

GAZIT-GLOBE LTD.

Directors' Report to Shareholders **For the period which ended June 30, 2005**

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 period which ended June 30, 2005:

1. A. General

The Company – directly and through subsidiaries and an associated company – is engaged in the acquisition, development, and management of properties in the USA, Canada, Israel and Finland and focuses mainly on supermarket-anchored shopping centers. In addition, the Company is active in the senior living sector in the USA, and also continues to seek out and realize opportunities in its business and/or in synergetic businesses, both in regions where it operates and also in other regions.

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

As of the date of the financial statements, the Group owns 315 properties, as follows:

- 299 operational shopping centers
- 10 shopping centers under development
- 5 senior living facilities (containing some 500 residential units)
- an office building in Tel-Aviv

The above properties have a Gross Leasable Area (“G.L.A.”) of some 3.2 million square meters. These properties have a book value of NIS 17 billion and generate an annual rental income of NIS 2.1 billion (gross annual rent from the properties currently owned at the exchange rate on the date of the financial statements). In addition, the Company – through its holdings in an associated company, Citycon Oyj. – has an interest in 145 properties in northern Europe.

In the USA, 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 First Capital Realty, Inc. as described below), 40% of EQY. EQY is an owner, developer and operator of neighborhood shopping centers anchored by national and regional supermarket chains and other necessity-oriented retailers, such as drug stores or discount retail stores, located primarily in growing metropolitan areas in the southern United States (mainly in the states of Florida, Texas and Georgia) and in the Boston, Massachusetts metropolitan area. EQY owns 181 operating shopping centers, with a G.L.A. of 1.8 million square meters, 7 shopping centers under development, and a partnership, which owns land for future development.

In addition, the Company - through Royal Senior Care (hereinafter – “RSC”), in which it owns a 50% interest - is active in the US senior living sector. RSC owns 5 senior living facilities encompassing approximately 500 residential units.

Operations in Canada are carried out through First Capital Realty (hereinafter – “FCR”), a public company listed on the Toronto Stock Exchange (TSX:FCR). As of the date of the financial statements, the Company owns 55% of FCR. FCR is an owner, developer and operator of neighborhood shopping centers anchored by national and regional supermarket chains and other necessity-oriented retailers, such as drug stores or discount retail stores, located primarily in growing metropolitan areas in the provinces of Ontario, Quebec, Alberta and British Columbia in Canada. FCR owns 117 properties in Canada, with a G.L.A. of approximately 1.35 million square meters, and 3 shopping centers under development. In addition, FCR owns 13.1 million shares of EQY.

In Israel, the Company owns 85% of the share capital of Gazit-Globe Israel (Development) Ltd. (hereinafter – “Gazit-Globe Israel”), which is engaged in the acquisition of shopping centers in Israel and which owns a shopping center and land for the future development of a shopping center. In addition, the Company owns an office building in Tel-Aviv.

In Finland, the Company is the largest shareholder (37.5%) in Citycon Oyj. Hereinafter – “Citycon”), a Finnish public company, whose shares are traded on the Helsinki Stock Exchange (HEX). As of June 30, 2005, Citycon owns 16 shopping centers and 127 stores, which are let primarily to supermarkets and other retail chains, with a G.L.A. of approximately 500 thousand square meters.

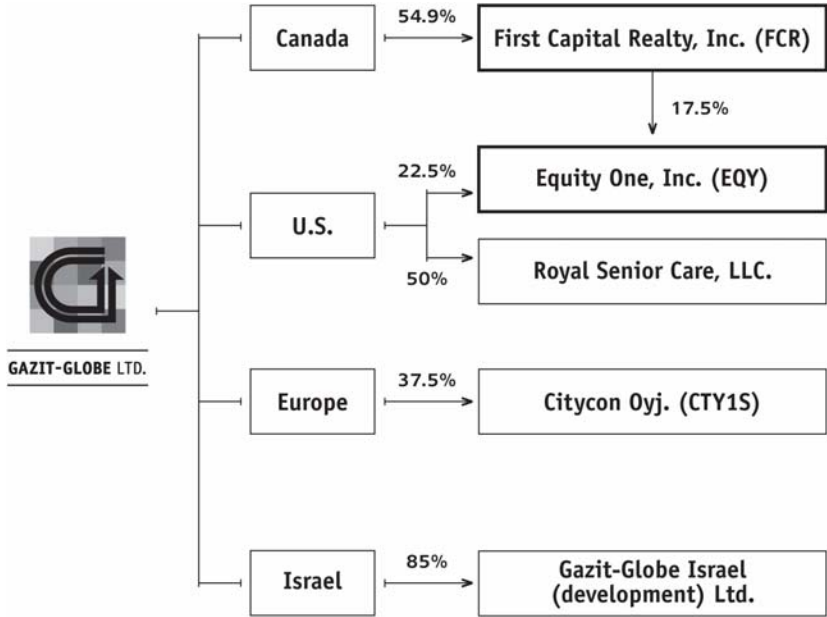
Supplementary data concerning the Group, including up-to-date presentations, supplemental packages with information regarding assets and liabilities, and other information, can be found on the Group's Internet website – www.gazit-globe.com and the Internet websites of the Group's companies:

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 Company's Holdings

The following table presents a summary of the Company's holdings as of June 30, 2005:

Name of company	Type of security	Holding (millions)	Holding percentage (%)	Book value (NIS in millions)	Market value as of June 30, 2005 (NIS in millions)	Market value as of the date of the financial statements (NIS in millions)
EQY ⁽¹⁾	Shares	16.8	22.5	1,050	1,744	1,821
FCR	Shares	34.9	54.7	1,767	2,635	2,691
FCR	Convertible debentures	38.2	38	136	144	145
Citycon	Shares	44.1	39.3	484	743	804
Investments in other companies (non-listed) and other assets ⁽²⁾				366	366	366
Total				3,803	5,632	5,827

The Company's net liabilities⁽³⁾ (including those of its wholly owned subsidiaries) amounted to NIS 2,430 million as of June 30, 2005.

As of June 30, 2005, the Company's issued share capital comprises 86.641 million shares (not including dormant shares held by the Company).

E. Highlights - Second Quarter 2005

- **The Group's investments amounted to NIS 1.0 billion, compared to NIS 0.9 billion in the corresponding quarter last year.**
- **Rental income amounted to NIS 527 million, an increase of 15% compared to the corresponding quarter last year. The increase was due to the acquisition of properties, the coming online of properties, whose development had been completed, and the improved occupancy rates and also the higher average rentals per square meter for the Group's properties.**
- **Gross profit amounted to NIS 273 million, compared to NIS 244 million for the corresponding quarter last year, an increase of 12%.**

⁽¹⁾ Represents only the Company's direct holding in EQY. (In addition, FCR holds 13.1 million shares of EQY).

⁽²⁾ Mainly represents the book-cost of a shopping center in Israel, the investment in Mishkenot Clal and RSC, and the office building in Tel-Aviv.

⁽³⁾ Net of financial assets.

- Cash flows from operating activities amounted to NIS 186 million, compared to NIS 159 million for the corresponding quarter last year, an increase of 17%.
- F.F.O.⁽¹⁾ amounted to NIS 46.6 million, NIS 0.56 per share, compared to NIS 41 million, NIS 0.48 per share, for the corresponding quarter last year.
- Net income amounted to NIS 17.8 million, NIS 0.24 per share, compared to NIS 14.4 million, NIS 0.16 per share, for the corresponding quarter last year.
- The ratio of debt to total market capitalization stood at 55.4% as of June 30, 2005, compared to 56.9% as of June 30, 2004. As of December 31, 2004, this ratio stood at 58%.

F. Highlights – First Six Months of the Year (hereinafter – “the reporting period”)

- The Group’s investments amounted to NIS 1.4 billion, compared to NIS 2.1 billion in the corresponding period last year.
- Rental income amounted to NIS 1 billion, an increase of 18% compared to the corresponding period last year. The increase was due to the acquisition of properties, the coming online of properties, whose development had been completed, and the improved occupancy rates and also the higher average rentals per square meter for the Group’s properties.
- Gross profit amounted to NIS 532 million, compared to NIS 467 million for the corresponding period last year, an increase of 14%.
- Cash flows from operating activities amounted to NIS 326 million, compared to NIS 253 million for the corresponding period last year, an increase of 29%.
- F.F.O.⁽¹⁾ amounted to NIS 92 million, NIS 1.09 per share, compared to NIS 76 million, NIS 0.91 per share, for the corresponding period last year.
- Net income (after neutralizing the non-recurring effect of implementing Israel Accounting Standard No. 19) amounted to NIS 62.7 million, NIS 0.76 per share, compared to NIS 35.7 million, NIS 0.43 per share, for the corresponding period last year.

⁽¹⁾ See section 3.C below.

- The Company, EQY and FCR raised NIS 227 million of equity capital from the public during the reporting period, compared to NIS 368 million during the corresponding period last year. As a result of the equity raising activities of EQY and FCR, the Company recorded a net gain in the reporting period of NIS 17.2, compared to a net gain of NIS 15 million in the corresponding period last year.

G. Change in Accounting 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.

The main changes resulting from the provisions of the Standard, compared to the provisions previously applied, are: the recognition of deferred taxes in respect of temporary differences arising when the measurement currency for accounting purposes differs from the measurement currency for tax purposes, and the recognition of deferred taxes in respect of temporary differences relating to land. The Standard is to be applied to financial statements covering periods commencing on, or after, January 1, 2005. The implementation of the Standard has been effected by taking into account its cumulative effect at the beginning of the year.

The Company has 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.

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 of new properties and in the redevelopment, expansion and construction of various other properties totaled NIS 1.4 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, EQY, FCR, RSC and Gazit-Globe Israel acquired 17 properties, with a total G.L.A. of some 143 thousand square meters, and 10 plots of land for future development. The total consideration for these acquisitions amounted to NIS 1.2 billion.

2. During the reporting period, EQY and FCR invested in excess of NIS 200 million in developing new properties and in the redevelopment of existing properties.
3. During the reporting period, EQY sold 2 properties with a total G.L.A. of some 28 thousand square meters for a total consideration of NIS 120 million. The net gain recognized by the Company from the sale of these properties amounted to NIS 6.2 million, compared to a net gain of NIS 2 million from the sale of properties in the corresponding period last year.
4. As of June 30, 2005, the Group had properties being developed and being redeveloped, as well as land for future development, at a cost of NIS 530 million. These properties and land did not generate any rental income during the reporting period.
5. As of the end of the second quarter of 2005, EQY's average basic monthly rental income was US\$ 9.3 per square meter. During the second quarter, EQY renewed leases on 19 thousand square meters, while increasing the average basic monthly rental on these leases by 3.9% to an average monthly rental of US\$ 12.3 per square meter, as well as signing new leases on 47 thousand square meters at an average basic monthly rental of US\$ 6.8 per square meter. During the second quarter, leases on 66 thousand square meters expired, on which the average monthly rental was US\$ 5.7 per square meter. The net cash inflows from same properties increased by 4.4%, compared to the corresponding period last year.

EQY's core properties had an average occupancy rate of 93.7% as of June 30, 2005 (June 30, 2004 – 92.5%).

6. As of the end the second quarter of 2005, FCR's average basic monthly rental income was C\$ 12 per square meter. During the second quarter, FCR renewed leases on 16 thousand square meters, while increasing the average basic monthly rental on these leases by 6.7% to an average monthly rental of C\$ 14.2 per square meter, as well as signing new leases on 13 thousand square meters at an average basic monthly rental of C\$ 14.3 per square meter. During the second quarter, leases on 7 thousand square meters expired, on which the average monthly rental was C\$ 12 per square meter. The net cash inflows from same properties increased by 1.7%, compared to the corresponding period last year.

FCR's properties had an average occupancy rate of 94.7% as of June 30, 2005 (June 30, 2004 – 93.8%).

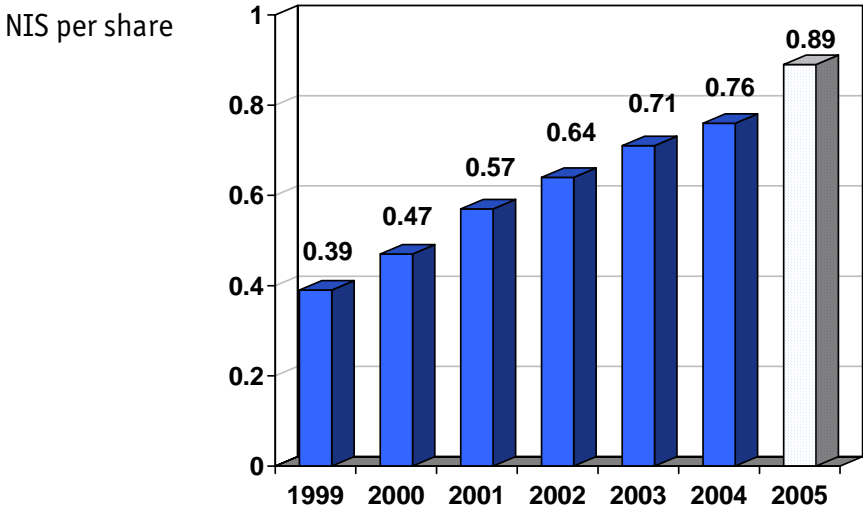
- B.** As to the issue of non-listed option warrants and the exercise of option warrants into shares of the Company – see notes 3A and 3D to the financial statements.
- C.** As to a public offering of shares and the conversion of convertible debentures into shares in subsidiaries - see notes 3B and 3E to the financial statements.

- D. As to debt raised by the Company and subsidiaries – see notes 3C, 3D, 3F and 3I to the financial statements.
- E. As to the establishment of Gazit-Globe Israel, which is engaged in the Israeli shopping centers sector, and the commitment to acquire its first shopping center in Israel – see note 3H to the financial statements.
- F. As to Arie Mintkavitch becoming a director and being appointed Deputy Chairman of the Board of Directors, and the conditions of his employment – see note 3G to the financial statements.
- G. During June 2005, Citycon effected the early repayment of a loan of € 68 million, due for settlement in June 2009 and bearing interest at an annual rate of 7.38%. At the same time, Citycon took a new loan of € 70 million, repayable in June 2010 and bearing interest at an annual rate of 4.7%. As a result of the aforesaid transaction, Citycon recorded a non-recurring expense of € 5.7 million (NIS 32 million), though the net saving in Citycon's financing costs – after taking into account the non-recurring expense – amounts to € 1.5 million (NIS 8.4 million) spread over 4 years.
- H. During June 2005, EQY announced that it had engaged a U.S. investment bank to assess strategic alternatives with regard to its property portfolio in Texas and Louisiana, including the possibility of selling the portfolio or entering into a joint venture with third parties with regard to the portfolio. EQY owns 32 properties with a G.L.A. of 280 thousand square meters in Texas and 15 properties with a G.L.A. of 150 thousand square meters in Louisiana. The basic rental income generated by the above properties amounts to US\$ 41 million per annum. Additionally, EQY has placed a further 15 properties on the market; these properties, located in various states, have a G.L.A. of 120 thousand square meters. All the properties referred to above, which have a carrying value of NIS 2 billion as of June 30, 2005, have been classified as "assets held for sale" and are presented among current assets.
- I. **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 the fourth quarter of 2004, the Company announced that the dividend to be declared in 2005 would be at least NIS 0.20 per share each quarter (NIS 0.80 per share on an annual basis). Upon approval of the financial statements for the first quarter of 2005, the Company decided to make an upward revision to the anticipated dividend amount for 2005 and announced that the dividend to be declared from the second quarter of 2005 and thereafter will be at least NIS 0.23 per share each quarter (an annual rate of NIS 0.92 per share).

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 1999-2005 is shown in the graph below:



3. A. Results of Operations

	For the 6 months which ended ended June 30		For the 3 months which ended ended June 30		For the year which ended December 31,
	2005	2004	2005	2004	2004
	Unaudited				Audited
	NIS in thousands (other than earnings per share data)				
Rental income	1,030,967	877,350	527,366	456,930	1,858,235
Rental operating expenses	330,115	280,397	166,323	145,305	598,675
Depreciation of rental properties	168,628	129,793	87,939	67,807	282,176
Gross profit	532,224	467,160	273,104	243,818	977,384
General and administrative expenses	84,629	73,533	42,482	38,012	159,392
Income from ordinary operations	447,595	393,627	230,622	205,806	817,992
Financing expenses, net	288,007	254,253	145,056	132,718	519,676
	159,588	139,374	85,566	73,088	298,316
Other income, net	59,392	27,126	16,050	1,366	129,202
Income before taxes on income	218,980	166,500	101,616	74,454	427,518
Taxes on income	45,496	24,667	23,123	13,594	55,029
Income after taxes on income	173,484	141,833	78,493	60,860	372,489
Company's share in profits of associated companies	26,913	11,676	15,494	11,680	36,004
Minority interest in earnings of subsidiaries	(137,727)	(117,781)	(76,151)	(58,164)	(298,383)
Net income before cumulative effect	62,670	35,728	17,836	14,376	110,110
Cumulative effect at beginning of period of change in accounting treatment (see section 1G above)	(56,525)	-	-	-	-
Net income	6,145	35,728	17,836	14,376	110,110
<u>Net earnings per share</u>					
Before cumulative effect, net per share	0.76	0.43	0.24	0.16	1.17
Cumulative effect at beginning of period of change in accounting treatment, per share	(0.63)	-	-	-	-
Net earnings per share	0.13	0.43	0.24	0.16	1.17
Number of shares used in computing net earnings per share	89,436	81,823	89,461	82,636	86,219

B. Analysis of Results of Operations for the Second Quarter of 2005

Rental income

The 15% increase compared with the corresponding period last year resulted from the acquisition of new properties, the coming online of properties whose development had been completed, and higher occupancy rates, as well as from the increase in the average rental fees per square meter for the Group's properties. In addition, during the second quarter of 2005, the Group recorded income from the termination of leases with tenants in the amount of NIS 12.7 million, compared to NIS 5.2 million in the corresponding period last year.

Rental operating expenses

The increase in rental operating expenses, compared to the corresponding period last year, stems from the increased number of properties, as referred to above. Rental operating expenses, as a percentage of rental income, fell from 31.8% for the corresponding period last year to 31.5%; this is due to the growth in income from the termination of leases with tenants, as referred to above. Neutralizing the effect of this factor, the above percentage has increased in comparison to the corresponding period last year, as a result of the relatively greater share in these items that now relates to FCR and RSC, whose operating expenses represent a higher percentage of income than EQY's.

Depreciation

The increase in property depreciation expenses compared to the corresponding 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 rental income rose from 14.8% for the corresponding period last year to 16.7%.

Gross profit

Gross profit amounted to NIS 273 million (51.8% of rental income); this compares to NIS 244 million (53.4% of rental income) for the corresponding period last year – an increase of 12%. The reduction in gross profit as a percentage of rental income is attributable to the increase in depreciation expenses as a percentage of rental income, as explained above.

General and administrative expenses

The increase in general and administrative expenses compared to the corresponding period last year stems from the growth in the Company's and the Group's activities, as referred to above. General and administrative expenses as a percentage of rental income amount to 8.1%, compared to 8.3% for the corresponding period last year.

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 9.4 billion in the second quarter of 2004 to an average balance of NIS 11.6 billion in the second quarter of 2005. Interest expenses reflect an average nominal interest rate of approximately 5.7% per annum on the Group's indebtedness.
2. The strengthening of the U.S. dollar against the shekel by 4.9% resulted in NIS 8.9 million in financing expenses from the erosion of the security deposits of Mishkenot Clal's tenants; in the corresponding period last year, the U.S. dollar weakened against the shekel by 0.7%, which resulted in financing income of NIS 1.5 million due to the erosion of tenants' security deposits.
3. Financing expenses include the results from transactions in securities that generated a gross gain of NIS 24.8 million in the reporting period, compared to a gain of NIS 2.8 million in the corresponding period last year.

Other income, net

This item usually consists of gains and losses in respect of capital transactions, such as the dilution of holdings in subsidiaries and real estate sales.

In the second quarter of 2005, the sale of a property by EQY produced a net gain for the Group of NIS 14.4 million (the Company's share being NIS 4.5 million), as compared to the loss of NIS 2 million (the Company's share being NIS 0.7 million) from the sale of properties in the corresponding period last year.

The Company's Share in the Profits of Associated Companies

The increase in this item is attributable to the Company's gross share in the profits of Citycon in the amount of NIS 15.5 million, compared to NIS 11.7 million in the corresponding period last year.

In the second quarter of 2005, Citycon revalued its investments in fixed assets to their fair value, in conformity with International Accounting Standard No. 40, resulting in an appreciation in their gross value of € 7.8 million (NIS 43.3 million). On the other hand, Citycon recorded a non-recurring gross expense of € 5.7 million (NIS 32 million) in respect of the early repayment of a loan, as described in section 2G.

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.

The Company is of the opinion that F.F.O. and F.F.O. per share are more accurate reflections of the 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 a previous period, and for comparing the Company's operating results to those of other property companies.

The table below presents the computation of the Company's F.F.O. and F.F.O. per share for the periods stated, after neutralizing the Company's share in the results of Mishkenot Clal, this operation having been sold subsequent to balance sheet date:

	For the 6 months which ended June 30		For the 3 months which ended June 30		For the year which ended December 31,
	2005	2004	2005	2004	2004
Reported NIS in thousands (other than F.F.O. data)					
Reported net income⁽²⁾	<u>62,670</u>	<u>35,728</u>	<u>17,836</u>	<u>14,376</u>	<u>110,110</u>
Adjustments:					
Gains from dilution in holdings of consolidated subsidiaries and other capital gains	(33,776)	(15,024)	-	(201)	(30,039)
Gains from the sale and appreciation of properties	⁽³⁾ (18,752)	(2,013)	⁽³⁾ (17,089)	703	(19,710)
Neutralization of Company's share in losses (profits) of Mishkenot Clal ⁽⁴⁾	<u>12,059</u>	<u>4,997</u>	<u>9,193</u>	<u>(709)</u>	<u>(1,056)</u>
Total adjustments	<u>(40,469)</u>	<u>(12,040)</u>	<u>(7,896)</u>	<u>(207)</u>	<u>(50,805)</u>
Company's share in depreciation and amortization	73,624	55,274	38,553	28,073	123,812
Neutralization of Company's share in depreciation and amortization of Mishkenot Clal ⁽⁴⁾	<u>(3,764)</u>	<u>(3,425)</u>	<u>(1,895)</u>	<u>(1,559)</u>	<u>(8,115)</u>
Total depreciation and amortization	<u>69,860</u>	<u>51,849</u>	<u>36,658</u>	<u>26,514</u>	<u>115,697</u>
F.F.O.	<u>92,061</u>	<u>75,537</u>	<u>46,598</u>	<u>40,683</u>	<u>175,002</u>
F.F.O. per share	<u>1.09</u>	<u>0.91</u>	<u>0.56</u>	<u>0.48</u>	<u>1.93</u>
F.F.O. per share (without the effect of convertible securities, which are included in the basic EPS computation)	<u>1.07</u>	<u>0.93</u>	<u>0.54</u>	<u>0.50</u>	<u>2.11</u>

⁽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 a company's independent auditors.

⁽²⁾ After neutralizing the cumulative effect at the beginning of the year of a change in accounting treatment, net (Israel Accounting Standard No. 19) (see section 1G above).

⁽³⁾ Includes the Company's share in the revaluation of Citycon's investments in fixed assets to their fair value, in conformity with International Accounting Standard No. 40, in the net amount of NIS 12.6 million.

⁽⁴⁾ After neutralizing the Company's share in the results of Mishkenot Clal, this operation having been sold subsequent to balance sheet date – see section 6A.

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, 2005, the liquid assets available to the Group, including short-term investments, totaled NIS 248 million, compared to NIS 109 million as of December 31, 2004. In addition, as of June 30, 2005, the Group had unutilized credit facilities available for immediate drawdown of NIS 2 billion, compared to NIS 1.2 billion as of December 31, 2004.

In aggregate, the Group has cash reserves and unutilized credit facilities available for immediate drawdown amounting to NIS 2.2 billion.

Investments in Associated Companies

Investments in associated companies, amounting to NIS 485 million as of June 30, 2005, relate primarily to the investment in 44.1 million shares of Citycon.

Long-Term Investments

Long-term investments, as of June 30, 2005, totaled NIS 359 million, compared to NIS 216 million as of December 31, 2004.

The increase in this item is derived primarily from the acquisition of marketable shares and debentures in companies active in the Group's areas of activity or in synergetic businesses, in regions where it is already active, net of the write down to the carrying value of the investment in the shares of Winn Dixie Stores Inc., see note 3J to the financial statements.

Fixed Assets, Net

Net fixed assets (that include rental properties held for sale, which are presented among current assets – see section 2H above), as of June 30, 2005, totaled NIS 16.7 billion, compared to NIS 14.7 billion at the end of 2004.

In the reporting period, the Group acquired properties, developed new properties and redeveloped existing properties at a total cost of NIS 1.4 billion. In addition, the strengthening of the U.S. dollar and the Canadian dollar against the shekel contributed NIS 0.8 billion to the increase in this item. Depreciation expenses for the reporting period amounted to NIS 169 million.

Long-Term Liabilities, Including Current Maturities

Long-term liabilities, including current maturities, as of June 30, 2005, totaled NIS 12.3 billion, compared to NIS 10.4 billion at the end of 2004.

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.

The long-term loans referred to above include current maturities in the amount of NIS 1.7 billion, compared to NIS 0.7 billion at the end of 2004.

The current maturities include the final settlement of loans (mortgages on properties), in the amount of NIS 0.4 billion, which are secured by a charge on the properties, and the repayment of an unsecured credit facility, in the amount of NIS 0.8 billion, that was granted to EQY by a consortium of banks and that EQY is entitled to extend for a further year. Based on past experience, the Group usually renews most of these loans by taking new, long-term secured and unsecured loans (at the end of 2004, the final settlement of loans included in current maturities (mortgages on properties) amounted to NIS 0.5 billion).

Shareholders' Equity

The change in shareholders' equity from NIS 1,302 million as of December 31, 2004 to NIS 1,373 million as of June 30, 2005 stems mainly from the exercise of option warrants into shares (NIS 53 million), from the income before cumulative effect for the reporting period (NIS 63 million), and from the increase due to "translation adjustments deriving from translation of the financial statements of FCR, EQY and Citycon" and other capital surpluses (NIS 49 million). These were partly offset by the cumulative effect at the beginning of the year of a change in accounting treatment, net (Israel Accounting Standard No. 19), amounting to NIS 56.5 million and the dividends of NIS 37 million paid by the Company.

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 63.4% as of June 30, 2005, compared to 60.9% as of June 30, 2004 and to 62% as of December 31, 2004.

The ratio of the Group's interest-bearing debt to total market capitalization stood at 55.4% as of June 30, 2005, compared to 56.9% as of June 30, 2004. As of December 31, 2004, the ratio stood at 58.3%.

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 2005 totaled NIS 326 million and NIS 186 million, respectively, compared to NIS 253 million and NIS 159 million for the corresponding periods last year, respectively. The growth in cash inflows from operating activities for the aforesaid periods was due to the continuing improvement in operating profit.

In addition, in order to fund the Group's activities during the reporting period and the second quarter of 2005, the Company and its consolidated subsidiaries raised capital totaling NIS 227 million and NIS 18 million, respectively, and took long-term loans and issued debentures in a net amount of NIS 1,237 million and NIS 997 million, respectively. The proceeds from the above sources were used primarily to finance investing activities for the purchase of fixed assets, which, net of proceeds from the disposal of fixed assets, totaled NIS 1,303 million and NIS 912 million in the reporting period and in the second quarter of 2005, respectively, and to finance long-term investments, net, which totaled NIS 157 million and NIS 28 million, respectively.

5. Donations

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

The Company donates to the charity "Larger than Life" – a voluntary, humanitarian organization that assists children and youngsters afflicted with cancer. Chaim Katzman, the Chairman of the Company's Board of Directors, serves as the Honorary President of "Larger than Life". The Company acts as the official sponsor of this organization.

The Company also 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).

During the reporting period, the Company's donations amounted to NIS 856,000.

6. Additional Information and Subsequent Events

- A.** As to the sale of the Company's holding in Mishkenot Clal to Azorim Properties Ltd. – see note 4A to the financial statements.
- B.** As to the capital raised by Citycon in July 2005 and the Company's participation in this fund raising – see note 4B to the financial statements.
- C.** In July 2005, the Company adopted an incentive plan for the Company's employees and officers, in conformance with Section 102 of the Income Tax Ordinance, under the capital gains track and with a trustee.

On August 21, 2005, within the framework of the above plan, the Company issued to Mr. Arie Mintkavitch, Deputy Chairman of the Board of Directors, 400,000 option warrants, which are convertible into Company shares at an exercise price of NIS 29.65 per share, subject to adjustments.

- D.** Subsequent to balance sheet date through to the date of the financial statements, EQY sold 2 properties (presented in the Company's balance sheet among current assets), having a total G.L.A. of 21 thousand square meters, for an aggregate consideration of NIS 78 million. As a result of the sale of these properties, the Company expects to record a capital gain of NIS 6 million in the third quarter of 2005.
- E.** In August 2005, the Company raised NIS 9.6 million through the issue of debentures (Series A), with a par value of NIS 9.7 million, to institutional investors. The issue was made by enlarging the existing debenture series, the par value of which, after this issue, amounts to NIS 673 million.
- F.** In August 2005, FCR announced that on September 30, 2005 it would redeem all its convertible debentures (Series C) totaling C\$ 100 million, by converting them - together with the interest accrued through that date – into FCR shares; this being in accordance with FCR's entitlement to enforce conversion on the holders of the convertible debentures. The Company, through wholly owned subsidiaries, holds 38% of the debentures (Series C), which have a par value of C\$ 38.2 million.

7. Participation in Peer Review

Pursuant to the directive of the Israel Securities Authority issued on July 28, 2005 dealing with "disclosure concerning the giving of consent for the performance of a peer review", the Company's Board of Directors has resolved that the Company takes a positive view of the performance of a peer review and the underlying objective for such a review – the assurance of a proper accounting audit being performed thoroughly, through the creation of supervisory mechanisms – and deems it correct to cooperate in the review's implementation and its furtherance. However, in the opinion of the Company, the peer review in its proposed format raises various legal and other issues, the principal of which relate to: the obligation of the reviewing accountant to maintain confidentiality with regard to the information he receives relating to the Company; the obligation of the reviewing accountant to avoid having a conflict of interests; the lack of any direct legal connection between the reviewing accountant and the

Company; and the question of the liability to the Company in the event of it being caused harm or damage. The mechanisms set forth in the peer review to resolve these issues do not provide the Company with sufficient protection. Should mechanisms be put in place that would satisfactorily resolve the Company's apprehensions, it would favorably consider cooperating with the peer review. It should also be noted that, with regard to foreign group companies listed on an overseas stock exchange, the transmission of information relating to such companies by the Company or by its independent auditors to the reviewers in a peer review (as is the case with respect to any third party) would be subject both to the provisions of the law applicable to that group company and also (so long as the aforesaid foreign law does not prohibit this) to the specific consent of the group company concerned.

The Company has concluded that its financial statements have been audited in accordance with the law by its independent auditors. It formed this opinion based – inter alia – on the fact that the accountants that audit the financial statements belong to an accounting firm, which is part of one of the four leading international firms and, as such, they are subject to defined work procedures; additionally, the fact that the Company has furnished its independent auditors with all the relevant information for the preparation of the financial statements further reinforces the Company's opinion.

Among the reasons why this matter has not been discussed at the general meeting of the Company's shareholders, at which the independent auditors are appointed, is that during the period between the issuance of the aforementioned directive and the Board of Directors' decision no such general meeting has been held; additionally, the proper forum for discussing issues of confidentiality, conflict of interests and liability is the meeting of the Company's Board of Directors.

8. 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 2004 on March 28, 2005, there have been no significant changes in the market risks or the way in which they are managed.

August 18, 2005

**Date of approval of
the Directors' Report**

**Chaim Katzman
Chairman of the Board of
Directors**

**Dori Segal
President and Director**