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

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

Securities registered pursuant to Section 12(b) of the Act:

| 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 |
|---|---|---|---|---|
| ☐ | ☐ | ☑ | ☑ | ☑ |

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 August 12, 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)

| | June 30, 2019 (Unaudited) | December 31, 2018 |
|---|---|---|
| **Assets** | | |
| Investment properties | | |
| Land | $ 73,279 | $ 72,630 |
| Building and other improvements | 223,972 | 241,897 |
| Construction in progress | 51 | 32 |
| Total | 297,302 | 314,559 |
| Less accumulated depreciation | (51,550) | (72,822) |
| Net investment properties | 245,752 | 241,737 |
| Cash and cash equivalents | 122,751 | 80,512 |
| Restricted cash and escrows | 2,572 | 3,229 |
| Accounts and rents receivable (net of allowance of $1,250 and $1,161) | 5,121 | 5,861 |
| Intangible assets, net | 669 | 408 |
| Deferred costs and other assets, net | 4,498 | 4,233 |
| Total assets | $ 381,363 | $ 335,980 |
| **Liabilities** | | |
| Debt, net | $ 74,795 | $ 34,953 |
| Accounts payable and accrued expenses | 8,996 | 11,653 |
| Intangible liabilities, net | 902 | 3,004 |
| Other liabilities | 2,039 | 2,270 |
| Total liabilities | 86,732 | 51,880 |
| Commitments and contingencies | | |
| **Stockholders' Equity** | | |
| Common stock, $0.01 par value, 1,000,000,000 shares authorized, 875,875,109 and 871,688,704 shares issued and outstanding as of June 30, 2019 and December 31, 2018, respectively | 8,759 | 8,717 |
| Additional paid-in capital | 1,408,925 | 1,407,502 |
| Accumulated distributions in excess of net income | (1,123,053) | (1,132,119) |
| Total stockholders' equity | 294,631 | 284,100 |
| Total liabilities and stockholders' equity | $ 381,363 | $ 335,980 |

See accompanying notes to the condensed consolidated financial statements.

**HIGHLANDS REIT, INC.**

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | **2019** | **2018** | **2019** | **2018** |
| **Revenues** | | | | |
| Rental income | $ 10,298 | $ 10,480 | $ 20,439 | $ 20,946 |
| Other property income | 103 | 343 | 220 | 522 |
| Total revenues | $ 10,401 | $ 10,823 | $ 20,659 | $ 21,468 |
| **Expenses** | | | | |
| Property operating expenses | 1,985 | 1,991 | 3,889 | 4,295 |
| Real estate taxes | 1,317 | 766 | 2,623 | 2,239 |
| Depreciation and amortization | 2,729 | 3,216 | 5,459 | 6,347 |
| General and administrative expenses | 3,082 | 3,004 | 7,465 | 7,183 |
| Total expenses | 9,113 | 8,977 | 19,436 | 20,064 |
| Gain on sale of investment properties, net | 8,841 | — | 8,841 | 25 |
| Income from operations | $ 10,129 | $ 1,846 | $ 10,064 | $ 1,429 |
| Interest income | 398 | 157 | 767 | 290 |
| Interest expense | (1,006) | (708) | (1,765) | (1,414) |
| Income before income taxes | 9,521 | 1,295 | 9,066 | 305 |
| Income tax benefit | — | — | — | 155 |
| Net income | $ 9,521 | $ 1,295 | $ 9,066 | $ 460 |
| Net income per common share, basic and diluted | $ 0.01 | $ 0.00 | $ 0.01 | $ 0.00 |
| Weighted average number of common shares outstanding, basic and diluted | 875,755,799 | 871,427,298 | 874,573,967 | 870,768,359 |

See accompanying notes to the condensed consolidated financial statements.

**HIGHLANDS REIT, INC.**

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

**Three and Six Months Ended June 30, 2019 and 2018**

| | Common Stock | | Additional Paid-in Capital | Accumulated Distributions in Excess of Net Income | Total |
|---|---|---|---|---|---|
| | Shares | Amount | | | |
| Balance at January 1, 2018 | 868,423,581 | $ 8,684 | $ 1,406,460 | $ (1,157,047) | $ 258,097 |
| Net loss | — | — | — | (835) | (835) |
| Share-based compensation | 3,078,425 | 31 | 985 | — | 1,016 |
| Common stock repurchased and retired | (116,334) | (1) | (40) | — | (41) |
| Balance at March 31, 2018 | 871,385,672 | $ 8,714 | $ 1,407,405 | $ (1,157,882) | $ 258,237 |
| Net income | — | — | — | 1,295 | 1,295 |
| Share-based compensation | 151,516 | 1 | 49 | — | 50 |
| Balance at June 30, 2018 | 871,537,188 | $ 8,715 | $ 1,407,454 | $ (1,156,587) | $ 259,582 |
| | | | | | |
| Balance at January 1, 2019 | 871,688,704 | $ 8,717 | $ 1,407,502 | $ (1,132,119) | $ 284,100 |
| Net loss | — | — | — | (455) | (455) |
| Share-based compensation | 3,900,689 | 39 | 1,326 | — | 1,365 |
| Balance at March 31, 2019 | 875,589,393 | $ 8,756 | $ 1,408,828 | $ (1,132,574) | $ 285,010 |
| Net income | — | — | — | 9,521 | 9,521 |
| Share-based compensation | 285,716 | 3 | 97 | — | 100 |
| Balance at June 30, 2019 | 875,875,109 | $ 8,759 | $ 1,408,925 | $ (1,123,053) | $ 294,631 |

See accompanying notes to the condensed consolidated financial statements.

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

| | Six Months Ended June 30, 2019 | Six Months Ended June 30, 2018 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $ 9,066 | $ 460 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 5,459 | 6,347 |
| Amortization of above and below market leases, net | (205) | (205) |
| Amortization of debt discounts and financing costs | 107 | 42 |
| Straight-line rental income | (332) | 40 |
| Gain on sale of investment properties, net | (8,841) | (25) |
| Non-cash stock-based compensation expense | 2,177 | 2,053 |
| Changes in assets and liabilities: | | |
| Accounts and rents receivable,net | (172) | (1,170) |
| Deferred costs and other assets, net | (236) | (509) |
| Accounts payable and accrued expenses | (1,753) | (1,692) |
| Other liabilities | (231) | 347 |
| Net cash flows provided by operating activities | $ 5,039 | $ 5,688 |
| Cash flows from investing activities: | | |
| Capital expenditures and tenant improvements | (560) | (612) |
| Investment in development | — | (1,760) |
| Acquisition of investment properties, net | (43,217) | (9,660) |
| Proceeds from sale of investment properties, net | 53,163 | 60 |
| Payment of leasing fees | (395) | (380) |
| Net cash flows provided by (used in) investing activities | $ 8,991 | $ (12,352) |
| Cash flows from financing activities: | | |
| Payment of debt issuance costs | (392) | — |
| Proceeds from credit agreement | 29,375 | — |
| Principal payments of mortgage debt | (311) | (540) |
| Payment for tax withholding for share-based compensation | (1,120) | (876) |
| Net cash flows provided by (used in) financing activities | $ 27,552 | $ (1,416) |
| Net increase (decrease) in cash and cash equivalents | $ 41,582 | $ (8,080) |
| Cash, cash equivalents and restricted cash, at beginning of period | 83,741 | 56,007 |
| Cash, cash equivalents and restricted cash, at end of period | $ 125,323 | $ 47,927 |

See accompanying notes to the condensed consolidated financial statements.

**HIGHLANDS REIT, INC.**

**Condensed Consolidated Statements of Cash Flows (unaudited)**
(Dollar amounts in thousands)

| | Six Months Ended June 30, | |
|---|---|---|
| | **2019** | **2018** |
| Supplemental disclosure of cash flows information: | | |
| Cash paid for interest | $ 1,471 | $ 1,379 |
| Cash paid for taxes | $ 27 | $ 136 |
| Supplemental schedule of non-cash investing and financing activities: | | |
| Non-cash accruals for capital expense and investment in development | $ 233 | $ 645 |
| Lease assets and liabilities arising from the recognition of right-of-use assets | $ 298 | $ — |
| 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)
**June 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 office assets, industrial assets, retail assets, a correctional facility, multi-family assets, unimproved land and a bank branch. Prior to April 28, 2016, Highlands was a wholly-owned subsidiary of InvenTrust Properties Corp. ("InvenTrust" and formerly known as Inland American Real Estate Trust, Inc.).

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. In connection with the Distribution, Highlands entered into a Separation and Distribution Agreement, Transition Services Agreement and Employee Matters Agreement with InvenTrust.

Each asset is owned by a separate legal entity, which maintains its own books and financial records, and each entity's assets are not available to satisfy the liabilities of other affiliated entities, except as otherwise disclosed in Note 7.

As of June 30, 2019, the Company owned 18 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 certain note disclosures contained in such audited financial statements have been omitted from these interim condensed consolidated financial statements.

Basis of Presentation

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

For the three and six months ended June 30, 2019 and 2018, comprehensive income equaled net income; therefore, separate condensed consolidated statements of comprehensive income are not included in the accompanying condensed consolidated financial statements.

Revenue Recognition

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

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

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

Rental income is recognized on a straight-line basis over the term of each lease. The difference between rental income earned on a straight-line basis and the cash rent due under the provisions of the lease agreements is recorded as deferred rent receivable and is included as a component of accounts and rents receivable in the accompanying 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 Accounting Standards Codification ("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 June 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 over the remaining lease term.The difference between the contractual rental rates and our estimate of market rental rates is measured over a period equal to the remaining non-cancelable term of the leases, including below-market renewal options for which exercise of the renewal option appears to be reasonably assured. The remaining term of leases with renewal options at terms below market reflect the assumed exercise of such below-market renewal options and assume the amortization period would coincide with the extended lease term.We perform, with the assistance of a third-party certified valuation specialist, the following procedures for properties we acquire:

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

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

Capitalization and Depreciation

Real estate is reflected at cost less accumulated depreciation. Ordinary repairs and maintenance are expensed as incurred. Depreciation expense is computed using the straight-line method. Building and other improvements are depreciated based upon estimated useful lives of 30 years for building and improvements and 5-15 years for furniture, fixtures and equipment and site improvements. Tenant improvements are amortized on a straight-line basis over the lesser of the life of the tenant improvement or the lease term as a component of depreciation and amortization expense. Leasing fees are amortized on a straight-line basis over the life of the related lease as a component of depreciation and amortization expense. Loan fees are amortized on a straight-line basis, which approximates the effective interest method, over the life of the related loan as a component of interest expense. Direct and indirect costs that are clearly related to the construction and improvements of investment properties are capitalized. Costs incurred for property taxes and insurance are capitalized during periods in which activities necessary to get the asset ready for its intended use are in progress. Interest costs are also capitalized during such periods.

Assets Held for Sale

In determining whether to classify an investment property as held for sale, the Company considers whether: (i) management has committed to a plan to sell the investment property; (ii) the investment property is available for immediate sale, in its present condition; (iii) the Company has initiated a program to locate a buyer; (iv) the Company believes that the sale of the investment property is probable; (v) the Company has received a significant non-refundable deposit for the purchase of the property; (vi) the Company is actively marketing the investment property for sale at a price that is reasonable in relation to its fair value; and (vii) actions required for the Company to complete the plan indicate that it is unlikely that any significant changes will be made to the plan. If all of the above criteria are met, the Company classifies the investment property as held for sale. On the day that these criteria are met, the Company suspends depreciation on the investment properties held for sale, including depreciation for tenant improvements and additions, as well as on the amortization of acquired in-place leases. The investment properties and liabilities associated with those investment properties that are held for sale are classified separately on the 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 June 30, 2019 and December 31, 2018.

Impairment

The Company assesses the carrying values of the respective long-lived assets, whenever events or changes in circumstances indicate that the carrying amounts of these assets may not be fully recoverable, such as a reduction in the expected holding period of the asset. If it is determined that the carrying value is not recoverable because the undiscounted cash flows do not exceed carrying value, the Company records an impairment loss to the extent that the carrying value exceeds fair value. The valuation and possible subsequent impairment of investment properties is a significant estimate that can and does change based on the Company’s continuous process of analyzing each asset and reviewing assumptions about uncertain inherent factors, as well as the economic condition of the asset at a particular point in time. The use of projected future cash flows and related holding period is based on assumptions that are consistent with the estimates of future expectations and the strategic plan the Company uses to manage its underlying business. However, assumptions and estimates about future cash flows and capitalization rates are complex and subjective. Changes in economic and operating conditions and the Company’s ultimate investment intent that occur subsequent to the impairment analyses could impact these assumptions and result in future impairment charges of the real estate assets.

***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 in the period of adoption and prospectively. As a lessee, the Company recognized a right-of-use asset and lease liability included in deferred costs and other assets and other liabilities, respectively, as of June 30, 2019, on the condensed consolidated balance sheets of approximately $298, 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 June 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.

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

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 six months ended June 30, 2019 and 2018, respectively, was not material.

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 June 30, 2019 and December 31, 2018, the Company's cash balances restricted for these uses were $2,572 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 $2,572 and $3,229, as of June 30, 2019 and December 31, 2018, respectively.

| | June 30, 2019 | December 31, 2018 |
|---|---|---|
| Cash and cash equivalents | $ 122,751 | $ 80,512 |
| Restricted cash | 2,572 | 3,229 |
| Total cash, cash equivalents and restricted cash | $ 125,323 | $ 83,741 |

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

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

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

## 3. Acquired Properties

The Company records identifiable assets and liabilities acquired at fair value. During the six months ended June 30, 2019, the Company acquired four multi-family assets for a gross acquisition price of $54,681. Under ASU No. 2017-01, the Company determined these transactions should be accounted for as asset acquisitions. Accordingly, the Company capitalized transaction costs of approximately $181.

| 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 |
| | | | $ 54,681 |

The purchase price allocation has been allocated as follows:

| | The Detroit and Detroit Terraces | The View | The Tennyson44 | Total |
|---|---|---|---|---|
| Land | $ 3,370 | $ 7,272 | $ 1,533 | $ 12,175 |
| Buildings and other improvements | 15,006 | 8,862 | 17,410 | 41,278 |
| Intangible assets, net | 301 | 286 | 248 | 835 |
| Total assets | $ 18,677 | $ 16,420 | $ 19,191 | $ 54,288 |
| | | | | |
| Debt discount on mortgage assumption | 393 | — | — | 393 |
| Total liabilities | $ 393 | $ — | $ — | $ 393 |
| | | | | |
| Total acquisition price | $ 19,070 | $ 16,420 | $ 19,191 | $ 54,681 |

During the six months ended June 30, 2018, the Company acquired one multi-family asset for a gross acquisition price of $9,679 and capitalized transaction costs of approximately $154. The purchase price allocation has been allocated as follows:

| | The Lafayette |
|---|---|
| Land | $ 2,457 |
| Buildings and other improvements | 7,067 |
| Intangible assets, net | 155 |
| Total acquisition price | $ 9,679 |

## 4. Disposed Properties

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

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

| 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 Company sold a vacant parcel of land adjacent to a retail asset during the six months ended June 30, 2018 for a gross disposition price of $60 and recognized a net gain on sale of investment properties of $25.

## 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 an average term of approximately five years for the six months ended June 30, 2019 and ranging from four to ten years for the year ended 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.

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.

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

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2019 | 2018 | 2019 | 2018 |
| Lease income related to fixed lease payments | $ 8,471 | $ 8,563 | $ 16,674 | $ 17,078 |
| Lease income related to variable lease payments | 1,827 | 1,917 | 3,765 | 3,868 |
| Other [(1)] | 103 | 343 | 220 | 522 |
| Lease income | $ 10,401 | $ 10,823 | $ 20,659 | $ 21,468 |

(1) For the three and six months ended June 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 June 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.

| | |
|---|---|
| 2019 | $ 11,174 |
| 2020 | 12,742 |
| 2021 | 10,830 |
| 2022 | 8,444 |
| 2023 | 7,925 |
| Thereafter | 26,284 |
| Total | $ 77,399 |

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 June 30, 2019, the balances were $298. 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 June 30, 2019 and a reconciliation of those cash flows to the operating lease liability at June 30, 2019.

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

| | | |
|---|---|---|
| 2019 | $ | 11 |
| 2020 | | 21 |
| 2021 | | 21 |
| 2022 | | 21 |
| 2023 | | 21 |
| 2024 | | 21 |
| Thereafter | | 373 |
| | | 489 |
| Imputed interest | | (191) |
| Lease liability | $ | 298 |

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

| | | |
|---|---|---|
| 2019 | $ | 21 |
| 2020 | | 21 |
| 2021 | | 21 |
| 2022 | | 21 |
| 2023 | | 21 |
| 2024 | | 21 |
| Thereafter | | 373 |
| Total | $ | 499 |

## 6. Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consist of the following:

| | June 30, 2019 | December 31, 2018 |
|---|---|---|
| Accrued real estate taxes | $ 5,535 | $ 5,669 |
| Accrued compensation | 1,945 | 3,232 |
| Accrued interest payable | 305 | 119 |
| Other accrued expenses | 1,211 | 2,633 |
| | $ 8,996 | $ 11,653 |

## 7. Debt

Total debt outstanding as of June 30, 2019 and December 31, 2018, net of unamortized deferred financing costs and debt discounts, was $74,795 and $34,953, respectively, and had a weighted average interest rate of 4.47% and 4.74% per annum, respectively. Deferred financing costs, net, as of June 30, 2019 and December 31, 2018 were $1,414 and $490, respectively. Debt discounts, as of June 30, 2019 and December 31, 2018 were $373 and $0, respectively. As of June 30, 2019, scheduled maturities for the Company’s outstanding mortgage indebtedness and the credit facility had various due dates through August 2027, as follows:

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

| For the year ended December 31, | As of June 30, 2019 | | Weighted average interest rate |
|---|---|---|---|
| 2019 | $ | — | —% |
| 2020 | | — | —% |
| 2021 | | — | —% |
| 2022 | | 9,266 | 5.24% |
| Thereafter | | 67,316 | 4.36% |
| Total | $ | 76,582 | 4.47% |

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 June 30, 2019 and December 31, 2018, the Company is in compliance with such covenants in all material respects.

The Company assumed an allocated principal mortgage loan amount of $11,449 and debt discount of $393 in connection with the acquisition of The Detroit and Detroit Terraces on January 8, 2019. 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 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 June 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 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 six months ended June 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.

## 8. Fair Value Measurements

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

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

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

***Non-Recurring Measurements***

During the six months ended June 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***

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

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

| | June 30, 2019 | | December 31, 2018 | |
|---|---|---|---|---|
| | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| Debt | $ 74,795 | $ 78,270 | $ 34,953 | $ 35,222 |

The Company estimates the fair value of its debt instruments using a weighted average market effective interest rate of 3.69% and 4.70% per annum as of June 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 3.43% to 4.22% as of June 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 six months ended June 30, 2019, no income tax benefit or expense was included on the condensed consolidated statements of operations. During the three and six months ended June 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.

**HIGHLANDS REIT, INC.**

**Notes to Condensed Consolidated Financial Statements (unaudited)**
(Amounts in thousands, except share and per share amounts)
**June 30, 2019**

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

| | Total | Net Lease | Retail | Multi-Tenant Office | Multi-family | Other |
|---|---|---|---|---|---|---|
| Rental income | $ 10,298 | $ 3,170 | $ 4,823 | $ 732 | $ 1,573 | $ — |
| Other property income | 103 | — | 4 | — | 99 | — |
| Total income | 10,401 | 3,170 | 4,827 | 732 | 1,672 | — |
| Operating expenses | 3,302 | 143 | 2,157 | 184 | 643 | 175 |
| Net operating income (loss) | $ 7,099 | $ 3,027 | $ 2,670 | $ 548 | $ 1,029 | $ (175) |
| Non-allocated expenses (a) | (5,811) | | | | | |
| Other income and expenses (b) | (608) | | | | | |
| Gain on sale of investment properties (c) | 8,841 | | | | | |
| Net income | $ 9,521 | | | | | |

(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.
(c) Gain on the sale of investment properties is related to one retail asset and one land parcel.

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

| | Total | Net Lease | Retail | Multi-Tenant Office | Multi-family | Other |
|---|---|---|---|---|---|---|
| Rental income | $ 10,480 | $ 3,176 | $ 6,009 | $ 925 | $ 370 | $ — |
| Other property income | 343 | — | 11 | 252 | 80 | — |
| Total income | 10,823 | 3,176 | 6,020 | 1,177 | 450 | — |
| Operating expenses | 2,757 | 171 | 2,254 | 621 | 200 | (489) |
| Net operating income | $ 8,066 | $ 3,005 | $ 3,766 | $ 556 | $ 250 | $ 489 |
| Non-allocated expenses (a) | (6,220) | | | | | |
| Other income and expenses (b) | (551) | | | | | |
| Net income | $ 1,295 | | | | | |

(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.

**HIGHLANDS REIT, INC.**

**Notes to Condensed Consolidated Financial Statements (unaudited)**
(Amounts in thousands, except share and per share amounts)
**June 30, 2019**

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

| | Total | Net Lease | Retail | Multi-Tenant Office | Multi-family | Other |
|---|---|---|---|---|---|---|
| Rental income | $ 20,439 | $ 6,350 | $ 9,817 | $ 1,484 | $ 2,788 | $ — |
| Other property income | 220 | — | 24 | — | 196 | — |
| Total income | 20,659 | 6,350 | 9,841 | 1,484 | 2,984 | — |
| Operating expenses | 6,512 | 300 | 4,325 | 358 | 1,196 | 333 |
| Net operating income (loss) | $ 14,147 | $ 6,050 | $ 5,516 | $ 1,126 | $ 1,788 | $ (333) |
| Non-allocated expenses (a) | (12,924) | | | | | |
| Other income and expenses (b) | (998) | | | | | |
| Gain on sale of investment properties (c) | 8,841 | | | | | |
| Net income | $ 9,066 | | | | | |
| Balance Sheet Data | | | | | | |
| Real estate assets, net (d) | $ 246,421 | $ 35,536 | $ 68,054 | $ 26,675 | $ 107,203 | $ 8,953 |
| Non-segmented assets (e) | 134,942 | | | | | |
| Total assets | $ 381,363 | | | | | |
| Capital expenditures | $ 560 | $ — | $ 288 | $ 7 | $ 265 | $ — |

(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.
(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 six months ended June 30, 2018.

| | Total | Net Lease | Retail | Multi-Tenant Office | Multi-family | Other |
|---|---|---|---|---|---|---|
| Rental income | $ 20,946 | $ 6,361 | $ 12,072 | $ 1,846 | $ 667 | $ — |
| Other property income | 522 | — | 19 | 340 | 163 | — |
| Total income | 21,468 | 6,361 | 12,091 | 2,186 | 830 | — |
| Operating expenses | 6,534 | 360 | 4,678 | 1,378 | 383 | (265) |
| Net operating income | $ 14,934 | $ 6,001 | $ 7,413 | $ 808 | $ 447 | $ 265 |
| Non-allocated expenses (a) | (13,530) | | | | | |
| Other income and expenses (b) | (969) | | | | | |
| Gain on sale of investment properties (c) | 25 | | | | | |
| Net income | $ 460 | | | | | |
| Balance Sheet Data | | | | | | |
| Real estate assets, net (d) | $ 272,358 | $ 41,377 | $ 146,141 | $ 46,471 | $ 28,701 | $ 9,668 |
| Non-segmented assets (e) | 56,848 | | | | | |
| Total assets | $ 329,206 | | | | | |
| Capital expenditures | $ 2,372 | $ — | $ 609 | $ 1,710 | $ — | $ 53 |

(a) Non-allocated expenses consists of general and administrative expenses and depreciation and amortization.
(b) Other income and expenses consists of interest income, interest expense and income tax benefit.

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

**11. Earnings Per Share**

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

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2019 | 2018 | 2019 | 2018 |
| **Numerator:** | | | | |
| Net income | $ 9,521 | $ 1,295 | $ 9,066 | $ 460 |
| **Denominator:** | | | | |
| Weighted average number of common shares outstanding - basic and diluted | 875,755,799 | 871,427,298 | 874,573,967 | 870,768,359 |
| **Basic and diluted earnings per share:** | | | | |
| Net income per common share | $ 0.01 | $ 0.00 | $ 0.01 | $ 0.00 |

**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 six months ended June 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 $250 that will vest in equal installments in August, 2019 and 2020, respectively, subject to the applicable executive's continued employment with the Company through the vest dates. During the six months ended June 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 June 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 June 30, 2019 is as follows:

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

| **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 | (7,385,716) | 0.35 |
| Other (1) | (121,212) | — |
| Balance at June 30, 2019 | 714,286 | $ 0.35 |

(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 six months ended June 30, 2019 and 2018, the Company recognized stock-based compensation expense of $2,177 and $2,053. For the three months ended June 30, 2019 and 2018, the Company recognized stock-based compensation expense of $184 and $198, respectively, related to the Incentive Award Plan. At June 30, 2019, there was approximately $115 of estimated unrecognized compensation expense related to these awards, which is expected to be recognized through August 1, 2020. For the six months ended June 30, 2019 and 2018, the Company paid $1,120 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 June 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 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 six months ended June 30, 2019, 24.1% 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.

**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 June 30, 2019, our portfolio of assets consisted of one office asset, two industrial assets, four retail assets, nine 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 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 June 30, 2019, and 2018.

**Basis of Presentation**

The accompanying condensed consolidated financial statements include the accounts of Highlands REIT, Inc., as well as all of Highlands' wholly-owned subsidiaries (collectively, the "Company"). Wholly-owned 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***

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

| Property | Location | Acquisition Date | Acquisition Price (in thousands) |
|---|---|---|---|
| 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 | 19,199 |
| | | | $ 54,689 |

During the six months ended June 30, 2019, we continued to execute on our strategy of disposing of legacy "non-core" assets by selling the following properties:

| Property | Location | Disposition Date | Gross Disposition Price (in thousands) | Sale Proceeds, Net (in thousands) | Gain on Sale (in thousands) |
|---|---|---|---|---|---|
| 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 six months ended June 30, 2019 and 2018***

Key performance indicators are as follows:

| | As of June 30, 2019 | As of June 30, 2018 |
|---|---|---|
| Economic occupancy (a) | 91.6% | 82.7% |
| Rent per square foot (b) | $ 17.52 | $ 15.68 |

(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) Three Months Ended June 30, | | | | (in thousands) Six Months Ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2019 | 2018 | Increase (Decrease) | | 2019 | 2018 | Increase (Decrease) | |
| Net income | $ 9,521 | $ 1,295 | $ 8,226 | N/A | $ 9,066 | $ 460 | $ 8,606 | N/A |

Net income increased by $8.2 million, to $9.5 million for the three months ended June 30, 2019, from $1.3 million for the three months ended June 30, 2018, primarily as a result of the gain on the sale of investment properties in the amount of $8.8 million, partially offset by a reduction in revenues as a result of dispositions during 2018.

Net income increased by $8.6 million, to $9.1 million for the six months ended June 30, 2019, from $0.5 million for the six months ended June 30, 2018, primarily as a result of the the factors discussed above.

*Operating Income and Expenses*

| | (in thousands) For the Three months ended June 30, | | | | (in thousands) For the Six months ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2019 | 2018 | Increase (Decrease) | | 2019 | 2018 | Increase (Decrease) | |
| Income: | | | | | | | | |
| Rental income | $ 10,298 | $ 10,480 | $ (182) | (1.7)% | $ 20,439 | $ 20,946 | $ (507) | (2.4)% |
| Other property income | 103 | 343 | (240) | (70.0)% | 220 | 522 | (302) | (57.9)% |
| Total revenues | $ 10,401 | $ 10,823 | $ (422) | (3.9)% | $ 20,659 | $ 21,468 | $ (809) | (3.8)% |
| | | | | | | | | |
| Expenses: | | | | | | | | |
| Property operating expenses | $ 1,985 | $ 1,991 | $ (6) | (0.3)% | $ 3,889 | $ 4,295 | $ (406) | (9.5)% |
| Real estate taxes | 1,317 | 766 | 551 | 71.9 % | 2,623 | 2,239 | 384 | 17.2 % |
| Depreciation and amortization | 2,729 | 3,216 | (487) | (15.1)% | 5,459 | 6,347 | (888) | (14.0)% |
| General and administrative expenses | 3,082 | 3,004 | 78 | 2.6 % | 7,465 | 7,183 | 282 | 3.9 % |
| Total expenses | $ 9,113 | $ 8,977 | $ 136 | 1.5 % | $ 19,436 | $ 20,064 | $ (628) | (3.1)% |

Property Income and Operating Expenses

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 $0.4 million in the three months ended June 30, 2019 compared to the same period in 2018 as a result of the disposition of 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 $0.8 million in the six months ended June 30, 2019 compared to the same period in 2018, primarily as a result of the factors discussed above.

Property operating expense reductions related to the Triangle and Bridgeside asset dispositions discussed above were offset by property operating expense increases related to the multi-family asset acquisitions during 2018 and 2019.

Property operating expenses decreased in the three and six months ended June 30, 2019 compared to the same period in 2018, primarily as a result of the disposition of 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 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 increased by $0.6 million and $0.4 million during the three and six months ended June 30, 2019, respectively, compared to the same periods in 2018, primarily as a result of an increase related to acquisitions offset by dispositions and 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 $0.5 million and $0.9 million for the three and six months ended June 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 expenses were generally consistent in the three and six months ended June 30, 2019 compared to the same period in 2018.

*Non-Operating Income and Expenses*

| | (in thousands) For the Three months ended June 30, | | | | (in thousands) For the Six months ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2019 | 2018 | Increase (Decrease) | | 2019 | 2018 | Increase (Decrease) | |
| Non-operating income and expenses: | | | | | | | | |
| Interest income | $ 398 | $ 157 | $ 241 | N/A | $ 767 | $ 290 | $ 477 | N/A |
| Gain on sale of investment properties, net | 8,841 | — | 8,841 | —% | 8,841 | 25 | 8,816 | N/A |
| Interest expense | (1,006) | (708) | 298 | 42.1% | (1,765) | (1,414) | 351 | 24.8 % |
| Income tax benefit | — | — | — | —% | — | 155 | (155) | (100.0)% |

Interest Income

Interest income increased by $0.2 million and $0.5 million during the three and six months ended June 30, 2019, respectively, as compared to the same periods in 2018 as a result of an increase in cash balances during the first and second quarters of 2019 compared to 2018.

Gain on Sale of Investment Properties

During the three and six months ended June 30, 2019, the gain on sale of investment properties was attributed to Highlands' sale of the Lincoln Center retail asset and the RDU land parcel.

During the six months ended June 30, 2018, the gain on sale of investment properties, recognized in the first quarter, was attributed to Highlands' sale of a vacant land parcel related to one of our retail assets.

Interest Expense

The increase in interest expense during the three and six months ended June 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 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.

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 June 30, 2018. During the three and six months ended June 30, 2019, no income tax benefit or expense was included on the condensed consolidated statements of operations.

*Leasing Activity*

Our primary source of funding for our property-level operating activities and debt payments is rent collected pursuant to our tenant leases. The following table represents lease expirations, excluding multi-family leases, as of June 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 | 5 | 67,266 | $ 975 | 4.6% | 4.0% | $ 14.49 |
| 2020 | 13 | 348,443 | 10,741 | 23.9% | 44.2% | 30.83 |
| 2021 | 5 | 116,633 | 1,714 | 8.0% | 7.1% | 14.70 |
| 2022 | 5 | 156,825 | 2,217 | 10.7% | 9.1% | 14.14 |
| 2023 | 4 | 11,155 | 181 | 0.7% | 0.7% | 16.22 |
| 2024 | 4 | 40,948 | 692 | 2.8% | 2.8% | 16.89 |
| 2025 | 4 | 32,367 | 391 | 2.2% | 1.6% | 12.10 |
| 2026 | 3 | 17,191 | 354 | 1.2% | 1.5% | 20.60 |
| 2027 | 5 | 595,816 | 5,686 | 40.9% | 23.4% | 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 | 391 | 1.7% | 1.6% | 16.08 |
| Grand Total | 56 | 1,458,228 | $ 24,300 | 100.0% | 100.0% | $ 16.66 |

The following table represents new and renewed leases that commenced in the six months ended June 30, 2019.

| | # of Leases | Gross Leasable Area (square feet) | Rent per square foot | Weighted Average Lease Term (years) |
|---|---|---|---|---|
| New | 2 | 7,967 | $ 18.72 | 5.96 |
| Renewals | 2 | 19,500 | $ 12.40 | 4.85 |
| Total | 4 | 27,467 | $ 14.23 | 5.17 |

During the six months ended June 30, 2019, four new leases and renewals commenced with gross leasable area totaling 27,467 square feet. The weighted average lease term for new and renewal leases was 5.96 and 4.85 years, respectively.

**Liquidity and Capital Resources**

As of June 30, 2019, we had $122.8 million of cash and cash equivalents, and $2.6 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:

- 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, 24.2% of our revenue for the six months ended June 30, 2019 is derived from a net lease with The GEO Group, Inc. on 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, we do not expect The GEO Group, Inc. to renew its lease on our Hudson correctional facility asset. The lease expires in January of 2020. See also Note 14 to the condensed consolidated financial statements for further information related to the The GEO Group, Inc.'s notice of non-renewal.

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 June 30, 2019 (dollar amounts are stated in thousands).

| Debt maturing during the year ended December 31, | As of June 30, 2019 | Weighted average interest rate, fixed |
|---|---|---|
| 2019 | $ — | —% |
| 2020 | — | —% |
| 2021 | — | —% |
| 2022 | 9,266 | 5.24% |
| Thereafter | 67,316 | 4.36% |
| Total | $ 76,582 | 4.47% |

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 wholly-owned property-owning subsidiary is unable to refinance or sell the related asset, or in the event that the estimated asset value is less than the mortgage balance, the applicable wholly-owned property-owning subsidiary may, if appropriate, satisfy a mortgage obligation by transferring title of the asset to the lender or permitting a lender to foreclose.

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

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 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.

Total debt outstanding as of June 30, 2019 and December 31, 2018 was $76.6 million million and $35.4 million, respectively, and had a weighted average interest rate of 4.47% and 4.74%, respectively, per annum.

**Summary of Cash Flows**

***Comparison of the six months ended June 30, 2019 and 2018***

| | (in thousands) | |
|---|---|---|
| | Six Months Ended June 30, | |
| | 2019 | 2018 |
| Net cash flows provided by operating activities | $ 5,039 | $ 5,688 |
| Net cash flows provided by (used in) investing activities | 8,991 | (12,352) |
| Net cash flows provided by (used in) financing activities | 27,552 | (1,416) |
| Net increase (decrease) in cash and cash equivalents | 41,582 | (8,080) |
| Cash, cash equivalents and restricted cash, at beginning of period | 83,741 | 56,007 |
| Cash, cash equivalents and restricted cash, at end of period | $ 125,323 | $ 47,927 |

Cash provided by operating activities was $5.0 million for the six months ended June 30, 2019 and $5.7 million for the six months ended June 30, 2018. Cash provided by operating activities decreased $0.6 million compared to the same period in 2018, primarily as a result of the disposition of assets during 2018.

Cash provided by investing activities was $9.0 million for the six months ended June 30, 2019 compared to cash used in investing activities of $12.4 million for the six months ended June 30, 2018. Cash provided by investing activities increased $21.3 million compared to the same period in 2018 as a result of the disposition of properties in 2019, partially offset by the acquisition of the three multi-family assets during the first and second quarters of 2019.

Cash provided by financing activities was $27.6 million for the six months ended June 30, 2019 compared to cash used in financing activities of $1.4 million for the six months ended June 30, 2018. Cash provided by financing activities for the six months ended June 30, 2019 was primarily related to borrowings in the amount of $30.0 million related to the Credit Facility. See also Note 7 to the condensed consolidated financial statements for a summary of the Credit Agreement. Cash used in financing activities for the six months ended June 30, 2018 was primarily related to principal payments on mortgage debt of $0.5 million and the payment for tax withholding on share-based compensation of $0.9 million.

We consider all demand deposits, money market accounts and investments in certificates of deposit and repurchase agreements with a maturity of six 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 six months ended June 30, 2019 and 2018, no cash distributions were paid by Highlands.

**Off-Balance Sheet Arrangements**

As of June 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 | |
|---|---|---|
| | June 30, 2019 | December 31, 2018 |
| **Balance Sheet Data:** | | |
| Total assets | $ 381,363 | $ 335,980 |
| Debt, net | $ 74,795 | $ 34,953 |

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2019 | 2018 | 2019 | 2018 |
| **Operating Data:** | | | | |
| Total revenues | $ 10,401 | $ 10,823 | $ 20,659 | $ 21,468 |
| Net income | $ 9,521 | $ 1,295 | $ 9,066 | $ 460 |
| Net income per common share, basic and diluted | $ 0.01 | $ 0.00 | $ 0.01 | $ 0.00 |
| **Balance Sheet Data:** | | | | |
| Cash, cash equivalents and restricted cash | $ 125,323 | $ 47,927 | $ 125,323 | $ 47,927 |
| Long-term obligations (a) | $ 76,880 | $ 55,345 | $ 76,880 | $ 55,345 |
| **Supplemental Measures (unaudited):** | | | | |
| Funds from operations and adjusted funds from operations (b) | $ 3,409 | $ 4,511 | $ 5,684 | $ 6,782 |
| **Cash Flows Data:** | | | | |
| Net cash flows provided by operating activities | $ 5,043 | $ 4,560 | $ 5,039 | $ 5,688 |
| Net cash flows provided by (used in) investing activities | $ 16,747 | $ (11,559) | $ 8,991 | $ (12,352) |
| Net cash flows provided by (used in) financing activities | $ (152) | $ (267) | $ 27,552 | $ (1,416) |

(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. For the periods presented, AFFO and FFO yield the same results.

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 June 30, 2019 | Three Months Ended June 30, 2018 | Six Months Ended June 30, 2019 | Six Months Ended June 30, 2018 |
|---|---|---|---|---|
| Net income | $ 9,521 | $ 1,295 | $ 9,066 | $ 460 |
| Depreciation and amortization | 2,729 | 3,216 | 5,459 | 6,347 |
| Gain on sale of investment properties, net | (8,841) | — | (8,841) | (25) |
| Funds from operations and adjusted funds from operations | $ 3,409 | $ 4,511 | $ 5,684 | $ 6,782 |

***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. Additionally, the Company believes the information included in the above table provides useful supplemental information that may facilitate comparisons of the Company's ongoing operating performance between periods, as well as between REITs that include similar disclosure.

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 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

Not applicable.

## 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 June 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 June 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 June 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 | Agreement of Purchase and Sale, dated February 13, 2019, by and among MB Lincoln Mall, LLC, as seller, and Lincoln Mall Owner, LLC., as purchaser (incorporated by reference to Exhibit 10.1 to the Company’s Quarterly Report on Form 10-Q, filed with the Securities and Exchange Commission on May 10, 2019) |
| 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 |

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* 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.

| Signature | Title | Date |
|---|---|---|
| /s/ Richard Vance<br>Richard Vance | President and Chief Executive Officer (Principal Executive Officer) | August 13, 2019 |
| /s/ Paul Melkus<br>Paul Melkus | Executive Vice President and Chief Financial Officer (Principal Financial Officer) | August 13, 2019 |



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# Section 2: 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: August 13, 2019

/s/ Richard Vance

Name: Richard Vance

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

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# Section 3: 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: August 13, 2019 | /s/ Paul Melkus |
| | Name: Paul Melkus |
| | Title: Executive Vice President and Chief Financial Officer (Principal Financial Officer) |

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# Section 4: 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 June 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: August 13, 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 5: EX-32.2 (EXHIBIT 32.2)

**Exhibit 32.2**

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

In connection with the Quarterly Report on Form 10-Q of Highlands REIT, Inc. (the “Company”) for the period ended June 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: | August 13, 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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