

GAZIT-GLOBE LTD.

Directors' Report to Shareholders For the periods ended June 30, 2006

The Board of Directors of Gazit-Globe Ltd. (hereinafter – “the Company”) is honored to present the financial statements of the Company and its consolidated subsidiaries for the periods ended June 30, 2006:

1. A. General

The Company – directly and through subsidiaries and an affiliate – is engaged in the acquisition, development, and management of income-producing properties in North America, Europe and Israel, and focuses mainly on supermarket-anchored shopping centers. In addition, the Company is active in the senior housing communities and the medical office buildings sectors in the U.S.A., and also continues to seek out and realize opportunities in its business and/or synergetic businesses, both in regions where it operates and other regions.

B. Properties of the Company and its Subsidiaries (hereinafter – “the Group”)

As of the date of the financial statements, the Group owns and manages, by itself and through an affiliate, 498 properties, as follows:

- 470 operational shopping centers and stores
- 17 shopping centers under development
- 7 senior housing communities (encompassing some 860 units)
- 2 senior housing communities under development
- 1 medical office building with a multi-story parking garage
- 1 office building in Tel-Aviv

The abovementioned properties have a Gross Leasable Area (“G.L.A.”) of approximately 4.2 million square meters. These properties are recorded in the Company’s books at a value of NIS 28 billion and generate an annual rental revenue of NIS 3.2 billion. (Annual rental revenue data is based on the gross annual rent from the properties currently owned at the exchange rate on the date of the financial statements.)

In addition, the Group has a 20% interest in an unconsolidated joint venture that owns and manages 29 shopping centers in Texas, U.S.A., with a G.L.A. of approximately 260 thousand square meters.

In the U.S.A., the Company operates mainly through Equity One Inc. (hereinafter – “EQY”), a public company listed on the NYSE (NYSE: EQY). EQY is a self-administrated, self-managed REIT (Real Estate Investment Trust) for tax purposes. As of the date of the financial statements, the Company owns, directly and indirectly (including through the subsidiary, First Capital Realty Inc., as described below), 41% of EQY. EQY’s properties are located primarily in growing metropolitan areas in the southeastern United States (mainly in Florida and Georgia) and in the Boston, Massachusetts metropolitan area. EQY owns and has interests in 164 operating shopping centers, with a G.L.A. of 1.6 million square meters and 5 shopping centers under development. It also has a 20% interest in an unconsolidated joint venture that owns and manages 29 shopping centers in Texas, U.S.A.

The Company is also active in the United States through Royal Senior Care (hereinafter – “RSC”) and ProMed Properties Inc. (hereinafter – “ProMed”). RSC, in which the Company holds a 50% interest, is active in the senior housing communities sector in the southeastern United States. RSC owns 7 senior housing communities, encompassing approximately 860 units, as well as 2 senior housing communities under development. ProMed, a wholly (100%) owned subsidiary, is engaged in the medical office buildings sector. ProMed owns a medical office building, with a G.L.A. of 24 thousand square meters, and an adjacent multi-story parking garage.

In Canada, the Company operates through First Capital Realty Inc. (“FCR”), a public company listed on the Toronto Stock Exchange (TSX: FCR). As of the date of the financial statements, the Company holds 53% of FCR. FCR’s properties are located primarily in growing metropolitan areas in the provinces of Ontario, Quebec, Alberta and British Columbia in Canada. FCR owns 140 properties in Canada, with a G.L.A. of approximately 1.6 million square meters, and 5 shopping centers under development. In addition FCR owns 13.3 million shares of EQY.

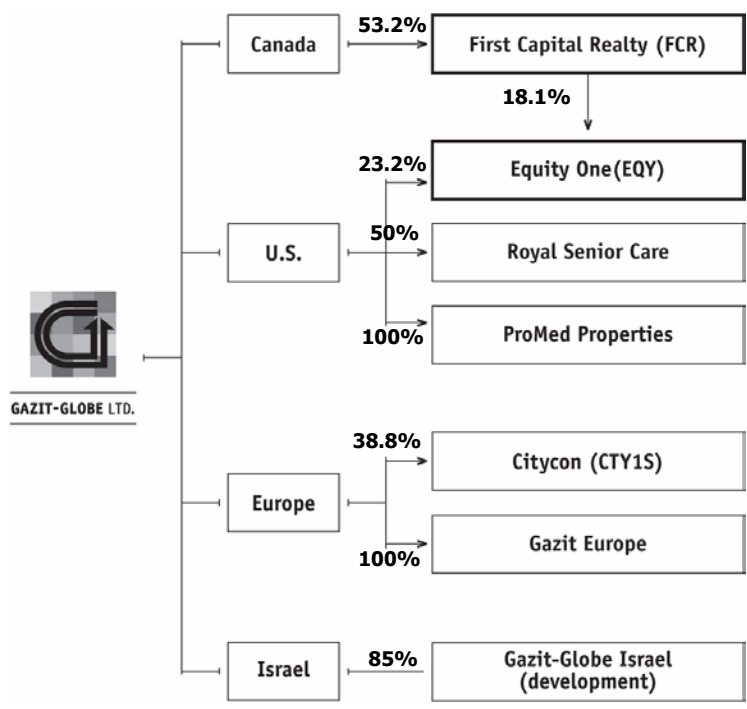
In Israel, the Company owns 85% of the share capital of Gazit-Globe Israel (Development) Ltd. (hereinafter – “Gazit Development”), which is an owner, developer and operator of shopping centers in Israel. Gazit Development owns 7 shopping centers, with a G.L.A. of approximately 63 thousand square meters, and also 7 plots of land for the future development of shopping centers. In addition, the Company owns an office building in Tel-Aviv.

In Europe, the Company operates mainly through Citycon Oyj. (hereinafter – Citycon), a Finnish public company, whose shares are listed on the Helsinki Stock Exchange (HEX). As of the date of the financial statements, the Company owns approximately 39% of Citycon’s share capital. Citycon is active in northern Europe (as of the date of the financial statements, in Finland, Sweden and Estonia) and owns 30 shopping centers and 127 stores, which are let primarily to supermarkets and other retail chains, with a G.L.A. of approximately 0.8 million square meters. An agreement has been signed for the sale of 76 of the aforementioned stores, and this transaction is expected to be closed during 2006. European operations are also conducted through Gazit Europe, a wholly (100%) owned subsidiary, which is engaged in the European shopping centers sector and which owns 2 shopping centers in Germany, with a G.L.A. of approximately 25 thousand square meters.

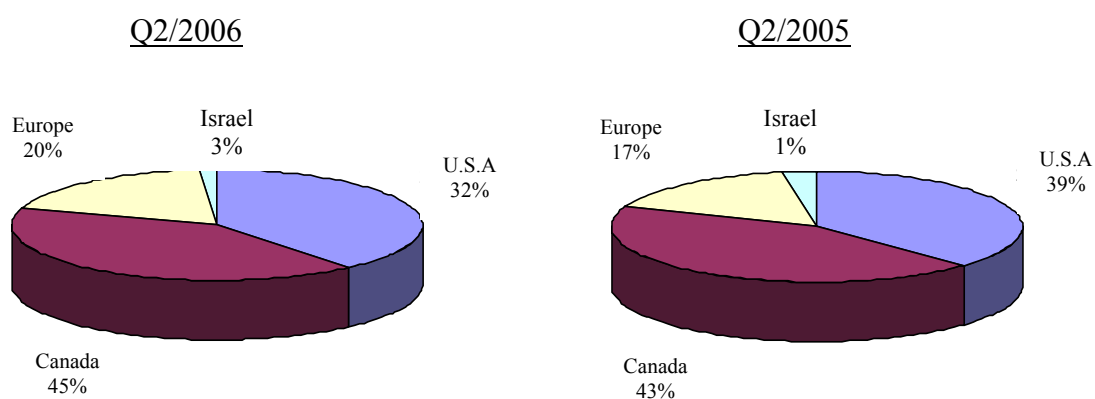
Other-publicly-accessible data concerning the Group, including up-to-date presentations, supplemental packages with information regarding assets and liabilities, and other information, can be found on the Group’s Internet website and the Internet websites of the Group’s companies:

www.gazit-globe.com
www.equityone.net
www.firstcapitalrealty.ca
www.citycon.fi

C. The Company's Major Holdings are Shown Below (Ownership Percentages are as of the Date of the Financial Statements):



D. The Following Chart Illustrates the Breakdown of Net Operating Income ("N.O.I.")⁽¹⁾, According to the Company's Operating Regions:



⁽¹⁾ The Company's share (by proportionate consolidation) - see section E2 below.

E. The Company's Holdings

1. The following table presents a summary of the Company's holdings as of June 30, 2006, as shown above:

Name of company	Type of security/ property	Holding (millions)	Holding percentage (%)	Book value (NIS in millions)	Market value as of June 30, 2006 (NIS in millions)
EQY ⁽¹⁾	Shares (NYSE)	17.1	23.2	1,047	1,588
FCR	Shares (TSX)	39.0	53.0	2,145	3,588
FCR	Convertible debentures (TSX)	11.9	11.9	46	48
Citycon	Shares (HEX)	60.8	36.8	1,021	1,238
RSC	Income-producing property	-	-	187	-
Gazit Europe	Income-producing property	-	-	364	-
ProMed	Income-producing property	-	-	385	-
Properties in Israel	Income-producing property	-	-	576	-
Other assets, net ⁽²⁾		-	-	39	-
Total		-	-	5,810	-

The Company's net liabilities ⁽³⁾ (including those of its wholly owned subsidiaries) amounted to NIS 3,324 million as of June 30, 2006.

2. Additional information is presented below concerning the Company's share in the income-producing property owned by the Group as of June 30, 2006, based on capitalized net operating income ("N.O.I.")⁽⁴⁾ methodology. The presentation of this information is intended to provide additional information, based on methodology that is generally accepted in the regions in which the Company operates, which might serve as an aid in analyzing the value of the Company's properties on the basis of the Company's financial results for the reporting period. It is emphasized that this information does not represent the Company's valuation of its present or future worth or the value of its shares.

⁽¹⁾ Represents only the Company's direct holding in EQY (in addition, FCR holds 13.3 million shares of EQY).

⁽²⁾ Mainly represents the book-value of the Gazit House and other assets, net of provision for deferred taxes.

⁽³⁾ Net of financial assets.

⁽⁴⁾ Property rental revenue, net of property operating expenses.

The sensitivity table below presents the value of the income-producing properties⁽¹⁾ owned by the Group according to the range of different cap rates generally accepted in the regions in which the Group operates, as of the date of publishing the financial statements. It should be noted that this presentation does not take into account existing construction rights in respect of the Company's properties.

In calculating the N.O.I., the following assumptions were made:

- a. The annual N.O.I. for each of the Group companies based on its quarterly results for the second quarter of 2006.
- b. The Company's proportionate share in the N.O.I. of the Group companies, as follows:

	For the 3 months ended June 30, 2006	For the year ended December 31, 2005	
	NIS in millions		
N.O.I. for the period	412	1,478	
Less – minority interests' share in N.O.I.	(221)	(858)	
Add – Company's share in Citycon's N.O.I.	41	127	
N.O.I. for the period	<u>232</u>	<u>747</u>	
N.O.I. for the year	<u>⁽²⁾929</u>	<u>747</u>	
<u>Cap Rate:</u>	<u>6.25%</u>	<u>6.50%</u>	<u>6.75%</u>
Value of proportionately consolidated income-producing property (NIS in millions)	<u>14,863</u>	<u>14,291</u>	<u>13,762</u>

The Group's liabilities, net of monetary assets, new properties and properties under development, which have not yet begun to produce income and which are presented at their carrying values in the Company's books (by the proportionate consolidation method) as of June 30, 2006, amounted to NIS 8,487 million.

3. As of June 30, 2006, the Company's issued share capital comprises 108.4 million shares (excluding treasury stock held by the Company).

⁽¹⁾ N.O.I. divided by the cap rate.

⁽²⁾ The cap rate for the second quarter of 2006 multiplied by 4.

F. Highlights - Second Quarter 2006

- The Group's investments amounted to NIS 0.9 billion, compared to NIS 1.0 billion in the same quarter last year. In addition, Citycon invested NIS 167 million in acquiring and developing properties, compared to NIS 27 million in the same quarter last year.
- Property rental revenue amounted to NIS 626 million, an increase of 19% compared to the same quarter last year. The increase was due to the enlargement of the property portfolio as a result of the acquisition of new properties, net of properties sold, the coming online of properties whose development had been completed and also the increase in the average rent per square meter received on the Group's properties.
- N.O.I. ⁽¹⁾ amounted to NIS 412 million, compared to NIS 361 million in the same quarter last year, an increase of 14%.
- Gross profit amounted to NIS 299 million, compared to NIS 273 million for the same quarter last year, an increase of 9%.
- Cash inflows from operating activities amounted to NIS 183 million, similar to those for the same quarter last year.
- F.F.O. ⁽²⁾ amounted to NIS 63.4 million, NIS 0.60 per share, compared to NIS 56.4 million, NIS 0.65 per share, for the same quarter last year, an increase of 12%. The decrease in F.F.O. per share is due mainly to the revaluation of index-linked loans following the steep rise in the "known" Israeli CPI index during the second quarter of 2006 (reflecting an annual inflation rate of 4.8%) and also to the issuance of capital during the second quarter, which has a dilutory effect in the short term.
- The Company, EQY and FCR raised NIS 520 million in share capital from the public, compared to NIS 18 million in the same quarter last year. As a result of the offerings made by FCR, the Company recorded net gains of NIS 26 million; the Company had no such gains in the same quarter last year.
- In April 2006, EQY closed the sales of income-producing properties and land in Texas to an unconsolidated joint venture (in which EQY has a 20% interest), as well as of other properties to third parties, for an aggregate consideration of NIS 1.7 billion. These sales generated a gross gain of NIS 126 million for the Company, compared to a gain of NIS 5 million in the same quarter last year.

⁽¹⁾ N.O.I. – Property rental revenue, net of property operating expenses.

⁽²⁾ See section 3C.

- Net income, which included higher than usual capital gains and a non-recurring write-down, amounted to NIS 126.5 million, NIS 1.16 per share, compared to NIS 17.6 million, NIS 0.20 per share, in the same quarter last year.
- The Company has written down a long-term investment in the shares of a real estate company listed in the U.S.A. by a gross amount of NIS 99 million, to the price at which said shares were listed at balance sheet date.
- Capital surpluses⁽¹⁾ (included within the line item “shareholders’ equity”, as described above) fell by NIS 43.7 million (NIS 0.41 per share), compared to a rise of NIS 53.8 million (NIS 0.62 per share) in the same quarter last year. The reduction in the capital surpluses is due to the weakening of the U.S. dollar, the Canadian dollar and the euro against the shekel in the second quarter of 2006, compared to the strengthening of the U.S. dollar and the Canadian dollar in the same quarter last year.
- Debt to market capitalization (derived from the market value of the Group’s holdings) stood at 52.4% as of June 30, 2006, compared to 55.4% as of June 30, 2005. As of December 31, 2005, this ratio stood at 52.2%.

G. Highlights - First Six Months of 2006 (hereinafter – “the reporting period”)

- The Group’s investments amounted to NIS 2.9 billion, compared to NIS 1.5 billion in the same period last year. In addition, Citycon invested NIS 645 million in acquiring and developing properties, compared to NIS 33 million in the same period last year.
- Property rental revenue amounted to NIS 1.3 billion, an increase of 25% compared to the same period last year. The increase was due to the enlargement of the property portfolio as a result of the acquisition of new properties, net of properties sold, the coming online of properties whose development had been completed and also the increase in the average rent per square meter received on the Group’s properties.
- N.O.I. amounted to NIS 847 million, compared to NIS 701 million in the same period last year, an increase of 21%.
- Gross profit amounted to NIS 621 million, compared to NIS 532 million for the same period last year, an increase of 17%.
- Cash inflows from operating activities amounted to NIS 338 million, compared to NIS 326 million for the same period last year, an increase of 4%.

⁽¹⁾ Capital surpluses deriving from translation of the financial statements of overseas investee companies operating independently.

- F.F.O.⁽¹⁾ amounted to NIS 133.6 million, NIS 1.29 per share, compared to NIS 110.7 million, NIS 1.29 per share, for the same period last year, an increase of 21%.
- Net income, which included higher than usual capital gains and a non-recurring write-down, amounted to NIS 166.8 million, NIS 1.60 per share, compared to net income (after neutralizing the non-recurring effect of Israel Accounting Standard No. 19) of NIS 62.4 million, NIS 0.70 per share, in the same period last year.
- The Company, EQY and FCR raised NIS 704 million, net, in share capital from the public, compared to NIS 227 million in the same period last year. As a result of the offerings made by EQY and FCR, the Company recorded net gains of NIS 29 million in the reporting period, compared to net gains of NIS 17.2 million in the same period last year.

H. Change in Reported Income Due to Changes in Accounting Standards

Israel Accounting Standard No. 19 – “Taxes on Income”, published by the Israel Accounting Standards Board (hereinafter – “the Standard”), was approved in July 2004. The Standard prescribes criteria for the recognition, measurement, presentation and disclosure for taxes on income in financial statements.

In the first quarter of 2005, the Company included in its statement of income (by means of a non-recurring charge) an expense of NIS 56.5 million in respect of the cumulative effect at the beginning of the year of adopting this Standard. Other than as stated above, the Company does not expect the application of the new Standard to have any further effect on its operating results, its financial position and/or its cash flows.

⁽¹⁾ See section 3C.

2. The Group and its Business Environment – Key Events and Changes During the Reporting Period

General

During the reporting period, the Group's investments in the acquisition and development of new properties and in the redevelopment, expansion and construction of various other properties, totaled NIS 2.9 billion. The effect of these investments on the operating results will be reflected in full during the remainder of the year.

A. Property Transactions

1. During the reporting period, the Group acquired 20 income-producing properties, with a total G.L.A. of approximately 207 thousand square meters, and 14 plots of land for future development. The total consideration for these acquisitions amounted to NIS 2.5 billion.
2. During the reporting period, the Group invested a total of NIS 0.4 billion in developing new properties and in the redevelopment of existing properties.
3. As of June 30, 2006, EQY has properties being developed that include land for the development of 5 properties on an area of approximately 1.3 million square meters. In addition, EQY is engaged in the redevelopment of 10 properties.

As of June 30, 2006, FCR has properties being developed that include land for the development of 5 properties on an area of approximately 139 thousand square meters. In addition, FCR is engaged in the development and redevelopment of 6 properties.

As of June 30, 2006, Gazit Development has 5 plots of land for the development of shopping centers.

The total cost of the properties and land as described above, which are being developed or are intended for future development, amounts to approximately NIS 1.3 billion. These properties and land did not generate any property rental revenue during the reporting period.

4. As of the end of the second quarter of 2006, EQY's and FCR's average basic monthly rental revenue was US\$10.38 per square meter. During the second quarter of 2006, EQY and FCR renewed leases on 66 thousand square meters, while increasing the average basic monthly rent on these leases by 4.8% to an average monthly rent of US\$10.93 per square meter, as well as signing new leases on 37 thousand square meters at an average basic monthly rent of US\$12.16 per square meter. During the second quarter of 2006, leases on 32 thousand square meters expired, on which the average monthly rent was US\$ 9.41 per square meter. The net operating income from the same properties increased by an average of 3.3%, compared to the same period last year.

EQY's and FCR's core properties had an average occupancy rate of 95.1% as of June 30, 2006 (the rate was 94.1% as of June 30, 2005).

5. As of June 30, 2006, RSC's properties had an occupancy rate of 94.5% (the rate was 93.8% as of June 30, 2005).

During the reporting period, RSC acquired 2 plots of land for the construction of additional senior housing communities, which will encompass approximately 400 units, for a total investment of US\$ 8 million.

In addition, RSC has completed the process of refinancing two mortgages on properties in South Carolina, on which RSC has taken a new, non-recourse loan secured by a mortgage on these properties from a leading institutional provider of mortgages to the senior housing communities sector. The new loan, which is for a 5-year period, is in an amount of US\$ 13.5 million. This is close to the amount paid by the Company for the acquisition of these two properties in 2004 and is at the same level of leverage.

6. In the reporting period, Citycon invested € 114 million (approximately NIS 645 million) in the acquisition of income-producing properties, in increasing its stake in existing shopping centers, and in the redevelopment of income-producing properties.

The net operating income from the same properties increased by 3.2%, compared to the same period last year.

As of June 30, 2006, Citycon's properties had an occupancy rate of 96.7% (the rate was 96.3% as of June 30, 2005).

- B.** As to the sale of Company shares and Company stock options to institutional and foreign investors, interested parties and the parent company for a total consideration of NIS 325 million - see note 3A to the financial statements.
- C.** As to the closing of ProMed's acquisition of a medical office building, with a multi-story parking garage, located in the state of New Jersey in the United States – see note 3B to the financial statements.
- D.** As to the exercise of stock options into shares of the Company by Clal Insurance, an interested party in the Company – see note 3C to the financial statements.
- E.** As to the agreement with Clal Finance Underwriting Ltd. for the receipt of services in relation to raising capital, marketing securities, banking and other areas, in consideration for the grant of non-listed stock options – see note 3D to the financial statements.

F. In January 2006, based on the capabilities and the experience accumulated by the Company in North America and Europe, the Company's Board of Directors authorized the Company's management to broaden the scope of operations in Europe and to examine the possibility of extending operations into Asia. To this end, the Board of Directors approved an investment budget of US\$ 1.5 billion over the next - 2 years. The investments will be made while maintaining the proper ratios of financial strength that have characterized the Group over the years and will be financed from the Company's own resources, as well as by raising capital and debt on the Israeli stock exchange and overseas financial markets.

Pursuant to the Board of Directors' decision, the broadening of the scope of operations in Europe and the examination of the possibility of extending operations into Asia will include the Company's existing areas of activity, viz.: mainly shopping centers, as well as senior housing communities and medical office buildings. Within this framework, the Company is currently assessing – in several geographical regions of Europe and Asia – various types of arrangements, including: the acquisition, development and construction of individual buildings, the acquisition of property portfolios and the acquisition of property companies – either by itself or through alliances and joint ventures with appropriate partners.

G. As to the replacement of EQY's credit facility – see note 3E to the financial statements.

H. As to the raising of debt by the Company – see note 3F to the financial statements.

I. As to the issue of debentures by EQY – see note 3G to the financial statements.

J. As to the issue of debentures by FCR – see note 3H to the financial statements.

K. As to the closing of a sale of 29 of EQY's income-producing properties and land in Texas to a joint venture with Investcorp and the sale of 2 other properties in Texas to third parties - see notes 3I and 3Q to the financial statements.

L. As to the issue of 500 thousand Company stock options, together with a wholly owned subsidiary's debentures with a nominal value of NIS 50 million, to institutional investors – see note 3K to the financial statements.

M. As to equity raising by FCR - see note 3L to the financial statements.

N. As to a rights issue made by Citycon – see note 3M to the financial statements.

O. As of June 30, 2006, the balance of long-term investments includes an investment in a real estate company listed in the U.S.A. (hereinafter – “the real estate company”). The total of the original investment, as of June 30, 2006, amounts to NIS 416 million. The market value of this investment, as of June 30, 2006 and as of the date of signing the financial statements, is NIS 317 million and NIS 207 million (at the exchange rate of June 30, 2006), respectively. Having examined and analyzed the fair value of the investment as of June 30, 2006 and based on publicly available data

issued by the real estate company, the Company decided to write-down its investment in the real estate company by an amount of NIS 99 million. Following this write-down, the investment is carried in the Company's books at a value of NIS 317 million as of June 30, 2006, which reflects the real estate company's market value as of balance sheet date. Subsequent to balance sheet date, the Company increased its investment in the real estate company by a further NIS 14 million. The Company will continue to review the value of its investment as before, taking into account its market value and in accordance with other data published by the real estate company in the future.

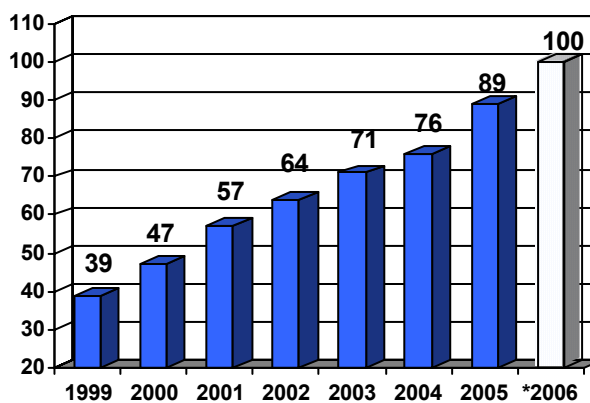
P. Dividend Distribution Policy

Pursuant to the Company's dividend policy, the Company announces at the end of each year the anticipated dividend for the subsequent year. In November 2005, the Company decided that the dividend to be declared in 2006 will not be less than NIS 0.25 per share per quarter (NIS 1.00 per share on an annualized basis).

The aforesaid is subject to the existence of adequate amounts of distributable income at the relevant dates, and is subject to the provisions of any law relating to dividend distributions and to decisions that the Company is permitted to take, including the appropriation of its income for other purposes and the revision of this policy.

The Company's dividend growth in the years 1999-2006 is shown in the graph below:

Agurot (hundredths of a NIS) per share



* Forecast

3. A. Results of Operations

	For the 6 months ended June 30		For the 3 months ended June 30		For the year ended December 31,
	2006	2005	2006	2005	2005
	Unaudited				Audited
	Reported NIS in thousands (other than net earnings per share data)				
Property rental revenue	1,286,822	1,030,967	625,537	527,366	2,195,821
Property rental operating expenses	439,742	330,115	213,717	166,323	717,762
Property rental depreciation	226,207	168,628	113,276	87,939	360,800
Gross profit	620,873	532,224	298,544	273,104	1,117,259
General and administrative expenses	120,378	(*)84,951	65,558	(*)42,804	189,102
Operating income	500,495	447,273	232,986	230,300	928,157
Financing expenses, net	378,867	288,007	207,780	145,056	622,058
	121,628	159,266	25,206	85,244	306,099
Other income, net	324,977	59,392	317,251	16,050	122,353
Income before taxes on income	446,605	218,658	342,457	101,294	428,452
Taxes on income	48,593	45,496	24,319	23,123	74,545
Income after taxes on income	398,012	173,162	318,138	78,171	353,907
Equity in earnings of affiliates	152,799	26,913	115,127	15,494	129,960
Minority interest in earnings of subsidiaries	(384,059)	(*) (137,658)	(306,801)	(*) (76,082)	(295,965)
Net income before cumulative effect	166,752	62,417	126,464	17,583	187,902
Cumulative effect as of the beginning of the period of change in accounting principle (see section 1H above)	-	(56,525)	-	-	(56,525)
Net income	166,752	5,892	126,464	17,583	131,377
<u>Net earnings per share of NIS 1 par value</u> <u>(in reported NIS)</u>					
<u>Fully diluted earnings per share</u>					
Before cumulative effect	1.60	0.70	1.16	0.20	2.05
Cumulative effect as of the beginning of the period of change in accounting principle	-	(0.66)	-	-	(0.63)
Net earnings	1.60	0.04	1.16	0.20	1.42
Number of shares used in computing fully diluted earnings per share					
	103,406	85,974	106,016	86,346	89,791

(*) Reclassified in accordance with Israel Accounting Standard No. 24 – see note 2D(4) to the financial statements.

B. Analysis of Results of Operations for the Second Quarter of 2006

Property rental revenue

The 19% increase compared with the same period last year is due to the enlargement of the property portfolio as a result of the acquisition of new properties, net of properties sold, the coming online of properties whose development had been completed and also the increase in the average rent per square meter received on the Group's properties.

Rental property operating expenses

The increase in rental operating expenses, compared to the same period last year, stems from the increased number of properties, as referred to above. Rental property operating expenses, as a percentage of property rental revenue, rose to 34.2% from 31.5% for the same period last year. This is mainly due to the relatively greater share in these items that now relates to FCR and RSC, whose operating expenses represent a higher percentage of revenue than EQY's.

Rental property depreciation

The increase in rental property depreciation expenses, compared to the same period last year, stems from the increased number of properties, as referred to above, as well as from the allocation of certain property costs to the term of the tenants' leases, which is shorter than the lifespan of the properties. Depreciation expenses as a percentage of property rental revenue rose to 18.1% from 16.7% for the same period last year.

Gross profit

Gross profit amounted to NIS 299 million (47.7% of property rental revenue); this compares to NIS 273 million (51.8% of property rental revenue) for the same period last year – an increase of 9%. The reduction in gross profit as a percentage of property rental revenue is attributable to the increase in rental property depreciation as a percentage of property rental revenue, and FCR's and RSC's relatively greater share in this item, as explained above.

General and administrative expenses

General and administrative expenses as a percentage of total revenues amount to 6.2%, compared to 7.7% in the same period last year. This reduction is mainly due to the line item "other income".

Financing expenses, net

The change in financing expenses stems from the following factors:

1. An increase in the Group's loans from an average balance of NIS 11.6 billion in the second quarter of 2005 to an average balance of NIS 15 billion in the second quarter of 2006. Interest expenses for the quarter reflect an average nominal interest rate of approximately 6% per annum on the Group's indebtedness.
2. The 1.2% rise in the "known" Israeli consumer price index ("C.P.I.") (reflecting an annual inflation rate of 4.8%) led to an increase in financing expenses, due to the revaluation of loans that are linked to the changes in the Israeli C.P.I., in the amount of NIS 12.1 million (NIS 0.11 per share), compared to NIS 3.1 million (NIS 0.04 per share) in the same period last year.
3. The financing expenses are net of income of NIS 5.9 million from investments in listed securities, compared to NIS 24.8 million received in the same period last year.

Other income, net

This item consists mainly of gains and losses in respect of capital transactions, such as the dilution of holdings in consolidated subsidiaries and real estate sales, as well as adjustments to the value of long-term investments.

The gain resulting from the dilution of holdings in consolidated subsidiaries amounts to a total of NIS 25.7 million. The Company had no such gains in the same period last year.

Additionally, the sale of income-producing properties and plots of land by EQY (see section 2K above) produced a gross gain for the Group of NIS 390 million (the Company's share being NIS 126 million), compared to the gain of NIS 14 million (the Company's share being NIS 5 million) from the sale of properties in the same period last year.

Furthermore, the Company has written down a long-term investment in the shares of a real estate company listed in the U.S.A by a gross amount of NIS 99 million, to the price at which said shares were quoted at balance sheet date (see section 2O above).

Equity in earnings of affiliates

The increase in this item is primarily attributable to the Company's equity in the earnings of Citycon in the amount of NIS 107.7 million, compared to NIS 15.5 million in the same period last year.

In the second quarter of 2006, Citycon revalued its investments in fixed assets to their fair value, in conformity with International Accounting Standard No. 40, resulting in an appreciation of € 59.8 million (approximately NIS 339 million) in

their gross value (the Company's share, net of related taxes, being approximately NIS 92 million).

C. F.F.O.⁽¹⁾ and F.F.O. per share

The Company's practice is to publish its F.F.O. results (which is the net reported income, after neutralizing non-recurring income and expenditure (including capital gains from the sale of properties and the gain from the dilution of its holdings in consolidated subsidiaries) and with the addition of the Company's share of depreciation of rental properties and amortization), and F.F.O. per share, as is already the accepted practice in those countries in which the Company operates, and in accordance with the position paper issued by the NAREIT – the U.S.-based National Association of Real Estate Investment Trusts.

In addition, beginning in 2006, Israel has adopted a REIT tax regime for companies that are real estate investment trusts, similar to that in effect in various other countries throughout the world. Such companies, under certain conditions, do not pay corporate tax. The Company thus considers that the presentation of F.F.O. and F.F.O. per share data, after neutralizing expenses and income in respect of deferred taxes (in other words, tax income and expenses that are not on a cash flows basis) provides a better comparison of the Company's operating results with those of other REIT companies in Israel and overseas.

The Company is of the opinion that F.F.O. and F.F.O. per share accurately reflect an additional aspect of the Company's operating results, providing a more appropriate basis for comparing the Company's operating results for a given period to those for previous periods, and for comparing the Company's operating results to those of other property companies.

⁽¹⁾ According to the NAREIT position paper, the F.F.O. index does not represent cash flow from current operations according to accepted accounting principles, nor does it reflect the cash held by a company, or its ability to distribute that cash, and it is not a substitute for the reported net income. Furthermore, the F.F.O. is not part of the data audited by the Company's independent auditors.

The table below presents the computation of the Company's F.F.O. and F.F.O. per share for the periods stated:

	For the 6 months ended June 30		For the 3 months ended June 30		For the year ended December 31,
	2006	2005	2006	2005	2005
	Reported NIS in thousands (other than F.F.O. per share data)				
Net income	166,752	⁽¹⁾62,417	126,464	17,583	⁽¹⁾187,902
Adjustments to net income:					
Depreciation and amortization	⁽²⁾ 202,840	69,860	⁽²⁾ 151,602	36,658	153,685
Gains from dilution in holdings of consolidated subsidiaries	(28,680)	(38,798)	(25,663)	-	(75,264)
Gains from the sale of properties	(118,918)	(7,130)	(118,310)	(4,976)	(13,782)
Losses from discontinued operations	-	12,059	-	9,193	12,059
Deferred tax expenses	15,643	16,748	11,644	6,479	22,279
Equity in earnings of affiliates ⁽³⁾	(152,799)	(26,913)	(115,127)	(15,494)	(129,960)
Equity in F.F.O. of affiliates	39,376	20,140	24,882	6,701	50,758
Other adjustments ⁽⁴⁾	9,423	2,362	7,865	266	9,075
Total adjustments to net income	(33,115)	48,328	(63,107)	38,827	28,850
F.F.O.	133,637	110,745	63,357	56,410	216,752
Primary F.F.O. per share⁽⁵⁾	1.30	1.29	0.60	0.65	2.43
Fully diluted F.F.O. per share⁽⁵⁾	1.29	1.29	0.60	0.65	2.41
Number of shares used in computing fully diluted earnings per share	103,406	85,974	106,016	86,346	89,791

⁽¹⁾ After neutralizing the cumulative effect at the beginning of the year of a change in accounting principle, net (Israel Accounting Standard No. 19) (see section 1H above).

⁽²⁾ Includes the adjustment to the value of a long-term investment, see section 2O above.

⁽³⁾ Includes the Company's equity in the revaluation of Citycom's investment in fixed assets to their fair value, in conformity with International Accounting Standard No. 40.

⁽⁴⁾ Expenses that are directly related to the income and expense items adjusted against the net income for the purpose of calculating F.F.O.

⁽⁵⁾ In conformance with Israel Accounting Standard No. 21, which has been applied for the first time in the first quarter of 2006.

4. Financial Status

Liquidity

The Group has a policy of maintaining a high level of liquidity that enables the pursuit of business opportunities in its areas of operations.

As of June 30, 2006, the liquid assets available to the Group, including short-term investments, totaled NIS 432 million, compared to NIS 351 million as of December 31, 2005. In addition, as of June 30, 2006, the Group had unutilized credit facilities available for immediate drawdown of NIS 1.8 billion, compared to NIS 2.1 billion as of December 31, 2005.

In aggregate, the Group has cash reserves and unutilized credit facilities available for immediate drawdown amounting to NIS 2.3 billion.

Current Assets

Current assets, as of June 30, 2006, totaled NIS 0.8 billion, compared to NIS 1.9 billion as of December 31, 2005. The reduction in current assets is due to closing the sale of rental properties, which were held for disposal, that were previously carried at a net cost of NIS 1.3 billion (see section 2K above).

Investments in Affiliates

Investments in affiliates, amounting to NIS 1,035 million as of June 30, 2006, relate primarily to the investment in 60.8 million shares of Citycon; investments in affiliates as of December 31, 2005 amounted to NIS 722 million. During the reporting period, the Company acquired additional Citycon shares, by means of purchases on the stock exchange and through participation in a rights issue, at an overall cost of NIS 164 million.

Long-Term Investments

Long-term investments, as of June 30, 2006, totaled NIS 969 million, compared to NIS 650 million as of December 31, 2005.

The increase in this item is derived primarily from the acquisition of listed shares and debentures in companies active in the Group's areas of activity or in synergetic businesses, in regions where it is already active. Among the investments included in the balance, as of June 30, 2006, are an investment in 3.7 million shares of DIM (see note 3J to the financial statements) and also an investment in a real state company, which is listed in the U.S.A (see section 2O above).

Fixed Assets, Net

Net fixed assets, as of June 30, 2006, totaled NIS 19.3 billion, compared to NIS 17 billion at the end of 2005.

In the reporting period, the Group acquired income-producing properties, developed new properties and redeveloped existing properties at a total cost of NIS 2.9 billion. In addition, the weakening of the U.S. dollar on the one hand, and the strengthening of the Canadian dollar and the euro on the other, against the shekel contributed a decrease of NIS 0.3 billion to this item. Depreciation expenses for the reporting period amounted to NIS 226 million.

Current Liabilities

Current liabilities, as of June 30, 2006, totaled NIS 1.5 billion, compared to NIS 1.9 billion at the end of 2005. The balance mainly consists of the line item “credit from banks and other credit granting institutions”, which mainly consist of the current maturities of long-term liabilities in the amount of NIS 0.9 billion, compared to NIS 1.2 billion at the end of 2005.

The balance of current maturities includes the final settlement of loans, in the amount of NIS 0.2 billion (at the end of 2005 - NIS 0.5 billion), which are secured by a charge on the properties. Based on past experience, the Group usually renews most of these loans by taking new, long-term secured and unsecured loans.

Long-Term Liabilities

Long-term liabilities, as of June 30, 2006 totaled NIS 14.1 billion, compared to NIS 12.3 billion at the end of 2005.

The increase in this item derives principally from the taking of new loans and the issuance of debentures, intended principally for financing investments in fixed assets and the acquisition of long-term investments.

Shareholders' Equity

The change in shareholders' equity from NIS 1,908 million as of December 31, 2005 to NIS 2,486 million as of June 30, 2006 stems mainly from the sale of treasury stock and stock options to institutional investors amounting to NIS 375 million, from the exercise of stock options into shares amounting to NIS 72 million, from the income for the reporting period amounting to NIS 167 million, and from the increase in the item “other capital surpluses” amounting to NIS 16 million. These were partly offset by the dividends of NIS 53 million paid and declared by the Company.

Shareholders' equity per share as of June 30, 2006 amounted to NIS 22.9 per share, compared to NIS 19.4 per share as of December 31, 2005. This is after a dividend distribution of NIS 0.50 per share during the reporting period.

Ratio of Debt to Total Assets

The ratio of the Group's interest-bearing debt to its gross assets (which includes the accumulated depreciation on the Group's assets) stood at 61.9% as of June 30, 2006, compared to 61.5% and 63.4% as of December 31, 2005 and June 30, 2005, respectively.

The ratio of the Group's interest-bearing debt to total market capitalization stood at 52.4% as of June 30, 2006, compared to 52.2% and 55.4% as of December 31, 2005 and June 30, 2005, respectively.

The Company considers that the fair value of its assets exceeds their carrying value in the Company's books, and accordingly, the ratio of debt to total assets more fairly reflects the Group's leverage ratios.

Cash Flows

Cash inflows from operating activities for the reporting period and for the second quarter of 2006 totaled NIS 338 million and NIS 183 million, respectively, compared to NIS 326 million and NIS 186 million, respectively, for the same periods last year.

In addition, in order to fund the Group's activities during the reporting period and during the second quarter of 2006, the Company and its consolidated subsidiaries raised capital totaling NIS 704 million and NIS 520 million, respectively, took long-term loans and issued debentures in a net amount of NIS 1,427 million and NIS 665 million, respectively, and sold fixed assets totaling NIS 1,694 million and NIS 1,664 million, respectively. The proceeds from the above sources were used primarily to finance investing activities for the purchase of fixed assets, which, in the reporting period and in the second quarter, totaled NIS 2,858 million and NIS 893 million, respectively in the reporting period, for further investments in affiliates, listed shares and debentures and long-term investments, in an aggregate net amount of NIS 832 million and NIS 543 million, respectively, and for the buyback by EQY of its own shares in an amount of NIS 225 million in the second quarter of 2006.

5. Donations

The Company customarily makes donations to charities and community welfare and education projects.

The Company makes donations to Tel-Aviv University, which has established and operates an institute focusing on research and studies of all manner of real estate related topics (The Chaim Katzman – Gazit-Globe Real Estate Institute). In this connection, the Company has pledged to make an annual donation of US\$ 150 thousand for a period of seven years.

The Company donates to the “College for All” charity – a not-for-profit organization working to close the gaps in education by means of creating equal opportunities for excellence. This vision is being realized through the provision of learning and other tools to students with ability and motivation, who come from underprivileged neighborhoods. The goal is to encourage such students into academic studies. In this connection, the Company has pledged to provide assistance to a group of students for a period of five years.

During the reporting period, the Group’s donations amounted to NIS 1,501 thousand.

6. Additional Information and Subsequent Events

- A.** From balance sheet date through the date of signing the financial statements, the Group invested a total of NIS 0.5 billion in acquiring new properties and land for future development.
- B.** As to the raising of debt by the Company offered under a shelf prospectus - see note 4A to the financial statements.
- C.** As to the issue of convertible debentures by Citycon and the Company’s participation in this issuance - see note 4B to the financial statements.
- D.** As to the raising of debt by FCR - see note 4C to the financial statements.
- E.** As to the raising of debt by EQY - see note 4D to the financial statements.
- F.** In July and August 2006, the Company donated in excess of NIS 1 million to institutes and charities providing humanitarian aid to the population living in northern Israel.

7. Reporting of Exposures to Market Risks and their Management

The individuals responsible for managing and reporting the Company’s market risks are Mr. Dori Segal, the Company’s president, and Mr. Gil Kotler, the Company’s Chief Financial Officer. Since the publication of the Company’s annual report for 2005 on March 20, 2006, there have been no significant changes in the market risks or the way in which they are managed.

Attached as Appendix I is the Company’s primary linkage balance sheet as of June 30, 2006.

August 15, 2006		
Date of approval of the Directors’ Report	Chaim Katzman Chairman of the Board of Directors	Dori Segal President and Director

**Appendix I to Board of Directors' Report
on the State of the Company's Affairs**

**Primary Linkage Balance Sheet
as of June 30, 2006**

	Linked to the consumer price index	In unlinked NIS	In US\$ or linked thereto	In C\$ or linked thereto	In euros	Unlinked	Total
	R e p o r t e d N I S i n t h o u s a n d s						
Monetary assets							
Cash and cash equivalents	-	9,497	113,507	35,021	9,497	-	167,522
Short-term investments	-	-	228,922	1,660	-	33,611	264,193
Tenants, accounts receivable and other debit balances	10,683	1,949	96,373	138,589	13,324	60,942	321,860
Long-term investments	3,993	-	1,661	10,403	-	953,194	969,251
Long-term loans and debit balances	2,756	-	68,976	42,170	-	-	113,902
	17,432	11,446	509,439	227,843	22,821	1,047,747	1,836,728
Non-monetary assets⁽¹⁾	-	576,336	8,576,361	9,839,342	1,396,448	242,824	20,631,311
	17,432	587,782	9,085,800	10,067,185	1,419,269	1,290,571	22,468,039
Liabilities							
Short-term credit from banks and other credit granting institutions	-	1	38,341	66,465	202	-	105,009
Trade and other payables and other credit balances	4,103	40,021	182,868	294,070	15,193	24,084	560,339
Debentures	924,679	-	3,234,445	1,041,033	180,507	-	5,380,664
Convertible debentures redeemable in shares of a consolidated subsidiary	-	-	-	344,015	-	-	344,015
Liabilities to financial institutions and others	-	91,840	3,133,700	5,471,033	392,548	-	9,089,121
Deposits from tenants	1,199	-	42,101	23,207	-	-	66,507
Liabilities for employee rights upon retirement	-	164	-	-	-	-	164
Deferred taxes	-	-	-	-	-	107,449	107,449
	929,981	132,026	6,631,455	7,239,823	588,450	131,533	15,653,268
Receipts in respect of conversion options in consolidated subsidiary	-	-	-	10,683	-	-	10,683
Proceeds from issuance of stock options of subsidiaries	-	-	1,207	2,070	-	-	3,277
Minority interests	-	-	-	-	-	4,314,960	4,314,960
Shareholders' equity	-	-	-	-	-	2,485,851	2,485,851
	929,981	132,026	6,632,662	7,252,576	588,450	6,932,344	22,468,039

⁽¹⁾ Mainly fixed assets, net.