating expenses and certain general and administrative expenses are not fixed and may increase in the future. Any increases would cause our cash flow and our operating results to decrease. If we are unable to offset these decreases with sufficient revenues across our portfolio, our financial condition, cash flows and results of operations may be materially adversely affected.

Our revenue from our retail assets will be impacted by the success and economic viability of our anchor retail tenants. Our reliance on single or significant tenants in certain buildings may decrease our ability to lease vacated space and adversely affect our financial condition, cash flows and results of operations.

In the retail sector, a tenant occupying all or a large portion of the gross leasable area of a retail center, commonly referred to as an anchor tenant, may become insolvent, may suffer a downturn in business or may decide not to renew its lease. Any of these events would result in a reduction or cessation in rental payments to us and would adversely affect our financial condition. A lease termination by an anchor tenant also could result in lease terminations or reductions in rent by other tenants whose leases may permit cancellation or rent reduction if another tenant’s lease is terminated. Similarly, the leases of some anchor tenants may permit the anchor tenant to transfer its lease to another retailer. The transfer to a new anchor tenant could reduce customer traffic in the retail center and thereby reduce the income generated by that retail center. A transfer of a lease to a new anchor tenant could also allow other tenants to make reduced rental payments or to terminate their leases in accordance with lease terms. If we are unable to re-lease the vacated space to a new anchor tenant, we may incur additional expenses in order to remodel the space to be able to re-lease the space to more than one tenant.

Public resistance to privatization of correctional facilities could negatively impact our tenants at such facilities, which could have an adverse impact on our business, financial condition or results of operations.

The management and operation of correctional facilities by private entities has not achieved complete acceptance by either government agencies or the public. Some governmental agencies have limitations on their ability to delegate their traditional management responsibilities for such facilities to private companies, and additional legislative changes or prohibitions could occur that further increase these limitations. In addition, the movement toward privatization of such facilities has encountered resistance from groups, such as labor unions, that believe that correctional facilities should only be operated by governmental agencies. In addition, negative publicity about poor conditions, an escape, riot or other disturbance at a privatelymanaged facility may result in adverse publicity to the private corrections industry. Any of these occurrences or continued trends may make it more difficult for the tenants of our correctional facilities to renew or maintain existing contracts or to obtain new contracts. Changes in governing political parties could also result in significant changes to previously established views of privatization. Increased public resistance to the privatization of correctional facility could have a material adverse effect on our tenants who operate in this industry, which could adversely impact the value of our correctional facility asset, our ability to re-lease such asset upon expiration of the existing lease term and our results of operations.

The land underlying a portion of one of our assets is subject to a ground lease, which could limit our use of the asset, and a breach or termination of the ground lease could materially and adversely affect us.

We lease a portion of the land underlying one of our assets, Sherman Plaza, from a third party through a ground lease covering such land. As a lessee under a ground lease, we are exposed to the possibility of losing the right to use the portion of our asset covered by the ground lease upon termination, or an earlier breach by us, of the ground lease. The ground lease may also restrict our use of the asset, which may limit our flexibility in renting the asset and may impede our ability to sell the asset.

Uninsured and underinsured losses at our assets could materially and adversely affect our revenues and profitability.

We intend to maintain comprehensive insurance on each of our current assets, including liability, fire and extended coverage, of the type and amount we believe are customarily obtained for or by property owners. There are no assurances that coverage will be available at reasonable rates. Various types of catastrophic losses, like windstorms, earthquakes and floods, environmental events and losses from foreign terrorist activities may not be insurable or may not be economically insurable. Even when insurable, these policies may have high deductibles and/or high premiums. Lenders may require such insurance. Our failure to obtain such insurance could constitute a default under loan agreements, and/or our lenders may force us to obtain such insurance at unfavorable rates, which could materially and adversely affect our profitability and revenues.

In the event of a substantial loss, our insurance coverage may not be sufficient to cover the full current market value or replacement cost of our lost investment. Should an uninsured loss or a loss in excess of insured limits occur, we could lose all or a portion of the capital we have invested in an asset, as well as the anticipated future revenue from the asset. In that event, we might nevertheless remain obligated for any mortgage debt or other financial obligations related to the asset. Inflation, changes in building codes and ordinances, environmental considerations and other factors might also keep us from using insurance proceeds to replace or renovate an asset after it has been damaged or destroyed. Under those circumstances, the insurance proceeds we receive might be inadequate to restore our economic position on the damaged or destroyed property, which could materially and adversely affect our profitability.

In addition, insurance risks associated with potential terrorist acts could sharply increase the premiums we pay for coverage against property and casualty claims. With the enactment of the Terrorism Risk Insurance Program Reauthorization Act of 2007, United States insurers cannot exclude conventional, chemical, biological, nuclear and radiation terrorism losses. These insurers must make terrorism insurance available under their property and casualty insurance policies; however, this legislation does not regulate the pricing of such insurance. In many cases, mortgage lenders have begun to insist that commercial property owners purchase coverage against terrorism as a condition of providing mortgage loans. Such insurance policies may not be available at a reasonable cost, which could inhibit our ability to finance or refinance our assets. In such instances, we may be required to provide other financial support, either through financial assurances or self-insurance, to cover potential losses. We may not have adequate coverage for such losses, which could materially and adversely affect our revenues and profitability.

We could incur significant, material costs related to government regulation and litigation with respect to environmental matters, which could materially and adversely affect our revenues and profitability.

Our assets are subject to various U.S. federal, state and local environmental laws that impose liability for contamination. Under these laws, governmental entities have the authority to require us, as the current owner of an asset, to perform or pay for the clean-up of contamination (including hazardous substances, asbestos and asbestos-containing materials, waste or petroleum products) at, on, under or emanating from the asset and to pay for natural resource damages arising from such contamination. Such laws often impose liability without regard to whether the owner or operator or other responsible party knew of, or caused such contamination, and the liability may be joint and several. Because these laws also impose liability on persons who owned an asset at the time it became contaminated, it is possible we could incur cleanup costs or other environmental liabilities even after we sell assets. Contamination at, on, under or emanating from our assets also may expose us to liability to private parties for costs of remediation and/or personal injury or property damage. In addition, environmental laws may create liens on contaminated sites in favor of the government for damages and costs it incurs to address such contamination. If contamination is discovered on our assets, environmental laws also may impose restrictions on the manner in which the assets may be used or businesses may be operated, and these restrictions may require substantial expenditures. Moreover, environmental contamination can affect the value of an asset and, therefore, an owner's ability to borrow funds using the asset as collateral or to sell the asset on favorable terms or at all. Furthermore, persons who sent waste to a waste disposal facility, such as a landfill or an incinerator, may be liable for costs associated with cleanup of that facility.

In addition, our assets are subject to various U.S. federal, state, and local environmental, health and safety laws and regulations that address a wide variety of issues, including, but not limited to, storage tanks, air emissions from emergency generators, storm water and wastewater discharges, lead-based paint, mold and mildew, and waste management. Some of our assets may handle and use hazardous or regulated substances and wastes as part of their operations, which substances and wastes are subject to regulation. Our assets incur costs to comply with these environmental, health and safety laws and regulations and could be subject to fines and penalties for non-compliance with applicable requirements.

Environmental laws in the U.S. also require that owners or operators of buildings containing asbestos properly manage and maintain the asbestos, adequately inform or train those who may come into contact with asbestos and undertake special precautions, including removal or other abatement, if that asbestos is disturbed during building renovation or demolition. These laws may impose fines and penalties on building owners or operators who fail to comply with these requirements and may allow third parties to seek recovery from owners or operators for personal injury associated with exposure to asbestos. Some of our assets may contain asbestos-containing building materials.

When excessive moisture accumulates in buildings or on building materials, mold growth may occur, particularly if the moisture problem remains undiscovered or is not addressed over a period of time. Some molds may produce airborne toxins or irritants. Indoor air quality issues can also stem from inadequate ventilation, chemical contamination from indoor or outdoor sources, and other biological contaminants such as pollen, viruses and bacteria. Indoor exposure to airborne toxins or irritants above certain levels can be alleged to cause a variety of adverse health effects and symptoms, including allergic or other reactions. As a result, the presence of significant mold or other airborne contaminants at any of our assets could require us to undertake a costly remediation program to contain or remove the mold or other airborne contaminants from the affected asset or increase indoor ventilation. In addition, the presence of significant mold or other airborne contaminants could expose us to liability to third parties if property damage or personal injury occurs.

Liabilities and costs associated with environmental contamination at, on, under or emanating from our assets, defending against claims related to alleged or actual environmental issues, or complying with environmental, health and safety laws could be material and could materially and adversely affect us. We can make no assurances that changes in current laws or regulations or future laws or regulations will not impose additional or new material environmental liabilities or that the current environmental condition of our assets will not be affected by our operations, the condition of the assets in the vicinity of our assets, or by third parties unrelated to us. The discovery of material environmental liabilities at our assets could subject us to unanticipated significant costs, which could significantly reduce or eliminate our profitability and the cash available for distribution to our stockholders.

Compliance or failure to comply with the Americans with Disabilities Act and other safety regulations and requirements could result in substantial costs.

Under the Americans with Disabilities Act of 1990 and the Accessibility Guidelines promulgated thereunder, which we refer to collectively as the ADA, all public accommodations must meet various U.S. federal requirements related to access and use by disabled persons. Compliance with the ADA's requirements could require removal of access barriers, and non-compliance could result in the U.S. government imposing fines or in private litigants winning damages.

Our assets are also subject to various U.S. federal, state and local regulatory requirements, such as state and local fire and life safety requirements. If we fail to comply with these requirements, we could incur fines or private damage awards. We do not know whether existing requirements will change or whether compliance with future requirements would require significant unanticipated expenditures that would affect our cash flow and results of operations. If we incur substantial costs to comply with the ADA or other safety regulations and requirements, it could materially and adversely affect our revenues and profitability.

Adverse judgments or settlements resulting from legal proceedings in which we may be involved in the normal course of our business could reduce our profits or limit our ability to operate our business.

In the normal course of our business, we are involved in various legal proceedings. The outcome of these proceedings cannot be predicted. If any of these proceedings were to be determined adversely to us or a settlement involving a payment of a material sum of money were to occur, it could materially and adversely affect our profits or ability to operate our business.

Additionally, we could become the subject of future claims by third parties, including current or former tenants, our employees, our investors or regulators. Any significant adverse judgments or settlements would reduce our profits and could limit our ability to operate our business. Further, we may incur costs related to claims for which we have appropriate third-party indemnity, but such third parties fail to fulfill their contractual obligations.

If we fail to maintain an effective system of disclosure controls and procedures and internal control over financial reporting, our ability to produce timely and accurate financial statements or comply with applicable regulations could be impaired.

We are subject to the reporting requirements of the Exchange Act and the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act. We expect that the requirements of these rules and regulations will continue to increase our legal, accounting and financial compliance costs, make some activities more time-consuming and costly, and may place a strain on our personnel, systems and resources.

The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. We are also required to make a formal assessment and provide an annual management report on the effectiveness of our internal control over financial reporting. In order to maintain the effectiveness of our disclosure controls and procedures and internal control over financial reporting, we have expended, and anticipate that we will continue to expend, significant resources, including accounting-related costs and management oversight.

Current controls and any new controls that we develop may become inadequate due to changes in conditions of our business. Further, weaknesses in our disclosure controls and procedures and internal control over financial reporting may be discovered in the future. Any failure to maintain or develop effective controls or any difficulties encountered in their implementation or improvement could harm our operating results or cause us to fail to meet reporting obligations and may result in a restatement of our financial statements for prior periods. Any failure to maintain effective internal control over financial reporting also could adversely affect the results of periodic management evaluations.

As an "emerging growth company," we are permitted to rely on exemptions from certain reporting and disclosure requirements, which may make our future public filings different than that of other public reporting companies.

We are an "emerging growth company" as defined in the JOBS Act, and we are eligible to take advantage of certain exemptions from various reporting and disclosure requirements that are applicable to public reporting companies that are not emerging growth companies. We will remain an emerging growth company for up to five years, or until the earliest of: (1) the last date of the fiscal year during which we had total annual gross revenues of $1.07 billion or more; (2) the date on which we have, during the previous three-year period, issued more than $1 billion in non-convertible debt; or (3) the date on which we are deemed to be a "large accelerated filer" as defined under Rule 12b-2 under the Exchange Act. For so long as we remain an emerging growth company, we will not be required to:

- have an auditor attestation report on our internal control over financial reporting pursuant to Section 404(b) of the Sarbanes-Oxley Act;

- submit certain executive compensation matters to stockholder advisory votes pursuant to the "say on frequency" and "say on pay" provisions (requiring a non-binding stockholder vote to approve compensation of certain executive officers) and the "say on golden parachute" provisions (requiring a non-binding stockholder vote to approve golden parachute arrangements for certain executive officers in connection with mergers and certain other business combinations) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010; or

- disclose certain executive compensation related items.

If we choose to take advantage of any or all of these exemptions, the information that we provide you in our future public filings may be different than that of other public reporting companies. The exact implications of the JOBS Act for us are still subject to interpretations and guidance by the Securities and Exchange Commission (the "SEC") and other regulatory agencies. In addition, if our business grows, we may no longer satisfy the conditions of an emerging growth company. We continue to evaluate and monitor developments with respect to these new rules and we cannot assure you that we will be able to take advantage of all of the benefits of the JOBS Act.

In addition, the JOBS Act provides that an emerging growth company may take advantage of an extended transition period for complying with new or revised accounting standards that have different effective dates for public reporting and private companies. This means that an emerging growth company can delay adopting certain accounting standards until such standards are otherwise applicable to private companies. We do not intend to take advantage of the extended transition period.

We are increasingly dependent on information technology, and potential cyber-attacks, security problems, or other disruption present risks.

A cyber incident is considered to be any adverse event that threatens the confidentiality, integrity or availability of our information resources. More specifically, a cyber incident is an intentional attack or an unintentional event that can include an intruder gaining unauthorized access to systems to disrupt operations, corrupt data or steal confidential information. As our reliance on technology has increased, so have the risks posed to our systems, both internal and those we have outsourced. Our three primary risks that could directly result from the occurrence of a cyber incident include operational interruption, damage to our relationships with our tenants and private data exposure. Our financial results and reputation may be negatively impacted by such an incident.

Risks Related to Debt Financing

If we are unable to repay or refinance our existing debt as it comes due, we may need to sell the underlying asset sooner than anticipated or the lender may foreclose, in which case our financial condition, cash flows and results of operations could be materially adversely affected.

Certain of our debt is secured by certain of our assets, and, if our wholly-owned property-owning subsidiaries are unable to repay or refinance the debt as it becomes due, we may need to sell the underlying asset sooner than anticipated or the lender may foreclose.

Although the mortgages on our properties do not mature in the near term, due to the near-term expiration of tenant leases at certain of these properties, we may be unable to make mortgage payments and may default under the applicable loan agreement. This may force us to dispose of those assets on disadvantageous terms, or the lender under such mortgages may foreclose, resulting in losses materially adversely affecting our cash flow, results of operations and financial condition. Generally, a borrower in foreclosure proceedings has limited or no control over the timing and speed of such proceedings, and the ultimate resolution of such proceedings may take years. The Company or its subsidiaries may act as guarantor under customary, non-recourse carve-out clauses in our wholly-owned property owning subsidiaries' mortgage loans.

Our special purpose property-owning subsidiaries may default under non-recourse mortgage loans.

All of our assets are held in special-purpose property-owning subsidiaries. In the future, such special purpose property-owning subsidiaries may default and/or send notices of imminent default on non-recourse mortgage loans where the relevant asset is or will be suffering from cash shortfalls on operating expenses, leasing costs and/or debt service obligations. If tenants at certain of our properties, fail to renew their leases and we are unable to find new tenants, we may be unable to make mortgage payments and may default under the loan agreement. Additionally, in connection with our separation from InvenTrust, certain lenders under such non-recourse mortgage loans may allege that a default has been deemed to occur under such loans.

Any default by our special purpose property-owning subsidiaries under non-recourse mortgage loans would give the special servicers the right to accelerate the payment on the loans and the right to foreclose on the asset underlying such loans. There are several potential outcomes on the default of a non-recourse mortgage loan, including foreclosure, a deed-in-lieu of foreclosure, a cooperative short sale, or a negotiated modification to the terms of the loan. There is no assurance that we will be able to achieve a favorable outcome on a cooperative or timely basis on any defaulted mortgage loan.

MB REIT, one of our wholly-owned subsidiaries, is subject to obligations under certain “non-recourse carve-out” indemnity agreements and guarantees that may be deemed to be triggered in the future.

As of December 31, 2018, three of our assets are encumbered by traditional non-recourse debt obligations. In connection with these loans, MB REIT entered into indemnity agreements and “non-recourse carve-out” guarantees, which provide for these otherwise non-recourse loans to become partially or fully recourse against MB REIT if certain triggering events occur. Although these events differ from loan to loan, some of the common events include:

- The special purpose property-owning subsidiary’s or MB REIT’s filing of a voluntary petition for bankruptcy or commencing similar insolvency proceedings;

- Subject to certain conditions, the special purpose property-owning subsidiary’s failure to obtain the lender’s written consent prior to any subordinate financing or other voluntary lien encumbering the associated asset; and

- Subject to certain conditions, the special purpose property-owning subsidiary's failure to obtain the lender's written consent prior to a transfer or conveyance of the associated asset.

In addition, other items that are customarily recourse to a non-recourse carve-out guarantor include, but are not limited to, the payment of real property taxes, the breach of representations related to environmental issues or hazardous substances, physical waste of the property, liens which are senior to the mortgage loan and outstanding security deposits.

In the event that any of these triggering events occur and such loans become partially or fully recourse against MB REIT, our business, financial condition, results of operations, and the value of our common stock would be materially adversely affected, and we may be forced to sell other assets and/or our insolvency could result. Additionally, in connection with our separation from InvenTrust, certain lenders under such non-recourse mortgage loans may allege that a default has been deemed to occur under such loans and may seek to recover from us and/or our subsidiaries the full extent of their losses with respect to such loans. Any allegations may create a distraction for our management, result in significant liability, or subject us to litigation that could be costly or otherwise materially adversely affect us.

Our failure to comply with the covenants in our Credit Agreement and other debt agreements could materially and adversely affect us.

The mortgages on our existing assets, and any future mortgages likely will, contain customary covenants such as those that limit our ability, without the prior consent of the lender, to further mortgage the applicable asset or to discontinue insurance coverage. In addition, such loans contain negative covenants that, among other things, preclude certain changes of control, inhibit our ability to incur additional indebtedness or, under certain circumstances, restrict cash flow necessary to make distributions to our stockholders. Any credit facility or secured loans that we may enter into likely will contain customary financial covenants, restrictions, requirements and other limitations with which we must comply. Our continued ability to borrow under any credit facility that we may obtain will be subject to compliance with our financial and other covenants, including covenants relating to debt service coverage ratios, leverage ratios, and liquidity and net worth requirements, and our ability to meet these covenants will be adversely affected if our financial condition and cash flows are materially adversely affected or if general economic conditions deteriorate. In addition, our failure to comply with these covenants, as well as our inability to make required payments, could cause a default under the applicable agreement, which could result in the acceleration of the debt and require us to repay such debt with capital obtained from other sources, which may not be available to us or may be available only on unattractive terms. Furthermore, if we default on secured debt, lenders can take possession of the asset or assets securing such debt. If we default on any of our agreements, it could have a material adverse effect on our financial condition, cash flows or results of operations.

In addition, in connection with our agreements we have entered, and in the future may enter, into lockbox and cash management agreements pursuant to which all or substantially all of the income generated by our assets will be deposited directly into lockbox accounts and then swept into cash management accounts for the benefit of our lenders and from which cash may not be distributed to us or will be distributed to us only after funding of certain items, which may include payment of principal and interest on our debt, insurance and tax reserves or escrows and other expenses. As a result, we may be forced to borrow additional funds in order to make distributions to our stockholders necessary to allow us to continue to qualify as a REIT.

The Credit Agreement, which governs our new secured credit facility, contains various covenants with which we must comply and which limit the discretion of management with respect to certain business matters. These covenants place restrictions on, among other things, our ability to incur additional indebtedness, grant liens on our assets, make certain types of investments, engage in acquisitions, mergers or consolidations, sell assets, enter into hedging transactions, enter into certain transactions with affiliates and, during the continuance of an event of default, make distributions and prepay certain types of indebtedness. The Credit Agreement also contains financial covenants with which we must comply, including a maximum leverage ratio, a maximum variable rate leverage ratio, a maximum amount of recourse indebtedness, a minimum fixed charge coverage ratio, a prohibition on recourse debt, a maximum amount of cross-collateralized non-recourse debt, a minimum tangible net worth and a minimum number of unencumbered properties we must own and a minimum value for such unencumbered properties. Any other debt agreement that we enter into may place additional restrictions on us and may require us to meet certain financial ratios and tests. In addition, the Credit Agreement contains, and any future debt agreements may contain, cross-default provisions that trigger an event of default if we fail to make payments or otherwise fail to comply with our obligations with respect to certain of our other indebtedness. Our continued ability to borrow under the Credit Agreement and any other indebtedness that we have or may obtain will be subject to compliance with the covenants in the Credit Agreement or in the debt agreement governing such other indebtedness.

Our failure to comply with these covenants, as well as our inability to make required payments under the Credit Agreement or any future debt agreement, could cause an event of default under the Credit Agreement, which, if not waived, could result in the termination of the financing commitments under the Credit Agreement, the acceleration of the maturity of the outstanding indebtedness thereunder and the lenders under the Credit Agreement obtaining ownership of our subsidiaries whose equity interests were pledged as collateral for such indebtedness, or could cause an event of default under such future debt agreement, which could result in the acceleration of the debt and, in the case of secured debt, the lenders taking possession of the property or properties securing such debt. If repayment of any of our indebtedness is accelerated and/or we are unable to make additional borrowings under the Credit Agreement or any of our other debt agreements, we cannot provide assurance that we would be able to borrow sufficient funds to refinance such indebtedness or that we would be able to sell sufficient assets to repay such indebtedness. Even if we were able to obtain new financing, it may not be on commercially reasonable terms, or terms that are acceptable to us.

We may be unable to satisfy our debt obligations upon a change of control.

Under the documents that govern our indebtedness, if we experience a change of control, we could be required to incur certain penalties, fees and other expenses, which may include repayment of the entire principal balance of some of our outstanding indebtedness plus additional fees and interest. We might not have sufficient funds to repay such amounts. Any of these events could have a material adverse impact on our liquidity, business, results of operations and financial condition.

Volatility in the financial markets and challenging economic conditions could adversely affect our ability to secure debt financing on attractive terms and our ability to service any future indebtedness that we may incur.

The domestic and international commercial real estate debt markets could become very volatile as a result of, among other things, the tightening of underwriting standards by lenders and credit rating agencies. This could result in less availability of credit and increasing costs for what is available. If the overall cost of borrowing increases, either by increases in the index rates or by increases in lender spreads, the increased costs may result in lower overall economic returns and potentially reducing future cash flow available for distribution. If these disruptions in the debt markets were to persist, our ability to borrow funds to finance activities related to real estate assets could be negatively impacted. In addition, we may find it difficult, costly or impossible to refinance indebtedness that is maturing.

Further, economic conditions could negatively impact commercial real estate fundamentals and result in declining values in our real estate portfolio and in the collateral securing any loan investments we may make, which could have various negative impacts. Specifically, the value of collateral securing any loan we hold could decrease below the outstanding principal amounts of such loans.

Borrowings may reduce the funds available for distribution and increase the risk of loss since defaults may cause us to lose the assets securing the loans.

We may from time to time borrow money for other purposes to, among other things, satisfy the requirement that we distribute at least 90% of our “REIT annual taxable income,” subject to certain adjustments, or as is otherwise necessary or advisable to assure that we qualify as a REIT for U.S. federal income tax purposes. Over the long term, however, payments required on any amounts we borrow reduce the funds available for, among other things, capital expenditures for existing assets or distributions to our stockholders because cash otherwise available for these purposes is used to pay principal and interest on this debt.

If there is a shortfall between the cash flow from an asset and the cash flow needed to service mortgage debt on an asset, then the amount of cash flow from operations available for distributions to stockholders may be reduced. In addition, incurring mortgage debt increases the risk of loss since defaults on indebtedness secured by an asset may result in lenders initiating foreclosure actions. In such a case, we could lose the asset securing the loan that is in default, thus reducing the value of your investment. For tax purposes, a foreclosure is treated as a sale of the asset or assets for a purchase price equal to the outstanding balance of the debt secured by the asset or assets. If the outstanding balance of the debt exceeds our tax basis in the asset or assets, we would recognize taxable gain on the foreclosure action and we would not receive any cash proceeds. We also may fully or partially guarantee any funds that subsidiaries borrow to operate assets. In these cases, we may be responsible to the lender for repaying the loans if the subsidiary is unable to do so.

Due to distressed assets within our portfolio and our relatively small size as compared with our former Parent’s size, it may be difficult for us to obtain debt financing or refinancing on favorable terms, or at all, which may adversely affect our business, financial condition and results of operations.

We may require debt financing from time to time for property improvements, tenant improvements, acquisition financing, leasing commissions, general corporate purposes and other working capital needs. There are currently, and are likely to continue to be, a number of distressed assets in our portfolio that are in danger of becoming subject to foreclosure proceedings. Lenders may consider the fact that such distressed assets exist within our portfolio when determining whether to advance credit to us in the future, even though each asset is owned by a separate subsidiary. Additionally, certain of our existing debt financing was entered into prior to our spin-off from InvenTrust. Due to our reduced size in comparison to InvenTrust, it may be difficult to refinance our existing debt on favorable terms. If we are unable to obtain debt financing on favorable terms, or at all, or if the ability to obtain financing is restricted by the terms of our credit facility or other indebtedness we may incur, our business, financial condition and results of operations may be adversely affected.

If we are unable to borrow at favorable rates, we may not be able to refinance existing loans at maturity.

If we are unable to borrow money at favorable rates, or at all, we may be unable to refinance existing loans at maturity. Further, we may enter into loan agreements or other credit arrangements that require us to pay interest on amounts we borrow at variable or “adjustable” rates. Increases in interest rates will increase our interest costs. If interest rates are higher when we refinance our loans, our expenses will increase, thereby reducing our cash flow. Further, during periods of rising interest rates, we may be forced to sell one or more of our assets earlier than anticipated in order to repay existing loans, which may not permit us to maximize the return on the particular assets being sold.

Interest-only indebtedness may increase our risk of default and ultimately may reduce our funds available for distribution to our stockholders.

We have obtained, and may continue to enter into mortgage indebtedness that does not require us to pay principal for all or a portion of the life of the debt instrument. During the period when no principal payments are required, the amount of each scheduled payment is less than that of a traditional amortizing mortgage loan. The principal balance of the mortgage loan is not reduced (except in the case of prepayments) because there are no scheduled monthly payments of principal required during this period. After the interest-only period, we may be required either to make scheduled payments of principal and interest or to make a lump-sum or “balloon” payment at or prior to maturity. These required principal or balloon payments will increase the amount of our scheduled payments and may increase our risk of default under the related mortgage loan if we do not have funds available or are unable to refinance the obligation.

Covenants applicable to current or future debt could restrict our ability to make distributions to our stockholders and, as a result, we may be unable to make distributions necessary to qualify as a REIT, which could materially and adversely affect us and the value of our common stock.

We intend to operate in a manner so as to maintain our qualification as a REIT for U.S. federal income tax purposes. In order to maintain our qualification as a REIT, we generally are required to distribute at least 90% of our REIT taxable income, determined without regard to the dividends paid deduction and excluding net capital gain, each year to our stockholders. To the extent that we satisfy this distribution requirement, but distribute less than 100% of our REIT taxable income, we will be subject to U.S. federal corporate income tax on our undistributed taxable income. In addition, we will be subject to a 4% nondeductible excise tax if the actual amount that we distribute to our stockholders in a calendar year is less than a minimum amount specified under the Code. If, as a result of covenants applicable to our current or future debt, including under the terms of our credit facility, we are restricted from making distributions to our stockholders, we may be unable to make distributions necessary for us to avoid U.S. federal corporate income and excise taxes and maintain our qualification as a REIT, which could materially and adversely affect us.

Increases in interest rates could increase the amount of our debt payments and adversely affect our ability to make distributions to our stockholders.

We may in the future borrow money bearing interest at variable rates, which would expose us to increases in costs in a rising interest rate environment. Increases in future interest rates would increase our interest expense for any existing variable rate debt, as well as any debt that must be refinanced at higher interest rates at the time of maturity. Our future earnings and cash flows could be adversely affected due to the increased requirement to service our debt and could reduce the amount we are able to distribute to our stockholders.

Our organizational documents have no limitation on the amount of indebtedness we may incur. As a result, we may become highly leveraged in the future, which could materially and adversely affect us.

Our organizational documents contain no limitations on the amount of debt that we may incur, and our board of directors may change our financing policy at any time without stockholder notice or approval. As a result, we may be able to incur substantial additional debt, including secured debt, in the future. Incurring debt could subject us to many risks, including the risks that:

- our cash flows from operations may be insufficient to make required payments of principal and interest;
- our debt and resulting maturities may increase our vulnerability to adverse economic and industry conditions;
- we may be required to dedicate a substantial portion of our cash flows from operations to payments on our debt, thereby reducing cash available for distribution to our stockholders, funds available for operations and capital expenditures, future business opportunities or other purposes;
- the terms of any refinancing may not be in the same amount or on terms as favorable as the terms of the existing debt being refinanced, or we may not be able to refinance our debt at all;
- we may be obligated to repay the debt pursuant to guarantee obligations; and
- the use of leverage could adversely affect our ability to raise capital from other sources or to make distributions to our stockholders and could adversely affect the value of our common stock.

If we violate covenants in future agreements relating to indebtedness that we may incur, we could be required to repay all or a portion of our indebtedness before maturity at a time when we might be unable to arrange financing for such repayment on attractive terms, if at all. In addition, indebtedness agreements may require that we meet certain covenant tests in order to make distributions to our stockholders.

Risks Related to Our Relationship with InvenTrust and the Separation

We may have potential business conflicts of interest with InvenTrust with respect to our past relationship.

Conflicts of interest may arise between InvenTrust and us in a number of areas relating to our past relationship, including:

- labor, tax, employee benefit, indemnification and other matters arising from our separation from InvenTrust;
- intellectual property matters; and
- employee recruiting and retention.

We may not be able to resolve any potential conflicts, and, even if we do so, the resolution may be less favorable to us than if we were dealing with an unaffiliated third party that was not historically our parent company.

Our agreements with InvenTrust may not reflect terms that would have resulted from arm's-length negotiations among unaffiliated third parties.

The agreements related to our separation from InvenTrust, which consist of the Separation and Distribution Agreement, the Transition Services Agreement and the Employee Matters Agreement, were negotiated in the context of our separation from InvenTrust while we were still part of InvenTrust and, accordingly, may not reflect terms that would have resulted from arm's-length negotiations among unaffiliated third parties. The terms of the agreements we negotiated in the context of our separation related to, among other things, allocations of assets, liabilities, rights, indemnifications and other obligations among InvenTrust and us. See "Part III-Item 13. Certain Relationships and Related Transactions and Director Independence."

Risks Related to Our Status as a REIT

Failure to remain qualified as a REIT would cause us to be taxed as a regular corporation, which would substantially reduce funds available for distributions to our stockholders.

Our qualification as a REIT depends on our ability to meet requirements regarding our organization and ownership, distributions of our income, the nature and diversification of our income and assets as well as other tests imposed by the Code. We cannot assure you that our actual operations for any one taxable year will satisfy these requirements. Further, new legislation, regulations, administrative interpretations or court decisions could significantly affect our ability to qualify as a REIT or the consequences of our qualification as a REIT. If we fail to qualify as a REIT in any taxable year, we will face serious tax consequences that will substantially reduce the funds available for distributions to our stockholders because:

- we would not be allowed a deduction for dividends paid to stockholders in computing our taxable income and would be subject to U.S. federal income tax at regular corporate rates;
- we could be subject to increased state and local taxes; and
- unless we are entitled to relief under certain U.S. federal income tax laws, we could not re-elect REIT status for the four taxable years after the year in which we failed to qualify as a REIT.

In addition, if we fail to qualify as a REIT, we will no longer be required to make distributions. As a result of all these factors, our failure to qualify as a REIT could impair our ability to expand our business and raise capital, and it would adversely affect the value of our common stock.

If either InvenTrust or MB REIT failed to qualify as a REIT, we would be prevented from electing to qualify as a REIT.

We believe that prior to the separation from InvenTrust, we were a "qualified REIT subsidiary" of InvenTrust. Under applicable Treasury regulations, if either (i) InvenTrust failed to qualify as a REIT in its 2012 through 2016 taxable years or (ii) MB REIT failed to qualify as a REIT for its 2012 taxable year through its taxable year that ended on December 15, 2015 (when MB REIT became a "qualified REIT subsidiary" of InvenTrust), unless such failure was subject to relief under U.S. federal income tax laws, we would be prevented from electing to qualify as a REIT for the four taxable years following the year in which InvenTrust or MB REIT failed to qualify.

Even if we continue to qualify as a REIT for tax purposes, we may face other tax liabilities that reduce our cash flows.

Even if we continue to qualify as a REIT for tax purposes, we may be subject to certain U.S. federal, state and local taxes on our income and assets, including taxes on any undistributed income, tax on income from some activities conducted as a result of a foreclosure, and state or local income, property and transfer taxes. In addition, any taxable REIT subsidiary ("TRS") that we may form will be subject to regular corporate U.S. federal, state and local taxes. Any of these taxes would decrease cash available for distributions to stockholders.

Failure to make required distributions would subject us to U.S. federal corporate income tax.

We intend to operate in a manner so as to maintain our qualification as a REIT for U.S. federal income tax purposes. In order to maintain our qualification as a REIT, we generally are required to distribute at least 90% of our REIT taxable income, determined without regard to the dividends paid deduction and excluding any net capital gain, each year to our stockholders. To the extent that we satisfy this distribution requirement, but distribute less than 100% of our REIT taxable income, we will be subject to U.S. federal corporate income tax on our undistributed taxable income. In addition, we will be subject to a 4% nondeductible excise tax if the actual amount that we pay out to our stockholders in a calendar year is less than a minimum amount specified under the Code.

REIT distribution requirements could adversely affect our liquidity and may force us to borrow funds or sell assets during unfavorable market conditions.

To satisfy the REIT distribution requirements, we may need to borrow funds on a short-term basis or sell assets sooner than anticipated, even if the then-prevailing market conditions are not favorable for these borrowings or sales. Our cash flows from operations may be insufficient to fund required distributions as a result of differences in timing between the actual receipt of income and the recognition of income for U.S. federal income tax purposes, or the effect of non-deductible capital expenditures, the creation of reserves or required debt service or amortization payments. In addition, we may recognize significant cancellation of indebtedness income or gain from the workout of our debt or the disposition of our assets in foreclosure or deed-in-lieu transactions, which will result in the receipt of taxable income in excess of the cash received, if any, from those transactions. The insufficiency of our cash flows to cover our distribution requirements could have an adverse impact on our ability to raise short- and long-term debt or sell equity securities in order to fund distributions required to maintain our qualification as a REIT.

The prohibited transactions tax may limit our ability to dispose of our assets, and we could incur a material tax liability if the IRS successfully asserts that the 100% prohibited transaction tax applies to some of or all our dispositions.

A REIT's net income from prohibited transactions is subject to a 100% tax. In general, prohibited transactions are sales or other dispositions of assets, other than foreclosure property, held primarily for sale to customers in the ordinary course of business. We may be subject to the prohibited transactions tax equal to 100% of net gain upon a disposition of an asset. As part of our plan to liquidate our portfolio, we intend to make dispositions of our assets in the future. Although a safe harbor to the characterization of the sale of property by a REIT as a prohibited transaction is available, some or all of our future dispositions may not qualify for that safe harbor. We intend to avoid disposing of property that may be characterized as held primarily for sale to customers in the ordinary course of business. To avoid the prohibited transaction tax, we may choose not to engage in certain sales of our assets or may conduct such sales through a TRS, which would be subject to U.S. federal, state and local income taxation. Moreover, no assurance can be provided that the IRS will not assert that some or all of our future dispositions are subject to the 100% prohibited transactions tax. If the IRS successfully imposes the 100% prohibited transactions tax on some or all of our dispositions, the resulting tax liability could be material.

The stock ownership limit imposed by the Code for REITs and our charter may restrict our business combination opportunities and you may be restricted from acquiring or transferring certain amounts of our common stock.

The stock ownership restrictions of the Code for REITs and the 9.8% stock ownership limit in our charter may restrict our business combination opportunities and restrict your ability to acquire or transfer certain amounts of our common stock.

In order to maintain our qualification as a REIT for each taxable year, five or fewer individuals, as defined in the Code, may not own, beneficially or constructively, more than 50% in value of our issued and outstanding capital stock at any time during the last half of a taxable year. Attribution rules in the Code determine if any individual or entity beneficially or constructively owns our capital stock under this requirement. Additionally, at least 100 persons must beneficially own our capital stock during at least 335 days of a taxable year for each taxable year. To help ensure that we meet these tests, our charter restricts the acquisition and ownership of shares of our capital stock. However, these ownership limits might delay or prevent a transaction or a change in our control or other business combination opportunities.

Our charter authorizes our directors to take such actions as are necessary and desirable to preserve our qualification as a REIT. Unless exempted by our board of directors (prospectively or retroactively), our charter prohibits any person from beneficially or constructively owning more than 9.8% in value or number of shares, whichever is more restrictive, of the outstanding shares of any class or series of our capital stock. Our board of directors may not grant an exemption from these restrictions to any proposed transferee whose ownership in excess of 9.8% of the value of our outstanding shares would result in our failing to qualify as a REIT. These restrictions on transferability and ownership will not apply, however, if our board of directors determines that it is no longer in our best interest to attempt to, or continue to, qualify as a REIT or that compliance is no longer required in order for us to maintain our qualification as a REIT.

Dividends payable by REITs do not qualify for the reduced tax rates available for some dividends.

The maximum tax rate applicable to "qualified dividend income" payable to U.S. stockholders that are taxed at individual rates is 20%. Under the federal tax legislation enacted in December 2017, commonly known as the Tax Cuts and Jobs Act (the “2017 Tax Legislation”), U.S. stockholders that are individuals, trusts and estates generally may deduct up to 20% of the ordinary dividends (e.g., dividends not designated as capital gain dividends or qualified dividend income) received from a REIT for taxable years beginning after December 31, 2017 and before January 1, 2026. Although this deduction reduces the effective tax rate applicable to certain dividends paid by REITs (generally to 29.6% assuming the shareholder is subject to the 37% maximum rate), such tax rate is still higher than the tax rate applicable to corporate dividends that constitute qualified dividend income. Accordingly, investors who are individuals, trusts or estates may perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends treated as qualified dividend income, which could adversely affect the value of the shares of REITs, including our common stock.

Complying with REIT requirements may limit our ability to hedge effectively.

The REIT provisions of the Code may limit our ability to hedge the risks inherent to our operations. Under current law, any income that we generate from derivatives or other transactions intended to hedge our interest rate risk with respect to borrowings made, or to be made, to acquire or carry real estate assets generally will not constitute gross income for purposes of the 75% and 95% income tests applicable to REITs. In addition, any income from certain other qualified hedging transactions would generally not constitute gross income for purposes of both the 75% and 95% income tests. However, we may be required to limit the use of hedging techniques that might otherwise be advantageous, which could result in greater risks associated with interest rate or other changes than we would otherwise incur.

We may be subject to adverse legislative or regulatory tax changes that could reduce the value of our common stock.

At any time, the U.S. federal income tax laws governing REITs or the administrative interpretations of those laws may be amended. We cannot predict when or if any new U.S. federal income tax law, regulation, or administrative interpretation, or any amendment to any existing federal income tax law, regulation or administrative interpretation, will be adopted, promulgated or become effective and any such law, regulation, or interpretation may take effect retroactively. We and our stockholders could be adversely affected by any such change in, or any new, U.S. federal income tax law, regulation or administrative interpretation. In addition, the law relating to the tax treatment of other entities, or an investment in other entities, could change, making an investment in such other entities more attractive relative to an investment in a REIT.

The 2017 Tax Legislation has significantly changed the U.S. federal income taxation of U.S. businesses and their owners, including REITs and their stockholders. Changes made by the 2017 Tax Legislation that could affect us and our stockholders include, among others:

- temporarily reducing individual U.S. federal income tax rates on ordinary income; the highest individual U.S. federal income tax rate has been reduced from 39.6% to 37% for taxable years beginning after December 31, 2017 and before January 1, 2026;
- permanently eliminating the progressive corporate tax rate structure, which previously imposed a maximum corporate tax rate of 35%, and replacing it with a flat corporate tax rate of 21%;
- permitting a deduction for certain pass-through business income, including dividends received by our stockholders from us that are not designated by us as capital gain dividends or qualified dividend income, which will allow individuals, trusts, and estates to deduct up to 20% of such amounts for taxable years beginning after December 31, 2017 and before January 1, 2026;
- reducing the highest rate of withholding with respect to our distributions to non-U.S. stockholders that are treated as attributable to gains from the sale or exchange of U.S. real property interests from 35% to 21%;
- limiting our deduction for net operating losses arising in taxable years beginning after December 31, 2017 to 80% of our REIT taxable income (determined without regard to the dividends paid deduction);
- generally limiting the deduction for net business interest expense in excess of 30% of a business's "adjusted taxable income," except for taxpayers that engage in certain real estate businesses (including most equity REITs) and elect out of this rule (provided that such electing taxpayers must use an alternative depreciation system with longer depreciation periods); and
- eliminating the corporate alternative minimum tax.

Many of these changes that are applicable to us were effective beginning with our 2018 taxable year, without any transition periods or grandfathering for existing transactions. The legislation is unclear in many respects and could be subject to potential amendments and technical corrections, as well as interpretations and implementing regulations by the IRS and the U.S. Department of the Treasury, any of which could lessen or increase the impact of the legislation. In addition, it is unclear how these U.S. federal income tax changes will affect state and local taxation, which often uses federal taxable income as a starting point for computing state and local tax liabilities. While some of the changes made by the tax legislation may adversely affect us in one or more reporting periods and prospectively, other changes may be beneficial on a going forward basis. We continue to work with our tax advisors and auditors to determine the full impact that the 2017 Tax Legislation as a whole will have on us.

The ability of our board of directors to revoke our REIT qualification without stockholder approval may cause adverse consequences to our stockholders.

Our charter provides that our board of directors may revoke or otherwise terminate our REIT election, without the approval of our stockholders, if it determines that it is no longer in our best interest to attempt to, or continue to qualify as a REIT. If we cease to be a REIT, we would become subject to U.S. federal income tax on our taxable income and would no longer be required to distribute most of our taxable income to our stockholders, which may have adverse consequences on our total return to our stockholders.

Changes to U.S. federal income tax laws could materially and adversely affect us and our stockholders.

The 2017 Tax Legislation makes substantial changes to the Code. Among those changes are a significant permanent reduction in the generally applicable corporate tax rate, changes in the taxation of individuals and other non-corporate taxpayers that generally but not universally reduce their taxes on a temporary basis subject to ‘‘sunset’’ provisions, the elimination or modification of various currently allowed deductions (including substantial limitations on the deductibility of interest and, in the case of individuals, the deduction for personal state and local taxes), and preferential rates of taxation on most ordinary REIT dividends and certain business income derived by non-corporate taxpayers in comparison to other ordinary income recognized by such taxpayers. The 2017 Tax Legislation also imposes certain additional limitations on the deduction of net operating losses, which may in the future cause us to be required to make distributions that will be taxable to our stockholders to the extent of our current or accumulated earnings and profits in order to comply with the annual REIT distribution requirements. The effect of these, and the many other, changes made in the 2017 Tax Legislation is highly uncertain, both in terms of their direct effect on the taxation of an investment in our common stock and their indirect effect on the value of our assets or market conditions generally. Furthermore, many of the provisions of the 2017 Tax Legislation will require guidance through the issuance of Treasury regulations in order to assess their effect. There may be a substantial delay before such regulations are promulgated, increasing the uncertainty as to the ultimate effect of the statutory amendments on us. It is also likely that there will be technical corrections legislation proposed with respect to the 2017 Tax Legislation this year, the effect of which cannot be predicted and may be adverse to us or our stockholders.

Additionally, the rules dealing with U.S. federal income taxation are continually under review by Congress, the IRS, and the U.S. Department of the Treasury. Any such changes could have an adverse effect on an investment in our shares or on the market value or the resale potential of our assets.

Risks Related to Ownership of Our Common Stock and Our Corporate Structure

There is no established public market for our shares and you may not be able to sell your shares.

Presently, we have no plans to list our shares of common stock on any securities exchange or other market, there is no established trading market for our shares, nor is there any assurance that one may develop. Our charter also prohibits the ownership of more than 9.8% (in value or number of shares, whichever is more restrictive) of the aggregate of the outstanding shares of any class or series of our capital stock by any person unless exempted prospectively or retroactively by our board. This may inhibit investors from purchasing a large portion of our shares. Our charter also does not require us to seek stockholder approval to liquidate our assets by a specified date, nor does our charter require us to list our shares for trading on a securities exchange or other market by a specified date or provide any other type of liquidity to our stockholders. Therefore, it will be difficult for you to sell your shares promptly or at all, including in the event of an emergency, and if you are able to sell your shares, you may have to sell them at a substantial discount from the estimated value per share.

The estimated value per share of our common stock is based on a number of assumptions and estimates that may not be accurate or complete and is also subject to a number of limitations.

On January 11, 2019, we announced an estimated value of our common stock equal to $0.35 per share. Our board of directors engaged Real Globe Advisors, LLC (“Real Globe”), an independent third-party real estate advisory firm, to estimate the per share value of our common stock on a fully diluted basis as of December 31, 2018. As with any methodology used to estimate value, the methodology employed by Real Globe and the recommendations made by us were based upon a number of estimates and assumptions that may not be accurate or complete. Further, different parties using different assumptions and estimates could derive a different estimated value per share, which could be significantly different from our estimated value per share. The estimated per share value does not represent (i) the amount at which our shares would trade at a national securities exchange, (ii) the amount a stockholder would obtain if he or she tried to sell his or her shares (iii) the amount per share that stockholders would receive in a sale of the entire Company in a single transaction or (iv) the amount stockholders would receive if we liquidated our assets and distributed the proceeds after paying all of our expenses and liabilities. Accordingly, with respect to the estimated value per share, we can give no assurance that:

- a stockholder would be able to resell his or her shares at this estimated value;
- a stockholder would ultimately realize distributions per share equal to our estimated value per share upon liquidation of our assets and settlement of our liabilities or a sale of the Company;
- our shares would trade at a price equal to or greater than the estimated value per share if we listed them on a national securities exchange;
- the certain estimated corporate-level transaction costs that we would expect to incur in connection with a future potential liquidity event reflected in our estimated value will be incurred at the level estimated by us; or
- the methodology used to estimate our value per share would be acceptable to FINRA or that the estimated value per share will satisfy the applicable annual valuation requirements under the Employee Retirement Income Security Act of 1974, as amended (“ERISA”) and the Code, with respect to employee benefit plans subject to ERISA and other retirement plans or accounts subject to Section 4975 of the Code.

Our cash available for distribution to stockholders may not be sufficient to pay distributions at expected or required levels, and we may need external sources in order to make such distributions, or we may not be able to make such distributions at all.

We generally intend over time to make annual distributions in an amount at least equal to the amount that will allow us to qualify as a REIT and to avoid current entity-level U.S. federal income taxes, however, we may not have sufficient cash from operations to make a distribution required to maintain our qualification as a REIT. All distributions will be made at the discretion of our board of directors and will depend on our historical and projected results of operations, liquidity and financial condition, REIT qualification, debt service requirements, capital expenditures and operating expenses, prohibitions and other restrictions under financing arrangements and applicable law and other factors as our board of directors may deem relevant from time to time. No assurance can be given that our projections will prove accurate or that any level of distributions will be made or sustained or achieve a market yield.

We may pay distributions from sources other than cash flow from operations or funds from operations, including funding such distributions from external financing sources, which may be available only at commercially unattractive terms, if at all. To the extent that the aggregate amount of cash distributed in any given year exceeds the amount of our current and accumulated earnings and profits for the same period, the excess amount will be deemed a return of capital for U.S. federal income tax purposes, rather than a return on capital. Furthermore, in the event that we are unable to fund future distributions from our cash flows from operating activities, the value of your shares, the sale of our assets or any other liquidity event may be materially adversely affected.

At any time that we are not generating cash flow from operations sufficient to cover the current distribution rate, we may determine to pay lower distributions, or to fund all or a portion of our future distributions from other sources. If we utilize borrowings for the purpose of funding all or a portion of our distributions, we will incur additional interest expense. We have not established any limit on the extent to which we may use alternate sources of cash for distributions, except that, in accordance with the law of the State of Maryland and our organizational documents, generally, we may not make distributions that would: (i) cause us to be unable to pay our debts as they become due in the usual course of business, (ii) cause our total assets to be less than the sum of our total liabilities, or (iii) jeopardize our ability to maintain our qualification as a REIT for so long as the board of directors determines that it is in our best interests to continue to qualify as a REIT. Distributions that exceed cash flow from operations may not be sustainable at current levels, or at all.

Future issuances of debt securities, which would rank senior to our common stock upon our liquidation, and future issuances of equity securities, which would dilute the holdings of our existing common stockholders and may be senior to our common stock for the purposes of making distributions, periodically or upon liquidation, may negatively affect the value of our common stock.

In the future, we may issue debt or equity securities or incur other borrowings. Upon our liquidation, holders of our debt securities and other loans and preferred stock will receive a distribution of our available assets before common stockholders. If we incur debt in the future, our future interest costs could increase, and adversely affect our liquidity and results of operations. We are not required to offer any additional equity securities to existing common stockholders on a preemptive basis. Therefore, additional common stock issuances, directly or through convertible or exchangeable securities, warrants or options, will dilute the holdings of our existing common stockholders and such issuances, or the perception of such issuances, may reduce the value of our common stock. Our preferred stock, if issued, would likely have a preference on distribution payments, periodically or upon liquidation, which could eliminate or otherwise limit our ability to make distributions to common stockholders. Because our decision to issue debt or equity securities or incur other borrowings in the future will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing, nature or success of our future capital raising efforts. Thus, common stockholders bear the risk that our future issuances of debt or equity securities or our incurrence of other borrowings will negatively affect the value of our common stock.

Your percentage ownership in us may be diluted in the future.

Your percentage ownership in us may be diluted in the future because of new equity issuances, capital market transactions or otherwise, including, without limitation, equity awards that may be granted to our directors, officers and employees.

Increases in market interest rates may reduce demand for our common stock and result in a decline in the value of our common stock.

The value of our common stock may be influenced by the dividend yield on our common stock (i.e., the amount of our annual distributions as a percentage of the fair market value of our common stock) relative to market interest rates. An increase in market interest rates, which are currently low compared to historical levels, may lead prospective purchasers of our common stock to expect a higher distribution yield, which we may not be able, or may choose not, to provide. Higher interest rates would also likely increase our borrowing costs and decrease our operating results and cash available for distribution. Thus, higher market interest rates could cause the value of our common stock to decline.

Our rights and the rights of our stockholders to take action against our directors and officers are limited.

Under Maryland law generally, a director is required to perform his or her duties in good faith, in a manner he or she reasonably believes to be in our best interests and with the care that an ordinarily prudent person in a like position would use under similar circumstances. Under Maryland law, directors are presumed to have acted in accordance with this standard of conduct. In addition, our charter eliminates the liability of our directors and officers to us and our stockholders for money damages, except for liability resulting from:

- actual receipt of an improper benefit or profit in money, property or services; or

- active and deliberate dishonesty by the director or officer that was established by a final judgment as being material to the cause of action adjudicated.

Our charter authorizes us to obligate ourselves and our bylaws obligate us, to the maximum extent permitted by Maryland law in effect from time to time, to indemnify and to pay or reimburse reasonable expenses in advance of final disposition of a proceeding to any present or former director or officer who is made or threatened to be made a party to the proceeding by reason of his or her service to us in that capacity and certain other capacities. As a result, we and our stockholders may have more limited rights against our directors and officers than might otherwise exist absent the current provisions in our charter and bylaws.

Certain provisions of Maryland law could inhibit changes in control.

Certain provisions of the Maryland General Corporation Law (“MGCL”), may have the effect of deterring a third party from making a proposal to acquire us or of impeding a change in our control under circumstances that otherwise could provide the holders of our common stock with the opportunity to benefit from a sale of our common stock, including:

- “business combination” provisions that, subject to limitations, prohibit certain business combinations between us and an “interested stockholder” (defined generally as any person who beneficially owns, directly or indirectly, 10% or more of the voting power of our outstanding voting stock or an affiliate or associate of ours who was the beneficial owner, directly or indirectly, of 10% or more of the voting power of our then outstanding voting stock at any time within the two-year period immediately prior to the date in question) for five years after the most recent date on which the stockholder becomes an interested stockholder, and thereafter impose fair price and/or supermajority stockholder voting requirements on these combinations; and

- “control share” provisions that provide that “control shares” of our company (defined as voting shares that, when aggregated with other shares controlled by the stockholder, entitle the stockholder to exercise one of three increasing ranges of voting power in electing directors) acquired in a “control share acquisition” (defined as the direct or indirect acquisition of ownership or control of issued and outstanding control shares) have no voting rights except to the extent approved by our stockholders by the affirmative vote of at least two-thirds of all the votes entitled to be cast on the matter, excluding all interested shares.

As permitted by Maryland law, we have elected, by resolution of our board of directors, to opt out of the business combination provisions of the MGCL, with respect to business combinations that have been approved by our board of directors (including a majority of directors who are not affiliated with the interested stockholder), and, pursuant to a provision in our bylaws, to exempt any acquisition of our stock from the control share provisions of the MGCL. However, our board of directors may by resolution elect to repeal the exemption from the business combination provisions of the MGCL and may by amendment to our bylaws opt into the control share provisions of the MGCL at any time in the future.

If we have a class of equity securities registered under the Exchange Act and at least three independent directors, certain provisions of the MGCL permit our board of directors, without stockholder approval and regardless of what is currently provided in our charter or bylaws, to adopt certain governance provisions, some of which (for example, a classified board) we do not have. These provisions may have the effect of limiting or precluding a third party from making an acquisition proposal for us or of delaying, deferring or preventing a change in our control under circumstances that otherwise could provide the holders of our common stock with the opportunity to benefit from a sale of our common stock. Our charter contains a provision whereby we elect, at such time as we become eligible to do so, to be subject to the provisions of Title 3, Subtitle 8 of the MGCL relating to the filling of vacancies on our board of directors.

If our board of directors were to elect to be subject to the provision of Subtitle 8 providing for a classified board or the business combination provisions of the MGCL or if the provision of our bylaws opting out of the control share acquisition provisions of the MGCL were amended or rescinded, these provisions of the MGCL could have anti-takeover effects.

All of our assets are owned by subsidiaries. We depend on dividends and distributions from these subsidiaries. The creditors of these subsidiaries are entitled to amounts payable to them by the subsidiaries before the subsidiaries may pay any dividends or other distributions to us.

All of our assets and assets are held through wholly-owned subsidiaries. We depend on cash distributions from our subsidiaries for substantially all of our cash flow. The creditors of each of our subsidiaries are entitled to payment of that subsidiary's obligations to them when due and payable before that subsidiary may make distributions or dividends to us. Thus, our ability to pay dividends, if any, to our stockholders depends on our subsidiaries' ability to first satisfy their obligations to their creditors and our ability to satisfy our obligations, if any, to our creditors.

In addition, our participation in any distribution of the assets of any of our subsidiaries upon the liquidation, reorganization or insolvency of the subsidiary, is only after the claims of the creditors, including trade creditors and preferred stockholders, if any, of the applicable direct or indirect subsidiaries are satisfied.

Our charter places limits on the amount of common stock that any person may own.

In order for us to maintain our qualification as a REIT under the Code, no more than 50% of the outstanding shares of our common stock may be beneficially owned, directly or indirectly, by five or fewer individuals at any time during the last half of each taxable year (other than the first taxable year for which an election to be a REIT has been made). Unless exempted by our board of directors, prospectively or retroactively, our charter prohibits any person or group from owning more than 9.8% in value or in number of shares, whichever is more restrictive, of the outstanding shares of any class or series of our capital stock. These provisions may have the effect of delaying, deferring or preventing a change in control of us, including an extraordinary transaction such as a merger, tender offer or sale of all or substantially all of our assets that might involve a premium price for holders of our common stock.

If anyone transfers shares in a way that would violate the ownership limit, or prevent us from maintaining our qualification as a REIT under the U.S. federal income tax laws, those shares instead will be transferred to a trust for the benefit of a charitable beneficiary and will be either purchased by us or sold to a person whose ownership of the shares will not violate the ownership limit. If this transfer to a trust fails to prevent such a violation or our continued qualification as a REIT, then the initial intended transfer shall be null and void from the outset. The intended transferee of those shares will be deemed never to have owned the shares. Anyone who acquires shares in violation of the ownership limit or the other restrictions on transfer in our charter bears the risk of suffering a financial loss when the shares are sold if the value of our shares falls between the date of purchase and the date of redemption or sale.

Our charter permits our board of directors to authorize the issuance of preferred stock on terms that may subordinate the rights of the holders of our current common stock or discourage a third party from acquiring us.

Our board may classify or reclassify any unissued shares of common or preferred stock into other classes or series of stock and establish the preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends and other distributions, qualifications, and terms or conditions of redemption of the stock and may amend our charter from time to time to increase or decrease the aggregate number of shares or the number of shares of any class or series that we have authority to issue without stockholder approval. Thus, our board of directors could authorize us to issue shares of preferred stock with terms and conditions that could subordinate the rights of the holders of our common stock or shares of preferred stock or common stock that could have the effect of delaying, deferring or preventing a change in control of us, including an extraordinary transaction such as a merger, tender offer or sale of all or substantially all of our assets, that might provide a premium price for holders of our common stock.

Our conflict of interest policy may not be successful in eliminating the influence of future conflicts of interest that may arise between us and our directors, officers and employees.

We have adopted a policy that any transaction, agreement or relationship in which any of our directors, officers or employees has a material direct or indirect pecuniary interest must be approved by a majority of our disinterested directors. Other than this policy, however, we may not adopt additional formal procedures for the review and approval of conflict of interest transactions generally. As such, our policies and procedures may not be successful in eliminating the influence of conflicts of interest.

Our board of directors may change our investment strategy without stockholder approval, which could alter the nature of your investment.

Our investment strategy may change over time. The methods of implementing our investment strategy may also vary, as new investment techniques are developed. Our investment strategy, the methods for implementing them, and our other objectives, policies and procedures may be altered by a majority of the directors without the approval of our stockholders. As a result, the nature of your investment could change without your consent. A change in our investment strategy may, among other things, increase our exposure to interest rate risk, default risk and commercial real property market fluctuations, all of which could materially and adversely affect our ability to achieve our investment objectives.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

As of December 31, 2018, the Company owned 15 revenue producing assets and two parcels of unimproved land.

General

The following is a list of the assets in the Highlands Portfolio as of December 31, 2018. All assets are 100% owned:

Property Name	Location	Segment	Classification	Total Gross Leasable Area (GLA) (in square feet)	Percentage of Economic Occupancy [(a)]	Annualized Base Rent [(b)] (in thousands)	Annualized Base Rent per Leased Square Foot [(c)]	Significant Tenants [(e)]
Buerger Brothers Lofts	Denver, CO	Multi-Family	Multi-Family	39,961	91.90%	$ 665	$ 18.10	n/a
Chamber Lofts	Denver, CO	Multi-Family	Multi-Family	40,809	83.93%	661	19.29	n/a
The Lafayette	Denver, CO	Multi-Family	Multi-Family	25,575	93.35%	631	26.42	n/a
Kenilworth Court	Denver, CO	Multi-Family	Multi-Family	16,611	87.60%	374	25.69	n/a
1620 Central Street	Evanston, IL	Multi-Family	Multi-Family	51,808	90.16%	1,309	28.02	n/a
Versacold USA - St. Paul	St. Paul, MN	Net Lease	Industrial	219,664	100.00%	1,219	5.55	Versacold USA, Inc.
Versacold USA -	New Ulm,							

New Ulm	MN	Net Lease	Industrial	269,985	100.00%	899	3.33	Versacold USA, Inc.
Trimble	San Jose, CA	Multi-Tenant Office	Multi-Tenant Office	176,905	54.71%	2,555	26.40	Alta Devices, Inc.
Hudson Correctional Facility	Hudson, CO	Net Lease	Correctional Facility	301,029	100.00%	10,166	33.77	The GEO Group, Inc.
Citizens - Providence	Providence, RI	Net Lease	Bank Branch	51,136	50.22%	404	15.73	Citizens Bank
Palazzo Land	Orlando, FL	Other	Unimproved Land	n/a	n/a	n/a	n/a	n/a
RDU Land	Raleigh, NC	Other	Unimproved Land	n/a	n/a	n/a	n/a	n/a
Shops at Sherman Plaza [(d)]	Evanston, IL	Retail	Retail	151,752	95.02%	3,295	22.85	Fitness International; Barnes & Noble Books; Target
Market at Hilliard	Hilliard, OH	Retail	Retail	115,221	100.00%	1,722	14.95	Bed Bath & Beyond; Michaels; Office Max; Old Navy
State Street Market	Rockford, IL	Retail	Retail	193,657	100.00%	1,830	9.45	Burlington Coat Factory; Dick's Sporting Goods; PetsMart
Buckhorn Plaza	Bloomsburg, PA	Retail	Retail	86,835	90.63%	1,037	13.17	Marmaxx Operating; Dollar Tree
Lincoln Mall	Lincoln , RI	Retail	Retail	456,666	89.89%	4,963	12.09	Stop & Shop; Cinema World; Lincoln Tech; Marshalls
Total				2,197,614	91.53%	$ 31,729	$ 15.77	

(a) Economic occupancy is defined as the percentage of total gross leasable area for which a tenant is obligated to pay rent under the terms of its lease agreement, regardless of the actual use or occupation by that tenant of the area being leased.

(b) Annualized base rent per leased square foot is computed as revenue for the last month of the period multiplied by twelve months. Annualized rent includes the effect of rent abatements, lease inducements, and straight-line rent GAAP adjustments.

(c) Annualized base rent per leased square foot is computed as annualized rent divided by the total occupied square footage at the end of the period.

(d) A portion of the land underlying this asset is subject to a ground lease. The term of the lease expires in October 2042, and the monthly payment as of December 31, 2018 is $1,749.

(e) Several of our assets have one or more tenants responsible for more than 10% of the asset's gross leasable area.

The following table sets forth our total gross leasable area (“GLA”) in square feet, percentage of economic occupancy and average annual base rent per leased square foot for our portfolio as of December 31 for the last three years:

As of	Total GLA (Sq. Ft.)	Percentage of Economic Occupancy	Average Annual Base Rent per Leased Square Foot
December 31, 2018	2,197,614	91.53%	$15.77
December 31, 2017	2,663,508	83.71%	$15.48
December 31, 2016	6,190,974	66.69%	$14.52

Lincoln Mall and Sherman Plaza accounted for 10% or more of our total assets as of December 31, 2018.

Hudson Correctional Facility, Lincoln Mall and Sherman Plaza accounted for 10% or more of our total revenues for the year ended December 31, 2018.

Hudson Correctional Facility

As of December 31, 2018, 2017 and 2016, the total GLA for Hudson Correctional Facility was 301,029 square feet, the economic occupancy was 100% and the average annual base rent per leased square foot was $33.77.

As of December 31, 2018, Hudson Correctional Facility has one tenant, The Geo Group, Inc., a correctional facility operator, whose economic occupancy is 100% of the total gross leasable square feet. However, the asset has not housed prisoners since October 2013. Its annualized base rent is $10.2 million. If The Geo Group, Inc. does not exercise its renewal option, its lease will expire in 2020. The lease has two ten-year renewal options. Given the niche market for the asset and the fact that the management and operation of correctional facilities by private entities has not achieved complete acceptance by either government agencies or the public, demand for this asset by other tenants and buyers is expected to be limited.

Lincoln Mall

The following table sets forth the GLA in square feet, percentage of economic occupancy and average annual base rent per leased square foot for Lincoln Mall as of December 31 for the last three years:

As of	Total GLA (Sq. Ft.)	Percentage of Economic Occupancy	Average Annual Base Rent per Leased Square Foot
December 31, 2018	456,666	89.89%	$12.09
December 31, 2017	445,466	92.56%	$12.33
December 31, 2016	445,466	92.40%	$12.55

Significant tenants based on annualized base rent as of December 31, 2018 include Stop and Shop, Inc. and Lincoln Tech.

On February 13, 2019, we entered into an agreement to sell Lincoln Mall for a gross sale price of $57.0 million. See Note 16 to the consolidated financial statements for additional information regarding the agreement to sell Lincoln Mall.

Sherman Plaza

The following table sets forth the GLA in square feet, percentage of economic occupancy and average annual base rent per leased square foot for Sherman Plaza as of December 31 for the last three years:

As of	Total GLA (Sq. Ft.)	Percentage of Economic Occupancy	Average Annual Base Rent per Leased Square Foot
December 31, 2018	151,752	95.02%	$22.85
December 31, 2017	152,786	94.01%	$20.03
December 31, 2016	150,709	88.90%	$20.62

Significant tenants based on annualized base rent as of December 31, 2018 include Fitness International, Target and Barnes and Noble Booksellers.

Lease Expirations

The following table sets forth lease expirations for all of our assets as of December 31, 2018, assuming none of the tenants exercise renewal options:

Lease Expiration Year	Number of Expiring Leases	GLA of Expiring Leases (Sq. Ft.)	Annualized Rent of Expiring Leases (in thousands)	Percent of Total Leased Area	Percent of Total Annualized Rent	Expiring Rent/Square Foot
2019	15	126,721	$ 1,846,000	6.0%	5.5%	$ 14.57
2020	37	532,521	13,755,000	25.1%	40.7%	25.83
2021	19	232,760	3,201,000	11.0%	9.5%	13.75
2022	10	218,910	2,998,000	10.3%	8.9%	13.70
2023	10	54,906	727,000	2.6%	2.2%	13.24
2024	8	168,339	1,822,000	7.9%	5.4%	10.83
2025	7	40,030	551,000	1.9%	1.6%	13.77
2026	8	31,655	731,000	1.5%	2.2%	23.11
2027	5	595,816	5,688,000	28.1%	16.7%	9.54
2028	7	38,459	884,000	1.8%	2.6%	22.99
Month to Month	4	13,500	200,000	0.6%	0.6%	14.84
Thereafter	15	68,953	1,400,000	3.2%	4.1%	20.30
	145	2,122,570	$ 33,803,000	100.0%	100.0%	$ 15.93

Mortgage Financing

The table below sets forth all material mortgages or other liens or encumbrances against any of our assets as of December 31, 2018. No debt was recourse to the Company, although the Company or its subsidiaries may act as guarantor under customary, non-recourse carve-out clauses in our wholly-owned property owning subsidiaries' mortgage loans.

Property	Current Principal amount (in thousands)	Interest and Amortization Provisions	Interest Rate	Prepayment Provisions	Maturity Date
Market at Hilliard	$15,761	Fixed Interest-Only for first 12 months	4.70%	If prior to 9/6/2026 must be in full, with penalty	12/6/2026
State Street Market	$9,365	Fixed Principal Plus Interest	5.24%	Only in full, and if prior to 1/6/22, with penalty	4/6/2022
Buckhorn Plaza	$10,317	Fixed Interest-Only for first 12 months	4.35%	If prior to 8/6/2026 must be in full, with penalty	11/6/2026

Item 3. Legal Proceedings

We are from time to time involved in legal actions arising in the ordinary course of business. We are not currently involved in any legal or administrative proceedings that we believe are likely to have a material adverse effect on our business, results of operations or financial condition.

Item 4. Mine Safety Disclosures

Not applicable.

Executive Officers of the Registrant

Richard Vance, age 55, has served as a director and our President and Chief Executive Officer since our formation in December 2015. Prior to our spin-off from InvenTrust Properties Corp. ("*InvenTrust*"), Mr. Vance served as Senior Vice President - Portfolio Management & Corporate Strategy for InvenTrust, where he was responsible for managing InvenTrust's "non-core" portfolio with regard to asset management, property operations and leasing. Beginning in 2013 and until InvenTrust's self-management in 2014, Mr. Vance served as Vice President for InvenTrust's former business manager, and, following InvenTrust's self-management, Mr. Vance continued to serve as Vice President for InvenTrust until 2015. In this role, Mr. Vance had various responsibilities, including spearheading InvenTrust's self-management and various asset management responsibilities. Beginning in 2010, Mr. Vance began working with InvenTrust's former business manager and former property manager as an independent consultant, and was primarily responsible for managing a diverse portfolio of InvenTrust's office, industrial and retail assets. Mr. Vance has more than 20 years of experience in commercial real estate and commercial real estate finance, including various positions prior to 2010 with GMAC Commercial Mortgage, Equity Residential, Deutsche Bank, Ernst & Young or their affiliates. Mr. Vance received a Master of Business Administration degree from the University of Michigan-Ann Arbor, a Juris Doctor from Loyola University of Chicago, and a Bachelor of Arts from the University of Michigan-Flint.

Joseph Giannini, age 55, has served as Senior Vice President, Chief Accounting Officer and Treasurer since our spin-off from InvenTrust on April 28, 2016. Prior to this, Mr. Giannini served as Vice President, Controller of Property Accounting of InvenTrust, where he was responsible for overseeing the property accounting for the retail and non-core assets. In addition, Mr. Giannini was responsible for reviewing, restructuring and implementing new processes within property accounting. From September 2008 through February 2014, Mr. Giannini served as the Hotel Controller for various affiliates of InvenTrust where he was responsible for all aspects of the hotel accounting, including working with third party property managers for InvenTrust's 100 plus hotel portfolio. Prior to September 2008, Mr. Giannini held various accounting positions with Lennar Corporation, AMLI Residential and Trammell Crow Residential Midwest. Mr. Giannini received his undergraduate Accounting degree from St. Joseph's College in Indiana in 1985. He also has a Master of Business Administration degree from Lake Forest Graduate School of Management and is a Certified Public Accountant. He is a member of the AICPA.

Robert J. Lange, age 36, has served as Executive Vice President, General Counsel and Secretary of Highlands since June 2016. Prior to joining the Company, Mr. Lange served as Vice President, Head Corporate Counsel and Assistant Secretary at InvenTrust, Highlands' former parent company. In that capacity, he oversaw all aspects of InvenTrust's corporate legal affairs, including material transactions, governance, public company reporting and compliance, employee matters and executive compensation and benefits. Prior to joining InvenTrust in 2014, Mr. Lange practiced law at Skadden Arps Slate Meagher & Flom LLP, where he represented companies in mergers and acquisitions and advised clients on a broad variety of general corporate matters. Mr. Lange received a Bachelor of Business Administration degree, with distinction, from the University of Wisconsin - Madison and a Juris Doctor degree, with honors, from the University of Chicago.

Paul A. Melkus, age 54, has served as Executive Vice President and Chief Financial Officer of Highlands since 2018. Prior to this appointment, Mr. Melkus served from April 2016 to April 2018 as a director of Highlands, chair of the board's audit committee, and a member of the board's compensation committee. Mr. Melkus served as Global Head of Capital Markets - Real Estate and Infrastructure Department for the Abu Dhabi Investment Authority, one of the world's largest sovereign wealth funds, and as a member of its Executive Committee from 2012 to 2016. In this role, he was responsible for the development of financing strategy and management of lending relationships for Abu Dhabi Investment Authority's global real estate investment portfolio. Mr. Melkus served as Senior Vice President - Capital Markets at General Growth Properties, Inc., a publicly traded REIT, from 2010 to 2011, as Director - Capital Markets at Deutsche Bank Asset Management from 2004 to 2009 and as Director - Capital Markets Investments at General Electric Capital Corporation from 1998 to 2004. Mr. Melkus has also consulted at Ernst & Young on a variety of capital markets and real estate related transactions and served as a securities analyst and asset manager at Northern Trust Company. Mr. Melkus is a graduate of DePauw University where he earned his Bachelor of Arts majoring in Economics and Management. He earned his Master of Science degree from the University of Wisconsin's Real Estate Investment and Urban Economics program.

Part II.

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Market Information

Our shares of common stock are not listed on a national securities exchange and there is not otherwise an established public trading market for our shares. We publish an estimated per share value of our common stock to assist broker dealers to comply with the rules published by the Financial Industry Regulatory Authority ("FINRA"). On January 11, 2019, we announced an estimated value of our common stock as of December 31, 2018 equal to $0.35 per share on a fully diluted basis.

Our board of directors (the "Board") engaged Real Globe Advisors, LLC ("Real Globe"), an independent third-party real estate advisory firm, to estimate the per share value of our common stock on a fully diluted basis as of December 31, 2018. Real Globe has extensive experience estimating the fair values of commercial real estate. The report furnished to the Board and the audit committee of the Board (the "Audit Committee") by Real Globe complies with the reporting requirements set forth under Standard Rule 2-2(a) of the Uniform Standards of Professional Appraisal Practice and is certified by a member of the Appraisal Institute with the MAI designation. The Real Globe report, dated as of January 8, 2019, reflects values as of December 31, 2018. Real Globe does not have any direct or indirect interests in any transaction with us or in any currently proposed transaction to which we are a party, and there are no conflicts of interest between Real Globe, on one hand, and the Company or any of our directors, on the other.

To estimate our per share value, Real Globe utilized the "net asset value" or "NAV" method which is based on the fair value of real estate, and all other assets, less the fair value of total liabilities, and also included certain estimated corporate-level transaction costs that we would expect to incur in connection with a future potential liquidity event, further described below. The fair value estimate of our real estate assets is equal to the sum of the individual real estate values.

Generally, Real Globe estimated the value of our wholly-owned real estate, using a discounted cash flow, or "DCF", of projected net operating income, less capital expenditures, for the ten-year period ending December 31, 2028 and applying a market supported discount rate and capitalization rate. In the unique instances that a discounted cash flow methodology was not deemed to be the most appropriate valuation methodology, including, but not limited to, the valuation of land assets, a sales comparison approach was utilized. For all other assets, comprised of working capital (which includes cash and other current assets net of current liabilities), fair value was determined separately. Real Globe also estimated the fair value of our long-term debt obligations by comparing market interest rates to the contract rates on our long-term debt and discounting to present value the difference in future payments.

The estimate of certain corporate-level transaction costs was provided to Real Globe by the Company. Given that our strategy involves a future potential liquidity option for current stockholders, management and the Board determined that the deduction of certain estimated corporate-level transaction costs in connection therewith was appropriate in determining our new estimated per share value. However, there are no assurances that such costs will be incurred at the level estimated by us. We cannot predict the timing of any potential liquidity event. As a result, the actual fees and expenses incurred by us in connection with the execution of our strategy could differ materially from the amount provided to Real Globe.

Real Globe determined NAV in a manner consistent with the definition of fair value under U.S. generally accepted accounting principles (or "GAAP") set forth in Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 820 Fair Measurements and Disclosures. Other than the deduction of certain estimated corporate-level transaction costs that we would expect to incur in connection with a future potential liquidity event, the net asset valuation performed by Real Globe complies with the Investment Program Association Practice Guideline 2013-01 "Valuation of Publicly Registered Non-Listed REITS", dated April 29, 2013.

Generally, net asset value per share was estimated by subtracting the fair value of our total liabilities from the fair value of our total assets and dividing the result by the number of common shares outstanding on a fully diluted basis as of December 31, 2018. Real Globe then applied a discount rate and terminal capitalization rate sensitivity analysis by adding and subtracting 50 basis points to the terminal capitalization rate and discount rate for assets where the concluded value was solely derived based on the discounted cash flow methodology, resulting in a value range equal to $0.38 - $0.43 per share on a fully diluted basis. The mid-point in the final range was $0.40 per share. For reporting purposes, all per share numbers are rounded to the nearest cent.

On January 10, 2019, the Audit Committee met to review and discuss Real Globe's report. Following this review, and considering management's support of Real Globe's analysis, the Audit Committee unanimously adopted a resolution accepting the Real Globe analysis. The Audit Committee also unanimously adopted a resolution recommending an estimate of per share value as of December 31, 2018 equal to $0.35 per share on a fully diluted basis. At a full meeting of our Board held on January 10, 2019, the Audit Committee made a recommendation to the Board that the Board adopt and the Company publish an estimate of per share value as of December 31, 2018 equal to $0.35 per share on a fully diluted basis. The Board unanimously adopted this recommendation of estimated per share value, which estimated value assumes a weighted average terminal capitalization rate equal to 7.45% and a discount rate equal to 8.52% and falls within the range of per share net asset values for the Company's common stock not including certain estimated corporate-level transaction costs provided by the Company that Real Globe provided in its report.

The following table shows a sensitivity range for estimated share price and terminal capitalization and discount rates:

	Range of Value and Rates		
	Not Including Certain Estimated Corporate-Level Transaction Costs		
	Low	**Midpoint**	**High**
Share Price	$0.38	$0.40	$0.43
Terminal Capitalization Rate	7.45%	6.95%	6.45%
Discount Rate	8.52%	8.02%	7.52%

In order to estimate the final range of value, Real Globe deducted $0.03 of certain estimated corporate-level transaction costs that were provided by the Company from the range of value above. The following chart presents the resulting final range of values, net of certain estimated corporate-level transaction costs that the Company would expect to incur in connection with a future potential liquidity event.

	Final Range of Value
	Share Price
Low	$0.35
Midpoint	$0.37
High	$0.40

As with any methodology used to estimate value, the methodology employed by Real Globe and the recommendations made by us were based upon a number of estimates and assumptions that may not be accurate or complete. Further, different parties using different assumptions and estimates could derive a different estimated value per share, which could be significantly different from our estimated value per share. The estimated per share value does not represent (i) the amount at which our shares would trade at a national securities exchange, (ii) the amount a stockholder would obtain if he or she tried to sell his or her shares (iii) the amount per share that stockholders would receive in a sale of the entire Company in a single transaction or (iv) the amount stockholders would receive if we liquidated our assets and distributed the proceeds after paying all of our expenses and liabilities. Accordingly, with respect to the estimated value per share, we can give no assurance that:

- a stockholder would be able to resell his or her shares at this estimated value;

- a stockholder would ultimately realize distributions per share equal to our estimated value per share upon liquidation of our assets and settlement of our liabilities or a sale of the Company;

- our shares would trade at a price equal to or greater than the estimated value per share if we listed them on a national securities exchange;

- the certain estimated corporate-level transaction costs that we would expect to incur in connection with a future potential liquidity event reflected in our estimated value will be incurred at the level estimated by us; or

- the methodology used to estimate our value per share would be acceptable to FINRA or that the estimated value per share will satisfy the applicable annual valuation requirements under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") and the Code, with respect to employee benefit plans subject to ERISA and other retirement plans or accounts subject to Section 4975 of the Code.

The estimated value per share was approved by our Board on January 10, 2019 and reflects the fact that the estimate was calculated at a moment in time. The value of our shares has changed over time and will be influenced by changes to the value of our individual assets as well as changes and developments in the real estate and capital markets. We currently anticipate publishing a new estimated share value within one year. Nevertheless, stockholders should not rely on the estimated value per share in making a decision to buy or sell shares of our common stock.

Stockholders

As of March 8, 2019 we had 166,715 stockholders of record.

Distributions

For the twelve months ended December 31, 2018 and 2017, no cash distributions were paid by us.

We generally intend over time to make annual distributions in an amount at least equal to the amount that will allow us to qualify as a REIT and to avoid current entity-level U.S. federal income taxes. To qualify as a REIT, we must distribute to our stockholders an amount at least equal to:

i. 90% of our REIT taxable income, determined before the deduction for dividends paid and excluding any net capital gain (which does not necessarily equal net income as calculated in accordance with GAAP); plus

ii. 90% of the excess of our net income from foreclosure property over the tax imposed on such income by the Code; less

iii. any excess non-cash income (as determined under the Code).

Distributions made by us will be authorized and determined by our board of directors, in its sole discretion, out of legally available funds, and will be dependent upon a number of factors, including our actual and projected results of operations, financial condition, cash flows and liquidity, our qualification as a REIT and other tax considerations, capital expenditures and other obligations, debt covenants, contractual prohibitions or other limitations under applicable law and other such matters as our board of directors may deem relevant from time to time. We cannot assure you that our distribution policy will remain the same in the future, or that any estimated distributions will be made or sustained.

Our ability to make distributions to our stockholders will depend upon the performance of our portfolio and our ability to successfully execute on our disposition strategy. Distributions will be made in cash to the extent cash is available for distribution. We may not be able to generate sufficient cash flows to pay distributions to our stockholders. To the extent that our cash available for distribution is less than the amount required to be distributed under the REIT provisions of the Code, we may consider funding sources other than cash flow from operations or funds from operations, which may reduce the amount of capital available for operations, may have negative tax implications, and may have a negative effect on the value of your shares under certain conditions. In addition, our board of directors could change our distribution policy in the future. See "Risk Factors - Risks Related to Our Status as a REIT."

Recent Sales of Unregistered Securities

None.

Item 6. Selected Financial Data

Not applicable.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with "Part I-Item 1A. Risk Factors," "Part II-Item 6. Selected Financial Data," "Part I-Item 1. Business," "Part I-Item 2. Properties" and the historical consolidated financial statements, and related notes included elsewhere in this Annual Report. The following discussion and analysis contains forward-looking statements based upon our current expectations, estimates and assumptions that involve risks and uncertainties. Our actual results could differ materially from those discussed in these forward-looking statements due to a variety of risks, uncertainties and other factors, including but not limited to, factors discussed in "Part I-Item 1A. Risk Factors" and "Disclosure Regarding Forward-Looking Statements." The following discussion and analysis should be read in conjunction with the Company's Consolidated Financial Statements and accompanying notes, which appear elsewhere in this Annual Report on Form 10-K.

Overview

We are a self-advised and self-administered real estate investment trust ("REIT") created to own and manage substantially all of the "non-core" assets previously owned and managed by our former parent, InvenTrust Properties Corp., a Maryland corporation ("InvenTrust"). On April 28, 2016, we were spun-off from InvenTrust through a pro rata distribution (the "Distribution") by InvenTrust of 100% of the outstanding shares of our common stock to holders of InvenTrust's common stock. Prior to or concurrent with the separation, we and InvenTrust engaged in certain reorganization transactions that were designed to consolidate substantially all of InvenTrust's remaining "non-core" assets in Highlands.

This portfolio of "non-core" assets, which were acquired by InvenTrust between 2005 and 2008, included assets that are special use, single tenant or build to suit; face unresolved legal issues; are in undesirable locations or in weak markets or submarkets; are aging or functionally obsolete; and/or have sub-optimal leasing metrics. A number of our assets are retail properties located in tertiary markets, which are particularly susceptible to the negative trends affecting retail real estate. As a result of these characteristics, such assets are difficult to lease, finance and refinance and are relatively illiquid compared to other types of real estate assets. These factors also significantly limit our asset disposition options, impact the timing of such dispositions and restrict the viable options available to the Company for a future potential liquidity event.

Our strategy is focused on preserving, protecting and maximizing the total value of our portfolio with the long-term objective of providing stockholders with a return of their investment. We engage in rigorous asset management, and seek to sustain and enhance our portfolio, and improve the quality and income-producing ability of our portfolio, by engaging in selective dispositions, acquisitions, capital expenditures, financing, refinancing and enhanced leasing. We are also focused on cost containment efforts across our portfolio, and improving our overall capital structure and making select investments in our existing "non-core" assets to maximize their value. To the extent we are able to generate cash flows from operations or dispositions of assets, in addition to the cash uses outlined above, our board of directors has determined that it is in the best interests of the Company to seek to reinvest in assets that are more likely to generate more reliable and stable cash flows, such as multi-family assets, as part of the Company's overall strategy to optimize the value of the portfolio, enhance our options for a future potential liquidity event and maximize shareholder value. Given the nature and quality of the "non-core" assets in our portfolio as well as current market conditions, we expect this strategy will take multiple years to develop and execute.

As of December 31, 2018, our portfolio of assets consisted of one office asset, two industrial assets, five retail assets, five multi-family assets, one correctional facility, two parcels of unimproved land and one bank branch. References to "Highlands," "the Company," "we" or "us" are to Highlands REIT, Inc., as well as all of Highlands' wholly-owned subsidiaries.

We currently have four business segments, consisting of (i) net lease, (ii) retail, (iii) multi-tenant office and (iv) multi-family. Our unimproved land assets are presented in "other." We may have additional or fewer segments in the future to the extent we enter into additional real property sectors, dispose of property sectors, or change the character of our assets. For the complete presentation of our reportable segments, see Note 11 to our consolidated financial statements for the years ended December 31, 2018 and 2017.

Basis of Presentation

Highlands was formed in December 2015 as a wholly-owned subsidiary of InvenTrust. Prior to the Distribution, we and InvenTrust effectuated certain reorganization transactions which were designed to consolidate the ownership of Highlands' asset portfolio into Highlands, transfer four retail assets previously owned directly or indirectly by legal entities that are now subsidiaries of Highlands to InvenTrust, facilitate our separation from InvenTrust and enable us to qualify as a REIT for U.S. federal income tax purposes commencing with our short taxable year ending December 31, 2016.

The accompanying consolidated financial statements include the accounts of Highlands, as well as all of Highlands' wholly-owned subsidiaries (collectively, "the Company"). Wholly-owned subsidiaries generally consist of limited liability companies (LLCs) and limited partnerships (LPs). The effects of all significant intercompany transactions have been eliminated.

For the years ended December 31, 2018 and 2017, comprehensive income equaled net income; therefore, separate consolidated statements of comprehensive income are not included in the accompanying consolidated financial statements.

Our Revenues and Expenses

Revenues

Our revenues are primarily derived from rental income and expense recoveries we receive from our tenants under leases with us, including monthly rent and other property income pursuant to tenant leases. Tenant recovery income primarily consists of reimbursements for real estate taxes, common area maintenance costs, management fees and insurance costs.

Expenses

Our expenses consist of property operating expenses, real estate taxes, depreciation and amortization expense, general and administrative expenses and provision for asset impairment. Property operating expenses primarily consist of repair and maintenance, management fees, utilities and insurance (in each case, some of which are recoverable from the tenant).

Key Indicators of Operating Performance

In evaluating our financial condition and operating performance, management focuses on the following financial and non-financial indicators, discussed in further detail herein:

- Cash flow from operations as determined in accordance with GAAP;
- Economic and physical occupancy and rental rates;
- Leasing activity and lease rollover;
- Management of operating expenses;
- Management of general and administrative expenses;
- Debt maturities and leverage ratios;
- Liquidity levels;
- Funds from operations (“FFO”), a supplemental non-GAAP measure; and
- Adjusted funds from operations (“AFFO”), a supplemental non-GAAP measure.

Acquisition and Disposition Activity

During the year ended December 31, 2018, we continued to invest in multi-family assets with the following acquisitions of properties:

Property	Location	Acquisition Date	Gross Acquisition Price	
The Lafayette	Denver, CO	5/15/2018	$	9,525
1620 Central Street	Evanston, IL	8/22/2018		20,500
Kenilworth Court	Denver, CO	9/12/2018		5,750
			$	35,775

On January 8, 2019, the Company acquired The Detroit Apartments and Detroit Terraces, two adjacent apartment buildings, located in Denver, Colorado, for a purchase price of $19.0 million. See Note 16 to the consolidated financial statements for additional information regarding subsequent events.

During the year ended December 31, 2018, we continued to execute on our strategy of disposing of legacy “non-core” assets by selling:

Property	Location	Date	Gross Disposition Price	
Buckhorn Plaza (partial lot sale)	Bloomsburg, PA	2/8/2018	$	60
Rolling Plains (correctional facility)	Haskell, TX	8/7/2018		3,600
Triangle Center [(1)]	Longview, WA	9/24/2018		38,340
Bridgeside Point	Pittsburgh, PA	12/28/2018		38,500
			$	80,500

[(1)] Mortgage debt in the amount of $19,479 was paid off with the proceeds from the sale.

On February 13, 2019, we entered into an agreement to sell Lincoln Mall for a gross sale price of $57.0 million. See Note 16 to the consolidated financial statements for additional information regarding the agreement to sell Lincoln Mall.

Results of Operations

Comparison of the years ended December 31, 2018 and 2017

Key performance indicators are as follows:

	As of December 31,			
	2018		2017	
Economic occupancy (a)		91.5%		83.7%
Rent per square foot (b)	$	15.77	$	15.48

(a) Economic occupancy is defined as the percentage of total gross leasable area for which a tenant is obligated to pay rent under the terms of its lease agreement, regardless of the actual use or occupation by the tenant of the area being leased. Actual use may be less than economic square footage.

(b) Rent per square foot is computed as annualized rent divided by the total occupied square footage at the end of the period. Annualized rent is computed as revenue for the last month of the period multiplied by twelve months. Annualized rent includes the effect of rent abatements, lease inducements and straight-line rent GAAP adjustments.

The increase in occupancy in 2018 is due to an increase in occupancy at one of our multi-tenant office assets.

Consolidated Results of Operations

	(in thousands) For the Year ended December 31,						
	2018		2017		Increase/(Decrease)		
Net income	$	24,928	$	173,999	$	(149,071)	(85.7)%

Net income decreased by $149.1 million to $24.9 million for the year ended December 31, 2018 from $174.0 million for the year ended December 31, 2017. The main factors contributing to the decrease were the gains on extinguishment of debt in the aggregate amount of $194.6 million related to the conveyance of our AT&T-Hoffman Estates, AT&T-St. Louis and Dulles Executive Plaza assets to our lenders in various cooperative foreclosure proceedings during 2017 and a reduction in operating income related to the disposition of assets during 2017. Partially offsetting these reductions include a reduction in the provision for asset impairment charges of $21.2, an increase in gain on the sale of investment properties of $19.1 million and a reduction in interest expense of $11.3 million driven by the reduction in debt.

Operating Income and Expenses

	(in thousands) For the Year ended December 31,			
	2018	2017	Increase/(Decrease)	
Property income:				
Rental income	$ 34,966	$ 47,115	$ (12,149)	(25.8)%
Tenant recovery income	7,795	7,342	453	6.2 %
Other property income	748	1,005	(257)	(25.6)%
	43,509	55,462	(11,953)	(21.6)%
Operating expenses:				
Property operating expenses	8,892	10,871	(1,979)	(18.2)%
Real estate taxes	5,028	7,420	(2,392)	(32.2)%
Depreciation and amortization	12,178	17,225	(5,047)	(29.3)%
General and administrative expenses	12,603	10,924	1,679	15.4 %
Provision for asset impairment	4,667	25,849	(21,182)	(81.9)%
Gain on sale of investment properties	27,863	8,674	19,189	221.2 %

Property Income and Operating Expenses

Rental income consists of monthly rent, straight-line rent adjustments, and amortization of acquired above and below market leases, pursuant to tenant leases. Tenant recovery income consists of reimbursements for real estate taxes, common area maintenance costs, management fees, and insurance costs. Other property income consists of lease termination fees and other miscellaneous property income. Property operating expenses consist of regular repair and maintenance, management fees, utilities, and insurance (in each case, some of which are recoverable from the tenant).

Total property income decreased by $12.0 million in the year ended December 31, 2018 compared to the same period in 2017 as a result of the disposition of the AT&T-St. Louis and Dulles Executive Plaza assets that were transferred to their respective lenders during 2017 as part of cooperative foreclosure processes. Partially offsetting these reductions were revenues from three multi-family asset acquisitions.

Real Estate Taxes

Real estate taxes decreased $2.4 million for the year ended December 31, 2018 compared to the same period in 2017 as a result of the property dispositions of AT&T-Hoffman Estates, Dulles Executive Plaza and AT&T-St. Louis at various times during 2017. Additional factors contributing to the reductions were the sale of one of the parcels of land during the fourth quarter of 2017, a reduction in the assessed value of one of the correctional facilities vacated during the first quarter of 2017 and an adjustment of 2017 taxes for one of our previously disposed net lease assets partially offset by increases related to the multi-family asset acquisitions.

Depreciation and Amortization

Depreciation and amortization decreased by $5.0 million for the year ended December 31, 2018 compared to the same period in 2017 primarily as a result of the disposition of one of our retail assets in 2018 and the dispositions discussed above during 2017 partially offset by increases related to the multi-family asset acquisitions.

General Administrative Expenses

General and administrative expenses increased by $1.7 million to $12.6 million for the year ended December 31, 2018 from $10.9 million for the year ended December 31, 2017, which is primarily related to the hiring of our new Chief Financial Officer and an increase in stock-based compensation expense, partially offset by a reduction in professional services.

Provision for Asset Impairment

For the year ended December 31, 2018, we identified certain assets that may have a reduction in the estimated fair market value. We recorded an impairment of investment properties of $4.7 million on one net lease asset and one land parcel for the year ended December 31, 2018.

For the year ended December 31, 2017, we identified certain assets that may have a reduction in the expected holding period or a major tenant moving out or not renewing an expiring lease, and reviewed the probability of these properties' disposition. We recorded an impairment of investment properties of $25.8 million on one net lease asset, one land parcel and one multi-tenant office asset.

Gain on Sale of Investment Properties

During the year ended December 31, 2018, the gain on sale of investment properties was $27.9 million, which is attributed to Highlands' sale of one retail asset, one multi-tenant office asset and one other asset during 2018.

During the year ended December 31, 2017, the gain on sale of investment properties was $8.7 million, which is attributed to Highlands' sale of two land parcels and one multi-tenant office asset during 2017.

Non-Operating Income and Expenses

	(in thousands) For the Year ended December 31,			
	2018	**2017**	**Increase/(Decrease)**	
Non-operating income and expenses:				
Interest income	$ 497	$ 156	$ 341	218.6 %
(Loss) gain on extinguishment of debt	(1,199)	194,581	(195,780)	(100.6)%
Other income	30	1,451	(1,421)	(97.9)%
Interest expense	(2,559)	(13,888)	(11,329)	(81.6)%

(Loss) Gain on Extinguishment of Debt

During the year ended December 31, 2018, the loss on extinguishment of debt was $1.2 million, related to prepayment penalties on the payoff of mortgage debt for the retail asset sold, discussed above. Gain on extinguishment of debt was $194.6 million which is attributed to two net lease assets and one multi-tenant office asset transferred to their respective lenders during 2017 in cooperative foreclosure proceedings.

Other Income

Other income decreased by $1.4 million for the year ended December 31, 2018 primarily related to the collection of a previously written-off construction deposit, net of legal fees, related to one of the land parcels located in Orlando, Florida during 2017.

Interest Expense

Interest expense decreased by $11.3 million to $2.6 million for the year ended December 31, 2018 from $13.9 million for the year ended December 31, 2017 primarily attributable to the property dispositions discussed above.

Leasing Activity

Our primary source of funding for our property-level operating activities and debt payments is rent collected pursuant to our tenant leases. The following table represents lease expirations as of December 31, 2018:

Lease Expiration Year	Number of Expiring Leases	Gross Leasable Area (GLA) of Expiring Leases (Sq. Ft.)	Annualized Rent of Expiring Leases (in thousands)	Percent of Total GLA	Percent of Total Annualized Rent	Expiring Rent/Square Foot
2019	15	126,721	$ 1,846	6.0%	5.5%	$ 14.57
2020	37	532,521	13,755	25.1%	40.7%	25.83
2021	19	232,760	3,201	11.0%	9.5%	13.75
2022	10	218,910	2,998	10.3%	8.9%	13.70
2023	10	54,906	727	2.6%	2.2%	13.24
2024	8	168,339	1,822	7.9%	5.4%	10.83
2025	7	40,030	551	1.9%	1.6%	13.77
2026	8	31,655	731	1.5%	2.2%	23.11
2027	5	595,816	5,688	28.1%	16.7%	9.54
2028	7	38,459	884	1.8%	2.6%	22.99
Month to Month	4	13,500	200	0.6%	0.6%	14.84
Thereafter	15	68,953	1,400	3.2%	4.1%	20.30
	145	2,122,570	$ 33,803	100.0%	100.0%	$ 15.93

The following table represents new and renewed leases that commenced in the year ended December 31, 2018.

	# of Leases	Gross Leasable Area	Rent per square foot	Weighted Average Lease Term
New	5	110,068	$ 27.50	9.91
Renewals	7	54,483	$ 11.11	4.31
Total	12	164,551	$ 22.07	8.05

During the year ended December 31, 2018, 12 new leases and renewals commenced with gross leasable area totaling 164,551 square feet. The weighted average lease term for new and renewal leases was 9.91 and 4.31 years, respectively.

As of December 31, 2017, 15 new leases and renewals commenced with gross leasable area totaling 301,691 square feet. The weighted average lease term for new and renewal leases was 8.56 and 1.94 years, respectively.

Critical Accounting Policies and Estimates

Revenue Recognition

The Company commences revenue recognition on our leases based on a number of factors. In most cases, revenue recognition under a lease begins when the lessee takes possession of or controls the physical use of the leased asset. Generally, this occurs on the lease commencement date. The determination of who is the owner, for accounting purposes, of the tenant improvements determines the nature of the leased asset and when revenue recognition under a lease begins. If we are the owner, for accounting purposes, of the tenant improvements, then the leased asset is the finished space and revenue recognition begins when the lessee takes possession of the finished space, typically when the improvements are substantially complete. If we conclude we are not the owner, for accounting purposes, of the tenant improvements (the lessee is the owner), then the leased asset is the unimproved space and any tenant improvement allowances funded under the lease are treated as lease incentives which reduces revenue recognized over the term of the lease. In these circumstances, we begin revenue recognition when the lessee takes possession of the unimproved space for the lessee to construct their own improvements. We consider a number of different factors to evaluate whether it or the lessee is the owner of the tenant improvements for accounting purposes. These factors include:

- whether the lease stipulates how and on what a tenant improvement allowance may be spent;
- whether the tenant or landlord retains legal title to the improvements;
- the uniqueness of the improvements;
- the expected economic life of the tenant improvements relative to the length of the lease; and
- who constructs or directs the construction of the improvements.

The determination of who owns the tenant improvements, for accounting purposes, is subject to significant judgment. In making that determination, we consider all of the above factors. No one factor, however, necessarily establishes its determination.

Rental income is recognized on a straight-line basis over the term of each lease. The difference between rental income earned on a straight-line basis and the cash rent due under the provisions of the lease agreements is recorded as deferred rent receivable and is included as a component of accounts and rents receivable in the accompanying consolidated balance sheets.

The Company records lease termination income if there is a signed termination agreement, all of the conditions of the agreement have been met, the tenant is no longer occupying the asset and amounts due are considered collectible.

Real Estate

We allocate the purchase price of real estate to land, building, other building improvements, tenant improvements, and intangible assets and liabilities (such as the value of above- and below-market leases, in-place leases and origination costs associated with in-place leases). The values of above- and below-market leases are recorded as intangible assets, net, and intangible liabilities, net, respectively, in the consolidated balance sheets, and are amortized as either a decrease (in the case of above-market leases) or an increase (in the case of below-market leases) to rental income over the remaining term of the associated tenant lease. The values associated with in-place leases are recorded in intangible assets, net in the consolidated balance sheets and are amortized to depreciation and amortization expense in the consolidated statements of operations over the remaining lease term.

The difference between the contractual rental rates and our estimate of market rental rates is measured over a period equal to the remaining non-cancelable term of the leases, including below-market renewal options for which exercise of the renewal option appears to be reasonably assured. The remaining term of leases with renewal options at terms below market reflect the assumed exercise of such below-market renewal options and assume the amortization period would coincide with the extended lease term.

We perform, with the assistance of a third-party certified valuation specialist, the following procedures for properties we acquire:

- Determine the accounting of the transaction as either a business combination or an asset acquisition;

- Estimate the value of the property “as if vacant” as of the acquisition date;
- Allocate the value of the property among land, building, and other building improvements and determine the associated useful life for each;
- Calculate the value and associated life of above- and below-market leases on a tenant-by-tenant basis. The difference between the contractual rental rates and our estimate of market rental rates is measured over a period equal to the remaining term of the leases (using a discount rate which reflects the risks associated with the leases acquired, including geographical location, size of leased area, tenant profile and credit risk);
- Estimate the fair value of the tenant improvements, legal expenses and leasing commissions incurred to obtain the leases and calculate the associated useful life for each;
- Estimate the fair value of assumed debt, if any, and value the favorable or unfavorable debt position acquired; and
- Estimate the intangible value of the in-place leases based on lease execution costs of similar leases as well as lost rent payments during an assumed lease-up period and their associated useful lives on a tenant-by-tenant basis.

We recognize gains and losses from sales of investment properties and land when we transfer control of a property and when it is probable that we will collect substantially all of the related consideration.

Capitalization and Depreciation

Real estate is reflected at cost less accumulated depreciation. Ordinary repairs and maintenance are expensed as incurred. Depreciation expense is computed using the straight line method. Building and other improvements are depreciated based upon estimated useful lives of 30 years for building and improvements and 5-15 years for furniture, fixtures and equipment and site improvements. Tenant improvements are amortized on a straight line basis over the lesser of the life of the tenant improvement or the lease term as a component of depreciation and amortization expense. Leasing fees are amortized on a straight-line basis over the life of the related lease as a component of depreciation and amortization expense. Loan fees are amortized on a straight-line basis, which approximates the effective interest method, over the life of the related loan as a component of interest expense.

Direct and indirect costs that are clearly related to the construction and improvements of investment properties are capitalized. Costs incurred for property taxes and insurance are capitalized during periods in which activities necessary to get the asset ready for its intended use are in progress. Interest costs are also capitalized during such periods.

Assets Held for Sale

In determining whether to classify an investment property as held for sale, the Company considers whether: (i) management has committed to a plan to sell the investment property; (ii) the investment property is available for immediate sale, in its present condition; (iii) the Company has initiated a program to locate a buyer; (iv) the Company believes that the sale of the investment property is probable; (v) the Company has received a significant non-refundable deposit for the purchase of the property; (vi) the Company is actively marketing the investment property for sale at a price that is reasonable in relation to its fair value; and (vii) actions required for the Company to complete the plan indicate that it is unlikely that any significant changes will be made to the plan.

If all of the above criteria are met, the Company classifies the investment property as held for sale. On the day that these criteria are met, the Company suspends depreciation on the investment properties held for sale, including depreciation for tenant improvements and additions, as well as on the amortization of acquired in-place leases. The investment properties and liabilities associated with those investment properties that are held for sale are classified separately on the consolidated balance sheets for the most recent reporting period and recorded at the lesser of the carrying value or fair value less costs to sell.

There were no assets held for sale on the consolidated balance sheet as of December 31, 2018 and December 31, 2017.

Impairment

The Company assesses the carrying values of the respective long-lived assets, whenever events or changes in circumstances indicate that the carrying amounts of these assets may not be fully recoverable, such as a reduction in the expected holding period of the asset. If it is determined that the carrying value is not recoverable because the undiscounted cash flows do not exceed carrying value, the Company records an impairment loss to the extent that the carrying value exceeds fair value. The valuation and possible subsequent impairment of investment properties is a significant estimate that can and does change based on the Company's continuous process of analyzing each asset and reviewing assumptions about uncertain inherent factors, as well as the economic condition of the asset at a particular point in time.

The use of projected future cash flows and related holding period is based on assumptions that are consistent with the estimates of future expectations and the strategic plan the Company uses to manage its underlying business. However, assumptions and estimates about future cash flows and capitalization rates are complex and subjective. Changes in economic and operating conditions and the Company's ultimate investment intent that occur subsequent to the impairment analyses could impact these assumptions and result in future impairment charges of the real estate assets.

Liquidity and Capital Resources

As of December 31, 2018, we had $80.5 million of cash and cash equivalents, and $3.2 million of restricted escrows.

Our principal demands for funds have been or will be:

- to pay the operating expenses of our assets;
- to pay our general and administrative expenses;
- to fund distributions;
- to service or pay-down our debt; and
- to fund capital expenditures and leasing related costs.

Generally, our cash needs have been and will be funded from:

- cash flows from our investment assets;
- proceeds from sales of assets; and
- proceeds from debt.

Our assets have lease maturities within the next two years that we expect to reduce our cash flows from operations. In particular, 23.0% of our revenue for the year ended December 31, 2018 is derived from a net lease with The GEO Group, Inc. on our Hudson correctional facility asset, which lease expires in January of 2020. There is no assurance that we will be able to re-lease these assets at comparable rates or on comparable terms, or at all.

We may, from time to time, repurchase our outstanding equity through cash purchases or via other transactions. Such repurchases or transactions, if any, will depend on our liquidity requirements, contractual restrictions, and other factors. The amounts involved may be material.

Borrowings

The table below presents, on a consolidated basis, the principal amount, weighted average interest rates and maturity date (by year) on our mortgage debt, as of December 31, 2018 (dollar amounts are stated in thousands).

Fixed rate mortgage debt maturing during the year ended December 31,	As of December 31, 2018	Weighted average interest rate, fixed
2019	$ —	—%
2020	—	—%
2021	—	—%
2022	9,365	5.24%
Thereafter	26,078	4.56%
Total	$ 35,443	4.74%

As of December 31, 2018 and December 31, 2017, no debt was recourse to the Company, although the Company or its subsidiaries may act as guarantor under customary, non-recourse carve-out clauses in our wholly-owned property owning subsidiaries' mortgage loans.

Our ability to pay off our mortgages when they become due is, in part, dependent upon our ability either to refinance the related mortgage debt or to sell the related asset. With respect to each loan, if the applicable wholly-owned property-owning subsidiary is unable to refinance or sell the related asset, or in the event that the estimated asset value is less than the mortgage balance, the applicable wholly-owned property-owning subsidiary may, if appropriate, satisfy a mortgage obligation by transferring title of the asset to the lender or permitting a lender to foreclose.

Volatility in the capital markets could expose us to the risk of not being able to borrow on terms and conditions acceptable to us for refinancing.

Mortgage loans outstanding as of December 31, 2018 and December 31, 2017 were $35.4 million and $55.9 million and had a weighted average interest rate of 4.74% and 4.92% per annum, respectively. For the year ended December 31, 2018 and 2017, we had no additional borrowings secured by mortgages on our assets.

On February 15, 2019, we entered into the Credit Agreement. The Credit Agreement provides for (i) a secured revolving credit facility (the “Revolving Credit Facility”) with revolving commitments in an aggregate principal amount of $50.0 million, including a letter of credit subfacility for 10% of the then available revolving commitments, and (ii) a secured term loan credit facility (the “Term Loan Facility” and together with the Revolving Credit Facility, the “Credit Facility”) with term loan commitments in an aggregate principal amount of $50.0 million. The Revolving Credit Facility has a maturity date of February 15, 2022, but can be extended at the Company’s option for two additional one-year periods conditioned on, among other things, payment of a 15-basis points extension fee upon each such extension. The Term Loan Facility has a maturity date of February 15, 2024. The Company currently expects to use borrowings under the Credit Facility for working capital purposes, which may include repayment of indebtedness, capital expenditures, lease up costs, redevelopment costs, property acquisitions and other general corporate purposes. In connection with entering into the Credit Facility, the Company borrowed $30.0 million under the Term Loan Facility. See Note 16 to the consolidated financial statements for additional information regarding the Credit Agreement.

Capital Expenditures and Reserve Funds

During the twelve months ended December 31, 2018, we made total capital expenditures of $4.3 million. Our total capital expenditures in 2017 was $8.8 million.

Summary of Cash Flows

Comparison of the years ended December 31, 2018 and ***December 31, 2017***

	(in thousands) For the Year ended December 31,	
	2018	**2017**
Cash provided by operating activities	$ 15,765	$ 26,405
Cash provided by investing activities	34,446	10,106
Cash used in financing activities	(22,477)	(44,667)
Increase (decrease) in cash and cash equivalents	27,734	(8,156)
Cash, cash equivalents and restricted cash, at beginning of year	56,007	64,163
Cash, cash equivalents and restricted cash, at end of year	$ 83,741	$ 56,007

Cash provided by operating activities was $15.8 million and $26.4 million for the years ended December 31, 2018, and 2017, respectively, and was generated primarily from operating income from property operations. Cash provided by operating activities decreased $10.6 million when comparing the year ended December 31, 2018 to the same period in 2017 primarily as a result of the disposition of assets during 2017. See also Note 4 to the consolidated financial statements.

Cash provided by investing activities was $34.4 million and $10.1 million for the years ended December 31, 2018 and 2017, respectively. Cash provided by investing activities increased $24.3 million when comparing the year ended December 31, 2018 to the same period in 2017. During the year ended December 31, 2018, cash provided by proceeds from the sale of investment properties, net was $76.5 million offset by cash used to purchase investment properties for $36.0 million, payments for capital expenditures of $4.3 million and payments for leasing fees of $1.8 million. In the year ended December 31, 2017, net cash provided by proceeds from the sale of investment properties was $38.5 million offset by cash used to purchase one property for $19.7 million, for capital expenditures of $8.8 million and for leasing fees of $0.4 million.

Cash used in financing activities was $22.5 million and $44.7 million for the years ended December 31, 2018 and 2017, respectively. Cash used in financing activities for the year ended December 31, 2018 was primarily related to principal payments on mortgage debt of $1.0 million and the payoff of one mortgage of $19.5 million. Cash used in financing activities for the year ended December 31, 2017 was primarily due to payoff of mortgage debt of $30.3 million and principal payments of mortgage debt of $6.2 million.

We consider all demand deposits, money market accounts and investments in certificates of deposit and repurchase agreements with a maturity of three months or less, at the date of purchase, to be cash equivalents. We maintain our cash and cash equivalents at financial institutions. The combined account balances at one or more institutions exceed the Federal Depository Insurance Corporation (“FDIC”) insurance coverage and, as a result, there is a concentration of credit risk related to amounts on deposit in excess of FDIC insurance coverage.

Funds From Operations and Adjusted Funds From Operations

The National Association of Real Estate Investment Trusts (“NAREIT”), an industry trade group, has promulgated a non-GAAP financial measure known as Funds From Operations, or FFO. As defined by NAREIT, FFO is net income (loss) in accordance with GAAP excluding gains (or losses) resulting from dispositions of properties, plus depreciation and amortization and impairment charges on depreciable property. We have adopted the NAREIT definition in our calculation of FFO as management considers FFO a widely accepted and appropriate measure of performance for REITs. FFO is not equivalent to our net income or loss as determined under GAAP.

Since the definition of FFO was promulgated by NAREIT, management and many investors and analysts have considered the presentation of FFO alone to be insufficient. Accordingly, in addition to FFO, we also use Adjusted Funds From Operations, or AFFO as a measure of our operating performance. We define AFFO, a non-GAAP financial measure, to exclude from FFO adjustments for gains or losses related to early extinguishment of debt instruments as these items are not related to our continuing operations. By excluding these items, management believes that AFFO provides supplemental information related to sustainable operations that will be more comparable between other reporting periods and to other public, non-traded REITs. AFFO is not equivalent to our net income or loss as determined under GAAP.

In calculating FFO and AFFO, impairment charges of depreciable real estate assets are added back even though the impairment charge may represent a permanent decline in value due to decreased operating performance of the applicable property. Further, because gains and losses from sales of property are excluded from FFO and AFFO, it is consistent and appropriate that impairments, which are often early recognition of losses on prospective sales of property, also be excluded.

We believe that FFO and AFFO are useful measures of our properties' operating performance because they exclude noncash items from GAAP net income. Neither FFO nor AFFO is intended to be an alternative to "net income" nor to "cash flows from operating activities" as determined by GAAP as a measure of our capacity to pay distributions. Other REITs may use alternative methodologies for calculating similarly titled measures, which may not be comparable to our calculation of FFO and AFFO.

The following section presents our calculation of FFO and AFFO to net income (in thousands):

	Year Ended December 31,	
	2018	2017
Net income	$ 24,928	$ 173,999
Depreciation and amortization related to investment assets	12,178	17,256
Impairment of investment properties	4,667	25,849
Gain on sale of investment properties, net	(27,863)	(8,674)
Funds from operations	$ 13,910	$ 208,430
Loss (gain) on extinguishment of debt	1,199	(194,581)
Adjusted funds from operations	$ 15,109	$ 13,849

The table below reflects additional information related to certain items that significantly impact the comparability of our FFO and AFFO and net income or significant non-cash items from the periods presented (in thousands).We have included this table because these items are not included in NAREIT's definition of FFO, but we believe these items provide useful supplemental information that may facilitate comparisons of our ongoing operating performance between periods, as well as between REITs that include similar disclosure.

	Year Ended December 31,	
	2018	2017
Amortization of mark to market debt discounts and financing costs	$ 80	$ 112

Distributions

For the years ended December 31, 2018 and 2017, no cash distributions were paid by Highlands.

Inflation

A number of our leases contain provisions designed to partially mitigate any adverse impact of inflation. With respect to current economic conditions and governmental fiscal policy, inflation may become a greater risk. Our leases typically require the tenant to pay its share of operating expenses, including common area maintenance, real estate taxes and insurance. By sharing these costs with our tenants, we may reduce our exposure to increases in costs and operating expenses resulting from inflation. A portion of our leases also include clauses enabling us to receive percentage rents based on a tenant's gross sales above predetermined levels or escalation clauses which are typically related to increases in the Consumer Price Index or similar inflation indices.

Off-Balance Sheet Arrangements

As of December 31, 2018 and December 31, 2017, we had no off-balance sheet arrangements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

HIGHLANDS REIT, INC.
Index

Item 8. Consolidated Financial Statements and Supplementary Data

All schedules other than those listed in the Index have been omitted, as the required disclosure is inapplicable or the information is presented in the financial statements or related notes.

See accompanying notes to consolidated financial statements.

Report of Independent Registered Public Accounting Firm

The Stockholders and Board of Directors Highlands REIT, Inc.:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Highlands REIT, Inc. (the Company) as of December 31, 2018 and 2017, the related consolidated statements of operations, equity, and cash flow for each of the years in the two-year period ended December 31, 2018, the related notes and financial statement schedule III (collectively, the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in two-year period ended December 31, 2018, in conformity with U.S. generally accepted accounting principles.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. 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, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ KPMG LLP

We have served as the Company's auditor since 2015.

Chicago, Illinois
March 22, 2019

HIGHLANDS REIT, INC.

Consolidated Balance Sheets
(Amounts in thousands, except share and per share amounts)

	As of December 31, 2018	As of December 31, 2017
Assets		
Investment properties		
Land	$ 72,630	$ 79,163
Building and other improvements	241,897	296,204
Construction in progress	32	483
Total	314,559	375,850
Less accumulated depreciation	(72,822)	(109,928)
Net investment properties	241,737	265,922
Cash and cash equivalents	80,512	53,852
Restricted cash and escrows	3,229	2,155
Accounts and rents receivable (net of allowance of $1,161 and $850)	5,861	4,897
Intangible assets, net	408	561
Deferred costs and other assets	4,233	2,230
Total assets	$ 335,980	$ 329,617
Liabilities		
Debt, net	$ 34,953	$ 55,273
Accounts payable and accrued expenses	11,653	11,048
Intangible liabilities, net	3,004	3,413
Other liabilities	2,270	1,786
Total liabilities	$ 51,880	$ 71,520
Commitments and contingencies		
Stockholders' Equity		
Common stock, $0.01 par value, 1,000,000,000 shares authorized, 871,688,704 shares issued and outstanding as of December 31, 2018	8,717	8,684
Additional paid-in capital	1,407,502	1,406,460
Accumulated distributions in excess of net income	(1,132,119)	(1,157,047)
Total stockholders' equity	284,100	258,097
Total liabilities and stockholders' equity	$ 335,980	$ 329,617

See accompanying notes to consolidated financial statements.

HIGHLANDS REIT, INC.

Consolidated Statements of Operations
(Amounts in thousands, except share and per share amounts)

	Year Ended December 31, 2018	Year Ended December 31, 2017
Revenues		
Rental income	$ 34,966	$ 47,115
Tenant recovery income	7,795	7,342
Other property income	748	1,005
Total revenues	$ 43,509	$ 55,462
Expenses		
Property operating expenses	8,892	10,871
Real estate taxes	5,028	7,420
Depreciation and amortization	12,178	17,225
General and administrative expenses	12,603	10,924
Provision for asset impairment	4,667	25,849
Total expenses	$ 43,368	$ 72,289
Gain on sale of investment properties	27,863	8,674
Income (loss) from operations	$ 28,004	$ (8,153)
Interest income	497	156
(Loss) gain on extinguishment of debt	(1,199)	194,581
Other income	30	1,451
Interest expense	(2,559)	(13,888)
Income before income taxes	$ 24,773	$ 174,147
Income tax benefit (expense)	155	(148)
Net income	$ 24,928	$ 173,999
Net income per common share, basic and diluted	$ 0.03	$ 0.20
Weighted average number of common shares outstanding, basic and diluted	871,177,934	867,687,575

See accompanying notes to consolidated financial statements.

HIGHLANDS REIT, INC.

Consolidated Statements of Equity
(Amounts in thousands, except share amounts)

For the years ended December 31, 2018 and 2017

	Common Stock		Additional Paid-in Capital	Accumulated Distributions in Excess of Net Income	Total
	Shares	Amount			
Balance at January 1, 2017	864,890,967	$ 8,649	$ 1,405,677	$ (1,331,046)	$ 83,280
Net income	—	—	—	173,999	173,999
Share-based compensation	3,532,614	35	783	—	818
Balance at December 31, 2017	868,423,581	$ 8,684	$ 1,406,460	$ (1,157,047)	$ 258,097
Net income	—	—	—	24,928	24,928
Share-based compensation	3,265,123	33	1,042	—	1,075
Balance at December 31, 2018	871,688,704	$ 8,717	$ 1,407,502	$ (1,132,119)	$ 284,100

See accompanying notes to consolidated financial statements.

HIGHLANDS REIT, INC.
Consolidated Statements of Cash Flow
(Dollar amounts in thousands)

	Year ended December 31,	
	2018	**2017**
Cash flows from operating activities:		
Net income	$ 24,928	$ 173,999
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	12,178	17,256
Amortization of above and below market leases, net	(407)	(416)
Amortization of debt discounts and financing costs	80	112
Straight-line rental income	(828)	271
Loss (gain) on extinguishment of debt	1,199	(194,581)
Gain on sale of investment properties, net	(27,863)	(8,674)
Provision for asset impairment	4,667	25,849
Non-cash stock-based compensation expense	2,497	1,438
Changes in assets and liabilities:		
Accounts and rents receivable, net	(432)	458
Settlement of balance due from InvenTrust	—	228
Deferred costs and other assets	(1,457)	(517)
Accounts payable and accrued expenses	658	11,305
Other liabilities	545	(323)
Net cash flows provided by operating activities	$ 15,765	$ 26,405
Cash flows from investing activities:		
Capital expenditures and tenant improvements	(4,251)	(8,833)
Proceeds from sale of investment properties, net	76,526	38,484
Acquisition of investment properties	(36,014)	(19,702)
Proceeds from insurance settlement	—	545
Payment of leasing fees	(1,815)	(388)
Net cash flows provided by investing activities	$ 34,446	$ 10,106
Cash flows from financing activities:		
Payoff of mortgage debt	(19,479)	(30,273)
Cash paid for debt extinguishment	—	(7,191)
Prepayment penalties on the payoff of mortgage debt	(1,158)	—
Principal payments of mortgage debt	(964)	(6,209)
Payment for tax withholding for share-based compensation	(876)	(994)
Net cash flows used in financing activities	$ (22,477)	$ (44,667)
Net increase (decrease) in cash and cash equivalents	27,734	(8,156)
Cash, cash equivalents and restricted cash, at beginning of year	56,007	64,163
Cash, cash equivalents and restricted cash, at end of year	$ 83,741	$ 56,007

See accompanying notes to consolidated financial statements.

HIGHLANDS REIT, INC.
Consolidated Statements of Cash Flow
(Dollar amounts in thousands)

	Year Ended December 31, 2018	Year Ended December 31, 2017
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 2,565	$ 5,933
Cash paid for taxes	185	—
Supplemental schedule of non-cash investing and financing activities:		
Non-cash accruals for capital expense and investment in development	$ —	$ 920
Mortgage loans payable and related obligations settled	$ —	$ 318,185
Real estate transferred to mortgage lender	$ —	$ (123,604)

See accompanying notes to consolidated financial statements.

1. Organization

Highlands REIT, Inc. (“Highlands”), which was formed in December 2015, is a Maryland corporation with a portfolio of office assets, industrial assets, retail assets, a correctional facility, five multi-family assets, unimproved land and a bank branch. Prior to April 28, 2016, Highlands was a wholly-owned subsidiary of InvenTrust Properties Corp. (“InvenTrust” and formerly known as Inland American Real Estate Trust, Inc.), its former parent.

On April 28, 2016, Highlands spun-off from InvenTrust through a pro rata distribution by InvenTrust of 100% of the outstanding shares of common stock, $0.01 par value per share (the “Common Stock”), of Highlands to holders of record of InvenTrust's common stock as of the close of business on April 25, 2016 (the “Record Date”). Each holder of record of InvenTrust's common stock received one share of Common Stock for every one share of InvenTrust's common stock held at the close of business on the Record Date (the “Distribution”). As a result, Highlands became an independent, self-advised, non-traded public company. Highlands has elected to be taxed, and currently qualifies, as a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended (the "Code") for U.S. federal income tax purposes commencing with Highlands' short taxable year ending December 31, 2016. In connection with the Distribution, Highlands entered into a Separation and Distribution Agreement, Transition Services Agreement and Employee Matters Agreement with InvenTrust. Refer to Note 14 for more details.

Each asset is owned by a separate legal entity, which maintains its own books and financial records, and each entity’s assets are not available to satisfy the liabilities of other affiliated entities, except as otherwise disclosed in Note 9.

As of December 31, 2018, the Company owned 15 assets and two parcels of unimproved land. As of December 31, 2017, the Company owned 15 assets and two parcels of unimproved land.

2. Summary of Significant Accounting Policies

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) and require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Basis of Presentation

The accompanying consolidated financial statements include the accounts of Highlands, as well as all of Highlands' wholly-owned subsidiaries (collectively, “the Company”). Wholly-owned subsidiaries generally consist of limited liability companies (LLCs) and limited partnerships (LPs). The effects of all significant intercompany transactions have been eliminated.

For the years ended December 31, 2018 and 2017, comprehensive income equaled net income; therefore, separate consolidated statements of comprehensive income are not included in the accompanying consolidated financial statements.

Revenue Recognition

The Company commences revenue recognition on our leases based on a number of factors. In most cases, revenue recognition under a lease begins when the lessee takes possession of or controls the physical use of the leased asset. Generally, this occurs on the lease commencement date. The determination of who is the owner, for accounting purposes, of the tenant improvements determines the nature of the leased asset and when revenue recognition under a lease begins. If we are the owner, for accounting purposes, of the tenant improvements, then the leased asset is the finished space and revenue recognition begins when the lessee takes possession of the finished space, typically when the improvements are substantially complete. If we conclude we are not the owner, for accounting purposes, of the tenant improvements (the lessee is the owner), then the leased asset is the unimproved space and any tenant improvement allowances funded under the lease are treated as lease incentives which reduces revenue recognized over the term of the lease. In these circumstances, we begin revenue recognition when the lessee takes possession of the unimproved space for the lessee to construct their own improvements. We consider a number of different factors to evaluate whether it or the lessee is the owner of the tenant improvements for accounting purposes. These factors include:

- whether the lease stipulates how and on what a tenant improvement allowance may be spent;
- whether the tenant or landlord retains legal title to the improvements;
- the uniqueness of the improvements;
- the expected economic life of the tenant improvements relative to the length of the lease; and
- who constructs or directs the construction of the improvements.

The determination of who owns the tenant improvements, for accounting purposes, is subject to significant judgment. In making that determination, we consider all of the above factors. No one factor, however, necessarily establishes its determination.

Rental income is recognized on a straight-line basis over the term of each lease. The difference between rental income earned on a straight-line basis and the cash rent due under the provisions of the lease agreements is recorded as deferred rent receivable and is included as a component of accounts and rents receivable in the accompanying consolidated balance sheets.

The Company records lease termination income if there is a signed termination agreement, all of the conditions of the agreement have been met and amounts due are considered collectible.

Real Estate

We allocate the purchase price of real estate to land, building, other building improvements, tenant improvements, and intangible assets and liabilities (such as the value of above- and below-market leases, in-place leases and origination costs associated with in-place leases). The values of above- and below-market leases are recorded as intangible assets, net, and intangible liabilities, net, respectively, in the consolidated balance sheets, and are amortized as either a decrease (in the case of above-market leases) or an increase (in the case of below-market leases) to rental income over the remaining term of the associated tenant lease. The values associated with in-place leases are recorded in intangible assets, net in the consolidated balance sheets and are amortized to depreciation and amortization expense in the consolidated statements of operations over the remaining lease term.

The difference between the contractual rental rates and our estimate of market rental rates is measured over a period equal to the remaining non-cancelable term of the leases, including below-market renewal options for which exercise of the renewal option appears to be reasonably assured. The remaining term of leases with renewal options at terms below market reflect the assumed exercise of such below-market renewal options and assume the amortization period would coincide with the extended lease term.

We perform, with the assistance of a third-party certified valuation specialist, the following procedures for properties we acquire:

- Estimate the value of the property “as if vacant” as of the acquisition date;
- Allocate the value of the property among land, building, and other building improvements and determine the associated useful life for each;
- Calculate the value and associated life of above- and below-market leases on a tenant-by-tenant basis. The difference between the contractual rental rates and our estimate of market rental rates is measured over a period equal to the remaining term of the leases (using a discount rate which reflects the risks associated with the leases acquired, including geographical location, size of leased area, tenant profile and credit risk);

- Estimate the fair value of the tenant improvements, legal expenses and leasing commissions incurred to obtain the leases and calculate the associated useful life for each;

- Estimate the fair value of assumed debt, if any, and value the favorable or unfavorable debt position acquired; and

- Estimate the intangible value of the in-place leases based on lease execution costs of similar leases as well as lost rent payments during an assumed lease-up period and their associated useful lives on a tenant-by-tenant basis.

We recognize gains and losses from sales of investment properties and land in accordance with FASB ASC 610-20, “Gains and Losses From the Derecognition of Nonfinancial Assets”. We recognize gains and losses from sales of investment properties and land when we transfer control of a property and when it is probable that we will collect substantially all of the related consideration.

Capitalization and Depreciation

Real estate is reflected at cost less accumulated depreciation. Ordinary repairs and maintenance are expensed as incurred. Depreciation expense is computed using the straight line method. Building and other improvements are depreciated based upon estimated useful lives of 30 years for building and improvements and 5-15 years for furniture, fixtures and equipment and site improvements. Tenant improvements are amortized on a straight line basis over the lesser of the life of the tenant improvement or the lease term as a component of depreciation and amortization expense. Leasing fees are amortized on a straight-line basis over the life of the related lease as a component of depreciation and amortization expense. Loan fees are amortized on a straight-line basis, which approximates the effective interest method, over the life of the related loan as a component of interest expense.

Direct and indirect costs that are clearly related to the construction and improvements of investment properties are capitalized. Costs incurred for property taxes and insurance are capitalized during periods in which activities necessary to get the asset ready for its intended use are in progress. Interest costs are also capitalized during such periods.

Assets Held for Sale

In determining whether to classify an investment property as held for sale, the Company considers whether: (i) management has committed to a plan to sell the investment property; (ii) the investment property is available for immediate sale, in its present condition; (iii) the Company has initiated a program to locate a buyer; (iv) the Company believes that the sale of the investment property is probable; (v) the Company has received a significant non-refundable deposit for the purchase of the property; (vi) the Company is actively marketing the investment property for sale at a price that is reasonable in relation to its fair value; and (vii) actions required for the Company to complete the plan indicate that it is unlikely that any significant changes will be made to the plan.

If all of the above criteria are met, the Company classifies the investment property as held for sale. On the day that these criteria are met, the Company suspends depreciation on the investment properties held for sale, including depreciation for tenant improvements and additions, as well as on the amortization of acquired in-place leases. The investment properties and liabilities associated with those investment properties that are held for sale are classified separately on the consolidated balance sheets for the most recent reporting period and recorded at the lesser of the carrying value or fair value less costs to sell.

There were no assets held for sale on the consolidated balance sheet as of December 31, 2018 and December 31, 2017.

Impairment

The Company assesses the carrying values of the respective long-lived assets, whenever events or changes in circumstances indicate that the carrying amounts of these assets may not be fully recoverable, such as a reduction in the expected holding period of the asset. If it is determined that the carrying value is not recoverable because the undiscounted cash flows do not exceed carrying value, the Company records an impairment loss to the extent that the carrying value exceeds fair value. The valuation and possible subsequent impairment of investment properties is a significant estimate that can and does change based on the Company’s continuous process of analyzing each asset and reviewing assumptions about uncertain inherent factors, as well as the economic condition of the asset at a particular point in time.

The use of projected future cash flows and related holding period is based on assumptions that are consistent with the estimates of future expectations and the strategic plan the Company uses to manage its underlying business. However, assumptions and estimates about future cash flows and capitalization rates are complex and subjective. Changes in economic and operating conditions and the Company’s ultimate investment intent that occur subsequent to the impairment analyses could impact these assumptions and result in future impairment charges of the real estate assets.

During the year ended December 31, 2018, the Company identified certain assets which may have a reduction in fair market value which represented an impairment trigger, and recorded an impairment of investment properties of $4,667 on one net lease asset and one land parcel. The Company recorded $4,667 and $25,849 of impairments during the years ended December 31, 2018 and 2017, respectively. See Note 9 to the consolidated financial statements for additional information.

Recently Issued Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, Leases (“ASU 2016-02”), which established ASC 842, *Leases*, which introduces a lessee model that brings most leases on the balance sheet and, among other changes, eliminates the requirement in current GAAP for an entity to use bright-line tests in determining lease classification. ASC 842 allows for several practical expedients which permit the following: no reassessment of lease classification or initial direct costs; use of the standard’s effective date as the date of initial application; and no separation of non-lease components from the related lease components and, instead, to account for those components as a single lease component if certain criteria are met. We expect to elect these practical expedients and adopt ASC 842 on January 1, 2019 using the effective date as our date of initial application. Therefore, financial information and disclosures under ASC 842 will not be provided for periods prior to January 1, 2019. The Company expects to elect the practical expedient, among others, to not separate lease and non-lease components for all qualifying leases. Due to the new standard’s narrowed definition of initial direct costs, the Company expects to expense as incurred certain lease origination costs currently capitalized and amortized to expense over the lease term. Any costs no longer qualifying as initial direct costs will result in an increase to general and administrative expense in the consolidated statements of operations in the period of adoption and prospectively. The Company does not believe this change will have a material impact on its consolidated financial statements and disclosures. As a lessee, the Company will be required to recognize a right-of-use asset and lease liability on the consolidated balance sheet of approximately $300, which was estimated by utilizing an average discount rate of approximately 4.5%, reflecting the Company's incremental borrowing rate. These initial estimates are based on the Company’s ground lease arrangement as of December 31, 2018. As a lessor, the Company believes that substantially all of the Company's leases will continue to be classified as operating leases under the new standard and will continue to record revenues from rental properties on a straight-line basis. However, certain ground, anchor, and other long-term leases entered into or acquired subsequent to the adoption date have an increased likelihood of being classified as either sales-type or finance-type leases.

In June 2018, the FASB issued ASU No. 2018-07, Compensation – Stock Compensation (Topic 718), Improvements to Nonemployee Share-Based Payment Accounting. This ASU is intended to simplify aspects of share-based compensation issued to non-employees by making the guidance consistent with the accounting for employee share-based compensation. It is effective for annual reporting periods, and interim periods within those years, beginning after December 15, 2018. The adoption of ASU No. 2018-07 is not expected to have a material impact on the consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement. This ASU modifies the disclosure requirements on fair value measurements. The ASU removes the requirement to disclose: the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy; the policy for timing of transfers between levels; and the valuation processes for Level 3 fair value measurements. Our effective date for adoption of this guidance is our fiscal year beginning January 1, 2020 with early adoption permitted. We are currently evaluating the effect that this guidance will have on our consolidated financial statements.

(Amounts in thousands, except share and per share amounts)

Recently Adopted Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers. The core objective of ASU No. 2014-09 (as codified in ASC 606) is for an entity to recognize revenue based on the consideration it expects to receive in exchange for goods or services. Additionally, this ASU requires entities to use a single model in accounting for revenues derived from contracts with customers. ASU No. 2014-09 replaces prior guidance regarding the recognition of revenue from sales of real estate, except for revenue from sales that are part of a sale-leaseback transaction. The provisions of ASU No. 2014-09, as subsequently amended in conjunction with ASU No. 2016-08, Principal versus Agent Considerations (Reporting Revenue Gross Versus Net), comprise ASC 606, Revenue Recognition, became effective for us on January 1, 2018. The Company elected the modified retrospective method of adoption, but determined that there was no cumulative adjustment to be recorded in connection with the adoption of ASC 606. We have evaluated all of our revenue streams to identify which of our revenue streams would be subject to the provisions of ASC 606 and any differences in the timing, measurement or presentation of revenue recognition. In evaluating our revenue streams, substantially all of our revenues result from leasing transactions that are not within the scope of the new standard and will be governed by the recently issued leasing guidance, ASU No. 2016-02, which is discussed above and will not be effective until January 1, 2019. As a result, the Company has concluded that the adoption of ASC 606 did not have a material impact on the process for, timing of, and presentation and disclosure of revenue recognition from contracts with tenants and other customers.

In August 2016, the FASB issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments. ASU No. 2016-15 addresses eight specific cash flow issues with the objective of reducing diversity in practice. The cash flow issues include debt prepayment or debt extinguishment costs and proceeds from the settlement of insurance claims. The Company adopted ASU No. 2016-15 effective January 1, 2018. The impact to the consolidated financial statements, in conjunction with the adoption of ASU No. 2016-18 discussed below, is the presentation of cash outflows of $1,158 and $7,191 classified as financing activities, that were previously included as operating activities, within the consolidated statement of cash flow for the year ended December 31, 2018 and 2017, respectively.

In November 2016, the FASB issued ASU No. 2016-18, Classification and Presentation of Restricted Cash in the Statement of Cash Flows. ASU No. 2016-18 requires an explanation in the cash flow statement of a change in the total of (1) total cash, (2) cash equivalents, and (3) restricted cash or restricted cash equivalents. The Company adopted ASU No. 2016-18 effective January 1, 2018, the effects of which include presenting restricted cash and escrows with cash and cash equivalents in the consolidated statement of cash flow. The Company is required to escrow cash balances for specific uses stipulated by certain of its lenders and other various agreements. As of December 31, 2018 and December 31, 2017, the Company’s cash balances restricted for these uses were $3,229 and $2,155, respectively. The inclusion of restricted cash increased cash, cash equivalents and restricted cash, at the beginning of the year, in the consolidated statement of cash flow by$2,155 and $7,034 as of January 1, 2018 and 2017, respectively, and cash, cash equivalents and restricted cash, at end of the year, by $3,229 and $2,155, as of December 31, 2018 and 2017, respectively.

	December 31, 2018	December 31, 2017
Cash and cash equivalents	$ 80,512	$ 53,852
Restricted cash	3,229	2,155
Total cash, cash equivalents and restricted cash	$ 83,741	$ 56,007

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (ASC 805) Clarifying the Definition of a Business (ASU 2017-01). ASU 2017-1 clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The definition of a business affects many areas of accounting, including acquisitions (including treatment of acquisition costs), disposals, goodwill, and consolidation. The guidance is effective for annual periods beginning after December 15, 2018, including interim periods within those periods. Early adoption of this standard is permitted. The Company early adopted ASU 2017-01 effective as of July 1, 2017, the effects of which were not material to the consolidated financial statements.

In February 2017, the FASB issued ASU No. 2017-05, Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets. As it relates to gains on sale of real estate, we will apply the provisions of ASC 610-20, Gain or Loss From

(Amounts in thousands, except share and per share amounts)

Derecognition of Non-financial Assets (ASC 610-20), and we expect to recognize any gains when we transfer control of a property and when it is probable that we will collect substantially all of the related consideration. The adoption of ASC 610-20 on January 1, 2018 did not have a material impact on our consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, Compensation-Stock Compensation (Topic 718), Scope of Modification Accounting. ASU No. 2017-09 clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as modifications. The guidance is effective prospectively for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, and early adoption is permitted. The early adoption of ASU No. 2017-09 in 2017 did not have a material impact on the consolidated financial statements.

3. Acquired Assets

The Company records identifiable assets and liabilities acquired at fair value. During the twelve months ended December 31, 2018, the Company acquired three multi-family assets for a gross acquisition price of $35.8 million. Under ASU No. 2017-01, the Company determined these transactions should be accounted for as asset acquisitions. Accordingly, the Company capitalized transaction costs of approximately $240.

The following table reflects the properties acquired during the year ended December 31, 2018.

Property	Location	Acquisition Date	Gross Acquisition Price	
The Lafayette	Denver, CO	5/15/2018	$	9,525
1620 Central Street	Evanston, IL	8/22/2018		20,500
Kenilworth Court	Denver, CO	9/12/2018		5,750
			$	35,775

During the year ended December 31, 2017, the Company acquired two buildings for a gross acquisition price of $19,702. Although acquired in a single transaction on August 21, 2017, the special purpose entity that now owns these assets contains the operations of the two distinct multi-family assets, Buerger Brothers Lofts and Chamber Lofts which are managed independently, and have been determined by management to be accounted for as two distinct assets. The Company capitalized transaction costs of approximately $100 during the year ended December 31, 2017.

4. Disposed Assets

The following table reflects the property dispositions during the year ended December 31, 2018.

Property	Location	Date	Gross Disposition Price	
Buckhorn Plaza (partial lot sale)	Bloomsburg, PA	2/8/2018	$	60
Rolling Plains (correctional facility)	Haskell, TX	8/7/2018		3,600
Triangle Center (1)	Longview, WA	9/24/2018		38,340
Bridgeside Point	Pittsburgh, PA	12/28/2018		38,500
			$	80,500

(1) Mortgage debt in the amount of $19,479 was paid off with the proceeds from the sale.

On April 10, 2017, the Company conveyed its Dulles Executive Plaza asset to its lenders via a deed of assumption and the non-recourse Commercial Mortgage-Backed Security (“CMBS”) debt was fully extinguished. Upon conveyance of the asset, the Company was fully released from its nonrecourse indebtedness and had no further continuing obligations to the lender. The Company recognized a gain on extinguishment of debt in the amount of $4,514 for the year ended December 31, 2017.

(Amounts in thousands, except share and per share amounts)

On April 20, 2017, the AT&T-Hoffman Estates asset was sold via sheriff's sale as part of the foreclosure process, which was approved by the court on May 18, 2017. The court-appointed receiver was discharged on July 6, 2017. As a result of the foreclosure sale, the Company satisfied its nonrecourse indebtedness and had no further continuing obligations to the lender. The Company recognized a gain on extinguishment of debt in the amount of $112,600 for the year ended December 31, 2017.

On August 22, 2017, the AT&T-St. Louis asset was sold via sheriff's sale as part of the foreclosure process. As a result of the foreclosure sale, the Company satisfied its nonrecourse indebtedness and had no further continuing obligations to the lender. The Company recognized a gain on extinguishment of debt in the amount of $77,467 for the year ended December 31, 2017.

For the year ended December 31, 2017, the Company recorded a gain on extinguishment of debt of $194,581.

The Company sold one multi-tenant office asset and two land parcels during the year ended December 31, 2017 for an aggregate gross disposition price of $39,415. The table below reflects sales activity for the year ended December 31, 2017 for the three assets included in the consolidated statements of operations.

Property	Location	Date	Gross Disposition Price
Denver Highlands	Denver, CO	10/16/2017	$ 8,000
Sand Lake land	Orlando, FL	10/26/2017	27,500
North Pointe land	Hanahan, SC	11/30/2017	3,915
			$ 39,415

For the years ended December 31, 2018 and 2017, the Company recorded a gain on the sale of investment properties of $27,863 and $8,674, respectively.

5. Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consist of the following:

	Year Ended December 31, 2018	2017
Accrued real estate taxes	$ 5,669	$ 6,488
Accrued compensation	3,232	1,919
Accrued interest payable	119	206
Other accrued expenses	2,633	2,435
Total accounts payable and accrued expenses	$ 11,653	$ 11,048

6. Leases

Operating Leases

Minimum lease payments to be received under operating leases, assuming no expiring leases are renewed, are as follows:

(Amounts in thousands, except share and per share amounts)

For the Year Ended December 31,	Minimum Lease Payment	
2019	$	29,214
2020		17,418
2021		14,014
2022		11,423
2023		10,358
Thereafter		36,357
Total	$	118,784

The remaining lease terms range from one year to fifteen years. The majority of the revenue from the Company's assets consists of rents received under long-term operating leases. Some leases provide for the payment of fixed base rent paid monthly in advance, and for the reimbursement by tenants to the Company for the tenant's pro rata share of certain operating expenses including real estate taxes, special assessments, insurance, utilities, common area maintenance, management fees, and certain building repairs paid by the landlord and recoverable under the terms of the lease. Under these leases, the landlord pays all expenses and is reimbursed by the tenant for the tenant's pro rata share of recoverable expenses paid. Certain other tenants are subject to net leases which provide that the tenant is responsible for fixed base rent as well as all costs and expenses associated with occupancy. Under net leases where all expenses are paid directly by the tenant rather than the landlord, such expenses are not included in the consolidated statements of operations. Under leases where all expenses are paid by the landlord, subject to reimbursement by the tenant, the expenses are included within property operating expenses and reimbursements are included in tenant recovery income on the consolidated statements of operations.

Approximately 23.0% of our revenue for the year ended December 31, 2018 is derived from a net lease with The GEO Group, Inc. on our Hudson correctional facility asset, which lease expires in January of 2020. There is no assurance that we will be able to re-lease these assets at comparable rates or on comparable terms, or at all.

7. Intangible Assets

The following table summarizes the Company's identified intangible assets and intangible liabilities as of December 31, 2018 and 2017.

	Balance as of December 31,			
	2018		2017	
Intangible Assets:				
Acquired in-place lease	$	19,884	$	18,903
Acquired above market lease		127		127
Accumulated amortization		(19,603)		(18,469)
Intangible assets, net	$	408	$	561
Intangible liabilities:				
Acquired below market lease		8,106		8,106
Accumulated amortization		(5,102)		(4,693)
Intangible Liabilities, net	$	3,004	$	3,413

The portion of the purchase price allocated to acquired above market lease costs and acquired below market lease costs are amortized on a straight line basis over the life of the related lease, including the respective renewal period for below market lease costs with fixed rate renewals, as an adjustment to other property income. Amortization pertaining to the above market lease costs was applied as a reduction to other property income. Amortization pertaining to the below market lease costs was applied as an increase to other property income. The portion of the purchase price allocated to acquired in-place lease intangibles is amortized on a straight line basis over the life of the related lease and is recorded as amortization expense.

(Amounts in thousands, except share and per share amounts)

The following table summarizes the amortization related to acquired above and below market lease costs and acquired in-place lease intangibles for the years ended December 31, 2018 and 2017.

	For the years ended December 31, 2018	2017
Amortization of:		
Acquired above market lease	$ (2)	$ (2)
Acquired below market lease	409	418
Net rental income increase	$ 407	$ 416
Acquired in-place lease intangibles	$ 735	$ 2,997

The following table presents the amortization during the next five years and thereafter related to intangible assets and liabilities as of December 31, 2018.

	2019	2020	2021	2022	2023	Thereafter	Total
Amortization of:							
Acquired above market lease	$ (2)	$ (2)	$ (1)	$ (1)	$ (1)	$ (4)	$ (11)
Acquired below market lease	379	313	297	297	297	1,421	3,004
Net rental income increase	**$ 377**	**$ 311**	**$ 296**	**$ 296**	**$ 296**	**$ 1,417**	**$ 2,993**
Acquired in-place lease intangibles	$ 397	$ —	$ —	$ —	$ —	$ —	$ 397

8. Debt

During the years ended December 31, 2018 and 2017, the following principal debt transactions occurred:

Balance at December 31, 2016	$ 381,981
Transfer of mortgages payable to lenders	(289,611)
Paydown of debt	(36,484)
Balance at December 31, 2017	$ 55,886
Paydown of debt	(20,443)
Balance at December 31, 2018	$ 35.443

Mortgages Payable

Mortgage loans outstanding as of December 31, 2018 and December 31, 2017, net of unamortized deferred financing costs, were $34,953 and $55,273, respectively, and had a weighted average interest rate of 4.74% and 4.92% per annum, respectively. Deferred financing costs, net, as of December 31, 2018 and December 31, 2017 were $490 and $613, respectively. As of December 31, 2018, scheduled maturities for the Company's outstanding mortgage indebtedness had various due dates through December 2026, as follows:

(Amounts in thousands, except share and per share amounts)

For the year ended December 31,	As of December 31, 2018	Weighted average interest rate
2019	$ —	—%
2020	—	—%
2021	—	—%
2022	9,365	5.24%
Thereafter	26,078	4.56%
Total	$ 35,443	4.74%

The Company's ability to pay off mortgages when they become due is dependent upon the Company's ability either to refinance the related mortgage debt or to sell the related asset. With respect to each loan, if the applicable wholly-owned property-owning subsidiary is unable to refinance or sell the related asset, or in the event that the estimated asset value is less than the mortgage balance, the applicable wholly-owned property-owning subsidiary may, if appropriate, satisfy a mortgage obligation by transferring title of the asset to the lender or permitting a lender to foreclose. As of December 31, 2018 and December 31, 2017, no debt was recourse to the Company, although Highlands or its subsidiaries may act as guarantor under customary, non-recourse carve-out clauses in our wholly-owned property-owning subsidiaries' mortgage loans.

Some of the mortgage loans require compliance with certain covenants, such as debt service ratios, investment restrictions and distribution limitations. As of December 31, 2018 and December 31, 2017, the Company is in compliance with such covenants in all material respects.

9. Fair Value Measurements

In accordance with ASC 820, Fair Value Measurement and Disclosures, the Company defines fair value based on the price that would be received upon sale of an asset or the exit price that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company uses a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value. The fair value hierarchy consists of three broad levels, which are described below:

- Level 1 - Quoted prices in active markets for identical assets or liabilities that the entity has the ability to access.
- Level 2 - Observable inputs, other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

The Company has estimated fair value using available market information and valuation methodologies the Company believes to be appropriate for these purposes. Considerable judgment and a high degree of subjectivity are involved in developing these estimates and, accordingly, they are not necessarily indicative of amounts that would be realized upon disposition.

Non-Recurring Measurements

During the year ended December 31, 2018, the Company identified certain assets which may have a reduction in the expected holding period or a reduction in fair market value which represented an impairment trigger, and recorded an impairment of investment properties of $4,667 on one net lease asset and one land parcel. The following table presents these assets measured at fair value on a nonrecurring basis as of December 31, 2018 aggregated by the level within the fair value hierarchy in which those measurements fall. Methods and assumptions used to estimate the fair value of these assets are described after the table.

(Amounts in thousands, except share and per share amounts)

	Fair Value								
	Level 1	Level 2	Level 3			Total		Provision for impairment	
December 31, 2018									
Investment Properties	—	—	$	19,225		$	19,225	$	4,667

(a) The estimate of fair value of the land parcel and net lease asset was based on recent negotiations for the sale of these assets to third parties. The estimate of fair value relating to the correctional facility's impairment analysis was based on a 10-year discounted cash flow model. The cash flows consist of observable inputs such as contractual revenues and unobservable inputs such as forecasted revenues and expenses. These unobservable inputs are based on market conditions and the Company's expected growth rates. Capitalization rates ranging from 4.0% to 10.5% and discount rates ranging from 5.3% to 11.0% were utilized in the models and are based upon observable rates that the Company believes to be within a reasonable range of current market rates.

During the year ended December 31, 2017, the Company identified certain assets which may have a reduction in the expected holding period, a reduction in occupancy or a reduction in fair market value which represented an impairment trigger, and recorded an impairment of investment properties of $25,849 on one net lease asset, one land parcel and one multi-tenant office asset. The following table presents these assets measured at fair value on a nonrecurring basis as of December 31, 2017 aggregated by the level within the fair value hierarchy in which those measurements fall. Methods and assumptions used to estimate the fair value of these assets are described after the table.

	Fair Value								
	Level 1	Level 2	Level 3			Total		Provision for impairment	
December 31, 2017									
Investment Properties	—	—	$	33,257	(a)	$	33,257	$	25,849

(a) The estimate of fair value of the land parcel and retail asset was based on recent negotiations for the sale of these assets to third parties. The estimate of fair value relating to the correctional facility's impairment analysis was based on a 10-year discounted cash flow model. The cash flows consist of observable inputs such as contractual revenues and unobservable inputs such as forecasted revenues and expenses. These unobservable inputs are based on market conditions and the Company's expected growth rates. Capitalization rates ranging from 5.50% to 10.50% and discount rates ranging from 7.00% to 13.50% were utilized in the models and are based upon observable rates that the Company believes to be within a reasonable range of current market rates.

(Amounts in thousands, except share and per share amounts)

Financial Instruments Not Measured at Fair Value

The table below represents the fair value of financial instruments presented at carrying values in the consolidated financial statements as of December 31, 2018 and as of December 31, 2017.

	December 31, 2018		December 31, 2017	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Mortgages payable	$ 35,443	$ 35,222	$ 55,886	$ 56,862

The Company estimates the fair value of its debt instruments using a weighted average market effective interest rate of 4.70% and 4.35% per annum as of December 31, 2018 and December 31, 2017, respectively. The Company estimates the fair value of its mortgages payable by discounting the anticipated future cash flows of each instrument at rates currently offered to the Company by its lenders for similar debt instruments of comparable maturities. The rates used are based on credit spreads observed in the marketplace during the quarter for similar debt instruments, and a floor rate that the Company has derived using its subjective judgment for each asset segment. Based on this, the Company determines the appropriate rate for each of its individual mortgages payable based upon the specific terms of the agreement, including the term to maturity, the quality and nature of the underlying property and its leverage ratio. The weighted average market effective interest rates used range from 4.18% to 5.03% and 4.10% to 4.92% as of December 31, 2018 and December 31, 2017, respectively. The fair value estimate of the unsecured credit facility approximated the carrying value due to limited market volatility in pricing. The assumptions reflect the terms currently available on similar borrowing terms to borrowers with credit profiles similar to the Company’s. The Company has determined that its debt instrument valuations are classified in Level 2 of the fair value hierarchy.

10. Income Taxes

The Company is taxed and operates in a manner that will allow the Company continue to qualify as a REIT for U.S. federal income tax purposes beginning with the Company’s short taxable year commencing immediately prior to the Company’s separation from InvenTrust and ending on December 31, 2016. So long as it maintains its qualification as a REIT, the Company generally will not be subject to U.S. federal income tax on taxable income that is distributed currently to stockholders. A REIT is subject to a number of organizational and operational requirements, including a requirement that it currently distribute at least 90% of its REIT taxable income (subject to certain adjustments) to its stockholders each year. If the Company fails to continue to qualify as a REIT in any taxable year, without the benefit of certain relief provisions, the Company will be subject to U.S. federal and state income tax on its taxable income at regular corporate tax rates and would not be able to re-elect REIT status during the four years following the year of the failure. Even if the Company qualifies for taxation as a REIT, the Company may be subject to certain state and local taxes on its income, property or net worth and U.S. federal income and excise taxes on its undistributed income.

MB REIT is currently disregarded as a separate entity from the Company for U.S. federal income tax purposes and is a QRS of the Company. All assets, liabilities and items of income, deduction and credit of MB REIT are treated for U.S. federal income tax purposes as those of the Company.

During the years ended December 31, 2018 and 2017, respectively, an income tax benefit of $155 and expense of $148, was included on the consolidated statements of operations. The Company accrues excise tax, if any, on estimated excess taxable income as taxable income is earned. For the twelve months ended December 31, 2018 and 2017, there was $0 and $155 U.S. federal excise tax accrual recorded.

In December 2017, the President signed into law H.R. 1, informally titled the Tax Cuts and Jobs Act. The Company conducted a review of the impact to Highlands and determined there was no impact to the Company's accounting for the income tax as of December 31, 2018.

Uncertain Tax Positions

(Amounts in thousands, except share and per share amounts)

The Company had no unrecognized tax benefits as of or during the two year period ended December 31, 2018. The Company expects no significant increases or decreases in unrecognized tax benefits due to changes in tax positions within one year of December 31, 2018. The Company has no material interest or penalties relating to income taxes recognized in the consolidated statements of operations for the years ended December 31, 2018 and 2017 or in the consolidated balance sheets as of December 31, 2018 and 2017. As of December 31, 2018, the Company's, including its predecessors', 2017, 2016 and 2015 tax years remain subject to examination by U.S. and various state tax jurisdictions.

11. Segment Reporting

GAAP has established guidance for reporting information about a company’s operating segments. The Company monitors and reviews its segment reporting structure in accordance guidance under Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) Topic 280, Segment Reporting (“ASC 280”) to determine whether any changes have occurred that would impact its reportable segments. In the fiscal year ended December 31, 2018, as a result of the evolution of the Company’s operations and asset acquisitions, the Company has determined it no longer operates in three operating segments. The Company has concluded its multi-family assets, previously included in other, now represent one operating segment. As a result of this change in the Company’s segment reporting, the Company currently has four business segments, consisting of (i) net lease, (ii) retail, (iii) multi-tenant office and (iv) multi-family. The net lease segment consists of single-tenant office and industrial assets, as well as the Company’s correctional facility. The Company’s unimproved land assets are presented below in Other.

The following table summarizes net property operations income by segment for the year ended December 31, 2018.

	Total	Net Lease	Retail	Multi-Tenant Office	Multi-family	Other
Rental income	$ 34,966	$ 12,478	$ 15,814	$ 4,394	$ 2,280	$ —
Tenant recovery income	7,795	247	7,312	132	104	—
Other property income	748	—	39	523	186	—
Total income	43,509	12,725	23,165	5,049	2,570	—
Operating expenses	13,920	577	9,461	2,702	1,063	117
Net operating income (loss)	$ 29,589	$ 12,148	$ 13,704	$ 2,347	$ 1,507	$ (117)
Non-allocated expenses (a)	(24,781)					
Other income and expenses (b)	(1,877)					
Provision for asset impairment (c)	(4,667)					
Gain on sale of investment properties (d)	27,863					
Loss on extinguishment of debt (e)	(1,199)					
Net income	$ 24,928					
Balance Sheet Data						
Real estate assets, net (f)	$ 242,144	$ 36,317	$ 113,853	$ 28,337	$ 54,159	$ 9,478
Non-segmented assets (g)	93,836					
Total assets	335,980					
Capital expenditures	$ 4,251	$ —	$ 676	$ 3,547	$ 35	$ (7)

HIGHLANDS REIT, INC.

Notes to Consolidated Financial Statements
(Amounts in thousands, except share and per share amounts)
December 31, 2018

(a) Non-allocated expenses consists of general and administrative expenses and depreciation and amortization.

(b) Other income and expenses consists of interest income, other income, interest expense, and income tax benefit.

(c) Provision for asset impairment includes $4,667 related to one net lease asset and one land parcel.

(d) Gain on the sale of investment properties is related to one retail asset, one multi-tenant office asset and one other asset.

(e) Loss on extinguishment of debt is related to prepayment penalties on the payoff of mortgage debt

(f) Real estate assets include intangible assets, net of amortization.

(g) Non-segmented assets include cash and cash equivalents, restricted cash and escrows, accounts and rents receivable and deferred costs and other assets.

(Amounts in thousands, except share and per share amounts)

The following table summarizes net property operations income by segment for the year ended December 31, 2017.

	Total	Net Lease	Retail	Multi-Tenant Office	Multi-family	Other
Rental income	$ 47,115	$ 23,207	$ 16,536	$ 6,962	$ 410	$ —
Tenant recovery income	7,342	289	7,098	(117)	28	44
Other property income	1,005	60	423	383	111	28
Total income	55,462	23,556	24,057	7,228	549	72
Operating expenses and real estate taxes	18,291	3,702	9,134	3,782	241	1,432
Net operating income (loss)	$ 37,171	$ 19,854	$ 14,923	$ 3,446	$ 308	$ (1,360)
Non-allocated expenses (a)	(28,149)					
Other income and expenses (b)	(12,429)					
Provision for asset impairment (c)	(25,849)					
Gain on sale of investment properties (d)	8,674					
Gain on extinguishment of debt (e)	194,581					
Net income	$ 173,999					
Balance Sheet Data						
Real estate assets, net (f)	$ 266,483	$ 42,671	$ 147,971	$ 46,791	$ 19,428	$ 9,622
Non-segmented assets (g)	$ 63,134					
Total assets	$ 329,617					
Capital expenditures	$ 8,833	$ —	$ 1,279	$ 7,381	$ —	$ 173

(a) Non-allocated expenses consists of general and administrative expenses and depreciation and amortization.

(b) Other income and expenses consists of interest income, other income, interest expense, and income tax expense.

(c) Provision for asset impairment includes $25,849 related to one multi-tenant office asset, one net lease asset, and one land parcel.

(d) Gain on sale of investment properties is related to the disposition of two land parcels and one multi-tenant office asset.

(e) Gain on extinguishment of debt is related to two net lease and one multi-tenant office asset.

(f) Real estate assets include intangible assets, net of amortization.

(g) Non-segmented assets include cash and cash equivalents, restricted cash and escrows, accounts and rents receivable, and deferred costs and other assets.

The above table has been presented to conform to the current year segment presentation. Multi-family assets were previously included in Other.

12. Earnings Per Share

Basic earnings per common share is calculated by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share is calculated by dividing net income by the weighted-average number of common shares outstanding during the period, plus any additional common shares that would have been outstanding if the dilutive potential common shares had been issued.

The following table reconciles net income attributable to the Company to basic and diluted EPS (in thousands, except share and per share data):

	Year Ended December 31,	
	2018	2017
Numerator:		
Net income	$ 24,928	$ 173,999
Denominator:		
Weighted average shares outstanding - basic and diluted	871,177,934	867,687,575
Basic and diluted income per share:		
Net income per common share	$ 0.03	$ 0.20

13. Share Based Compensation

Incentive Award Plan

On April 28, 2016, the board of directors adopted, ratified and approved the Highlands REIT, Inc. 2016 Incentive Award Plan (the "Incentive Award Plan"), under which the Company may grant cash and equity-based incentive awards to eligible employees, directors, and consultants. Prior to the Company's spin-off from InvenTrust, the board of directors of the Company (then a wholly-owned subsidiary of InvenTrust) adopted, and InvenTrust, as the sole stockholder of Highlands, approved, the Incentive Awards Plan.

For the year ended December 31, 2018, the Company has granted 5,924,244 of fully vested shares of common stock with an aggregate value of $1,955 based on an estimated fair value per share of $0.33. Additionally, pursuant to an employment agreement with one of its executive officers, the Company has granted shares with an aggregate value of $700 that will fully vest on or before March 15, 2019, subject to the applicable executive's continued employment with the Company through the vest date.

Under the guidance of ASC 718, during the year ended December 31, 2017, 1,940,476 shares of common stock awards granted were treated as a modification of the terms of the original awards for two of the Company's executive officers, resulting in an increase in compensation expense of $650 at the modification date.

Under the Incentive Award Plan, the Company is authorized to grant up to 43,000,000 shares of the Company's common stock pursuant to awards under the plan. At December 31, 2018, 25,565,439 shares were available for future issuance under the Incentive Award Plan. A summary of the Company's stock awards activity as of December 31, 2018 is as follows:

Non-Vested stock awards	Stock Awards	Weighted Average Grant Date Fair Value
Balance at January 1, 2018	—	$ —
Granted	8,045,456	0.33
Vested	(5,924,244)	0.33
Forfeited	—	—
Balance at December 31, 2018	2,121,212	$ 0.33

The Company recognized stock-based compensation expense for the years ended December 31, 2018 and 2017 of $2,497 and $1,438, respectively, related to the Incentive Award Plan. At December 31, 2018, there was approximately $158 of estimated unrecognized compensation expense related to these awards. For the years ended December 31, 2018 and 2017, the Company paid $876 and $994, respectively, related to tax withholding for share-based compensation.

The Company repurchased and retired 116,334 of fully vested shares previously awarded to an employee pursuant to a separation agreement during the first quarter of 2018. The shares were repurchased for $0.33 per share, which was based on the Company's estimated share value as of December 31, 2017.

14. Commitments and Contingencies

The Company is subject, from time to time, to various legal proceedings and claims that arise in the ordinary course of business. While the resolution of these matters cannot be predicted with certainty, management believes, based on currently available information, that the final outcome of such matters will not have a material adverse effect on the financial statements of the Company.

Highlands has also agreed to indemnify InvenTrust against all taxes related to the Company, its subsidiaries and its assets, including taxes attributable to periods prior to the separation and distribution. InvenTrust has agreed to indemnify the Company for any taxes attributable to InvenTrust's or MB REIT's failure to maintain its qualification as a REIT for any taxable year ending on or before December 31, 2016.

(Amounts in thousands, except share and per share amounts)

15. Quarterly Supplemental Financial Information (unaudited)

The following represents the results of operations, for each quarterly period, during 2018 and 2017.

	For the Quarter Ended			
	March 31, 2018	June 30, 2018	September 30, 2018	December 31, 2018
Total revenues	$ 10,645	$ 10,823	$ 11,649	$ 10,392
Property operating expenses	2,304	1,991	2,353	2,244
Real estate taxes	1,474	766	1,388	1,400
Depreciation and amortization	3,131	3,216	3,406	2,425
General and administrative expenses	4,179	3,004	2,594	2,826
Provision for asset impairment	—	—	—	4,667
Total expenses	11,088	8,977	9,741	13,562
Gain on sale of investment properties	25	—	12,276	15,562
Income (loss) from operations	(418)	1,846	14,184	12,392
Interest income	133	157	81	126
Loss on extinguishment of debt	—	—	(1,199)	—
Other income	—	—	23	7
Interest expense	(706)	(708)	(700)	(445)
(Loss) income before income taxes	(991)	1,295	12,389	12,080
Income tax benefit	155	—	—	—
Net (loss) income	(836)	1,295	12,389	12,080
Net (loss) income per common share, basic and diluted	$ 0.00	$ 0.00	$ 0.01	$ 0.01
Weighted average number of common shares outstanding, basic and diluted (a)	870,102,100	871,427,298	871,537,188	871,624,475

(Amounts in thousands, except share and per share amounts)

	For the Quarter Ended			
	March 31, 2017	June 30, 2017	September 30, 2017	December 31, 2017
Total revenues	$ 16,835	$ 14,884	$ 13,003	$ 10,740
Property operating expenses	3,186	2,801	2,395	2,489
Real estate taxes	3,461	1,094	1,352	1,513
Depreciation and amortization	5,624	4,876	3,288	3,437
General and administrative expenses	4,078	2,596	2,089	2,161
Provision for asset impairment	—	712	485	24,652
Total expenses	16,349	12,079	9,609	34,252
Operating income (loss)	486	2,805	3,394	(23,512)
Interest income	40	16	18	82
(Loss) gain on sale of investment properties	(3)	—	(29)	8,706
Gain on extinguishment of debt	—	116,900	77,466	215
Other income (loss)	3	3	1,489	(44)
Interest expense	(7,365)	(4,324)	(1,542)	(657)
(Loss) income before income taxes	(6,838)	115,400	80,796	(15,211)
Income tax (benefit) expense	(2)	9	—	(155)
Net (loss) income	(6,840)	115,409	80,796	(15,366)
Net (loss) income per common share, basic and diluted	$ (0.01)	$ 0.13	$ 0.09	$ (0.02)
Weighted average number of common shares outstanding, basic and diluted (a)	865,591,047	868,272,875	868,423,581	868,423,581

(a) Quarterly income per common share amounts may not total the annual amounts due to rounding and the changes in number of weighted common shares outstanding.

16. Subsequent Events

Acquisition of The Detroit Terraces

On January 8, 2019, we completed the acquisition of The Detroit Apartments and Detroit Terraces, two adjacent apartment buildings with 80 units, located in Denver, Colorado, for a gross acquisition price of $19.0 million.

Agreement of Purchase and Sale for Lincoln Mall

On February 13, 2019, as reported in our Current Report on Form 8-K filed with the SEC on February 13, 2019, the Company, through MB Lincoln Mall, L.L.C. (the "Seller"), a wholly-owned subsidiary of the Company, entered into an Agreement of Purchase and Sale (the "Agreement") with an affiliate of Acadia Strategic Opportunity Fund V LLC (the "Purchaser"), an unaffiliated third-party buyer. Pursuant to the Agreement, the Seller will sell certain property located in Lincoln, Rhode Island commonly known as the "Lincoln Center" to the Purchaser for a gross sale price of $57.0 million, subject to certain adjustments and prorations described in the Agreement.

The Agreement contains customary representations and warranties, which survive the closing of the sale for a period of nine months. Pursuant to the Agreement, the Seller's aggregate liability to the Purchaser for claims for any breaches of any representations or warranties of the Seller is limited to no more than $1.425 million and subject to a deductible of $50,000.

Purchaser deposited $2.0 million in earnest money into escrow on February 19, 2019. The earnest money is fully-refundable to the Purchaser prior to the expiration of the Purchaser's due diligence period. Upon the expiration of the due diligence period, the earnest money is non-refundable except where, among other things, the Seller defaults in the performance of any of its obligations under the Agreement. If the Seller so defaults, the Purchaser would have the option to terminate the Agreement and, in addition to seeking repayment of the earnest money, the Purchaser may seek reimbursement of its actual third-party costs and expenses not to exceed $100,000.

Under the Agreement, the closing of the sale is scheduled to occur ten business days following the expiration of the Purchaser's due diligence period (which may be extended under certain circumstances), subject to the Purchaser's ability to delay the closing for up to an additional ten business days and further subject to the satisfaction of the closing conditions set forth in the Agreement.

The asset has been classified as net investment properties as of December 31, 2018 with a net book value of approximately $45.5 million.

Credit Agreement

On February 15, 2019, as reported in our Current Report on Form 8-K filed with the SEC on February 21, 2019, the Company entered into a Credit Agreement (the "Credit Agreement") by and among the Company, as borrower, The Huntington National Bank ("HNB"), individually and as administrative agent, issuing lender, lead arranger, book manager and syndication agent, and certain other lenders thereunder.

The Credit Agreement provides for (i) a secured revolving credit facility (the "Revolving Credit Facility") with revolving commitments in an aggregate principal amount of $50.0 million, including a letter of credit subfacility for 10% of the then available revolving commitments, and (ii) a secured term loan credit facility (the "Term Loan Facility" and together with the Revolving Credit Facility, the "Credit Facility") with term loan commitments in an aggregate principal amount of $50.0 million. The Credit Agreement provides that, subject to customary conditions, including obtaining lender commitments and compliance with its financial maintenance covenants under the Credit Agreement, the Company may seek to increase the aggregate lending commitments under the Credit Agreement by up to $100 million, with such increase in total lending commitments to be allocated to increasing the revolving commitments and/or establishing one or more new tranches of term loans at the Company's request.

The Company currently expects to use borrowings under the Credit Facility for working capital purposes, which may include repayment of indebtedness, capital expenditures, lease up costs, redevelopment costs, property acquisitions and other general corporate purposes. In connection with entering into the Credit Facility, the Company borrowed $30.0 million under the Term Loan Facility.

The Revolving Credit Facility has a maturity date of February 15, 2022, but can be extended at the Company's option for two additional one-year periods conditioned on, among other things, payment of a 15-basis points extension fee upon each such extension. The Term Loan Facility has a maturity date of February 15, 2024. The Company is permitted to prepay all or any portion of the loans under the Credit Facility prior to maturity without premium or penalty, subject to reimbursement of any LIBOR breakage costs of the lenders.

The interest rates applicable to loans under the Revolving Credit Facility are, at the Company's option, equal to either a base rate plus a margin ranging from 1.0% to 1.3% per annum or LIBOR plus a margin ranging from 2.0% to 2.3% per annum based on the debt to assets ratio of the Company and its consolidated subsidiaries. The interest rates applicable to loans under the Term Loan Facility are, at the Company's option, equal to either a base rate plus a margin ranging from 0.9% to 1.2% per annum or LIBOR plus a margin ranging from 1.9% to 2.2% per annum based on the debt to assets ratio of the Company and its consolidated subsidiaries. In addition, the Company will pay (a) an unused facility fee on the revolving commitments under the Revolving Credit Facility ranging from 0.15% to 0.25% per annum, calculated daily based on the average unused commitments under the Revolving Credit Facility, and (b) with respect to any amount of the Term Loan Facility that remains undrawn during the period beginning thirty (30) days after the execution of the Credit Agreement and ending one year after execution of the Credit Agreement, an unused facility fee of 0.25% per annum, calculated daily based on the undrawn portion of the Term Loan Facility.

The Credit Facility is guaranteed, jointly and severally, by certain subsidiaries of the Company (the “Subsidiary Guarantors”), and is secured by a pledge of equity interests in the Subsidiary Guarantors. The Credit Agreement contains customary covenants that, among other things, restrict, subject to certain exceptions, the ability of the Company and its subsidiaries to incur indebtedness, grant liens on their assets, make certain types of investments, engage in acquisitions, mergers or consolidations, sell assets, enter into hedging transactions, enter into certain transactions with affiliates and make distributions. The Credit Agreement requires the Company to comply with financial maintenance covenants to be tested quarterly, including a maximum debt to asset value ratio, a minimum fixed charge coverage ratio, a minimum tangible net worth, a maximum variable rate debt to asset value ratio, a prohibition on recourse debt and a maximum amount of cross-collateralized non-recourse debt. The Credit Agreement also contains certain covenants around the value and diversity of the properties owned by the Subsidiary Guarantors. The Credit Agreement also contains certain customary events of default, including the failure to make timely payments under the Credit Facility or other material indebtedness, the failure to satisfy certain covenants and specified events of bankruptcy and insolvency.

HIGHLANDS REIT, INC.
Schedule III
Real Estate and Accumulated Depreciation
(Amounts in thousands)

		Initial Cost (A)				Gross amount at which carried at end of period				
	Encumbrance	Land	Buildings and Improvements	Adjustments to Land Basis (B)	Adjustments to Building Basis (B)	Land and Improvements	Buildings and Improvements	Total (C)	Accumulated Depreciation (D,E)	Date of Completion of Construction or Acquisition
Retail										
BUCKHORN PLAZA Bloomsburg, PA	10,317	1,651	11,770	(35)	2,146	1,616	13,916	15,531	6,155	2006
LINCOLN MALL Lincoln, RI		11,000	50,395		9,063	11,000	59,456	70,457	24,941	2006
SHERMAN PLAZA Evanston, IL		9,655	30,982		9,724	9,655	40,706	50,361	16,596	2006
STATE STREET MARKET Rockford, IL	9,365	3,950	14,184		1,821	3,950	16,006	19,956	7,340	2006
THE MARKET AT HILLIARD Hilliard, OH	15,761	4,432	13,308		3,397	4,432	16,705	21,137	7,224	2005
Net Lease										
CITIZENS (CFG) RHODE ISLAND Providence, RI		1,278	3,817	(702)	(2,947)	576	870	1,446	196	1970
ATLAS - ST PAUL St. Paul, MN		3,890	10,093			3,890	10,093	13,983	3,974	2007
ATLAS-NEW ULM New Ulm, MN		900	9,359			900	9,359	10,259	3,691	2007
HUDSON CORRECTIONAL FACILITY Hudson, CO		1,382		(908)	18,017	474	18,017	18,491	—	2009

HIGHLANDS REIT, INC.
Schedule III
Real Estate and Accumulated Depreciation
(Amounts in thousands)

		Initial Cost (A)				Gross amount at which carried at end of period				
	Encumbrance	Land	Buildings and Improvements	Adjustments to Land Basis (B)	Adjustments to Building Basis (B)	Land and Improvements	Buildings and Improvements	Total (C)	Accumulated Depreciation (D,E)	Date of Completion of Construction or Acquisition
Multi-tenant office										
TRIMBLE I San Jose, CA		12,732	10,045		5,784	12,732	15,829	28,561	1,629	2013
Multi-family										
BUERGER BROTHER LOFTS Denver, CO		3,117	7,114		2	3,117	7,123	10,240	344	2017
CHAMBER LOFTS Denver, CO		2,797	6,388		8	2,797	6,388	9,185	310	2017
THE LAFAYETTE Denver, CO		2,457	7,067			2,457	7,067	9,524	156	2018
KENILWORTH COURT Denver, CO		2,496	3,203			2,496	3,203	5,699	34	2018
1620 CENTRAL STREET Evanston, IL		3,075	17,140			3,075	17,140	20,215	228	2018
Other										
PALAZZO DEL LAGO Orlando, FL		8,938			19	8,938	19	8,957	4	2010
RDU Land Raleigh, NC		1,220		(695)		525		525		2015
Totals	$ 35,443	$74,970	$ 194,865	$ (2,340)	$ 47,034	$ 72,630	$ 241,897	$314,527	$ 72,822	

(Amounts in thousands)

Notes to Schedule III:

The Company had $32 of assets included in construction in progress at December 31, 2018, which have been omitted from the prior table. The aggregate cost of real estate owned at December 31, 2018 for U.S. federal income tax purposes was approximately $381,647 (unaudited).

(A) The initial cost to the Company represents the original purchase price of the asset, including amounts incurred subsequent to acquisition which were contemplated at the time the asset was acquired.

(B) Adjustments to basis include provisions for asset impairments, partial dispositions and costs capitalized subsequent to acquisitions.

(C)Reconciliation of real estate owned:

	2018	2017
Balance at January 1	$ 375,367	$ 515,049
Acquisitions and capital improvements	38,303	27,740
Dispositions and write-offs	(73,105)	(157,872)
Asset impairments	(26,038)	(9,550)
Balance at December 31,	$ 314,527	$ 375,367

(D)Reconciliation of accumulated depreciation:

	2018	2017
Balance at January 1	$ 109,928	$ 84,651
Depreciation expense	10,984	13,430
Dispositions and write-offs	(26,720)	(4,452)
Asset impairments	(21,370)	16,299
Balance at December 31,	$ 72,822	$ 109,928

(E)Depreciation is computed based upon the following estimated lives:

Buildings and improvements	30 years
Tenant improvements	Life of the lease
Furniture, fixtures, & equipment	5-15 years

Item 9. Changes in or Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Disclosure Controls and Procedures

As required by Rule 13a-15(b) and Rule 15d-15(b) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), our management, including our principal executive officer and our principal financial officer evaluated, as of December 31, 2018, the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and Rule 15d-15(e) of the Exchange Act. Based on that evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures, as of December 31, 2018, were effective at a reasonable assurance level for the purpose of ensuring that information required to be disclosed by us in this report is recorded, processed, summarized and reported within the time periods specified by the rules and forms of the Exchange Act and is accumulated and communicated to management, including our principal executive officer and our principal financial officer, as appropriate, to allow timely decisions regarding required disclosures.

Internal Control Over Financial Reporting.

Our management is responsible for establishing and maintaining adequate internal controls over financial reporting pursuant to Exchange Act Rules 13a-15(f) and 15d-15(f) as of December 31, 2018. Our management, including our principal executive officer and principal financial officer evaluated the effectiveness of our internal controls over financial reporting based on the framework in "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013). Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can only provide reasonable assurance with respect to financial statement preparation and presentation. Based on its evaluation, our management has concluded that we maintained effective internal control over financial reporting as of December 31, 2018.

Changes in Internal Control over Financial Reporting

There has been no change in the Company’s internal control over financial reporting during the quarter ended December 31, 2018 that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

Item 9B. Other Information

2019 Annual Meeting of Stockholders Record Date

On February 5, 2019, the Board established the close of business on March 8, 2019 as the record date for determining stockholders entitled to vote at our 2019 annual meeting of stockholders, to be held on May 9, 2019.

Part III

Item 10. Directors, Executive Officers and Corporate Governance.

Except as set forth below, the information called for by this Item is contained in our definitive Proxy Statement for our 2019 Annual Meeting of Stockholders, and is incorporated herein by reference.

See Part I, “Executive Officers of the Registrant” of this annual report for information regarding the executive officers of the Company.

Code of Ethics

Our board has adopted a code of ethics and business conduct (the “Code of Ethics and Business Conduct”) applicable to our directors, officers and employees, which is available on our website at www.highlandsreit.com through the “Investor Relations - Governance Documents” tab. In the event that the Company amends or waives any of the provisions of the Code of Ethics that applies to the Company's Chief Executive Officer, Chief Financial Officer or Principal Accounting Officer, and other senior financial officers performing similar functions, the Company intends to disclose the subsequent information on its website. In addition, printed copies of the Code of Ethics and Business Conduct are available to any stockholder, without charge, by writing us at Highlands REIT, Inc., attn Corporate Secretary, 332 S. Michigan Avenue, 9th Floor, Chicago, Illinois 60604.

Item 11. Executive Compensation.

The information called for by this Item is contained in our definitive Proxy Statement for our 2019 Annual Meeting of Stockholders, and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Except as set forth below, the information called for by this Item is contained in our definitive Proxy Statement for our 2019 Annual Meeting of the Stockholders, and is incorporated herein by reference.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table sets forth information regarding securities authorized for issuance under our equity compensation plans, as of December 31, 2018.

	(a)	(b)	(c)
Plan category	Number of securities to be issued upon exercise of outstanding rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders			
Highlands REIT, Inc. 2016 Incentive Award Plan	—	—	25,565,439
Equity compensation plans not approved by security holders	—	—	—
Total	—	—	25,565,439

Item 13. Certain Relationships and Related Transactions, and Director Independence.

The information called for by this Item is contained in our definitive Proxy Statement for our 2019 Annual Meeting of Stockholders, and is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services.

The information called for by this Item is contained in our definitive Proxy Statement for our 2019 Annual Meeting of Stockholders, and is incorporated herein by reference.

Part VI.

Item 15. Exhibits and Financial Statement Schedules

(a) List of documents filed:

a. Financial Statements:

i. Report of Independent Registered Public Accounting Firm

ii. The consolidated financial statements of the Company are set forth in the report in Item 8.

b. Financial Statement Schedules:

i. Real Estate and Accumulated Depreciation (Schedule III)

ii. All schedules other than those indicated in the index have been omitted as the required information is inapplicable or the information is presented in the consolidated financial statements or related notes.

c. Exhibits:

i. The list of exhibits filed as part of this Annual Report is set forth on the Exhibit Index attached hereto.

(b) Exhibits:

a. The exhibits filed in response to Item 601 of Regulation S-K are listed on the Exhibit Index attached hereto.

(c) Financial Statement Schedules

All schedules other than those indicated in the index have been omitted as the required information is inapplicable or the information is presented in the consolidated financial statements or related notes.

Item 16. Form 10-K Summary

Omitted at registrant's option.

EXHIBIT NO.	DESCRIPTION
2.1	Separation and Distribution Agreement between Highlands REIT, Inc. and InvenTrust Properties Corp., dated as of April 15, 2016 (incorporated by reference to Exhibit 2.1 to the Company’s Current Report on Form 8-K filed on April 14, 2016)
3.1	Articles of Amendment and Restatement of Highlands REIT, Inc. (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-8, filed with the Securities and Exchange Commission on April 27, 2016)
3.2	Amended and Restated Bylaws of Highlands REIT, Inc. (incorporated by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K, filed with the Securities and Exchange Commission on April 28, 2016)
10.1	Transition Services Agreement between Highlands REIT, Inc. and InvenTrust Properties Corp., dated as of April 28, 2016 (incorporated by reference to Exhibit 2.1 to the Company’s Current Report on Form 8-K filed on April 14, 2016)
10.2	Employee Matters Agreement between Highlands REIT, Inc. and InvenTrust Properties Corp., dated as of April 28, 2016 (incorporated by reference to Exhibit 2.1 to the Company’s Current Report on Form 8-K filed on April 14, 2016)
10.3#	Highlands REIT, Inc. 2016 Incentive Award Plan (incorporated by reference to Exhibit 99.1 to the Company’s Registration Statement on Form S-8, filed with the Securities and Exchange Commission on April 27, 2016)
10.4#	Form of Indemnification Agreement entered into between Highlands REIT, Inc. and each of its directors and executive officers (incorporated by reference to Exhibit 10.5 of Company’s Registration Statement on Form 10, filed with the Securities and Exchange Commission on March 18, 2016)
10.5#	First Amendment to Highlands REIT, Inc. 2016 Incentive Award Plan (incorporated by reference to Exhibit 10.5 to the Company’s Quarterly Report on Form 10-Q, filed with the Securities and Exchange Commission on May 10, 2016)
10.6#	Form of Highlands REIT, Inc. 2016 Incentive Award Plan Stock Payment Award Grant Notice (incorporated by reference to Exhibit 10.8 to the Company’s Quarterly Report on Form 10-Q, filed with the Securities and Exchange Commission on May 10, 2016)
10.7#	Amended and Restated Employment Agreement, dated November 7, 2018, by and between Highlands REIT, Inc. and Richard Vance (incorporated by reference to Exhibit 10.1 to the Company’s Current Report on Form 8-K, filed with the Securities and Exchange Commission on November 8, 2018)
10.8#	Amended and Restated Employment Agreement, dated November 7, 2018, by and between Highlands REIT, Inc. and Robert J. Lange (incorporated by reference to Exhibit 10.2 to the Company’s Current Report on Form 8-K, filed with the Securities and Exchange Commission on November 8, 2018)
10.9#	Highlands REIT, Inc. Director Compensation Program (incorporated by reference to Exhibit 10.9 of Amendment No. 1 to the Company’s Registration Statement on Form 10, filed with the Securities and Exchange Commission on April 8, 2016)
10.10#	Highlands REIT, Inc. Retention Bonus Plan (incorporated by reference to Exhibit 10.10 to the Company's Quarterly Report on Form 10-Q, filed with the Securities Exchange Commission on August 12, 2016)
10.11#	Change in Control Severance Agreement between Highlands REIT, Inc. and Joseph Giannini, dated as of August 9, 2016 (incorporated by reference to Exhibit 10.11 to the Company's Quarterly Report on Form 10-Q, filed with the Securities Exchange Commission on August 12, 2016)
10.12#	Amended and Restated Employment Agreement, dated November 7, 2018, by and between Highlands REIT, Inc. and Paul Melkus (incorporated by reference to Exhibit 10.3 to the Company’s Current Report on Form 8-K, filed with the Securities and Exchange Commission on November 8, 2018)
10.13	Credit Agreement, dated February 15, 2019, by and among Highlands REIT, Inc., a Maryland corporation, as borrower, and certain of its subsidiaries, as guarantors, The Huntington National Bank, certain other lending institutions party thereto, as lenders, and The Huntington National Bank, as administrative agent and as issuing lender, lead arranger, book manager and syndication agent (incorporated by reference to Exhibit 10.1 to the Company’s Current Report on Form 8-K, filed with the Securities and Exchange Commission on February 21, 2019)
21.1*	List of Subsidiaries
23.1*	Consent of KPMG LLP
31.1*	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

EXHIBIT NO.	DESCRIPTION
32.2*	Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Link Document

* Filed as part of this Annual Report on Form 10-K.

\# Management contract or compensatory plan or arrangement.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

HIGHLANDS REIT, INC.
By: /s/ Richard Vance
Name: Richard Vance
Title: President and Chief Executive Officer (Principal Executive Officer)
Date: March 22, 2019

Pursuant to the requirements of the Securities Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Richard Vance Richard Vance	President and Chief Executive Officer (Principal Executive Officer)	March 22, 2019
/s/ Paul Melkus Paul Melkus	Executive Vice President and Chief Financial Officer (Principal Financial Officer)	March 22, 2019
/s/ Joe Giannini Joe Giannini	Senior Vice President, Chief Accounting Officer and Treasurer (Principal Accounting Officer)	March 22, 2019
/s/ R. David Turner R. David Turner	Director and Chairman	March 22, 2019
/s/ Jeffrey L. Shekell Jeffrey L. Shekell	Director	March 22, 2019

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Section 2: EX-21.1 (EXHIBIT 21.1)

Exhibit 21.1

List of Subsidiaries

Entity Name	***Jurisdiction of Incorporation or Formation***

1560 Downing LLC Delaware	Delaware
1620 Central LLC Delaware	Delaware
Buckhorn SP, LLC Delaware	Delaware
Champa Street Lofts, LLC Delaware	Delaware
Detroit Street Denver LLC Delaware	Delaware
Highlands Property Management, LLC Delaware	Delaware
IA CFG Portfolio, L.L.C. Delaware	Delaware
IA New Ulm Atlas, L.L.C. Delaware	Delaware
IA Orlando Palazzo, L.L.C. Delaware	Delaware
IA Orlando Sand, L.L.C. Delaware	Delaware
IA RDU Center Drive, L.L.C. Delaware	Delaware
IA St. Paul Atlas, L.L.C. Delaware	Delaware
IVT PPD Hudson Associates, L.L.C. Delaware	Delaware
MB Bloomsburg Buckhorn, LLC Delaware	Delaware
MB Columbus Hilliard, L.L.C. Delaware	Delaware
MB Evanston Sherman, L.L.C. Delaware	Delaware
MB Lincoln Mall, L.L.C. Delaware	Delaware
MB Pittsburgh Bridgeside DST Delaware	Delaware
MB REIT (Florida), Inc. Florida	Florida
MB Rockford State, L.L.C. Delaware	Delaware
The Lafayette Denver, LLC Delaware	Delaware
Trimble-Junction Ventures, LLC	Delaware

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Section 3: EX-23.1 (EXHIBIT 23.1)

Exhibit 23.1

Consent of Independent Registered Public Accounting Firm

The Board of Directors
Highlands REIT, Inc.:

We consent to the use of our report incorporated by reference in the registration statement on Form S-8 (No. 333-210952) of Highlands REIT, Inc. of our report dated March 16, 2018, with respect to the consolidated balance sheets of Highlands REIT, Inc. as of December 31, 2017 and 2016, and the combined consolidated statements of operations, equity, and cash flow for each of the years in the three-year period ended December 31, 2017 and the related financial statement schedule III, which report appears in the December 31, 2017 annual report on Form 10-K of Highlands, REIT, Inc. herein and to the reference to our firm under the heading “Experts” in the prospectus.

/s/ KPMG, LLP

Chicago, Illinois
March 22, 2019

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Section 4: EX-31.1 (EXHIBIT 31.1)

Exhibit 31.1

Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Richard Vance, certify that:

1. I have reviewed this Annual Report on Form 10-K of Highlands REIT, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 22, 2019

/s/ Richard Vance
Name: Richard Vance
Title: President and Chief Executive Officer (Principal Executive Officer)

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Section 5: EX-31.2 (EXHIBIT 31.2)

Exhibit 31.2

Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Paul Melkus, certify that:

1. I have reviewed this Annual Report on Form 10-K of Highlands REIT, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 22, 2019

/s/ Paul Melkus

Name: Paul Melkus

Title: Executive Vice President and Chief Financial Officer (Principal Financial Officer)

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Section 6: EX-32.1 (EXHIBIT 32.1)

Exhibit 32.1

Certification of Principal Executive Officer
Pursuant To 18 U.S.C. Section 1350,
as Adopted Pursuant to
Section 906 of The Sarbanes-Oxley Act of 2002

In connection with the Annual Report on Form 10-K of Highlands REIT, Inc. (the "Company") for the period ended December 31, 2018 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned officer of the Company certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to such officer's knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 22, 2019

/s/ Richard Vance
Name: Richard Vance
Title: President and Chief Executive Officer (Principal Executive Officer)

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

The foregoing certification is being furnished solely pursuant to 18 U.S.C. Section 1350 and is not being filed as a part of the Report or on a separate disclosure document.

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Section 7: EX-32.2 (EXHIBIT 32.2)

Exhibit 32.2

Certification of Principal Financial Officer
Pursuant To 18 U.S.C. Section 1350,
as Adopted Pursuant to
Section 906 of The Sarbanes-Oxley Act of 2002

In connection with the Annual Report on Form 10-K of Highlands REIT, Inc. (the "Company") for the period ended December 31, 2018 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned officer of the Company certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to such officer's knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 22, 2019	/s/ Paul Melkus Name: Paul Melkus Title: Executive Vice President and Chief Financial Officer (Principal Financial Officer)

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

The foregoing certification is being furnished solely pursuant to 18 U.S.C. Section 1350 and is not being filed as a part of the Report or on a separate disclosure document.

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