

## LETTER FROM THE CHAIRMAN OF THE BOARD TO SHAREHOLDERS:\*



Chaim Katzman  
Chairman of the Board of  
Directors

My fellow Shareholders:

I was wondering how best to sum up a good year. Our Company earned approximately NIS 983 million; we achieved a return on capital of 24% and increased our cash flow by 15%. And yet, despite these impressive achievements our market value fell by approximately 26%.

The explanation of this contradiction, in my opinion, is the market's misinterpretation of the subprime crisis. The market has viewed this as an overarching real estate issue and failed to draw the necessary distinctions between the different real estate sectors. The truth is that the subprime crisis is primarily tied to the housing mortgage bond industry; namely residential real estate, and is not directly tied to income producing real estate, the sphere in which Gazit-Globe operates. However, we believe that up to this point, the lines between institutional and residential real estate have become blurred and the market has failed to draw distinctions between the different real estate sectors. And, as a consequence, all institutions tied to the real estate industry have been effected.

There is no doubt that the excess supply of finance and the dramatic price increases over recent years have resulted in some real estate companies losing contact with reality. This distinction was especially true with regard to the failure to distinguish between institutional and non-institutional properties. Institutional properties are those characterized by extreme barriers to entry, superior location and credit tenants whereas non-institutional properties are those located in less desirable areas with low barriers to entry and non-credit tenants.

The market's failure to draw these distinctions has created broad confusion. It has caused a waiver of the fundamental principles of investment management and the most basic business caution. It appears that in the frenzied pursuit of easy profits, the public has forgotten two facts: that we need to pay interest, and, finally that at the end of the day, loans need to be repaid.

We have been here before. The US capital markets faced similar issues at the end of the 1980's when the banking industry folded like a house of cards as a result of years of wild and irresponsible loan policies. Then, Gazit-Globe anticipated what was taking place and succeeded in preserving the highest levels of liquidity. As a result, when the market turned, Gazit was able to acquire high quality property portfolios at bargain prices. Now, my fellow shareholders, history has repeated itself.

A year ago, in my letter to you I wrote that "as usual" there were no free meals in the real estate industry and only the professionals and the very cautious would succeed in the long-term. It is those that showed restraint by not getting excited by every "mega purchase" (at peak prices) that will weather the current storm.

This current crisis, as with many previous crises, will bring the market back to normal levels and will cause a rationalization in business management. And, when the dust settles, the market will once again display the wisdom in recognizing the value of companies like Gazit-Globe whose portfolio consists of high quality commercial real estate coupled with strong professional management. The market will again behave with plenty of caution and responsibility - until it forgets its lessons again.

In the interim, we will witness a process, the signs of which are already discernible in the market that will provide the larger, well financed, vertically integrated real estate companies the ability to flourish and grow. These companies will understand how to operate and succeed at every stage of the real estate "food chain". They will know how to locate, build, manage and finance real estate. Many of these real estate companies will establish joint ventures with large institutional partners who are seeking stable and growing cash flows, secured by leases with investment grade tenants.

For the past two years Gazit Globe has been involved in a process that will establish it as one of the true global leaders in the international real estate sector. We have strengthened our managerial structure with both the appointment of Miki Bar Haim as CEO and the promotion of Dori Segal to the position of Deputy Chairman. In addition, we have recruited high quality managers for our offices in Brazil, Germany and the United States. Finally, we have reinforced the ranks of our core businesses: FCR in Canada, EQY in the United States, CITYCON in Europe and Gazit-Global Development in Israel and Bulgaria.

During the past year, while the markets have been acting irrationally, we have remained focused and disciplined. We acquired a significant holding in A. Dori, one of Israel's leading construction companies. Furthermore, at the start of 2008, in the US, we announced a strategic alliance with The State of California Public Employees' Retirement System (CalPERS), one of the largest pension funds in the world. And, in Finland, we established an alliance with The Government of Singapore Investment Corporation (GIC), one of the largest real estate investors in the world. The acquisitions and alliances of the past year speak for themselves. They are illustrative of our ability to take advantage of the confusion swirling in the marketplace that ensures when the current crisis ends (and it will), we will emerge stronger and more global.

I am aware of the atmosphere of gloom that is currently gripping the capital and real estate markets. It would be a mistake to get caught up in the turmoil. Rather, we view the present situation as an opportunity to examine the facts and not the mood. Our investment considerations include the following:

1. Scrutinize the properties of the company: Is it a quality portfolio? Are the properties situated in good locations, in areas with extreme barriers to entry and/or rapid growth? How are

- rents relative to market? Are the assets of an "institutional" standard? Would you like to be the owner of this portfolio if you had the opportunity to be?
2. Study the cash flow of the company: Is it protected? Is the cash flow from sufficiently diversified sources? Is it stable? What is the possibility that the cash flow will grow? Does it service the repayment of debt, even slightly?
  3. Analyze the structure of the debt: Does it carry a fixed or variable interest rate? Is it long or short term? Is the pre-payment schedule sufficiently spread out so as not to cause a shortage of cash flow? Does the company have a clear dividend policy?
  4. Consider the management of the company: Would you feel comfortable with the management? Do they have strong ethical values? Do they have enough experience and know how to steer the company through stormy times? Will they be able to locate business opportunities and to nurture them? Is this a management team that knows how to establish itself as an international company? Are the interests of the managers identical to the interests of the shareholders of the company and are their rewards a function of the success of the company?

Be selective. If you have the wisdom to invest in a company that possesses the criteria mentioned above, and if you agree with me that real estate is a long term investment, then I have no doubt that you will realize that the uncertainty in the market represents a golden opportunity that will bear fruit for many years to come. We utilize the same principles when we study possible investments in properties or property companies. Beyond that, we factor in our experience and expertise, at improving the assets and their cash flows; our capability to enhance the quality of management of the company acquired and, naturally, the influence the transaction has on our balance sheet and cash flow and our ability to repay the debt over a long period.

In conclusion, I would like to thank all the managers and employees of our company and its subsidiaries. Without their hard work all this would not have been possible. I would also like to thank the members of the Board of Directors and especially my partner and friend Dori Segal, as well as my "alter ego" - Vice Chairman, Arie Mientkavich - for all his assistance and patience. We at Gazit-Globe will continue this year, as we do every year, to be driven to achieve what we have managed to do in the past - and with even more enthusiasm.

I wish to thank you, our Shareholders, for remaining with us especially in these unusual times.

Chaim Katzman  
Chairman of the Board