

Section 1: 10-Q (10-Q)

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2019

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
(State or Other Jurisdiction of
Incorporation or Organization)

81-0862795

(I.R.S. Employer Identification No.)

332 S Michigan Avenue, Ninth Floor
Chicago, Illinois
(Address of Principal Executive Offices)

60604
(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:

Title of each class	Trading Symbol	Name of each exchange on which registered
Common Stock	N/A	N/A

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 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 the definitions 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
<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>

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

As of November 11, 2019 there were 876,074,038 shares of the registrant’s common stock outstanding.

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HIGHLANDS REIT, INC.**Condensed Consolidated Balance Sheets**

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

	September 30, 2019	December 31, 2018
	(Unaudited)	
Assets		
Investment properties		
Land	\$ 77,574	\$ 72,630
Building and other improvements	246,211	241,897
Construction in progress	85	32
Total	323,870	314,559
Less accumulated depreciation	(53,810)	(72,822)
Net investment properties	270,060	241,737
Cash and cash equivalents	116,335	80,512
Restricted cash and escrows	4,419	3,229
Accounts and rents receivable (net of allowance of \$1,154 and \$1,161)	4,878	5,861
Intangible assets, net	1,229	408
Deferred costs and other assets, net	4,261	4,233
Total assets	\$ 401,182	\$ 335,980
Liabilities		
Debt, net	\$ 93,385	\$ 34,953
Accounts payable and accrued expenses	9,028	11,653
Intangible liabilities, net	872	3,004
Other liabilities	2,647	2,270
Total liabilities	105,932	51,880
Commitments and contingencies		
Stockholders' Equity		
Common stock, \$0.01 par value, 1,000,000,000 shares authorized, 876,074,038 and 871,688,704 shares issued and outstanding as of September 30, 2019 and December 31, 2018, respectively	8,761	8,717
Additional paid-in capital	1,408,993	1,407,502
Accumulated distributions in excess of net income	(1,122,545)	(1,132,119)
Accumulated other comprehensive loss	(82)	—
Total Highlands REIT, Inc. stockholders' equity	295,127	284,100
Non-controlling interests	123	—
Total equity	295,250	284,100
Total liabilities and equity	\$ 401,182	\$ 335,980

See accompanying notes to the condensed consolidated financial statements.

HIGHLANDS REIT, INC.
Condensed Consolidated Statements of Operations and Comprehensive Income (unaudited)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Revenues				
Rental income	\$ 8,955	\$ 11,446	\$ 29,394	\$ 32,392
Other property income	243	203	463	725
Total revenues	\$ 9,198	\$ 11,649	\$ 29,857	\$ 33,117
Expenses				
Property operating expenses	1,565	2,353	5,454	6,648
Real estate taxes	1,156	1,388	3,779	3,628
Depreciation and amortization	3,109	3,406	8,568	9,753
General and administrative expenses	2,373	2,594	9,838	9,776
Total expenses	8,203	9,741	27,639	29,805
Gain on sale of investment properties, net	—	12,276	8,841	12,301
Loss on extinguishment of debt	—	(1,199)	—	(1,199)
Income from operations	995	12,985	11,059	14,414
Interest income	581	81	1,348	371
Other income	—	23	—	23
Interest expense	(1,058)	(700)	(2,823)	(2,114)
Income before income taxes	518	12,389	9,584	12,694
Income tax benefit	—	—	—	155
Net income	518	12,389	9,584	12,849
Net income attributable to non-controlling interests	(10)	—	(10)	—
Net income attributable to Highlands REIT, Inc. common stockholders	\$ 508	\$ 12,389	\$ 9,574	\$ 12,849
Net income per common share, basic and diluted	\$ 0.00	\$ 0.01	\$ 0.01	\$ 0.01
Weighted average number of common shares outstanding, basic and diluted	876,007,008	871,537,188	875,057,625	871,027,452
Comprehensive income				
Net income	\$ 518	\$ 12,389	\$ 9,584	\$ 12,849
Unrealized loss on derivatives	(96)	—	(96)	—
Total other comprehensive loss	(96)	—	(96)	—
Comprehensive income	422	—	9,488	—
Comprehensive loss attributable to non-controlling interests	4	—	4	—
Comprehensive income attributable to Highlands REIT, Inc. common stockholders	\$ 426	\$ 12,389	\$ 9,492	\$ 12,849

See accompanying notes to the condensed consolidated financial statements.

HIGHLANDS REIT, INC.
Condensed Consolidated Statements of Equity (unaudited)

(Dollar amounts in thousands, except share amounts)

Three and Nine Months Ended September 30, 2019 and 2018

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Accumulated Distributions in Excess of Net Income	Total Company's Stockholders Equity	Non-controlling Interests	Total Equity
	Shares	Amount						
Balance at January 1, 2018	868,423,581	\$ 8,684	\$ 1,406,460	\$ —	\$ (1,157,047)	\$ 258,097	\$ —	\$258,097
Net loss	—	—	—	—	(835)	(835)	—	(835)
Share-based compensation	3,078,425	31	985	—	—	1,016	—	1,016
Common stock repurchased and retired	(116,334)	(1)	(40)	—	—	(41)	—	(41)
Balance at March 31, 2018	871,385,672	\$ 8,714	\$ 1,407,405	\$ —	\$ (1,157,882)	\$ 258,237	\$ —	\$258,237
Net income	—	—	—	—	1,295	1,295	—	1,295
Share-based compensation	151,516	1	49	—	—	50	—	50
Balance at June 30, 2018	871,537,188	\$ 8,715	\$ 1,407,454	\$ —	\$ (1,156,587)	\$ 259,582	\$ —	\$259,582
Net income	—	—	—	—	12,389	12,389	—	12,389
Balance at September 30, 2018	871,537,188	\$ 8,715	\$ 1,407,454	\$ —	\$ (1,144,198)	\$ 271,971	\$ —	\$271,971
Balance at January 1, 2019	871,688,704	\$ 8,717	\$ 1,407,502	\$ —	\$ (1,132,119)	\$ 284,100	\$ —	\$284,100
Net loss	—	—	—	—	(455)	(455)	—	(455)
Share-based compensation	3,900,689	39	1,326	—	—	1,365	—	1,365
Balance at March 31, 2019	875,589,393	\$ 8,756	\$ 1,408,828	\$ —	\$ (1,132,574)	\$ 285,010	\$ —	\$285,010
Net income	—	—	—	—	9,521	9,521	—	9,521
Share-based compensation	285,716	3	97	—	—	100	—	100
Balance at June 30, 2019	875,875,109	\$ 8,759	\$ 1,408,925	\$ —	\$ (1,123,053)	\$ 294,631	\$ —	\$294,631
Net income	—	—	—	—	508	508	10	518
Other comprehensive loss	—	—	—	(82)	—	(82)	(14)	(96)
Non-controlling interest equity contributions	—	—	—	—	—	—	127	127
Share-based compensation	198,929	2	68	—	—	70	—	70
Balance at September 30, 2019	876,074,038	\$ 8,761	\$ 1,408,993	\$ (82)	\$ (1,122,545)	\$ 295,127	\$ 123	\$295,250

See accompanying notes to the condensed consolidated financial statements.

HIGHLANDS REIT, INC.
Condensed Consolidated Statements of Cash Flows (unaudited)
(Amounts in thousands)

	Nine Months Ended September 30,	
	2019	2018
Cash flows from operating activities:		
Net income	\$ 9,584	\$ 12,849
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,568	9,753
Amortization of above and below market leases, net	(236)	(307)
Amortization of debt discounts and financing costs	208	63
Straight-line rental income	(180)	(491)
Loss on extinguishment of debt	—	1,199
Gain on sale of investment properties, net	(8,841)	(12,301)
Non-cash stock-based compensation expense	2,220	2,249
Changes in assets and liabilities:		
Accounts and rents receivable, net	(79)	(866)
Deferred costs and other assets, net	(18)	(879)
Accounts payable and accrued expenses	(1,644)	(650)
Other liabilities	281	236
Net cash flows provided by operating activities	\$ 9,863	\$ 10,855
Cash flows from investing activities:		
Capital expenditures and tenant improvements	(765)	(2,299)
Investment in development	—	(1,678)
Acquisition of investment properties, net	(70,921)	(36,015)
Proceeds from sale of investment properties, net	53,163	40,722
Payment of leasing fees	(447)	(1,255)
Net cash flows used in investing activities	\$ (18,970)	\$ (525)
Cash flows from financing activities:		
Payment of debt issuance costs	(424)	—
Proceeds from credit agreement	29,375	—
Proceeds from mortgage debt	18,684	—
Payoff of mortgage debt	—	(19,479)
Prepayment penalties on the payoff of mortgage debt	—	(1,158)
Principal payments of mortgage debt	(465)	(811)
Payment for tax withholding for share-based compensation	(1,177)	(876)
Contributions from non-controlling interests	127	—
Net cash flows provided by (used in) financing activities	\$ 46,120	\$ (22,324)
Net increase (decrease) in cash, cash equivalents and restricted cash	37,013	(11,994)
Cash, cash equivalents and restricted cash, at beginning of period	83,741	56,007
Cash, cash equivalents and restricted cash, at end of period	\$ 120,754	\$ 44,013

See accompanying notes to the condensed consolidated financial statements.

HIGHLANDS REIT, INC.**Condensed Consolidated Statements of Cash Flows (unaudited)**
(Dollar amounts in thousands)

	Nine Months Ended September 30,	
	2019	2018
Supplemental disclosure of cash flows information:		
Cash paid for interest	\$ 2,399	\$ 2,139
Cash paid for taxes	\$ 36	\$ 201
Supplemental schedule of non-cash investing and financing activities:		
Non-cash accruals for capital expense and investment in development	\$ 19	\$ 1,182
Write off of rent receivables	\$ 153	\$ —
Loss on disposal of tenant improvements	\$ 299	\$ —
Other liabilities arising from unrealized loss on derivative instruments	\$ 96	\$ —
Lease assets and liabilities arising from the recognition of right-of-use assets	\$ 300	\$ —
Assumption of mortgage debt on acquired properties	\$ 11,449	\$ —

See accompanying notes to the condensed consolidated financial statements.

HIGHLANDS REIT, INC.
Notes to Condensed Consolidated Financial Statements (unaudited)
(Amounts in thousands, except share and per share amounts)
September 30, 2019

The accompanying Condensed Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. Readers of this Quarterly Report should refer to the audited consolidated financial statements of Highlands REIT, Inc. for the year ended December 31, 2018, which are included in the Annual Report on Form 10-K, as filed with the U.S. Securities and Exchange Commission by Highlands REIT, Inc. on March 22, 2019, as certain note disclosures contained in such audited consolidated financial statements have been omitted from this Report. In the opinion of management, all adjustments (consisting of normal recurring accruals, except as otherwise noted) necessary for a fair presentation, and to make these financial statements not misleading, have been included in these financial statements.

1. Organization

Highlands REIT, Inc. (“Highlands”), which was formed in December 2015, is a Maryland corporation with a portfolio of industrial assets, retail assets, a correctional facility, multi-family assets, an office asset, 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.). Unless stated otherwise or the context otherwise requires, the terms “we,” “our” and “us” and references to the “Company” refer to Highlands and its consolidated subsidiaries.

On April 28, 2016, Highlands was 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.

Each of our assets 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 7.

On August 16, 2019, we formed a limited liability company with a third-party partner (the “Corvue Venture”). The purpose of the Corvue Venture is to acquire, own and manage one multi-family investment property commonly known as Evolve at Allendale. We have an approximate 85% interest in the Corvue Venture and, in connection with the acquisition of Evolve at Allendale, we funded equity contributions to the Corvue Venture in the approximate amount of \$9,000. See Note 3 for additional information regarding the basis of presentation of the Corvue Venture which is consolidated in the accompanying condensed consolidated financial statements. In conjunction with this acquisition, the Corvue Venture secured a mortgage on the property in the amount of \$18,750. See Note 7 for additional information related to the mortgage.

As of September 30, 2019, the Company owned 19 assets and one parcel of unimproved land. As of December 31, 2018, the Company owned 15 assets and two parcels of unimproved land.

2. Summary of Significant Accounting Policies

The accompanying condensed 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 condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Refer to the Company's audited consolidated financial statements for the year ended December 31, 2018 included in the Company's Annual Report on Form 10-K, filed with the U.S. Securities and Exchange Commission on March 22, 2019, as

HIGHLANDS REIT, INC.
Notes to Condensed Consolidated Financial Statements (unaudited)
(Amounts in thousands, except share and per share amounts)
September 30, 2019

certain note disclosures contained in such audited financial statements have been omitted from these interim condensed consolidated financial statements.

Principles of Consolidation and Basis of Presentation

The accompanying condensed consolidated financial statements reflect the accounts of Highlands and its consolidated subsidiaries. Highlands consolidates its wholly-owned subsidiaries and any other entities which it controls (i) through voting rights or similar rights or (ii) by means other than voting rights if Highlands is the primary beneficiary of a variable interest entity (“VIE”). The portions of the equity and net income of consolidated subsidiaries that are not attributable to the Company are presented separately as amounts attributable to non-controlling interests in our condensed consolidated financial statements. Entities which Highlands does not control and entities which are VIEs in which Highlands is not a primary beneficiary, if any, are accounted for under appropriate GAAP. Highlands' subsidiaries generally consist of limited liability companies (“LLCs”). The effects of all significant intercompany transactions have been eliminated.

Variable Interest Entities

A VIE is an entity that either (i) has insufficient equity to permit the entity to finance its activities without additional subordinated financial support, or (ii) has equity investors who lack the characteristics of a controlling financial interest. Under Accounting Standards Codification (“ASC”) 810 - Consolidation, an entity that holds a variable interest in a VIE and meets certain requirements would be considered to be the primary beneficiary of the VIE and is required to consolidate the VIE in its consolidated financial statements. In order to be considered the primary beneficiary of a VIE, an entity must hold a variable interest in the VIE and have both the power to direct the activities that most significantly impact the economic performance of the VIE, and the right to receive benefits from, or the obligation to absorb losses of, the VIE that could be potentially significant to the VIE. See Note 3 for additional discussion of the Company's consolidated variable interest entity.

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 the Company or the lessee is the owner of the tenant improvements for accounting purposes. These factors include:

HIGHLANDS REIT, INC.
Notes to Condensed Consolidated Financial Statements (unaudited)
(Amounts in thousands, except share and per share amounts)
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- 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 condensed consolidated balance sheets.

Rental income lease related receivables, which include contractual amounts accrued and unpaid from tenants and accrued straight-line rents receivable, are reduced for credit losses. Such amounts are recognized as a reduction to real estate rental revenues. The Financial Accounting Standards Board (“FASB”) clarified in July 2019 that, under ASC 842, lessors can continue to recognize a reserve (i.e., allowance for uncollectible operating lease receivables) under the loss contingency guidance in ASC 450-20 after applying the collectibility guidance in ASC 842. We evaluate the collectability of lease receivables monthly using several factors including a lessee’s creditworthiness. We recognize the credit loss on lease related receivables when, in the opinion of management, collection of substantially all lease payments is not probable. When collectability is determined not probable, any lease income subsequent to recognizing the credit loss is limited to the lesser of the lease income reflected on a straight-line basis or cash collected. The adoption of ASU 2016-02 resulted in an adjustment of \$92 to rental income and property operating expenses, associated with lease related receivables where collection of substantially all operating lease payments is not probable as of January 1, 2019. There were no material changes to that assessment as of September 30, 2019.

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 condensed 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 condensed consolidated balance sheets and are amortized to depreciation and amortization expense in the condensed consolidated statements of operations and comprehensive income 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;

HIGHLANDS REIT, INC.
Notes to Condensed Consolidated Financial Statements (unaudited)
(Amounts in thousands, except share and per share amounts)
September 30, 2019

- 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 condensed 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 condensed consolidated balance sheets as of September 30, 2019 and December 31, 2018.

Impairment

HIGHLANDS REIT, INC.
Notes to Condensed Consolidated Financial Statements (unaudited)
(Amounts in thousands, except share and per share amounts)
September 30, 2019

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.

Recently Issued Accounting Pronouncements

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 condensed consolidated financial statements.

Recently Adopted 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 elected these practical expedients, upon adoption, on January 1, 2019, using the effective date as our date of initial application and no transition adjustment was recognized. Therefore, financial information and disclosures under ASC 842 will not be provided for periods prior to January 1, 2019. The Company elected 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, beginning January 1, 2019, the Company recognizes expense as incurred on certain lease origination costs previously capitalized and amortized to expense over the lease term. Any costs no longer qualifying as initial direct costs are an increase to property operating expenses in the condensed consolidated statements of operations and comprehensive income in the period of adoption and prospectively. As a lessee, beginning January 1, 2019, the Company recognized a right-of-use asset and lease liability included in deferred costs and other assets and other liabilities, respectively, with a balance as of September 30, 2019, on the condensed consolidated balance sheets of approximately \$300, which was estimated by utilizing an average discount rate of approximately 4.5%, reflecting the Company's incremental borrowing rate. These estimates are based on the Company's ground lease arrangement as of September 30, 2019. 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 have an increased likelihood of being classified as either sales-type or finance-type leases.

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 statements of cash flows within the condensed consolidated financial statements for the nine months ended September 30, 2019 and 2018, respectively, was not material.

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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 condensed consolidated statements of cash flows. The Company is required to escrow cash balances for specific uses stipulated by certain of its lenders and other various agreements. As of September 30, 2019 and December 31, 2018, the Company's cash balances restricted for these uses were \$4,419 and \$3,229, respectively. The inclusion of restricted cash increased cash, cash equivalents and restricted cash, at the beginning of the year, in the condensed consolidated statements of cash flows by \$3,229 and \$2,155 as of January 1, 2019 and 2018, respectively, and cash, cash equivalents and restricted cash, by \$4,419 and \$3,229, as of September 30, 2019 and December 31, 2018, respectively.

	September 30, 2019	December 31, 2018
Cash and cash equivalents	\$ 116,335	\$ 80,512
Restricted cash	4,419	3,229
Total cash, cash equivalents and restricted cash	\$ 120,754	\$ 83,741

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 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 condensed consolidated financial statements.

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 on January 1, 2019 did not have a material impact on our condensed consolidated financial statements.

3. Acquired Properties

The Company records identifiable assets and liabilities acquired at fair value. During the nine months ended September 30, 2019, the Company acquired five multi-family assets for a gross acquisition price of \$82,377, including capitalized transaction costs of approximately \$377.

Property	Location	Acquisition Date	Acquisition Price
The Detroit and Detroit Terraces	Denver, Colorado	January 8, 2019	\$ 19,070
The View	San Diego, California	April 5, 2019	16,420
The Tennyson44	Denver, Colorado	June 11, 2019	19,191
Evolve at Allendale ⁽¹⁾	Allendale, MI	August 16, 2019	27,696
			\$ 82,377

⁽¹⁾ The purchase price of this acquisition was funded by the Corvue Venture with equity contributions from its members and with debt obtained by the Corvue Venture, as further discussed in Note 7. The portion of the aggregate equity contributions funded to the Corvue Venture that is not attributable to the Company is presented separately as amounts attributable to non-controlling interests in our condensed consolidated financial statements.

The purchase price allocation has been recorded as follows:

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	The Detroit and Detroit Terraces	The View	The Tennyson44	Evolve at Allendale	Total
Land	\$ 3,370	\$ 7,272	\$ 1,533	\$ 4,295	\$ 16,470
Buildings and other improvements	15,006	8,862	17,410	22,460	63,738
Intangible assets, net	301	286	248	941	1,776
Total assets	\$ 18,677	\$ 16,420	\$ 19,191	\$ 27,696	\$ 81,984
Debt discount on mortgage assumption	393	—	—	—	393
Total liabilities	\$ 393	\$ —	\$ —	\$ —	\$ 393
Total acquisition price	\$ 19,070	\$ 16,420	\$ 19,191	\$ 27,696	\$ 82,377

Consolidated VIE

As of September 30, 2019, we have determined we are the primary beneficiary of one VIE - the Corvue Venture and have consolidated the operations of this entity in the accompanying condensed consolidated financial statements.

We reviewed the operating agreement of the Corvue Venture in order to determine our rights and the rights of our third-party partner, including whether those rights are protective or participating. We have determined we are the primary beneficiary of the Corvue Venture because we have (a) the power to direct the activities that most significantly impact the economic performance of the Corvue Venture, (b) the obligation to absorb the losses that could be significant to the Corvue Venture and (c) the right to receive the benefits that could be significant to the Corvue Venture.

Included in total assets on the Company's condensed consolidated balance sheets as of September 30, 2019 is \$28,409 related to the Corvue Venture. Included in total liabilities on the Company's condensed consolidated balance sheets as of September 30, 2019 is \$19,293 related to the Corvue Venture. The assets of the Corvue Venture may only be used to settle obligations of the Corvue Venture and the creditors of the Corvue Venture have no recourse to the general credit of the Company.

During the nine months ended September 30, 2018, the Company acquired three multi-family assets for a gross acquisition price of \$36,015, including capitalized transaction costs of approximately \$240.

Property	Location	Acquisition Date	Acquisition Price
The Lafayette	Denver, Colorado	May 15, 2018	\$ 9,679
1620 Central Street	Evanston, Illinois	August 22, 2018	20,552
Kenilworth Court	Denver, Colorado	September 12, 2018	5,784
			\$ 36,015

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The purchase price allocation has been allocated as follows:

	The Lafayette	1620 Central Street	Kenilworth Court	Total
Land	\$ 2,457	\$ 3,075	\$ 2,496	\$ 8,028
Buildings and other improvements	7,067	17,133	3,203	27,403
Intangible assets, net	155	344	85	584
Total acquisition price	\$ 9,679	\$ 20,552	\$ 5,784	\$ 36,015

4. Disposed Properties

The following table reflects the property dispositions during the nine months ended September 30, 2019. The Company recognized a net gain on sale of investment properties of \$8,841.

Property	Location	Disposition Date	Gross Disposition Price	Sale Proceeds, Net	Gain on Sale
RDU land	Raleigh, North Carolina	May 29, 2019	\$ 600	\$ 554	\$ 29
Lincoln Center	Lincoln, Rhode Island	June 21, 2019	55,750	52,609	8,812
			\$ 56,350	\$ 53,163	\$ 8,841

The following table reflects the property dispositions during the nine months ended September 30, 2018. The Company recognized a net gain on sale of investment properties of \$12,301.

Property	Location	Disposition Date	Gross Disposition Price	Sale Proceeds, Net	Gain on Sale
Buckhorn Plaza (partial lot sale)	Bloomsburg, PA	February 8, 2018	\$ 60	\$ 60	\$ 25
Rolling Plains (correctional facility)	Haskell, TX	August 7, 2018	3,600	3,237	3,368
Triangle Center ⁽¹⁾	Longview, WA	September 24, 2018	38,340	37,425	8,908
			\$ 42,000	\$ 40,722	\$ 12,301

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

5. Leases

Leasing as a lessor

Revenue Recognition

We lease multifamily properties under operating leases with terms of generally one year or less. We lease commercial properties (our net lease, office and retail segments) under operating leases with remaining lease terms that range from less than one year to ten years as of September 30, 2019 and terms that range from less than one year to twenty years as of December 31, 2018.

We recognize rental income and rental abatements from our multifamily and commercial leases when earned on a straight-line basis over the lease term. Recognition of rental income commences when control of the leased space has been transferred to the tenant.

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We recognize cost reimbursement income from pass-through expenses on an accrual basis over the periods in which the expenses were incurred. Pass-through expenses are comprised of real estate taxes, operating expenses and common area maintenance costs which are reimbursed by tenants in accordance with specific allowable costs per tenant lease agreements.

Parking revenues are derived from leases and monthly parking agreements. We recognize parking revenues from leases on a straight-line basis over the lease term and other parking revenues as earned.

Upon adoption of ASU 2016-02, we elected not to bifurcate lease contracts into lease and non-lease components, since the timing and pattern of revenue is not materially different and the non-lease components are not the primary component of the lease. Accordingly, both lease and non-lease components are presented in rental income in our condensed consolidated financial statements. The adoption of ASU 2016-02 did not result in a material change to our recognition of real estate rental revenue.

Lease related receivables, which include contractual amounts accrued and unpaid from tenants and accrued straight-line rents receivable, are reduced for credit losses. Such amounts are recognized as a reduction to real estate rental revenues. The FASB clarified in July 2019 that, under ASC 842, lessors can continue to recognize a reserve (i.e., allowance for uncollectible operating lease receivables) under the loss contingency guidance in ASC 450-20 after applying the collectibility guidance in ASC 842. We evaluate the collectability of lease receivables monthly using several factors including a lessee's creditworthiness. We recognize the credit loss on lease related receivables when, in the opinion of management, collection of substantially all lease payments is not probable. When collectability is determined not probable, any lease income subsequent to recognizing the credit loss is limited to the lesser of the lease income reflected on a straight-line basis or cash collected.

On August 2, 2019, we received a notice of non-renewal from The GEO Group, Inc. indicating that it will not be seeking an extension of its lease on our Hudson correctional facility asset. The lease on this asset expires on January 23, 2020. For the nine months ended September 30, 2019, 25.1% of our revenue was derived from The GEO Group, Inc.'s net lease on our Hudson correctional facility asset. A non-renewal by The GEO Group Inc. was contemplated when we recorded an impairment of the asset of \$3,765 during the fourth quarter of 2018. While we will seek to re-lease or find alternative users for this asset, given the nature of the property, its location and its extended period of vacancy, we expect it will be very difficult to re-lease or find alternative users for this property. Even if we are successful in finding alternative users, we expect it will take an extended period of time to do so, if at all. Further, we believe it is unlikely that we will be able to find alternative users on similar terms. As we do not expect to find alternative users, re-lease the property, or re-lease on similar terms in the foreseeable future, we expect the non-renewal to have a material adverse effect on our financial condition, cash flows and results of operations. Notwithstanding the non-renewal, we believe we have sufficient liquidity and capital resources to fund our operations for the foreseeable future.

Lease income related to the Company's operating leases is comprised of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Lease income related to fixed lease payments	\$ 7,805	\$ 9,323	\$ 24,480	\$ 26,401
Lease income related to variable lease payments	1,150	2,123	4,914	5,991
Other ⁽¹⁾	243	203	463	725
Lease income	\$ 9,198	\$ 11,649	\$ 29,857	\$ 33,117

⁽¹⁾ For the three and nine months ended September 30, 2019 and 2018, respectively, other is primarily comprised of parking revenues and termination fees related to early lease expirations.

Future Minimum Rental Income

As of September 30, 2019, commercial operating leases provide for future minimum rental income, assuming no expiring leases are renewed, as follows. Apartment leases are not included as the terms are generally for one year or less.

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2019	\$	5,632
2020		12,896
2021		11,034
2022		8,647
2023		8,128
Thereafter		26,569
Total	\$	72,906

As of December 31, 2018, commercial operating leases provide for future minimum rental income assuming no expiring leases are renewed, as follows:

2019	\$	27,551
2020		17,323
2021		14,014
2022		11,423
2023		10,358
Thereafter		36,357
Total	\$	117,026

Leasing as a Lessee

We lease a portion of the land underlying one of our retail assets, Sherman Plaza, from a third party through a ground lease covering such land with a lease term expiring in October 2042.

Upon adoption of ASU 2016-02, we recognized a right of use asset (included in deferred costs and other assets) and lease liability (included in other liabilities). At September 30, 2019, the balances were \$300 and were recorded in the condensed consolidated balance sheets. We used a discount rate of approximately 4.5%, reflecting the Company's incremental borrowing rate.

The following table sets forth the undiscounted cash flows of our scheduled obligations for future minimum payments on our operating ground lease at September 30, 2019 and a reconciliation of those cash flows to the operating lease liability at September 30, 2019.

2019	\$	5
2020		21
2021		21
2022		21
2023		21
2024		21
Thereafter		373
		483
Imputed interest		(183)
Lease liability	\$	300

The following table sets forth our scheduled obligations for future minimum payments on our operating ground lease at December 31, 2018.

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2019	\$	21
2020		21
2021		21
2022		21
2023		21
2024		21
Thereafter		373
Total	\$	<u>499</u>

6. Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consist of the following:

	September 30, 2019	December 31, 2018
Accrued real estate taxes	\$ 5,229	\$ 5,669
Accrued compensation	2,462	3,232
Accrued interest payable	401	119
Other accrued expenses	936	2,633
	<u>\$ 9,028</u>	<u>\$ 11,653</u>

7. Debt

Total debt outstanding as of September 30, 2019 and December 31, 2018, net of unamortized deferred financing costs and debt discounts, was \$93,385 and \$34,953, respectively, and had a weighted average interest rate of 4.13% and 4.74% per annum, respectively. Deferred financing costs, net, as of September 30, 2019 and December 31, 2018 were \$1,433 and \$490, respectively. Debt discounts, as of September 30, 2019 and December 31, 2018 were \$360 and \$0, respectively. As of September 30, 2019, scheduled maturities for the Company's outstanding mortgage indebtedness and the credit facility had various due dates through August 2027, as follows:

For the year ended December 31,	As of September 30, 2019	Weighted average interest rate
2019	\$ —	—%
2020	—	—%
2021	—	—%
2022	9,217	5.24%
2023	18,750	3.27% ⁽¹⁾
Thereafter	67,211	4.21%
Total	<u>\$ 95,178</u>	<u>4.13%</u>

⁽¹⁾ See below for discussion of the swap agreement entered into with the mortgage loan obtained in connection with the acquisition of the Evolve at Allendale asset. The weighted average interest rate reflected is the strike rate.

The Company's ability to pay off the 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 mortgage 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.

Some of the mortgage loans require compliance with certain covenants, such as debt service ratios, investment restrictions and distribution limitations. As of September 30, 2019 and December 31, 2018, the Company is in compliance with such covenants in all material respects.

On January 8, 2019, the Company assumed a principal mortgage loan amount of \$11,089, net of a debt discount of \$360 in connection with the acquisition of The Detroit and Detroit Terraces. The contractual rate and terms of the assumed debt was marked to market as of the acquisition

date. According to the terms of the note agreement, the contractual fixed interest rate is 3.99% and payments are interest only through September 30, 2022. The maturity date of the mortgage loan is on August 31, 2027.

On February 15, 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 \$50,000, including a letter of credit subfacility for 10% of the then available revolving commitments, and (ii) a

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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 \$50,000.

The Credit Agreement provides that, subject to customary conditions, including obtaining lender commitments and compliance with its financial covenants under the Credit Agreement, the Company may seek to increase the aggregate lending commitments under the Credit Agreement by up to \$100,000, 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, 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 \$30,000 under the Term Loan Facility as of September 30, 2019.

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 London Interbank Offered Rate (“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. The Company has chosen the second option for the interest rate applicable to the current loan under the term loan facility during the nine months ended September 30, 2019. 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 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.

The Company obtained a mortgage loan in the principal amount of \$18,750 in connection with the acquisition of Evolve at Allendale on August 16, 2019. The Company entered into a swap agreement with respect to the loan, effective through its September 1, 2023 maturity date, to swap the variable interest rate to a fixed rate of approximately 3.27% per annum. The interest rate is based on the LIBOR plus the applicable spread. The effective interest rate as of September 30, 2019, is approximately 3.95%.

8. Fair Value Measurements

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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.

Financial Assets and Liabilities Measured at Fair Value on a Recurring Basis

Risk Management Objective of Using Derivatives

The Company is exposed to certain risk arising from both its business operations and economic conditions. The Company principally manages its exposures to a wide variety of business and operational risks through management of its core business activities. The Company manages economic risks, including interest rate, liquidity, and credit risk primarily by managing the amount, sources, and duration of debt funding and, to a limited extent, the use of derivative financial instruments. Specifically, the Company may enter into derivative financial instruments to manage exposures that arise from business activities that result in the receipt or payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company's derivative financial instruments, described below, are used to manage differences in the amount, timing, and duration of the Company's known or expected cash receipts and its known or expected cash payments principally related to the Company's borrowings.

Cash Flow Hedges of Interest Rate Risk

The Company's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company may use interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable-rate amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. We do not enter into derivative financial instruments for speculative purposes. As of September 30, 2019, we had one derivative financial instrument designated as a cash flow hedge, with a notional amount of \$18,750 and a maturity date of September 1, 2023. This derivative is an interest rate swap that is measured at fair value on a recurring basis.

For derivatives designated and that qualify as cash flow hedges of interest rate risk, the gain or loss on the derivative is recorded in accumulated other comprehensive income or loss on the condensed consolidated balance sheets and is subsequently reclassified into interest expense in the same period during which the hedged transaction affects earnings. The amount recorded as other comprehensive loss related to the unrealized loss on our derivative financial instrument was \$96 for the three and nine months ended September 30, 2019. The Company had no derivative instruments during the three and nine months ended September 20, 2018. Realized gains and losses will be recognized as they accrue in interest expense.

Amounts reported in accumulated other comprehensive loss related to derivatives will be reclassified to interest expense as interest payments are made on our variance rate debt. The Company estimates that \$23 will be reclassified as a decrease to interest expense over the next twelve months.

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The table below presents the fair value of the Company's derivative financial instrument as well as its classification on the condensed consolidated balance sheets as of September 30, 2019. The Company did not have any derivative instruments as of December 31, 2018.

	September 30, 2019			
	Level 1	Level 2	Level 3	Total
Derivative financial instruments designated as cash flow hedges:				
Classified as liabilities in "Other liabilities"	\$ —	\$ 96	\$ —	\$ 96

The fair value of our derivative financial instrument was determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of the derivative financial instrument. This analysis reflected the contractual terms of the derivative, including the period to maturity, and used observable market-based inputs, including interest rate market data and implied volatilities in such interest rates. While it was determined that the majority of the inputs used to value the derivative fall within Level 2 of the fair value hierarchy under authoritative accounting guidance, the credit valuation adjustments associated with the derivative also utilized Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default. However, as of September 30, 2019, the significance of the impact of the credit valuation adjustments on the overall valuation of the derivative financial instrument was assessed, and it was determined that these adjustments were not significant to the overall valuation of the derivative financial instrument. As a result, it was determined that the derivative financial instrument in its entirety should be classified in Level 2 of the fair value hierarchy.

Non-Recurring Measurements

During the nine months ended September 30, 2019 and 2018, the Company did not identify any impairment triggers that required the assets to be measured at fair value.

Financial Instruments Not Measured at Fair Value

The table below represents the fair value of financial instruments presented at carrying values in the condensed consolidated financial statements as of September 30, 2019 and as of December 31, 2018.

	September 30, 2019		December 31, 2018	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Debt	\$ 93,385	\$ 96,784	\$ 34,953	\$ 35,222

The Company estimates the fair value of its debt instruments using a weighted average market effective interest rate of 3.54% and 4.70% per annum as of September 30, 2019 and December 31, 2018, respectively. The Company estimates the fair value of its mortgage loans and term loan facility 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 mortgage loans and term loan facility 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 3.22% to 3.91% as of September 30, 2019. For certain debt, the Company estimates the fair value of debt instruments based on the fair value of the underlying collateral. The Company has determined that its debt instrument valuations are classified in Level 2 of the fair value hierarchy.

9. Income Taxes

The Company is taxed and operates in a manner that will allow the Company to continue to qualify as a REIT for U.S. federal income tax purposes. 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 to stockholders. A REIT is subject to a number of organizational and operational requirements, including a requirement that it 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. Although the Company qualifies for taxation as a REIT, the Company may be subject to certain state and local taxes on its income and U.S. federal income and excise taxes on its undistributed income.

During the three and nine months ended September 30, 2019, no income tax benefit or expense was included on the condensed

consolidated statements of operations and comprehensive income. During the three and nine months ended September 30, 2018, an income tax benefit of \$0 and \$155, respectively, was included on the condensed consolidated statement of operations.

10. 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 with guidance under FASB ASC Topic 280, Segment Reporting ("ASC 280") to determine whether any changes have occurred that would impact its reportable segments. During the 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 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 by segment for the three months ended September 30, 2019.

	Total	Net Lease	Retail	Multi-Tenant Office	Multi-family	Other
Rental income	\$ 8,955	\$ 3,083	\$ 2,740	\$ 754	\$ 2,360	\$ 18
Other property income	243	—	111	—	132	—
Total income	9,198	3,083	2,851	754	2,492	18
Operating expenses	2,721	174	1,280	184	975	108
Net operating income (loss)	\$ 6,477	\$ 2,909	\$ 1,571	\$ 570	\$ 1,517	\$ (90)
Non-allocated expenses (a)	(5,482)					
Other income and expenses (b)	(477)					
Net income attributable to non-controlling interests	(10)					
Net income attributable to Highlands REIT, Inc. common stockholders	<u>\$ 508</u>					

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

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

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The following table summarizes net property operations by segment for the three months ended September 30, 2018.

	Total	Net Lease	Retail	Multi-Tenant Office	Multi-family	Other
Rental income	\$ 11,446	\$ 3,182	\$ 6,182	\$ 1,446	\$ 636	\$ —
Other property income	203	—	13	92	98	—
Total income	11,649	3,182	6,195	1,538	734	—
Operating expenses	3,741	98	2,524	685	284	150
Net operating income (loss)	\$ 7,908	\$ 3,084	\$ 3,671	\$ 853	\$ 450	\$ (150)
Non-allocated expenses (a)	(6,000)					
Other income and expenses (b)	(596)					
Gain on sale of investment properties (c)	12,276					
Loss on extinguishment of debt (d)	(1,199)					
Net income	\$ 12,389					

- (a) Non-allocated expenses consist of general and administrative expenses and depreciation and amortization.
(b) Other income and expenses consists of interest income, other income and interest expense.
(c) Gain on the sale of investment properties is related to one retail asset and one other asset.
(d) Loss on extinguishment of debt is related to prepayment penalties on the payoff of mortgage debt.

The following table summarizes net property operations by segment for the nine months ended September 30, 2019.

	Total	Net Lease	Retail	Multi-Tenant Office	Multi-family	Other
Rental income	\$ 29,394	\$ 9,433	\$ 12,557	\$ 2,238	\$ 5,166	\$ —
Other property income	463	—	135	—	328	—
Total income	29,857	9,433	12,692	2,238	5,494	—
Operating expenses	9,233	475	5,605	542	2,163	448
Net operating income (loss)	\$ 20,624	\$ 8,958	\$ 7,087	\$ 1,696	\$ 3,331	\$ (448)
Non-allocated expenses (a)	(18,406)					
Other income and expenses (b)	(1,475)					
Gain on sale of investment properties (c)	8,841					
Net income attributable to non-controlling interests	(10)					
Net income attributable to Highlands REIT, Inc. common stockholders	\$ 9,574					
Balance Sheet Data						
Real estate assets, net (d)	\$ 271,289	\$ 35,146	\$ 66,950	\$ 26,533	\$ 133,708	\$ 8,952
Non-segmented assets (e)	129,893					
Total assets	\$ 401,182					
Capital expenditures	\$ 765	\$ —	\$ 315	\$ —	\$ 450	\$ —

- (a) Non-allocated expenses consists of general and administrative expenses and depreciation and amortization.
(b) Other income and expenses consists of interest income and interest expense.
(c) Gain on the sale of investment properties is related to one retail asset and one land parcel.
(d) Real estate assets include intangible assets, net of amortization.

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

The following table summarizes net property operations by segment for the nine months ended September 30, 2018.

	Total	Net Lease	Retail	Multi-Tenant Office	Multi-family	Other
Rental income	\$ 32,392	\$ 9,542	\$ 18,255	\$ 3,292	\$ 1,303	\$ —
Other property income	725	—	32	432	261	—
Total income	33,117	9,542	18,287	3,724	1,564	—
Operating expenses	10,276	458	7,201	2,064	667	(114)
Net operating income	\$ 22,841	\$ 9,084	\$ 11,086	\$ 1,660	\$ 897	\$ 114
Non-allocated expenses (a)	(19,529)					
Other income and expenses (b)	(1,565)					
Gain on sale of investment properties (c)	12,301					
Loss on extinguishment of debt (d)	(1,199)					
Net income	\$ 12,849					
Balance Sheet Data						
Real estate assets, net (e)	\$ 268,991	\$ 40,730	\$ 116,462	\$ 47,470	\$ 54,651	\$ 9,678
Non-segmented assets (f)	53,793					
Total assets	\$ 322,784					
Capital expenditures	\$ 3,977	\$ —	\$ 1,835	\$ 2,076	\$ 9	\$ 57

- (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) Gain on the sale of investment properties is related to one retail asset, a parcel of one retail asset and one other asset.
(d) Loss on extinguishment of debt is related to prepayment penalties on the payoff of mortgage debt.
(e) Real estate assets include intangible assets, net of amortization.
(f) Non-segmented assets include cash and cash equivalents, restricted cash and escrows, accounts and rents receivable and deferred costs and other assets.

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11. Earnings Per Share

Basic earnings per common share is calculated by dividing net income attributable to Highlands REIT, Inc. common stockholders by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share is calculated by dividing net income attributable to Highlands REIT, Inc. common stockholders 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):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Numerator:				
Net income attributable to Highlands REIT, Inc. common stockholders	\$ 508	\$ 12,389	\$ 9,574	\$ 12,849
Denominator:				
Weighted average number of common shares outstanding - basic and diluted	876,007,008	871,537,188	875,057,625	871,027,452
Basic and diluted earnings per share:				
Net income per common share	<u>\$ 0.00</u>	<u>\$ 0.01</u>	<u>\$ 0.01</u>	<u>\$ 0.01</u>

12. 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 nine months ended September 30, 2019, the Company granted 6,100,002 shares of common stock with an aggregate value of \$2,135 based on an estimated net asset value per share of \$0.35. Additionally, for accounting purposes, the Company granted shares with an aggregate value of \$125 that will vest in August, 2020, subject to the applicable executive's continued employment with the Company through the vest date. During the nine months ended September 30, 2018, the Company granted 5,772,728 of fully vested shares of common stock with an aggregate value of \$1,905 based on an estimated net asset value per share of \$0.33.

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. As of September 30, 2019, 17,465,437 shares were available for future issuance under the Incentive Award Plan. A summary of the Company's stock awards activity as of September 30, 2019 is as follows:

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Non-Vested stock awards	Stock Awards	Weighted Average Grant Date Fair Value
Balance at January 1, 2019	\$ 2,121,212	\$ 0.33
Granted	6,100,002	0.35
Vested	(7,742,859)	0.35
Other ⁽¹⁾	(121,212)	—
Balance at September 30, 2019	<u>\$ 357,143</u>	<u>\$ 0.35</u>

⁽¹⁾ Represents the change in the number of shares granted in 2018 based on an estimated net asset value per share of \$0.33 and the actual shares vested in 2019 based on an estimated net asset value per share of \$0.35.

For the three months ended September 30, 2019 and 2018, the Company recognized stock-based compensation expense of \$43 and \$196, respectively, related to the Incentive Award Plan and was recorded in the condensed consolidated financial statements. For the nine months ended September 30, 2019 and 2018, the Company recognized stock-based compensation expense of \$2,220 and \$2,249. At September 30, 2019, there was approximately \$70 of estimated unrecognized compensation expense related to these awards, which is expected to be recognized through August 1, 2020. For the nine months ended September 30, 2019 and 2018, the Company paid \$1,177 and \$876, 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 three months ended September 30, 2018. The shares were repurchased for \$0.33 per share, which was based on the Company's announced estimated share value as of December 31, 2017.

13. 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 a failure by InvenTrust or MB REIT (Florida), Inc., a subsidiary of the Company, to qualify as a REIT for any taxable year ending on or before December 31, 2016.

14. Subsequent Events

On October 24, 2019, the Company, through The Muse Owner, LLC, a wholly-owned subsidiary of the Company, completed the purchase of certain real property and improvements located at 2270 South University Boulevard, Denver, Colorado for a gross purchase price of \$48.7 million, exclusive of closing costs. The seller is not affiliated with the Company.

Item 2. 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-Financial Information,” and the historical consolidated financial statements, and related notes included elsewhere in our Annual Report on Form 10-K. 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” in our Annual Report on Form 10-K. The following discussion and analysis should be read in conjunction with the Company's Consolidated Financial Statements and accompanying notes, which appear in our Annual Report on Form 10-K.

Certain statements in this Quarterly Report on Form 10-Q, 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 Quarterly Report on Form 10-Q. Such risks, uncertainties and other important factors include, among others: the risks, uncertainties and factors set forth in our filings with the U.S. Securities and Exchange Commission, including our Annual Report on Form 10-K; 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; difficulty selling or re-leasing our properties 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 separation from InvenTrust and our ability to operate as a stand-alone public reporting company; 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; 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; 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.

The following discussion and analysis should be read in conjunction with the Company's Condensed Consolidated Financial Statements and accompanying notes, which appear elsewhere in this Quarterly Report on Form 10-Q.

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 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 September 30, 2019, our portfolio of assets consisted of one office asset, two industrial assets, four retail assets, ten multi-family assets, one correctional facility, one parcel 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 and consolidated 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 10 to our Condensed Consolidated Financial Statements for the quarters ended September 30, 2019, and 2018.

Basis of Presentation

The accompanying condensed consolidated financial statements reflect the accounts of Highlands and its consolidated subsidiaries (collectively, the “Company”). Highlands consolidates its wholly-owned subsidiaries and any other entities which it controls (i) through voting rights or similar rights or (ii) by means other than voting rights if Highlands is the primary beneficiary of a variable interest entity (“VIE”). The portions of the equity and net income of consolidated subsidiaries that are not attributable to the Company are presented separately as amounts attributable to non-controlling interests in our condensed consolidated financial statements. Entities which Highlands does not control and entities which are VIEs in which Highlands is not a primary beneficiary, if any, are accounted for under appropriate GAAP. Highlands’ subsidiaries generally consist of limited liability companies (“LLCs”). The effects of all significant intercompany transactions have been eliminated.

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

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Our expenses consist of property operating expenses, real estate taxes, depreciation and amortization expense and general and administrative expenses. 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 flows 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.

See “Selected Financial Data” for further discussion of the Company’s use, definitions and limitations of FFO and AFFO.

Acquisition and Disposition Activity

During the nine months ended September 30, 2019, we continued to invest in multi-family assets by acquiring the following properties:

				(in thousands)
Property	Location	Acquisition Date	Acquisition Price	
The Detroit and Detroit Terraces	Denver, Colorado	January 8, 2019	\$	19,070
The View	San Diego, California	April 5, 2019		16,420
The Tennyson44	Denver, Colorado	June 11, 2019		19,191
Evolve at Allendale ^{(1) (2)}	Allendale, MI	August 16, 2019		27,696
			\$	<u>82,377</u>

⁽¹⁾ The Company accounted for these transactions as asset acquisitions and capitalized \$377 of total acquisition costs to the basis of the properties.

⁽²⁾ The purchase price of this acquisition was funded by the Corvue Venture with equity contributions from its members and with debt obtained by the Corvue Venture, as further discussed in Note 7. The portion of the aggregate equity contributions funded to the Corvue Venture that is not attributable to the Company is presented separately as amounts attributable to non-controlling interests in our condensed consolidated financial statements.

During the nine months ended September 30, 2019, we continued to execute on our strategy of disposing of legacy “non-core” assets by selling the following properties:

						(in thousands)
Property	Location	Disposition Date	Gross Disposition Price	Sale Proceeds, Net	Gain on Sale	
RDU land	Raleigh, North Carolina	May 29, 2019	\$ 600	\$ 554	\$ 29	
Lincoln Center	Lincoln, Rhode Island	June 21, 2019	55,750	52,609	8,812	
			\$ 56,350	\$ 53,163	\$ 8,841	

Results of Operations

Comparison of the three and nine months ended September 30, 2019 and 2018

Key performance indicators are as follows:

	As of September 30,	
	2019	2018
Economic occupancy (a)	91.1%	91.5%
Rent per square foot (b)	\$ 17.49	\$ 16.36

- (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.

Condensed Consolidated Results of Operations

	(in thousands)				(in thousands)			
	Three Months Ended September 30,				Nine Months Ended September 30,			
	2019	2018	Increase (Decrease)		2019	2018	Increase (Decrease)	
Net income	\$ 518	\$ 12,389	\$ (11,871)	(95.8)%	\$ 9,584	\$ 12,849	\$ (3,265)	25.4%

Net income decreased by \$11.9 million, to \$0.5 million for the three months ended September 30, 2019, from \$12.4 million for the three months ended September 30, 2018, primarily as a result of the gain on the sale of investment properties in the amount of \$12.3 million during the three months ended September 30, 2018 and a reduction in income from operations as a result of dispositions during 2018, partially offset by loss on extinguishment of debt recognized during during the same period in 2018.

Net income decreased by \$3.3 million, to \$9.6 million for the nine months ended September 30, 2019, from \$12.8 million for the nine months ended September 30, 2018, primarily as a result of a reduction in income from operations as a result of dispositions during 2018.

Operating Income and Expenses

	(in thousands)				(in thousands)				
	For the three months ended September 30,				For the nine months ended September 30,				
	2019	2018	Increase (Decrease)		2019	2018	Increase (Decrease)		
Income:									
Rental income	\$ 8,955	\$ 11,446	\$ (2,491)	(21.8)%	\$ 29,394	\$ 32,392	\$ (2,998)	(9.3)%	
Other property income	243	203	40	19.7 %	463	725	(262)	(36.1)%	
Total revenues	\$ 9,198	\$ 11,649	\$ (2,451)	(21.0)%	\$ 29,857	\$ 33,117	\$ (3,260)	(9.8)%	
Expenses:									
Property operating expenses	\$ 1,565	\$ 2,353	\$ (788)	(33.5)%	\$ 5,454	\$ 6,648	\$ (1,194)	(18.0)%	
Real estate taxes	1,156	1,388	(232)	(16.7)%	3,779	3,628	151	4.2 %	
Depreciation and amortization	3,109	3,406	(297)	(8.7)%	8,568	9,753	(1,185)	(12.2)%	
General and administrative expenses	2,373	2,594	(221)	(8.5)%	9,838	9,776	62	0.6 %	
Total expenses	\$ 8,203	\$ 9,741	\$ (1,538)	(15.8)%	\$ 27,639	\$ 29,805	\$ (2,166)	(7.3)%	

Property Income and Operating Expenses

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Rental income consists of monthly rent, straight-line rent adjustments, tenant recovery income 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 revenues decreased by \$2.5 million in the three months ended September 30, 2019 compared to the same period in 2018, primarily as a result of the disposition of the Lincoln Center retail asset during the second quarter of 2019, the Triangle retail asset during the third quarter of 2018 and the Bridgeside multi-tenant office asset during the fourth quarter of 2018. These reductions were partially offset by an increase in rental revenue related to multi-family assets acquired during 2018 and 2019 and an increase in occupancy at one of the office assets.

Total revenues decreased by \$3.3 million in the nine months ended September 30, 2019 compared to the same period in 2018, primarily as a result of the factors discussed above.

Property operating expenses decreased in the three and nine months ended September 30, 2019 compared to the same periods in 2018, primarily as a result of the disposition of the Triangle retail asset during the third quarter of 2018, the Bridgeside multi-tenant office asset during the fourth quarter of 2018 and the disposition of the Lincoln Center asset during the second quarter of 2019. These reductions were partially offset by an increase in property operating expenses related to multi-family assets acquired during 2018 and 2019 and an increase in occupancy at one of the office assets.

Real Estate Taxes

Real estate taxes decreased by \$0.2 million during the three months ended September 30, 2019 compared to the same period in 2018, primarily as a result of the asset dispositions discussed above. Real estate taxes increased by \$0.2 million during the nine months ended September 30, 2019 compared to the same period in 2018, primarily as a result of a favorable adjustment recognized in 2018 for 2017 taxes related to one of our previously disposed net lease assets.

Depreciation and Amortization

Depreciation and amortization decreased by \$0.3 million and \$1.2 million for the three and nine months ended September 30, 2019, respectively, compared to the same periods in 2018, primarily as a result of the asset impairment on the correctional facility recognized during 2018 and the asset dispositions discussed above. These reductions were partially offset by increases related to the multi-family asset acquisitions.

General Administrative Expenses

General and administrative expense decreased by \$0.2 million for the three months ended September 30, 2019 compared to the same period in 2018, primarily as a result of lower expenses related to professional services. General and administrative expenses were generally consistent in the nine months ended September 30, 2019 compared to the same period in 2018.

Non-Operating Income and Expenses

	(in thousands)				(in thousands)			
	For the three months ended September 30,				For the nine months ended September 30,			
	2019	2018	Increase (Decrease)		2019	2018	Increase (Decrease)	
Non-operating income and expenses:								
Interest income	\$ 581	\$ 81	\$ 500	N/A	\$ 1,348	\$ 371	\$ 977	N/A
Gain on sale of investment properties, net	—	12,276	(12,276)	(100.0)%	8,841	12,301	(3,460)	(28.1)%
Loss on extinguishment of debt	—	(1,199)	(1,199)	(100.0)%	—	(1,199)	(1,199)	(100.0)%
Other income	—	23	(23)	(100.0)%	—	23	(23)	(100.0)%
Interest expense	(1,058)	(700)	358	51.1 %	(2,823)	(2,114)	709	33.5 %
Income tax benefit	—	—	—	—	—	155	(155)	(100.0)%

Interest Income

Interest income increased by \$0.5 million and \$1.0 million during the three and nine months ended September 30, 2019, respectively, as compared to the same periods in 2018 as a result of an increase in cash balances during the first nine months of 2019 compared to 2018.

Gain on Sale of Investment Properties and Loss on Extinguishment of Debt

During the nine months ended September 30, 2019, the gain on sale of investment properties was attributed to Highlands' sale of the Lincoln Center retail asset in the second quarter and the RDU land parcel in the first quarter.

During the three and nine months ended September 30, 2018, the gain on sale of investment properties and loss on extinguishment of debt was attributed to Highlands' sale of our Triangle retail asset and one of our other assets. Loss on extinguishment of debt was for prepayment penalties associated with the mortgage loan related to the Triangle retail asset paid off with proceeds from the asset sale.

Interest Expense

The increase in interest expense during the three and nine months ended September 30, 2019, compared to the same periods in 2018, is primarily due to borrowings under the Term Loan Facility in the amount of \$30.0 million in connection with entering into the credit facility. Additional factors contributing to the increase, is the Company's assumption of a mortgage loan of \$11.4 million in connection with the acquisition of The Detroit and Detroit Terraces on January 8, 2019 and the mortgage loan in the amount of \$18.8 million obtained in connection with the acquisition of Evolve at Allendale on August 16, 2019.

Income Taxes

The Company accrues excise tax, if any, on estimated excess taxable income as taxable income is earned. For the three months ended March 31, 2018, an income tax benefit of \$0.2 million was related to a change in estimates of a U.S. federal excise tax accrual based on changes in the estimated taxable income for the year ended December 31, 2017. No such expense or benefits were recognized during three months ended September 30, 2018. During the three and nine months ended September 30, 2019, no income tax benefit or expense was included on the condensed consolidated statements of operations and comprehensive income.

Leasing Activity

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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, excluding multi-family leases, as of September 30, 2019:

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	4	23,416	\$ 424	1.6%	1.8%	\$ 18.12
2020	11	355,750	10,844	24.8%	45.2%	30.48
2021	5	116,633	1,714	8.1%	7.1%	14.70
2022	5	156,825	2,217	10.9%	9.2%	14.14
2023	4	11,155	181	0.8%	0.8%	16.22
2024	4	40,948	692	2.9%	2.9%	16.89
2025	6	42,047	544	2.9%	2.3%	12.94
2026	4	20,191	428	1.4%	1.8%	21.22
2027	5	595,816	5,686	41.5%	23.7%	9.54
2028	4	36,159	790	2.5%	3.3%	21.86
MTM	2	11,125	167	0.8%	0.7%	15.04
Thereafter	2	24,300	327	1.7%	1.4%	13.47
Grand Total	56	1,434,365	\$ 24,016	100.0%	100.0%	\$ 16.74

The following table represents new and renewed leases that commenced during the nine months ended September 30, 2019.

	# of Leases	Gross Leasable Area (square feet)	Rent per square foot	Weighted Average Lease Term (years)
New	7	44,431	\$ 16.46	8.06
Renewals	5	65,017	\$ 13.76	3.61
Total	12	109,448	\$ 14.86	5.42

During the nine months ended September 30, 2019, twelve new leases and renewals commenced (not including multi-family leases) with gross leasable area totaling 109,448 square feet. The weighted average lease term for new and renewal leases was 8.06 and 3.61 years, respectively.

Liquidity and Capital Resources

As of September 30, 2019, we had \$116.3 million of cash and cash equivalents, and \$4.4 million of restricted cash and escrows.

Our principal demands for funds have been or may be:

- to pay the operating expenses of our assets;
- to pay our general and administrative expenses;
- to pay for acquisitions;
- to pay for capital commitments;
- 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:

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- 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 are likely to reduce our cash flows from operations. In particular, 25.1% of our revenue for the nine months ended September 30, 2019 is derived from a net lease with The GEO Group, Inc. of our Hudson correctional facility asset, which lease expires in January of 2020. Pursuant to the notice of non-renewal we received from The GEO Group, Inc., dated August 2, 2019, The GEO Group, Inc. will not renew its lease of our Hudson correctional facility asset.

We may, from time to time, repurchase our outstanding equity and/or debt securities, if any, 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 condensed consolidated basis, the principal amount, weighted average interest rates and maturity date (by year) on our mortgage debt and debt from our credit facility, as of September 30, 2019 (dollar amounts are stated in thousands).

	Debt maturing during the year ended December 31,	As of September 30, 2019	Weighted average interest rate
2019		\$ —	—%
2020		—	—%
2021		—	—%
2022		9,217	5.24%
2023		18,750	3.27% ⁽¹⁾
Thereafter		67,211	4.21%
Total		\$ 95,178	4.13%

⁽¹⁾ See Note 8 in the accompanying condensed consolidated financial statements for discussion of the swap agreement entered into with the mortgage loan obtained in connection with the acquisition of Evolve at Allendale asset. The weighted average interest rate reflected is the strike rate.

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 mortgage loan, if the applicable 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 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.

The Company assumed an allocated principal mortgage loan amount of \$11.4 million in connection with the acquisition of The Detroit and Detroit Terraces on January 8, 2019. According to the terms of the note agreement, the contractual fixed interest rate is 3.99% and payments are interest only through September 30, 2022. The maturity date of the mortgage loan is on August 31, 2027.

On February 15, 2019, we entered into a Credit Agreement with Huntington National Bank. 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

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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 Company obtained a principal mortgage loan amount of \$18.8 million in connection with the acquisition of Evolve at Allendale on August 16, 2019. We entered into a swap agreement with respect to the loan, effective through August 31, 2023, to swap the variable interest rate to a fixed rate of approximately 3.27% per annum. The interest rate is based on the London Interbank Offered Rate (“LIBOR”) plus the applicable spread. The effective interest rate as of September 30, 2019, is approximately 3.95%.

Total debt outstanding as of September 30, 2019 and December 31, 2018 was \$95.2 million and \$35.4 million, respectively, and had a weighted average interest rate of 4.13% and 4.74%, respectively, per annum.

Summary of Cash Flows

Comparison of the nine months ended September 30, 2019 and 2018

	(in thousands)	
	Nine Months Ended September 30,	
	2019	2018
Net cash flows provided by operating activities	\$ 9,863	\$ 10,855
Net cash flows used in investing activities	(18,970)	(525)
Net cash flows provided by (used in) financing activities	46,120	(22,324)
Net increase (decrease) in cash, cash equivalents and restricted cash	37,013	(11,994)
Cash, cash equivalents and restricted cash, at beginning of period	83,741	56,007
Cash, cash equivalents and restricted cash, at end of period	\$ 120,754	\$ 44,013

Cash provided by operating activities was \$9.9 million for the nine months ended September 30, 2019 and \$10.9 million for the nine months ended September 30, 2018. Cash provided by operating activities decreased \$1.0 million compared to the same period in 2018, primarily as a result of the disposition of assets during 2018 and 2019.

Cash used in investing activities was \$19.0 million for the nine months ended September 30, 2019 compared to \$0.5 million for the nine months ended September 30, 2018. Cash used in investing activities increased \$18.4 million compared to the same period in 2018 as a result of the acquisition of multi-family assets partially offset by proceeds received from the disposition of one of our retail assets during the nine months ended September 30, 2019.

Cash provided by financing activities was \$46.1 million for the nine months ended September 30, 2019 compared to cash used in financing activities of \$22.3 million for the nine months ended September 30, 2018. Cash provided by financing activities for the nine months ended September 30, 2019 was primarily related to borrowings in the amount of \$30.0 million related to the Credit Facility and borrowings related to the acquisition of multi-family assets in the amount of \$18.7 million. See also Note 7 to the condensed consolidated financial statements for a summary of the Credit Agreement. Cash used in financing activities for the nine months ended September 30, 2018 was primarily related to the payoff of mortgage debt in the amount of \$19.5 million and prepayment penalties in the amount of \$1.1 million related to the sale of one of our retail assets.

We consider all demand deposits, money market accounts and investments in certificates of deposit and repurchase agreements with a maturity of nine months or less, at the date of purchase, to be cash equivalents. We maintain our cash and cash equivalents at financial institutions. The condensed 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.

Distributions

For the nine months ended September 30, 2019 and 2018, no cash distributions were paid by Highlands.

Off-Balance Sheet Arrangements

As of September 30, 2019 and December 31, 2018, we had no off-balance sheet arrangements.

Selected Financial Data

The following table shows our condensed consolidated selected financial data relating to our condensed consolidated historical financial condition and results of operations. Such selected data should be read in conjunction with the condensed consolidated financial statements and related notes appearing elsewhere in this report (dollar amounts are stated in thousands, except per share amounts).

	As of	
	September 30, 2019	December 31, 2018
Balance Sheet Data:		
Total assets	\$ 401,182	\$ 335,980
Debt, net	\$ 93,385	\$ 34,953

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Operating Data:				
Total revenues	\$ 9,198	\$ 11,649	\$ 29,857	\$ 33,117
Net income	\$ 518	\$ 12,389	\$ 9,584	\$ 12,849
Net income per common share, basic and diluted	\$ 0.00	\$ 0.01	\$ 0.01	\$ 0.01

Balance Sheet Data:				
Cash, cash equivalents and restricted cash	\$ 120,754	\$ 44,013	\$ 120,754	\$ 44,013
Long-term obligations (a)	\$ 95,478	\$ 35,088	\$ 95,478	\$ 35,088

Supplemental Measures (unaudited):				
Funds from operations (b)	\$ 3,581	\$ 3,519	\$ 9,265	\$ 10,301
Adjusted funds from operations (b)	\$ 3,581	\$ 4,718	\$ 9,265	\$ 11,500

Cash Flows Data:				
Net cash flows provided by operating activities	\$ 4,824	\$ 5,167	\$ 9,863	\$ 10,855
Net cash flows (used in) provided by investing activities	\$ (27,961)	\$ 11,827	\$ (18,970)	\$ (525)
Net cash flows (used in) provided by financing activities	\$ 18,568	\$ (20,908)	\$ 46,120	\$ (22,324)

(a) Includes right of use liabilities, principal amounts of mortgages payable and borrowings related to the Credit Facility.

(b) 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):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Net income attributable to Highlands REIT, Inc. common stockholders	\$ 508	\$ 12,389	\$ 9,574	\$ 12,849
Depreciation and amortization ^(a)	3,073	3,406	8,532	9,753
Gain on sale of investment properties, net	—	(12,276)	(8,841)	(12,301)
Funds from operations	3,581	3,519	9,265	10,301
Loss on extinguishment of debt	—	1,199	—	1,199
Adjusted funds from operations	\$ 3,581	\$ 4,718	\$ 9,265	\$ 11,500

(a) The depreciation and amortization add-back excludes the portion of expense attributable to the non-controlling interest.

Use and Limitations of Non-GAAP Financial Measures

FFO and AFFO do not represent cash generated from operating activities under GAAP and should not be considered as an alternative to net income or loss, operating profit, cash flows from operations or any other operating performance measure prescribed by GAAP. Although we present and use FFO and AFFO because we believe they are useful to investors in evaluating and facilitating comparisons of our operating performance between periods and between REITs that report similar measures, the use of this non-GAAP measure has certain limitations as an analytical tool. This non-GAAP financial measure is not a measure of our liquidity, nor is it indicative of funds available to fund our cash needs, including our ability to fund capital expenditures, contractual commitments, working capital, service debt or make cash distributions. This measurement does not reflect cash expenditures for long-term assets and other items that we have incurred and will incur. This non-GAAP financial measure may include funds that may not be available for management's discretionary use due to functional requirements to conserve funds for capital expenditures, property acquisitions and other commitments and uncertainties. This non-GAAP financial measure, as presented, may not be comparable to non-GAAP financial measures as calculated by other real estate companies.

We compensate for these limitations by separately considering the impact of these excluded items to the extent they are material to operating decisions or assessments of our operating performance. Our reconciliation to the most comparable GAAP financial measures, and our condensed consolidated statements of operations and comprehensive income and cash flows, include interest expense, capital expenditures and other excluded items, all of which should be considered when evaluating our performance, as well as the usefulness of our non-GAAP financial measure. This non-GAAP financial measure reflects an additional way of viewing our operations that we believe, when viewed with our GAAP results and the reconciliation to the corresponding GAAP financial measure, provides a more complete understanding of factors and trends affecting our business than could be obtained absent this disclosure. We strongly encourage investors to review our financial information in its entirety and not to rely on a single financial measure.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are subject to market risk associated with changes in interest rates both in terms of variable-rate debt and the price of new fixed-rate debt upon maturity of existing debt and for acquisitions.

Interest Rate Risk

Our interest rate risk management objectives are to limit the impact of interest rate changes on earnings and cash flows and to lower our overall borrowing costs. As of September 30, 2019, our debt included an outstanding variable-rate term loan of \$30.0 million and a variable rate mortgage loan of \$18.8 million, which has been swapped to a fixed rate. If market rates of

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interest on all variable-rate debt as of September 30, 2019, that is not under a swap agreement, permanently increased or decreased by 1%, the annual increase or decrease in interest expense on the variable-rate debt and future earnings and cash flows would be approximately \$0.3 million.

With regard to our variable-rate financing, we assess interest rate cash flow risk by identifying and monitoring changes in interest rate exposures that may adversely impact expected future cash flows and by evaluating hedging opportunities. We maintain risk management control systems to monitor interest rate cash flow risk attributable to both outstanding or forecasted debt obligations.

We may use financial instruments to hedge exposures to changes in interest rates on loans. To the extent we do, we are exposed to credit risk and market risk. Credit risk is the risk of failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes us, which creates a credit risk for us. When the fair value of a derivative contract is negative, we owe the counterparty and, therefore, it does not pose credit risk. We seek to minimize the credit risk in derivative instruments by entering into transactions with what we believe are high-quality counterparties. Market risk is the adverse effect on the value of a financial instrument resulting from a change in interest rates.

In the event that LIBOR is discontinued, the interest rate for certain of our debt instruments, including our unsecured Revolving Credit Facility due 2022, unsecured Term Loan Facility due 2024 and interest rate swap agreements that are indexed to LIBOR, will be based on a replacement rate or an alternate base rate as specified in the applicable documentation governing such debt or swaps or as otherwise agreed upon. Such an event would not affect our ability to borrow or maintain already outstanding borrowings or swaps, but the replacement rate or alternate base rate could be higher or more volatile than LIBOR prior to its discontinuance. We understand that LIBOR is expected to remain available through the end of 2021, but may be discontinued or otherwise become unavailable thereafter.

Our credit facilities and interest rate swaps are indexed to USD-LIBOR. However, as our Credit Facility and interest rate swap agreements have provisions that allow for a transition to a new alternative rate, we believe that the transition from USD-LIBOR to the alternative rate will not have a material impact on our condensed consolidated financial statements.

As of September 30, 2019, we had one derivative financial instrument designated as a cash flow hedge, with a notional amount of \$18.8 million and a maturity date of September 1, 2023. The fair value of the derivative was \$0.01 million as of September 30, 2019 and is included in other liabilities in the accompanying consolidated condensed balance sheets. The gains or losses resulting from marking-to-market our derivative financial instruments during the periods presented are recognized as an increase or decrease in comprehensive income on our condensed consolidated statements of operations and comprehensive income.

Item 4. 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 September 30, 2019, 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 September 30, 2019, were effective at a reasonable assurance level for the purpose of ensuring that information required to be disclosed by us in this Quarterly 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.

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 September 30, 2019 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II.

Item 1. 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 1A. Risk Factors

Not applicable.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

The exhibits filed in response to Item 601 of Regulation S-K are listed on the Exhibit Index attached hereto and are incorporated herein by reference.

EXHIBIT NO.	DESCRIPTION
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	Offer Letter, dated June 6, 2019, by and between Highlands REIT, Inc. and Kimberly A. Karas (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 July 12, 2019)
10.2	Change in Control and Severance Agreement, dated as of July 8, 2019, by and between Highlands REIT, Inc. and Kimberly A. Karas (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 July 12, 2019)
10.3*	Purchase and Sale Agreement, dated as of September 26, 2019, by and between Hill University Partners Owner, LLC and The Muse Owner, LLC
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
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 Quarterly Report on Form 10-Q.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

<u>Signature</u>	<u>Date</u>
<u>/s/ Richard Vance</u> Name: Richard Vance Title: President and Chief Executive Officer (Principal Executive Officer)	November 12, 2019
<u>/s/ Paul Melkus</u> Name: Paul Melkus Title: Executive Vice President and Chief Financial Officer (Principal Financial Officer)	November 12, 2019

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Section 2: EX-10.3 (EXHIBIT 10.3)

PURCHASE AND SALE AGREEMENT

THIS PURCHASE AND SALE AGREEMENT (the “Agreement”) is made as of September 26, 2019 (the “Effective Date”), by and between **HILL UNIVERSITY PARTNERS OWNER, LLC**, a Delaware limited liability company (“Seller”), and **THE MUSE OWNER, LLC**, a Delaware limited liability company (“Purchaser”).

WITNESSETH:

Seller is the owner of the “Property” (more specifically defined herein) located at 2270 South University Boulevard, Denver Colorado. On the terms set forth herein, Seller desires to sell the Property to Purchaser and Purchaser desires to purchase the Property from Seller.

NOW THEREFORE, In consideration of the foregoing recitals, One Hundred and 00/100 Dollars (\$100.00) (the “Contract Consideration”) and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, Seller and Purchaser hereby agree as follows:

**ARTICLE 1
PURCHASE AND SALE**

1.1 Agreement of Purchase and Sale. Subject to the terms and conditions hereinafter set forth, Seller agrees to sell and convey and Purchaser agrees to purchase the following:

1.1.1 that certain tract or parcel of land situated in Denver County, Colorado more particularly described on **EXHIBIT A** attached hereto and made a part hereof, together with all and singular the rights and appurtenances pertaining to such property, including any right, title and interest of Seller in and to adjacent streets, alleys or rights-of-way, strips or gores, privileges, easements, and

development, mineral and air rights (collectively, the “Land”);

1.1.2 the buildings, structures, fixtures and other improvements on the Land, including specifically, without limitation, that certain apartment building, consisting of 120 residential apartment units (“Residential Units”), one ground-floor leasing office, and 137 parking spaces, having a street address of 2270 South University Boulevard, Denver, Colorado (collectively, the “Improvements”);

1.1.3 all of Seller’s right, title and interest in and to all tangible personal property upon the Land or within the Improvements or used exclusively in connection with the operation, ownership, maintenance, management, leasing or occupancy of the Improvements, including specifically, without limitation, appliances, furniture, art work, carpeting, draperies and curtains, office equipment, tools and supplies, materials not incorporated in the Improvements and held for repairs and replacements, satellite dishes, and other items of personal property (excluding cash) used exclusively in connection with the operation of the Land and the Improvements, and those personal property items set forth on **EXHIBIT D** attached hereto (collectively, the “Personal Property”);

1.1.4 all of Seller’s right, title and interest in and to (i) all leases, subleases, licenses and other occupancy contracts, whether or not of record, which provide for the use or occupancy of the Residential Units, space and/or facilities on or relating to the Land or Improvements and which are in effect as of the Effective Date and in force as of the Closing Date (including, without limitation, any and all modifications, extensions and amendments thereto) (collectively, the “Leases”) as listed and described on **EXHIBIT B** (the “Rent Roll”) attached hereto and made a part hereof, to the extent in force as of the Closing Date; (ii) any new Leases or modifications to existing Leases entered into after the Effective Date in accordance with this Agreement to the extent in force as of the Closing Date; and (iii) all security deposits and guaranties held by Seller under the Leases as of the Closing Date; and

1.1.5 all of Seller's right, title and interest in and to: (i) all assignable contracts relating to the upkeep, repair, maintenance, management or operation of the Land, Improvements or Personal Property, including, but not limited to, all service and maintenance contracts, employment agreements, collective bargaining agreements, equipment leases, utility agreements, management agreements, parking agreements and other agreements relating to or affecting any portion of the Property (collectively, the "Operating Agreements") which will extend beyond the date of Closing provided such are not terminated in accordance with Section 5.3.5 including, without limitation: (A) the Operating Agreements listed and described on EXHIBIT C (the "Operating Agreements Schedule") attached hereto and made a part hereof, to the extent in force as of the Closing Date; and (B) any new Operating Agreements or modifications to existing Operating Agreements entered into after the Effective Date in accordance with this Agreement to the extent in force as of the Closing Date; (ii) all assignable business or other licenses, franchises, bonds, certificates of occupancy, authorizations, approvals and permits affecting or otherwise used in or relating to the ownership, occupancy or operation of any part of the Land, Improvements or Personal Property; (iii) all domain names, URLs, websites, trade names, trademarks, service marks, copyrights and goodwill associated with the ownership and operation of the Land or Improvements (iv) all assignable existing warranties and guaranties, if any, issued in connection with the Improvements or the Personal Property, and (v) all plans and specifications for the Improvements (items (ii), (iii), (iv) and (v), collectively, the "Intangibles"). The term "Intangibles" shall exclude any computer software, phone systems, corporate licenses and financial reporting systems.

1.2 Property Defined. The Land, the Improvements, the Personal Property, the Leases, the Operating Agreements and the Intangibles are hereinafter sometimes referred to collectively as the "Property." The Property shall not include any bank accounts of Seller or Seller's right to payments of Delinquent Rent pursuant to Section 4.4.6 below.

1.3 Permitted Exceptions. The Property shall be conveyed subject to the matters which are, or are deemed to be, Permitted Exceptions pursuant to Article 2 hereof (herein collectively referred to as the "Permitted Exceptions").

1.4 Purchase Price. Seller is to sell and Purchaser is to purchase the Property for a total of Forty Eight Million Seven Hundred Thousand Dollars (\$48,700,000) (the "Purchase Price").

1.5 Payment of Purchase Price. The Purchase Price, as increased or decreased by prorations and adjustments as herein provided, shall be payable in full at Closing in cash by wire transfer of immediately available federal funds to an escrow bank account of the Escrow Agent (as defined in Section 1.6 below).

1.6 Earnest Money. Within three (3) business days after the Effective Date, Purchaser shall deposit with Fidelity National Title (the "Escrow Agent"), having its office at 8055 E. Tufts Ave., Suite 300, Denver, Colorado, Attention: Elizabeth Greco grecoe@fnf.com the sum of Two Million Dollars (\$2,000,000) (the "Earnest Money") in good funds, by federal wire transfer. All references in this Agreement to Earnest Money shall be deemed to refer to the Earnest Money, together with all interest earned thereon.

1.7 Contract Consideration. Notwithstanding anything to the contrary herein, the parties acknowledge and agree that the Contract Consideration (receipt of which is hereby acknowledged by Seller) (a) is not deemed a portion of the Purchase Price, (b) constitutes separate and independent consideration from Purchaser to Seller for the execution of this Agreement by Seller and delivery thereof to Purchaser, and (c) shall not be refundable by Seller to Purchaser notwithstanding any termination of this Agreement by Purchaser or Seller.

1.8 Escrow Account; Escrow Agent Liability; Joinder.

1.8.1 On or prior to the deposit of the Earnest Money, Seller and Purchaser shall open an escrow account with the Escrow Agent (the "Escrow Account") by delivering to Escrow Agent a fully executed copy of this Agreement. The Escrow Agent shall hold the Earnest Money in the Escrow Account in accordance with the terms and conditions of this Agreement. The Earnest Money shall be held in FDIC insured account (s) and shall not be commingled with the funds of Escrow Agent. Escrow fees and expenses shall be shared equally by Seller and Purchaser. If the Closing does not occur at the time and in the manner provided in this Agreement because of the default of one of the parties, all costs of cancellation of the Escrow Account, if any, shall be paid by the defaulting party. If requested by

Purchaser, Escrow Agent shall invest the Earnest Money in an interest-bearing account upon receipt of a W-9 and investment instructions from Purchaser. If Purchaser terminates this Agreement by written notice to Seller on or before the expiration of the Due Diligence Period, upon Escrow Agent's receipt of such unilateral notice, the Earnest Money shall be immediately delivered by Escrow Agent to Purchaser without any further instruction or approval by Seller to Escrow Agent, and neither party hereto shall have any further rights, obligations or liabilities hereunder except to the extent that any right, obligation or liability set forth herein expressly survives termination of this Agreement. Unless Purchaser has timely exercised its right to terminate this Agreement under Section 3.2, after the expiration of the Due Diligence Period, the Earnest Money shall be nonrefundable to Purchaser, except as otherwise expressly set forth in this Agreement.

1.8.2 The parties acknowledge that Escrow Agent is acting solely as a stakeholder at their request and for their convenience, and that Escrow Agent shall not be deemed to be the agent of either of the parties. Escrow Agent shall not be liable for any action taken by Escrow Agent in good faith in conformity with the provisions of this Agreement, including any action in holding or dealing with the Earnest Money, except for Escrow Agent's gross negligence or willful misconduct. Escrow Agent, in its capacity as escrow agent, shall be entitled to rely on any document or paper received by it, believed by such Escrow Agent, in good faith, to be bona fide and genuine. In the event of any dispute as to the disposition of the Earnest Money or any other monies held in escrow, or of any documents held in escrow, Escrow Agent may, if such Escrow Agent so elects, interplead the matter by filing an interpleader action in a court of general jurisdiction in the county or circuit where the Property is located (to the jurisdiction of which both parties do hereby consent), and pay into the registry of the court the Earnest Money, or deposit any such documents with respect to which there is a dispute in the registry of such court, whereupon such Escrow Agent shall be relieved and released from any further liability as Escrow Agent hereunder. All costs and expenses (including reasonable attorneys' fees) incurred by the party who prevails in the interpleader suit, including any amounts required to be deposited to replace any depletion of the Earnest Money charged by Escrow Agent to pay its escrow fees, shall immediately be paid by the non-prevailing party to the prevailing party. Escrow Agent shall not be liable for Escrow Agent's compliance with any legal process, subpoena, writ, order, judgment and decree of any court, whether issued with or without jurisdiction, and whether or not subsequently vacated, modified, set aside or reversed. Escrow Agent undertakes to perform only such duties as are expressly set forth in this Agreement and no implied duties or obligations shall be read into this Agreement against Escrow Agent.

1.8.3 Escrow Agent has executed this Agreement in the place indicated on the signature page hereof in order to confirm that Escrow Agent has received and shall hold the Earnest Money in escrow, and shall disburse the Earnest Money and take such other actions as described herein pursuant to the provisions of this Agreement. Escrow Agent shall not be considered a party to this Agreement for any other purpose. If at any time hereafter this Agreement shall be amended by Purchaser and Seller in writing, it shall not be necessary for Escrow Agent to join in or execute such amendment provided that no such amendment may specifically modify Escrow Agent's express obligations set forth in this Agreement. It is understood and agreed that an amendment to any time period or deadline set forth in this Agreement shall not be deemed an amendment to Escrow Agent's express obligations of this Agreement requiring Escrow Agent's acknowledgment. Copies of any amendment to this Agreement may be delivered by either party to Escrow Agent. Upon receipt of any such amendment, Escrow Agent agrees to observe and comply with the terms of any such amendment made in accordance herewith.

ARTICLE 2 TITLE AND SURVEY

2.1 Commitment for Title Insurance. Within ten (10) days after the Effective Date, Seller shall deliver to Purchaser a commitment for an ALTA 2006 title insurance policy with an effective date no earlier than thirty (30) days prior to the Effective Date (the "Title Commitment") prepared by Fidelity National Title Insurance Company (the "Title Company") covering the Property, together with copies of all instruments referenced in Schedule B of the Title Commitment (the "Title Documents"). Delivery of the Title Commitment and the Title Documents may be made by way of electronic document portal provided by the Title Company to which Purchaser is granted access.

2.2 Survey. Seller shall deliver the Existing Survey, as defined in Section 3.3.12, to Purchaser and Purchaser may, at its cost and in its discretion, order a surveyor to update the Existing Survey (such updated survey, the "Updated Survey").

2.3 Title Objections; Cure of Title Objections.

2.3.1 Purchaser shall have through the date that is the later of seven (7) business days after (a) receipt of the last of the Title Commitment, the Title Documents and the Updated Survey (the "Title Objection Deadline"), and (b) the Effective Date, but in no event later than the expiration of the Due Diligence Period to examine title to the Property and to provide Seller with a written notice (a "Title Objection Notice") of any objections Purchaser may have to any exceptions to title disclosed in the Title Commitment or matters disclosed by the Updated Survey. Any exception to title disclosed in the Title Commitment or the Updated Survey to which Purchaser does not object to in the Title Objection Notice shall be deemed a Permitted Exception. In addition, Permitted Exceptions shall include: (i) the rights of tenants, as tenants only, under the Leases, (ii) the lien of real estate taxes and assessments not yet due and payable, and (iii) that certain Restrictive Covenant Concerning Condominium Ownership recorded in the real property records on April 13, 2016, at Reception No. 2016047160.

2.3.2 In the event Purchaser timely delivers a Title Objection Notice, Seller shall have the right, but not the obligation, to attempt to remove, satisfy or otherwise cure any exceptions to title so objected to in the Title Objection Notice. Notwithstanding the foregoing, at or prior to Closing, Seller, at its sole cost and expense, shall cause to be removed of record from the Property: (a) any deed of trust or mortgage or other similar security instruments (including, without limitation, any UCC financing statements) arising by, through or under Seller, (b) any mechanic's, materialman's or supplier's liens arising by, through or under Seller, and (c) delinquent taxes or assessments (collectively, "Monetary Liens"). On or before 5:00 PM (Denver Time) on the date that is five (5) business days after receipt of a timely Title Objection Notice, Seller may give written notice (a "Title Response") to Purchaser informing Purchaser of Seller's election with respect to the matters noted in the Title Objection Notice. If Seller fails to give a Title Response on or before such date and time, Seller shall be deemed to have elected not to cure all of the matters objected to in the Title Objection Notice. If Seller elects to cure the exceptions in its Title Response, Seller shall be required to do so. Seller's failure to cure any such exceptions that it has elected to cure prior to Closing shall entitle Purchaser to its remedies under Section 6.2 hereof.

2.3.3 If Seller elects not to cure, or is deemed to have elected not to cure, any exceptions to title set forth in the Title Objection Notice, Purchaser's sole remedy hereunder in such event shall be either: (i) to accept title to the Property subject to such exceptions as if Purchaser had not objected thereto and without reduction of the Purchase Price, or (ii) to terminate this Agreement, whereupon the Earnest Money shall be returned to Purchaser and neither party hereto shall have any further rights, obligations or liabilities hereunder except to the extent that any right, obligation or liability set forth herein expressly survives termination of this Agreement.

2.3.4 To terminate this Agreement pursuant to this Section 2.3, Purchaser must give written notice to Seller of its election to terminate this Agreement not later than five (5) business days after Seller notifies Purchaser that Seller elects not to cure, or is deemed to have elected not to cure, any title objections set forth in the Title Objection Notice.

2.4 Conveyance of Title. At Closing, Seller shall convey and transfer to Purchaser (or its permitted assignee) such title to the Property as will enable the Title Company to issue to Purchaser (or its permitted assignee) an ALTA 2006 Owner's Policy of Title Insurance with extended coverage (the "Title Policy") covering the Property in the full amount of the Purchase Price and reflecting no exceptions to title other than the Permitted Exceptions. It shall not be a condition to Closing that the Title Policy contain any endorsements (other than an endorsement over the general exceptions and those endorsements Seller has expressly agreed to obtain, including, without limitation, pursuant to a Title Response).

2.5 Amendments to Title Commitment. Purchaser shall have the right to object to any title exceptions first raised by the Title Company in any updates and/or amendments to the Title Commitment or any amendments to the Updated Survey ("New Exceptions") by giving written notice to Seller of the New Exceptions to which Purchaser

is objecting within five (5) business days after the receipt by Purchaser of any such update and/or amendment (and the Closing Date shall be extended as necessary to allow Purchaser time to review and object to any New Exception). If Purchaser does not object to any New Exception by giving timely written notice as herein provided, such New Exception shall be a Permitted Exception. In the event Purchaser gives timely written notice of objection to any New Exception as herein provided, Seller shall have three (3) business days to respond to such and Purchaser's rights and Seller's obligations with respect thereto shall be the same as provided with respect to the Title Objection Notice pursuant to the provisions of Section 2.3 (and the Closing Date shall be extended as necessary to allow for Seller to respond to Purchaser's notice, if at all).

ARTICLE 3 DUE DILIGENCE PERIOD

3.1 Right of Inspection. During the period beginning upon the Effective Date and ending at 5:00 p.m. MST on September 17, 2019 (hereinafter referred to as the "Due Diligence Period"), Purchaser shall have the right to make a physical inspection of the Property (but Purchaser may not do any invasive testing, such as core sampling or drilling wells, without Seller's prior written approval) and to examine at such place or places at the Property, in the offices of Seller's property manager, GREP Southwest, LLC, a Delaware limited liability company (the "Property Manager") or elsewhere at the Property as the same may be located, any operating files maintained by Seller or its Property Manager in connection with the ownership, leasing, maintenance and/or management of the Property, including, without limitation, the Leases, lease files, Operating Agreements, insurance policies, bills, invoices, receipts and other general records relating to the income and expenses of the Property, correspondence, surveys, plans and specifications, warranties for services and materials provided to the Property, but excluding materials which are not directly related to the ownership, leasing, maintenance and/or management of the Property such as Seller's internal memoranda, financial projections, budgets, appraisals, accounting and tax records and similar proprietary or confidential information. Seller agrees to provide Purchaser with any such files related to the ownership, leasing, maintenance and/or management of the Property promptly after Purchaser's request therefor. Purchaser understands and agrees that any on-site inspections or testing of the Property shall be conducted upon at least twenty-four (24) hours' prior notice to Seller. Purchaser agrees to restore the Property to substantially the same condition existing immediately prior to Purchaser's inspection in the event of any damage to the Property caused by Purchaser or its agents or invitees and to indemnify against and hold Seller harmless from any claim for liabilities, costs, expenses (including reasonable attorneys' fees actually incurred) damages or injuries arising out of or resulting from Purchaser's or its agents' or invitees' entry onto, inspection or testing of, or use of the Property; provided, however, in no event shall Purchaser be liable for, and any such indemnity from Purchaser will not include any claims to the extent caused by, (i) pre-existing conditions (except to the extent exacerbated by the negligence or willful misconduct of Purchaser or Purchaser's agents) and/or (ii) the fraud, gross negligence or willful misconduct of Seller or any of Seller's members, employees, licensees, contractors, agents and invitees, and notwithstanding anything to the contrary in this Agreement, such obligation to indemnify and hold harmless Seller shall survive Closing or any termination of this Agreement. Purchaser shall maintain commercial general liability and property damage insurance in an amount equal to or greater than \$1,000,000 per occurrence, and not less than \$2,000,000 in the aggregate, and in form and substance adequate to insure against all liability of Purchaser and its consultants, and each of its agents, employees or contractors, arising out of the inspections or testing. Evidence of such insurance coverage shall be produced upon request from Seller and, if required by Seller, Seller shall be named as an additional named insured on Purchaser's insurance certificates prior to Purchaser's (or its agent's) entry upon the Property. If Purchaser desires to contact tenants or conduct interviews with any tenants, Purchaser shall have the right to do so, and Seller or Property Manager shall arrange for a tenant interview/meeting with each tenant at a mutually convenient time for Purchaser, Seller (and/or Property Manager) and the tenant and Seller shall have the right to have a representative (including Property Manager) present, at all times, during such tenant interview/meeting. Purchaser agrees that its contact and discussions with and interviews of tenants shall only be conducted in accordance with the provisions outlined above, provided, however, that Seller shall not be in default under this Agreement in the event that any tenant shall refuse or fail to meet with Purchaser. The terms and provisions of this Section 3.1 shall also apply to any inspections or investigations conducted by Purchaser prior to the Effective Date, and, to the extent that Purchaser does not terminate this Agreement prior to the expiration of the Due Diligence Period pursuant to Section 3.2 below, Purchaser is permitted to continue to make inspections of the Property after the expiration of the Due Diligence Period and through the Closing Date in accordance with the terms and provisions of this Section 3.1.

3.1.1 Notwithstanding anything to the contrary contained herein, and subject at all times to the rights of tenants under the Leases: (i) Seller and Purchaser shall agree on a date and time prior to the expiration of the Due Diligence Period during which Purchaser may inspect all of the Residential Units, including any occupied Residential Units; and (ii) Purchaser shall have the right to inspect not less than ten (10) of the Residential Units at the Property of Purchaser's choosing (in its sole discretion) ("Final Inspection") on the date that is two (2) days prior to the Closing Date without being required to provide the notice required by this Section 3.1 for such inspection.

3.2 Termination. Purchaser acknowledges and agrees that Purchaser: (i) has had the opportunity to inspect the Property; and, (ii) shall no longer have any right to terminate this Agreement based solely upon the Due Diligence Period under this Section 3.2. Purchaser shall be bound to proceed to Closing and consummate the transaction contemplated hereby pursuant to the terms of this Agreement (subject to Seller's performance and any other express right of termination provided herein).

3.3 Due Diligence Information. Purchaser acknowledges that, pursuant to an Access, Indemnity and Confidentiality Agreement between Purchaser and Seller dated August 12, 2019 (the "Access Agreement"), Seller has delivered or caused to be delivered to Purchaser (or made available on-site or through a document portal on the Internet which Purchaser has free access to) copies of the following documents, schedules and other information described below to the extent in Seller's or Property Manager's possession or control (without any requirement that Seller be required to create or obtain any financial reports or documents not currently maintained by Seller or Property Manager or modify the standard format in which it currently produces such reports or documents) (collectively, the "Due Diligence Information"):

3.3.1 Rent Roll and Leases. A copy of the Rent Roll for the Property, which includes an itemization of the security deposit held under each Lease, along with copies of all Leases (including all amendments, modifications, supplements and correspondence), and all residential lease files (which shall be made available for on-site inspection).

3.3.2 Delinquency Report. A complete list and description of any and all monetary delinquencies or defaults under any of the Leases and copies of aged A/R and collection correspondence (which shall be made available for on-site inspection).

3.3.3 Operating Agreements. Copies of service contracts and a summary sheet listing all in-place contracts and contacts with service providers to the Property.

3.3.4 Permits. Copies of all current certificates of occupancy and parking permits or licenses relating to or affecting the Property (collectively "Permits") of or from any person, including any governmental authority, held by Seller or Property Manager, including any pending applications.

3.3.5 Property Taxes. Copies of the tax bills for the last three (3) full calendar years and year to date with respect to the Property, including, without limitation, real and personal property taxes and any special assessments.

3.3.6 Operating Statements. Detailed property income and operating expenses in Yardi format for 2018 and 2019 year-to-date.

3.3.7 Prior Studies. Copies of the most recent third-party studies and reports with respect to the environmental status and physical condition of the Property.

3.3.8 Plans. All development plans and documents, including, but not limited to, all engineering and architectural reports (provided, however, such may be made available at the Property).

3.3.9 Insurance. Copies of Seller's certificates of insurance for the Property and a recent so-called "loss run" report.

3.3.10 Zoning Reports. Copy of any zoning report for the Property.

3.3.11 Litigation. A list and description of all threatened or pending litigation, action or dispute relating to the Property.

3.3.12 Existing Title Policy and Survey. Seller's existing title insurance policy and most recent ALTA Survey (the "Existing Survey"), including all endorsements and all documents pertaining to exceptions noted in such policy or survey.

Except for Seller's Representations (as defined in Section 5.2.1), Seller makes no representations or warranties as to the truth, accuracy or completeness of any of the Due Diligence Information. It is the parties' express understanding and agreement that subject to Seller's Representations, any Due Diligence Information is provided only for Purchaser's convenience in making its own examination and determination prior to the end of the Due Diligence Period as to whether it wishes to purchase the Property, and, in doing so, Purchaser shall rely exclusively on its own independent investigation and evaluation of every aspect of the Property and Seller's Representations and not on any Due Diligence Information or other materials supplied by Seller or Property Manager.

ARTICLE 4 CLOSING

4.1 Time and Place. The consummation of the transaction contemplated hereby ("Closing") shall be held through an escrow at the offices of Title Company, on October 18, 2019 (the "Closing Date"). The Closing shall occur on a so-called "New York style" basis with the disbursement of closing funds prior to the recordation of the Deed, but only upon satisfaction of the conditions precedent to Closing set forth herein. At Closing, Seller and Purchaser shall perform the obligations set forth in, respectively, Section 4.2 and Section 4.3, the performance of which obligations shall be concurrent conditions.

4.1.1 Extension of the Closing Date. Either party to this Agreement shall have a one-time right to extend the Closing Date to any business day on or before October 28, 2019 upon written notice to the non-extending party on or before October 18, 2019.

4.2 Seller's Obligations at Closing. At Closing, Seller, at its sole cost and expense,

shall:

4.2.1 deliver to Purchaser a duly executed special warranty deed (the "Deed"), in the form attached hereto as EXHIBIT E, conveying the Land and Improvements, subject only to the Permitted Exceptions;

4.2.2 deliver to Purchaser a duly executed bill of sale conveying the Personal Property in the form attached hereto as EXHIBIT F;

4.2.3 assign to Purchaser, and Purchaser shall assume, the landlord/lessor interest in and to the Leases in effect as of the Effective Date and remaining in force as of the Closing Date or entered into after the Effective Date in accordance with this Agreement by duly executed assignment and assumption agreement in the form attached hereto as EXHIBIT G;

4.2.4 assign to Purchaser, and Purchaser shall assume, Seller's interest in the Operating Agreements (not including those terminated pursuant to this Agreement) and the other Intangibles by duly executed assignment and assumption agreement in the form attached hereto as EXHIBIT H;

4.2.5 join with Purchaser to execute a notice (the "Tenant Notices") in form attached hereto as EXHIBIT I, which Purchaser shall send to each tenant under each of the Leases;

4.2.6 deliver to Purchaser a certificate, dated as of the date of Closing and executed on behalf of Seller by a duly authorized officer thereof, in form attached hereto as EXHIBIT J (the "Bring-Down Certificate"), stating that the Seller's Representations, as they may have been modified in accordance with Subsection 5.2.1, are true and correct as of the date of Closing;

4.2.7 deliver to Purchaser and the Title Company such evidence as such parties may reasonably require as to the authority of the person or persons executing documents on behalf of Seller, including certified copies of organizational documents, good standing certificates (dated within 30 days of the then scheduled Closing Date), and resolutions;

4.2.8 deliver to Purchaser an affidavit duly executed by Seller (or a non-disregarded controlling entity), in form attached hereto as **EXHIBIT K**, stating that Seller (or a non-disregarded controlling entity) is not a “foreign person” as defined in the Federal Foreign Investment in Real Property Tax Act of 1980 and the 1984 Tax Reform Act;

4.2.9 join with Purchaser to execute a notice (the “Vendor Notices”) in form attached hereto as **EXHIBIT L**, which Purchaser shall send to each vendor under the Operating Agreements assumed by Purchaser;

4.2.10 deliver to the Title Company a form of owner’s affidavit and other documents or undertakings, reasonably satisfactory to Seller, sufficient to cause the Title Policy to be issued in accordance with this Agreement, along with a gap indemnity; provided, however, in no event shall such documents expand the scope of Seller’s obligations or liabilities under this Agreement;

4.2.11 deliver to the Title Company a settlement statement/closing statement setting forth the Purchase Price and all additions and subtractions thereto made in accordance with the terms and conditions of this Agreement;

4.2.12 deliver to the Title Company any required state, county and city transfer declarations executed by Seller;

4.2.13 deliver to Purchaser evidence of the termination of the Terminated Contracts (as defined below), the Management Agreement (as defined below), and other agreements with affiliates of the Seller relating to the Property (if any);

4.2.14 deliver to Purchaser and the Title Company an executed IRS Form 1099;

4.2.15 deliver to Purchaser and the Title Company the executed Escrow Agreement;

4.2.16 deliver to Purchaser and the Title Company a lien waiver from the Property Manager; and

4.2.17 deliver to Purchaser such other documents as may be reasonably required to effectuate the transactions contemplated by this Agreement and/or to effectuate the closing of the transaction contemplated hereunder, provided however, in no event shall such documents expand the scope of Seller’s obligations or liabilities under this Agreement.

4.3 Purchaser’s Obligations at Closing. At Closing, Purchaser shall:

4.3.1 pay to Seller the full amount of the Purchase Price, as increased or decreased by prorations and adjustments as herein provided, in immediately available wire transferred funds, it being agreed that at Closing the Earnest Money shall be delivered to Seller and applied towards payment of the Purchase Price;

4.3.2 join Seller in execution of the instruments described in Subsections 4.2.3, 4.2.4, 4.2.5, 4.2.9, 4.2.11, 4.2.12, and 4.2.15 above;

4.3.3 deliver to the Title Company such evidence as the Title Company may reasonably require as to the authority of the person or persons executing documents on behalf of Purchaser; and

4.3.4 deliver to Seller such other documents as may be reasonably required to effectuate the transactions contemplated by this Agreement and/or to effectuate the closing of the transaction contemplated hereunder,

provided however, in no event shall such documents expand the scope of Purchaser's obligations or liabilities under this Agreement.

4.4 Credits and Prorations.

4.4.1 Except as otherwise specified in the other subsections of this Section 4.4 (including with respect to rents and real estate and personal property taxes and assessments), the following shall be apportioned with respect to the Property as of 12:01 A.M., on the day of Closing, as if Purchaser were vested with title to the Property during the entire day upon which Closing occurs: (i) rents, if any, as and when collected (the term "rents" as used in this Agreement includes all payments due and payable by tenants under the Leases, and pre-paid rents), (ii) real estate and personal property taxes and assessments levied against the Property (such to be done on an "accrual basis" with Seller responsible for payment, either directly or through a credit to Purchaser, of all real estate and personal property taxes and assessments for each day of Property ownership by Seller), (iii) payments under the Operating Agreements assumed by Purchaser in accordance with this Agreement, (iv) gas, electricity and other utility charges for which Seller is liable, if any, such charges to be apportioned at Closing on the basis of the most recent meter reading occurring prior to Closing, and (v) any other operating expenses or other items pertaining to the Property which are customarily prorated between a purchaser and a seller in the area in which the Property is located. Seller shall be responsible for and shall pay all operating expenses and trade accounts of the Property (including charges and fees under the Operating Agreements) in the ordinary course of business up to and including 11:59 P.M. on the day preceding the Closing Date. To the extent any operating expenses and amounts owing under trade accounts are known or can be determined as of the Closing Date, Seller shall pay such items at Closing. Charges which are payable by any tenant to a third party shall not be apportioned hereunder (i.e. trash removal expenses).

4.4.2 At Closing, Seller shall credit to the account of Purchaser the amount of all security deposits under the Leases (to the extent such security deposits have not been applied against delinquent rents or otherwise as provided in the applicable Lease and in accordance with this Agreement). Seller shall not have the right to draw upon any tenant security deposits under Leases after the Closing. If any Lease security deposits are not in the form of cash, such as a letter of credit or certificate of deposit, Seller shall deliver at Closing such non-cash security deposits and any other documents or instruments duly executed by Seller as necessary to conform to the procedures established by the issuer or depository institution to assign or otherwise transfer to Purchaser the benefits of such security deposits (such transfer to be effectuated only after Closing) and Purchaser shall be credited with the amount of any transfer fees due thereunder.

4.4.3 Seller shall pay any real estate and personal property taxes and assessments with respect to the Property (i) which are delinquent or (ii) which are due and payable on or prior to the Closing Date but not yet delinquent. Real estate and personal property taxes and assessments with respect to the Property that are not yet due and payable as of the Closing Date and accrued in the tax year or years prior to Closing, together with any costs incurred by Seller in protesting such taxes or assessments on the Property if such protest shall apply to tax periods after the Closing, shall be prorated on an accrual basis based on the portion of the tax year or years which has elapsed prior to the Closing Date.

Seller acknowledges that Purchaser shall have the right to control the progress of and to make all decisions with respect to any a real property tax contest, appeal, or protest for the Real Property (a "Protest") assessed for all tax years during or after the tax year in which the Closing occurs. If, after the Closing, Purchaser or Seller receives (in the form of a refund, credit, or otherwise) any amounts as a result of a Protest, such amounts will be applied as follows: first, to reimburse Purchaser or Seller, as applicable, for all costs incurred in connection with the Protest; and second to Purchaser to the extent that such refund applies to the period from and after the Closing Date and to Seller to the extent that such refund applies to the period prior to the Closing Date.

4.4.4 Utilities payable by the owner of the Property, including, without limitation, steam, water, electricity and natural gas (but not including propane or other fuel which may be stored at the Property), which are not directly paid by tenants, shall be prorated as of the Closing. Seller shall use reasonable efforts to cause the meters, if any, for utilities to be read the day on which the Closing Date occurs and to pay the bills rendered on the basis of such readings. If any such meter reading for any utility is not available, then adjustment therefor shall be made on the basis

of the most recently issued bills therefor which are based on meter readings no earlier than thirty (30) days prior to the Closing Date; and such adjustment shall be reprinted when the next utility bills are received. Seller shall be entitled to receive a refund of such deposits from the utility companies, and Purchaser shall post its own deposits.

4.4.5 Intentionally deleted.

4.4.6 All collected rent and other collected income under Leases in effect on the Closing Date for the month in which Closing occurs shall be prorated as of the Closing. On the Closing Date, Seller shall furnish Purchaser with a statement of prepaid rents and uncollected past-due rents. Any prepaid rents received by Seller for the period following the Closing Date shall be paid over by Seller to Purchaser. Uncollected past-due rent due to Seller for periods prior to Closing (“Delinquent Rents”) shall not be prorated at Closing. Any non-Delinquent Rent collected by Seller after the Closing Date shall be promptly remitted to Purchaser. Delinquent Rent collected by Seller and Purchaser after the Closing Date shall be delivered as follows: (i) if Seller collects Delinquent Rent for the Property, Seller shall, within fifteen (15) days after the receipt thereof, deliver to Purchaser any such Delinquent Rent which Purchaser is entitled to hereunder relating to the Closing Date and any period thereafter, and (ii) if Purchaser collects any Delinquent Rent from the Property, Purchaser shall, within fifteen (15) days after the receipt thereof, deliver to Seller any such Delinquent Rent which Seller is entitled to hereunder relating to the period prior to the Closing Date. Anything herein to the contrary notwithstanding, Seller and Purchaser agree that all rents received by Seller or Purchaser after the date of Closing shall be applied as follows: (x) first to any calendar month or months following the calendar month in which the Closing occurred until the tenant under such Lease is current with respect to all rents payable after the Closing Date, (y) then to the calendar month in which the Closing occurred, and (z) then to calendar months prior to the month in which the Closing occurred. Purchaser will make commercially reasonable efforts after the Closing Date to collect all rents (including Delinquent Rent) in the usual course of Purchaser’s operation of the Property, provided that such reasonable efforts in respect to such Delinquent Rents shall be limited to the sending of invoices to the applicable tenants for three (3) calendar months after the Closing Date, and if same are not paid as a result thereof, Purchaser shall have no further obligation in respect thereof. Purchaser will not be obligated to institute any lawsuit or other collection procedures to collect Delinquent Rent. If Purchaser elects to institute any legal proceedings, any rents or payments collected pursuant to any such legal proceedings shall be applied first to the payment of Purchaser’s costs and expenses incurred in bringing and prosecuting such legal proceedings, and then disbursed between Seller and Purchaser in accordance with the terms of this Agreement. In no event shall Seller have any right to commence any lawsuit or other collection procedures against any tenant subsequent to the Closing Date of any kind or nature and agrees that its sole right in respect of rents that pertain to the period prior to the Closing Date shall be the right to receive payments made by Purchaser pursuant to this Section 4.4.6.

4.4.7 All of the provisions of this Section 4.4 shall survive Closing for the periods identified above.

4.5 Closing Costs.

4.5.1 Seller shall pay: (i) the fees of any counsel representing Seller in connection with this transaction; (ii) one-half (1/2) of any escrow fee which may be charged by the Escrow Agent or Title Company (except as provided in Section 1.8 above); (iii) the cost of the search and exam fee for the Title Commitment and the cost of the base premium for the issuance of the Title Policy with any endorsements required for Seller to cure any title objections (excluding the cost extended coverage and any other endorsements requested by Purchaser); (iv) all transfer taxes, if any, other than the documentary fee due upon recordation of the Deed, and (v) the brokerage fee.

4.5.2 Purchaser shall pay: (i) the fees of any counsel representing Purchaser in connection with this transaction; (ii) one-half (1/2) of any escrow fees charged by the Escrow Agent or Title Company (except as provided in Section 1.8 above); (iii) the premium for the issuance of any endorsements to the Title Policy requested by Purchaser including extended coverage; (iv) the cost of any modifications to the Updated Survey; (v) the fees for recording the Deed conveying the Property to Purchaser; and (vi) all costs of Purchaser’s due diligence.

4.5.3 All other costs and expenses incident to this transaction and the closing thereof shall be paid by the party incurring same.

4.6 Conditions Precedent to Obligation of Purchaser. The obligation of Purchaser to consummate the transaction hereunder shall be subject to the fulfillment on or before the date of Closing of all of the following conditions, any or all of which may be waived by Purchaser in its sole discretion:

4.6.1 Seller shall have delivered to Purchaser all of the items required to be delivered to Purchaser pursuant to the terms of this Agreement, including but not limited to, those provided for in Section 4.2.

4.6.2 All of the representations and warranties of Seller contained in this Agreement, as they may have been modified pursuant to Section 5.2.2, shall be true and correct in all material respects as of the Closing Date, subject to those disclosures permitted to be included within the Bring-Down Certificate.

4.6.3 Seller shall have performed and observed, in all material respects, all covenants and agreements of this Agreement to be performed and observed by Seller as of the Closing Date.

4.6.4 There shall be no damage or loss to the Residential Units in excess of \$50,000 in the aggregate; provided, however, in the event of such damage or loss to the Residential Units, and Purchaser gives written notice of such damage or loss to Seller, Seller shall have two (2) business days to respond to such (and the Closing Date shall be extended as necessary to allow for Seller to respond to Purchaser's notice, if at all) and offer to, at Purchaser's election and to Purchaser's satisfaction, either (i) promptly repair such damage or loss at Seller's sole cost and expense, pursuant to plans and specifications approved by Purchaser prior to commencing such work, or (ii) if such damage or loss cannot reasonably be repaired prior to the Closing Date, give Purchaser a credit for an amount reasonably estimated by the parties to repair such damage or loss. If Seller fails to give a response on or before such date and time, Seller shall be deemed to have elected not to offer Purchaser either option to resolve and repair such damage or loss.

4.6.5 The Title Policy shall be issued and delivered to Purchaser in the form required pursuant to Section 2.4 above.

4.6.6 If set forth in a Title Objection Notice, Seller shall obtain an estoppel certificate from each and every party to any reciprocal easement agreement or other condition, covenant or restriction (the "REA Estoppel Certificate") which provides for the delivery of an estoppel which is of record against the Land (each, an "REA"), provided such forms are provided to Seller prior to the expiration of the Due Diligence Period;

4.7 Conditions Precedent to Obligation of Seller. The obligation of Seller to consummate the transaction hereunder shall be subject to the fulfillment on or before the date of Closing of all of the following conditions, any or all of which may be waived by Seller in its sole discretion:

4.7.1 Seller shall have received the Purchase Price as adjusted pursuant to and payable in the manner provided for in this Agreement.

4.7.2 Purchaser shall have delivered to Seller all of the items required to be delivered to Seller pursuant to the terms of this Agreement, including but not limited to, those provided for in Section 4.3.

4.7.3 All of the representations and warranties of Purchaser contained in this Agreement shall be true and correct in all material respects as of the Closing Date.

4.7.4 Purchaser shall have performed and observed, in all material respects, all covenants and agreements of this Agreement to be performed and observed by Purchaser as of the Closing Date.

4.8 Notice and Cure. If any condition to a party's obligation to close hereunder has not been satisfied on or before the date of Closing, such party shall notify the other party thereof, whereupon the other party shall have three (3) business days to attempt to cause such condition to be satisfied.

4.9 Failure of Condition. If a condition set forth in Section 4.6 or Section 4.7 remains unsatisfied following such notice and opportunity to cure, the party for whose benefit the condition exists may thereupon terminate this Agreement by written notice to the other party, whereupon the Earnest Money shall be returned to Purchaser and neither party hereto shall have any further rights, obligations or liabilities hereunder except to the extent that any right, obligation or liability set forth herein expressly survives termination of this Agreement. This Section shall not limit or negate any remedies to which a party is entitled hereunder (including without limitation receipt of the Earnest Money) in the event of a breach of this Agreement by the other party.

4.10 Possession and Post-Closing Deliveries. Possession of the Property (subject to the Permitted Exceptions) shall be delivered by Seller to Purchaser at Closing. At Closing, Seller shall deliver to Purchaser (which may be delivered by leaving such in the office of the building located at the Property) the Leases, Operating Agreements, Intangibles and all keys to entrance doors and equipment and utility rooms at the Property, which shall be properly tagged for identification, in the possession or control of Seller or Seller's agents, together with such other leasing and property files and records.

4.11 GAP Closing; Title Company's Instructions at Closing. The transaction contemplated hereby shall be closed by means of a so-called "New York Style" closing with the concurrent delivery of the Deed and payment of the Purchase Price through an escrow with the Title Company so long as the Title Company is irrevocably committed to issue the Title Policy in the form required pursuant to Section 2.4 herein. At Closing, Seller and Purchaser agree to execute such additional escrow instructions as Title Company may reasonably require and which are not inconsistent with the provisions hereof in order to consummate the transactions contemplated hereunder; provided, however, that in the event of any conflict between the provisions of this Agreement and any supplementary escrow instructions, the terms of this Agreement shall control.

ARTICLE 5 REPRESENTATIONS, WARRANTIES AND COVENANTS

5.1 Representations and Warranties of Seller. Seller hereby makes the following representations and warranties to Purchaser:

5.1.1 Organization; Authority. Seller has been duly organized and is validly existing and in good standing under the laws of Delaware and is qualified to transact business in state where the Property is located. Seller has the full right, power and authority to (i) enter into this Agreement and the instruments and documents referenced herein, (ii) transfer all of the Property to be conveyed by Seller pursuant this Agreement and the instruments and documents referenced herein, and (iii) consummate or cause to be consummated the transactions contemplated pursuant this Agreement and the instruments and documents referenced herein. The person signing this Agreement on behalf of Seller is authorized to do so.

5.1.2 Consents. There are no consents or approvals of any third persons, or any federal, state or local governmental authorities, including, without limitation, any internal board of directors or other approval process, that are required in connection with the performance by Seller of its obligations under this Agreement or the instruments and documents referenced herein.

5.1.3 Conflicts; Pending Actions. There is no agreement, document or instrument to which Seller is a party or binding on Seller or the Property which is in conflict with this Agreement, or which limits or impairs Seller's ability to execute or perform its obligations under this Agreement or the instruments and documents referenced herein. There is no action, suit, arbitration, injunction, unsatisfied order, decree or judgment, governmental investigation or proceeding pending or, to Seller's knowledge, threatened, against or relating to Seller or the Property (including, without limitation, any of the Leases, Operating Agreements, Personal Property, Intangibles or any other portion of the Property), which would affect Purchaser or the Property after the Closing.

5.1.4 Leases. Attached hereto as **EXHIBIT B** is a true and correct copy of the Rent Roll in Seller's standard format, which was prepared by Seller in the ordinary course of its business and is the Rent Roll used and relied upon by Seller in its operation of the Property. To Seller's knowledge, the Rent Roll lists all leases or occupancy

agreements affecting the Property, and copies of the Leases contained within the Due Diligence Information are complete and correct copies of such Leases in Seller's possession. Seller is the current landlord under each of the Leases. The rents and other sums due or to become due under each Lease have not been assigned, encumbered or subjected to any lien by Seller (other than pursuant to existing Monetary Liens to be fully satisfied at Closing). Except as contained in the Due Diligence Information, no notice of any default of the lessor under the Leases has been given by any tenant or, to the best of Seller's knowledge, is pending. Each Lease provided as part of the Due Diligence Information is the entire agreement between Seller and the tenant under such Lease, including all representations and warranties, and there are no other agreements between Seller and such tenants of any kind. Each of the Leases is valid and enforceable in accordance with its terms, is in full force and effect, and neither the lessor under the Leases nor, to Seller's knowledge and except as set forth in the Due Diligence Information, any of the tenants is in default of any of its obligations under any of the Leases.

5.1.5 Lease Brokerage. There are no lease brokerage agreements, leasing commission agreements or other agreements providing for payments of any amounts for leasing activities or procuring tenants with respect to the Property, which remain in effect as of the Effective Date. No brokerage commissions or finders' fees are payable upon the renewal of any existing Leases.

5.1.6 Due Diligence Information. The documents included in the Due Diligence Information are correct and complete copies of such documents in Seller's possession.

5.1.7 Operating Agreements. Except for the Operating Agreements disclosed on **EXHIBIT C**, there are no other management, maintenance, construction, service or other similar contracts or commitments relating to the Property in effect as of the Effective Date. Seller has provided Purchaser with true and complete copies of all of the Operating Agreements, including all modifications, supplements and amendments thereto.

5.1.8 Operating Statements. The historical operating statements of the Property prepared by Seller or Seller's property manager, which have been delivered or made available to Purchaser, were prepared by Seller in the ordinary course of its business and are the operating statements used and relied upon by Seller in its operation of the Property.

5.1.9 No Violations. Except as contained in the Due Diligence Information, Seller has not received any written notice of any (i) violation of any laws, codes, ordinances or regulations which remain uncured, (ii) work that is required to be done upon or in connection with the Property, where such work remains outstanding, or (iii) default under any documents recorded against the Property and listed in the Title Commitment.

5.1.10 Condemnation. No condemnation or eminent domain proceedings relating to the Property or its access to or from public streets or utilities are pending, nor to Seller's knowledge, have been threatened in writing.

5.1.11 Assessments; Tax Protests. There are no special assessments with respect to the Property that are not reflected on the tax bills for the Property. There are no pending proceedings appealing the real estate taxes or assessments assessed against the Property.

5.1.12 Utilities. Seller has not received any written notice of actual or threatened reduction or curtailment of any utility service now supplied to the Property or that such utility service is not installed in compliance with all requirements of law.

5.1.13 Environmental Matters. Seller has not received any written notice from any federal, state, county or municipal authority as to: (i) the existence of any "Hazardous Materials" at the Property; (ii) the violation of any Environmental Laws with respect to the Property; or (iii) any liabilities under any Environmental Law. As used herein, the term "Hazardous Materials" shall mean: (a) any chemical or other substance, product or material which is defined as a "hazardous substance," "hazardous waste," "hazardous material," "pollutant," "contaminant," or "toxic," "infectious," "radioactive," "carcinogenic," or "mutagenic" material under any Environmental Law, or (b) asbestos and gasoline and other petroleum products (including crude oil or any fraction thereof). In no event shall the term Hazardous Materials be defined to include de minimus quantities of items lawfully stored or located in, on or under

the Land and which are permitted to be upon the Property pursuant to the terms of any Lease. “Environmental Law” shall mean any law, regulation, rule, order, or other authority of any governmental or quasi-governmental authority or administrative agency with jurisdiction over the Property regarding the protection of human health or the environment, including, but not limited to, the following federal laws and their amendments, analogous state and local laws, and any regulations promulgated thereunder: the Clean Air Act, the Clean Water Act, the Oil Pollution Control Act, the Comprehensive Environmental Response, Compensation, and Liability Act of 1986, the Emergency Planning and Community Right to Know Act, the Solid Waste Disposal Act, the Resource Conservation and Recovery Act, the Safe Drinking Water Act, the Federal Insecticide, Fungicide and Rodenticide Act, and the Toxic Substances Control Act.

5.1.14 Non-Foreign Status. Seller is not a “foreign person”, “foreign partnership”, “foreign trust” or “foreign estate” within the meaning of Section 1445 of the Code.

5.1.15 No Employees. Seller has no employees, either at-will or in the context of an employment contract with Seller, and any employees associated with the Property are employees of Seller’s property manager.

5.1.16 No Bankruptcy. Seller is not party as debtor to any insolvency or bankruptcy proceeding or made an assignment for the benefit of creditors under any applicable state or federal bankruptcy or insolvency law. Seller has not (i) suffered the appointment of a receiver to take possession of all, or substantially all, of Seller’s assets, (ii) suffered the attachment or other judicial seizure of all, or substantially all, of Seller’s assets, (iii) admitted in writing its inability to pay its debts as they come due, or (iv) made an offer of settlement, extension or composition to its creditors generally.

5.1.17 OFAC Compliance. Neither Seller, nor (to the knowledge of Seller) any affiliate of Seller, any partner, member or stockholder in Seller, or (to the knowledge of Seller) any beneficial owner of Seller, or any such partner, member or stockholder of Seller or any affiliate of any of the foregoing (i) is a Blocked Party; (ii) is owned or controlled by, or is acting, directly or indirectly, for or on behalf of, any Blocked Party; or (iii) has instigated, negotiated, facilitated, executed or otherwise engaged in this Agreement directly or indirectly on behalf of any Blocked Party. Seller shall immediately notify Purchaser if any of the foregoing warranties and representations becomes untrue. For purposes of this Agreement, “Blocked Party” shall mean any party or nation that (a) is listed on the Specially Designated Nationals and Blocked Persons List maintained by the Office of Foreign Asset Control, Department of the U.S. Treasury (“OFAC”) pursuant to Executive Order No. 13224, 66 Fed. Reg. 49079 (Sept. 25, 2001) or other similar requirements contained in the rules and regulations of OFAC (the “Order”) or in any enabling legislation or other Executive Orders in respect thereof (the Order and such other rules, regulations, legislation, or orders are collectively called the “Orders”) or on any other list of terrorists or terrorist organizations maintained pursuant to any of the rules and regulations of OFAC or pursuant to any other applicable Orders (such lists are collectively referred to as the “Lists”); or (b) has been determined by competent authority to be subject to the prohibitions contained in the Orders.

5.2 Changed Circumstances; Limitations Regarding Seller’s Representations and Warranties.

5.2.1 Changed Circumstances. If Seller becomes aware, other than through Purchaser or its agents, of any act or circumstances which would change or render incorrect, in any material respect, any representation or warranty made by Seller under this Agreement, Seller will give prompt written notice of such changed fact or circumstance to Purchaser; in which event, unless Seller elects to cause and does cause the representation or warranty to again become true or correct prior to Closing, Purchaser may elect, as its sole and exclusive remedy hereunder, at law or in equity to either (a) terminate this Agreement at or prior to the Closing (in which case, the Earnest Money shall be returned to Purchaser, and neither party hereto shall have any further rights, obligations or liabilities hereunder except to the extent that any right, obligation or liability set forth herein expressly survives termination of this Agreement), or (b) waive any objection to the representation or warranty to the extent it has become untrue or incorrect and to proceed with the Closing. Without limitation on the foregoing, if Purchaser has knowledge of any untruth of any of the representations and warranties made by Seller in this Agreement prior to the Closing and nonetheless elects to proceed to Closing, Purchaser shall be deemed to have waived all rights against Seller in connection with any such untruth.

5.2.2 Limitations. The representations and warranties of Seller in this Agreement (including, without limitation, Section 5.1) or in any document delivered to Purchaser in connection with the closing of this Agreement, as modified in accordance with Section 5.2.1 (collectively, “Seller’s Representations”) shall be true upon the date made, shall be deemed to be repeated at and as of the Closing Date and shall survive the Closing for a period of twelve (12) months (the “Survival Period”).

5.3 Covenants of Seller. Seller hereby covenants with Purchaser as follows:

5.3.1 From the Effective Date hereof until the Closing or earlier termination of this Agreement, Seller shall operate, maintain and insure the Property in substantially the same manner in which Seller has operated and maintained the Property prior to the date hereof. From the Effective Date until the Closing or earlier termination of this Agreement, Seller shall not place any easements, covenants, restrictions or other instruments on the Property other than any instruments and other matters which Seller causes to be released and discharged of record prior to Closing.

5.3.2 Intentionally deleted.

5.3.3 Seller agrees that, between the Effective Date of this Agreement and the Closing Date or the date of termination of this Agreement (whichever occurs first), Seller will not, without the prior written consent of Purchaser, enter into any Leases which would be binding on Purchaser or the Property after the Closing, except for Leases entered into in the ordinary course of business on Seller’s standard form of lease, at rental rates that are considered “market” for the class of building and same geographic area, and for a term not longer than thirteen (13) months. Seller shall deliver all new Leases to Purchaser within five (5) business days of execution but in no event less than five (5) business day prior to Closing.

5.3.4 Seller shall have the right to continue to enter into service contracts, similar agreements or modifications or terminations of existing Operating Agreements (provided such are terminable without penalty or termination fee upon 30 days’ notice or less) with respect to the Property pursuant to its normal course of business, and shall keep Purchaser informed as to the existence of any new service contracts or similar agreements or modifications of existing Operating Agreements and shall promptly deliver a copy thereof to Purchaser. Notwithstanding the foregoing, after the Due Diligence Period, Seller shall not enter into any new service contract or similar agreement or modify any existing Operating Agreement without the prior written consent of Purchaser (unless (i) such is required in connection with an emergency or (ii) if such Operating Agreement will be fully performed or cancelled by Seller at Seller’s sole cost and expense prior to Closing), which consent shall not be unreasonably withheld or delayed.

5.3.5 Prior to expiration of the Due Diligence Period, Purchaser may designate those Operating Agreements that Purchaser desires to have Seller terminate effective as of the Closing (“Terminated Contracts”) and Seller agrees to terminate the Terminated Contracts prior to or effective as of the Closing; provided that Seller shall not be obligated to deliver any notices of termination of any of the Operating Agreements until after the expiration of the Due Diligence Period and provided, further, that Seller shall not be required to terminate the following Operating Agreements which, by their terms and conditions, may not be terminated without penalty or early termination fee: N/A. Seller shall assign to Purchaser at Closing all of the Contracts other than the Contracts which Seller is obligated to terminate pursuant to this Section. that Purchaser hereby acknowledges and agrees that Purchaser shall be required to assume, and shall assume at Closing, those Operating Agreements identified on EXHIBIT C as non-terminable and any income, credits, expenses, or other amounts due under such non-terminable Operating Agreements shall be prorated by the parties at Closing pursuant to Section 4.4 hereinabove. In all events, Seller shall terminate its management agreement with Property Manager (the “Management Agreement”) effective as of the Closing at Seller’s sole cost and expense. If an Operating Agreement is terminable, but not terminable effective at or prior to Closing, Seller shall nonetheless terminate such Operating Agreement, at Seller’s sole cost and expense, and Purchaser shall be required to assume such at Closing for any period of time after the Closing that the Operating Agreement remains in effect, provided, however, Seller shall use commercially reasonable efforts to cause such terminations to effective at or prior to Closing.

5.3.6 Seller shall deliver to Purchaser copies of any written notices received from (i) a governmental or public authority (or a third party acting under the authority of a governmental or public authority),

(ii) a tenant under a Lease or a party under an Operating Agreement, or (iii) any party under any documents recorded against the Property and listed in the Title Commitment.

5.3.7 In the event that after expiration of the Due Diligence Period, Seller receives any written notification from a governmental or public authority (or a third party acting under the authority of a governmental or public authority) notifying Seller that the Property is in violation of any applicable fire, health, building, use, occupancy, zoning or other applicable laws, then (i) if the estimated cost to cure such violation is \$100,000 or less (as reasonably determined by the parties), Seller shall cure such violation or, if such cannot reasonably be cured prior to the Closing Date, give Purchaser a credit for an amount reasonably estimated by the parties to cure such violation, and (ii) if the estimated cost to cure such violation is greater than \$100,000 (as reasonably determined by the parties) or a Non-Monetary Violation (as hereinafter defined), then Seller shall, in written notice to Purchaser prior to the Closing Date, elect to either (A) cure such violation or, if such cannot reasonably be cured prior to the Closing Date and is not a Non-Monetary Violation, provide Purchaser with a credit against the Purchase Price at Closing in the amount equal to the estimated cost to cure such violation, as reasonably determined by the parties, or (B) not to cure such violation. In the event Seller elects to (and does prior to Closing) cure any such violation or provide Purchaser with a credit against the Purchase Price as specified in subsections (i) or (ii)(A) above, then Purchaser shall proceed with the Closing (and in the event of a credit, accept title to the Property subject to such violation as a Permitted Exception). In the event Seller elects not to cure such violation pursuant to subsection (ii)(B) above, then Purchaser shall elect to either (X) proceed with Closing and accept title to the Property subject to the applicable violation as a Permitted Exception, or (Y) terminate this Agreement, whereupon the Earnest Money shall be returned to Purchaser plus additional cash to reimburse Purchaser for its documented out-of-pocket expenses actually incurred in connection with the transaction contemplated hereby, but in no event shall such additional cash reimbursement payment ever exceed \$50,000, and neither party hereto shall have any further rights, obligations or liabilities hereunder except to the extent that any right, obligation or liability set forth herein expressly survives termination of this Agreement. As used herein, a "Non-Monetary Violation" is a violation of any applicable fire, health, building, use, occupancy, zoning or other applicable laws that cannot easily be cured by the expenditure of money and affects the integrity, viability, prominence, use or income producing capability of the Property, including, without limitation, (i) anything that would allow a tenant to terminate its Lease, (ii) the reduction of parking at the Property, (iii) the reduction or other adverse impact to any point of ingress or egress to the Property, or (iv) any civil or criminal action involving the Property for which the risk of seizure or forfeiture of the Property is a remedy.

5.3.8 Seller shall use commercially reasonable efforts to request estoppels from any counterparty to an easement or declaration requested by Purchaser in a Title Objection Notice. Seller's inability to obtain any such estoppels shall not be a default by Seller hereunder, but rather such shall give rise to a mere failure of a condition precedent to Closing.

5.3.9 Seller shall not enter into any employment contract or collective bargaining agreement in respect of the Property without the prior written consent of Purchaser.

5.3.10 From the expiration of the Due Diligence Period through the date of Closing, Seller shall terminate all negotiations (and shall not commence any new negotiations) with any other parties concerning the purchase of the Property (or any portion thereof or interest therein), and Seller shall not show the Property or otherwise offer for sale the Property (or any portion thereof or interest therein) to any other prospective buyers.

5.4 Representations and Warranties of Purchaser. Purchaser hereby represents and warrants to Seller:

5.4.1 ERISA. Purchaser is not acquiring the Property with the assets of an employee benefit plan as defined in Section 3(3) of ERISA.

5.4.2 Authority. Purchaser has the full right and power to purchase the Property as provided in this Agreement and to carry out Purchaser's obligations hereunder, and all requisite action necessary to authorize Purchaser to enter into this Agreement and to carry out its obligations hereunder have been, or by the Closing will have been, taken. The person signing this Agreement on behalf of Purchaser is authorized to do so.

5.4.3 Pending Actions. There is no action, suit, arbitration, unsatisfied order, decree or judgment, government investigation or proceeding pending or, to Seller's knowledge, threatened, against Purchaser or relating to which, if adversely determined, could individually or in the aggregate materially interfere with the consummation of the transaction contemplated by this Agreement.

5.4.4 Ownership/Control. Purchaser is owned and/or controlled by Highlands REIT, Inc., a Maryland corporation and a real estate investment trust. Purchaser shall immediately notify Seller if any of the foregoing warranties and representations becomes untrue.

5.5 Survival of Representations and Warranties. The representation and warranties of the Purchaser set forth in Section 5.4 shall be true when made, shall be deemed to be repeated at and as of the Closing Date and shall survive the Closing for the Survival Period.

ARTICLE 6 DEFAULT

6.1 Default by Purchaser. If for any reason (other than Seller's default or the permitted termination of this Agreement by either Seller or Purchaser as herein expressly provided), (a) Purchaser fails to consummate the purchase of the Property on the Closing Date in breach of this Agreement, or (b) Purchaser fails to perform of any of its obligations to be performed prior to the Closing Date (other than its indemnity obligations under Section 3.1 of this Agreement) and (i) such default is susceptible to being cured and Seller has provided ten (10) days prior written notice to Purchaser upon which, if necessary, the Closing Date shall be extended to provide Purchaser such cure period (unless such default is waived by Seller), or (ii) such default is not susceptible to being cured and Seller has provided prior written notice to Purchaser, then Seller shall be entitled, but not required, as its sole and exclusive remedy, to terminate this Agreement and receive the Earnest Money as liquidated damages for the breach of this Agreement, and neither party hereto shall have any further rights, obligations or liabilities hereunder except to the extent that any right, obligation or liability set forth herein expressly survives termination of this Agreement. It is agreed between the parties hereto that the actual damages to Seller in the event of such breach are impractical to ascertain and that the Earnest Money is a reasonable estimate thereof. IN NO EVENT SHALL PURCHASER'S DIRECT OR INDIRECT PARTNERS, SHAREHOLDERS, MEMBERS, MANAGERS, OWNERS OR AFFILIATES, ANY OFFICER, MANAGER, DIRECTOR, EMPLOYEE OR AGENT OF THE FOREGOING, OR ANY AFFILIATE OR CONTROLLING PERSON THEREOF HAVE ANY LIABILITY FOR ANY CLAIM, CAUSE OF ACTION OR OTHER LIABILITY ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE PROPERTY, WHETHER BASED ON CONTRACT, COMMON LAW, STATUTE, EQUITY OR OTHERWISE.

6.2 Default by Seller. If for any reason (other than Purchaser's default or the permitted termination of this Agreement by either Seller or Purchaser as herein expressly provided), (a) Seller fails to consummate the sale of the Property on the Closing Date in breach of this Agreement, or (b) Seller fails to perform of any of its obligations to be performed prior to the Closing Date and (i) such default is susceptible to being cured and Purchaser has provided ten (10) days prior written notice to Seller upon which, if necessary, the Closing Date shall be extended to provide Seller such cure period (unless such default is waived by Purchaser), or (ii) such default is not susceptible to being cured and Purchaser has provided prior written notice to Seller, then Purchaser shall be entitled, but not required, as its sole remedy, either (a) to receive the return of the Earnest Money, which return shall operate to terminate this Agreement and neither party hereto shall have any further rights, obligations or liabilities hereunder except to the extent that any right, obligation or liability set forth herein expressly survives termination of this Agreement, except that (in such a case) Seller shall be liable to pay Purchaser additional cash to reimburse Purchaser for its documented out-of-pocket expenses actually incurred in connection with the transaction contemplated hereby; or (b) to enforce specific performance of Seller's obligation to execute the documents required to convey the Property to Purchaser, it being understood and agreed that the remedy of specific performance shall not be available to enforce any other obligation of Seller hereunder. In the event that Purchaser fails to commence an action against Seller pursuant to clause (b) of the preceding sentence within sixty (60) days after the scheduled Closing Date, Purchaser shall automatically be deemed to have terminated the Agreement pursuant to clause (a) of the preceding sentence. Notwithstanding the foregoing, in the event that specific performance is not available as a remedy due to the acts or omissions of Seller, Purchaser shall

have the right to sue for its actual damages (but not for consequential or punitive damages). Except as expressly provided above, Purchaser expressly waives its rights to seek damages in the event of Seller's default hereunder.

IN NO EVENT SHALL SELLER'S DIRECT OR INDIRECT PARTNERS, SHAREHOLDERS, MEMBERS, MANAGERS, OWNERS OR AFFILIATES, ANY OFFICER, MANAGER, DIRECTOR, EMPLOYEE OR AGENT OF THE FOREGOING, OR ANY AFFILIATE OR CONTROLLING PERSON THEREOF HAVE ANY LIABILITY FOR ANY CLAIM, CAUSE OF ACTION OR OTHER LIABILITY ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE PROPERTY, WHETHER BASED ON CONTRACT, COMMON LAW, STATUTE, EQUITY OR OTHERWISE.

6.3 Post-Closing. After the Closing, in the event of any breach of any of the covenants, representations, warranties or indemnities hereunder or under any other agreement, document, certificate or instrument delivered by the parties (or affiliate thereof) which survive the Closing for any period of time (a "Post-Closing Default"), each party shall have all remedies existing under applicable law with respect to such Post-Closing Default; provided, however, in no event shall either party ever be entitled (i) to recover from the other party damages in excess of Five Hundred Thousand Dollars (\$500,000) (the "Cap"), provided that the Cap shall not apply to a breach of Seller's representation or warranty set forth in Section 8.1, any amounts to be repored by the parties following the Closing pursuant to the express terms of this Agreement, or any legal fees incurred by a party pursuant to Section 6.5 below; or (ii) to recover consequential or punitive damages. Further, if a Post-Closing Default is curable, prior to a party's exercise of any right or remedy as a result thereof, the other party shall first deliver written notice to the other and give the other ten (10) days thereafter in which to cure said Post-Closing Default. The provisions of this Section 6.3 shall survive the Closing of the transaction contemplated by this Agreement.

6.4 Escrow Agreement. In order to secure the performance of Seller's obligations under Section 6.3 of this Agreement for Post-Closing Defaults, at Closing, Seller shall escrow Three Hundred Thousand Dollars (\$300,000) from the Purchase Price to be held by the Escrow Agent pursuant to an escrow agreement in the form of EXHIBIT M attached hereto (the "Escrow Agreement").

6.5 Attorneys' Fees. Should any party hereto employ an attorney for the purpose of enforcing or construing this Agreement, or any judgment based on this Agreement, in any legal proceeding whatsoever, including insolvency, bankruptcy, arbitration, declaratory relief or other litigation, the prevailing party shall be entitled to receive from the other party or parties thereto reimbursement for all reasonable out-of-pocket attorneys' fees and all costs, whether incurred at the trial or appellate level, including but not limited to service of process, filing fees, court and court reporter costs, investigative costs, expert witness fees and the cost of any bonds, whether taxable or not, and such reimbursement shall be included in any judgment, decree or final order issued in that proceeding. The "prevailing party" means the party who obtains substantially the result sought, whether by settlement, mediation, judgment or otherwise. A party's rights and remedies under this Section 6.5 shall not limit and shall, in any event, be in addition to its rights and remedies under any other provision of this Agreement. The provisions of this Section 6.5 shall survive the Closing of the transaction contemplated by this Agreement or the termination of this Agreement.

6.6 Indemnity Obligations. To the extent either party is required to obtain or maintain insurance under any provision of this Agreement (an "Insuring Party"), nothing in this Article 6 shall be deemed to limit the other party's right to pursue any claim against the Insuring Party that survives termination or Closing of this Agreement to the full extent of the insurance coverage which the Insuring Party was required to maintain, whether or not the Insuring Party actually maintained such insurance.

ARTICLE 7 RISK OF LOSS

7.1 Notice and Estimate of Casualty. In the event of loss or damage to the Property or any portion hereof, Seller shall immediately provide Purchaser with written notice of such loss or damage, and as soon thereafter as practicable shall provide Purchaser with an estimate made by an architect, engineer or contractor selected by Seller and reasonably acceptable to Purchaser of the cost and amount of time to repair such damage. The date of Closing shall become the later of the date set forth in Section 4.1 and 20 days after Purchaser's receipt of such notice. If

Purchaser does not terminate this Agreement in accordance with Section 7.3, then Purchaser shall be given an opportunity to review and approve any construction contract which Seller proposes to enter into to have such damage repaired, and Purchaser shall not unreasonably withhold or delay such approval. Notwithstanding the foregoing, Seller may take any actions required by law or reasonably necessary to protect the life and safety of the occupants of the Property or the public or to prevent further damage without prior notice or approval of Purchaser.

7.2 Minor Damage. In the event of loss or damage to the Property or any portion hereof which is not a Major Loss (as hereinafter defined), Seller shall promptly contract for and commence the repairs and complete so much thereof as may be accomplished prior to the date of Closing. If such repairs are not completed on or before the date of Closing, (i) the Closing shall take place as scheduled, (ii) Seller shall assign to Purchaser at Closing all of Seller's right, title and interest to any claims and proceeds Seller may have with respect to any casualty insurance policies or condemnation awards relating to the premises in question that have not then been expended for repairs (including any proceeds of business interruption or rent loss insurance payable with respect to periods from and after the Closing Date), (iii) Seller shall execute and deliver to Purchaser any and all instruments or documentation reasonably requested by Purchaser to effectuate such assignment, including, without limitation, an executed acknowledgement of the assignment from the insurance provider, (iv) Seller will assign to Purchaser, and Purchaser will assume the rights and obligations under the construction contract pursuant to which such repairs are being completed. If Seller is required to assign a casualty claim to Purchaser, the Purchase Price shall be reduced by an amount equal to the deductible amount under Seller's insurance policy. Seller shall not adjust any insurance proceeds or condemnation awards without Purchaser's prior written consent (which consent shall not be unreasonably withheld) and, after Closing, Seller shall reasonably cooperate with Purchaser in the processing of any claims against Seller's insurance or the applicable governmental authority. Upon Closing, full risk of loss with respect to the Property shall pass to Purchaser.

7.3 Major Damage. In the event of a Major Loss, Seller shall immediately provide Purchaser with written notice of such Major Loss, and Purchaser shall have fifteen (15) days after receipt of Seller's written notice to elect to terminate this Agreement by written notice to Seller. If Purchaser elects to terminate this Agreement within the time period set forth in this Section 7.3, the Earnest Money shall be returned to Purchaser and neither party hereto shall have any further rights, obligations or liabilities hereunder except to the extent that any right, obligation or liability set forth herein expressly survives termination of this Agreement. If Purchaser does not elect to terminate this Agreement within the time period set forth in this Section 7.3, then this Agreement shall remain in full force and effect and the parties shall proceed in accordance with Section 7.2 above.

7.4 Definition of "Major Loss". For purposes of Sections 7.2 and 7.3, "Major Loss" shall mean: (i) loss or damage to the Property or any portion thereof such that the cost of repairing or restoring the premises in question to a condition substantially identical to that of the premises in question prior to the event of damage would be equal to or greater than two percent (2%) of the Purchase Price or more; (ii) any uninsured casualty in an amount equal to or greater than Fifty Thousand Dollars (\$50,000), (iii) any loss which would result in any reduction or abatement of rent payable under any Lease (unless covered by rent loss insurance) or would allow any tenant to terminate its Lease, or (iv) any condemnation or written threat of condemnation by a governmental authority which would (A) permanently and materially impair the current use of the Property, (B) ingress or egress to or from the Property, (C) result in any reduction or abatement of rent payable under any Lease or would allow any tenant to terminate its Lease, (D) would take sufficient parking spaces or driveways located on the Property causing the Property to violate applicable zoning requirements, or (E) affect any portion of the Land intended to be developed or any portion of the current Improvements.

ARTICLE 8 COMMISSIONS

8.1 Brokerage Commissions. Each party agrees that (i) neither party has engaged any broker or finder in connection with the transactions contemplated by this Agreement other than CBRE ("Broker"), which was engaged by Seller and will be paid by Seller under a separate agreement, and (ii) should any claim be made for brokerage commissions or finder's fees by any broker or finder by, through or on account of any acts of said party or its representatives other than Broker, said party will indemnify, defend and hold the other party free and harmless from and against any and all loss, liability, cost, damage and expense in connection therewith. The provisions of this paragraph shall survive Closing.

ARTICLE 9
DISCLAIMERS AND WAIVERS

9.1 No Reliance on Documents. Except as expressly stated in this Agreement, including any Seller's Representation, or in any document delivered by Seller to Purchaser in connection with the Closing, Seller makes no representation or warranty as to the truth, accuracy or completeness of any materials, data or information delivered by Seller to Purchaser in connection with the transaction contemplated hereby. Without limiting the generality of the foregoing provisions, but except as otherwise expressly stated in this Agreement or in any document delivered by Seller to Purchaser in connection with the Closing, Purchaser acknowledges and agrees that (i) any environmental or other report with respect to the Property which is delivered by Seller to Purchaser shall be for general informational purposes only, (ii) Purchaser shall not have any right to rely on any such report delivered by Seller to Purchaser, but rather will rely on its own inspections and investigations of the Property and any reports commissioned by Purchaser with respect thereto, and (iii) neither Seller, any affiliate of Seller nor the person or entity which prepared any such report delivered by Seller to Purchaser shall have any liability to Purchaser for any inaccuracy in or omission from any such report.

9.2 Disclaimers. (A) ACCORDINGLY, EXCEPT FOR SELLER'S REPRESENTATIONS OR AS EXPRESSLY STATED IN ANY DOCUMENT DELIVERED BY SELLER TO PURCHASER IN CONNECTION WITH THE CLOSING, IT IS UNDERSTOOD AND AGREED THAT SELLER IS NOT MAKING AND HAS NOT AT ANY TIME MADE ANY WARRANTIES OR REPRESENTATIONS OF ANY KIND OR CHARACTER, EXPRESSED OR IMPLIED, WITH RESPECT TO THE PROPERTY, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OR REPRESENTATIONS AS TO HABITABILITY, MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, TITLE (OTHER THAN SELLER'S LIMITED WARRANTY OF TITLE TO BE SET FORTH IN THE DEED), ZONING, TAX CONSEQUENCES, LATENT OR PATENT PHYSICAL OR ENVIRONMENTAL CONDITION, UTILITIES, OPERATING HISTORY OR PROJECTIONS, VALUATION, GOVERNMENTAL APPROVALS, THE COMPLIANCE OF THE PROPERTY WITH GOVERNMENTAL LAWS, THE TRUTH, ACCURACY OR COMPLETENESS OF THE PROPERTY DOCUMENTS OR ANY OTHER INFORMATION PROVIDED BY OR ON BEHALF OF SELLER TO PURCHASER, OR ANY OTHER MATTER OR THING REGARDING THE PROPERTY. PURCHASER ACKNOWLEDGES AND AGREES THAT UPON CLOSING SELLER SHALL SELL AND CONVEY TO PURCHASER AND PURCHASER SHALL ACCEPT THE PROPERTY "AS IS, WHERE IS, WITH ALL FAULTS", EXCEPT TO THE EXTENT EXPRESSLY PROVIDED IN SELLER'S REPRESENTATIONS OR AS EXPRESSLY STATED IN ANY DOCUMENT DELIVERED BY SELLER TO PURCHASER IN CONNECTION WITH THE CLOSING. PURCHASER HAS NOT RELIED AND WILL NOT RELY ON, AND SELLER IS NOT LIABLE FOR OR BOUND BY, ANY EXPRESSED OR IMPLIED WARRANTIES, GUARANTIES, STATEMENTS, REPRESENTATIONS OR INFORMATION PERTAINING TO THE PROPERTY OR RELATING THERETO (INCLUDING SPECIFICALLY, WITHOUT LIMITATION, PROPERTY INFORMATION PACKAGES DISTRIBUTED WITH RESPECT TO THE PROPERTY) MADE OR FURNISHED BY SELLER, THE MANAGER OF THE PROPERTY, OR ANY REAL ESTATE BROKER OR AGENT REPRESENTING OR PURPORTING TO REPRESENT SELLER, TO WHOMEVER MADE OR GIVEN, DIRECTLY OR INDIRECTLY, ORALLY OR IN WRITING, UNLESS SPECIFICALLY SET FORTH IN SELLER'S REPRESENTATIONS OR AS EXPRESSLY STATED IN ANY DOCUMENT DELIVERED BY SELLER TO PURCHASER IN CONNECTION WITH THE CLOSING. PURCHASER REPRESENTS TO SELLER THAT PURCHASER HAS CONDUCTED, OR WILL CONDUCT PRIOR TO CLOSING, SUCH INVESTIGATIONS OF THE PROPERTY, INCLUDING BUT NOT LIMITED TO, THE PHYSICAL AND ENVIRONMENTAL CONDITIONS THEREOF, AS PURCHASER DEEMS NECESSARY TO SATISFY ITSELF AS TO THE CONDITION OF THE PROPERTY AND THE EXISTENCE OR NONEXISTENCE OR CURATIVE ACTION TO BE TAKEN WITH RESPECT TO ANY HAZARDOUS OR TOXIC SUBSTANCES ON OR DISCHARGED FROM THE PROPERTY, AND WILL RELY SOLELY UPON SAME AND NOT UPON ANY INFORMATION PROVIDED BY OR ON BEHALF OF SELLER OR ITS AGENTS OR EMPLOYEES WITH RESPECT THERETO, OTHER THAN SUCH REPRESENTATIONS, WARRANTIES AND COVENANTS OF SELLER AS ARE EXPRESSLY SET FORTH IN THIS AGREEMENT OR AS EXPRESSLY STATED IN ANY DOCUMENT DELIVERED BY SELLER TO PURCHASER IN CONNECTION WITH THE CLOSING.

(B) UPON CLOSING, PURCHASER SHALL ASSUME THE RISK THAT ADVERSE MATTERS, INCLUDING BUT NOT LIMITED TO, CONSTRUCTION DEFECTS AND ADVERSE PHYSICAL AND ENVIRONMENTAL

CONDITIONS, MAY NOT HAVE BEEN REVEALED BY PURCHASER'S INVESTIGATIONS, AND PURCHASER, UPON CLOSING, SHALL BE DEEMED TO HAVE WAIVED, RELINQUISHED AND RELEASED SELLER (AND SELLER'S OFFICERS, DIRECTORS, SHAREHOLDERS, EMPLOYEES AND AGENTS) FROM AND AGAINST ANY AND ALL CLAIMS, DEMANDS, CAUSES OF ACTION (INCLUDING CAUSES OF ACTION IN TORT), LOSSES, DAMAGES, LIABILITIES, COSTS AND EXPENSES (INCLUDING ATTORNEYS' FEES AND COURT COSTS) OF ANY AND EVERY KIND OR CHARACTER, KNOWN OR UNKNOWN, WHICH PURCHASER MIGHT HAVE ASSERTED OR ALLEGED AGAINST SELLER (AND SELLER'S OFFICERS, DIRECTORS, SHAREHOLDERS, EMPLOYEES AND AGENTS) OR PROPERTY MANAGER AT ANY TIME BY REASON OF OR ARISING OUT OF ANY LATENT OR PATENT CONSTRUCTION DEFECTS OR PHYSICAL CONDITIONS, VIOLATIONS OF ANY APPLICABLE LAWS (INCLUDING, WITHOUT LIMITATION, ANY ENVIRONMENTAL LAWS). NOTWITHSTANDING ANYTHING TO THE FOREGOING IN THIS CLAUSE (B), (1) SUBJECT TO THE LIMITATIONS STATED IN THIS AGREEMENT, SELLER SHALL STILL REMAIN LIABLE FOR ANY COVENANTS, REPRESENTATIONS AND WARRANTIES HEREUNDER THAT EXPRESSLY SURVIVE CLOSING, AND ITS COVENANTS, REPRESENTATIONS OR WARRANTIES, IF ANY, IN ANY AGREEMENT, DOCUMENT, CERTIFICATE OR INSTRUMENT DELIVERED BY SELLER TO PURCHASER AT CLOSING (THE "CLOSING DOCUMENTS"), AND (2) NOTHING HEREIN IS INTENDED TO REQUIRE PURCHASER TO INDEMNIFY SELLER FOR EVENTS, FACTS, OR CIRCUMSTANCES OCCURRING PRIOR TO CLOSING UNLESS EXPLICITLY ASSUMED BY PURCHASER PURSUANT HERETO OR IN THE CLOSING DOCUMENTS DELIVERED BY PURCHASER AT CLOSING.

ARTICLE 10 MISCELLANEOUS

10.1 Confidentiality. All Due Diligence Information shall be used solely for the purpose of determining whether or not the Property is suitable for Purchaser's purpose and for no other reason. All Due Diligence Information shall be kept in strict confidence by Purchaser and shall not be disclosed to any individual or entity other than those Representatives (as defined below) of Purchaser who need to know the information for the purpose of assisting Purchaser in making such determination. The foregoing shall not apply to any Due Diligence Information which is in the public domain (other than as a result of a breach of this Section 10.1) or which must be disclosed by reason of subpoena or under applicable law or regulation, or with respect to information that Purchaser may have received from sources other than Seller (or its Representatives) or as a result of its inspections. Purchaser will indemnify and hold Seller harmless from and against any and all actual out-of-pocket loss, liability, cost, damage or expense Seller may suffer or incur as a result of the disclosure by Purchaser or a Representative of Purchaser of any Due Diligence Information to any individual or entity other than a Representative of Purchaser (except as provided above) and/or the use of any Due Diligence Information by Purchaser or a representative of Purchaser for any purpose other than as herein provided. As used herein, "Representative" shall mean any owner, member, partner, shareholder, existing or prospective investor or partner, affiliate, agent, representative, attorney, consultant, engineer, other adviser or lender of a party and any employee, officer, director or shareholder of any of them. In the event of a breach or threatened breach by Purchaser of this Section 10.1, Seller shall be entitled to an injunction restraining Purchaser or its Representatives from disclosing, in whole or in part, any Due Diligence Information. Nothing herein shall be construed as prohibiting Seller from pursuing any other available remedy at law or in equity for such breach or threatened breach. The provisions of this Section 10.1 shall not survive the Closing, but shall continue in full force and effect for a period of one year following any termination of this Agreement pursuant to any right of termination granted herein or otherwise.

10.2 Public Disclosure. Prior to Closing, any release to the general public (as opposed to Representatives of a party) of information with respect to the sale contemplated herein or any matters set forth in this Agreement will be made only in the form approved by Purchaser and Seller and their respective counsel. Notwithstanding anything to the contrary contained in this Agreement, Purchaser shall be freely permitted to (a) make customary inquiries of governmental authorities having jurisdiction over the Property with respect to standard due diligence inquiries and inspections, including, without limitation, the Property's compliance with laws and whether violations have been noticed by any such governmental authorities, and/or (b) make all disclosures necessary to comply with reporting requirements to the United States Securities and Exchange Commission.

10.3 Time is of the Essence. Time is of the essence in the performance of each term, condition and covenant contained in this Agreement. No extension of time for performance of any obligation or act shall be deemed an extension of time for performance of any other obligation or act.

10.4 Assignment.

10.4.1 Purchaser may not assign its rights under this Agreement without first obtaining Seller's prior written approval, which approval may be given or withheld in Seller's reasonable discretion. The assignment of any of Purchaser's rights under this Agreement without Seller's prior written consent shall constitute a default by Purchaser under this Agreement. Purchaser shall give Seller prior written notice of any proposed assignment of this Agreement. Such notice shall identify the proposed assignee or transferee and the constituent controlling individuals and/or entities thereof.

10.4.2 The provisions of Subsection 10.4.1 to the contrary notwithstanding, Purchaser may assign this Agreement to a Permitted Assignee (as hereinafter defined) without the prior written consent of Seller. In no event, however, shall the assignment of this Agreement to a Permitted Assignee be effective or of any force or effect whatsoever unless (i) Purchaser shall give Seller at least five (5) days prior written notice of any proposed assignment of this Agreement to a Permitted Assignee, identifying the proposed assignee and the constituent controlling individuals and/or entities thereof, (ii) Purchaser shall have delivered to Seller an instrument whereby the Permitted Assignee expressly assumes each of the obligations of Purchaser under this Agreement (which instrument may be executed and delivered concurrently with the Closing). Any assignment of this Agreement by the originally named Purchaser to a Permitted Assignee shall not release or otherwise relieve the originally named Purchaser herein from any obligations hereunder. For purposes of this Section 10.4, the term "Permitted Assignee" shall mean (a) a corporation in which Purchaser directly or beneficially owns or controls a majority of the stock entitled to vote for directors, (b) a general partnership in which a subsidiary of Purchaser is a general partner owning a majority of the total partnership interests therein, (c) a limited partnership in which a subsidiary of Purchaser is the sole general partner, (d) a limited liability company in which Purchaser directly or beneficially owns a majority of the interests therein or is the sole manager thereof, and (e) a limited liability company that is controlled by the parent company of Purchaser.

10.5 Notices. Any notice pursuant to this Agreement shall be given in writing by (i) personal delivery, or (ii) reputable overnight delivery service with proof of delivery, or United States Mail, postage prepaid, registered or certified mail, return receipt requested, or facsimile or electronic mail transmission sent to the intended addressee at the address set forth below, or to such other address or to the attention of such other person as the addressee shall have designated by written notice sent in accordance herewith, and shall be deemed to have been given either at the time of personal delivery, or, in the case of expedited delivery service or mail, as of the date of first attempted delivery at the address and in the manner provided herein, or, in the case of facsimile or electronic mail transmission, as of the date of the facsimile or electronic mail transmission. Unless changed in accordance with the preceding sentence, the addresses for notices given pursuant to this Agreement shall be as follows:

If to Seller: HILL UNIVERSITY PARTNERS OWNER, LLC
8100 East Maplewood Avenue, Suite #220
Greenwood Village, Colorado 80111
Attn: James R. Hill
[Email: jhill@hill-companies.com](mailto:jhill@hill-companies.com)

With a copy to: Otten, Johnson Robinson, Neff & Ragonetti, P.C.
950 Seventeenth Street
Denver, Colorado 80202
Attention: Thomas Macdonald
[E-mail: mac@ottenjohnson.com](mailto:mac@ottenjohnson.com)

If to Purchaser: The Muse Owner, LLC

332 S. Michigan Avenue, Ninth Floor
Chicago, Illinois 60604
Attn: Robert J. Lange
[Email: robert.lange@highlandsreit.com](mailto:robert.lange@highlandsreit.com)

With copies to: Levenfeld Pearlstein, LLC
Two North LaSalle Street, Suite 1300
Chicago, Illinois 60602
Attention: Elizabeth C. O'Brien, Esq.
[E-mail: eobrien@lplegal.com](mailto:eobrien@lplegal.com)

Any counsel designated above or any replacement counsel which may be designated respectively by either party or such counsel by written notice to the other party is hereby authorized to give notices hereunder on behalf of its respective client.

10.6 Binding Effect. This Agreement shall not be binding in any way upon the parties hereto unless and until this Agreement is fully executed by Seller and Purchaser.

10.7 Modifications. This Agreement cannot be changed orally, and no executory agreement shall be effective to waive, change, modify or discharge it in whole or in part unless such executory agreement is in writing and is signed by the parties against whom enforcement of any waiver, change, modification or discharge is sought. No waiver by either party of any failure or refusal to comply with its obligations shall be deemed a waiver of any other or subsequent failure or refusal to so comply.

10.8 Notification Letters. Purchaser shall deliver (or cause to be delivered) the Tenant Notices and the Vendor Notices to each of the tenants under the Leases and the vendors under the assigned Operating Agreements. The provisions of this paragraph shall survive Closing.

10.9 Calculation of Time Periods. Unless otherwise specified, in computing any period of time described in this Agreement, the day of the act or event after which the designated period of time begins to run is not to be included and the last day of the period so computed is to be included, unless such last day is a Saturday, Sunday or legal holiday under the laws of the State in which the Property is located, in which event the period shall run until the end of the next day which is neither a Saturday, Sunday or legal holiday. The final day of any such period shall be deemed to end at 5:00 PM, Denver time. The term "business day" as used herein shall mean any day that federal banks are open for business within the State in which the Property is located, other than Saturdays and Sundays.

10.10 Successors and Assigns. The terms and provisions of this Agreement are to apply to and bind the permitted successors and assigns of the parties hereto.

10.11 Entire Agreement. This Agreement, including the Exhibits, contains the entire agreement between the parties pertaining to the subject matter hereof and fully supersedes all prior written or oral agreements and understandings between the parties pertaining to such subject matter.

10.12 Further Assurances. Each party agrees that it will without further consideration execute and deliver such other documents and take such other action, whether prior or subsequent to Closing, as may be reasonably requested by the other party to consummate more effectively the purposes or subject matter of this Agreement, but without any obligation on the part of either party to incur any liability or make any undertaking beyond that provided in this Agreement. The provisions of this Section 10.12 shall survive Closing.

10.13 Counterparts/Facsimile Execution. This Agreement may be executed in counterparts, and all such executed counterparts shall constitute the same agreement. A counterpart of this Agreement transmitted by electronic means (including so-called PDF) or facsimile will, if it is executed, be deemed in all respects to be an original document,

and any signature on that document shall be deemed to be an original signature with the same binding legal effect as an original executed counterpart of this Agreement.

10.14 Severability. If any provision of this Agreement is determined by a court of competent jurisdiction to be invalid or unenforceable, the remainder of this Agreement shall nonetheless remain in full force and effect.

10.15 Applicable Law. This Agreement is performable in the state in which the Land is located and shall in all respects be governed by, and construed in accordance with, the substantive federal laws of the United States and the laws of such state. Seller and Purchaser hereby irrevocably submit to the jurisdiction of any state or federal court sitting in the state in which the Land is located in any action or proceeding arising out of or relating to this Agreement and hereby irrevocably agree that all claims in respect of such action or proceeding shall be heard and determined in a state or federal court sitting in the state in which the Land is located. Purchaser and Seller agree that the provisions of this Section 10.15 shall survive the Closing of the transaction contemplated by this Agreement.

10.16 No Third Party Beneficiary. The provisions of this Agreement and of the documents to be executed and delivered at Closing are and will be for the benefit of Seller and Purchaser only and are not for the benefit of any third party, and accordingly, no third party shall have the right to enforce the provisions of this Agreement or of the documents to be executed and delivered at Closing.

10.17 Exhibits and Schedules. The following schedules or exhibits attached hereto shall be deemed to be an integral part of this Agreement:

<u>Exhibit A</u>	Legal Description of the Land
<u>Exhibit B</u>	Rent Roll
<u>Exhibit C</u>	Operating Agreements Schedule
<u>Exhibit D</u>	Personal Property
<u>Exhibit E</u>	Form of Deed
<u>Exhibit F</u>	Form of Bill of Sale
<u>Exhibit G</u>	Form of Assignment of Leases
<u>Exhibit H</u>	Form of Assignment of Operating Agreements and Intangibles
<u>Exhibit I</u>	Form of Tenant Notice
<u>Exhibit J</u>	Form of Bring-Down Certificate
<u>Exhibit K</u>	Form of Certificate of Non-Foreign Status
<u>Exhibit L</u>	Form of Vendor Notice
<u>Exhibit M</u>	Form of Escrow Agreement

10.18 Captions. The section headings appearing in this Agreement are for convenience of reference only and are not intended, to any extent and for any purpose, to limit or define the text of any section or any subsection hereof.

10.19 Construction. The parties acknowledge that the parties and their counsel have reviewed and revised this Agreement and that the normal rule of construction to the effect that any ambiguities are to be resolved against the drafting party shall not be employed in the interpretation of this Agreement or any exhibits or amendments hereto.

10.20 Termination of Agreement. It is understood and agreed that if either Purchaser or Seller terminates this Agreement pursuant to a right of termination granted hereunder, such termination shall operate to relieve Seller and Purchaser from all obligations under this Agreement, except for such obligations as are specifically stated herein to survive the termination of this Agreement.

10.21 Survival. The provisions of this Article 10 and any other provisions of this Agreement which by their terms are intended to be performed or be applicable after Closing shall survive Closing and shall not be merged into the execution and delivery of the Deed (subject to any express limitation upon the time period of such survival contained herein, including Section 5.3.1). The foregoing is in addition to and not in exclusion of any survival provisions elsewhere set forth in this Agreement.

10.22 No Recordation. Neither this Agreement nor any memorandum of the terms hereof shall be recorded or otherwise placed of public record and any breach of this covenant shall, unless the party not placing same of record is otherwise in default hereunder, entitle the party not placing same of record to pursue its rights and remedies under Article 6. Notwithstanding the foregoing, Purchaser shall be permitted to record a memorandum of the terms hereof or affidavit of this Agreement in the event that Purchaser institutes a suit or action against Seller to enforce the terms of this Agreement pursuant to Purchaser's right of specific performance hereunder.

10.23 Limited Liability. Prior to the Closing, Purchaser's recourse for any breach or default hereunder by Seller shall be limited solely to the assets of Seller. Following the Closing, to the extent that Seller may be liable to Purchaser for any breach or default pursuant to the express provisions of this Agreement, then, subject to the limitations set forth in Section 5.3, Section 6.3 and elsewhere in this Agreement, recourse may be had by Purchaser solely under the Escrow Agreement against any asset of the Seller, including without limitation, Seller's interest in the proceeds of the sale, assignment and transfer of the Property pursuant to this Agreement. Purchaser shall have no recourse against any member or affiliate of Seller.

10.24 Waiver of Jury Trial. **TO THE EXTENT PERMITTED BY APPLICABLE LAW, THE PARTIES HEREBY WAIVE TRIAL BY JURY IN ANY ACTION, PROCEEDING OR COUNTERCLAIM BROUGHT BY EITHER PARTY AGAINST THE OTHER ON ANY MATTER ARISING OUT OF OR IN ANY WAY CONNECTED WITH THIS AGREEMENT. THE PARTIES ACKNOWLEDGE THAT THEY HAVE RETAINED COUNSEL OF THEIR OWN CHOOSING AND SUCH COUNSEL HAS FULLY EXPLAINED THE CONTENT AND LEGAL EFFECT OF THIS SECTION. SELLER OR PURCHASER, AS APPLICABLE, IS HEREBY AUTHORIZED TO FILE A COPY OF THIS SECTION IN ANY PROCEEDING AS CONCLUSIVE EVIDENCE OF THIS WAIVER BY PURCHASER OR SELLER, AS APPLICABLE.**

10.25 Indemnification. Seller hereby agrees to defend, indemnify and hold Purchaser and all directors, officers, shareholders, affiliates, members, managers, partners, employees and agents of Purchaser (each, a "Purchaser Indemnified Party") harmless from and against all losses, damages, costs and expenses incurred by a Purchaser Indemnified Party (including, without limitation, legal fees and disbursements) arising out of any third-party tort claims and related litigation, actions or proceedings based on actions or events occurring prior to the Closing Date (other than any such matter or thing that is caused by the actions of a Purchaser Indemnified Party). The provisions of this Section 10.25 shall survive the Closing.

10.26 Tax-Deferred Exchange. Seller and Purchaser acknowledge that either one or both of them may be entering into this transaction in connection with a tax-deferred exchange (the "Exchange"). If requested by either party, the other party shall cooperate with the requesting party in effectuating such Exchange, including executing any documents, instruments or agreements reasonably requested by the requesting party, provided the other party shall not be obligated to (i) expend any costs in connection with such Exchange or (ii) accept or assume any additional obligations or liabilities in connection with such Exchange.

[signatures on next page – Page S-1]

IN WITNESS WHEREOF, Seller and Purchaser have duly executed this Purchase and Sale Agreement as of the Effective Date.

SELLER:

HILL UNIVERSITY PARTNERS OWNER, LLC, a Delaware limited liability company

By: /s/ James R. Hill
James R. Hill, Authorized Representative

PURCHASER:

THE MUSE OWNER LLC,
a Delaware limited liability company

By: **HIGHLANDS REIT, INC.**, a Maryland corporation

By: /s/ Richard Vance-----
Richard Vance, President

IN WITNESS WHEREOF, Seller and Purchaser have duly executed this Purchase and Sale Agreement as of the Effective Date.

SELLER:

HILL UNIVERSITY PARTNERS OWNER, LLC, a Delaware limited liability company

By:
James R. Hill, Authorized Representative

PURCHASER:

THE MUSE OWNER LLC,
a Delaware limited liability company

By: **HIGHLANDS REIT, INC.**, a Maryland corporation

By: /s/ Richard Vance
Richard Vance, President

JOINDER OF ESCROW HOLDER

Escrow Agent has executed this Agreement in order to confirm that Escrow Agent has received and shall hold the Earnest Money in escrow, and shall disburse the Earnest Money pursuant to the provisions hereof.

FIDELITY NATIONAL TITLE INSURANCE COMPANY

By: __

Name: __

Title: __

Date: __

File # __

Joinder

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Section 3: 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 Quarterly Report on Form 10-Q 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: November 12, 2019

/s/ Richard Vance

Name: Richard Vance

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

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Section 4: 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 Quarterly Report on Form 10-Q 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: November 12, 2019

/s/ Paul Melkus

Name: Paul Melkus

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

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Section 5: 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 Quarterly Report on Form 10-Q of Highlands REIT, Inc. (the "Company") for the period ended September 30, 2019 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: November 12, 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 6: EX-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 Quarterly Report on Form 10-Q of Highlands REIT, Inc. (the "Company") for the period ended September 30, 2019 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: November 12, 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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