Azrieli Group Ltd.

Periodic Report

As of December 31, 2016

Part A Description of the Corporation's Business

Part B Board Report

Part C Consolidated Financial Statements Dated 31 December 2016

Part D Further Details about the Corporation

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AZRIELI GROUP

NAOMI SHENKAR
LEGAL TRANSLATIONS LTD
תרגומי משפט בע"מ

March 21, 2017

We hereby confirm that we prepared the English translation attached to the financial statements of Azrieli Group Ltd. (the "Statements"), and that the translation is fair.

We hereby express our consent that the translation of the Statements, as well as this confirmation, be included in the annual report of Azrieli Group Ltd.

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Azrieli Group

Part A

Description of the Corporation's Business

Chapter A

GENERAL DEFINITIONS

Azrieli Group Ltd. hereby respectfully files the Description of the Corporation's Business Report as of December 31, 2016 (the "**Report Date**"), reviewing the description of the Group and development of business thereof, in 2016 (the "**Report Period**") until the Report Release Date. The Report is prepared pursuant to the provisions of Regulation 8a of the Securities Regulations (Periodic and Immediate Reports), 5730-1970. Figures appearing in the Report are true as of the Report Date. However, in certain cases details appear in the Report reviewing events which occurred subsequently to the Report Date and shortly before the date of release thereof on March 22, 2017 (the "**Report Release Date**") and in such cases the Company notes that these are provided as of the Report Release Date.

Materiality

The materiality of the information included in this Report, including a description of the material transactions and/or material projects, is evaluated from the point of view of the Company. It should be clarified that, in a part of the cases, the Company, in its exclusive discretion, decided to expand the description necessary, in order to give a more comprehensive picture of the subject being discussed.

Forward Looking Information

The description of the corporation's business in this Chapter A partly includes forward looking information as defined in the Securities Law. Such information which is presented below and indicated as forward looking information, includes forecasts, assessments, estimates or other information that is deemed as uncertain information which refers to a future event and which relies, inter alia, on publications of the Central Bureau of Statistics, Bank of Israel, other relevant professional entities and in addition, on internal estimates of the Company that are based on statistics, experience and information accumulated by the Company over the years. Actual results may materially differ from those forecasted in the context of the forward looking information as aforesaid, as a result of a large number of factors, including as a result of the risk factors, in whole or in part, as described in Section 28 below, all as will be specified in the specific references to forward looking information later in the chapter. Sentences which include expressions such as "expected", "intends", "estimates", "foresees", "expects" and similar expressions indicate that this is forward looking information. Such information reflects the Company's current point of view regarding future events that are based on estimates and therefore are subject to risk and uncertainty.

Definitions

In this Chapter, the following terms shall bear the meaning stated alongside them:

"**TASE**"	Tel Aviv Stock Exchange Ltd.;
"**Granite**" or "**Granite Hacarmel"**	Granite Hacarmel Investments Ltd.;
"**Board of Directors' Report**"	The Company's Board of Directors' Report on the State of the Company's Affairs as of December 31, 2016, which is included in Chapter B of the Periodic Report;
"**Periodic Report**" or "**Report**"	The Company's periodic report for 2016;
"**Financial Statements**"	The consolidated financial statements of the Company as of December 31, 2016, which are included in Chapter C of the Company's Periodic Report;
"**Company**"	Azrieli Group Ltd.;
"**Companies Law**"	The Companies Law, 5759-1999;
"**Securities Law**"	The Securities Law, 5728-1968;
"**Leumi Card**"	Leumi Card Ltd.;
"**Midroog**"	Midroog Ltd.;
"**Contribution Shares**"	6,902,000 ordinary shares of the Company, which Azrieli Holdings transferred, by way of contribution, without consideration, to the Azrieli Foundation (Israel). For further details, see the Company's immediate report of March 16, 2014 (Ref. No.: 2014-01-015204), which is included herein by way of reference;
"**Ma'alot**"	Standard & Poor's Maalot Ltd.;
"**Nadav Investments**"	Nadav Investments Inc., a private company incorporated under Canadian Law, fully owned and controlled by Azrieli Holdings Inc., a private company incorporated under Canadian Law, which is owned and controlled by Messrs. Sharon Azrieli, Naomi Azrieli and Danna Azrieli.;
"**Sonol**"	Sonol Israel Ltd.;

“**Supergas**”	Supergas Israeli Gas Distribution Company Ltd.;
“**Azrieli E-Commerce**”	Azrieli E-Commerce Ltd. (formerly: Netex New Media Ltd.);
“**Azrieli Holdings**”	Azrieli Holdings Inc.;
“**Granite Group**”	Granite Hacarmel and/or subsidiaries and/or affiliates thereof;
“**Azrieli Group**” or “**Group**”	The Company and/or subsidiaries and/or companies affiliated thereto;
“**Canit Hashalom**”	Canit Hashalom Investments Ltd., a subsidiary of the Company;
“**Azrieli Foundation (Israel)**”	The Azrieli Foundation (Israel), R.A. 580503118, a not-for-profit association registered in Israel, acting, *inter alia*, to promote education and culture through projects in the fields of culture, welfare and science;
“**Azrieli Foundation (Canada)**”	The Azrieli Foundation is a registered Canadian charitable foundation, incorporated and seated in Canada, whose assets are designated for donations and for the funding of philanthropic activities in Israel and in Canada, which is a stakeholder in the Company.
“**Prospectus**”	A public offering prospectus published by the Company on May 12, 2010 as amended on May 12, 25 and 30, 2010;
“**Shelf Prospectus**”	A shelf prospectus released by the Company on May 10, 2016 bearing the date May 11, 2016 (for details see the Company’s immediate report of May 10, 2016 (Ref.: 2016-01-063049);
“**GES**”	G.E.S.- Global Environmental Solutions Ltd.

CHAPTER A: DESCRIPTION OF THE COMPANY'S BUSINESS

PART ONE: DESCRIPTION OF THE GENERAL DEVELOPMENT OF THE COMPANY'S BUSINESS

1. The Company's operations and description of the development of its business

1.1 General

The Company was incorporated on January 6, 1983, as a private company according to the laws of the State of Israel. On June 3, 2010, the Company's shares were issued to the public for the first time and began to be traded on TASE on June 7, 2010, and the Company became a public company, within the meaning thereof in the Companies Law. Commencing from July 1, 2010, the shares of the Company are included in the Tel Aviv 35 Index (Formerly Tel Aviv 25 index). The Company's Series B and Series C bonds are included, *inter alia*, in the Tel Bond 40 Index, and its Series D bonds are included in the Tel Bond 20 Index.

As of the Report Release Date, Azrieli Holdings, a private company, incorporated under Canadian law, holding directly and indirectly, through its holding of the entire share capital of Nadav Investments, the direct controlling shareholder of the Company, 55.62% of the share capital and 61.31% of the voting rights of the Company[1] in practice and on a fully diluted basis. As the Company has been informed, Azrieli Holdings is controlled by Sharon Azrieli, Naomi Azrieli and Danna Azrieli, whether directly or through Canadian holding corporations[2].Shortly before the release date of this Report, a shareholder agreement was signed between Sharon Azrieli, Naomi Azrieli and Danna Azrieli (in person and by companies they control) and Azrieli Holdings, Nadav Investments (which is the direct controlling shareholder of the Company) and another Canadian corporation, which is a shareholder of Azrieli Holdings. For details about the control of the Company and about the aforesaid agreement, see Regulation 21A of Chapter D of this Report and the immediate report of March 21, 2017 (Ref.: 2017-01-026388), which is included herein by way of reference.

As of the Report Date, the Company is engaged, both on its own and through its subsidiary and investee companies, primarily in the various real estate segments, with most of the business operations of the Company being in the retail center and mall segment in Israel, in the office and other space for lease segment in Israel and abroad, and in the senior housing segment. The Company has an additional operating

[1] Including all of the voting rights by virtue of the Contribution Shares (as defined in the above "Definitions" section).

[2] For details, see the immediate report of January 5, 2017 regarding interested parties' holdings (Ref.: 2017-01-002916), which is included herein by way of reference.

segment centralized under Granite Hacarmel, which is engaged , through subsidiaries, in the marketing of alternative energy sources and chemicals, wastewater and water treatment (the "**Granite Segment**"). The Group has additional business of e-commerce and minority holdings in financial corporations, all as hereinafter specified. Until July 2016, the Company, through Granite, held Sonol, which engaged in a segment comprising the direct marketing of petroleum distillates and fueling and commerce complexes. In view of the closing of the transaction for the sale of the Group's holdings in Sonol, the Sonol business has become discontinued operations. In the long term, as previously reported by the Company, the Company intends to focus on the core areas of the real estate business and therefore examines, from time to time, its holdings in the non-real estate segments.

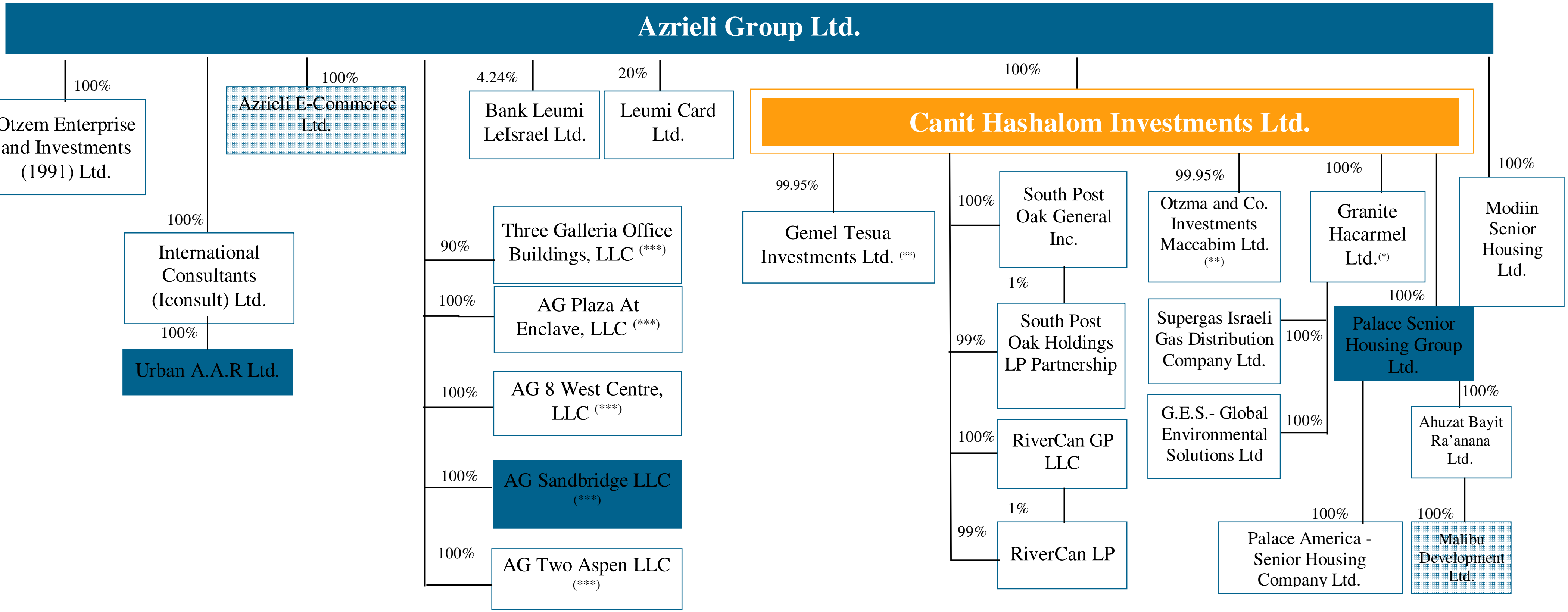
Azrieli Group is the leading real estate group in Israel, which was founded by Mr. David Azrieli OBM and led by Ms. Danna Azrieli, Active Chairman of the Company's Board of Directors, who was appointed to her position in July 2014, after many years in which she served in key positions in the Group. The operations of the Group are carried out by means of a managerial headquarter that is comprised of professionals having a great deal of seniority and managerial experience, most of whom have been associated with the Company and the Group's companies for many years. The Company estimates that the Group, headed by the Chairman of the Board, Ms. Danna Azrieli, as well as the experienced officers and managers in the Company who are considered professional and leading in the field, constitute some of the success factors for the Company's business results. See Section 17 of Chapter A of the Report for additional details about the human capital of the Company.

As of 2008 (transition date: January 1, 2007), the Company's financial statements have been prepared in accordance with International Accounting Rules (IFRS), according to which, *inter alia*, investment properties are presented at fair value.

Chapter A of the Report (this chapter) should be read together with its other parts, including the notes to the Financial Statements.

1.2 **<u>The Group's main holdings chart as of the Report Release Date</u>**[3]

1.2.1 Following is a chart updated as of the Report Release Date:



(*) Main holdings only.
(**) 0.05% of these companies held by IC.
(***) Indirectly, through companies and/or partnerships.

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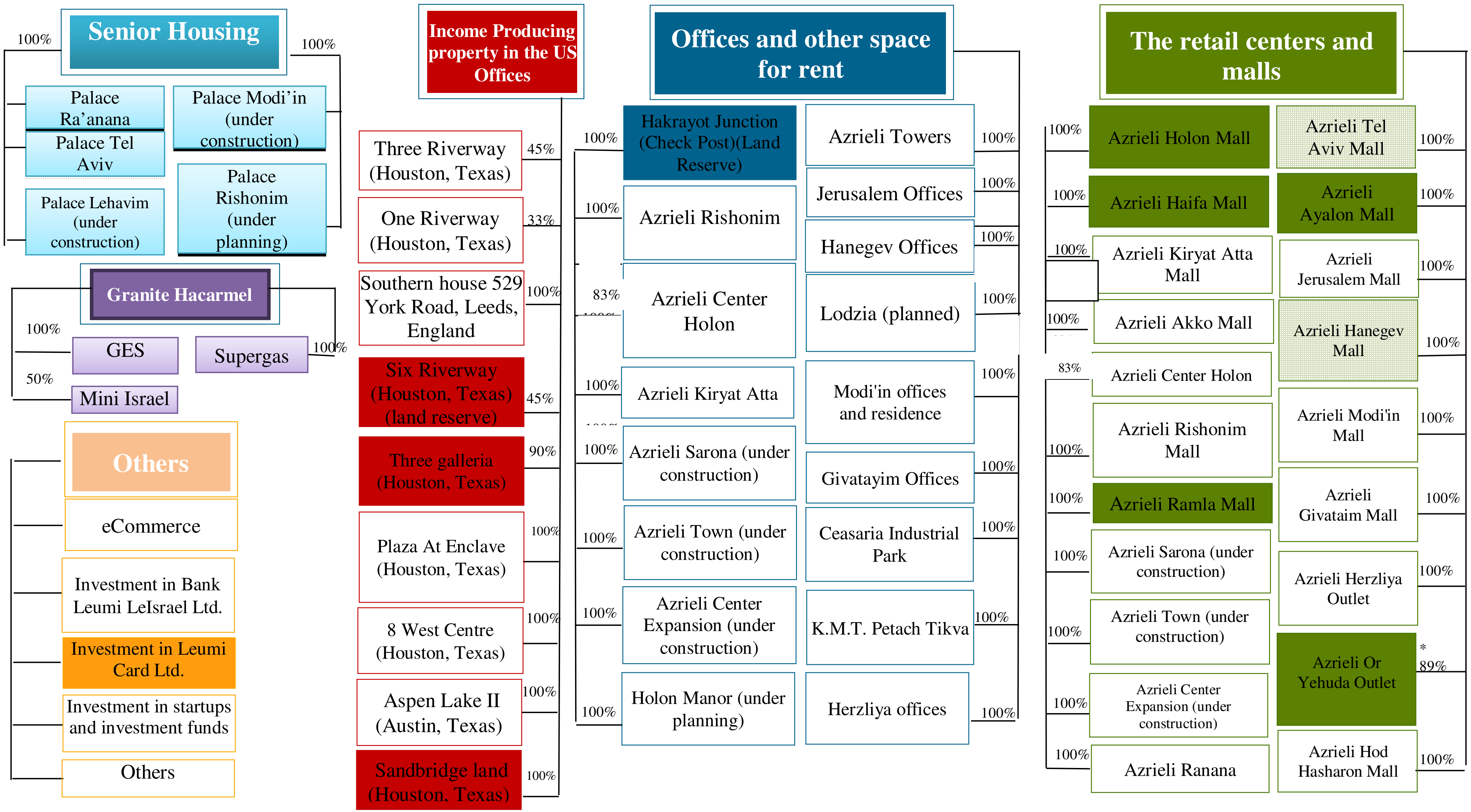
[3] The chart does not include companies that are inactive as of the Report Release Date nor property management companies.

1.2.2 As of the Report Release Date, the Group's asset holdings chart, in the final holdings structure, by operating segment, is as follows:



(*) The holding rate was determined after the deduction of stores not owned by the Company.

1.3 Main developments occurring in the Company's structure and business in 2016 and until the Report Release Date

1.3.1 Purchase of income-producing property (Lodzia)

1) Closing of the acquisition of property in Holon: on April 13, 2016 the Company closed the acquisition of the full ownership rights in a real property in a registered area of approx. 53 thousand sqm located at the Holon Industrial Zone, with approx. 14,300 sqm of built-up areas of retail and workshop structures that are leased to various tenants, after it had received approval from the Antitrust Commissioner, in consideration for NIS 280 million plus V.A.T.. The land designation according to a valid zoning plan is a special employment area with a retail front and it includes building rights of approx. 193 thousand sqm above ground and parking basements[4].

2) Closing of the acquisition of “Yediot Aharonot House” (expansion of the Azrieli Tel Aviv Center)

March 31, 2016 saw the closing[5] of the acquisition of full title to land in the area of approx. 8,400 sqm, adjacent to the Azrieli Tel Aviv Center, which land currently holds the “Yediot Aharonot House”, which, as of the Report Release Date, the Company has began the demolition of.

3) Closing of the acquisition of Azrieli Town

August 31, 2016 saw the closing of a transaction for the purchase of land designated for the Azrieli Town project. The Company has paid the balance of the consideration and possession of the lot has been handed over thereto[6].

4) Acquisition of an office building in Austin, Texas, U.S.

In August 2016, a consolidated company purchased an office building (construction of which had been completed in August 2015), situated in Austin, Texas, U.S., in consideration for approx. $40.5 million. The size of the property is 128,990 sq ft (11,984 sqm) and it is occupied by a single tenant with a lease contract until 2028 with no option for early exit. The property was purchased with an average yield rate of approx. 8% for the term of the contract. For the purchase of the property, the consolidated company took a loan in the sum of $22 million for a 7-year period bearing a fixed dollar interest rate of 3.65% per annum.

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[4] For further details, see the Company’s immediate reports of March 2, 2016, March 23, 2016 and April 14, 2016 (Ref.: 2016-01-039331, 2016-01-012798, and 2016-01-048550 respectively), which are included herein by way of reference, and Note 14F to the Financial Statements.

[5] For further details, see the Company’s immediate reports of May 22, 2013 and April 3, 2016 (Ref.: 2013-01-068386 and 2016-01-023433 respectively), which are included herein by way of reference, and Note 14E to the Financial Statements

[6] For further details, see the Company’s immediate report of September 1, 2016 (Ref: 2016-01-115657), which is included herein by way of reference.

1.3.2 **<u>Closing of the acquisition of a digital commerce business</u>**

On June 2, 2016 (following the receipt of approval from the Antitrust Commissioner on May 18, 2016), a transaction was closed for the purchase of an e-commerce business from Buy2 Networks Ltd., a public company whose shares are listed on TASE, in consideration for NIS 70 million subject to adjustments, such that the net consideration, as of the Report Date, is approx. NIS 61 million. In addition, the Company will pay a sum of approx. NIS 5 million per year for management services for the business segment, which the seller will provide for a 24-month period[7].

1.3.3 **<u>Financing Transactions</u>**

Date	**Type of Financing**	**Sum Raised (NIS in millions)**	**Annual Interest Rate**	**Duration**	**Collateral**	**Notes**
July 2016	Bond issue (Series D)	2,194	1.34	7.6	None	According to a shelf offering report published on July 5, 2016 (Ref.: 2016-01-075079) under the Company's Shelf Prospectus published on May 10, 2016 (Ref.: 2016-01-063049). For further details with respect to the Series D bonds, see Note 21B(5) to the Financial Statements.
May 2016	Private financing from an institutional body	550	1.5	6.5	Yes	Immediate report of May 2, 2016 (Ref.: 2016-01-057004)(included by way of reference) and Note 21B(9) to the Financial Statements.
May 2016	Private financing from an institutional body	300	Prime (-) 0.1	0.3	Yes	Immediate report of May 2, 2016 (Ref.: 2016-01-057553)(included by way of reference). In November 2016 the loan was repaid according to its original terms.
April 2016	Private financing from an institutional body	250	1.35%	1.7	No	The Company has an obligation to comply with financial covenants identical to the covenants stipulated in the indentures of the Company's Series B and Series C bonds (the "**Indentures**"). The

[7] For further details, see the Company's immediate reports of May 3, 2016 and June 2, 2016 (Ref.: 2016-01-057901 and 2016-01-043209), which are included herein by way of reference.

						agreement causes standard causes for acceleration, including ones included in the Indentures. The agreement further includes an obligation not to grant a floating charge on the Company's assets, in whole or in part, to any entity whatsoever, unless the Company simultaneously creates a floating charge in favor of the lender, identical in rank and scope (*pari passu*).

It is noted that in July and August 2016, the Group prepaid loans in the aggregate sum of NIS 900 million (of which approx. NIS 300 million were short-term loans, with the balance mostly consisting of long-term loans scheduled for repayment in March 2017). Some of the aforesaid loans were secured by collateral of various types, which were discharged following the repayment of the loans.

Shelf Prospectus

On May 10, 2016, the Company published a Shelf Prospectus, following the receipt of a permit from the Israel Securities Authority (ISA).

1.3.4 **Transactions related to the senior housing segment**

1) Winning a tender for acquisition of leasehold rights with senior housing designation in Rishon Lezion: on March 13, 2016, the Company, through a consolidated company, won a tender conducted by the Israel Land Authority for the purchase of leasehold rights in a lot in an area of 3.4 thousand sqm with senior housing designation at the Rakafot Neighborhood in east Rishon Lezion, designated for the construction of at least 250 senior housing units and approx. 3 thousand sqm of retail space, in consideration for approx. NIS 26 million. According to the terms of the tender, the consolidated company paid development costs in the amount of approx. NIS 22 million[8].

2) Closing of the acquisition of a senior home and a retail center in Ra'anana

On May 25, 2016, the acquisition of 100% of the shares of Ahuzat Bayit Ra'anana Retirement Home Ltd.[9], which holds and manages "Ahuzat Bayit" (presently known as "**Palace Ra'anana**"), a senior home, and "Park Mall" (presently known as Azrieli Ra'anana), a retail

[8] For further details see immediate report of March 13, 2016 (Ref.: 2016-01-005097), which is included herein by way of reference.

[9] On the date of the transaction, Ahuzat Bayit was a Bond Company, within the definition of such term in the Companies Law. On June 29, 2016, Ahuzat Bayit announced the full and final repayment of the bonds (Series A), upon payment of the early redemption on June 29, 2016, and the Company ceased to be a Reporting Corporation, within the definition of such term in the Securities Law.

center in Ra'anana, in consideration for NIS 55 million, following the receipt of approval from the Antitrust Commissioner on April 13, 2016[10].

1.3.5 **Transactions related to the business of Granite Hacarmel Group**

Closing of the sale of Sonol: On July 24, 2016 (the "**Closing Date**"), Granite Hacarmel closed the transaction for the sale of all of its holdings (100%) in Sonol, to Israel Oil & Gas Fund L.P., a limited partnership incorporated in Israel, the general partner of which is controlled by Mr. David Weissman. On the closing date and subsequently thereto, the purchaser paid the part of the consideration intended to be paid on the Closing Date[11].

Furthermore, the Company and Granite, including through Sonol, sold third parties all of their holdings in the lands of Pi Glilot and in the shares of Pi Glilot (which holds the long-term lease rights to land in the Pi Glilot complex), for a total consideration of approx. NIS 130 million. These transactions have not been closed yet. In addition, after receipt of the consideration, Granite Hacarmel prepaid a long-term loan, as collateral for which the shares of Sonol had been pledged. In view of the aforesaid, Sonol is presented in the Financial Statements as discontinued operations. For further details see Note 8 to the Financial Statements.

1.3.6 **Additional events**

Changes in the Office of an Officer

On March 23, 2016, the Company reported the appointment of Mr. Menachem Einan as a director of the Company (Ref.: 2016-01-012291), which is included herein by way of reference. On August 9, 2016, the Company's general meeting approved the appointment of Mr. Einan, and also approved the renewal of the office of the outside directors, Messrs. Ephraim Halevy and Niv Ahituv for a (third) term of service of three years (Ref.: 2016-01-100267), which is included herein by way of reference. During Q2/2016, Mr. Ofer Avram, VP, Head of Offices, and Ms. Michal Kamir, General Counsel, Company Secretary and Internal Enforcement Officer, ended their offices with the Company. Messrs. Gideon Avrami (formerly the CEO of the management company of the Azrieli Jerusalem (Malcha) Mall) and Ran Tal, have been respectively appointed in their stead. On March 21, 2017, the office of the Company's internal auditor, Mr. Gali Gana, ended and the board of directors appointed Mr. Moshe Cohen to the position in his stead. The Company will release the updated status of officers in proximity to the release of this Report.

Class Actions

On April 14, 2016, a joint motion was filed for the approval of a settlement agreement and the validation of a judgment in connection with a motion filed

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[10] For details see the Company's immediate reports of March 24, 2016, March 27, 2016, April 13, 2016 and May 25, 2016 (Ref.: 2016-01-013692, 2016-01-014163, 2016-01-048331 and 2016-01-034146, respectively), which are included herein by way of reference and Note 14I(3) to the Financial Statements.

[11] For further details, see the Company's immediate reports of June 18, 2015, October 26, 2015, February 2, 2016, April 14, 2016, June 19, 2016 and July 24, 2016 (Ref.: 2015-01-050991, 2015-01-141945, 2016-01-021562, 2016-01-048793, 2016-01-052239, and 2016-01-088873 respectively), which are included herein by way of reference.

with the Economic Department at the District Court in Tel Aviv (the "**Court**"), against the Company and against the subsidiary, Canit Hashalom, for the certification of a class action concerning a full tender offer closed by the Company in September 2012 with respect to the shares of the public in Granite Hacarmel. On September 19, 2016, a hearing was held in Court, in which the parties accepted the Court's recommendation, whereby the Petitioner will withdraw the class certification motion (according to the provisions of Section 16 of the Class Action Law, 5756-2006) and the Respondents (the Company and the subsidiary) will pay the Petitioner a sum of NIS 50,000 and the fees of the Petitioner's counsel in the sum of NIS 250,000 plus V.A.T., without acknowledging any of the Petitioner's claims. These understandings were sanctioned as a judgment[12].

<u>Tax Assessment</u>

On December 5, 2016, the Tax Authority issued the Company and Canit Hashalom tax assessments to the best of judgment (the "**Assessment**") in the total amount of approx. NIS 170 million for the years 2011-2014 (inclusive). It is noted that a tax liability is included in the Company's Financial Statements with respect to parts of the amount of the Assessment. The Company disputes the positions of the Tax Authority and believes, *inter alia*, in reliance on its professional advisors, that it has sound claims against such positions, and it has therefore submitted an objection to the Assessment in January 2017. In the Company's estimation, no material effect on the Company's Financial Statements is expected[13].

2. <u>Main operating segments of the Group</u>

As of the Report Date, the business operations of the Group are focused on the real-estate market in Israel, and the Group also operates in the income-producing real estate segment abroad.

In view of the closing of the transaction for the sale of the Group's holdings in Sonol, as of the quarterly statement for June 30, 2016, Sonol's operations have become discontinued operations, in accordance with GAAP, and it is presented in the Company's income statements separately from the continuing operations (see Note 8 to the Financial Statements). In view of the aforesaid, as of the statement for Q3/2016, the Company has begun reporting its operations in the Granite Segment as a separate operating segment, within the definition of such term in GAAP. Furthermore, as of the statement for Q3/2016, the Company's operations in the senior housing segment are being described as a separate operating segment, in view of the establishment and expansion of the operations and investment in projects under development in this segment.

As of the Report Date, the Company reports to the public on <u>five</u> operating segments:

(1) **The retail centers and malls in Israel segment –** In this operating segment, the Group focuses, primarily, on promoting, constructing, acquiring, renting, managing and maintaining malls and retail centers in Israel. As of the Report Date, the Group owns 15

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[12] For further details, see the Company's immediate report of August 8, 2013, April 26, 2016 and September 20, 2016 (Ref.: 2013-01-113148, 2016-01-055675 and 2016-01-125794, respectively), which are included herein by way of reference.

[13] For details see the Company's immediate report of December 6, 2016 (Ref.: 2016-01-136948), which is included herein by way of reference.

malls and retail centers in Israel (including Azrieli Ra'anana, formerly known as "Park Mall", which was acquired in the Report Period as part of the acquisition of Palace Ra'anana), in a total leasable area of approx. 310 thousand sqm leased (on a consolidated basis and the Company's share) to some 1,800 tenants, with most of the malls and retail centers spread throughout the large cities in Israel. In the framework of this operating segment, the Company provides management services to the retail centers and malls maintained thereby, with the management being performed by the Company and/or designated management companies in relation to each mall or retail center that is owned by the Group, which enters into management agreements with the tenants. All of the malls and retail centers also include car parks (above or underground) which serve the visitors and the potential tenants. See Section 8 of Chapter A of the Report for additional details regarding the retail centers and malls segment.

(2) **The office and other space for lease segment in Israel –** In this operating segment, the Company focuses, primarily, on promoting, constructing, acquiring, renting, managing and maintaining office buildings and parks for offices and high-tech industry, logistic areas and storage in Israel. As of the Report Date, the Group owns 11 income-producing properties in the office and other space for lease segment in Israel, in a total leasable area of approx. 392 thousand sqm (on a consolidated basis and the Company's share) that are leased to about 550 tenants. Most of the Group's income-producing areas in this operating segment constitute part of the Group's projects which integrate commercial areas, as portrayed in the retail centers and malls segment, and area designated for office and other space for lease. See Section 9 of Chapter A of the Report for additional details regarding the office and other space for lease segment in Israel.

(3) **The income-producing property segment in the U.S.** – As of the Report Date, the Group's companies own 7 office properties for lease outside of Israel, in a total leasable area of approx. 199 thousand sqm (the Company's share is approx. 189 thousand sqm) that are leased to some 250 tenants. See Section 10 of Chapter A of the Report for additional details with respect to the income-producing property segment in the U.S.

(4) **The senior housing segment** – The Company has two active senior homes in an aboveground built-up area of approx. 79 thousand sqm, which comprise approx. 560 senior housing units, and three projects under development and construction for approx. 840 residential units in a total area of approx. 107 thousand sqm. For further details about the senior housing segment, see Section 11 of Chapter A of the Report.

(5) **The Granite Segment** – The Company holds (through Granite Hacarmel) 100% of the rights in Supergas, which engages in the marketing of alternative energy sources; 100% (through Granite Hacarmel) of GES, which is engaged in chemicals, wastewater and water treatment. For further details about the Granite Segment, see Section 12 of Chapter A of the Report.

The eCommerce Business

Further to the Company's reports, whereby it continues to examine business opportunities related to the expansion of its operations to additional segments that coincide with its business strategy, the Company has acquired e-commerce operations from Buy2 Networks Ltd. The Company aims to become part of the world of digital commerce, which has been gathering momentum in Israel and throughout the world and create an additional growth engine, while simultaneously developing the core business in traditional commerce. For further details about Azrieli's operations in the e-commerce segment, see Section 14.1 of Chapter A of the Report.

Other assets and business:

The Company also has investments in banking and financial corporations, investments in venture capital and start-up companies and in investment funds. See Section 14.2 of Chapter A of the Report for additional details.

3. Investments in the Company's capital and transactions in its shares

3.1 To the best of the Company's knowledge, no investments have been made in the Company's capital over the past two years and no other material transaction has been executed in the Company's shares by an interested party outside of the TASE during the two years preceding December 31, 2016, as well as until this Report Release Date, except as specified below:

Subject of the Report	Report Release Date	Reference[14]
Began to be an interested party by virtue of holdings – Migdal Insurance and Financial Holdings Ltd.	February 12, 2015 and amending report of March 5, 2015	2015-01-030247 2015-01-044836
The Azrieli Foundation (Canada) sold 150,000 ordinary shares of the Company in an off-TASE transaction, to investors who are not interested parties of the Company, in order that the public holdings (as such term is defined in the TASE Rules) will be at least 25%.	February 22, 2015 February 25, 2015	2015-01-035629 2015-01-038659
The Azrieli Foundation (Canada) sold 6,063,638 ordinary shares of the Company in off-TASE transactions, as part of the preparations toward the index reform announced by TASE.	April 15, 2015 March 29, 2016 March 30, 2016 April 3, 2016	2015-01-078715 2016-01-016773 2016-01-018678 2016-01-023424
Changes that occurred in the holdings of Mr. Menachem Einan, a director of the Company	April 3, 2016 January 1, 2017	2016-01-024156 2017-01-000042

3.2 As of the Report Release Date, Azrieli Holdings holds 55.62% of the Company's share capital (directly and/or indirectly) and approx. 61.31% of the voting rights, the Azrieli Foundation (Canada) holds 8.55% of the Company's share capital, and the Azrieli Foundation (Israel) holds 5.69% of the Company's share capital and no voting rights.

3.3 For details on other, non-material, transactions which were carried out by interested parties of the Company see the Company's current reports.

3.4 For details on the status of holdings of interested parties in the Company see immediate report of January 5, 2017 (Ref.: 2017-01-002916), which is included herein by way of reference.

4. Dividends

4.1 Following are details on the dividend distributions in 2015, 2016 and 2017 (until the Report Release Date):

[14] All of the reports in this section below are included herein by way of reference.

Resolution Date	Distribution Date	Dividend Amount per Share (NIS)	Dividend Amount (NIS in millions)
March 16, 2015	May 4, 2015	2.6387	320
March 22, 2016	May 4, 2016	3.2983	400
March 21, 2017	May 10, 2017	3.9580	480

4.2 The above-specified distributions did not require obtaining a court approval.

4.3 The Company's retained earnings available for distribution as of December 31, 2016 are approx. NIS 12.7 billion (such retained earnings also include the revaluation fund for financial assets available for sale and property revaluation profits).

4.4 For further details on the dividend distribution in the Company and a dividend distribution limitation, see Notes 23B. and 21B(3) to the financial statements.

PART TWO: OTHER INFORMATION

5. Financial information regarding the Company's operating segments

The following presents financial data of the Company, as specified in the Company's financial statements (NIS in thousands) for the years 2014 to 2016. Figures for the years 2014-2014 have been restated in view of the sale of the Sonol business**:

Y2016:

	Retail centers and malls in Israel	Office and other space for lease in Israel	Income-producing property in the U.S.	Senior housing	Granite	Adjustments*	Consolidated
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Revenues							
Total revenues from outsiders	973,971	446,810	228,906	94,934	653,249	7,546	2,405,416
Total revenues from other Group operating segments	-	-	-	-	-	-	-
Total	973,971	446,810	228,906	94,934	653,249	7,546	2,405,416
Attributed costs							
Costs not representing revenues from other Group operating segments	,195455	77,645	105,354	65,634	570,179	11,597	,1,025864
Costs representing revenues of other Group operating segments	-	-	-	-	-	-	-
Total	195,451	77,645	105,354	65,634	570,179	11,597	1,025,860
Income from operations attributed to operating segment (NOI in the income-producing real estate segments)	,778516	369,165	123,552	29,300	83,070	(4,051)	,1,379552
Variable costs attributed to the operating segment	,195455	77,645	105,354	-	374,445	4,476	,757375
Fixed costs attributed to the operating segment	-	-	-	65,634	195,734	7,121	268,489
Increase (decrease) in the fair value of investment property	220,001	517,076	(82,245)	55,746	-	-	,710578
Income from operations attributable to the shareholders of the parent company	778,113	368,668	118,986	29,271	82,743	(4,051)	1,373,730
Income from operations attributable to non-controlling interests	407	497	4,566	29	327	-	5,826
Total assets attributed to the operating segment	12,074,258	8,218,829	2,176,253	1,494,520	1,297,992	73,855	25,335,707

*Adjustments to the consolidated basis derive from ecommerce and insurance operations. For details, see Section 14 of this Chapter.
For explanations by the board of directors with respect to the financial data of the Company as included in its consolidated financial statements, see the Company's Board of Directors' Report in Chapter B of the Report.

**In view of the closing of the transaction for the sale of the Group's holdings in Sonol, Sonol's operations have become discontinued operations. In accordance with GAAP, Sonol's operations are presented in the Financial Statements in comparison figures as discontinued operations. Therefore, as of the quarterly statement for September 30, 2016, the Company has begun reporting its operations in the Granite Segment and in the senior housing segment as separate operating segments, within the definition of this term in GAAP. As of the quarterly statement for September 30, 2016, the senior housing segment and the Granite Segment are deemed separate operating segments for the purpose of the Company's quarterly and periodic statements.

Y2015:

	Retail centers and malls in Israel	Office and other space for lease in Israel	Income-producing property in the U.S.	Senior housing	Granite	Adjustments*	Consolidated
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Revenues							
Total revenues from outsiders	931,135	419,607	236,247	35,556	731,309	1,038	2,354,892
Total revenues from other Group operating segments	-	-	-	-	-	-	-
Total	931,135	419,607	236,247	35,556	731,309	1,038	2,354,892
Attributed costs							
Costs not representing revenues from other Group operating segments	183,508	72,122	104,602	23,819	643,854	124	1,028,029
Costs representing revenues of other Group operating segments	-	-	-	-	-	-	-
Total	183,508	72,122	104,602	23,819	643,854	124	1,028,029
Income from operations attributed to the operating segment (NOI in the income-producing real estate segments)	747,627	347,485	131,645	11,737	87,455	914	1,326,863
Variable costs attributed to the operating segment	183,508	72,122	104,602	-	454,875	124	815,231
Fixed costs attributed to the operating segment	-	-	-	23,819	188,979	-	212,798
Increase (decrease) in the fair value of investment property	122,972	70,294	(28,294)	14,099	-	-	179,071
Income from operations attributable to the shareholders of the parent company	745,066	344,578	125,853	11,634	86,688	914	1,314,733
Income from operations attributable to non-controlling interests	2,561	2,907	5,792	103	767	-	12,130
Total assets attributed to the operating segment	11,055,969	6,829,670	2,052,023	803,266	1,175,267	1,912,532	23,828,727

*Adjustments to the consolidated basis derive from insurance operations, with the exception of the total assets which also include the assets of the discontinued operations. See Section 13 of this Chapter.

For explanations by the board of directors with respect to the financial data of the Company as included in its consolidated financial statements, see the Company's Board of Directors' Report in Chapter B of the Report.

Y2014:

	Retail centers and malls in Israel	Office and other space for lease in Israel	Income-producing property in the U.S.	Senior housing	Granite	Adjustments*	Consolidated
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Revenues							
Total revenues from outsiders	877,464	386,954	191,467	---	871,699	955	2,328,539
Total revenues from other Group operating segments	---	---	---	---	---	---	---
Total	877,464	386,954	191,467	---	871,699	955	2,328,539
Attributed costs							
Costs not representing revenues from other Group operating segments	167,995	69,039	84,163	---	799,564	54	1,120,815
Costs representing revenues of other Group operating segments	---	---	---	---	---	---	---
Total	167,995	69,039	84,163	---	799,564	54	1,120,815
Income from operations attributed to the operating segment (NOI in the income-producing real estate segments)	709,469	317,915	107,304	---	72,135	901	1,207,724
Variable costs attributed to the operating segment	167,995	69,039	84,163	---	597,412	54	918,663
Fixed costs attributed to the operating segment	---	---	---	---	202,152	---	202,152
Increase (decrease) in the fair value of investment property	(89,278)	117,106	8,873	---	(10,641)	---	26,060
Income from operations attributable to the shareholders of the parent company	706,909	315,263	101,755	---	71,502	901	1,196,330
Income from operations attributable to non-controlling interests	2,560	2,652	5,549	---	633	---	11,394
Total assets attributed to the operating segment	10,595,488	6,134,174	2,026,057	75,801	,2578,984	,2207,961	23,618,465

*Adjustments to the consolidated basis derive from insurance operations, with the exception of the total assets which also include the assets of the discontinued operations. See Section 13 of this Chapter.

For explanations by the board of directors with respect to the financial data of the Company as included in its consolidated financial statements, see the Company's Board of Directors' Report in Chapter B of the Report.

6. General environment and the effect of external factors on the Company's business

Following are the assessments of the Company as to the major trends, events and developments in the macroeconomic environment of the Company, which to the best of its knowledge and estimates, have or are anticipated to have an effect on the business results or the developments in the Group's operating segments. For details with respect to regulatory restrictions on the Company, see Section 23 of Chapter A of the Report.

The estimates of the Company below in this section and in this Report are based, *inter alia*, on data published and not independently examined by the Company. Every reference appearing in this section should be considered data not under the control of the Company and uncertain, and it is based, *inter alia*, on data published by the Bank of Israel, as specified below.

6.1 The business in Israel

As a company operating in the Israeli market, with its various industries, the Company is exposed to macro-economic changes in the condition of the economy in general and in the real estate industry, in particular. The central economic factors affecting the business of the Company and the Group companies in Israel are specified below.

Israel	For the Year Ended on		
	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2014
Macroeconomic parameters *			
Gross Domestic Product (PPP)*	$297.0 billion	$285.3 billion	$275.3 billion
Product per Capita (PPP)*	$34,834	$34,053	$33,526
Growth rate in the Domestic Product (PPP)*	4.1%	3.6%	5.0%
Growth Rate in the Product per Capita (PPP)*	2.3%	1.6%	3.0%
Inflation Rate **	(0.2)%	(1.0)%	(0.2)%
Return on long term domestic governmental debt *** (NIS)	2.2%	2.1%	2.5%
Rating of long term governmental debt **** (domestic rating)	A+/STABLE	A+/STABLE	A+/STABLE
Rating of long term governmental debt (international rating) ****	A+/STABLE	A+/STABLE	A+/STABLE
Exchange Rate of domestic currency compared to the Dollar as of the last day of the year**	3.845	.3902	.3889

* Source: the International Monetary Fund website – www.imf.org - World Economic Outlook Database The figures for 2016 are based on a forecast of October 2016.
** Source: the Central Bureau of Statistics: www.cbs.gov.il
*** Source: yield on government debt, the Bank of Israel website: www.boi.org.il, yield-to-maturity on unlinked fixed-interest 10-year bonds (gross).
**** Source: S&P rating report at www.standardandpoors.com, updated as of May 2016, from the website of the Ministry of Finance.

6.1.1 General

1) Political-security situation – The Company's business is affected by the political-security situation in Israel. The Company's management estimates that significant and long-term deterioration in the political security situation may cause a decline in the business in malls and retail centers, decline in demands and a decrease in prices in the income-producing property segment.

(2) Credit availability and cost – Changes in financing cost and availability and the scope of available credit in the banking and non-banking system affect the real estate industry and the profitability thereof. As a result of the implementation of structural reforms implemented in recent years in the capital market (such as the Bachar Reform, the pension reform and the tax reform) the banks' position as the main credit providers to the business sector has diminished, and a non-banking credit market had developed, constituting an alternative for financing assets and projects. The local capital market too, constitutes a source for the raising of funds to finance the Company's business activity, whether in shares or in bonds, and also presently serves as the Company's primary source of financing.

Thanks to the financial strength of the Company, its accessibility to sources of bank financing, and the relatively low scope of pledges on properties, taking into consideration the extent of business thereof, the Company estimates that no difficulties are anticipated in raising the financing required thereby.

(3) Fluctuations in the inflation rate, the Consumer Price Index and the interest rates – The real estate industry is exposed to risks deriving from changes in the interest rates, inflation rate and in the Consumer Price Index (CPI). The Company finances most of its business operations by means of loans linked to the CPI or linked to the Prime interest rate or to the Bank of Israel interest rate. In addition, most of the Company's revenues from rent are also linked to the CPI. The CPI decreased in 2016 by 0.2%, compared with a decrease of 1% in the course of 2015. At the end of 2016, inflation expectations for the capital market in 2017 were at a rate of 0.6%, and the deriving expectations from the banks' internal interest rates were at a rate of (0.4%)[15]. The Prime interest rate in 2016 remained at 1.60%, similar to the rate in 2015. The Bank of Israel interest rate in 2016 remained at 0.1%, similar to the rate in 2015.

(4) Fluctuations in the exchange rate of the U.S. dollar – Changes in the exchange rate of the dollar have a marginal effect on the growth rate of the CPI in Israel and on the economic results of the Company, the functional currency of which for operations outside of Israel is, for the most part, the U.S. dollar. In the course of 2016, the dollar rate fluctuated against the Shekel, and at the end of 2016, the exchange rate was similar to the exchange rate at the year's start. However, the first two months of 2017 saw the appreciation of the Shekel against the dollar.

6.1.2 Effects on the income-producing property in Israel segment

(1) The income-producing property in Israel segment – For a description of the trends related to the income-producing property in Israel segment, in relation to each of the Company's business segments, see Sections 8.1, 9.1 and 11.1 below.

[15] Bank of Israel, press release, February 27, 2017, the Monetary Committee decided to leave the interest for March 2017 at the level of 0.1%, the Bank of Israel website http://www.boi.org.il/he/NewsAndPublications/PressReleases/Pages/InterestRate27-2-17.aspx.

(2) The rate of growth and consumption per capita in Israel - In real terms, the growth of the Israeli economy was accelerated in 2016, and the real activity indicates that growth will continue in the upcoming years. The gross domestic product (GDP) increased by approx. 4% in 2016, compared with 2.5% in 2015. In addition, a high level of employment was maintained and the unemployment rate continued to decline down to an annual average of approx. 4.8% (4.6% in Q4/2016). This year, private consumption expenditure increased by 6.3%, following an increase of 4.3% in 2015. Net of the 2% population growth, private consumption expenditure per capita increased by 4.2%. However, Israel is highly affected by developments in the global economy and the local economy will continue to be affected by the slowdown in the growth, *inter alia*, due to the low growth rate in China, by the ability of the U.S. economy to maintain growth in view of the geopolitical changes, by the ability of Europe to cope with the standstill in economic growth and high unemployment rate and the political instability in the Middle East. According to publications of the Bank of Israel, at the end of December 2016 the macroeconomic forecast was updated, and according thereto growth in 2017 is expected to amount to approx. 3.1%. Forecasts by the International Monetary Fund also predict that, in the next two years, Israel's product will grow by approx. 3% per year.

6.1.3 **Data which may affect the results of the Granite Segment**

The results of the Granite Segment are mainly exposed to the following effects: (1) changes in fuel prices, which affect the demand for Supergas' LPG and natural gas products; (2) effects of the competition in the alternative energy sources' market, which might adversely affect the business of Supergas, including a decrease in profit rates and the loss of market share; (3) regulatory changes applying from time to time to the operations of the Granite Segment, which might affect the businesses of the Segment, its financial position and the business results of the Granite Segment; (4) dependency on refineries, which are the main LPG supplier and on the Tamar gas reservoir, which is Supergas' only natural gas supplier; (5) since the companies in the Granite Segment are engaged in operations that are subject to environmental regulation, including regulation concerning the segment of treatment, production and use of water, wastewater and hazardous and toxic substances, it is exposed to damage that might be caused due to such products or due to failures and malfunctions in such operations.

6.2 The business in the U.S.

U.S.	For the Year Ended on		
	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2014
Macroeconomic parameters			
Gross Domestic Product (PPP) (1) (U.S. $ in billions)	18,562	18,037	17,393
Product per Capita (PPP) (1) (U.S. $)	57,294	56,084	54,502
Growth rate in the Domestic Product (PPP) (1)	2.91%	3.70%	4.20%
Growth Rate in the Product per Capita (PPP) (1)	2.16%	2.90%	3.41%
Inflation Rate (2)	2.1%	0.7%	0.8%
Return on long term domestic governmental debt (3)	2.45%	2.27%	2.17%
Rating of long term governmental debt (4)	AA+/Stable	AA+/Stable	AA+/Stable
Exchange Rate New Shekel to U.S. Dollar (5)	3.845	3.902	3.889

(1) The product data is based on a publication by the International Monetary Fund ("**IMF**") in October 2016 (http://www.imf.org).
(2) According to publications by the U.S. Department of Labor.
(3) According to the U.S. Department of Treasury with respect to bonds for a period of 10 years from December 31, 2016.
(4) According to the rating by S&P (www.standardandpoors.com).
(5) According to Bank of Israel data.

The Company's business in the U.S. is primarily affected by the economic situation in the U.S. economy in general, and in the income-producing commercial real estate sector in particular, the demand and supply in the area in which the Company's properties are located and the amount of rent therefor. To the best of the Company's knowledge, similarly to recent years, the U.S. economy continued to be stable also in 2016. In Q4/2015the U.S. economy grew at an annual rate of 1.9%, following an annual growth rate of 3.5% in the three months preceding this quarter. In the entire year of 2016, growth rate was 1.6%, which is lower than the 2.5% rate of 2015. For details with respect to the Houston Texas area, where the majority of the Company's business in the income-producing property in the U.S. segment is situated, see Section 10 of Chapter A of the Report.

The above information in Sections 6.1 and 6.2 concerning the general environment and the external factors that affect the Company's business, includes information based on subjective estimates and approximations of the Company in consideration of past experience, as well as publications and surveys written by professionals in connection with the condition of the Israeli economy, the real estate sector, the Granite Segment and the senior housing segment, and the condition of the economy in countries in which the Company operates, as detailed above in this section. The above data are only approximations and it is possible that they are incomplete, but, in the Company's estimation, are able to provide a general picture, even if inexact, of the markets in which it operates in the various operating segments. In view of the above, and due to the existence of causes beyond the control of the Company, the actual results may vary from the estimates specified above and below if a change should take place in one of the factors which were taken into account in these estimates or the economic crisis shall aggravate, the condition of the economy and/or the security situation shall become worse or due to the realization of any of the risk factors specified in Section 28 of this chapter, and mainly the global financial crisis, the condition of the economy in Israel and in the U.S. and the security situation in Israel, changes in relevant interest *rates and indices, decline in demand for space for lease and in rent prices, deterioration of strength of primary tenants, and the costs of financing sources*.

PART THREE: DESCRIPTION OF THE GROUP'S BUSINESS IN THE INVESTMENT PROPERTY SEGMENT – AGGREGATE

7. Aggregate disclosure with respect to the investment property segment[16]

The disclosure with respect to the Company's investment property operating segment is made in accordance with the draft of the amendment to the Securities Regulations (Details of the Prospectus and the Draft Prospectus – Structure and Form) (Amendment), 5764-2013, as released by the ISA in December 2013, which had been adopted by the Company even prior to the entering into effect of the same.

7.1 General

The Group began its activity in the investment property segment in 1983 and since then and as of the Report Date the Company operates in development, construction, acquisition, lease, management and maintenance of malls and retail centers in Israel as well as office and hi-tech parks, office and industry, light industry and storage buildings in Israel. Commencing from 2001 the Company began to operate in these segments also overseas (mainly in the U.S.).

As a development company, the Company examines, from time to time, growth and increase goals for the expansion of its scope of operations, and checks opportunities to purchase income-producing properties and lands for real estate development in Israel and overseas in the core segments thereof (retail and office spaces) and also in tangential segments such as senior housing and storage areas (logistics).

Underlying the Company's policy is the basic assumption whereby the property's location is the most important factor for its success. Accordingly, upon examination of the location of a potential property, the Company ascribes significant weight to the population growth potential in the examined area and the urban development anticipated therein, based, *inter alia*, on urban research, segmentation of the existing and anticipated population, competition in the area and the unique or typical commercial needs of such area.

The Group's strategy and business in the investment property segment is performed both through initiation, development and construction of new properties and acquisition of existing income-producing property, upgrading the same and maximizing potential thereof. In the Report Period, a certain increase was recorded in the margins between the rates of capitalization on the properties and the financing costs, a trend which the Company estimates allows it to develop and purchase income-producing properties also at development yields or cap rates for purchase that are lower compared to rates in previous periods.

The Group, by itself (through companies which are entirely controlled thereby), manages and operates the properties, their construction and betterment while using the know-how and experience accrued by the Group, in order to give added value to its properties, tenants and the public visiting the properties.

The Company's properties in the retail centers and malls segment are located in the center of residential neighborhoods and at entrances to urban areas, insofar as possible,

[16] Disclosure is made jointly for the retail centers and malls in Israel segment, the office and other space for lease in Israel segment and the income-producing property in the U.S. segment and the Group's senior housing segment. For further details regarding the senior housing see Section 11 of Part A of the Report.

on main traffic arteries. Due to the location of the properties, their accessibility, spacious car parks, tenant mix and variety of activities therein, they attract a large and diverse target audience. Some of the retail centers include office space for lease designated to provide a supplementary response for the target audience's needs, according to the nature of the retail center and its location.

The Company's properties in the office and other space for lease in Israel segment, including the properties under construction, are located primarily in the central region, where there is an active demand for office buildings of various types. The Company's properties in this segment are characterized by a high level of finish and management, relatively extensive floor and office spaces, and are located close to central transport arteries and include designated parking lots.

According to its policy, for the maximization of its profits and in order to improve the experience of the users of the Group’s properties, the Company acts, as necessary, to upgrade its existing properties, while using the existing and potential commercial, office and other areas, improving the tenant mix and adjusting the same to the target audience, renovating the properties, renewing the systems therein, creating a unique user experience, implementing technological and/or digital improvements, all in order to adjust the same to the audience’s needs and taste which varies from time to time.

As previously reported by the Company, the Company examines, from time to time, the expansion of its operations, including entry into close real estate segments. Thus, in 2014, the Company began developing the senior housing business, upon the purchase of senior housing land in the city of Modi’in. At present, the Company has two active senior homes: Palace Tel Aviv, which was acquired in 2015, and Palace Ra’anana (formerly Ahuzat Bayit Ra’anana), the acquisition of which was closed in Q2/2016. The Company also has two additional projects under construction - the first in Modi’in and the second in Lehavim, which are scheduled to be opened in 2018 and in 2019, respectively. An additional Company project, in the city of Rishon LeZion, is in planning.

The Company intends to continue developing an operating segment that will be characterized by quality senior housing facilities, with a high standard of finish and comprehensive services for the senior population in a manner which enables the tenants to continue to conduct a private and independent lifestyle, in a comfortable and spacious residential unit, while enjoying a supportive and active environment, which contains all of the necessary community services, under one roof. The group’s senior homes include quality sport facilities, community culture services and classes, maintenance and cleaning services, certain medical services, security etc. Usually, senior housing projects also include (one or more) long-term-care units. For additional details regarding land see Section 7.8 of Chapter A of the Report.

Set forth below are aggregate figures regarding investment property owned by the Group. The figures will be presented jointly with regard to properties from the four operating segments of investment property owned by the Company, namely: the retail centers and malls in Israel segment, the office and other space for lease segment in Israel, the senior housing segment and the overseas income-producing property segment. For further details regarding the operating segments and regarding material properties and a very material property, see Sections 8, 9 and 10 of this Chapter.

7.2 Summary results in the investment property segments*

7.2.1 Summary of the aggregate results in the Group's four investment property segments

	For the year ended on		
	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2014
	NIS in millions		
Total business revenues (consolidated)	**1,745**	**1,607**	**1,456**
Profit from revaluations (consolidated)	**711**	**179**	**37**
Business profits (consolidated)**	**2,012**	**1,417**	**1,171**
Same property NOI (consolidated)	**1,201**	**1,183**	**-**
Same property NOI (corporation's share)	**1,195**	**1,174**	**-**
Total NOI (consolidated)**	**1,301**	**1,238**	**1,134**
Total NOI (corporation's share)**	**1,295**	**1,227**	**1,124**

(1) The figures do not include the investment properties component appearing in Sonol which does not constitute a part of the income-producing property segment of the Company.
(2)For details with respect to additional financial indicators which were examined by the Company, see Sections 1.3.10 to 1.3.15 of Chapter B (the Board of Directors' Report).
** The figures include the NOI of Palace Tel Aviv Medical and Palace Ra'anana LTC Units according to the management's position, which deems them part of the NOI of the senior homes although they are not investment properties (and therefore, the tables of the property chapter below shall not include information in respect thereof) and due to non-materiality in their separate presentation.

7.2.2 Summary of the results in the retail centers and malls in Israel segment

	For the year ended on		
	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2014
	NIS in millions		
Total business revenues (consolidated)	**973**	**931**	**877**
Profit (loss) from revaluations (consolidated)	**220**	**123**	**(89)**
Business profits (consolidated)	**999**	**871**	**620**
Same property NOI (consolidated)	**734**	**724**	**708**
Same property NOI (corporation's share)	**733**	**721**	**706**
Total NOI (consolidated)	**779**	**748**	**709**
Total NOI (corporation's share)	**778**	**745**	**707**

7.2.3 Summary of the results in the office and other space for lease in Israel segment

	For the year ended on		
	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2014
	NIS in millions		
Total business revenues (consolidated)	**447**	**420**	**387**
Profit from revaluations (consolidated)	**517**	**70**	**117**
Business profits (consolidated)	**886**	**418**	**435**
Same property NOI (consolidated)	**369**	**347**	**318**
Same property NOI (corporation's share)	**369**	**347**	**318**
Total NOI (consolidated)	**369**	**347**	**318**
Total NOI (corporation's share)	**369**	**345**	**315**

7.2.4 Summary of the results in the income-producing property in the U.S. segment

	For the year ended on		
	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2014
	NIS in millions		
Total business revenues (consolidated)	**229**	**236**	**191**
Profit (loss) from revaluations (consolidated)	**(82)**	**(28)**	**9**
Business profits (consolidated)	**42**	**104**	**116**
Same property NOI (consolidated)	**98**	**112**	**101**
Same property NOI (corporation's share)	**92**	**106**	**96**
Total NOI (consolidated)	**124**	**132**	**107**
Total NOI (corporation's share)	**119**	**126**	**102**

7.2.5 Summary of the results in the senior housing segment

	For the year ended on		
	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2014
	NIS in millions		
Total business revenues (consolidated)	**95**	**36**	**-**
Profit from revaluations (consolidated)	**56**	**14**	**-**
Business profits (consolidated)	**85**	**26**	**-**
Same property NOI (consolidated)	**-**	**-**	**-**
Same property NOI (corporation's share)	**-**	**-**	**-**
Total NOI (consolidated)	**29**	**12**	**-**
Total NOI (corporation's share)	**29**	**12**	**-**

7.3 The geographic territories in which the Group operates in the investment property segments

As of the Report Date, the Company operates in two main geographic territories, Israel and the U.S Most of the Company's business is in Israel, where the Company operates throughout the country, including North, Center, South and other urban areas, without preference to specific areas and without investing special managerial inputs in specific areas. The Company estimates that the State of Israel constitutes one geographical territory in terms of the risks and yields of the income-producing property business. In the U.S. the Company operates, as of the Report Date, mainly in Houston, Texas.

For details regarding the macroeconomic parameters affecting the business in Israel and the U.S., see Section 6 of Chapter A of the Report.

7.4 Breakdown of the investment property business

Set forth below are details of the Company's investment property business, in the four investment property operating segments, namely, the malls and retail centers in Israel, the office and other space for lease in Israel, senior homes and the land designated for this segment, and income-producing property in the U.S., on a consolidated basis, broken-down by the various uses of the space of each segment. All of the figures in the following tables do not include the investment property component appearing in Granite Hacarmel's operations, including in Sonol, which is presented in the Financial Statements as discontinued operations and does not constitute part of the income-producing property segment of the Company. The commercial use in Israel in the tables below is attributed to the retail centers and malls operating segment, whereas the office, industrial and residential uses are attributed in Israel to the office and other space for lease operating segment (and do not constitute operating segments in and of themselves). Furthermore, as of Q3/2016, the Company's operations in the senior housing segment is being described in the Company's Financial Statements as a separate operating segment, in view of the establishment and expansion of the operations and investment in projects under development in the segment, the Company has begun reporting its operations in the senior housing segment, and it is therefore included as a separate column in the following tables. The figures of the income-producing property segment in the U.S. all appear under the U.S. territory, in accordance with the various breakdowns, which also do not constitute operating segments in and of themselves, while the amounts with respect to this territory are translated into NIS according to the conversion rate of 1 US Dollar =NIS 3.845.

The following breakdown of uses is in the format in which the information is presented to the Group's management. As a rule, in properties whose main use is commerce, the car park was attached to such use, whereas in properties whose main use is offices, the car park was attached to such use. As for the Tel Aviv Azrieli Center, for the purpose of the Report, the car park space is divided equally between the commercial and office uses, due to its similar contribution to both uses. As for the Herzliya Business Park, as of 2016 for the purpose of the Report, the areas of the car park are divided into 25% for retail and 75% for offices, in view of the increased use of the car park by the visitors of the retail areas.

The following terms shall hereinafter have the meaning set forth beside them:

"**Space**"/"**Area**" – the space/area for which rent is paid, with the addition of unleased areas (excluding areas sold or acquired after the Report Date, if any). With respect to senior housing, the area refers to all of the built area of the home, in view of the fact that the rate of the public areas in the senior housing facility that the Company operates, out of the total facility area is relatively large and the public areas are also intended to serve the tenants of the homes.

"**Revenues**" – all payments made by the tenant, including rent, management fees, profit from electricity, parking fees and other payments, if any.

(1) Breakdown of income-producing property space (aggregate) by territories and uses, as of December 31, 2016 (in sqm)

Territories	Uses	Offices	Industry	Retail	Residence	Senior Housing*	Car Parks	Total	% of total area of properties
Israel	Consolidated	360,688	22,521	309,987	8,698	47,596	541,954	1,291,444	**79%**
	Corporation's share	360,688	22,521	309,987	8,698	47,596	541,954	1,291,444	**80%**
U.S.	Consolidated	198,905	-	-	-	-	139,223	338,128	**21%**
	Corporation's share	188,995	-	-	-	-	136,445	325,440	**20%**
Total	**Consolidated**	559,593	22,521	309,987	8,698	47,596	681,177	1,629,572	**100%**
	Corporation's share	549,683	22,521	309,987	8,698	47,596	678,399	1,616,884	**100%**
% of total property area	**Consolidated**	34%	1%	19%	1%	3%	42%	100%	
	Corporation's share	**34%**	**1%**	**19%**	**1%**	**3%**	**42%**	**100%**	

*559 residential units – adjoined residential units are treated as one unit.

(2) Breakdown of income-producing property space (aggregate) by territories and uses, as of December 31, 2015 (in sqm)

Territories	Uses	Offices	Industry	Retail	Residence	Senior Housing*	Car Parks	Total	% of total area of properties
Israel	Consolidated	346,188	18,885	298,125	8,698	23,166	511,597	1,206,659	**78%**
	Corporation's share	343,277	18,885	297,128	8,622	22,963	509,203	1,200,078	**79%**
U.S.	Consolidated	186,894	-	-	-	-	150,874	337,768	**21%**
	Corporation's share	176,709	-	-	-	-	147,101	323,810	**22%**
Total	**Consolidated**	533,082	18,885	298,125	8,698	23,166	662,471	1,544,427	**100%**
	Corporation's share	519,986	18,885	297,128	8,622	22,963	656,304	1,523,888	**100%**
% of total property area	**Consolidated**	35%	1%	19%	1%	1%	43%	100%	
	Corporation's share	**34%**	**1%**	**19%**	**1%**	**2%**	**43%**	**100%**	

*231 residential units – adjoined residential units are treated as one unit.

(3) Breakdown of the fair value of income-producing properties (aggregate) by territories and uses, as of December 31, 2016 (in sqm)[17]

Territories	Uses	Offices	Industry	Retail	Residence	Senior Housing*	Total	% of total area of properties
Israel (NIS in thousands)	**Consolidated**	5,162,154	92,490	10,949,585	143,200	1,086,063	17,433,492	89%
	Corporation's share	5,162,154	92,490	10,949,585	143,200	1,086,063	17,433,492	89%
U.S.* (USD in thousands)	**Consolidated**	559,936	-	-	-	-	559,936	11%
	Corporation's share	537,486	-	-	-	-	537,486	11%
Total (NIS in thousands)	**Consolidated**	7,315,107	92,490	10,949,585	143,200	1,086,063	19,586,445	100%
	Corporation's share	7,228,786	92,490	10,949,585	143,200	1,086,063	19,500,124	100%
% of total property value	**Consolidated**	37%	-	56%	1%	6%	100%	
	Corporation's Share	37%	-	56%	1%	6%	100%	

* Gross value, without setoff of the balance of deposits from tenants. The value after setoff of the tenant deposits balance is approx. NIS 460 million.

[17] The fair value of the Group's income-producing properties in Israel is according to valuations the Group received, which were prepared by a certified land appraiser independent of the Company or of the Group companies as of December 31, 2016. As to the properties overseas, the valuations were prepared by certified land appraisers, who are defined as dependent due to the indemnification given to them in view of the directives of the ISA (excluding a non-material property in the amount of approx. NIS 40 million whose value was updated by the Company)

(4) Breakdown of the fair value of income-producing properties (aggregate) by territories and uses, as of December 31, 2015 (in sqm)[18]

Territories	Uses	Offices	Industry	Retail	Residence	Senior Housing*	Total	% of total area of properties
Israel (NIS in thousands)	**Consolidated**	4,865,048	74,684	10,620,708	139,300	566,688	16,266,428	89%
	Corporation's share	4,823,567	74,684	10,584,067	138,078	561,717	16,182,113	89%
U.S.* (USD in thousands)	**Consolidated**	524,765	-	-	-	-	524,765	11%
	Corporation's share	501,321	-	-	-	-	501,321	11%
Total (NIS in thousands)	**Consolidated**	6,912,682	74,684	10,620,708	139,300	566,688	18,314,062	100%
	Corporation's share	6,779,722	74,684	10,584,067	138,078	561,717	18,138,268	100%
% of total property value	**Consolidated**	38%	-	58%	1%	3%	100%	
	Corporation's Share	38%	-	58%	1%	3%	100%	

* Gross value, without setoff of the balance of deposits from tenants. The value after setoff of the tenant deposits balance is approx. NIS 275 million.

(5) Breakdown of NOI of income-producing properties (aggregate) by territories and uses (aggregate), for the year ended on December 31, 2016

Territories	Uses	Offices	Industry	Retail	Residence	Senior Housing*	Total	% of total property NOI
Israel (NIS in thousands)	Consolidated	358,833	6,829	778,516	3,503	29,300	1,176,981	90%
	Corporation's share	358,341	6,829	778,113	3,499	29,300	1,176,082	91%
U.S.* (USD in thousands)	Consolidated	32,133	-	-	-	-	32,133	10%
	Corporation's share	30,946	-	-	-	-	30,946	9%
Total (NIS in thousands)	**Consolidated**	482,385	6,829	778,516	3,503	29,300	1,300,533	100%
	Corporation's share	477,327	6,829	778,113	3,499	29,300	1,295,068	100%
% of total property NOI	**Consolidated**	37%	1%	60%	-	2%	100%	
	Corporation's Share	37%	1%	60%	-	2%	100%	

*The figure includes the NOI of Palace Tel Aviv Medical and Palace Ra'anana LTC Units, as aforesaid.

(6) Breakdown of NOI of income-producing properties (aggregate) by territories and uses (aggregate), for the year ended on December 31, 2015

Territories	Uses	Offices	Industry	Retail	Residence	Senior Housing*	Total	% of total property NOI
Israel (NIS in thousands)	Consolidated	338,242	5,810	747,628	3,433	11,737	1,106,850	89%
	Corporation's share	335,365	5,810	745,066	3,403	11,634	1,101,278	90%
U.S.* (USD in thousands)	Consolidated	33,738	-	-	-	-	33,738	11%
	Corporation's share	32,253	-	-	-	-	32,253	10%
Total (NIS in thousands)	**Consolidated**	469,886	5,810	747,628	3,433	11,737	1,238,484	100%
	Corporation's share	461,218	5,810	745,066	3,403	11,634	1,227,131	100%
% of total property NOI	**Consolidated**	38%	-	61%	-	1%	100%	
	Corporation's Share	38%	-	61%	-	1%	100%	

[18] The fair value of the Group's income-producing properties in Israel is according to valuations the Group received, which were prepared by a certified land appraiser independent of the Company or of the Group companies as of December 31, 2015. As to the properties overseas, the valuations were prepared by certified land appraisers, who are defined as dependent due to the indemnification given to them in view of the directives of the ISA (excluding a non-material property in the amount of approx. NIS 49 million whose value was updated by the Company).

* The figure includes the NOI Palace Tel Aviv Medical, as aforesaid.

(7) Breakdown of NOI of income-producing properties (aggregate) by territories and uses (aggregate), for the year ended on December 31, 2014

Territories	Uses	Offices	Industry	Retail	Residence	Total	% of total property NOI
Israel (NIS in thousands)	Consolidated	308,837	5,592	709,469	3,485	1,027,383	91%
	Corporation's share	306,216	5,592	706,909	3,455	1,022,172	91%
U.S.* (USD in thousands)	Consolidated	27,592	-	-	-	27,592	9%
	Corporation's share	26,165	-	-	-	26,165	9%
Total (NIS in thousands)	**Consolidated**	416,141	5,592	709,469	3,485	1,134,687	100%
	Corporation's share	407,971	5,592	706,909	3,455	1,123,927	100%
% of total property NOI	**Consolidated**	37%	-	63%	-	100%	
	Corporation's Share	37%	-	63%	-	100%	

(8) Breakdown of real estate revaluation profit (loss) (aggregate) territories and uses, for the year ended on December 31, 2015

Territories	Uses	Offices	Industry	Retail	Residence	Senior Housing	Total (NIS in thousands)	% of Total Revaluation Profit
Israel (NIS in thousands)	Consolidated	510,318	3,023	220,001	3,735	55,746	,792823	112%
	Corporation's share	510,318	3,023	220,001	3,735	55,746	,792823	111%
U.S.* (USD in thousands)	Consolidated	(21,390)	-	-	-	-	(21,390)	(12%)
	Corporation's share	(19,946)	-	-	-	-	(19,946)	(11%)
Total (NIS in thousands)	**Consolidated**	428,073	3,023	220,001	3,735	55,746	710,578	100%
	Corporation's share	433,626	3,023	220,001	3,735	55,746	,716131	100%
% of total revaluation profit	**Consolidated**	60%	-	31%	1%	8%	100%	
	Corporation's Share	61%	-	30%	1%	8%	100%	

(9) Breakdown of real estate revaluation profit (loss) (aggregate) territories and uses, for the year ended on December 31, 2015

Territories	Uses	Offices	Industry	Retail	Residence	Senior Housing	Total (NIS in thousands)	% of Total Revaluation Profit
Israel (NIS in thousands)	Consolidated	54,664	1,730	122,971	13,900	14,099	207,364	116%
	Corporation's share	54,165	1,730	121,805	13,778	13,972	205,450	115%
U.S.* (USD in thousands)	Consolidated	(7,251)	-	-	-	-	(7,251)	(16%)
	Corporation's share	(6,777)	-	-	-	-	(6,777)	(15%)
Total (NIS in thousands)	**Consolidated**	26,370	1,730	122,971	13,900	14,099	179,070	100%
	Corporation's share	27,722	1,730	121,805	13,778	13,972	179,007	100%
% of total revaluation profit	**Consolidated**	15%	1%	68%	8%	8%	100%	
	Corporation's Share	15%	1%	68%	8%	8%	100%	

(10) Breakdown of real estate revaluation profit (loss) (aggregate) territories and uses, for the year ended on December 31, 2014

Territories	**Uses**	**Offices**	**Industry**	**Retail**	**Residence**	**Total (NIS in thousands)**	**% of Total Revaluation Profit**
Israel (NIS in thousands)	Consolidated	98,650	6,569	(89,278)	11,887	27,828	76%
	Corporation's share	97,796	6,569	(89,303)	11,783	26,845	72%
U.S.* (USD in thousands)	Consolidated	2,282	-	-	-	2,282	24%
	Corporation's share	2,697	-	-	-	2,697	28%
Total (NIS in thousands)	**Consolidated**	107,522	6,569	(89,278)	11,887	36,700	100%
	Corporation's share	108,284	6,569	(89,303)	11,783	37,333	100%
% of Total Revaluation Profits	**Consolidated**	293%	18%	(243%)	32%	100%	
	Corporation's Share	290%	18%	(239%)	31%	100%	

(11) Specification of actual average monthly rent per sqm by territories and uses

Uses	Offices		Industry		Retail		Residence	
	For the year ended on							
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
Israel (in NIS)	77	76	28	28	199	206	38	38
Maximum (*)	(**)104	(**)101	-	-	329	326	-	-
Minimum (*)	35	34	-	-	69	81	-	-
U.S. (in USD)	19	18	-	-	-	-	-	-

The maximum represents the average rent per sqm in the property for which the rent average is highest, whereas the minimum represents the average rent per sqm in the property for which the rent average is lowest. The table does not include figures with respect to the senior housing, in respect of which the average payment of tenants for a residential unit in 2016 is NIS 11,284 per month (in 2015 NIS 12,944 per month) (including revenues from the forfeiture of deposits and payment of monthly maintenance fees).

* The broad range of rent in all of the uses derives, *inter alia*, from the diversity in the nature of the leased property, in the type of the leased unit in the property even in the same building, and in other parameters that are not expressed in this table.

** The maximum represents the average rent per sqm of Azrieli Center towers, and does not include the rent of the hotel. If the average included the rent of the hotel, the average for 2016 would be approx. NIS 99 per sqm and the average for 2015 would be approx. NIS 97 per sqm.

(12) Specification of average occupancy rates by territories and uses*

Uses	Offices			Industry			Retail			Senior Housing			Residence		
		Percentage (%)													
	As of Dec. 31, 2016	For Y2016	For Y2015	As of Dec. 31, 2016	For Y2016	For Y2015	As of Dec. 31, 2016	For Y2016	For Y2015	As of Dec. 31, 2016	For Y2016	For Y2015	As of Dec. 31, 2016	For Y2016	For Y2015
Israel	99%**	99%**	99%	100%	100%	100%	98%	97%	97%	98%	92%	99%	100%	100%	100%
U.S.	85%	83%	91%	--	--	--	--	--	--	--	--	--	--	--	--

* The average occupancy rate was calculated based on the lease agreements' data for the beginning of the period and for the end of each period.

** Excluding the two Phase B buildings of the Azrieli Holon Center, which were opened at the end of 2015 and at the end of Q1/2016 and which are in lease-up stages. The occupancy rate of the office and other space for lease segment including Phase B of the Azrieli Holon Center is approx. 95% as of December 31, 2016 and approx. 93% in 2016 .

(13) Number of income-producing buildings, by territories and uses*

Uses	Offices		Industry		Retail		Senior Housing		Residence	
	For the year ended									
	Dec.31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015
Israel	10	10	1	1	16	15	2	1	1	1
U.S.	7	6	--	--	--	--	-	-	--	--
Total income-producing properties	17	16	1	1	16	15	2	1	1	1

* A number of properties have several different uses, and in such cases the properties were classified in the table under each of such uses.

(14) Breakdown of actual average yield rates (according to year-end value), by territories and uses*

Uses	Offices		Industry		Retail		Senior Housing**		Residence	
For the year ended on (percentages)										
	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015	Dec. 31, 2016	Dec. 31, 2015
Israel	6.95%	6.95%	7.38%	7.78%	7.11%	7.04%	4.93%	2.80%	2.45%	2.46%
U.S.	5.74%	6.43%	---	---	---	---	---	---	---	---

The rate of the yield is a division of the actual NOI by the value of the property as of end of year. In the event of the acquisition of properties or completion of construction thereof in the course of the year, the index does not reflect the rate of the annual yield from these properties. The rate of the actual yield does not constitute the CAP rate that the Group used for revaluation of its properties.

* The figures do not represent representative yield but rather the division of actual NOI by the value of the properties, and do not take into account other influences, such as properties populated, properties purchased during the period, revenues expected from vacant spaces, expected investments in the property etc.

** For the senior housing segment – calculated according to net value (after deduction of the tenant deposits balance) as of end of period.

7.5 Projected revenues due to signed lease contracts (NIS in thousands)

Period of Revenue Recognition		Revenues from Fixed Components	Number of Ending Contracts	Area Contemplated in the Ending Agreements (sqm in thousands)
Y2017	Q/1	319,162	175	21
	Q/2	319,162	175	21
	Q/3	305,350	241	29
	Q/4	295,462	364	44
Y2018		1,017,581	847	138
Y2019		1,017,581	847	138
Y2020		610,171	590	154
Y2021 forth		1,692,218	918	352
Total		5,371,238	4,117	890

The revenues figures in the above table, which include revenues from rent, management fees and parking, were calculated based on the basic amounts determined in the lease agreements, linked to the CPI known on December 31, 2016, and based on the following assumptions: (1) The exercise of the tenants' options to extend the lease periods included in the lease contracts, was not taken into account, since the CODM does not review, on a regular basis, the expected revenue figures under the assumption of the exercise of options granted to the tenants to extend the lease period; (2) Lease contracts, the lease period under which has ended, and new lease contracts have not yet been signed with the tenants, were not taken into account; (3) The possibility of sale of the properties or the purchase of new income-producing property, was not taken into account; (4) Fines due to early termination, if any, were not taken into account; (5) The increments to the rent due to percentages of the sales were not taken into account for calculation of the rent, and (6) No change has occurred in the management fees advance payments per tenant in respect of 2016.

The Company's revenues include variable components due to additional revenue from sales alone. The Company does not prepare estimates for revenues from variable components which are immaterial in relation to the Company's revenues from its income-producing properties, and therefore it does not have the information.

The revenue figures specified in the above table are under the assumption that the options for extension of the lease periods included in the lease contracts will not be exercised, although many of the Company's tenants usually extend the lease agreements upon the expiration thereof, according to the extension options specified in the agreements.

The above figures are based on the Company's assessment considering signed agreements as of the Report Date and constitute forward-looking information, as this term is defined in the Securities Law. Actual results may significantly differ from the above specified estimates and the implications thereof, for various reasons, including early termination of lease contracts or a business crisis of any of the tenants.

7.6 Main tenants

In 2016, the Company did not have a tenant, the revenue from whom constituted 10% or more of its total revenues.

7.7 Properties under construction In Israel(*) (aggregate level) by use

Uses	Parameters	For the Year Ended		
		December 31, 2016	December 31, 2015	December 31, 2014
Retail (4)	Number of properties under construction at the end of the period	4	2	4
	Total space under construction (planned) at the end of the period (sqm in thousands) (1)	49	31	63
	Total costs invested in the current period (consolidated) (NIS in thousands)	206,673	85,855	434,160
	The amount at which the properties are presented in the statements at the end of the period (consolidated) (NIS in thousands)	940,822	401,305	1,017,214
	Construction budget in the consecutive period (estimate) (consolidated) (NIS in thousands)	90,000-130,000	135,000-175,000	180,000-220,000
	Total estimated balance of construction budget for completion of the construction work (consolidated) (estimate as of the end of the period) (NIS in thousands) (2)	163,000-195,000	35,000-55,000	165,000-175,000
	Rate of built-up area in respect of which lease contracts have been signed (%)	29%	26%	41%
	Projected annual income from projects to be completed in the consecutive period and in which contracts have been signed for 50% of the area or more (consolidated) (estimate) (NIS in thousands)(4)	Approx. 45,000	-	Approx. 60,000
Offices and Others (4)	Number of properties under construction at the end of the period	4	4	3
	Total space under construction (planned) at the end of the period (sqm in thousands) (1)	227	171	203
	Total costs invested in the current period (consolidated) (NIS in thousands)	441,446	311,916	390,168
	The amount at which the properties are presented in the statements at the end of the period (consolidated) (NIS in thousands)	2,042,796	1,400,489	1,215,240
	Construction budget in the consecutive period (estimate) (consolidated) (NIS in thousands)	245,000-285,000	410,000-450,000	340,000-380,000
	Total estimated balance of construction budget for completion of the construction work (consolidated) (estimate as of the end of the period) (NIS in thousands) (2)	480,000-575,000	155,000-225,000	430,000-490,000
	Rate of built-up area in respect of which lease contracts have been signed (%)	47%	20%	9.4%
	Projected annual income from projects to be completed in the following period and in which contracts have been signed for 50% of the area or more (consolidated) (estimate) (NIS in thousands) (4)	Approx. 165,000	Approx. 1,200	-
Residence (4)	Number of properties under construction at the end of the period	2	-	-
	Total space under construction (planned) at the end of the period (sqm in thousands) (1)	48	-	-
	Total costs invested in the current period (consolidated) (NIS in thousands)	16,470	-	-
	The amount at which the properties are presented in the statements at the end of the period (consolidated) (NIS in thousands)	522,910	-	-
	Construction budget in the consecutive period (estimate) (consolidated) (NIS in thousands)	35,000-75,000	-	-
	Total estimated balance of construction budget for completion of the construction work (consolidated) (estimate as of the end of the period) (NIS in thousands) (2)	490,000-535,000	-	-
	Rate of built-up area in respect of which lease contracts have been signed (%)	-	-	-
	Projected annual income from projects to be completed in the following period and in which contracts have been signed for 50% of the area or more (consolidated) (estimate) (NIS in thousands)	-	-	-
Senior Housing	Number of properties under construction at the end of the period	2	1	-
	Total space under construction (planned) at the end of the period (sqm in thousands) (1)	79	35	-
	Total costs invested in the current period (consolidated) (NIS in thousands)	111,203	17,889	-
	The amount at which the properties are presented in the statements at the end of the period (consolidated) (NIS in thousands)	207,276	74,096	-
	Construction budget in the consecutive period (estimate) (consolidated) (NIS in thousands)	185,000-225,000	80,000-100,000	-
	Total estimated balance of construction budget for completion of the construction work (consolidated) (estimate as of the end of the period) (NIS in thousands) (2)	275,000-305,000	166,000-176,000	-
	Rate of built-up area in respect of which contracts have been signed (%)	8%	0%	-

	Projected annual income from projects to be completed in the following period and in which contracts have been signed for 50% of the area or more (consolidated) (estimate) (NIS in thousands) (3)	-	--	-

*The Company has no properties under construction outside of Israel.
(1) Marketable space.
(2) Balance of construction budget after the expiration of the consecutive period.
(3) There are no projects that expected to be completed in the consecutive period in which contracts for 50% or more of the area have been signed.
(4) Projects which combine several uses were split among the various uses.

Properties Under Development – Further Details:

Set forth below is a specification regarding the main new properties under development as of the Report Date in the operating segments of investment property and in the senior housing segment (for further details see Section 1.1.2 of the Board of Directors' Report in Chapter B of this Report):

Azrieli Sarona, Tel Aviv

The Company fully owns the long-term lease rights in a lot of an area of approx. 9.4 thousand sqm in the Sarona complex in Southern Hakirya in Tel Aviv, which is intended for the construction of an office and commercial project. As of the Report Release Date, the construction of the office tower and the retail areas at the project is in progress, pursuant to permits the Company has received, and a Form 4 has been received for the car parks (not for population). As of the Report Release Date, for the project is in advanced marketing stages, with lease agreements signed or advanced-stage drafts exchanged with respect to 95% of the leasable office space (of which, for approx. 60% of the leasable office space contracts have been signed). For further details, see Section 1.1.2 of the Board of Directors' Report, as well as the Company's reports dated May 29, 2011 and May 30, 2011 (Ref.: 2011-01-165339 and 2011-01-167994, respectively), which are included herein by way of reference.

Azrieli Town (Formerly Azrieli North Center)

On October 22, 2012, the Company won a tender for the purchase of the rights of Clalit Health Fund in a lot in the area of approx. 10thousand sqm on 146 Menachem Begin Road in the Northern Tel Aviv Central Business District. The project is adjacent to the Azrieli Towers and scheduled to be completed in 2020. On August 31, 2016, the transaction in the land was closed, the Company paid the balance of the consideration, and possession of the lot was handed thereto. In May 2016, the Company applied for an aboveground building permit, which is under approval proceedings by the Local Committee. In September 2016, the Local Committee had approved the Company’s application for a shoring, excavation and foundation permit for the project, which was received in January 2017, and the Company commenced the work under the permit. As of the Report Release Date, the Company has signed agreements for the lease of areas in the scope of 26 thousand sqm, which represent more than 50% of the leasable office space in the project. As of the Report Release Date, the Company is promoting a zoning plan for the addition of residential and office rights.

For further details see the Company’s immediate report of October 22, 2012 (Ref.: 2012-01-261381), which is included herein by way of reference and Section 1.1.2 of the Board of Directors’ Report.

Azrieli Holon Center

Pursuant to a joint transaction agreement with the City of Holon, the Group, through Canit Hashalom, is entitled to receive 83% of the areas which were constructed in a plot of land with an overall area of approx. 34 thousand sqm in the eastern industrial zone of Holon and 120 thousand sqm of leasable space, (17% shall remain in the ownership of the City of Holon). It is noted that as of the Report Date, Canit Hashalom has been registered as an owner of the land. In the framework of the project, the Company has built a business park, which includes buildings for high-tech industries, offices, retail and exhibition halls, service areas and parking areas, as well as additional uses. As of the Report

Release Date, the project has been completed and the Company has signed agreements for the lease of areas in the scope of approx. 91 thousand sqm of the leasable office space and agreements for the lease of approx. 6,500 sqm of the retail space, which jointly represent approx. 85% of the leasable space in the entire project. For further details regarding the agreement and the terms and conditions thereof, see Note 31B(8) to the Financial Statements and Section 1.1.2 of the Board of Directors' Report.

Azrieli Rishonim Center

The Group, through Canit Hashalom, is the owner of a plot of land of an area of approx. 19 thousand sqm in Rishon Lezion (the "**Site**"), adjacently to Road 431 and the Rishonim Railway Station, which allows for high accessibility. The applicable zoning plan allows the construction of leasable areas in the scope of approx. 50 thousand sqm and approx. 82,095 sqm of aboveground and underground parking areas. In September 2013, the zoning plan that applies to the project's Site was conclusively approved. As of the Report Release Date, the Company is acting to promote a zoning plan for the addition of 20 thousand sqm to the office tower. During January 2017, the Company also received a permit for the construction of a pedestrian bridge to connect the HaIrus Neighborhood with the area of the railway station and the retail center. Construction of the mall and the office tower was completed in Q1/2017, and as of the Report Release Date, the project has received an occupancy permit, the mall has been opened to the general public and possession was handed over to several tenants towards the lease-up of the office tower. As of the Report Release Date, the Company has signed agreements for a rate of approx. 60% of the leasable office space at the project. For further details, see Section 1.1.2 of the Board of Directors' Report.

Palace Modi'in Senior Housing

In May 2014, the Company closed a transaction to purchase 100% of the shares of a private company which is the holder of 100% of the rights to a capitalized long-term lease of approx. 10.5 thousand sqm located in the city of Modi'in, which pursuant to the valid zoning plan are designated for a senior housing facility.

On the land, the Company intends to build a senior housing facility for the elderly population that will include approx. 240 senior housing units, approx. 60 assisted living units, and approx. 72 beds in the long-term-care wing, in a built-up area of approx. 35 thousand sqm (main + service). As of the Report Release Date, the Company has obtained a permit for the construction of the project's basement floor, and also an aboveground building permit for all of the residential units in the project. The Company continues to perform the work, with structure work currently in progress. The Company continues marketing activity of the residential units, and extensive response from potential tenants is apparent. For further details see the Company's immediate reports dated February 17, 2014 (Ref.: 2014-01-041110) and May 1, 2014 (Ref.: 2014-01-055626) included herein by way of reference as well as Section 1.1.2 of the Board Report.

Palace Lehavim Senior Housing

In December 2014, the Company won a tender issued by the Israel Land Authority, for the long-term leasehold of land in the area of approx. 28 thousand sqm in the southern town of Lehavim. The Company intends to construct a senior home for the elderly on the land, which home will comprise 350 residential units, and LTC unit with full medical observation, and retail space of up to approx. 1,500 sqm. As of the Report Release Date, applications for building permits in the project have been submitted, and a permit for foundation and excavation work has been received. In October 2016, an appeal was filed by Lehavim residents against the decision of the licensing authority to approve the aboveground permit for the project. As of the Report Release Date, the decision of the appeals committee has been received, which decision rejected the appellants' claims, other than with respect to the number of LTC units in the project. The appeals committee has approved the construction of one

LTC unit only, and the Company is acting for the issuance of an aboveground building permit in accordance therewith. The appeals' committee decision also determined that, subject to a recommendation by the Ministry of Health, the construction of another LTC unit may be permitted, and the Company has received the recommendation of the Ministry of Health and will act to submit the same to the committee. For further details see the Company's immediate report of December 2, 2014 (Ref.: 2014-01-212310), which is included herein by way of reference, and Section 1.1.2 of the Board of Directors' Report.

Expansion of the Azrieli Tel Aviv Center

In May 2013, the Company engaged in an agreement for the purchase of full title to the land of approx. 8,400 sqm in the intersection of the streets Menachem Begin Road and Noah Moses in Tel Aviv, adjacently to the Azrieli Tel Aviv Center, which held the building known as the "Yediot Aharonot House" in the area of approx. 18,000 sqm. As of the Report Date, the transaction has been closed and possession of the lot has been handed over to the Company. The Company commenced the demolition of the said building in March 2017. As of the Report Date, the total existing rights for the lot are 41,275 sqm of aboveground main areas for uses of retail, residence and offices, and 44,400 sqm of aboveground service areas. The rights include up to 19 thousand sqm of an aboveground parking structure which is convertible into the zoning plan uses, *inter alia*, retail. The Company is acting to change the zoning plan, and in April 2016, the deposit was approved (subject to conditions set by the district committee) of the zoning plan with an urban-mixed designation, which allows uses of retail, offices, hotels, residence and senior housing with aboveground building rights of 147,260 sqm (gross), and, in addition, approx. 3,000 sqm of underground main retail space. In the framework of the committee's decision, the Company has undertaken, insofar as the zoning plan is approved, to allocate from the aforesaid rights in the project up to 2 public floors to the Municipality of Tel Aviv – Jaffa, and has also undertaken to perform various tasks in the vicinity of the project, including in the Azrieli Center. As of the Report Release Date, the Company has complied with the conditions of the district committee and has published the zoning plan for deposit. The Company intends to construct retail space that will serve to expand the existing mall and a multi-story tower, subject to receipt of the required statutory approvals.

For further details see the Company's immediate report of May 22, 2013 (Ref.: 2013-01-068386), which is included herein by way of reference, and Section 1.1.2 of the Board of Directors' Report.

Betterment of existing properties

During the Report Period, the Company continued to promote the betterment of existing properties, *inter alia*, at the Azrieli Akko Mall where the Company is acting for the addition of parking and office floors. The Company has also purchased an adjacent lot designated for retail and offices, which is currently used as an additional parking area, and the Company is in initial planning procedures with respect to the lot. Furthermore, construction of the Zappa Club at the Azrieli Haifa Mall has been completed, and the Club has been opened to the general public, and the Urbanica Store has been opened. Furthermore, the Company is acting to promote a zoning plan, *inter alia*, for the expansion of the Azrieli Haifa Mall. During the Report Period, the renovation of the Azrieli Be'er Sheva Mall was completed, and the Company has commenced the renovation of the Azrieli Jerusalem (Malcha) Mall. In the Azrieli Tel Aviv Mall, an Urbanica store has been opened. In addition, the Company is acting for the promotion of a zoning plan for the addition of offices at the Holon Mall, and for the promotion of a zoning plan for the addition of floors at the Herzliya Business Park. In the Palace Ra'anana Senior Home, the Company is in advanced planning stages of a zoning plan for additional building rights above the building of the Azrieli Ra'anana Retail Center, and has also commenced the renovation of the buildings of Palace Ra'anana.

The Company's estimates in this Section 7.7 are forward-looking information, as defined in the Securities Law, which is based on subjective estimates of the Company as of the Report Date, and the materialization thereof, in whole or in part, is uncertain, or they may materialize in a significantly different manner, inter alia, due to factors which are beyond its control, including changes in market conditions, the period of time that shall be required for approval of the building plans for performance and the construction input prices.

7.8 **Land (aggregate)**

The table below presents a summary of figures on the Company's land reserves:

Territory		**For the year ended on:**	
		December 31, 2016	**December 31, 2015**
Israel	The amount at which the lands are presented in the financial statements at the end of the period (NIS in thousands)	482,654	148,694
	Total area of the lands at the end of the period (sqm in thousands)	96.9	80.8
U.S.	The amount at which the lands are presented in the financial statements at the end of the period (USD in thousands)	6,060	1,125
	Total area of the lands at the end of the period (sqm in thousands)	13.7	1.6

As of the Report Date, the construction in some of the Company's land reserves is impossible due to planning and other restrictions.

Land reserves – further details:

Following are details regarding the lands intended for construction as of the Report Date in the operating segments of investment properties and in the senior housing segment (for further details see Section 1.1.2 of the Board of Directors' Report in Chapter B of this Report):

Holon Manor Land

On February 24, 2015, the Company won a tender held by the Israel Land Authority for the purchase of 4 employment-designated lots in the employment zone of the city of Holon, in a total area of 12.4 thousand sqm, in consideration for approx. NIS 64 million. Two of the aforesaid lots (approx. 6.2 thousand sqm) will be used by the Company to construct a project designated for retail and offices, with marketable spaces of approx. 27 thousand sqm. As of the Report Release Date, a conditional excavation and shoring permit has been approved. The Company is acting to comply with the stipulated conditions and is also in licensing stages for a basement building permit.

Property in the Holon Industrial Zone – Lodzia

A property consisting of land in a registered area of approx. 53 thousand sqm, located in the Holon Industrial Zone, acquisition of was which was closed in April 2016 (for details see Section 1.3.1 above) and additional land originally purchased in the framework of an ILA tender and constituting part of the Holon Manor land. The Company is in licensing stages for building permits for shoring, excavation and basements.

As of the Report Date, the Lodzia land holds approx. 14.3 thousand sqm of built-up areas of retail and workshop structures, which are leased-out to various tenants. The seller is entitled to all of the revenues after deduction of the management expenses of the property (NOI) in the 12 months as of the signing date of the agreement, in a sum estimated at approx. NIS 10 million.

Senior Housing Land in Rishon LeZion

As stated in Section 1.3.4 above, a consolidated company of the Company has won a tender issued by the Israel Land Authority, for a lot of 3.4 thousand sqm designated for senior housing in HaRakafot Neighborhood in East Rishon LeZion. The project is in initial planning stages.

Sale of Pi Glilot Land

On May 10, 2016, the Company and Granite, including through Sonol, sold third parties all of their holdings of land in Pi Glilot and shares of Pi Glilot (which holds the long-term leasehold on land in the Pi Glilot complex), for a total consideration of approx. NIS 130 million. The transactions are yet to be closed.

Purchase and Sale of Properties (aggregate)

Territory	Parameters (figures of area and amounts in thousands)		Period (Year ended on)		
			December 31, 2016	December 31, 2015	December 31, 2014
Israel (NIS)	Properties Sold	Number of properties sold in the period	--	--	--
		Consideration from realization of properties sold in the period (consolidated)	--	--	--
		Area of properties sold in the period (consolidated)	--	--	--
		NOI of properties sold (consolidated)	--	--	--
		Profit / loss due to realization of the properties (consolidated)	--	--	--
	Properties Purchased	Number of properties purchased in the period	3(3)	4(2)	2(1)
		Cost of properties purchased in the period (consolidated) (4)	846,627	653,952	58,100
		NOI of properties purchased (consolidated)	19,000(6)	20,000(5)	Land
		Area of properties purchased in the period (consolidated)	85	45	40
U.S. (US Dollar)	Properties Sold	Number of properties sold in the period	--	--	--
		Consideration from sale of properties in the period	--	--	--
		Area of properties sold in the period (consolidated)	--	--	--
		NOI of properties sold	--	--	--
		Profit / loss in respect of realization of the properties (consolidated)	--	-	--
	Properties Purchased	Number of properties purchased in the period	2(3)	--	1(2)
		Cost of properties purchased in the period (consolidated)	173,723	--	76,000
		NOI of properties purchased (consolidated)	13,000(7)	--	5,300
		Area of properties purchased in the period (consolidated)	24	--	21

(1) In 2014, the Group purchased the following properties: (a) Land for senior housing in Modi'in – for details see Section 7.7 of Chapter A of the Report; (b) An office building in Houston, Texas. U.S.; (c) Land for senior housing in Lehavim – for details see Section 7.7 of Chapter A of the Report.

(2) In 2015 the Group purchased the following properties: (a) land in Akko; (b) land in Holon for details see Section 7.7 of Chapter A of the Report; (c) Palace Tel Aviv Senior Housing facility for details see Section 11.1 of Chapter A of the Report; (d) Pi Glilot Land

(3) In 2016, the Group acquired the following properties: (a) The land of Lodzia in Holon – for details see Section 7.8 of Chapter A of the Report; (b) Senior housing land in Rishon LeZion – for details see Section 7.8 of Chapter A of the Report; (c) The Palace Ra'anana Senior Home (in the framework of the acquisition of the Ahuzat Bayit company) – for details see Section 13.1 of Chapter A of the Report; (d) An office building in Austin, Texas, U.S. – for details see Section 1.3.1 of Chapter A of the Report; (e) Land in Houston, Texas, U.S.

(4) The costs include the entire purchase amount even if not yet paid and exclude purchase taxes and transaction closing costs.

(5) The NOI includes only Palace Tel Aviv Senior Home, the other properties purchased are land.

(6) The NOI only includes Palace Ra'anana Senior Housing and the Ra'anana retail center. The other acquired properties were land.

(7) The NOI only includes the office building in Austin. The additional property is land.

7.9 Fair value adjustments of values in the Statement of Financial Position required at corporation level

		As of (Consolidated)(NIS in thousands)	
		December 31, 2016	December 31, 2015
Presentation in the Description of the Corporation's Business Report	Total Income-Producing Property (as presented in the total column in the income-producing properties fair value by territory and use tables as of December 31, 2016 and December 31, 2015 Number 3+4)	19,586,445	18,314,062
	Total Income-Producing Property under Construction (as presented in the "Total"column in Table 7.7) in Israel	3,713,804	1,875,890
	Total Land for Investment in Israel (as presented in the "Total" column in Table 7.8)	482,654	148,694
	Total Land for Investment in the U.S. (as presented in the "Total column in Table 7.8)	23,301	4,390
	Consolidated Total	,23806,204	20,343,036
Adjustments	Adjustments to value deriving from receivables items	(89,749)	(84,317)
	Other adjustments[19]	6,281	12,420
	Total adjustments	(83,468)	(71,897)
	Total, After Adjustments	23,722,736	20,271,139
Presentation in the Statement of Financial Position	Investment Property Item in the Statement of Financial Position (Consolidated)	20,002,651	18,395,248
	Investment Property under Construction Item in the Statement of Financial Position (Consolidated)	3,720,085	1,875,891
	Total	23,722,736	20,271,139

For an explanation with respect to the changes in the investment property items between 2015 and 2016, see Sections 1.12.1, 1.12.2 and 1.12.3 of Chapter B of this Report.

[19] In 2016, the adjustments are for immaterial costs for projects in early planning stages. In 2015 - the investment properties of the Granite Segment were not included within the description of the Company's investment properties and were recorded in the adjustments item as a sum total, since the Company does not deem the entire Granite Segment as part of the Company's income-producing properties segments.

7.10 Adjustments to FFO profits

The Company is not required to perform FFO disclosure since the total revenues of the Company from investment properties are lower than 90% of the Company's total consolidated revenues during the report year and year preceding it. In view thereof, the Company calculates FFO profits for the income-producing property business only with the necessary adjustments. For details and a calculation of the FFO profits for the Company's income-producing properties business, see Section 1.3.13 of the Board of Directors' Report.

PART FOUR: DESCRIPTION OF THE GROUP'S BUSINESS - DESCRIPTION OF THE GROUP'S BUSINESS PER OPERATING SEGMENT AND MATERIAL PROPERTIES

8. The retail centers and malls in Israel segment

8.1 General information on the operating segment

8.1.1 General

Most of the Group's malls and retail centers are spread out throughout the central cities of Israel and are located close to the main traffic thoroughfares which enable easy access and outdoor or indoor parking. The retail centers and malls are optimally planned according to the needs of the population in the area in which the mall is located, and they offer a wide and varied mix of shops in the fields of fashion, footwear, jewelry, gifts, house-wares, communications, electronics and computers, optical devices, entertainment and food centers for the wellbeing of the visitors, easy access and a large number of parking spaces. The Company puts an emphasis on tenants' mix in each one of the malls and retail centers owned thereby, which it believes shall constitute a center of public attraction to each one of them, in accordance with the characteristics of the local public, and performs suitable marketing work, upgrades and renovates the systems and appearance of the malls and performs technological adjustments. During the Report Period, the Company expanded the marketing methods of the malls through use of the digital space where most of the end consumers of the retail centers and malls spend time for other purposes, through personal marketing and attractive promotion campaigns, in a manner capable of providing the end-consumer, *inter alia*, a unique shopping experience, which will commence in the digital domain and end in shopping at the Group's malls. Thus, for example, during 2016, the Company launched the Azrieli Malls app, which compiles unique shopping offers and sales at the Group's malls, the ability to pay for parking at the mall and useful information for visitors. The Group also launched the Azrieli Gift Card, which is issued either digitally or as a physical card and is redeemable in a broad range of chain stores at the Group's malls.

The Company routinely focuses on the betterment of the Group's existing properties and acts for optimization in the use of its commercial spaces and creates a suitable and modern mix of tenants while differentiating between the projects in order to maintain the relative advantage versus the Group's existing and future competitors.

Most of the Group's lease contracts in Israel are for periods of three to five years and in most cases include an option for additional lease periods (usually three to five additional years), other than agreements in respect of relatively large leasable space, which are mostly signed for longer lease periods ranging between 8 to 25 years (including extensions and exercised options). Most lease agreements include rent that is composed of fixed rent or of rent derived as a percentage of the tenant's turnover in the leased premises, whichever is higher; however, in most cases, the rent actually paid to the Company is the fixed rent, and the Company's revenues from turnover-dependent rent are in an immaterial amount. The Company did not have a principal tenant, the rent paid by whom for 2016 accounted for 10% or more of the total revenues of the Company in its Financial Statements for 2016. The occupancy rate of the Group's properties in this operating segment, from the date of lease-up of the retail centers and malls in Israel, and as of the Report Date, is approx. 98%.

The Group's retail centers and malls in Israel are managed, with relation to each mall or retail center, by designated management companies established by the Group, which enter with the tenants into management agreements for the purpose of management and maintenance of the public areas, in consideration for management fees.

Most of the management agreements determine that the management fees will be paid based on the cost of the management services, plus overhead expenses. The management services include, *inter alia*, marketing services of the mall and/or the retail center, both to visitors and to potential tenants, security services, cleaning of public areas, gardening, maintenance of elevators and public systems. The management companies collect from the tenants the management fees or the maintenance fees, which are used, *inter alia*, for financing the maintenance of public areas. The management company leases from the Group companies, as the case may be, in each of the malls and retail centers, an area in a small scope located in a non-central area of the mall or retail center, to serve as the offices and storage rooms of the management company, in consideration for fixed rent. In most of the management agreements between the management companies and the tenants, the management companies undertake to maintain and operate the public areas in the malls and retail centers, including cleaning, security, renewal, advertising, insurance, under conditions and to the extent that will be determined by the management companies from time to time.

All of the Group's retail centers and malls include also car parks (aboveground and/or underground) which serve the visitors and the potential tenants, with some of the car parks being open to the general public and some requiring payment.

Above or in proximity to the retail areas in some of the malls and retail centers there are areas designated for lease as offices. See Section 9 below for additional details on the office and other space for lease segment.

8.1.2 <u>The structure of the operating segment and changes occurring therein</u>

The retail centers and malls in Israel segment is affected by the business activities in the economy, the political and security situation and the economic condition in Israel. Various entities operate in the retail centers and malls segment which locate, plan, construct, lease and maintain properties designated for lease for various uses.

To the best of the Company’s knowledge, based, *inter alia*, on publicly-available information, at the outset, most of the malls relied on large anchor tenants (such as supermarkets, department stores and movie theatres), which were considered to be crowd attracting. However, in recent years, the concept has changed for the malls in Israel and an opposite trend has begun, of removal or reduction of the space of the anchors, due to the low rent per sqm paid by such tenants and the large space occupied thereby. However, there are presently “new” anchors in the form of large and leading fashion stores.

Note that in recent years, there has been an increase in the retail space intended for the fashion industry in the malls in Israel segment and in the Company's properties in the operating segment, and in the last two years, revenues of the fashion industry constitute approx. 49% of the revenues of the retail centers and malls in Israel segment.

In recent years, there has been a noticeable trend of brand fashion retail chains growing strong at the expense of single local stores, including international fashion retail chains, the construction of low-priced power centers outside of cities, which compete with the malls, as well as the process of consolidation among large companies in the Israeli economy that own retail centers and malls, which represents an advantage for size over smaller competitors, while creating operational efficiency. In addition, an increasingly strengthening trend can be observed in the context of which, several retail groups hold a growing number of leading brands and consequently expand the spaces leased thereby in each mall and necessarily improve their bargaining power vis-à-vis the malls. Furthermore, we are witnessing the development of new formats of large branded family-oriented stores.

In addition, in view of the changes that have occurred in recent years in the Israeli consumer's shopping habits, new retailing brings to the consumer's fingertips and doorstep a larger variety of products, a quicker and more convenient service and mainly personal tailoring of products according to the consumer’s preferences and habits. The Group is operating in order to examine and develop ways to combine the new digital retailing and the popular mall experience in a manner which creates a novel consumption experience.

8.1.3 <u>Restrictions, legislation, standards and special constraints applying to the operating segment</u>

This operating segment is subject mainly to the land laws and the land use and zoning laws. In addition, the business in this segment is affected by legislative updates in the field of business licensing, land taxation and municipal taxation. See Section 23 of this chapter for details on the matter of the restrictions, legislation, standards and additional constraints applying to the Group.

8.1.4 <u>Changes in the volume of business and profitability of the segment</u>

During recent years, the volume of operations of the Group in the retail centers and malls segment grew, mainly due to the development and construction of new income-producing properties (for a specification of the properties under construction see Section 7.7 above.) or expansion and renovation of existing properties, as well as the acquisition of existing income-producing properties (the purchase of the Azrieli Givatayim Mall, the purchase of the Azrieli Haifa Mall and the purchase of the full control of the Azrieli Hod Hasharon Mall).

The indicators for activity in 2016 show that the Israeli market is continuing to grow. The gross domestic product, at fixed prices and the gross domestic product *per capita*, increased in 2016 by approx. 4.1% and approx. 2.3% respectively. There was also an increase recorded in the private consumption and private consumption *per capita* by approx. 6.3% and approx. 4.2% respectively. The rate of unemployed is low and is approx. 4.6% and the average compensation in the market increased. Stability was maintained in the income-producing property segment in Israel, both on the demand level and on the rent prices and occupancy rate level. The (known) CPI recorded a 0.3% decrease in Q4/2016 and an identical decrease in the entire year of 2016. The Bank of Israel interest rate in 2016is at the historical low rate of 0.1%. The Prime interest rate is 1.6%.

However, sometimes, a challenging environment is occasionally felt in negotiations with tenants toward the signing of new lease agreements or the renewal of existing contracts.

The Report Period was characterized by an increase in the average turnover[20] in the Group's malls. In the Company's estimation, coming years may see changes in the competitive balance between the players in the income-producing real estate sector, among other things, due to the opening of new retail centers and the expansion of the supply of retail space all across the country.

See Section 1.12.1 of Chapter B of the Report for the Board of Directors' explanations on changes to the fair value of the Group's investment property as of the Report date.

The Company's management estimates that the wide dispersion of the portfolio of properties owned thereby, the maintenance and active management of the properties, their location mainly in areas of demand, the high business positioning of the properties and the Company's investment in the betterment of its properties for maintaining such advantage, the high occupancy rates, the broad variety of businesses in the malls and retail centers of the Group and the suitable mix of businesses, and the Company's stable capital structure, contribute to a reduction of the exposure of the Company's businesses to a crisis and/or to significant instability due to the materialization of any of the Company's risk factors.

The Company's aforesaid estimations regarding the changes in the income-producing real estate sector in Israel and the effects of such changes on the Company's results are merely subjective assessments and constitute forward-looking information, within the definition of such term in the Securities Law. Actual results and effects may materially differ from the aforesaid estimations and what they imply for various reasons, including an additional intensification of competition, a decrease in demands and a deterioration in the economic situation in Israel.

8.1.5 <u>Critical success factors in the operating segment and changes occurring therein</u>

The Company estimates that the main success factors in the segment are, *inter alia*, locating retail centers and malls in areas where there is a high level of demand, the right geographic location of retail centers and malls as a response to the needs of the residents in each area, expertise in development, unique architectural planning, management and construction of retail centers and malls through the professional management team employed by the Group, the creation of a mix of diverse, quality tenants with financial strength, know-how and experience in marketing, property management and operation, the positive goodwill of the Company, its business positioning and financial strength which

[20] Revenue figures are based on the figures provided by the tenants. In addition, not all of the tenants report to the Group on the revenue figures.

allows development at relatively low financing costs and provision of immediate response to attractive business opportunities.

8.1.6 Changes to the system of suppliers and raw materials for the operating segment

In the framework of the maintenance and management of income-producing properties segment, the Group has no material suppliers with which it engages and it does not purchase raw materials in material scopes.

8.1.7 Main barriers to entry and exit of the operating segment and changes occurring therein

Entry Barriers - To the Company's belief**,** entities operating in the retail centers and malls segment require, primarily, equity and financial strength. The main barrier to entry for the development and construction of a retail center, after finding suitable land in an area of demand, is the need for financial strength that enables to obtain financing for the purpose of the construction, *inter alia*, due to a growing trend whereby developers are increasing investment budgets for lessees of income-producing properties upon the initial lease-up of areas under development. In addition, required mostly are professional knowledge, experience in development segment, positive reputation in the industry, availability of financing sources at good terms and land reserves available and planned in areas with high levels of demand for leasable space for commercial purposes. In addition, entities operating in the retail centers and malls segment are required to meet high regulatory requirements, *inter alia*, antitrust, zoning, business licensing, safety, accessibility and environmental regulation. It shall be noted, that despite the high barriers to entry, it is possible to indicate a significant increase in the construction and development of many retail centers, all over Israel, in recent years. In addition, it is possible to operate in the retail centers and malls segment in lower costs through acquiring retail centers from single developers, extending existing commercial areas, upgrading and renovating retail centers as well as through managing retail centers without the acquisition thereof.

To the Company's belief, the malls' barriers to entry are significantly higher than those of power centers outside the cities, due to the high construction costs that characterize the malls (including the cost of the land, which is more expensive since the locations of the malls are closer to the city centers).

Exit Barriers - exiting this operating segment is mainly contingent on the ability to dispose of properties, which is a direct result of the location of the properties, their physical condition and the condition of the market, as well as various costs, including in connection with land taxation.

8.1.8 Structure of competition in the operating segment and changes occurring therein

For a description of the structure of the competition in this operating segment, see Section 8.4 below.

8.1.9 Manner of execution of purchases or construction of properties

For details on the manner of execution of purchases or construction of properties see Section 8.1.9 of the Company's periodic report for 2013, which was released on March 19, 2014 (Ref.: 2014-01-017433), as amended on March 23, 2014 (Ref.: 2014-01-021204) (the "**2013 Periodic Report**").

8.2 <u>Material properties</u>

Set forth in the table below is a concentration of figures pertaining to material properties of the Group in the retail centers and malls segment as of December 31, 2016 which were evaluated by the valuator Mr. Ronen Katz, a partner at Greenberg Olpiner & co (*) through the income capitalization method:

Name and features of property			Year	Information item											According to Regulation 8b(i) (as applicable)
				Fair value/book value at end of period (NIS in thousands)	Revenues from rent during the period (NIS in thousands)	Actual NOI during the period (NIS in thousands)	Rate of Yield (%)	Adjusted Rate of Yield (%)	Rate of Yield on the Cost (%)	Property Value to Debt Ratio (LTV)	Revaluation profits (losses) (consolidated) (NIS in thousands)	Occupancy rate as of the end of the period (%)	Average monthly rent per sqm from main use – retail (in NIS)	Ratio of average revenue per sqm to average rent per sqm**	Other assumptions underlying the valuation
Azrieli Tel Aviv Mall (1)	Territory	Israel	**2016**	2,181,045	118,098	147,364	6.76%	7.10%	29%	0%	384	100%	329	14%	Main rent cap rate – 7.00%[21]. Weighted cap rate – 7.09%.
	Functional currency	NIS													
	Main use	Retail	**2015**	2,149,581	118,570	145,452	6.77%	7.22%	28%	0%	58,131	100%	326	14%	Main rent cap rate-7.00%[22] Weighted cap rate-7.13%
	Construction cost (NIS in millions)	512													
	Corporation's share (%)	In 2016 – 100%; in previous years - 99.1%	**2014**	2,060,790	117,079	142,872	6.93%	7.15%	28%	0%	44,361	100%	326	13%	Rent cap rate-7.00%[23] Weighted cap rate-7.13%
	Area [sqm]	35,747													
Azrieli Ayalon Mall (2)	Territory	Israel	**2016**	1,610,000	102,662	113,469	7.05%	7.23%	25%	0%	24,190	100%	261	13%	Main rent cap rate – 7.00%[24]. Weighted cap rate – 7.05%.
	Functional currency	NIS													

[21] Approx. 25% of the rent (for large areas) was capitalized according to a cap rate of 6.75%.
[22] Approx. 25% of the rent (for large areas) was capitalized according to a cap rate of 6.75%.
[23] Approx. 20% of the rent (for large areas) was capitalized according to a cap rate of 6.75%.
[24] Approx. 39% of the rent (for large areas) was capitalized according to a cap rate of 6.75%.

Name and features of property			Year	Information item											According to Regulation 8b(i) (as applicable)
				Fair value/book value at end of period (NIS in thousands)	**Revenues from rent during the period (NIS in thousands)**	**Actual NOI during the period (NIS in thousands)**	**Rate of Yield (%)**	**Adjusted Rate of Yield (%)**	**Rate of Yield on the Cost (%)**	**Property Value to Debt Ratio (LTV)**	**Revaluation profits (losses) (consolidated) (NIS in thousands)**	**Occupancy rate as of the end of the period (%)**	**Average monthly rent per sqm from main use – retail (in NIS)**	**Ratio of average revenue per sqm to average rent per sqm****	**Other assumptions underlying the valuation**
	Main Use	Retail	**2015**	1,579,500	97,749	106,811	6.76%	7.25%	23%	0%	(12,955)	100%	258	13%	Rent cap rate-7.00%[25] Weighted cap rate-7. 07%
	Construction cost (NIS in millions)	461													
	Corporation's share (%)	100%	**2014*****	1,229,472	85,798	92,080	7.49%	7.23%	52%	0%	1,129	100	313	15%	Rent cap rate-7.00% Weighted cap rate-7. 11%
	Area [sqm]	33,136													
Azrieli Jerusalem Mall (excluding the office component)	Territory	Israel	**2016**	1,974,160	125,331	138,412	7.01%	7.15%	31%	0%	76,135	100%	278	12%	Rent cap rate-6.80. Weighted cap rate-7.09% .
	Functional Currency	NIS													
	Main Use	Retail	**2015**	1,880,316	125,071	137,808	7.33%	7.31%	31%	0%	(8,558)	99%	282	12%	Main rent cap rate-7.00%[26] Weighted cap rate-7.14%
	Construction Cost (NIS millions)	447													
	Corporation's share (%)	100%	**2014**	1,873,033	124,052	133,153	7.11%	7.18%	30%	0%	26,511	100%	278	12%	Rent cap rate-7.00%[27] Weighted cap rate-7.05%
	Area [sqm]	,39716													
The other Properties (other than material and highly material)			**2016**	10,943485	731,387	692,450	--	--	--	--	556,381	--	--	--	--
The other Properties (other than material and highly material)			**2015**	9,880,111	695,688	638,136	--	--	--	--	117,884	--	--	--	--

[25] Approx. 25% of the rent (for large areas) was capitalized according to a cap rate of 6.75%.
[26] Approx. 30% of the rent (for large areas) was capitalized according to a cap rate of 6.75%.
[27] Approx. 26% of the rent (for large areas) was capitalized according to a cap rate of 6.75%.

Name and features of property	Year	Information item											According to Regulation 8b(i) (as applicable)
		Fair value/book value at end of period (NIS in thousands)	Revenues from rent during the period (NIS in thousands)	Actual NOI during the period (NIS in thousands)	Rate of Yield (%)	Adjusted Rate of Yield (%)	Rate of Yield on the Cost (%)	Property Value to Debt Ratio (LTV)	Revaluation profits (losses) (consolidated) (NIS in thousands)	Occupancy rate as of the end of the period (%)	Average monthly rent per sqm from main use – retail (in NIS)	Ratio of average revenue per sqm to average rent per sqm**	Other assumptions underlying the valuation
The other Properties (other than material and highly material)	**2014**	8,299,612	611,318	564,011	--	--	--	--	(89,145)	--	--	--	--

* Mr. Ronen Katz is a certified real estate appraiser, with B.A. in Agricultural Economy and Administration from the Agriculture Faculty of the Hebrew University in Jerusalem, and has gained experience as a real estate appraiser since 1997.

** The figure is to the Company's best knowledge. It does not include lease agreements which do not include rent from sales and is given based on information received from the tenants or from other third parties (as the case may be), and therefore the Company cannot verify that this information is indeed true.

*** In 2014 all of the figures do not include the second floor which was opened in 2015 excluding revaluation profits.

(1) The figures include 50% of the profits of the Azrieli Center parking lot (another 50% were included in a very material property – Azrieli Center offices, a valuation with respect to which is attached to this Report).

(2) The Company is registered in the Land Registration Bureau as a long-term lessee of Azrieli Ayalon Mall for a 49-year period ending on August 1, 2031, with an option for an additional 49-year period. The Municipality of Ramat Gan owns the adjacent car park, which includes approx. 2,350 parking spaces. The Municipality of Ramat Gan has undertaken (and an easement therefor has been registered) to enable a right of passage for vehicles and pedestrians, as well as an open parking right for the public, including the Mall's visitors, in the parking spaces that were arranged (excluding 250 parking spaces, use of which will discontinue insofar as the Municipality realizes building rights thereon) and so long as the Company continues leasing and operating the Azrieli Ayalon Mall. Due to shortage of parking space and use by the neighboring office buildings of the parking areas around the mall, during 2015 an agreement was executed with the Municipality of Ramat Gan for the regulation of parking by marking it in blue and white while reserving the Company's rights in the car park and granting free parking to the mall's visitors at certain times.

8.3 The table below contains a summary of data about a material income-producing building under construction of the Group, as of December 31, 2016. It shall be emphasized that the uses of this property will be divided between the operating segment of the retail centers and malls in Israel and the operating segment of the office and other space for lease in Israel, according to the different uses in the designation of the building rights in the property:

Name and Features of the Property			Reporting Period	Financial Data: Aggregate Cost at Year-End, including Land, Construction Development and Financing (consolidated) in NIS	Financial Data: Data on Fair Value and Revaluations: Fair Value/Book Value at the end of the Period (consolidated) (NIS in thousands)	Financial Data: Data on Fair Value and Revaluations: Revaluation Profits (Losses) in the Period (consolidated) (in NIS)	Rate of Completion at Year-End [engineering] (%)	Rate of Property's Areas with respect to which Binding Lease Contracts have been Signed as of Year-End (%)	Data on Valuation and its Underlying Assumptions: Valuator's Name and Experience	Data on Valuation and its Underlying Assumptions: Valuation Model	Data on Valuation and its Underlying Assumptions: Additional Underlying Assumptions of the Valuation
Name of the Property	Azrieli Sarona	Annual Data with respect to the Property	Y2016	1,563,236	1,766,450	230,726	77%	51%	* Mr. Ronen Katz is a certified real estate appraiser, with a B.A. in Agricultural Economy and Administration from the Agriculture Faculty of the Hebrew University in Jerusalem, and has gained experience as a real estate appraiser since 1997.	Presented according to fair value under the DCF method	Cap rate for retail and office space for which contracts are yet to be signed – 8.5%; for space for which contracts have been signed – mainly 7.75%. Completion costs and developer profit were deducted.
Location of the Property	Tel Aviv										
Date of Land Purchase	May2011		Y2015	1,169,201	1,141,689	-	50%	18%	N/A	Presented according to fair value under the cost method	N/A
Actual Share of the Corporation (%)	100%										
Method of Presentation in Consolidated Report	Fair Value										
Estimated construction completion date	Q3/2017 (offices) 2018 (retail)		Y2014	934,282	906,770	-	29%	4.7%	934,282	Presented	N/A

Designated Areas of the Property (by usage) (sqm)	118,000 sqm offices 11,500 sqm retail									according to fair value under the cost method	
Total Projected Investment, including Land, Construction and Development (NIS in millions)	1,600-1,660										
Other Properties under Construction 2016				1,650,409	1,953,635	315,272	-	-	-	-	-
Other Properties under Construction 2015 *				827,045	736,936	(49,475)	-	-	-	-	-
Other Properties under Construction 2014*				1,320,955	1,325,688	7,904	-	-	-	-	-

* In respect of the properties under construction as being at the end of the relevant year, even if the same are not included in properties under construction on December 31, 2016.

8.4 **Competition**

Beyond the aforesaid, in the Company’s estimation, over recent years, the retail centers and malls in Israel segment has been characterized with high competitiveness, and to the best of the Company's knowledge, there are more than 300 retail centers in Israel. The structure, size and business mix of each retail center are adjusted to the characteristics of the demand of those leasing areas in the geographical region in which it is located. The competition in this area revolves around several parameters, of which the main ones are: (1) the geographical location of the properties and the level of demand for spaces for lease in such area; (2) the level of revenues in the properties; (3) the rent level and management and maintenance costs; (4) the quality of construction of the leased buildings; (5) the level of auxiliary services and, (6) The Lessor's goodwill.

As of the Report Date, the Company operates in that operating segment principally in the development and construction of retail centers, and focuses on discovering reserves of land in attractive locations and with the potential for high revenues, and therefore the competition vis-à-vis bodies which concentrate primarily on acquisitions of existing retail centers is lower. In retail complexes and centers located in residential areas a competition could also develop with local developers. The market trends over the recent years and the attempt to adjust the characteristics of the retail center accurately to local demands and to the substitutes available to the consumer have blurred the lines distinguishing between the different types of retail centers.

Due to the intensification of the competition in the sector, the addition of retail space in many regions and a trend of increase in on-line commerce, the Company acted in 2016 and will continue to act for the development of the end consumer marketing segment. *Inter alia*, the Company continues activity for branding of the Group’s malls through a uniform language of communication in the properties themselves, marketing activities and campaigns on the different types of media, and planning of further marketing, branding and differentiation activities and sales campaigns for all of the Group's malls (hard sale).

To the best of the Company's knowledge, a number of entities operate in Israel which hold significant portions of properties in the retail centers and malls segment, including Reit 1 Ltd., Gazit Globe Ltd., Melisron Ltd., Industrial Buildings Ltd., Amot Investments Ltd., Jerusalem Economy Ltd. and Big Shopping Centers (2004) Ltd. In addition, to the best of the Company's knowledge, in recent years new players are joining the market such as the institutional bodies (either directly or through a managing body which knows the operating segment well) and investment funds, that seek alternative yield for the members and for themselves.

The Company estimates that the geographic location of the retail center and its differentiation directly affect its characteristics and its tenant mix since each center adjust itself to the sizes of the geographic market in which it is located in order to create a center of attraction which is unique therefor and deal with centers existing in the area which created the consumers’ purchase habits. For the most part, the tenants will consider the benefit of space in a retail center with a better geographic location, a mix conforming to its business operations versus its cost and with a better reputational image.

Competition for the private consumer is also mainly characterized by the geographic location and against other centers of the power center-type as well as shops on city streets. Most of the retail centers and malls serve the population residing or employed in the geographic area in which the retail center is situated. Nonetheless, the Azrieli Tel Aviv Mall, due to its location, accessibility and proximity to the train station and to major intersections, serves consumers from all across Israel.

In the Company’s estimation, the tenant mix in the retail center influences the competition vis-à-vis the private consumer - the types of the shops and their branding, the atmosphere and shopping experience, benefits to consumers, events initiated in the framework of the retail center, access to the retail center and available parking (free or paid) – all of these are branding the retail center and create a competitive advantage. The main parameters that support the attractiveness of the retail center for the consumer are, *inter alia*, location, size, innovative look and business mix adjusted to the needs of the customers in the area. The malls and retail centers are therefore required to renovate, upgrade and adjust the tenant mix therein.

In the Company's assessment, the volume of its business in the retail centers and malls in Israel segment is large, and it is one of the leading companies in the field in Israel. As of the Report Date, approx. 1,800 tenants operate stores and retail in the Group’s retail centers and malls. In the Company’s estimation, the factors and methods that help the Group cope with the competition in the segment are as follows:

- ☒ Most of the retail centers and malls of the Group are characterized by quality planning and a high-quality tenant mix, which the Company carefully maintains over the years and that contribute to its competitive advantage and offer to the visitors to the retail centers and malls a quality shopping experience;

- ☒ The volume of the Company’s business in the segment allows the Company to engage with chains and service providers at beneficial terms;

- ☒ The volume of the Company’s business in the segment allow the Company to specialize in the management of retail centers and malls in an efficient manner in order to lead to savings in costs and in manpower;

- ☒ Most of the Company's tenants are large chains and/or companies with superior financial strength and the lease agreements therewith are for a relatively long period;

- ☒ The Company's retail centers and malls are located in high-demand areas, enabling the Company to lease the properties to numerous and diverse types of tenants;

- ☒ The expertise of the Group in the planning and construction of retail centers and malls according to the needs of the tenants and visitors in the retail center and/or mall.

- ☒ The scope of business and the Company's experience in the segment, allows it to carry out marketing activities also to the end consumers, the mall visitors and to adopt innovation in the retail segment, improving the experience of shopping at the Company's shopping centers, including use of digital media. For details with respect to the closing of the acquisition of a digital commerce business in the Report Year, see Section 1.3.2 of Chapter A of the Report. For details with respect to the launch of the Azrieli Gift Card and the Azrieli Malls app, see Section 8.1.1 of Chapter A of the Report.

8.5 **<u>Goals and business strategy for the segment</u>**

See Section 26 of this chapter for the Company's goals and the Group’s strategy.

9. The Office and other space for lease in Israel segment

9.1 General information on the operating segment

9.1.1 General

In this operating segment, the Group operates, as of the Report Date, in the development, construction, acquisition, lease, management and maintenance in Israel of parks for offices and the high-tech industry, office buildings and industrial buildings, workshops and storage. The parks for offices and office buildings are designated primarily for businesses in the segments of liberal professions, service providers, headquarters of financial entities, hotelkeeping, medical services and high-tech industry, which are characterized by a large number of personnel and a demand for adjacent parking spaces.

Most of the Group's lease agreements are for periods of about five years on average, with the tenant given an option for additional lease periods of about five years and the rent is at a fixed amount per each square meter of the leased space.

All of the Group's office and other space for lease properties in Israel include also car parks (above or underground) which serve the tenants and their customers.

In this operating segment, the Group's income-producing space that are leased to third parties are mainly divided into two types:

a. Parks for businesses and for high- tech industries- The Group specializes in responding to the special needs of the high-tech industries and the construction of purpose-built buildings fitted in advance to the needs of the tenants. The purpose-built construction provides a comprehensive and complete solution to tenants, that includes the guidance of the tenant beginning from the stage of preparing the working plans for purposes of the design requested by the tenants, the planning and construction of the building in full cooperation with the tenant and through responding to all of the tenant's demands as to the interior of the leasehold. The business parks present a quality and clean working environment in a central location, quality infrastructure, green areas and parking spaces.

b. Office towers - The Group has office towers that are leased, in most cases, with high occupancy to numerous and diverse tenants for long lease periods.

The office and other space for lease segment of the Group in Israel is managed with relation to each building or group of buildings through the Company or designated management companies owned by the Group, which engage with the tenants in management agreements. Most of the management agreements determine that the management fees will be paid on the basis of the cost of the management services plus overhead expenses. The management companies collect from the tenants the management fees or the maintenance fees, which are used, *inter alia*, for financing the maintenance of public areas, whereas in most of the management agreements between the Company or the management companies and the tenants, the management companies undertake to maintain and operate the public areas, including cleaning, security, renewals, advertising and insurance, under terms and in the scopes as shall be determined by the management companies from time to time.

9.1.2 The structure of the operating segment and the changes occurring therein

The office and other space for lease segment is mainly affected by the economic activities in Israel and abroad. Various entities are active in this operating segment which locate, plan, construct, lease and maintain properties designated for lease for various uses. There are many companies in Israel in the office and other space for lease segment, including large, veteran and leading companies, which own properties in large volumes, as well as smaller, local developers who operate in specific geographic areas. The business in this segment is generally characterized by the fact that part of the costs of construction or acquisition is financed by independent sources and the remainder is financed by credit from outside sources.

9.1.3 Restrictions, legislation, standards and special constraints applying to the operating segment

This operating segment is subject mainly to the land laws and the land use and zoning laws. In addition, the business in this segment is affected by legislative updates in the field of business licensing, land taxation and municipal taxation. See Section 23 of this chapter for details on the matter of the restrictions, legislation, standards and additional constraints applying to the Group.

9.1.4 Changes in the volume of business and profitability of the segment

To the best of the Company's knowledge, in 2016, the office segment continued, to demonstrate stability, which was reflected in stability in the demand for office space and in stability in the amount of the rent in many projects. Due to a shortage in supply of available high-quality office space in Tel Aviv and Herzliya, the Report Period was characterized by a moderate rise in rent in leading projects in Tel Aviv and Herzliya.

In addition, the soundness recorded in the hi-tech industry, creates, and in the Company’s estimate, will continue to create, in the upcoming years, demand for office space due to the projected continued increase in the number of employees in the information technology, information security and cyber sectors. In view of the aforesaid, there is a noticeable increase in the Company’s exposure to the high-tech sector, due to the increase in the lease of offices to companies of this sector.

As of the Report Date, the Group has preserved very high occupancy rates in its income-producing properties in the segment and even increased its total revenues from rent. The Company estimates that its financial strength, the strength of the Company's tenants, some of which constitute the leading firms in the economy (AAA tenants), its high liquidity and standing in the financial market are advantages and strengthen its status in the segment. See Section 1.12.2 of the Board of Directors' Report for details concerning the development of the revenues from this operating segment.

In addition, in recent years, the Company has acted to expand its business in this operating segment, *inter alia*, by development and construction of new projects (the Azrieli Sarona project in Tel Aviv, the Azrieli Holon Center and an office tower in Azrieli Rishonim Mall). Furthermore, as part of the business strategy the Company is examining attractive investment opportunities and the creation of new growth engines also in tangential segments, and possibilities to create a synergy with the other operating segments thereof, such as construction of logistic storage structures.

The Company estimates, in view of the aforesaid and due to the supply of new office buildings in the center of Israel in coming years, the Company estimates that due to an increase which, to the best of the Company's knowledge, is expected in the supply of new office buildings in the center of Israel commencing from the middle of 2017 forth, a moderate decrease in the prices of rent may occur in lower-demand areas (Bnei Brak, Ramat Gan and the suburbs of Tel Aviv). The Company estimates that such decrease is not expected to have a very material effect in the long term on the rent prices of the Company's properties, which are essentially characterized by a high quality level of construction, location and management, the level of demand for which in recent years has continuously increased. In addition, a large part of the increase in the supply of offices in the central region is made up of buildings that are being constructed in the context of purchase groups, or buildings that are intended to be sold to a large number of buyers, that are not expected to materially affect the rent prices in the central region. In addition, in the Company’s estimation, the coming years may see changes in the competitive balance between the players in the income-producing real estate sector, *inter alia*, due to the lease-up of office space projects, primarily in the Dan Metropolitan Area, which pose challenges for the sector.

The Company's aforesaid estimations with regard to the changes in the segment and the effect thereof on the Company's results are merely subjective estimations and forward looking information as per the definition thereof in the Securities Law. The actual results and effects may significantly differ from the estimations specified above and the implications thereof, for various reasons, inter alia, a further strengthening of the competition, a decrease in the demand for office spaces and a worsening of the economic situation in Israel.

9.1.5 Critical success factors in the operating segment and changes occurring therein

The Company estimates that the main success factors of the Company in the segment are, *inter alia*, the geographic dispersion and the location of the income-producing properties in areas in demand throughout Israel for offices, commerce and industry, the quality of the properties, expertise in development and architectural planning, management and construction of properties conforming to potential tenants, in relation to which the Company had engaged in advance in lease contracts through the professional management team employed by the Group, the level of demand and supply of properties of a similar type which dictate the terms of the lease contracts and the potential changes thereto, know-how and experience in marketing, property management and operation, the positive goodwill of the Company, its business positioning and financial strength which allows immediate response to attractive business opportunities.

9.1.6 Changes to the system of suppliers and raw materials for the operating segment

Within the framework of this segment, the Group has no material suppliers with which it engages and does not purchase raw materials in material scopes.

9.1.7 Main barriers to entry and exit of the operating segment and the changes occurring therein

Barriers to Entry - To the Company's belief, entities operating in this operating segment require mainly equity and financial strength. In addition, professional know-how, experience in the development segment, positive reputation in the industry and available and planned land reserves in areas with high demand for office buildings space for lease bear great importance. Development in the segment requires financial soundness which enables operating in the development segment at relatively low financing costs

Barriers to Exit - exiting this operating segment is conditional, mostly, on the ability to realize properties, which is a direct result of the location of the properties, their physical condition and the condition of the economy, as well as various costs, including in connection with land taxation.

9.1.8 Structure of competition in the operating segment and changes occurring therein

See Section 9.3 below for a description of the structure of competition in this operating segment.

9.1.9 Manner of executing acquisitions of the Company

See Section 8.1.9 of Chapter A of the 2013 Periodic Report, which is included in this Report by reference for a description of the manner of acquisition and exercise of the Group's rights in properties.

9.1.10 Acquisitions performed in the Report Period and thereafter

For details regarding the closing of the acquisition of Azrieli Town and the closing of the acquisition of "Yediot Aharonot House", see Section 1.3.1 of Chapter A of the Report.

For details on main new properties that are under construction on the Report Date – Azrieli Sarona Center, Tel Aviv, and Azrieli Rishonim mall, see Section 7.7 of Chapter A of the Report.

9.2 Details on the very material properties of the Group in the office and other space for lease segment – for details see Section 8.3 above.

9.2.1 Azrieli Tel Aviv Towers

The following tables include data regarding the office towers in Azrieli Center, Tel Aviv, which, as of the Report Date, constitutes 10.1% of the Company's total properties and complies with the definition of a very material property. The valuation of this property which is defined as a very material valuation, is attached to this Report as Annex D to the Board of Directors' Report.

The Group, through Canit Hashalom, is the holder of all of the lease rights in the center named “Azrieli Center”. Azrieli Center extends over a land block at a total area of approx. 33 thousand sqm, located in the center of Tel Aviv, on a junction which is a main transport route and in proximity to the main transport routes of Tel Aviv (Ayalon Highways, Derech Hashalom, Menachem Begin Road) and HaShalom train station, located on Hashalom intersection.

To the best of the Company’s knowledge, as of the Report Date, Azrieli Center is the largest business center in Israel, with an overall built-up area (gross) of approx. 328,393sqm, comprising an underground car park and storage rooms (at an area of 122,258 sqm), a mall including 3 commercial floors and a public floor (at an area of 61,110sqm), public passage bridges over Menachem Begin Road and Hashalom Railway at an area of 1,365 sqm and three towers: the Round Tower (at an area of 55,823 sqm), which includes 38 office floors and another roof floor serving as an observatory and a restaurant; the Triangle Tower (at an area of 47,348 sqm), which includes 35 office floors and 2 more service floors; and the Square Tower, which is a tower with mixed uses (at an area of 40,489 sqm), including 18 office floors above the 13 hotel floors. For details about the Company’s plans to expand the center and the closing of the acquisition of the “Yediot Aharonot House”, see Section 7.7 of this chapter of the Report.

9.2.2 Presentation of the property

	Details as of December 31, 2016
Name of property:	**Azrieli Towers**
Location of property:	**Tel Aviv**
Property areas – split by usage;	**Offices – 131,264 sqm; hotel – 18,000 sqm; offices used by the Group – 1,855 sqm.**
Company’s share in the property:	**100%**
Structure of holding in the property:	**Through Canit Hashalom which is wholly (100%) held by Azrieli Group Ltd.**
Corporation’s actual share in the property:	**100%**
State the names of the partners in the property*:	-
Date of acquisition of the property:	**The land was acquired in August 1992.**
Specification of legal rights in the property (ownership, lease etc.):	**Capitalized long-term leasehold.**
Significant unutilized building rights:	-

Status of registration of legal rights:	In July 2014, the registration of Canit Hashalom's lease rights with the Land Registration Bureau was completed.
Special issues (material building code violations, soil contamination, etc.):	**There are no special material issues. For further details see the valuation attached hereto.**
Method of presentation in the Financial Statements:	**Consolidation**

For details on the registration of rights in the property, pledges and guarantees, pertaining to Azrieli Center towers, see Section 9.2.8 of Chapter A of the Report. It shall be noted that all of Azrieli Center's space is designated for lease on the free market, other than space for self-use by Canit Hashalom and the Group's companies (on the top office floor of the Round Tower and part of Floor 33 and other negligible areas, such as archives, gallery, storeroom, etc.), and other than an area of approx. 5,500 sqm, which is located in the project's basement which is designated for building of an IEC sub-station which was sub-leased in 2006 to the Israel Electric Corp. Ltd. in consideration for an amount of approx. NIS 14 million, for the entire lease period of Canit Hashalom (such area was not taken into account in the valuation of the center which is attached to this Report).

Yarden Hotels M.H.Y. Ltd. which operates the hotel, which is located in the Square Tower of Azrieli Towers, has a business license for the operation of the hotel that as of the Report Date, is effective until December 31, 2017.

9.2.3 Main figures

Figures per 100%. The Company's share in the property – 100%	**Y2016**	**Y2015**	**Y2014**		**On date of purchase of the property**
Fair value at end of the period (NIS in thousands)	2,877,755	2,821,819	2,780,410	Cost of construction (NIS in millions)	1,292
Revaluation profits (NIS in thousands)	53,485	24,643	53,845	Date of purchase of the land	August 1992
Average occupancy rate (%)	100%	100%	100%		—
Leased space (sqm)	149,264	149,529	149,613		—
Total income (NIS in thousands) (*) per month	243,453	239,495	237,537		—
Average rent per sqm per month (NIS) (**)	104	101	98		—
Average rent per sqm per month in contracts signed during the period (NIS)	126	123	120		—
NOI (NIS in thousands)	208,841	206,354	202,571		—
Adjusted NOI (NIS in thousands)	215,166	213,131	210,028		—
Actual yield rate (%)	7.3%	7.3%	7.3%		—
Adjusted yield rate (%)	7.5%	7.6%	7.6%		—
Number of tenants at end of reporting year	131	135	150		—

(*) The revenues and NOI include 50% of the revenues and the car park's NOI.

(**) Excluding the hotel's rent. If the average included the hotel's rent, the average for 2016 would be approx. NIS 99 per sqm, and the average for 2015 would be approx. NIS 94 per sqm.

9.2.4 Breakdown of revenues and cost structure

Figures per 100%. The Company's share in the property – 100%	**Y2016**	**Y2015**	**Y2014**
Revenues:	**(NIS in thousands)**		
From rent – fixed	176,520	172,643	170,620
From rent – variable*	-	-	-
From management fees	37,606	37,708	38,288
From car park	24,028	24,221	24,847
Others	5,299	4,924	3,782
Total Revenues	243,453	239,496	237,537
Costs:			
Management, maintenance and operation	34,611	33,142	34,966
Depreciation	127	96	96
Other expenses	-	-	-
Total Costs:	34,738	33,238	35,062
Profit:	208,715	206,258	202,475
NOI:	208,841	206,354	202,571

(*) No turnover addition for lease of offices.

9.2.5 Principal tenants at the property

The Company does not have an anchor tenant (as defined in the Regulations) or a principal tenant at the property the revenues from whom generate 20% or more of the property's revenues.

9.2.6 Projected revenues due to signed lease contracts

	Year ending December 31, 2017	Year ending December 31, 2018	Year ending December 31, 2019	Year ending December 31, 2020	Year ending December 31, 2021, forth
	NIS in thousands (figures according to 100%. Corporation's share in the property – 100%)				
Fixed components	219,558	178,734	132,207	110,686	150,976
Variable components (estimate)*	—	—	—	—	—
Total	219,558	178,734	132,207	110,686	150,976

*For the purpose of calculating the rent, supplements to the rent for a percentage of the turnover were not taken into account, since the Company's management has no estimate of such sums. In 2016, the variable component consisted of approx. NIS 428 thousand (for 2014 and 2015 there was none).

The revenue amounts in the above table, were calculated based on the basic amounts set forth in the lease agreements while linked to the CPI known on December 31, 2016, and based on the following assumptions: (1) The exercise of options for extension of the lease periods included in the lease contracts was not taken into account; (2) Lease contracts which the lease period pursuant thereto has ended and new lease contracts have not yet been signed with the tenants were not taken into account; (3) The possibility of sale of the properties or purchase of new income-producing properties was not taken into account; (4) Early termination fines, if any, were not taken into account; and (5) no change will occur in the advance payments of management fees for each tenant for year 2016.

The amounts of revenues specified in the aforesaid table are under the assumption that the options for extension of the lease periods included in the lease contracts would not be exercised, in spite of the fact that many of the tenants in the Company's premises usually tend to extend the lease agreements upon their termination.

The above figures are based on the estimates of the Company considering the signed agreements as of the Report Date and constitute forward-looking information, within the definition thereof in the Securities Law. Actual results may significantly differ from the above specified estimates and the implications thereof, for various reasons, including early termination of lease contracts or a business crisis of any of the tenants.

9.2.7 Specific financing for the property

<table>
<tr><th colspan="3">Specific Financing</th><th>Loans:</th></tr>
<tr><td rowspan="4">Balances in the Statement of Financial Position</td><td rowspan="2">December 31, 2016 (NIS in thousands)</td><td>Presented as current maturities:</td><td>88,750</td></tr>
<tr><td>Presented as long-term loans:</td><td>355,000</td></tr>
<tr><td rowspan="2">December 31, 2015(NIS in thousands)</td><td>Presented as current maturities:</td><td>88,750</td></tr>
<tr><td>Presented as long-term loans:</td><td>443,750</td></tr>
<tr><td colspan="3">Fair value as of December 31, 2016 (NIS in thousands)</td><td>438,881</td></tr>
<tr><td colspan="3">Original date of taking the loan</td><td>August 2013</td></tr>
<tr><td colspan="3">Original amount of loan (NIS in thousands)</td><td>710,000</td></tr>
<tr><td colspan="3">Effective Interest Rate as of December 31, 2016 (%)</td><td>1.16%</td></tr>
<tr><td colspan="3">Dates of repayment of principal and interest</td><td>The principal is returned in equal semiannual payments until August 2021.
The interest is paid on the unpaid balance every 6 months.</td></tr>
<tr><td colspan="3">Key financial covenants</td><td>The Lender shall have the right to accelerate payment under the loan upon fulfillment of generally accepted causes, which are provided in the agreement, including, inter alia, a material adverse change in the tenant status in the Round Tower or if the ratio between the balance of the loan as of the calculation date and the value of the Round Tower (as shall be determined by an appraiser, who shall appraise the Round Tower once a year) (LTV), commencing from the end of two years as of the date of the provision of the loan, amounts to not more than 70% (and its rate decreases over the term of the loan down to 25% one year prior to repayment of the loan in full). This ratio, as of December 31, 2016, is approx. 37%.</td></tr>
</table>

Other key covenants	**-**
Is the corporation compliant with key stipulations and with the financial covenants as of the end of the reporting year	**Yes**
Is it non-recourse	**No**

9.2.8 Pledges and material legal restrictions on the property

Type		**Details**	**The amount secured by the pledge December 31, 2016(*) (NIS in thousands)**
Pledges	**First-ranking**	**Part of the lobby floor, the roof floor and Floors 11-49 of the Round Tower are pledged by a fixed charge to an institutional body group (also see Section 19.3 below).**	**443,750**
(1) Canit Hashalom has provided the City of Tel Aviv with a guarantee in the amount of NIS 8 million, linked to the Residential Construction Input Price Index (standing, as of December 31, 2016 at approx. NIS 24 million), which is intended to secure Canit Hashalom's compliance with its obligations in connection with the performance of the development and construction work for the project. This guarantee is expected to be returned to Canit Hashalom upon the issuance of a certificate of completion for the project. As of the Report Date, Canit Hashalom is acting towards obtaining the aforesaid certificate of completion, and does not expect any part of the guarantee to be forfeited. The provisions of this section constitute forward-looking information which is based upon estimates of the Company in reliance on past experience and the actual results may be different, primarily due to requirements of the authorities which are unknown as of the Report Date. (2) On February 28, 2008, Canit Hashalom signed a letter of undertaking addressed to the City of Tel Aviv and also provided an additional bank guarantee in the amount of approx. NIS 8 million, linked to the CPI (in the sum of approx. NIS 9 million, as of December 31, 2016), in connection with the granting of a Form 4 for the square tower of the project, in the context of which it undertook to act to establish a steering team to evaluate the need to build another tunnel underneath the Kaplan interchange, and further undertook to build the tunnel at its expense, to the extent determined as aforesaid. Insofar as the construction of the aforesaid tunnel will be required, Canit Hashalom estimates the cost of construction in the amount of approx. NIS 7 million.			

9.2.9 Details regarding the valuation

		Y2016	Y2015	Y2014
The value determined (NIS in thousands)		**,2877,755**	**2,821,819**	**2,780,410**
Identity of the appraiser[28]		**Ronen Katz of Greenberg Olpiner & Co.**	**Ronen Katz of Greenberg Olpiner & Co.**	**Ronen Katz of Greenberg Olpiner & Co.**
Is the appraiser independent?		**yes**	**yes**	**yes**
Is there an indemnification agreement?		**yes**	**yes**	**yes**
Date of validity of the valuation (the date to which the valuation pertains)		**Dec. 31, 2016**	**Dec. 31, 2015**	**Dec. 31, 2014**
The valuation model		**DCF**	**DCF**	**DCF**
Main parameters used for the valuation[29]				
The valuation according to the Income Approach	**Gross leasable area used in the calculation (sqm)[30]**	**,149264**	**149,529**	**149,506**
	Representative occupancy rate out of the leasable area for the purpose of valuation (%)[31]	**100%**	**100%**	**100%**
	Representative average monthly rent per leased sqm for the purpose of valuation	**101.1**	**100.3**	**98.7**
	Representative NOI for the purpose of valuation (NIS in thousands)[32]	**215,166**	**213,131**	**210,028**
	Annual average periodic expenses for preservation	**See "Other main parameters" below**		
	Weighted cap rate used for the valuation	**.734%**	**.737%**	**.736%**
	Other main parameters	**Projected investments in the property were depreciated,**	**Projected investments in the property were depreciated, as well as investments due to contractual undertakings to the City of Tel Aviv. The overall depreciation of the**	**Projected investments in the property were depreciated, as well as investments due to**

[28] Mr. Ronen Katz is a certified real estate appraiser, holding a B.A. in Agricultural Economy and Administration from the Agriculture Faculty of the Hebrew University in Jerusalem, and has gained experience as a real estate appraiser since 1997.

[29] The valuation is attached as annex D to the Board Report.

[30] Not including area for the Company's own use of approx. 1,855 sqm on the last office floor and part of floor 33 of the round tower.

[31] Represents the ratio of marketed area out of the total area, but in appraisal, value was taken for vacant areas too.

[32] Including 50% of representative NOI of the car park which is included in the property value. (The remaining 50% were included in the valuation of the mall).

		as well as investments due to contractual undertakings to the City of Tel Aviv. The overall depreciation of the property value due to the aforesaid totaled at approx. NIS 54 million.	**property value due to the aforesaid totaled at approx. NIS 68 million.**	**contractual undertakings to the City of Tel. The overall depreciation of the property value due to the aforesaid totaled at approx. NIS 77 million.**
Value sensitivity analyses		**Change in value (NIS in thousands)**		
Cap rates	**Rise of 0.25%**	**(96,575)**	**(94,776)**	**(93,327)**
	Decline of 0.25%	**103,386**	**101,427**	**99,875**
Average rent per sqm	**Rise of 5%**	**126,297**	**125,099**	**123,006**
	Decline of 5%	**(126,297)**	**(125,099)**	**(123,006)**

9.3 Competition

The income-producing property segment in general and the office and other space for lease segment in particular, is characterized by a high level of competition. The competition in the office and other space for lease segment in Israel is characterized by a high level of competition which revolves around a number of parameters, the main ones of which are: (1) the geographic location of the properties and the level of demand for spaces for lease in that area; (2) the rent level and management and maintenance costs; (3) the quality of construction of the leased buildings; (4) The level of auxiliary services, and (5) the Lessor's goodwill. The competition in this sector exists both at the stage of identification of the properties for purposes of initiation, development and construction of properties, and at the stage of the leasing of the properties. The Group is exposed in Israel to competition by numerous companies engaging in the lease of business property, in areas of demands similar to those in which the Group's properties are located, while in most cases, the competition is local competition. Thus, for example, the competition for the Azrieli Center is the high priced office buildings in Tel Aviv and the competition for the Herzliya Business Park is other alternate office buildings in that area.

To the best of the Company's knowledge, several bodies are active in Israel, holding significant shares of the office and other space for lease segment, including Reit 1 Ltd., Gav Yam Land Ltd., Nitzba Holdings 1995 Ltd., Industrial Buildings Ltd., Levinstein Properties Ltd. and Amot Investments Ltd. In the Company's estimation, the scope of its business in the office and other space for rent in Israel segment is among the leading companies in the segment, particularly with completion of the projects which are, as of the Report Date, under construction.

The factors assisting the Company to deal with the competition in this segment are as follows:

☒ The Company's volume of operation in the segment enables the Company to communicate with companies and service providers at beneficial terms.

☒ The Company's volume of operation in the segment enables the Company to specialize in the management of commercial parks and office buildings in an efficient manner which leads to savings in costs and in manpower.

☒ Most of the Company's tenants are companies with high financial strength and the lease agreements therewith are for a relatively long period of time.

☒ The Company's office and other space for lease is located in areas of high demand, enabling the Company to lease the properties to numerous diverse types of tenants.

☒ The unique characteristics of the Group's properties, such as: a retail center in proximity to the office space for rental, access to public transportation, including the railroad and underground car parks for the convenience of the tenants and their customers.

☒ Most of the Company's office space is characterized by its high quality and prestigious nature, which distinguishes the Company's property from those of the competing companies and strengthen its competitive edge.

9.4 **Goals and business strategy in the segment**

See Section 26 of this chapter for details on the Company's goals and the Group's strategy.

10. The income-producing property in the U.S. segment

10.1 General

As of the Report Release Date, the Group owns seven (7) office rental properties outside of Israel (six in the U.S.), of a total leasable area of approx. 199 thousand sqm (the Company's share is approx. 189 thousand sqm), which is leased to approx. 250 tenants. The Company's properties in this operating segment do not amount to material properties or very material properties. For aggregate details regarding all of the Company's income-producing properties in this operating segment (including a land reserve in Section 7.8 above), see Section 7 of Chapter A of the Report, under the geographic territory of the U.S.

About 50% of the Group's office properties in this operating segment are multi-tenant properties and the other 50% are properties with a small number of tenants. All are Class A properties that also include car parks (aboveground or underground) which are used by the tenants. The properties are located in high demand areas with more office building clusters. Unlike the Company's properties in Israel, in some of the Company's properties in the U.S., the Company holds the property together with one or more local partners. As of the Report Date, the Company is routinely examining the expansion of its activity in additional markets, mainly in North America (in addition to Houston and Austin in Texas), with an emphasis on markets where the population of the metropolitan area exceeds two million residents.

The office buildings in the operating segment are mostly intended for businesses (*inter alia* from the energy industry) and service providers which are characterized by a large number of employees and demand for adjacent parking spaces. Most of the Group's lease contracts in this operating segment are for periods of between three and ten years, while often the tenant is given an option for additional lease periods of approx. five years. The rent is at a fixed amount per square meter (or the U.S. customary unit – sq ft) of the leased area, while often the lease contract includes a rent increase during the term of the lease.

Unlike the Group's office properties in Israel, the Group's office space in the U.S. is managed by professional and local management companies with which the Company has engaged in agreements, and which the Group is entitled to terminate by advance notice of 30 days. The management companies collect from the tenants the rent, as well as current expenses, such as security, cleaning, maintenance, municipal taxes, insurance, gardening, maintenance of elevators and public systems. The Company is examining, in a current manner, possibilities for both operational and property management streamlining.

10.2 The structure of the operating segment and changes occurring therein

Between 2011-2016, the Company expanded its business in the U.S. and made several purchase transactions - the first of three office towers in the "Galleria" area of the city of Houston, Texas, and two additional transactions for the purchase of two office buildings in the "Energy Corridor" and “West Belt” area of Houston, Texas. In the Report Period, the Company purchased an office building in Austin, Texas and a land block in Houston, which is adjacent to a Company-owned property. Most of the Group’s properties in the U.S. are situated in the Houston metropolitan area, which is inhabited by approx. 6 million people[33] and where population growth in the last 30 years exceeded the U.S. average. Such growth stemmed, *inter alia*, from a high quality of life, a low unemployment rate, the absence of state income tax and an attractive cost of living.

The income-producing property segment in the U.S. is affected by the economic activity in the U.S. economy, and mainly by the economic business in Houston and its office lease market.

The recovery process in Houston after the economic crisis which began in 2008, was among the quickest throughout the U.S. and good figures continued to be recorded in the local economy, mainly thanks to the strong connection that the local economy has with the energy market which experienced a significant price increase until mid-2014. The summer of 2014 saw the beginning of a global downtrend in energy prices, which began affecting the local economy in 2015. This effect is demonstrated in the unemployment rate in the Houston metropolitan area which was 4.9% in November 2016, identical to the rate in November 2015 and approx. 0.6% higher than the unemployment rate in November 2014[34].. Toward the end of 2016, after the OPEC member countries reached an agreement on the reduction of inventories, the level of energy prices stabilized. This trend also affects the office segment in Houston.

The effect of this trend during the years 2015-2016 on the office real estate market in Houston, was reflected in various ways such as: A steep decline in the number of new lease transactions and low occupancy levels in projects whose construction had recently been completed, a decrease in the number of projects planned towards commencement of construction; a significant increase in the rate of vacant space; an increase in the number of areas on the sublease market; a decrease in rent prices; and, at the same time, the increased willingness of property owners to grant incentives to new tenants such as a high budget for "improvements to the leased property" and a long

[33] The figures are taken from publications of the real estate consulting company Cushman and Wakefield.

[34] The figures are taken from publications by the real estate brokerage firm Colvill Office Report Q4 2016.

"grace period".

In addition to the effect of the gas and energy sector on Houston's economy, to the best of the Company's knowledge, the local economy is expected to also be affected by growth in the activity of Houston's port and its large medical center[35].

The property in Austin, Texas, which the Company during the year, is a new property whose construction had been completed in 2015 and is wholly occupied by a high-tech company. One of the growth engines of the demand for office space in Austin is the numerous high-tech companies whose research and development activities are concentrated in this city.

10.3 **Restrictions, legislation, standards and special constraints applying to the operating segment**

This operating segment is subject mainly to the local planning and building laws and land laws. In addition, the business in this segment is affected by legislation and regulation of authorities in the fields of environmental protection, safety, business licensing, land taxation and municipal taxation. See Section 23 of the Report for details on the matter of the restrictions, legislation, standards and additional constraints applying to the entire Group.

10.4 **Changes in the volume of business and profitability of the segment**

As aforesaid, 2016 saw the continued trend of increase in vacant space in the Houston office market, from an increase in office space inventory due to the completion of projects under construction, the lack of demand on the part of energy companies consequently to the decrease in energy prices, as well as from an increase in the office space placed on the sublease market. In the course of 2016, 5 million sq ft of Class A leasable properties were added to the Houston metropolitan area[36]. The total rate of vacant space in the Houston metropolitan area grew from 14.1% to 15.7% in the course of 2016, whereas vacant space rate in Class A office buildings was 13.7% at the end of 2016[37]. In addition, to the best of the Company's knowledge, in 2016, rent prices dropped in view of the competition between property owners and in view of the competition stemming from the sublease market.

10.5 **Critical success factors in the operating segment and changes occurring therein**

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[35] The figures are taken from publications of the real estate consulting company Cushman and Wakefield.

[36] The figures are taken from publications by the real estate brokerage firm Colvill Office Report Q4 2016.

[37] According to figures appearing in MarketView Insert, Houston, Office Q4 2016, published by CBRE in Q4 2016.

The Company estimates that the main success factors in this operating segment are its know-how, expertise and experience in the location and acquisition of attractive properties that will yield a high return, and the location of local management companies specializing in the local market, for the purpose of management of the properties and marketing of the space therein. The Company estimates that the success factors in the acquisition of such properties in the operating segment are, *inter alia*, location of worthwhile transactions and identification of opportunities in the market with a fast response capability, acquisition of properties in attractive, high demand locations with improvement potential, acquisition of properties of a high building and finishing standard, acquisition of properties with a range of related services that are not available in nearby properties which are competing for new contracts, performance of meticulous due diligence investigations, *inter alia* with respect to the expected expense structure in the property and the profit increase potential, the strength of the tenants in the property and the nature of the collateral, as well as knowledge of the financial markets and the various players therein for the purpose of achieving attractive financing terms.

10.6 **Main barriers to entry and exit in the operating segment and changes occurring therein**

Barriers to Entry - To the Company's belief**,** entities operating in this operating segment require mainly equity and financial strength which allow the acquisition of existing properties at relatively low financing costs. In addition, professional know-how, experience in the segment of acquisitions and management of income-producing properties, as well as know-how and experience in the credit and financing sector are important. Positive goodwill is another important element, both during tenders for the acquisition of income-producing properties and in order to attract attractive tenants to the properties.

Barriers to Exit - exiting this operating segment is conditional, mostly, on the ability to realize properties, which is a direct result of the location of the properties, their physical condition and the condition of the economy, as well as various costs, including in connection with land taxation.

10.7 **Structure of competition in the operating segment and changes occurring therein**

The income-producing property industry, in the U.S. and in Houston in particular, is characterized by a high level of competition. Competition in this segment revolves around a number of parameters, of which the principal ones are; (1) the geographic location of the properties and the level of demand for the space for lease in that area; (2) the amount of the rent and the management and maintenance costs; (3) the granting of incentives to new tenants or upon renewal of the lease agreement, such as improvements in the leased premises or a certain lease period in which the tenant will not be charged any rent; (4) the quality of construction of the leased buildings; (5) the level of related services; and (6) the reputation of the lessor. The competition in this sector exists both at the stage of acquisition of the properties and at the stage of lease-out of the properties. See Section 10.10 below for a description of the structure of competition in this operating segment.

10.8 **Manner of executing acquisitions of the Company**

For the purpose of the Group's development in this operating segment, the Group focuses, as of the Report Date, on the acquisition of existing and populated income-producing properties, and is not building new properties itself. In addition, the Company usually enters into financing agreements with different financing bodies for the purpose of the acquisition of the properties in this operating segment, usually under non-recourse terms (with exceptions standard in the U.S. with respect to which a guarantee of the Company is provided). See section 8.1.9 of Chapter A of the 2013 Periodic Report, which section is included herein by way of reference for a description of the manner of acquisition and exercise of the entire Group's rights in properties.

10.9 **Acquisitions performed in the Report Period**

For details with respect to the acquisition of an office building in Austin, Texas during the Report Period, see Section 1.3.1 above.

10.10 **Competition**

The income-producing property segment in the U.S. is, in general, characterized by a high level of competition in all aspects pertaining to the rent, the quality of the finishing of the building and other unique characteristics of the property. The Group is exposed in the U.S. to competition by numerous companies engaging in business property lease, in areas of demands similar to those in which the Group's properties are located. The market of leasable offices in Houston, Texas, constitutes approx. 212.5 million sq ft of leasable office space (of which approx. 115 million sq ft is defined as Class A), and includes a large number of properties. To the best of the Company's knowledge, several bodies are active in Houston, holding significant shares of the office lease areas segment[38], and the Group's share in the income-producing property segment in the U.S. is negligible.

The factors assisting the Company to deal with the competition in this segment are as follows: (1) The Company's office lease areas are located in high demand attractive areas, enabling the Company to lease the properties to numerous and diverse types of tenants; (2) most of the Group's properties in this operating segment have special characteristics, including: green building rating (LEED certification), financially sound tenants, attractive location adjacent to large retail

[38] According to figures appearing in MarketView insert, Houston, Office, Q4, 2016 published by CBRE in Q4 2016.

centers, as well as a high parking space ratio relative to the size of the property; (3) most of the Company's office space in this operating segment is characterized by a high building and finishing standard and has been granted the highest rating level of office properties (Class A).

The Group engages in this operating segment in management agreements with strong local entities which have vast experience in and deep knowledge of the local market, for the purpose of management and lease of the properties.

10.11 **Goals and business strategy in the segment**

See Section 26 of the Report for details on the Company's goals and the Group's strategy.

11. <u>The Senior Housing Segment</u>

11.1. <u>General information about the senior housing segment</u>

The Group's operations in the senior housing segment are presently concentrated under the "Palace" brand ("**Palace**" or the "**Palace Chain**") and it engages in the operation and development of senior homes for the elderly population that feature a high finishing standard and the provision of high-standard related services, which are designated for tenants who are capable of leading an independent life. As of the Report Release Date, the Palace Chain employs approx. 420 employees in total. As specified below, all senior homes of the Palace Chain operate LTC units (either inside or adjacently to the senior homes). The construction of LTC units is also planned for senior homes that are under development and construction.

During the Report Period, Palace continued to develop the senior housing business, following its purchase of the "Palace Tel Aviv" senior home in 2015 and the "Palace Ra'anana" senior home in the Report Period, as specified below. Palace has also purchased rights in three different sites designated for senior homes.

As of the date of this Report, Palace holds and operates two upscale senior homes as specified below:

1) **Palace Tel Aviv** – a senior home at the center of Tel Aviv, including an advanced medical center for recuperation and LTC, also known as "Palace Tel Aviv", which consists of 231 senior residential units, and "Palace Medical", which contains 136 beds in 4 different units (jointly: "**Palace Tel Aviv**");

2) **Palace Ra'anana** – a senior home in Ra'anana, including an LTC unit, also known as "Palace Ra'anana" (formerly: "Ahuzat Bayit"), which consists of 328 residential units and 67 LTC beds in two units ("**Palace Ra'anana**"), as well as an active retail center located adjacently to the senior home and known as Azrieli Ra'anana (formerly: "Park Mall").

Palace has also acquired the rights in three sites, on which it is planning and constructing additional senior homes which are in various stages of development and construction, including: (1) Palace Modi'in – a senior home in the city of Modi'in, which is in advanced construction stages as of the Report Date and is expected to comprise approx. 240 residential units and approx. 136 LTC beds ("**Palace Modi'in**"); (2) Palace Lehavim – land situated within the Lehavim Local Council, which is in advanced planning and construction stages toward the construction of a retirement village, which is expected to include approx. 350 residential units and approx. 36 LTC beds ("**Palace Lehavim**"); and (3) Palace Rishon LeZion - in March 2016, the Company won a tender issued by the Israel Land Authority for the purchase of long-term leasehold rights in a lot of approx. 3.4 thousand sqm designated for senior housing and situated in HaRakafot Neighborhood in East Rishon LeZion, which is designated for the construction of approx. 250 residential units, an LTC wing and approx. 3 thousand sqm of retail space ("**Palace Rishon LeZion**").

11.2. Structure of the senior housing operating segment and the changes occurring therein[23]

To the best of Palace's knowledge, recent years have seen an increase in the life expectancy of the elderly population in Israel, alongside a rise in the standard of living of such population. According to data from the Central Bureau of Statistics (CBS)[24], at the end of 2015, there were approx. 938,900 residents at the age of 65 years or older living in Israel, representing a rate of approx. 11.1% of the population of Israel's residents. Nearly one half of them (approx. 44%) are older than 75. According to population forecasts, by 2035 persons who are 65 years of age or older will be around 1,660,000 in number, representing approx. 14.6% of the population. According to CBS data and publications by Standard & Poor's Ma'alot ("**Ma'alot**")[25], alongside the increase in life expectancy, there is considerable improvement in the standard of living of the elderly, which is reflected in their increased participation in the Israeli employment market, an improvement in their physical, financial and social wellbeing, and an increase in their general satisfaction with their lives. In the elderly housing sector, a distinction may be made between two main solutions: retirement homes and senior homes. Most retirement homes are characterized by elderly residents of middle-to-low socioeconomic status, who are not independent and require constant nursing and medical services. Residents of the traditional retirement homes mostly share one room and their schedule is dictated by the retirement home's operator. According to Ma'alot's publications, retirement homes in Israel consist of approx. 10,000 residential units.

Unlike retirement homes, the senior housing market is aimed at an aged population which is financially established and mostly independent. Senior homes feature modern and luxurious services and facilities, including deluxe complexes that include expansive public areas containing facilities such as: a swimming pool, spa and fitness club, class rooms, restaurant, cafeteria, clinic, and the like. Senior homes provide a respectable and high-quality solution for the elderly, and allow the tenants to lead an independent life in the residential units, along with a social life in the public complexes and the provision of initial medical attention and LTC when necessary. According to Ma'alot's publications, as of the Report Date, the senior housing market consists of approx. 12,500 senior housing units. As a result of the increase and improvement in the life expectancy of the elderly as described above, and due to the desire of such tenants to conduct an active and social lifestyle, there has been an increase in the demand for senior residential units.

The Senior Housing Law, 5772-2012 (the "**Senior Housing Law**"), which took effect in 2012, has regulated operations in the Israeli senior housing sector for the first time. The Senior Housing Law prescribes various rules in relation to the permits and requirements for the operation of senior homes, including the duty to receive a senior home operation license, and also prescribes sanctions for the violation of such rules. For additional details with respect to the regulation of the senior housing sector, see Section 23.1.3 below.

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[23] This information is taken from the following sources:
Mashav (National Information Center for Old Age Planning) – the Elderly in Israel, Statistical Year Book 2014 - https://goo.gl/ouxS3D
The Central Bureau of Statistics – Press Release for the Senior Citizen Day of October 1, 2015 - https://goo.gl/CgI8GN
Amidar – Senior Housing – https://goo.gl/JAkoGT
Standard & Poor's Ma'alot – the Senior Housing Market in Israel – Potential for Expansion – 2015 - https://goo.gl/O4nLuM
Midroog – Rating of Senior Housing Companies in Israel – Methodological Report 2014 – https://goo.gl/1wAjC9
Globes Dun's 100 – Senior Housing Ratings for 2015 - https://goo.gl/Bj0Rjp
[24] The Central Bureau of Statistics – Press Release for the Senior Citizen Day of October 1, 2016 - https://goo.gl/EzVAjZ
[25] Ma'a lot – The Senior Housing Market in Israel, June 2015 - https://goo.gl/F3oj4l

Tenant agreements

Palace's engagements with the tenants of the senior homes are made by means of tenant agreements that grant the tenants the right to use the residential unit and the public areas and also grant them entitlement to the service basket offered and provided by every senior home to its tenants, *inter alia*, in view of the provisions of the Senior Housing Law and by virtue of the relevant engagement agreement. The language of the agreements with the tenants varies among the various senior homes operated by Palace (*inter alia*, considering the fact that some were purchased from previous owners), and according to the time of their signing and the provisions of the law at such time.

As a rule, the engagement is made by means of the standard track, i.e., the deposit forfeiture track, which includes the resident depositing a deposit for the duration of the term of the agreement. In most cases, the amount of the deposit is determined according to the location of the home and the services provided thereby, the size of the apartment and the finishing level, the levels of demand, and more (the "**Deposit**"). The tenant agreement determines the period over which the deposit will be forfeited (mostly over the course of 12 years) (the "**Forfeiture Period**") and the rate at which it will be forfeited every year (mostly a rate ranging between 3% and 4%, plus V.A.T. as required by law). At the elapse of the Forfeiture Period, the forfeiture of the Deposit comes to an end and the balance of the principal plus linkage differentials is repaid to the tenant or his heirs upon the expiration of the tenant agreement and the discontinuance of use of the residential unit.

The tenant agreement also specifies the collateral to be provided to secure the Deposit.

In view of the Group's financial soundness, Palace also enables tenants to engage in alternative tracks to the deposit forfeiture track described above, including a lease track in which the tenant pays rent on a monthly basis etc.; however, the scope of such tracks is significantly smaller than that of the track described above.

In addition to the forfeiture of the Deposit and/or the payment of rent as described above, the tenant agreement provides the amount of the monthly maintenance fees to be collected from the tenant. Subject to the provisions of the Senior Housing Law, Palace may increase the maintenance fees at a real rate and subject to an actual increase in the operating expenses of the home, and, in any event, by no more than the maximum increase rate specified in the tenant agreement.

11.3. Restrictions, legislation, standardization and special constraints applicable to the senior housing operating segment

For details with respect to restrictions, legislation, standardization and special constraints applicable to the operating segment, see Section 23.1.3 below.

11.4. Changes in the scope and profitability of the senior housing operations

According to the various publications as specified in Section 11.2 above, the increase in life expectancy combined with the increase in population and the improvement in the standard of living among the elderly population targeted by Palace lead to an increase in the scope of demand for high-quality and luxurious senior housing solutions in Israel and to the expansion of Palace's operations in the segment.

Furthermore, the increased awareness of the target group to the advantages of senior housing and the recognition that senior homes for the aged population are a respectable and high-quality solution for this population, while differentiating this operating segment from the image associated with traditional retirement homes, contributes to the development of this segment. As of the Report Date, Palace holds rights in three sites on which it is planning and constructing additional senior homes, and Palace's management expects that their completion and occupancy will increase the scope of its operations in the senior housing segment and turn Palace into a significant and leading player in the senior housing market in Israel.

The information regarding the factors which in the estimation of Palace's management may affect the scope of its operations in the senior housing segment and the implications thereof on Palace's positioning as a significant and leading player in the senior housing market as aforesaid, constitute forward-looking information, as defined in the Securities Law, 5728-1968, which is based on the estimations of Palace's management. Such estimations are based on external information sources and subjective assessments by Palace's management. Actual results may differ from the estimations so predicted.

11.5. Developments in the markets or changes in the characteristics of customers

As aforesaid, the scope of the operations in the senior housing segment is growing, as a result of the increased life expectancy of the aged population. This trend is also characterized by the desire of parts of such population to preserve the high standard of living and quality of life to which they have become accustomed during the years of their life, and the feeling of loneliness and lack of independence created due to the difficulty in accessibility to the various community services compared with the fulfillment of needs provided by senior housing. In addition, whereas the elderly population had been deterred in the past from moving to senior housing due to the negative image associated therewith and the poor level of services featured thereby, the senior housing setting presently provides a high quality of life while ensuring a safe environment that preserves the tenant's independence, cares for his health, ensures an active daily schedule, which includes culture, sports, social interaction and community, and facilitates living at a high level of comfort in luxurious centers. The entry of leading players such as Palace into the senior housing sector, which players introduce a modern construction standard of high-level senior homes into the sector, also contributes to the improvement of this image. These developments have brought with them new market demands for expansion of the services offered in senior housing. Therefore, recent years have seen an increased demand for an environment that offers, in addition to the basic services, a variety of social and cultural activities, such as a swimming pool, spa, classes, restaurant, cafeteria, alternative medicine services and more.

11.6. Critical success factors in the senior housing operating segment and the changes occurring therein

It is Palace's management's position that there are several critical success factors in the operating segment, which include: (1) Knowledge, experience and management: The senior housing segment is complex and requires experience in and knowledge of issues that are unique to the elderly population, with an emphasis on the operation of senior housing homes. The ability to optimally manage a senior home bears great importance in Palace's coping with the competition against the existing competitors in the sector; (2) Financial soundness: The Group's ability to withstand the costs involved in the construction, purchase and/or operation of premium high-level senior homes is critical to the subsistence of Palace's operations and its positioning as a leading player in the senior housing market, and may be a central consideration in the choice of a senior home by potential tenants. In addition, Palace's ability to provide collateral to the tenants and repay the funds of the Deposit deposited by them, as mandated by the Senior Housing Law, constitutes, in the estimation of Palace's management, a key success factor; (3) Structure of the senior home, the residential units and the surroundings: Since the senior housing sector is on the course of constant development, both in terms of the quality of the structures and residential units and in terms of the level and variety of services, it is necessary to maintain a high construction and finishing standard in the senior home and the public areas thereof, which constitutes a critical success factor in the sector; (4) Location and nationwide presence: A central and accessible location that also facilitates access to nearby centers, recreation and cultural institutions, convenient access to railway stations and public transportation as well as traffic arteries, in the area of the senior home, constitutes an advantage and a central consideration in the choice of a senior home. Furthermore, the location of the senior home in relation to the place of residence of the children and family and former life center of the tenant is a highly significant factor that affects the tenant's choice of such or other senior home. A more attractive location of the senior home brands it as a more luxurious place and affects the price and the amount of the deposits that may be charged for the residential unit; (5) The size of the residential center: A large residential center consisting of hundreds of residential units entails economies of scale in view of the number and diversity of the tenants residing therein, which enables and creates an abundance of activities and a vibrant community and social life; (6) Reputation and branding: The right branding of a senior home, i.e., the attribution of positive values such as quality, enjoyment, luxury, value for money, the branding of the company running the senior home, years' long reputation, the company's stability, etc., and the creation of a positive position and perception among consumers with respect to the senior home, bear importance in the positioning of the senior home in relation to its competitors; (7) Tenant satisfaction: Tenants who express high satisfaction with their standard of living in the senior home are a major marketing tool vis-à-vis potential clients, which has a high cost-to-benefit ratio. Palace ensures that it is attentive to the needs of the tenants and provides them with a quick response, while maintaining a high level of service and personal response to each and every tenant. Palace also holds various multigenerational events that involve the tenants of the homes and their families in order to expose Palace's senior homes and the services provided thereby to as many potential clients as possible.

11.7. Key entry and exit barriers of the senior housing operating segment and the changes occurring therein

In the estimation of Palace's management, the principal barriers for entry into the senior housing operating segment are:

(1) The need for unique knowledge, experience and reputation, which are required for the construction and management of a senior home;

(2) The need for material capital investments for the purpose of purchase or construction of modern senior housing homes of a high finishing standard and their marketing;

(3) The shortage of potentially economically viable land for the construction of senior homes;

(4) The ability to comply with regulation requirements that prescribe threshold conditions for the operation of senior homes;

(5) The requirement for financial soundness and current cash flow for the purpose of ensuring the ability to repay deposits, and, *inter alia*, the provision of collateral to the tenants according to the provisions of the Senior Housing Law.

In the estimation of Palace's management, the principal barriers for exit from the senior housing operating segment are:

(1) The difficulty in finding a purchaser for such operation due to the substantial scope of investment, the knowledge and the experience required for the operation of a senior

home under the provisions of the Senior Housing Law;

(2) Long-term contractual obligations and the difficulty in evicting tenants within a short time.

11.8. Alternatives to the senior housing sector and the changes occurring therein

As of the Report Date, the principal alternative to the senior housing sector is the residence of the elderly in households. In 2015, approx. 97% of persons 65 years old or older and approx. 89% of persons 85 years old or older were living in households[26]. Among the reasons that may be listed as leading to such high rates, one may specify the improvement in the lifestyle and health of the aged population in recent years, which allow for independent living, and the increase in the variety of services offered to the aged population at home (for example, emergency call centers, medical care at home, etc.). Furthermore, the ability to be assisted by live-in caregivers makes it easier for the elderly to stay at home.

Another alternative to the operating segment is retirement homes which are mostly characterized by elderly residents of middle-to-low socioeconomic status, who are not independent and are in need of constant medical and nursing services, with the cost of residence in such homes being lower than that of senior homes.

It is noted that Palace's management estimates that the existing alternatives on the market do not fully address the social and cultural life aspects that Palace offers in the senior homes, and the sense of security that senior homes provide to their tenants, which constitutes a significant consideration when choosing an alternative to senior housing,

11.9. Manner of performance of the Company's acquisitions

For a description of the manner of purchase and exercise of the Group's rights in properties, see Section 8.1.9 of the 2013 Periodic Report, which section is included herein by way of reference.

11.10. Acquisitions made during and after the Report Period

For details with respect to the closing of the acquisition of a senior home and the Azrieli Ra'anana Retail Center and the winning of a tender for the purchase of long-term leasehold rights with a senior housing designation in Rishon LeZion, see Section 1.3.1 of Chapter A of the Report.

11.11. Competition

To the best of Palace's knowledge, as of the Report Date, there are more than 50 entities operating approx. 100 senior homes in Israel, among which are Mish'an Center, Mediterranean Towers, Ahuzot Rubinstein, Bayit Bakfar and others, with half of them located in the Tel Aviv District. In the estimation of Palace's management, the following may be listed among the factors that affect the structure of the competition in the sector: (1) Geographical location, which constitutes a central consideration in the choice of a senior home by potential tenants, who tend to prefer a senior home located in proximity to their family members' place of residence or in proximity to their previous living environment; (2) The nature of the tenants in the senior home and their lifestyle, due to the importance of the cultural and social life that senior homes offer tenants; (3) The standard of the residential units, public areas and other

[26] The Central Bureau of Statistics - Press Release for the Senior Citizen Day of October 1, 2016 - https://goo.gl/EzVAjZ

facilities that the senior home offers its tenants; (4) The amount of the deposit and the usage fees collected from the tenants. In Palace's estimation, as of the date of this Report, Palace's market share in the senior housing market is approx. 4.5% based on the presently existing homes and irrespective of the operation of the Medical units.

Principal methods for coping with the competition

In order to preserve Palace's competitive position in the senior housing market and cope with the existing competition, Palace takes, *inter alia*, the following measures:

(1) Preserving and ensuring a high standard of services and maintenance in the senior homes. In Palace's estimation, the standard of maintenance and services that Palace provides its tenants is among the highest in the sector.

(2) Constructing new senior homes in attractive and competitive geographic locations, built to a high finishing standard that includes public areas, luxurious convenience facilities, including infrastructure for the provision of functional services according to the tenants' needs.

(3) Preserving and ensuring a high level of tenant satisfaction, attention to their various needs and quick personal response.

(4) Maintenance of an effective marketing and sales layout and branding of the chain as a premium chain under the "Palace" brand.

In the estimation of Palace, its competitive position is favorably affected by the following factors: The reputation and high branding of the existing homes (Palace Tel Aviv and Palace Ra'anana), impeccable management and service, the Group's financial soundness, presence in demanded marketing areas and more.

In the estimation of Palace, its competitive position may be adversely affected by the following factors: entry into and/or expansion of competitors into the senior housing market, mainly in the geographical areas in which Palace operates.

11.12. Goals and business strategy

For a specification of the Company's goals and the Group's strategy, see Section 26 of the Report.

12. The Granite Segment

12.1. General information about the Granite Segment

As of the Report Date, the Company, through Canit Hashalom, holds 100% of the issued and paid-up capital of Granite Hacarmel, which is mainly active in the marketing of alternative energy sources (LPG and natural gas) through its subsidiary Supergas, and in the treatment of water, wastewater and chemicals, through its subsidiary GES.

12.2. Alternative energy sources – general information

In the marketing of alternative energy sources, Granite operates through Supergas.

12.2.1. Marketing of alternative energy sources

Supergas is engaged in the marketing of alternative energy sources such as LPG, natural gas and compressed natural gas ("**CNG**"). Alternative energy sources are mainly used in the operation of industrial burners, the operation of ovens in bakeries and restaurants, the heating of institutions, the heating of henhouses in agriculture, and in household cooking and heating. In the context of such activity, Supergas purchases locally, imports, stores, markets and distributes LPG to industrial, business, institutional and household customers.

12.2.2. Restrictions, legislation, standardization and special constraints applicable to the operations of Supergas

The operations of Supergas are subject to laws, regulations and orders which pertain, *inter alia*, to the determination of specific instructions pertaining to the marketing of the products, to the determination of standards of quality, safety, security, storage, labeling and identification of products, transportation, proper business management, consumer protection, environmental protection, price control and various legislation and standardization restrictions. For details with respect to restrictions, legislation, standardization and special constraints applicable to the operations of Supergas, see Section 12.15 below.

Various regulatory requirements, including ones requiring compliance with strict safety requirements for the purpose of supply of LPG and CNG, compel Supergas to make considerable financial investments in order to comply therewith. See further details in Section 12.15 below.

12.2.3. Changes in the scope and profitability of Supergas

See Section 1.12.5 of the Board of Directors' Report ("Contribution of the Granite Segment to the Business Results").

12.2.4. Developments in the markets of the Supergas operations or changes in the characteristics of its customers

Recent years have seen an intensification of the competition in the marketing of alternative energy sources, mainly due to an increase in the number of competitors, which leads to a decrease in prices in the sector. However, Supergas' standard of service and reputation are also factors in customers' decisions on the choice of supplier in this sector.

12.2.5. Critical success factors in the Supergas operations and the changes occurring therein

The key success factors are: developed marketing, distribution and logistics, reliability of supply, ability to extend credit to customers, a developed billing and collection system, professional knowledge, safety level, service quality and price.

12.2.6. Changes in suppliers and raw materials in the operating segment

For details with respect to raw materials and suppliers, see Section 12.13 below.

12.2.7. Key entry and exit barriers of the Supergas operations and the changes occurring therein

LPG marketing requires gas supplier licensing. The receipt of such license and compliance with the conditions thereof, and with the conditions of additional provisions of the law that apply to those operating in this sector, entail considerable investments in manpower and equipment.

Natural gas operations require engagement for the purchase of natural gas. CNG operations require the receipt of a license from the Ministry of National Infrastructures, Energy and Water Resources (the "**Ministry of National Infrastructures**").

Supergas has long-term contractual engagements with suppliers and customers, which might be a barrier to exit the sector. Furthermore, the vacating of various sites and facilities may involve costs and may also serve as an exit barrier.

12.2.8. Structure of the competition in the Supergas operations and changes occurring therein

For details with respect to the structure of the competition in the operating segment and changes occurring therein, see Section 12.8 below.

12.3. Products and services

Alternative energy sources

Supergas is primarily engaged in the marketing of LPG, natural gas and CNG. Supergas' products serve as energy sources in the operation of industrial burners, the operation of ovens in bakeries and restaurants, the heating of institutions, the heating of henhouses in agriculture, and in household cooking and heating. LPG is marketed to customers in movable gas containers (of 12 kg and 48 kg capacities) and by means of the refilling of gas in immovable bulk gas containers located on the customers' premises. Supergas also markets to its customers LPG-operated devices (water heaters, heaters and household radiators). Natural gas is marketed to customers by means of the natural gas distribution network directly to plants or by means of conveying CNG in containers to plants to which the distribution network has not yet arrived.

12.4. Breakdown of revenues and profitability of products and services

Supergas' revenues from the operations of marketing alternative energy sources in 2014 and 2015 and the Report Period totaled NIS 544,384 thousand, NIS 498,921 thousand and NIS 504,806 thousand respectively, which respectively represent 24%, 21% and 21% of the Company's total revenues.

12.5. Customers

Supergas' customers in the alternative energy sources segment include industrial customers, various institutional and commercial customers, customers engaged in agriculture, commerce and private households. Supergas is also the only LPG supplier to the Israel Defense Forces

(IDF), the Israel Police and the Israel Prison Service.

Supergas' engagements with its commercial customers include installation of the equipment, storage of the LPG, and with some customers – the supply of customer-premises equipment. The term of Supergas' engagement with its customers is affected, *inter alia*, from the amount of investment in the equipment made available to the customer. With its institutional customers, engagements are mostly based on the winning of tenders.

Supergas is not dependent on a single customer or a small number of customers, whose loss would materially affect it. Furthermore, Supergas has no single customer the revenues from whom are 10% or more of the total revenues of Supergas.

12.6. **Marketing and Distribution**

Marketing of alternative energy sources

Supergas markets its products both directly and through independent agents that act to seek and engage with customers. LPG sales to household and small business customers are also carried out through call centers located in the various branches of Supergas. LPG supply to customers is carried out by means of transportation of movable gas containers (of 12 kg and 48 kg capacities) and by means of the transport of LPG in tanks for the purpose of refilling immovable bulk containers (of various capacities) located on the customers' premises.

Supergas, through wholly-owned subsidiaries thereof, acts to market natural gas and CNG among potential institutional and industrial customers in various regions all across the State of Israel. For the marketing of natural gas, Supergas has recruited professionals that specialize in the planning and construction of natural gas and CNG systems, in order to provide the customers with services of conversion of the energy systems installed with the customers to working with natural gas. The supply of natural gas to the customers is carried out by means of the gas pipe that runs from the Tamar Reservoir to the natural gas reception terminal at the shores of the State of Israel, and subsequently on to the national transportation system and the regional distribution networks. Supergas is dependent on such gas pipe. In addition, Supergas markets CNG in tanks to plants which the transportation system has not yet reached.

12.7. **Order backlog**

Most of the orders of alternative energy sources' products are delivered a short time before the supply date.

12.8. **Competition**

The alternative energy sources market is characterized by the existence of competition, both with respect to the product types and with respect to the marketing and distribution to commercial, institutional and private customers. The products marketed by Supergas face competition against various fuel products, which are also used in the operation of industrial burners and ovens. In recent years, competition between the companies operating in the segment has increased, which led, *inter alia*, to an increase in discounts to customers and to flexibility in the credit extended to customers and the terms of payment. The market features strong competition, as the product marketed by Supergas and its competitors is uniform.

In LPG marketing, Supergas' main competitors are Pazgas Ltd., the American Israeli Gas Corporation Ltd. (known as Amisragas) and New Dorgas Ltd. There are also several other small gas companies in the market. In the estimation of Supergas' management as of the Report Date, Supergas' market share in LPG marketing is approx. 18%.

In natural gas marketing through the distribution network, Supergas' main competitors are Dor Alon Gas Technologies Ltd., Delek Natural Gas Ltd., Amisragas, and Oshrad Natural Gas Ltd.

The principal considerations taken into account by customers when choosing an LPG and natural gas supplier are: a professional engineering and technical layout, supply reliability, safety, service and the price of the product. Supergas dedicates efforts to the improvement of its customer service, *inter alia*, by improving availability, safety and reliability. Supergas further acts to enhance its employees' professional knowledge.

12.9. **Seasonality**

LPG consumption is affected by seasonality. LPG sales in the wintertime are higher, since LPG is used for heating, among other things.

12.10. **Fixed assets, real properties and facilities**

12.10.1. Alternative energy sources

Supergas operates two main logistic facilities for the storage, refilling and supply of LPG: (1) A storage, refilling and distribution facility in Kiryat Ata in an overall area of approximately 15 thousand sqm. This area is leased by Supergas from the Israel Land Administration. The facility includes LPG warehouses with an overall storage capacity of approx. 300 tons in bulk tanks and approx. 250 tons in containers; (2) a central logistics center located in the Ramla industrial zone in an overall area of approximately 4.4 thousand sqm. This area is leased by Supergas from the Israel Land Administration. The facility includes a warehouse for the storage of LPG cylinders with an overall storage capacity of 100 tons, equipment warehouses, a heating department, a workshop, a laboratory and a machining shop; (3) In addition, Supergas leases storage volume of approx. 1,500 tons in the facilities of EAPC in Ashkelon, which allows it, *inter alia*, to import LPG, accumulate a stock of LPG thereby reducing LPG importation in wintertime.

In addition, Supergas also stores LPG in tanks installed on the customers' premises, and lends its customers equipment owned thereby (gas containers, regulators and gas meters) against a deposit according to the State Economy Arrangements Regulations (Legislative Amendments) (Gas Sector – Replacing a Gas Supplier), 5751-1991.

Supergas holds a plant for natural gas compression in the Alon Tavor Industrial Zone, in the total area of approx. 11 thousand sqm. The plan includes an advanced system for the treatment of natural gas that arrives at the plan by means of the transportation network and the compression thereof to high pressure. CNG is transported to the customers' premises by means of tanker trucks held by Supergas.

12.11. **Intangible assets**

12.11.1. Trademarks

Supergas has registered trademarks by which it is recognized as a longstanding, known and dominant company in the Israeli market. The principal trademarks are: "Supergas Israeli Gas Distribution Company Ltd.", which includes Supergas' logo, and "Supergas Natural", which includes the logo of Supergas Natural.

12.11.2. Distribution rights

Over the years, Supergas has acquired gas distribution rights from agents that had worked therewith in various geographic areas. The payments paid for the purchase of the rights are presented in the Financial Statements as distribution rights at the reduced cost of NIS 51 million.

12.11.3. Licenses

Supergas holds a gas supplier license from the Ministry of Natural Infrastructures for LPG purchase and marketing in portable and immovable containers, KPG transportation, LPG refilling in portable containers and LPG bulk storage, LPG purchase and marketing in non-refillable containers and LPG purchase and marketing to gas-operated vehicles in fueling stations. Furthermore, Supergas Home Ltd., a wholly-owned subsidiary of Supergas, holds a gas supplier license for LPG purchase and marketing in portable and immovable containers.

Supergas Natural holds a CNG supplier license from the Gas Authority at the Ministry of Natural Infrastructures for the refilling and unloading of movable pressure containers via a fixed compression station or fixed unloading facility, and for the transportation and storage of movable pressure containers to consumers and their transportation back to the compression facility for refilling by means of CNG tanker trucks.

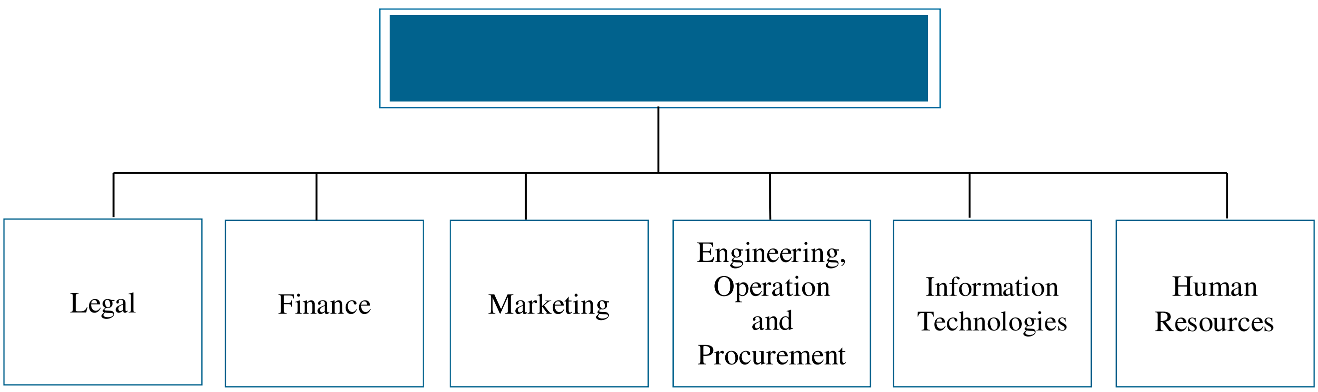
Super N.G. Ltd. ("**Super NG**") and Super N.G. Hadera and the Valleys Ltd. ("**Super NG Hadera**") hold licenses for the construction and operation of a natural gas distribution network.

12.12. Human capital

12.12.1. Organizational structure and workforce

Supergas places a special emphasis on the quality of human capital, by employing professional manpower possessing knowledge and vast experience in the variety of fields required within the areas of its operations. Most of the Company's employees, mainly in the management ranks, have substantial tenure with the Company and extensive experience in the fields of its operations.

12.12.2. The following chart describes Supergas' organizational structure as of the Report Date:



As of December 31, 2016, Supergas employs approx. 350 employees. The following table specifies the breakdown of employees into the main fields:

Position	Number of Employees December 31, 2016	Number of Employees December 31, 2015
Officers and senior management	6	6
Marketing and sales	250	258
Finance	27	31
IT	4	4
Human resources and administration	2	2
Engineering, operation and procurement	63	70
Total employees	352	371

12.12.3. Investments in training, instruction and development of the human capital

Supergas holds professional training and instruction sessions for its employees, according to the employee's position and the needs of Supergas. Supergas' employees participate, *inter alia*, in exhibitions, seminars and study days on various matters pertaining to Supergas. Instruction sessions on safety, fire, work at heights and so forth are conducted according to the duties prescribed by the provisions of the law applicable to Supergas and its operations. Furthermore, a special emphasis is placed on instruction sessions on safety and service.

12.12.4. Employment agreements

The 255 employees employed by Supergas and its subsidiaries are employed under the provisions of two collective bargaining agreements that are periodically updated in negotiations (about once in three years). Such collective bargaining agreements are currently in negotiations toward the extension thereof (according to the agreed negotiation arrangements). Until their formal renewal, the collective bargaining agreements continue to apply, are automatically renewed for an additional period, as per the law. In the event of disagreements in the negotiation, industrial peace clauses apply until the resolution of the disputes.

The collective bargaining agreements regulate the entire employment relations, and, *inter alia*, the employment terms and conditions (including for specific groups such as technicians), social benefits (pension or managers' insurance, advanced study fund, leave, sick leave, recuperation and the like), participation in expenses such as telephone and vehicle, prior notice, dismissal, confidentiality and non-competition, discipline and more.

The employment terms and conditions of other employees, including the officers and senior management employees, are regulated by means of personal agreements and their conditions are individually determined.

12.13. **Raw materials and suppliers**

12.13.1. Alternative energy sources

Supergas, as other gas companies in Israel, is dependent on Oil Refineries Ltd. ("**ORL**") and Oil Refineries Ashdod Ltd. ("**ORA**"), as primary and central suppliers of LPG. In the event that ORL and ORA do not provide Supergas with the quantity of LPG it wishes to purchase therefrom, and Supergas is required to increase the quantity of LPG directly imported thereby, a preparation period will be required and additional costs may be involved. Such import will be subject to and contingent on finding a solution to the existing problem of lack of sufficient storage space for the imported LPG and ability to unload the same. However, it should be noted that ORL and ORA are obligated by law to refrain from discrimination in the supply of LPG to their customers. Due to the increase in LPG consumption in the winter months and the inability of the Israeli refineries to supply such quantities, a shortage of LPG occurs in the winter months. Therefore, Supergas imports LPG. The price of imported LPG is mostly higher than its purchase price from the refineries in Israel.

In 2014, 2015 and 2016, Supergas purchased from Israeli refineries approx. 83%, approx. 73% and approx. 73% of the total amount of LPG purchased thereby, respectively. The rest of the LPG purchased by Supergas was purchased primarily from import.

The State Economy Arrangements Regulations (Legislative Amendments) (Gas Sale by Refineries and Gas Suppliers), 5770-2009, prescribe the quotas to be supplied by refineries to gas marketing companies in months of shortage. See Section 12.15 below with respect to these regulations.

Supergas purchases the natural gas it markets to its customers from the Tamar partnership, which produces the natural gas from the Tamar Reservoir situated in the Mediterranean Sea. Supergas, as the other natural gas marketers, is completely dependent on the Tamar partnership, which is the sole source of natural gas supply.

The Leviathan Reservoir, located in proximity to the Tamar Reservoir, is a potential gas source for future use. According to public information held by Supergas, the estimated gas quantity in the Leviathan Reservoir is significantly larger than the quantity in the Tamar Reservoir. As of the Report Date, commercial use of the Leviathan Reservoir is not yet available.

12.14. **Environmental risks and their management**

12.14.1. General

Supergas deems environmental protection, the prevention of environmental hazards, and adherence to maximum safety in all components of its business operations, as values of utmost priority. Supergas dedicates great resources and time to realize this purpose. However, due to Supergas' operations and its working with hazardous substances, it involves several environmental risks stemming from the possibility of Supergas' operations leading to various environmental hazards. To cope with such environmental risks, Supergas acts for increased safety in its various operations and for compliance with the mandatory provisions of the law pertaining thereto.

Supergas routinely acts for implementation of and compliance with the provisions of the law and regulation applicable thereto, including the directives and instructions of the Ministry of Energy and the Ministry of Environmental Protection. Supergas is also in constant contact with the municipalities relevant to its operations, the Israel Fire Services and any other relevant authority – all, in order to prevent environmental hazards and minimize potential environmental risks.

12.14.2. Environmental risks bearing material implications

LPG is a hazardous substance to both those working therewith and the environment. Improper activity and/or use thereof may cause explosion, flare-up, or poisoning, and consequently harm persons, the environment and property. Working with LPG thus dictates extra care in adhering to various safety rules and taking various precautions, which Supergas follows and acts for assimilation thereof amongst its employees and suppliers. Due to the aforesaid and as shall be further specified below, Supergas' operations is subject to various provisions of law; various regulatory provisions; requires various approvals and licenses and is reviewed by various administrative authorities, such as the Ministry of Energy and the Ministry of Environmental Protection.

Supergas has permits for the construction and operation of LPG repositories across the country, including the logistics center in Ramla and Supergas' refilling, storage and distribution facility in Kiryat Ata. For the past several years, the facility in Kiryat Ata has not had a business license due to the municipality's refusal to grant a business license, as aforesaid. For the legal proceedings pertaining to the gas farm in Kiryat Ata and the conditions required for its operation, see Notes 33B4 and 33B5 to the Financial Statements. Supergas has an approval from the Israel Fire Services for the Kiryat Ata facility, effective until January 2018, in the context of which the facility will operate in a reduced scope as a refilling and distribution facility, while reducing the quantities of LPG held -all according to the restrictions prescribed in such approval.

Poison permit – The Hazardous Substances Law, 5753-1993, prescribes that the holding of LPG in a site at which the amount of LPG storage exceeds 8,000 kg requires a "poison permit" from the official in charge authorized by the Minister of Environmental Protection. Furthermore, a poison permit is also required for the natural gas compression plant in Alon Tavor. Following discussions between Supergas and the Ministry of Environmental Protection, the Ministry's approval for the continued operation of the gas farm in Kiryat Ata has been obtained, in the outline specified in the approval issued until June 3, 2017 and permitting Supergas to use the facility subject to conditions specified in the permit.

Furthermore, Supergas holds poison permits for the refilling and supply facilities owned thereby.

12.14.3. <u>Civil, tortious and criminal liability and administrative sanctions</u>

In view of the nature of its activity and business, Supergas is exposed to various civil, criminal, administrative and tortious claims, inter alia in cases of damage occurring as a result of various incidents related to LPG or natural gas. This may adversely affect Supergas' business results, its business and its goodwill. In order to insure its assets and its liability deriving from the work with hazardous substances as aforesaid, Supergas purchases standard insurance policies customary in Israel. Such policies are subject to various exclusions and restrictions. There is no certainty that the coverage and/or the liability caps of the policies cover all of the risks involved in Supergas' business.

In addition, due to the provisions of the law and the regulation applicable thereto, Supergas is exposed to the initiation of criminal proceedings against it, including the filing of indictments against its officers and itself, and to the imposition of various administrative sanctions thereon. A conviction of criminal offenses might lead to a criminal record against the officers of Supergas and against the Company and to the imposition of heavy fines on Supergas. Administrative sanctions against Supergas might lead to the imposition of (temporary or permanent) bans on Supergas' business or parts thereof.

12.15. **Restrictions and Supervision over the operations of Supergas**

Set forth below is a concise review of laws, regulations, orders, restrictions and requirements pertaining to Supergas' business:

Licensing and safety

The Gas Law (Safety and Licensing), 5749-1989 (the "**Gas Law**") regulates the matter of licensing of gas suppliers and the matter of safety in work with gas. The law requires, *inter alia*, receipt of a license for the supply of gas and for the performance of gas work and receipt of a permit for the installation of gas facilities. The Gas Law further requires that gas systems be tested periodically.

In addition, there are binding standards for gas containers, gas systems, the installation of a central gas system etc. Standardization includes, *inter alia*, a labeling duty, technical instructions, pressure tests and safety tests that must be carried out prior to the supply of gas, as well as the performance of routine periodic tests for LPG containers and for gas systems and facilities.

As gas is defined as a hazardous substance, various activities with gas require permits under the Hazardous Substances Law, 5753-1993 (the "**Hazardous Substances Law**"). The Hazardous Substances Law prescribes that no person shall work with poisonous substances unless holding a poison permit from the commissioner as defined in the Hazardous Substances Law. Supergas has a general poison permit for its activity and also for facilities thereof which require a poison permit as aforesaid.

In the framework of its operations, Supergas transports, both itself and through subcontractors, LPG and CNG, which, as aforesaid, are deemed hazardous substances. For the purpose of such operation, Supergas holds an appropriate license for transportation and a license for transportation of hazardous substances according to the Transportation Regulations.

Purchase of LPG from the refineries

In 2007, control over the refineries by way of setting a maximum LPG price was lifted and in its stead, supervision is effected by way of reporting on profitability, prices and quantities. If one or more of the following cases takes place: (1) the refineries fail to comply with the reporting duties applicable thereto in relation to quantities and prices of petroleum products; (2) it transpires that the refinery sold LPG at a price exceeding the import price in the month preceding the month in which the sale was made; or (3) the refinery supplied LPG to different consumers at a different price at the same time - control of the ex-refinery LPG maximum price shall be reinstated.

Furthermore, in 2009, regulations[27] were promulgated, which regulate the matter of LPG sale by the refineries. Among other things, the regulations define new, small and large gas suppliers, and the corresponding gas allocations to such suppliers in months of shortage, i.e. months in which the refinery is unable to supply the full gas demand therefrom.

Control of LPG prices

The Control of Prices of Commodities and Services Order (Application of the Law to LPG), 5770-2010 prescribes that supervision over LPG will be at the level of reporting on

[27] The State Economy Arrangements Regulations (Legislative Amendments) (Gas Sale by Gas Suppliers and Refineries), 5770-2009.

profitability and prices according to Chapter G of the Control of Prices of Commodities and Services Law, 5756-1996 (the "**Control of Prices of Commodities and Services Law**"). The manner of reporting on LPG profitability was published under the said order in May 2010, and according thereto gas marketing companies, including Supergas, shall annually furnish the Supervisor of Prices with data as stated in the manner of reporting on profitability.

September 2011 saw the publication of the report of the Socioeconomic Change Committee (the "**Trajtenberg Committee**"), in which report the Trajtenberg Committee proposed to impose, for the short term, control over the ex-refinery and retail LPG prices, which would lead to their reduction. At the same time, the Trajtenberg Committee proposed to set up a governmental team that would propose further reform in the LPG sector.

In May 2013, a letter from the Ministry of National Infrastructures was received at Supergas' offices, from which letter it arises that the Director of the Fuel and Gas Administration and the Supervisor of Prices at the Ministry of Energy are considering recommending the imposition of control over LPG prices in sales via central gas dispensers and via containers to the private sector, further to the supervision at the level of profitability reporting as described above. The letter includes a preliminary draft of attribution of Supergas' costs to the LPG margin, which was prepared by the Fuel Administration and is based, according to the letter, on data submitted by Supergas and data processing by the Ministry of National Infrastructures. Supergas responded to the Ministry of Energy and, *inter alia*, rejected most of the calculations and assumptions underpinning the said letter.

As of the Report Release Date, it has not been decided whether such control will be imposed. Insofar as control is imposed, the manner of its imposition and the implications thereof are unclear. Therefore, Supergas is unable to predict the effect of control on the Company, if and insofar as imposed.

Moreover, the Control of Prices of Commodities and Services Order (Determination of Control Level and Maximum Prices for a Deposit for Gas Equipment), 5776-2015 defines the maximum deposit prices that a gas supplier may charge a domestic gas consumer for the supply of gas equipment, and prohibits the collection of a deposit for gas equipment not listed in the order. The order also sets, *inter alia*, provisions concerning an update of the deposit price and a refund of the deposit to the consumer.

<u>Promotion of competition in the gas sector</u>

In the context of increasing the competition in gas for domestic consumption, laws and regulations were enacted with respect to the conduct of gas companies vis-à-vis domestic consumers. Such laws and regulations regulate, *inter alia*, the manner of replacing a gas supplier, the prohibition on retention actions vis-à-vis customers who have given a gas supplier replacement notice, the refunding of gas deposits, the grant of option to an incoming gas supplier to purchase the gas tanks from the outgoing gas supplier etc.

Supergas is also subject to various provisions in the framework of its being an entity that provides a service to consumers, both in the context of the Consumer Protection Law (such as scheduling the time for technician arrival, maximum hold time for human telephone response, etc.) and in the context of specific legislation (such as which services are included in the gas price, various provisions concerning the manner of charging for gas consumption, conduct vis-à-vis debtors, etc.).

June 2015 saw the entry into effect of regulations took pertaining to the provision of information concerning gas supply. Such regulations impose a duty on gas suppliers to provide the consumer, on the gas invoice, with the addresses of the other consumers connected to the same central gas system or with an identification code for the supplier's website where such addresses will be available. In addition, gas suppliers are required to transfer, at the beginning of every month, to the Director of the Gas Administration, a report specifying the average prices charged to domestic consumers in the two months preceding the report, broken down by local authority, the type of gas infrastructure (12/48 containers, portable container, immovable container) and the type of service provided (e.g., installation, connection and supply). The Director of the Gas Administration is entitled to post the report also on the website of the Ministry of National Infrastructures. Moreover, any gas supplier that has a website is obligated to post the appropriate report on such site.

In addition, additional legislative amendments were made in the Arrangements Law for the Years 2017-2018, the purpose of which is to increase competition in the gas sector and address, *inter alia*, a change of the majority of apartment owners required to replace the gas supplier, the prevention of discrimination between consumers connected to the same tank and in the deposit fees.

<u>Draft of the Liquefied Petroleum Gas Bill, 5776-2015, various draft regulations and various orders</u>

The Draft Bill, the new draft regulations and the new orders (which have been published for the public's comments) seek to regulate, *inter alia*, the licensing duty of LPG suppliers (including by agents) those engaged in LPG work, the validity term of the license of LPG suppliers, the duty to test LPG facilities and LPG-consuming appliances prior to the supply of LPG and once per the period to be determined, the duty to supply LPG only to a consumer with whom there is a written agreement, the duty to take out insurance to cover the liability of the LPG supplier for any incident in the sum no lesser than U.S. $5 million, the order of the actions to be taken upon a gas incident, etc.

In addition to the safety aspect, the Gas Bill proposes to authorize the Minister of National Infrastructures, Energy and Water Resources, in consultation with the Consumer Protection Commissioner and with the approval of the Knesset's Economic Affairs Committee, to determine criteria regarding the level, nature and quality of the services provided by an LPG supplier license holder. In early 2016, Supergas provided its response to the aforesaid Bill, arguing, *inter alia*, that the proposed amendment includes many unreasonable and unconstitutional provisions as well as provisions that will damage the LPG market in the State of Israel. The Ministry of National Infrastructures is presently working on the publication of a new draft bill, while addressing the comments of Supergas and additional gas companies. Furthermore, Supergas also provided its comments on the draft regulations and the various orders and is presently awaiting the revised drafts.

<u>Natural gas operations</u>

Supergas' operations in the natural gas marketing sector is subject to the provisions of the Natural Gas Sector Law, 5762-2002 (the "**Gas Sector Law**"), which is the principal law regulating the Israeli natural gas sector. The Gas Sector Law prescribes, *inter alia*, that engagement in activities of construction and operation of a transportation system or part thereof, construction and operation of a distribution network or part thereof, and construction and operation of a storage facility, are prohibited, unless done pursuant to a license granted by the Minister of National Infrastructures and in accordance with the conditions thereof.

The Gas Sector Law further prescribes that the following are prohibited from engaging in the sale and marketing of natural gas: (a) a transportation license holder; (b) an electricity supplier.

According to the Gas Sector Law, engagement in the sale and marketing of natural gas does not require a license, but the Minister of Infrastructures may determine, upon the fulfillment of the conditions prescribed by the Gas Sector Law and with the consent of the Minister of Finance and approval by the Knesset's Economic Affairs Committee, that, for a period to be determined, engagement in natural gas marketing will require a license.

In April 2013, the Control of Prices of Commodities and Services Order (Application of the Law to Natural Gas and Determination of Control Level), 5773-2013 and an announcement by the Supervisor of Prices at the Ministry of National Infrastructures were published, whereby every marketer or anyone that has signed a contract for the marketing or sale of natural gas, is required to report on the profitability and prices of natural gas, once every six months, on the dates and in the manner published by the Supervisor.

Antitrust

Since 1999 Supergas has implemented an internal enforcement program in the format defined by the Antitrust Authority (the "**Antitrust Authority**"). Supergas updates the internal enforcement program from time to time and follows the outline defined therein for efficient and effective internal enforcement of the provisions of the Restrictive Trade Practices Law, 5748-1988 (the "**Restrictive Trade Practices Law**"), the regulations and the orders promulgated thereunder. Participation in the program increases the awareness of Supergas' employees and managers as aforesaid of the requirements of the Restrictive Trade Practices Law and opens up channels of communication between the employees and the senior management of Supergas, and also between them and the officer in charge of internal enforcement of the Restrictive Trade Practices Law, as appointed by Supergas' management. Beyond the aforesaid, through the enforcement program, Supergas is doing everything in its power to ensure that Supergas, its managers and its employees act and will act in accordance with the provisions of the law, thereby reducing the exposure of itself and its managers and employees to legal proceedings related to this matter.

On September 13, 2016, investigators of the Antitrust Authority arrived at Supergas' offices for the purpose of collecting documents in connection with an investigation conducted by the Authority, on the suspicion of violation of the Restrictive Trade Practices Law.

Standardization and quality control

Supergas markets its products in accordance with various standards that are relevant to the marketing and supply of LPG which are published from time to time by virtue of the Standards Law, 5713-1953. The standards specify technical requirements that apply to products including with respect to product specifications, methods of production, storage, supply, operation etc.

Supergas is certified under quality standard ISO 9001-2000, which concerns quality assurance for the production-supporting management processes. Once every six months the Standards Institution of Israel holds an audit of compliance with the procedures and requirements. Supergas has also been certified under safety standard OHSAS 18001. Supergas has systems for quality control, security and quality management in accordance with the requirements of such standards. Compliance with the procedures and requirements is inspected by the Standards Institution of Israel every six months. Supergas has specific employees who are in charge of quality assurance.

12.16. **Material agreements**

Construction and operation of natural gas distribution networks

In the segment of construction and operation of natural gas distribution networks, Supergas acts through Super NG and Super NG Hadera, which are equally held by Supergas and by Shapir Civil and Marine Engineering Ltd.

In November 2009, Super NG was granted a license for the construction of a natural gas distribution network in the central region and for the operation thereof for a term of 25 years. Under the terms and conditions of the license, Super NG is obligated to invest approx. NIS 160 million in the construction of the distribution network, which sum will be paid over the course of 8 years according to the milestones specified in the license, and it will receive its revenues from a one-time connection fee and from the distribution fee tariff according to the size of the customer (the extent of natural gas consumption).

Super NG has several signed contracts with customers for natural gas distribution services. In September 2015 an approval for piping natural gas to a distribution pipe at the Ramla Industrial Zone was received. As of the Report Date, the consumers in this area have yet to begin consuming natural gas.

In view of bureaucratic and regulatory difficulties which are delaying progress with rollout of the network and the connection of consumers, Super NG is acting to update the timetables set in the license.

In April 2013, Super NG Hadera was granted a license for the construction of a natural gas distribution network in the Hadera and Valleys region and for the operation thereof for a term of 25 years. Under the terms and conditions of the license, Super NG Hadera is required to invest NIS 217 million in the construction of the distribution network, which sum shall be paid over the course of 5 years, according to the milestones specified in the license, and it will receive its revenues from a one-time connection fee and from the distribution fee tariff according to the size of the customer (the extent of natural gas consumption).

Super NG Hadera is working on the completion of planning of first sections of the distribution network and continues to develop the construction of the network.

In view of bureaucratic and regulatory difficulties which are delaying progress with rollout of the network and the connection of consumers, Super NG Hadera is acting to update the timetables set in the license.

The shareholders of Super NG and Super NG Hadera have also provided, according to their holdings, a guarantee in favor of the Natural Gas Authority, in accordance with the terms and conditions of the tender and the license.

Treatment of Water, Wastewater and Chemicals

12.17. General information about GES

In the water, wastewater, chemicals and environmental protection sector, Granite operates through GES and consolidated companies thereof (the "**GES Operations**"). GES engages in engineering design, construction and production, operation and maintenance of plants for water filtration and improvement, seawater desalination, pumping stations and water pools, treatment of well water and treated wastewater and treatment of sanitary, industrial, municipal and organic wastewater. In addition, GES, by itself and thorough its subsidiaries, engages in marketing and development of chemical products for the purpose of metal treatment and protection, and also in the importation and marketing of oils, adhesives and chemicals for industry.

12.17.1. Structure of the competition in the GES Operations and changes occurring therein

GES and its consolidated companies act in this sector through two divisions:

The water and wastewater division

The division engages in the production, construction, operation and maintenance of seawater and brackish water desalination plants; wastewater treatment and treated wastewater reclamation; water betterment and wastewater treatment in the industrial sector; water purification and wastewater treatment in the municipal sector; implementation of special chemicals for the treatment of water and wastewater, desalination and cooling towers for the municipal and industrial sector; provision of system operation and maintenance services; planning and production of systems for wastewater and water treatment. GES presently operates approx. 70 plants all across Israel (approx. 40 water treatment plants and approx. 30 wastewater treatment plants).

Industrial chemicals division

The division engages in production, importation and marketing of chemicals and finishing processes for metals; chemicals for the preparation of surfaces for painting and industrial paint strippers; electrochemical coating materials for the high-tech and electronics industries; industrial cleaning materials; special industrial adhesives and lubricants and chemicals for water and an operation of solvent recycling for parts washers.

12.17.2. Restrictions, legislation, standardization and special constraints applicable to the GES Operations

The GES Operations in the operating segments thereof is subject to various laws, regulations, orders and permits related to health and environmental protection. Thus, as regards the quality of drinking water and the quality of treated wastewater, its operations are subject to the provisions of the People's Health Ordinance and the regulations promulgated thereunder. As regards environmental protection, the GES Operations are subject to the provisions of permits for disposal into the sea and authorization orders for disposal into a stream under the Prevention of Marine Pollution by Land-Based Sources Law, 5748-1988, the Water Law 5719-1959 and the Water Regulations (Prevention of Water Pollution) (Use and Disposal of Sewage Sludge), 5764-2004. The GES Operations are also subject, *inter alia*, to the provisions of poison permits under the Hazardous Substances Law and to specific provisions determined with respect to the provision of services and the marketing of products. The GES

Operations are further subject to standardization with respect to quality, safety, security, the storage of raw materials and products, their labeling, their identification and transportation, and also to the provisions of the law with respect to business licensing and consumer protection laws. For details with respect to restrictions, legislation, standardization and special constraints applicable to the operating segment, see Section 12.28 below.

12.17.3. Changes in the scope and profitability of the GES Operations

See Section 1.12.5 of the Board of Directors' Report (the contribution of the Granite Segment to the results of the operations).

12.17.4. Developments in the markets of the GES Operations or changes in the characteristics of its customers

Recent years have seen a development trend in the water and wastewater industry. The increased awareness of the shortage of clean water in various parts of the world, including Israel, alongside technological developments that led to reduced water treatment costs and saturation in the desalination and water treatment sector in Israel. On the other hand, increased regulation and enforcement create opportunities in the wastewater treatment industry.

12.17.5. Critical success factors in the GES Operations and the changes occurring therein

In the water and wastewater segment

The integration and implementation of advanced water and wastewater treatment methods and technologies, which lead to energetic and operational streamlining, are a factor that affects the production costs in the water and wastewater plants constructed and operated by GES. Such streamlining leads to tenders being won and to engagement in agreements in the water and wastewater segment for the sale and operation of water and wastewater treatment plants, in Israel and abroad.

In the chemicals segment

The production and distribution of high-quality chemicals of world leading producers to customers that demand high-quality and not necessarily inexpensive products.

12.17.6. Changes in suppliers and raw materials

Several factors, which are specified below, support the continued activity of construction, upgrade, operation and maintenance of plants for the treatment and desalination of wells and for the treatment and purification of wastewater and reclamation thereof for industrial and agricultural use, and possibly even an increase in the use of such means. Thus, such factors include the shortage of drinking water in some areas of Israel, the high costs of the potable water used both for drinking and for industry along with the damage to wells due to the salification and contamination of aquifers in past years and the strict enforcement of the regulation that governs the treatment of municipal and industrial wastewater. For details with respect to raw materials and suppliers, see Section 12.26 below.

12.17.7. Key entry and exit barriers of the GES Operations and changes occurring therein

The principal barriers for entry into operations in GES's business field in the desalination and treatment of water and wastewater, are the accumulation of proven experience in the construction and operation of similar plants, which is a threshold requirement in most tenders and engagements in the sector, skilled and experienced manpower, including water and wastewater engineers and technicians, and the receipt of the appropriate contractor licenses required for the purpose of construction of plants of such type.

The principal barriers for exit from this field are the completion of the construction of the plants, supply of which has been undertaken by GES, expiration of the warranty period granted in the framework of the plant construction agreements, and the ending of maintenance and operation agreements undertaken by GES.

In the chemicals sector in which GES operates, the principal barriers for entry are the existence of a suitable production facility, which requires approvals by various authorities, chief of which is the Ministry of Environmental Protection, and the knowledge required for the production of the materials, as well as engagements with leading producers in the world for the receipt of intellectual property usage rights for the purpose of producing and supplying ready-made products for sale and distribution.

The principal barriers for exit from this segment mainly pertain to the ending of the lease agreement of the production facility's premises and the duties imposed on GES in connection with the requirements of the law and the Ministry of Environmental Protection in the vacating of land on which operations of such type were conducted.

12.17.8. Structure of the competition in the GES Operations and changes occurring therein

For details with respect to the structure of the competition in the GES Operations and changes occurring therein, see Section 12.21 below.

12.18. **Products and Services**

12.18.1. Water and wastewater segment

The primary systems used by GES for the treatment of water and wastewater are: membranal high-pressure systems for the separation of salts, systems of filtration and purification through chemicals and various filters, anaerobic and aerobic systems for the treatment of industrial and municipal wastewater and systems for the treatment of sewage sludge. The systems include dosage, command and control units.

GES offers its customers a broad range of water and wastewater treatment systems and solutions, the principal of which are: Brackish water and seawater treatment systems; wastewater treatment systems; well betterment and improvement plants; water treatment methods based on diverse technologies; treatment of steam systems and energy centers; plants for the desalination of treated wastewater to irrigation standard.

GES offers customers project supervision and management, including construction, professional support and backup services, which include the instruction of operators at the customer's site, professional advice and consultation in the operation of the project, maintenance and operation services, monitoring and supervision for the purpose of performing process optimization and the performance of periodic surveys and ongoing maintenance of the project.

12.18.2. Chemicals segment

The principal services and products of GES in the chemicals segment include surface treatments, adhesives and sealing materials, chemicals for electrolytic coating and printed circuit boards, special industrial lubricants, industrial maintenance products, recycling of industrial cleaning materials and chemicals for water.

12.19. **Customers**

GES's customers include water corporations and local authorities, government-owned companies and industrial companies.

12.20. **Marketing and Distribution**

GES invests great efforts in diverse marketing activities in each of its operating segments. Such marketing activities include the following:

(1) Domestic sales agents – some of GES's people are domestic sales agents who are on the ground on a daily basis in order to identify new customers, address the needs of existing customers, and market GES's products.

(2) Distributors – in the chemicals segment, there are some 10 large distributors (mostly stores) nationwide, through which GES markets some of its products.

(3) Management and maintenance of informational websites at the addresses: www.ges.co.il and www.ges-texma.co.il, which include an extensive description of the company's operations and products and contact information.

(4) Activity amongst professionals – GES maintains relations with professionals in the context of exhibitions (in Israel and abroad), professional conferences, training sessions, seminars, etc.

(5) Tenders – GES has a system for identifying tenders and requests for proposals for the performance of projects relevant to its operating segments, including the preparation of tender bids and proposals for such requests.

In addition, GES conducts export activities in all of its operating segments. Most of GES's products marketed abroad are marketed under the "GES" brand.

12.21. **Competition**

In its operating segments, GES faces competition by a large number of companies engaged in the construction of systems for water purification and wastewater treatment, as well as companies engaged in the manufacture and import of chemicals. Competition exists both in the search for and identification of new customers and in the provision of high-quality services in all of GES's operating segments. Competition revolves around prices, service quality, financing terms and technical specifications. The operations of the divisions of GES in the fields of projects and operation have a large number of competitors, including: Nirosoft, Rimon, E.L.D., Elco, Winter, Odis, IDE, Palgey Maim, Lesico, Shtang, Mekorot Development, T.G.L., Minrav, Baran, Shikun & Binui Water, EPT, Hutchison, Ludan, Elad, Jetline, and D.S. Service Provision.

In the chemicals segment, each of the division's product lines has several significant competitors that produce and/or import alternative products to the division's products, such as: Amza and Elad Technologies in chemicals, Nalco and YWCT in water chemicals, Layogev, Pronat and Rotal in adhesives, and the large energy companies (Paz and Delek) in lubricants.

12.22. **Production Capacity**

GES's production layout is centered in two sites: Akko South and Askar (in the Akko area).

Water and wastewater segment

The production layout responsible for the construction of water and wastewater treatment systems is based in the Askar site, which is situated in the municipal area of Regional Council Matteh Asher. GES has the capacity to simultaneously produce a large number of plants. In cases of multiple orders, GES has the ability to transfer production for the performance of the orders by subcontractors.

Chemicals segment

The Akko South site, which is situated in the municipal area of the Akko Municipality, hosts the production layout responsible for the production of special chemicals for the treatment of metals, water, wastewater, desalination, and cooling towers for the municipal and industrial sectors.

All finished products in the chemicals segment are manufactured to order. Under GES's policy, the production site does not produce a regular inventory of finished materials, but rather per customers' orders.

GES uses approx. 60% of the production potential of the production site. The potential production capacity is approx. 5,000 tons of various types of chemicals, assuming that production work is performed in two shifts per 24 hours, with work presently performed in one shift.

12.23. **Fixed Assets, Real Property and Plants**

GES and its wholly-owned subsidiary GES Plant Operation Ltd. have several water and wastewater treatment plants in the framework of BOT and BOO agreements with the private and municipal sectors. GES has machines and equipment that are used to produce chemicals and an evaporation plant for the treatment of industrial wastewater, which are situated in the Akko South production site.

GES's production layout is centered in two sites: Akko South and Askar (in the Akko area), which are leased from a third party. GES's water and wastewater division has the capacity to simultaneously produce a large number of plants.

12.24. **Intangible Assets**

12.24.1. Trademarks

GES has a trademark on goods and services supplied thereby which include: the provision of environmental protection solutions, seawater and brackish water desalination, wastewater treatment and treated wastewater reclamation, water betterment and implementation of special chemicals for water treatment.

The registration of the trademarks is highly important, since they serve as means for the identification of GES's products in its business field with GES.

12.24.2. Distribution rights

In the chemicals segment, GES has a large number of marketing and distribution agreements with companies in Israel and around the world which are leading in their fields. Under such agreements, GES is the official representative in the marketing, production and import of these companies in Israel.

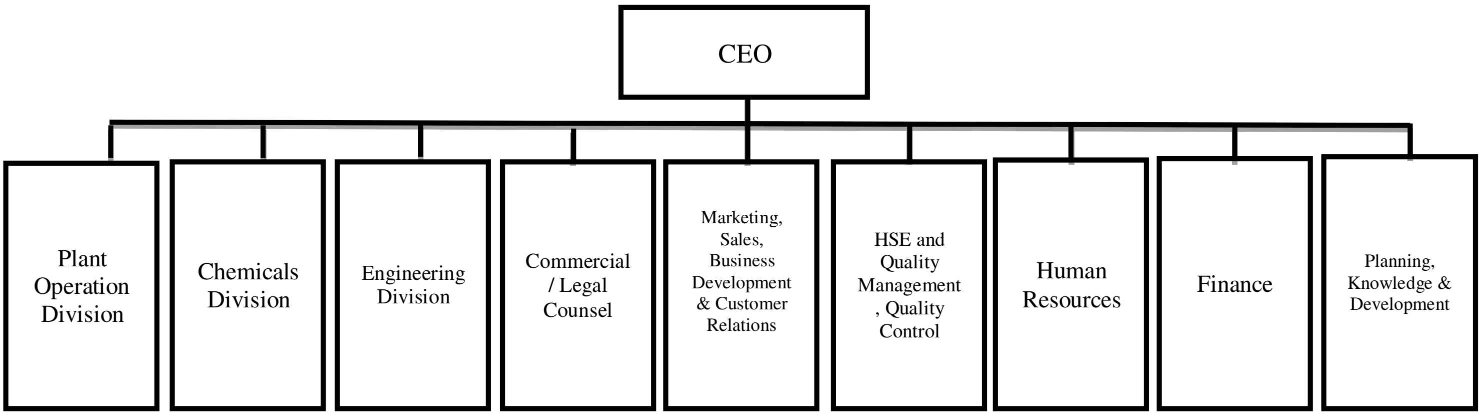
12.24.3. Marketing and distribution Agreements

The chemicals segment has a large number of marketing and distribution agreements with companies in Israel and around the world which are leading in their fields. Under such agreements, GES is the official representative in the marketing, production and import of such companies in Israel.

12.25. **Human Capital**

As of December 31, 2016, GES employs approx. 210 employees.

12.25.1. A description of the organizational structure of GES follows:



12.25.2. Breakdown of employees by position:

The breakdown of GES's employees is detailed below:

Position/Division	Number of Employees December 31, 2016	Number of Employees December 31, 2015
GES Management	23	22
Water and Wastewater Division		
Production and operation	94	85
Marketing and sales	20	21
Chemicals Division		
Production and operation	32	30
Marketing and sales	41	35
Total employees	**210**	**193**

12.25.3. Benefits and the nature of employment agreements

GES employs permanent employees, 49 of whom are employees who are subject to special collective bargaining agreements. GES is not dependent on any particular employee.

The other employees of GES are employees employed under personal employment agreements, temporary employees employed under the rules of the special collective bargaining agreement and the general labor law, seasonal employees, and contractor employees engaged under agreements with employment agencies.

The permanent, monthly and temporary employees are divided as follows:

Permanent employees are divided into two groups as follows:

(1) Permanent employees employed under a collective bargaining agreement **–** As of the Report Date, this group consists of 45 employees (Generation A and Generation B). The terms and conditions of their employment are provided by a collective bargaining agreement of 1988, which is valid to date. GES employees working in the production department, workshop and junior clerks (according to an agreed list of professions) are subject to the terms and conditions of such collective bargaining agreement.

(2) Permanent employees under personal agreements – As of the Report Date, this group consists of 167 employees. Standard employment agreements apply between GES and such employees which provide, in most cases, the employee's salary, working hours, social benefits, such as managers' insurance, provident funds, pension funds, advanced study fund, entitlement to leave, recuperation pay and sick leave, participation in mobile telephone expenses, reimbursement of *per diem* expenses, the period of prior notice for resignation and for dismissal, confidentiality and non-competition. Most of the employees are employed based on an overtime-inclusive salary. About 50% of the employees receive a company vehicle for their use for the purpose of fulfilling their duties. Salespersons are granted quarterly incentives. All personal contracts include an express provision as to the application of Section 14 of the Severance Pay Law, 5723-1963, and the balance is covered by full severance pay contributions.

Monthly employees are employed under special personal agreements in a part-time position and receive their wages on an hourly basis. Most of the monthly employees are students who work at GES as part of the performance of a final project or internship. At the end of the period, they terminate their employment or join GES as regular employees.

In addition, GES has agreements in place with several employment agencies for the placement of temporary professional employees. The temporary employees are usually employed for specific purposes and for predefined time periods.

12.25.4. Liabilities for the termination of employment relations

The liabilities of GES and its subsidiaries to employees for the termination of employment relations are covered by current payments to insurance companies for managers' insurance policies, pension funds and provident funds, and by a provision in the Group's financial statements reflecting liabilities thereof which are not so covered.

12.26. **Raw Materials and Suppliers**

The main raw materials used by GES for the water and wastewater operation are: finished equipment, which includes pumps, membranes, pressure cabins, tanks and chemicals for the operation of water and wastewater plants. Such raw materials and equipment items are acquired from leading companies in the world. All of the purchased raw materials and parts are checked by a quality control lab and the Quality Assurance Department of GES according to international standards. In some cases, equipment items are manufactured specifically for GES according to defined requirements for specific projects, especially when particularly good abilities and quality of materials are required according to the customer's demand. Supply times of such equipment range from one month to a period longer than one year. Substantial raw materials are mainly purchased from local suppliers, and parts are also imported, mainly from the U.S., Canada, Korea and European countries.

In the chemicals operation, GES uses numerous raw materials for its and its customers' purposes, the principal ones of which are: 60% nitric acid and technical hydrochloric acid. These raw materials are purchased chiefly from the local market. All of the purchased raw materials are checked by a quality control lab and the Quality Assurance Department of GES. Supply time of the raw materials in the chemicals segment is immediate when purchased from the local market and around two months when imported. Most of the imported raw materials are purchased from U.S. and European suppliers.

12.27. **Environmental risks and their management**

12.27.1. GES's operations of industrial and sanitary wastewater treatment, recycling of materials and water treatment and betterment, and production and distribution of chemicals (including adhesives, lubricants, oils) are subject to the environmental protection provisions relevant to the operating segment. Operations in such fields are performed under the supervision of the Ministry of Health which performs routine tests to examine the quality of the water generated in the treatment plants and in the desalination plant, and under the supervision of the Ministry of Environmental Protection and the Water Authority over the quality of the wastewater treatment in the treatment plants and compliance with the production permit. In addition, in the context of this activity, supervision is exercised also by government authorities such as the Ministry of Environmental Protection, the Water Commission and the Water Economy Administration, the local authorities and the water and sewage corporations.

Under various provisions of the law and permits issued thereto, GES is obligated to comply with stringent standards with respect to the drinking water desalinated in its plants and the treated wastewater discharged into streams and into the sea or used in agriculture.

GES treats industrial wastewater created in the production of chemicals at GES's Akko South production site in full and in accordance with the provisions of the law and the requirements of the Ministry of Environmental Protection and the Municipal Association for Environmental Protection.

The implications of failure in the treatment of byproducts (such as sewage sludge and brine) created in the context of GES's operations constitute a risk of environmental hazard and soil contamination. Deviation from the provisions of the law and the requirements of the Ministry of Environmental Protection and the Municipal

Association for Environmental Protection might lead to health damage or environmental damage, including the supply of substandard drinking water, harm to agricultural crops and soil contamination. GES also handles and trades in poisonous and hazardous substances within its business operation of manufacture and distribution of products in the segment of water and industrial chemicals and within the maintenance of GES's water and wastewater treatment plants. GES has valid poison permits and a hazardous substances certification.

GES's chemicals production site includes a wastewater treatment plant. The plant treats the wastewater of the production site and the wastewater of customers transported to GES's plant with the approval of the Ministry of Environmental Protection.

Furthermore, since a large part of the GES Operations is based on the use of chemicals, GES is supervised by the Ministry of Environmental Protection and the municipal authorities and is committed to the protection of the environment and to working in accordance with the environmental standards, laws and regulations of the Ministry of Environmental Protection and the relevant municipal associations, including the provisions of the Hazardous Substances Law.

12.27.2. <u>GES's policy on environmental risk management</u>

GES's policy is to fully comply with all of the requirements of the provisions of the law pertaining to environmental protection. GES's business is in the field of treatment of industrial and sanitary wastewater, recycling of materials and treatment and betterment of water, and production and distribution of chemicals (including adhesives, lubricants, oils). GES regularly implements Environmental Protection Standard ISO 14001 and is annually certified by the Standards Institution of Israel.

GES implements an internal environmental enforcement program, under which periodic inspections are performed in order to ascertain that the company's operations in the various sites comply with the requirements of the various environmental protection laws and the business licenses applicable to the various plants operated by GES. GES conducts environmental and occupational monitoring on an annual basis to ascertain that there are no deviations from the level permitted under the standardization.

Once every three years, GES conducts a job safety analysis (JSA) in all of the company's sites and carries out the remedial actions required pursuant to the analysis.

GES employs a full-time safety and environmental protection manager, whose responsibility includes management, monthly supervision of sites, training and the organization of emergency teams for an environmental incident, investigation of incidents and implementation of remedial actions, in order to reduce the exposure to environmental risks.

GES annually carries out occupational medical check-ups for employees who are exposed to hazardous substances and to noise in their work, in accordance with the provisions of the law. The check-ups for the employees and the medical follow-up are performed by the occupational clinic of the Rambam Hospital.

In the framework of GES's operations both in the water and wastewater treatment segment and in the chemicals production and distribution segment, use is made of materials defined as hazardous substances under appropriate licenses and poison permits issued for the purpose of water and wastewater treatment and also due to their being a raw material for the production of chemicals, which are also defined as hazardous substances. Failures in the production, operation, storage, use or transportation of such substances might lead to environmental hazards or to accidents, such as: flare up, air pollution, soil contamination and more. The GES Operations in such fields is performed under an environmental enforcement program in which exposures have been and are mapped, and based thereon, emphases are made and preventive action is taken and considerable management resources and input are invested.

12.28. **Restrictions on and Supervision of the GES Operations**

12.28.1. Water and wastewater

This operation in Israel is subject to various legal provisions that regulate environmental protection and the quality of the water and wastewater treated by GES in the various plants, chief of which are the Water Law and the regulations thereunder, the Prevention of Marine Pollution by Land-Based Sources Law, the Water Regulations (Prevention of Water Pollution – Use and Disposal of Sewage Sludge), the People's Health Ordinance and the regulations thereunder, the Water and Sewage Corporations Law and their rules, the Hazardous Substances Law, the Environmental Protection Law (Emissions and Transmissions to the Environment – Register and Reporting Duties) and more. Such laws, ordinances and regulations prescribe a line of provisions pertaining to the protection of water sources and the prevention of water contamination, the quality of the water and treated wastewater produced at the plants, the types of treated wastewater, the manner of disposal of the sewage sludge and wastewater in various cases, the hazardous substances that are used and the manner of storage thereof, the emission of contaminators from the GES plants and more. In addition to the aforesaid, GES operates in accordance with and by virtue of certificates, permits and specific instructions by the various authorities.

12.28.2. Chemicals

This operation is subject to various legal provisions that regulate environmental protection, chief of which is the Hazardous Substances Law and the regulations thereunder, the Clean Air Law, the Environmental Protection Law (Emissions and Transmissions to the Environment – Register and Reporting Duties) and more. Such laws, ordinances and regulations regulate the manner of preventing the emission of contaminators from GES's production plants and the reporting of such emissions, procurement, storage, production and trade in the hazardous substances distributed by GES and more. In addition to the aforesaid, GES operates in accordance with and by virtue of certificates, permits and specific instructions by the various authorities.

February 2013 saw the publication of the Organization of Labor Inspection Regulations (Safety Management Program), 5773-2013 (the "**Safety Regulations**"). The Safety Regulations took effect in August 2014 (18 months as of the date of publication thereof), and are applicable to a "Factory", within the meaning thereof in the Work Safety Ordinance [New Version], 5730-1970, wherein at least 50 workers are employed. Under the Safety Regulations, the Chemical Division is required to conduct an occupational health and safety management program, with the purpose of preventing work accidents and occupational diseases, reducing the risks to the employees and complying with the legislation's requirements on issues of occupational health and safety. The Safety Regulations further prescribe that the "Holder of the Workplace" (as defined in the Regulations) will be responsible for compliance with the provisions thereof, will act to ensure the implementation of the program and will take the appropriate measures in order to ensure that every employee appointed by him follows the provisions. As of the Report Date, it appears that the Safety Regulations do not have a material effect on the manner and costs of the operations of GES.

GES holds all of the licenses and permits required by law, as aforesaid.

12.29. **Granite Segment – other operations**

Other than the operations described above, Granite is a 50%-partner in a limited partnership that has built and operates a unique tourist attraction known as "Mini Israel", which presents miniature models of renowned Israeli sites.

12.30. **Goals and business strategy**

Supergas and GES periodically examine their strategic plans and update their goals according to the developments in the markets in which they operate. Supergas seeks to expand the range of energy solutions provided thereby to its customers and to expand and diversify its customers in its operating segments. Supergas and GES also act for the constant improvement of customer service and for strict compliance with safety and environmental protection rules, and also act for the identification of new business opportunities.

13. **<u>The Sonol Segment – Discontinued Operations</u>**

13.1. Until July 2016, the Group operated through Sonol in two principal business sectors: direct marketing and fueling and retail complexes. The Group, through Granite Hacarmel, held 100% of the rights in Sonol.

13.2. In accordance with the Group's strategy of focusing on the core areas of the real estate business and its ongoing examination of holdings that are not within its core business, on April 14, 2016, Granite Hacarmel entered into a transaction for the sale of all of its holdings (100%) in Sonol to Israel Oil & Gas Fund L.P., a limited partnership incorporated in Israel, the general partner of which is controlled by Mr. David Weissman, in consideration for a total sum of NIS 363.5 million, most of which will be paid on the transaction's closing date (subject to certain adjustments stipulated in the agreement), and some of which will be paid on a date subsequent to the transaction's closing date. As part of the transaction, it is agreed that as of the transaction's closing date and for a 4-year period, the Company and Granite Hacarmel will not compete with Sonol's business. This obligation does not apply to the operations and business plan of the Supergas Group.

On July 24, 2016, in view of the fulfillment of the conditions precedent specified in the agreement, the transaction was closed, without material change. On the closing date and thereafter, the purchaser paid such part of the consideration as was scheduled for payment on the closing date. For further details, see the Company's reports of June 18, 2015, October 26, 2015, February 2, 2016, April 14, 2016, June 19, 2016 and July 24, 2016 (Ref.: 2015-01-050991, 2015-01-141945, 2016-01-021562, 2016-01-048793, 2016-01-052239, and 2016-01-088873, respectively), which are included herein by way of reference.

13.3. In view of the sale of Sonol and in accordance with GAAP, as of the transaction's closing date, Sonol is presented in the Financial Statements as discontinued operations. For further details, see Note __ to the Financial Statements.

PART FIVE: ADDITIONAL OPERATIONS

14. Azrieli Group - Additional Business

14.1. The e-commerce business

On June 2, 2016 the Company closed a transaction for the purchase of an e-commerce business from Buy2 Networks Ltd. This business is currently operated by Azrieli E-Commerce (formerly Netex New Media Ltd.).

This company has operated an e-commerce website since 2010. Such website operated, until February 2017, under the brand name "Buy2" ("**Buy2**"). As of February 2017, this website was re-launched by Azrieli E-Commerce under the brand name "Azrieli.com" at the address www.azrieli.com ("**Azrieli.com**" or the "**E-Commerce Website**")

Azrieli.com offers internet users a range of products and services, which are supplied by various businesses of various areas, including electricity and electronics, home and garden, parents and children, and more. Furthermore, the E-Commerce Website grants internet users benefits that vary from time to time, including free shipping and express deliveries to the customer's home and payment in installments.

Azrieli.com facilitates a comprehensive solution of online marketing and sale for businesses that seek to sell products and services at Azrieli.com, including the storage of products in a central logistics center, the sale, supply and distribution of products to the customer's home, through third parties. Azrieli E-Commerce works on the development of long-term relations and work interfaces with the businesses active on Azrieli.com, aiming to retain and increase the cooperation. Alongside the sale of the businesses' products, Azrieli E-Commerce selectively purchases products it sells on the E-Commerce Website and supplies such products to customers by means of third parties.

In addition to the aforesaid business, as part of Azrieli.com's operations, the website displays a range of domestic tourism and foreign tourism (an operation in cooperation with a third party).

Azrieli E-Commerce employs some 65 employees and its offices are located at the industrial zone of Hod HaSharon.

General description of the E-Commerce Business

Recent years saw changes in the shopping habits of Israeli consumers alongside technological changes that enable online shopping and render a larger range of online-offered products and services available to the consumer. Online shopping enables quick and convenient service which is customized to the consumer's consumption habits and preferences. In recent years, the e-commerce business in Israel has been developing at an accelerated pace and this sector is expected to double by 2020 and reach approx. NIS 15 billion, which are expected to represent approx. 12% of the Israeli retail market in that year[28].

Concurrently with the increase in the range of products purchased online by Israeli consumers, there is a noticeable increase in online shopping on international websites (such as eBay, AliExpress, Next and Amazon). In the estimation of Azrieli E-Commerce, the volume of the activity is affected by the volume of private consumption and changes in Israeli consumers' use of the internet. Use of the internet by means of mobile devices, such as tablets and cellular telephones, may contribute to greater exposure and availability of e-commerce services.

[28] http://tasc-consulting.com/_Uploads/dbsAttachedFiles/ecommerce.pdf

Entry and exit barriers

The setup of a line of suppliers, while developing ties and retaining the relationship therewith, may serve as an entry barrier to new players in the short-term and the mid-term. Furthermore, the development of the technology required for the operation of the e-commerce business in similar form and scope and the need to generate a high rate of user traffic may serve as entry barriers to new players, *inter alia*, due to the great importance of the website's reliability and the high costs involved in the recruitment of user traffic. Moreover, the building of a registered user database, including the ability of mailing thereto, also serves as an entry barrier.

Exit barriers may stem from the need to convert a complex set of agreements with various suppliers, and also from the need to preserve the brand name and its credibility among the public of customers.

Restrictions on and supervision of the operations

The e-commerce operations are subject to various laws, such as: the Consumer Protection Law, 5741-1981 and the regulations thereunder, the Privacy Protection Law, 5741-1981, the Communications Law (Telecommunications and Broadcasting), 5742-1982, and the Debit Cards Law, 5746- 1986. .

Furthermore, since purchases on Azrieli.com are made by means of credit cards, various provisions and restrictions required by the credit card companies apply, including security standard PCI.

Competition

The e-commerce market is a competitive market and includes competition by international websites that offer shipping to Israel (such as eBay and AliExpress) along with Israeli e-commerce websites, such as Walla! Shops, Shufersal, GetIt, and Daka 90, as well as the websites of other companies on which such companies directly offer their products for sale.

In the estimation of Azrieli E-Commerce, the success factors in the e-commerce operations are, *inter alia*: (a) The offering of high-quality products and services on attractive terms to internet users; (b) Engagement with reliable businesses, in a blend addressing a broad array of internet users; (c) User traffic and the size of the mailing list; (d) Reliable and available customer service; (e) Technological improvements and innovations that contribute to the improvement of the quality of the website's applications, with an emphasis on the devising of simple and user-friendly interfaces. In addition, the development of innovative sale formats for optimal exhaustion of the retail platform; (f) Compliance with supply time obligations, which contributes to the increase of the number of repeat purchases by Azrieli.com customers.

The Company's estimations with respect to the e-commerce operations, including the development of such operations in Israel, the increase in online purchases and the volume of operations in the segment constitute forward-looking information, within the meaning of this term in the Securities Law, 5728-1968, which is based on publications in the field and subjective assessments by the Company's management as of the Report Date. There is no certainty that such estimations will materialize, in whole or in part, and they may also materialize in a materially different manner, *inter alia*, changes in market conditions, changes in customer preferences, competition and deterioration in the economic situation, which might affect customers' consumption habits.

14.2. Investments in financial assets available for sale in the banking and finance sector

14.2.1. Investment in Leumi Card

On May 26, 2008, the Company invested the sum of NIS 360 million, as a passive financial investment, in Leumi Card (the total investment less a dividend received as of the Report Date, is NIS 314 million), and in consideration for which Leumi Card issued shares to the Company representing 20% of the issued and paid-up capital of Leumi Card (post money and on a fully diluted basis) (the "**Investment Agreement**"). The Company's investment in Leumi Card is presented on its books as an available for sale financial asset, according to GAAP. The value of the Company's investment in Leumi Card as of December 31, 2016, in accordance with an independent valuation was approx. NIS 562 million.

Within the framework of the Investment Agreement, the Company undertook to comply with and fulfill regulatory requirements to be imposed, if any, on the shareholders of Leumi Card, in its capacity as an Auxiliary Corporation, as this term is defined in the Banking Law (Licensing), 5741-1981. To the best of the Company's knowledge, as of the Report Date, no regulatory requirements as aforesaid have been imposed on the Company except as specified below.

On May 6, 2010, for the purpose of clarifying the lack of material effect of the Company on Leumi Card, the Company's board of directors decided to irrevocably waive the Company's voting rights in connection with two percent (2%) of the issued and paid-up capital of Leumi Card held thereby, such that, in view of the said waiver, the Company is holding 20% of the issued and paid-up capital of Leumi Card and 18% of the voting rights therein.

Within the framework of the Investment Agreement, the Company and Leumi Card undertook to one another, *inter alia*, as follows:

a. **Recommendation on the appointment of directors** – The Company will be entitled to recommend the appointment of two directors to the board of directors of Leumi Card, as well as their removal from office and the appointment of others in their stead, with one director serving as an outside director according to the provisions of Proper Conduct of Banking Business. The agreement provides that should the Company's holdings decline to less than 20% due to a sale of shares or transfer thereof to an unauthorized third party, or less than 18% as a result of a private placement of Leumi Card shares, or less than 15%, the Company will be entitled to recommend the appointment of only one director. The Company's right to appoint directors shall expire in the event that its holdings decline to less than 10% due to a sale of shares or transfer thereof to an unauthorized third party or in any other event in which its holdings decline to less than 8%. On May 6, 2010, further to the said resolution of the same date, the Company's board of directors resolved to irrevocably waive the right to recommend the appointment of another director to Leumi Card, as an outside director. As of the Report Date, only one director holds office on behalf of the Company on the board of directors of Leumi Card, which consists of 8 directors (3 of whom are outside directors).

b. **Letter of indemnification** – In the agreement, the Company granted Leumi Card a letter of indemnification, under conditions back-to-back with the conditions of the letter of indemnification provided by Bank Leumi Le-Israel Ltd. ("**Bank Leumi**") in favor of the directors holding office at Leumi Card (and as long as it shall not have been changed without the advance written consent of the Company), whereby in any event in which Leumi Card will be obligated to indemnify the directors holding office therein on behalf of the Company, the Company will indemnify Leumi Card, upon receiving its written demand, for any amount paid by Leumi Card as aforesaid.

c. **Rights upon a transfer of shares** – The Company will have the right to tag along in a sale and/or transfer of control in Leumi Card to a third party who is not an authorized transferee of Leumi Financial Holdings Ltd. ("**Leumi Holdings**"), Leumi Card's controlling shareholder, until the occurrence of certain events which are specified in the agreement, such as a public offering. In addition, Leumi Holdings was granted a right of first refusal and a bring-along right vis-à-vis the Company upon a transfer of shares.

d. **Shareholder financing –** The parties have undertaken to provide financing to Leumi Card proportionately to their holdings at such time, pursuant to a resolution of the board of directors of Leumi Card. The agreement sets forth dilution formulae for the dilution of a party which does not finance its share as aforesaid.

Dividend policy in Leumi Card

The dividend distribution at Leumi Card is subject to the directives of the Supervisor of Banks, including compliance with capital adequacy restrictions mandated by the Basel Directives. Dividend distribution is allowed subject to the provisions of the Companies Law, which stipulates, *inter alia*, that the Company may perform a distribution out of its profits, provided that there is no reasonable concern that the distribution would deny the Company of its ability to comply with its existing and projected liabilities, when they become due. On February 23, 2016, Leumi Card board of directors decided on the distribution of a dividend in the amount of NIS 50 million which was paid on March 1, 2016. The Company's share out of the total said dividend is NIS 10 million. According to the dividend distribution policy document, which was updated and approved by Leumi Card's board of directors, it was decided on February 22, 2017 to distribute a dividend in the amount of NIS 50 million (approx. NIS 0.2 per share). The distribution date was scheduled for March 1, 2017. Leumi Card's financials are publicly posted on Leumi Card's website and are available for inspection at the following link:

https://www.leumi-card.co.il/he-il/GeneralPages/Pages/FinancialReport.aspx

Loyalty Program

On May 26, 2008, the Company entered into a cooperation agreement with Leumi Card for the establishment of a program for the benefit of customers of the commercial centers and malls owned by the Company and/or affiliates of the Company, whose members would hold a Leumi Card card conferring special benefits and services (the "**Loyalty Program Agreement**").

The Loyalty Program Agreement regulates the relationship between the parties, and, *inter alia*, sets forth provisions with regards to the terms of the loyalty card to be issued to the customers of the commercial centers and malls of the Company and its design, including the Company's rights to the loyalty program trademark and the member database, and registration thereof in its name.

On January 7, 2010, the Company entered into a licensing agreement with Leumi Card for the use of trademarks, whereby the Company granted Leumi Card an exclusive license to use all of the trademarks registered in the Company's name in connection with the "Multi Azrieli" mark, in connection with a loyalty program of same name.

The license is effective throughout the term of the Loyalty Program Agreement and subject to the conditions thereof. During 2011, the Company registered the trademark "Multi Azrieli" with the Registrar of Patents, Designs and Trademarks at the Ministry of Justice, including the registration of the Leumi Card as a licensee of the "Multi Azrieli" trademark, in accordance with the said licensing agreement.

In the agreement, the Company undertook to employ a management team to manage the Program's activities throughout the term of the agreement, at an annual cost that shall not exceed the amount of NIS 250,000, to be financed by Leumi Card. In addition, the Company neither has had, nor expects to have any revenues or benefits in connection with the Loyalty Program Agreement.

To the best of the Company's knowledge, as of the Report Date, the Loyalty Program comprises approx. 163,000 valid loyalty cards, out of, to the best of the Company's knowledge, approx. 2.5 million valid credit cards that are held by Leumi Card customers.

The loyalty card provides discounts on products of some of the Group's companies, and at the parking lots adjacent to the Azrieli malls.

For further details, see Note 12A(2) to the Financial Statements.

The Concentration Law

December 2014 saw the publication of the list of significant financial entities under the Promotion of Competition and Reduction of Concentration Law, 5774-2013 (the "**Concentration Law**"). Leumi Card was not included in the original list. In April 2015, the Antitrust Commissioner published an updated list of the significant financial entities according to the Concentration Law, and included Leumi Card therein. Upon the fulfillment of the two following conditions: the Group continues to be deemed a significant non-financial corporation and Leumi Card continues to be deemed a significant financial entity, the Group shall be required to reduce its Leumi Card shareholdings to below a holding rate of 10% until December 11, 2019.

On July 10, 2014, the Supervisor of Banks released an update to the Directive on Proper Conduct of Banking Business No. 312, regarding a banking corporation's business with related persons (the "**Amendment**"). Following the Amendment, the controlling shareholders of Azrieli Group, their spouses, children and dependents are defined as "related persons" of a banking corporation, in addition to Azrieli Group, which was included in the definition of "related person" already prior to the Amendment. Such expansion may affect the amount of credit that Azrieli Group or any of its corporations will be able to receive from Bank Leumi or Leumi Card. However, at this stage the Company is not aware of such effect.

The Promotion of Competition and Reduction of Concentration in the Israeli Banking Market Law

Further to the publication of the report of the Committee for Increased Competition in Common Banking and Financial Services (the "**Strum Committee**") in July 2016, the Promotion of Competition and Reduction of Concentration in the Israeli Banking Market Law, 5777-2017 (the "**Law**") passed second and third readings on January 23, 2017. The Law prohibits a bank with large scale operations from operating the issuance of payment cards, clearing payment cards, and holding a corporation that operates such issuance or settlement. This provision applies to Bank Leumi and Bank Hapoalim as of the elapse of 3 years as of the publication date or after 4 years as of the publication date, if, in a 3-year period, the bank's rate of holdings in means of control of the company shall have decreased to 40% or less and at least 25% of the means of control of the payment card company shall have been issued to the public.

The Law also includes a series of provisions designated to facilitate competition by the separated companies and players, including:

1. The setting of "nascent" protections for new players during the transition period (as of the commencement date prescribed by the Law and until 5 years after the publication, and with respect to Hapoalim and Leumi – 3 years as of the separation date, or 5 years as of the publication date, whichever is later), including: (a) In the transition period determined by the Law, a bank that issues payment cards, which controlled or held means of control in a credit card company on the date of publication of the Law, will carry out the issuance processing through an operating company and will allow it to be party to the issuance contract; (b) From the elapse of 2 years as of the publication of the law, a limit on the scope of issuance processing a bank may perform through one credit card company to 52% of the total of new payment cards issued to its customers;

2. Limits on credit facilities: During the period between 4 years as of the publication of the Law and 7 years as of the publication of the Law, the total credit facilities on credit cards of customers of Bank Hapoalim and Bank Leumi every year will not exceed 50% of the total credit facilities existing in 2015 (such calculation will only take into account customer credit facilities exceeding NIS 5,0000);

3. Access to information: (a) Credit card companies may use contact details of customers during the transition period, provided that such details were received by the company incidentally to the performance of issuance or operation of issuance for a bank, for the purpose of contacting customers to offer the provision of services as an issuer or the provision of credit even without the customers' consent, and (b) they will be allowed access to financial information in the customer's account only.

4. The limits on banks on the scope of issuance processing, restrictions related the distribution of revenues between the bank and the credit card company, restrictions related to approaching customers for the issuance of a new bank card or a change of the terms and conditions of an existing credit card contract and limits on the total credit facilities will apply during the transition period, as will provisions related to the distribution of non-bank cards by banks.

5. A duty on a longtime acquirer to engage with a new acquirer in an agreement for the provision of hosting services. The terms and conditions of the agreement and the price of the services will be determined on certain conditions by the Minister of Finance.

6. Duties on a acquirer related to work with an aggregator, on the conditions specified in the Law.

7. The setup of computer infrastructures, the duty of sale of computer services and operation thereof by the banks, and the lease of real property used for this purpose.

In addition, in November 2016, the Bank of Israel published an instruction to Bank Hapoalim and Bank Leumi to make changes in the composition of the board of directors of the two credit card companies to be separated therefrom according to the provisions of the law (although on the date of the instruction the law had not yet passed second and third readings).

<u>The Control of Financial Services Law (Regulated Financial Services), 5776-2016</u>

The Control of Financial Services Law (Regulated Financial Services), 5776-2016 (the "**Control Law**") prescribes duties of licensing and supervision over entities engaged in a line of financial services, including (non-bank) credit providers and financial assets service providers, as defined in the Control Law. The licensing duties will take effect on June 1, 2017, other than sections that will take effect subsequently thereto.

Debit and EMV

On February 10, 2015, the Supervisor of Banks released a summary report including recommendations regarding increasing the competition in the payment card sector, concurrently with the release of a list of directives for implementation of the said move. On June 29, 2015, the Supervisor of Banks released a letter regarding the "Expansion of Debit Card Distribution" and an amendment to Proper Conduct of Banking Business Directive No. 470 regarding payment cards, including operative steps for the implementation of recommendations pertaining to the expansion of use of debit cards, including with respect to fees charged to the customers and directives regarding the assimilation of the EMV standard in Israel, including with respect to the use of smart cards at points of sale and ATMs. The directives will gradually take effect from July 1, 2015 until December 31, 2018.

According to the Banking Order (Service to the Customer) Control of Service Provided by an Issuer to an Acquirer in relation to the Cross-Settlement of Debit Transactions (Temporary Provision) 5775-2015, the cross-fee for debit transactions has been announced a controlled fee and its price has been set at 0.3%, for a one year period, as of the date of the Order's entry into effect, in order to allow for preparation for the determination of the fee by the Antitrust Commissioner. This order took effect on April 1, 2016 and will be in force until March 31, 2017.

Proper Conduct of Banking Business Directive No. 472 on "Acquirers and Settlement of Payment Card Transactions"

On May 1, 2016, aiming to allow additional entities in Israel to perform credit card settlement by means of receipt of a license from the Bank of Israel, thereby increasing the competition in the settlement sector, the Banking Supervision Department published Proper Conduct of Banking Business Directive No. 472, which is applicable to any acquirer and banking corporation engaged in settlement, further to previously published drafts.

The Directive defines the requirements of cleared capital, with several relaxations determined for an acquirer, in whose last annual financial statement, the balance of receivables does not exceed NIS 2 billion, and other relaxations for an acquirer whose balance of receivables exceeds NIS 2 billion, with respect to the capital requirements under Proper Conduct of Banking Business Directives 201-211. Furthermore, the Directive prescribes, with respect to an acquirer whose balance of receivables does not exceed NIS 2 billion, protection of the funds under settlement by means of their holding in a trust account.

The Directive requires the setting of a policy for the provision of settlement services and for the approval of new businesses, as well as current review procedures and the monitoring of trends of declined debit charges and also sets several requirements with respect to the relationship between the acquirer and the businesses.

In addition, the Directive allows the acquirer to distribute, lease-out or sell customer premises equipment for the performance of payment card transactions (POS), on the conditions specified in the Directive.

Furthermore, provisions pertaining to the transfer of funds from the acquirer to the business in debit card and prepaid card transactions and with respect to the transition to the EMV standard, which had been formerly regulated by Proper Conduct of Banking Business Directive No. 470, were relocated to the Directive, with several changes made in the timetables prescribed by Proper Conduct of Banking Business Directive No. 470.

The Directive took effect on June 1, 2016, with the exception of several sections for which different commencement dates were determined.

Credit Data Law, 5776-2016 – The process of legislation of the Credit Data Law, 5776-2016 was completed during Q2/2016. The law determines a comprehensive arrangement for the setup and operation of a system for sharing the credit data of individuals, at the core of which is a public database of credit data to be set up and managed by the Bank of Israel. Draft Credit Data Regulations, which are intended to supplement the provisions of the law, were published on June 18, 2016.

Additional Regulatory Changes

Following are details on regulatory changes which are in various stages of legislation and promulgation. There is no certainty that the legislative processes which are detailed will be completed and whether the conditions and the provisions which will be determined will be similar to their language as of the Report Date. Therefore, at this stage, the Company cannot assess if and how these changes, if finally enacted and promulgated will have an effect, if any, on credit card companies in general, and on Leumi Card in particular.

Regulation of Non-Bank Loans Bill (Amendment No. 3) (Institutional Lenders, Maximum Interest and Penalties), 5775-2015 – On July 27, 2015, a Bill for the Amendment of the Non-Bank Loans Law passed on its first reading in the Knesset, as part of the implementation of the conclusions of the Committee for Increase of Competition in the Banking Sector in Israel (see Chapter "Limitations and Supervision Relating to Credit Cards"). The Amendment provides a mechanism, different to that which currently exists, for determining maximum interest, and further determines that the provisions of the law relating to the maximum interest rate will be applicable to all the lenders in the market, including banking institutions and credit card companies. The Amendment also provides that a breach of the provisions of the law regarding maximum interest will constitute a criminal offense.

Reduction of the Use of Cash Bill, 5775-2015 – On July 27, 2015, the Bill for the Reduction of the Use of Cash, 5775-2015, passed on its first reading in the Knesset, its objective being to gradually limit the use of cash and negotiable checks. *Inter alia*, the law authorizes the Antitrust Commissioner to supervise the cross-fee on payment cards and also updates the definitions and the applicability of the law on different types of payment cards and debit cards. Pursuant to the bill, the law will only be applicable upon the existence of a system which allows for the settlement of debit card transactions, the availability of debit cards, and the availability of debit cards at the Postal Bank, alongside the possibility of opening an appropriate account therefor at the Postal Bank.

Report on "Payment Card Transaction Chain"

On July 18, 2016, the final report of a working group headed by the Head of Payment Systems Oversight Unit (the "**Working Group**"), which had been appointed by the Bank of Israel following the recommendations of the Committee for Reduction of the Use of Cash in the Israeli Economy and of the Cost of Living Cabinet, which indicated the need to promote an additional switch for the execution of payment card transactions.

According to the report, the Working Group conducted a comprehensive examination of all of the links in the transaction chain and recommended that measures be taken to remove the existing barriers in the market and allow for the entry of new players.

Among other things, the final report addresses the following issues: Expansion of the activity and participation in the National Payments Council; appointment of a payment card committee that will include relevant regulators and players on the payment card market; regulation of the principles and rules for the development and use of the "Ashrait EMV" protocol; authorization of terminals; and setup of a central settlement interface.

Draft Outline for the Establishment of a New Bank

On June 14, 2016, the Banking Supervision Department published a draft outline for the establishment of a new bank in Israel, with the first part of the document focused on the outline for the grant of a bank license to the credit card companies, and the second part of the document focused on the required conditions and relaxations for the establishment of a new bank from the ground up. The relaxations pertain, *inter alia*, to automation and operation requirements, capital requirements, the process of receipt of the license and digital banking. The outline further includes the construction of a supervision model and regulation that are suitable for new and small banks.

Document of Principles of Regulation of Payment Services in Israel

On October 5, 2016, the Bank of Israel published a document of principles of regulation of payment services in Israel. The principles in the document rely on the provisions of the EU Payment Services Directive. The issues addressed by the principles document include, *inter alia*, the regulation and licensing of entities that provide a line of services including payment services that include transfer to a third party or payment for a product or service; the issuance of means of payment and the settlement of transactions. The principles also include the regulation of access to payment systems and the repeal of the Payment Card Law, 5746-1986. These principles are expected to be incorporated into legislation in several stages. At this stage, legislation is promoted which regulates the activity of non-bank entities in the field of financial services, which are expected to also provide payments services (see above with respect to the Control Law).

14.2.2. **Investment in Bank Leumi**

On April 30, 2009, the Company acquired from third parties, unaffiliated with the Company, as a passive financial investment, ordinary shares of Bank Leumi, a banking corporation whose shares are listed on TASE, representing approx. 4.8% of the issued and paid-up share capital of Bank Leumi, in consideration for a sum total of approx. NIS 742 million. During 2016 and up to the Report Release Date, the Company disposed of some of its holdings in Bank Leumi for a total sum of approx. NIS 96 million, and its holding presently represents approx. 4.24% of Bank Leumi's issued and paid-up share capital (as of the Report Date, total investment less a dividend received is approx. NIS 596 million). The value of the Company's investment in Bank Leumi as of December 31, 2016 was approx. NIS 1,040 million. The Company's investment in Bank Leumi is presented on its books as an available for sale financial asset, according to GAAP. For details of a disagreement between the Company and Bank Leumi, see Note 12(2) to the Financial Statements.

In 2016, the Company recorded a comprehensive profit (before tax) of approx. NIS 166 million due to this investment. For details, see Section 1.1.1 of the Board of Directors' Report.

On the date of the acquisition, on April 30, 2009, the share price was 1,055 (in *Agorot*). As of December 29, 2016, the share price was 1,586 *Agorot*, whereas at the close of trading on March 19, 2017, the share price was 1,635 *Agorot*.

In 2016, Bank Leumi did not distribute a dividend to its shareholders; the total amount of dividends received from the date of investment due to Bank Leumi's shares is NIS 67 million. Bank Leumi's financials are publicly posted on the distribution website of the ISA at www.magna.isa.gov.il and on the TASE website at www.tase.co.il.

14.2.3. **Investments in high-tech start-up companies and investment funds**

The Company invests subsequent investments in various high-tech start-up companies with a special emphasis on the medical, software and other such segments, which, in its estimation, have a large market potential and reflect innovation in their segments. The Company's investments in venture capital are made in amounts that are immaterial to the Company, with the intention of disposing of these investments upon the sale of the target company, the sale of its technology or its issue to the public. As a general rule, most of the Company's investments are in companies that have undergone the preliminary stage of development of the products and/or the services thereof. These investments are risk-intensive, and their results depend, *inter alia*, on many external factors over which the Company has no control.

As of December 31, 2016, the Company has invested in 4 active investment funds and start-up companies, which are presented at fair value in the sum of approx. NIS 23,700 thousand, compared with a fair value in the sum of approx. NIS 25,162 thousand as of December 31, 2016.

14.2.4. **Holdings in other foreign companies**

As of the Report Date, the Company holds, through Otzem Initiation & Investments (1991) Ltd., full ownership of Azrieli Insurance Corporation in Barbados, which serves as a reinsurer for companies that provide property insurance services. As of the Report Date, Azrieli Insurance Corporation provides reinsurance services only with respect to insurance granted to the Group's companies.

In addition, the Company holds approx. 3.8% of the issued and paid-up share capital of Health and Fitness East Med. B.V., which operates the "Holmes Place" chain of fitness centers in Greece.

PART SIX: MATTERS COMMON TO THE GROUP'S ACTIVITIES IN ALL OF ITS OPERATING SEGMENTS[29]

15. Fixed assets, land and facilities

The Company's offices are situated on the 48th floor and part of the 33rd floor of the Round Tower in Azrieli Center in Tel Aviv. The Company leases its offices, a gross area of 1,855 sqm, from Canit Hashalom for a long-term period, for immaterial amounts.

The Group has no material fixed assets.

The main fixed assets of Palace Tel Aviv are a building which includes the nursing and recuperation wings, See Section 11.1 of Chapter A above.

Supergas' main fixed assets are equipment that is loaned to its customers to be used for LPG supply, such as: stationary or portable gas tanks, meters, regulators and other gas equipment which is installed at Supergas' customers (both the domestic customers and the commercial and institutional customers). For the most part, upon expiration of the engagement the customer is required to return the equipment loaned thereto to Supergas.

16. Intangible assets

The primary trade mark of the Company and the Group companies (excluding Granite and its subsidiaries) which is under registration processes, is a designed mark which includes the inscription "Azrieli Group", and the Group's logo:

As of the Report Release Date, the Company owns approx. fifty registered trademarks, among others, the trademark of Azrieli Malls Group, on its ownor together with the name of the relevant mall and/or retail center, and the Multi Azrieli trademark. In addition, the Group filed additional applications for registration of trademarks, which applications are under registration and review, mainly in respect of new properties and properties under construction, and also in respect of the E-Commerce Website launched by the Company in February 2017 – Azrieli.com. Furthermore, trademarks have been registered on the shape of the ball that appears at the entrance to some of the Company's malls. Registered trademarks are valid for 10 years and can be renewed, per the Company's decision, for additional periods of 10 years each, without limit, subject to the payment of a renewal fee.

17. Human capital

17.1. General

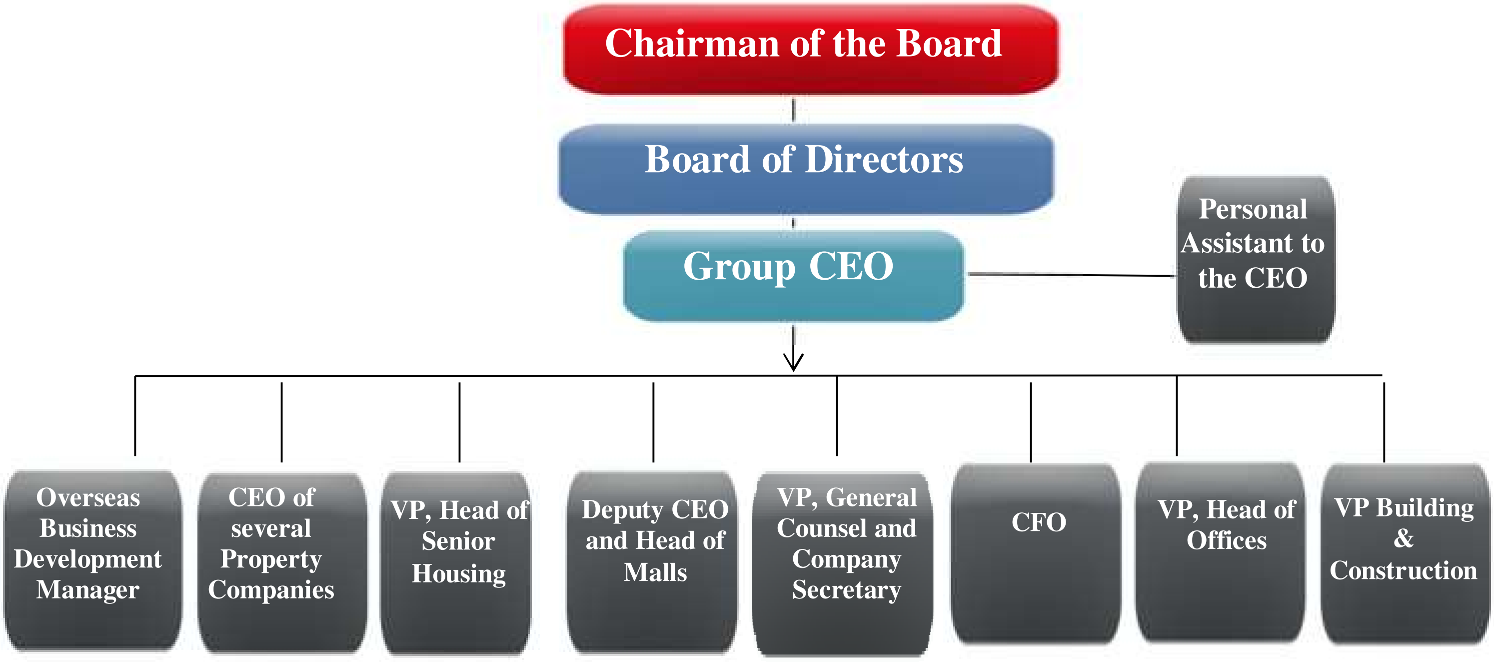
The Company places special emphasis on the quality of human capital, particularly at the Company's management level, by hiring a professional workforce with vast knowledge and experience in a variety of fields which are required within the framework of the Company's

[29] This part "Matters Common to the Group's Activities in All of its Operating Segments" does not include the operating segment of Granite Hacarmel and companies controlled thereby and the e-commerce business, unless otherwise expressly stated.

operating segments. Most of the Company's employees, mainly at its management level, have significant seniority in the Company, and vast experience in its operating segments. Unless otherwise noted, the specification in this Section does not include reference to human capital aspects of the Granite Segment. (For details regarding the human capital in the Granite Segment, see Sections 12.12 and 12.25 of Chapter A of the Report). In view of the aforesaid, in this section, the term "Group" does not include the Granite Segment and the e-commerce business.

17.2. **Organizational structure and workforce**

The diagram below describes the Group's organizational structure as of the Report Release Date:



As of December 31, 2016, the Group companies employ 300 employees. The segmentation of the employees in the main segments is detailed below:

Department	Number of Employees as of December 31, 2016	Number of Employees as of December 31, 2015
Management Headquarters	55	50
Commercial Centers and Malls Segment	162	160
Office and Other Space for Lease in Israel Segment	74	71
Income-producing property in the U.S. Segment*	1	1
Senior housing headquarters**	8	5
Total	**300**	**287**

*One employee from the management headquarters is attributed to the income-producing property in the U.S. segment.

**For details with respect to all employees of senior housing segment, see Section 11.11 above.

The Group's management and headquarters employs 55 employees, including the Group's CEO, the Deputy CEO and Head of Malls, CFO, VP, General Counsel and Company Secretary, VP and Head of the Office Segment, Overseas Business Development Manager, VP, Head of Senior Housing and VP Engineering and Construction. The people that belong to the Group's managerial headquarters are people with vast managerial experience, many of whom have been by the Group's side for many years. The increase in the number of employees relative to the previous year is attributed to the growth in the Company's operations in the income-producing real estate sector and especially due to the increase in the senior housing operations. 162 employees are employed in the Group's retail centers and malls segment, 142 of whom work for the management and maintenance teams of the retail centers and malls engaged in the current management of the retail centers and malls, and 18 provide marketing services to all of the Group's retail centers and malls.

74 employees work in the office and other space for lease in Israel segment, 70 of whom work for the segment's management and maintenance teams engaged in the current management of the offices, and 4 engage in the provision of marketing services.

As of the Report Date, the income-producing property in the U.S. segment is managed by the Company's headquarters and the Overseas Business Development Manager and management services and other services are provided to the Group in this segment by local professional management companies, as of the Report Date.

As of the Report Date, there are, between the Company and the Group companies, cooperation and agreements in connection with the provision of management services between themselves, including, *inter alia*, financial advice, strategic advice and current management advice, in consideration for a monthly payment. In addition, there are management agreements with the Group companies which derive, in part, as a percentage of such company's total expenses. The total payments that were made between the Group companies (including a management agreement between Granite Hacarmel and Canit Hashalom) for these management services, in 2015 and 2016, amounted to the sum of approx. NIS 50 million and approx. NIS 52 million, respectively. For details regarding changes in the office of officers of the Company in the Report Period, see a specification with respect to Section 26 and Section 26A in Chapter D of the Report.

17.3. **<u>Investment in training, instruction and development of human capital</u>**

The Group companies hold training and instruction workshops from time to time for their employees in accordance with the employee's position and the Group's needs, in order to ensure that employees have adequate training. Once a year, the Company holds concentrated training for officers and employees of the Company in accordance with the Company's Internal Enforcement Program, including in the areas of securities, business licensing, labor law, environment, safety and accessibility, prevention of sexual harassment as well as additional training held from time to time according to need. Employees of the Group companies keep abreast of fields touching on their responsibilities in the Group, from time to time, by participating in exhibitions, seminars, conferences and professional courses.

17.4. **<u>Benefits given to employees and the nature of the employment agreements</u>**

Employees of the Group are employed under personal contracts and no collective bargaining agreements apply.

The employment conditions of the Group's employees include, in some cases, *inter alia*, *per diems*, travel expenses/car maintenance/making a vehicle available to the employee, managers insurance/pension fund, advanced training fund, annual leave, recuperation pay, basic health insurance, work disability insurance, payment for global overtime, reimbursement of expenses and a 13th salary.

Additionally, the Group's third party insurance policy is an extended policy that includes coverage for professional liability for the management companies and the Company's employees who are professionals, with a liability cap of $2 million per incident and per insurance period, as part of the policy's liability cap.

In addition to the above, all of the Company's and the Group Companies' liabilities are covered in respect of the employees' social benefits and termination of the employment relationship by deposits that are made in severance pay funds and insurance policies and/or provisions that exist on the Company's books. For a description of the Company's liabilities in relation to the employees' social benefits and termination of the employment relationship, see Note 22 to the Company's Financial Statements.

17.5. Employment of officers and senior management employees of the Group

As of the Report Date, members of senior management in the Group are hired as employees under personal employment agreements or through management agreements.

The Company estimates that the Group headed by the Chairman of the Board, Ms. Danna Azrieli and the CEO of the Group, Mr. Yuval Bronstein, as well as the experienced officers and managers in the Company who are considered professional and leading in the field, constitute some of the success factors for the Company's business results.

The Group's business was established by Mr. David Azrieli OBM and has developed, *inter alia*, on the basis of the know-how and vast experience accrued thereby over many years in the income-producing property, mainly in Israel. Mr. Menachem Einan, who had joined him and served as the Company's CEO for 20 years, serves as a director of the Company as of the Report Date. For details regarding the agreement with Mr. Einan, which has expired as of the Report Release Date, see immediate report of March 18, 2015 (Ref.: 2015-01-053536) included herein by way of reference.

17.6. Group officers compensation plan

For details regarding the Company's officer compensation policy approved on October 6, 2016 by the general meeting of the Company's shareholders (Ref.: 2016-01-060735), see immediate report of August 28, 2016 (Ref.: 2016-01-111643), which is included herein by way of reference.

For details regarding the allotment of phantom units to officers of the Company, see Notes 37C(5) and 37C(6) to the Financial Statements.

18. Working capital

18.1. Working capital

As of December 31, 2016, the Group has negative working capital (excluding Granite Hacarmel and Azrieli E-Commerce) in the sum of approx. NIS 1.7 billion compared with negative working capital in the sum of approx. NIS 1 billion, as of December 31, 2015. The deficit in the working capital derives, *inter alia*, from the decision of the Company's management, at this stage, to finance its activity through short-term credit, considering the business opportunity of low rates of interest on these credits. For details regarding the Company's board of directors' estimation regarding the deficit in the working capital see Section 1.6(c) of the Board of Directors' Report.

The company estimates that should it decide to exchange the said credit for long term credit at any point in time, it would be able to do so and therefore the aforesaid working capital deficit does not affect its ability to timely repay its liabilities.

For details regarding the Company's liquid means and its credit raising possibilities, see Section 1.6 of the Board of Directors' Report.

18.2. Customer credit

In the income-producing property segment there is no customer credit since the lease agreements with tenants contain provisions for payment of rent in advance and for monthly or quarterly periods. The Group collects the rent pursuant to the terms and conditions of the lease agreement, usually, by way of a standing order, bank transfers and postdated checks. The tenants, before the handing over of the leased premises thereto, provide collateral for performance of their undertakings pursuant to the lease agreements and the management agreements (bank guarantees, deposits, promissory notes, personal guarantees, etc.). The cases in which rent is not paid in advance are immaterial to the Group.

18.3. Suppliers credit

The Company receives credit from its suppliers (primarily contractors and maintenance service providers) for average periods ranging from 15 to 60 days, after the requested service has been completed (on average - a period of approx. 45 days). The scope of credit from suppliers in the Group, as of December 31, 2016, amounted to approx. NIS 155 million, compared with a sum of approx. NIS 125 million as of December 31, 2015.

18.4. Working capital of the Granite Segment

As of the Report Date, the Granite Segment (Supergas and GES), has (net) working capital in the amount of approx. NIS 90 million, comprising the total of current assets (which mainly consist of cash, trade receivables, other receivables and inventory) less the current liabilities (which mainly consist of current liabilities to banks, current bond maturities and trade and other payables). Working capital does not include balances of the Granite Group vis-à-vis the parent company, Granite Hashalom.

19. Financing

19.1. General

Unless otherwise noted, the specification in Sections 19.1-19.16 does not include reference to financing aspects related to Granite Hacarmel and other companies controlled thereby. For details regarding Granite Hacarmel's financing, see Section 19.17 of Chapter A of the Report. In this section, the term "Group" does not include Granite Hacarmel and other operations of Granite Hacarmel.

The Group finances its activities from independent resources, from bank credit from financial institutions and non-bank credit, including through the issue of bonds from institutional bodies. The Group has long-term liabilities to banking corporations and non-bank financing sources amounting, as of December 31, 2016, to the sum of approx. NIS 9 billion (including current maturities). Most of the agreements include provisions pursuant to which the Company has the right to prepayment which is contingent, in most cases, upon the payment of a prepayment fine to the financing entity. Additionally, the loan agreements with banking corporations contain certain conditions, upon the occurrence of which, the banks may accelerate the loan amounts (primarily in the case of restructuring and a change of control in the Company, delinquent payments, receivership, and an adverse change in the value of the collateral, if and insofar as collateral was provided). To the best of the Company's knowledge, as of the Report Release Date, the conditions for acceleration of the loans have not been fulfilled. For details concerning the financial liabilities of the Group as of December 31, 2016, see Section 1.6(e) of the Board of Directors' Report. For details concerning projected payments per year, see immediate report on the Company's status of liabilities dated March 22, 2017 which is published concurrently with this Report. For further details concerning the Company's financing in general, see Section 1.6 of the Board of Directors' Report.

19.2. **<u>The Group's loan balance (not intended for specific uses) as of December 31, 2016</u>**

Set forth below is a specification of the average interest rate and the effective interest rate (which, as specified below, as of the Report Date, is identical to the average interest) on long-term loans and short-term loans that were in effect during 2016, and which are not intended for specific uses by the Group, while distinguishing between bank credit sources and non-bank credit sources:

6						
	Long-Term Loans			**Short-Term Loans**		
	Amount (NIS in thousands)	**Average Interest Rate**	**Effective Interest Rate**	**Amount (NIS in thousands)**	**Average Interest Rate**	**Effective Interest Rate**
Non-bank sources – Index-linked financing	5,525,929	1.56	1.57	--	--	**--**
Banking sources - Index-linked Financing	329,930	4.67	4.67	--	--	**--**
Non-bank sources - NIS financing	250,000	1.35	1.35	655,370	0.4	**0.4**
Banking sources – foreign currency financing	--	--	--	19,941	2.22	**2.22**
Total financial liabilities	**6,105,859**	**1.72**	**1.73**	**675,311**	**0.45**	**0.45**

19.3. **<u>Reportable credit made available to the Company</u>**

Set forth below is a specification of the balances of the material loans that were provided to the Company as of December 31, 2016 (NIS in thousands)[24].

Loan provision date	Loan designation	Type of Loan: Banking corporation	Type of Loan: Short-term	Type of Loan: Long-term	Balance (including current maturities) as of December 31, 2016 (NIS in millions)	Sum of loan taken	Type and rate of annual interest	Principal repayment dates	Interest repayment dates	Linkage	Guarantees / collateral (NIS in thousands)	Is the Company compliance with the financial covenants?	Repayment due date of long-term loans
August 2013	Financing of Azrieli Center	Institutional body group		X	710	444	1.16%	Semiannual	Semiannual	CPI	Pledge of the rights of Canit Hashalom in part of the lobby floor, the roof floor and Floors 11-49 of the Round Tower in Azrieli Center in Tel Aviv. Acceleration right for standard causes set forth in the agreement, which include, *inter alia* – an adverse material change in the status of tenants or the ratio between the loan balance as of the calculation date and the value of the Round Tower (according to an external appraisal revaluation once a year) (LTV), as of the elapse of 2 years from the loan provision date exceeds 70% (the rate decreases to 25% over the loan period).	Yes – for the results of the calculation of compliance with covenants, see Note 21B1 of the Financial Statements	Until August 2021
May 2016	Current needs	Institutional body		X	550	552	1.5%	Quarterly, as of July/2018	Quarterly	CPI	Canit Hashalom placed a first-ranking fixed charge in an unlimited amount on the Azrieli Rishonim Center in Rishon LeZion, including its rights to receive rent from the tenants in the property and its rights under insurance policies in relation thereto. Financial covenants as provided	Yes – for the results of the calculation of compliance with covenants, see Note 21B3 of the Financial Statements	April 2028

[24] In accordance with legal position no. 104-15: Reportable Credit Event, of October 30, 2011, http://www.isa.gov.il/Download/IsaFile_6187.pdf, and the parameters that the Board of Directors approved for examination of materiality in the reporting procedure in the framework of the Internal Enforcement Program.

											in the indentures of the Company's Series B and Series C bonds, i.e.: net debt to net assets ratio not exceeding 60% and equity not to fall below NIS 5 billion. In addition, the Company has undertaken as of April 1, 2018 to maintain a debt to collateral ratio (LTV) of no more than 80%. Furthermore, restrictions on dividend distributions, such that no distributions will be performed if as a result thereof equity shall fall below NIS 6 billion and the debt to assets ratio shall exceed 50%. An undertaking not to create a floating charge identical in rank and scope (*pari passu*).		

The Company has other non-material loans from banking corporations whose balance on the books, as of December 31, 2016, is approx. NIS 0.5 billion. These loans bear interest ranging between 4.2% and 5.8% and will be paid in 2017-2020. In addition, the Company has undertaken vis-à-vis some of the banking corporations not to create a floating charge on all of its assets without receipt of their consent, and that in the event of a breach vis-à-vis the banking corporations, they will be entitled to accelerate also other loans that shall have been given to the Company.

As of December 31, 2016, the total long-term credit received from Bank Hapoalim amounts to the sum of approx. NIS 330 million, and the total long-term credit received from Bank Leumi amounts to the sum of approx. NIS 160 million. As of December 31, 2016, the scope of the Group's unmortgaged investment property is in the sum of approx. NIS 17.3 billion, as specified in Section 1.6 of the Board of Directors' Report, out of the sum total of the Group's income-producing properties in the sum of approx. NIS billion. For details on non-bank credit see in this section below.

19.4. **<u>Reportable credit made available to the Group's companies</u>**

Set forth below is a specification of the balances of the material loans that were provided to the Group companies as of December 31, 2015 (NIS in thousands):

Borrowing Corporation	Loan provision date	Loan designation	סוג ההלוואה			Sum of loan taken	Balance as of December 31, 2016 (Company's share) (NIS in millions)	Principal repayment dates	Interest repayment dates	Annual interest rate	Linkage	Guarantees (NIS in thousands) / Pledge	Repayment due date of long-term loans
			Banking corporation / financial institution	Short-term	Long-term								
Shareholders of the property [30]	February 2014	Acquisition of Three Galleria	Foreign financial institution A		X	$130 million	**470**	Monthly	Monthly	5.998%	U.S.$	Pledge of the property and all of rights related thereto and deriving therefrom. Guarantee by the Company, forfeitable only in several specific instances defined in the loan agreement. The Company's undertaking to indemnify the financer for its damage in the event of certain breaches of the buyer's undertakings in the loan agreement	By March 2021

Companies of the Group has other non-material loans whose balance on the books, as of December 31, 2016, is approx. NIS 738 million, approx. NIS 697 million of which are linked to foreign currency and bear interest ranging between 3.2% and 5.5%, which shall be repaid in 2017-2025 and there are no financial covenants for these loans. A balance of approx. 41 million constitutes a Shekel variable interest loan against which there are pledges and financial covenants and it will be due for payment in the years 2017-2022.

[30] The loan was taken by Three Galleria Office Buildings, LLC, 90% of which are indirectly held by the Company. The presented amount of the loan is in respect of100% of the loan.

19.5. **Non-bank financing for the Company**

Commercial paper

In March 2016 the Company expanded a series of unrated commercial paper (CP) by NIS 40 million par value to a total sum of NIS 190 million, in addition to the existing rated series in a total amount of NIS 480 million par value. As of the Report Release Date, the Company has two CP series, a rated series in the amount of approx. NIS 465 million (following the repayment of approx. NIS 15 million over the year's course) and an unrated series in the amount of approx. NIS 190 million. For details regarding the Company's CP see Note 21A to the Financial Statements. For details with respect to the rating of the Company's CP, see Section 19.12.6 of Chapter A of the Report.

Long-term loans from institutional bodies

The Company has non-material loans from institutional bodies, the balance of which in the books as of December 31, 2016 is approx. NIS 0.5 billion. Such loans bear fixed interest at a rate ranging between 0.74% and 1.35%, and will be repaid in 2017-2023. The loans involve financial covenants, with which, as of the Report Date, the Company complies.

The Company's Series A Bonds

During the Report Period, principal and interest payments were made in accordance with the payment schedule thereof. As of the Report Date, the balance of the par value of the Company's Series A Bonds is NIS 407 million. In accordance with the terms and conditions thereof, the final maturity date of the Company's Series A Bonds is March 31, 2017. The Series A Bonds are registered for trade on the TACT Institutional system. For details regarding the current credit rating of the Series A Bonds, see Section 19.12.2 of Chapter A of the Report. For details with respect to the Company's bonds see Notes 21B(1) and 21B(2) to the Financial Statements.

The Company's Series B Bonds

During the Report Period, principal and interest payments were made in accordance with the payment schedule thereof. As of the Report Date, the balance of the par value of the Company's Series B Bonds is NIS 1,101 million. In accordance with the terms and conditions thereof, the final maturity date of the Company's Series B Bonds is April 1, 2025. For details regarding the current credit rating of the Series B Bonds, see Section 19.12.3 of Chapter A of the Report. For details with respect to the Company's bonds see Note 21B(3) to the Financial Statements.

The Company's Series C Bonds

During the Report Period, principal and interest payments were made in accordance with the payment schedule thereof. As of the Report Date, the balance of the par value of the Company's Series C Bonds is NIS 1,005 million. In accordance with the terms and conditions thereof, the final maturity date of the Company's Series C Bonds is July 1, 2027. For details regarding the current credit rating of the Series C Bonds, see Section 19.12.4 of Chapter A of the Report. For details with respect to the Company's bonds see Note 21B(4) to the Financial Statements.

The Company's Series D Bonds

On July 5, 2016, the Company published a shelf offering report for the issue and listing on TASE of up to NIS 2.2 billion par value of a new bond series (Series D), by virtue of a shelf prospectus of the Company. On July 7, 2016, the Company announced that according to the issue results, approx. NIS 2,194 million par value of Series D Bonds had been allotted in consideration for approx. NIS 2,194 million (approx. NIS 2,177 million after attribution of issue expenses). For details regarding the Series D Bonds, see Note 21B(5) to the Financial Statements. For details regarding the current credit rating of the Series D Bonds see Section 19.12.5 of Chapter A of the Report. As of the Report Date, the par value balance of the Company's Series D Bonds in circulation, is NIS 2,194 million.

19.6. Non-bank financing for the Group's companies

In the year of the Report and as of the Report Date, other than as specified with respect to non-bank financing of the Company in Section 19.5 above, no use of non-bank financing has been made for companies of the Group.

19.7. Inter-company loans

Set forth below is a specification of the balances of loans provided between the Group companies, excluding inter-company debit and credit balances, as of December 31, 2016 (NIS in millions) in amounts exceeding NIS 20 million:

The Lending Corporation in the Group	The Borrowing Corporation in the Group	Date of Provision of the Loan	Original Loan Amount (NIS in millions)	Last Date For Payment	Annual Interest	Linkage	Balance Of Loan Amount As Of Dec. 31, 2016 (NIS in millions)
Canit Hashalom (1)	Gemel Tesua	January 2009	74	January 2019	---	---	**74**
Canit Hashalom (2)	**AG Galleria Office Buildings LP**	**February 2011**	**99**	**February 2021**	**Libor+ 7.1%**	**U.S. $**	**109(3)**

* For a description of the balances of the loans provided by the Company to the Group companies, see Section 11 of Part D of the Report.

(1) Against the loan, Gemel Tesua issued a capital note in the sum of NIS 74 million to Canit Hashalom, bearing neither interest nor linkage, and the date of payment thereof will be no earlier than January 1, 2019, although the parties may agree to postpone the payment date. Payment of the capital note is not secured by any collateral and is inferior to other Gemel Tesua undertakings and precedes only the distribution of surplus assets upon dissolution.

(2) The loan is in the sum of approx. U.S. $28 million.

(3) The loan balance, including unpaid interest as of December 31, 2016, is approx. NIS 172 million.

19.8. Credit restrictions

The Series A bonds issued by the Company included an undertaking not to distribute dividends to the Company's shareholders if the credit rating may be prejudiced. For further details, see Section 19.12 of Chapter A of the Report.

For a description of the Company's undertakings in connection with the issue of the Series B Bonds, Series C Bonds and Series D Bonds vis-à-vis the bondholders, see Note 21B to the Financial Statements.

For the purpose of securing sufficient liquidity for payment of the commercial paper, the Company has undertaken to keep liquid cash balances and/or signed and unused credit facilities and/or other liquid financial holdings at a total scope of at least NIS 200 million.

As of December 31, 2016, and as of the Report Release Date, the Company meets all of the restrictions imposed thereon as stated above.

19.9. **Credit facilities**

As of the Report Date, the Group has not been provided with any binding credit facilities or non-binding credit facilities.

19.10. **Bank and non-bank credit received between the date of the Financial Statements as of December 31, 2016 until shortly before the Report Release Date**

The Company took no bank and non-bank credit in the period between December 31, 2016 and until soon before the Report Release Date.

19.11. **Loans repaid between the date of the Financial Statements as of December 31, 2016 and shortly before the Report Release Date**

No such loans have been repaid, over and above current payments in accordance with the payment schedule of each loan.

19.12. **Credit rating**

19.12.1. On January 19, 2017, Ma'alot ratified the Company's rating AA+/Stable/ilA-1+, which Ma'alot had given the Company on January 31, 2016 (Ref.: 2016-01-020275). To inspect the full report by Ma'alot, see the Company's immediate report of January 19, 2017 (Ref.: 2017-01-008085), which is included herein by way of reference.

19.12.2. Rating of the Company's Series A Bonds:

Rating agency	Rating date	Rating	Notes
Ma'alot	March 2007	AA	
Ma'alot	May 2009	AA	Rating on watch list with negative implications
Ma'alot	December 2009	AA – stable outlook	Company removed from watch list
Ma'alot	December 2010	AA – positive outlook	
Ma'alot	November 2011	AA stable	
Ma'alot	December 2012	AA stable	
Ma'alot	October 2013	AA stable	
Ma'alot	**January 2015**	**AA+ stable**	**Present rating**
Midroog	March 2007	Aa2	
Midroog	August 2010	Aa2 stable outlook	
Midroog	June 2011	Aa2 stable outlook	
Midroog	June 2012	Aa2 stable outlook	

Midroog	August 2013	Aa2 stable outlook	
Midroog	June 2013	Aa2 stable outlook	
Midroog	September 2014	Aa2 stable outlook	
Midroog	November 2015	Aa1 stable outlook	
Midroog	**July 2016**	**Aa1 stable outlook**	**Present rating**

To inspect Midroog's report on the Company's Series A Bonds, see the Company's immediate report of July 20, 2016 (Ref.: 2016-01-086899), which is included herein by way of reference.

19.12.3. Rating of the Company's Series B Bonds:

Rating agency	Rating date	Rating	Notes
Ma'alot	January 2015	AA+ stable	
Maalot	June 2015	**AA+ stable**	**Present rating**

To inspect Maalot's rating report of the Company's Series B Bonds, see the Company's immediate report of June 21, 2015 (Ref.: 2015-01-052239), which is included herein by way of reference.

19.12.4. Rating of the Company's Series C Bonds:

Rating agency	Rating date	Rating	Notes
Ma'alot	September 2015	**AA+ stable**	**Present rating**

To inspect Ma'alot's rating report of the Company's Series C Bonds, see the Company's immediate report of September 3, 2015 (Ref.: 2015-01-112698) which is included herein by way of reference

19.12.5. Rating of the Company's Series D Bonds:

Rating agency	Rating date	Rating	Notes
Midroog	**July 5, 2016**	**Aa1 stable**	
Midroog	**July 20, 2016**	**Aa1 stable**	**Present rating**

To inspect Midroog's report on the Company's Series D Bonds, see the Company's immediate report of July 20, 2016 (Ref.: 2016-01-086899), which is included herein by way of reference.

19.12.6. Rating of the Company's commercial paper:

Rating agency	Rating date	Rating	Notes
Midroog	July 2009	P-1	
Midroog	June 2011	P-1	
Midroog	June 2012	P-1	
Midroog	June 2013	P-1	
Ma'alot	**June 2014**	**ilA-1+**	**Present rating**.

To inspect Ma'alot's rating report, see the Company's immediate report of June 23, 2014 (Ref.: 2014-01-096798), which is included herein by way of reference.

19.12.7. Rating of private loans taken by the Company

Rating agency	Rating date	Rating	Notes
Midroog	**September 2014**	**Aa2 stable**	**Rating of private loan in the sum of NIS 250 million** **Present rating**
Ma'alot	**March 2016**	**AA+**	**Rating of private loan in the sum of NIS 250 million** **Present rating**

To inspect Midroog's report on a private loan in the sum of NIS 250 million, see the Company's immediate report of September 21, 2014 (Ref.: 2014-01-161508), which is included herein by way of reference.

To inspect Ma'alot's report on a private loan in the sum of NIS 250 million, see the Company's immediate report of March 29, 2016 (Ref.: 2016-01-017358), which is included herein by way of reference.

19.13. **Pledges**

For details regarding various pledges which were created by the Company and the Group's companies to secure their obligations, see Note 32 to the Financial Statements.

19.14. **Guarantees**

In the ordinary course of business, at the request of the Company, bank guarantees are issued by banking corporations in connection with its properties, including guarantees to secure the obligations of the Company and the Group's companies in the aggregate sum of approx. NIS 129 million. For information regarding additional guarantees which the Company has issued, *inter alia* in relation to the financing of the acquisition of properties overseas, see Sections 5-8 of Note 32B to the Financial Statements.

19.15. **Variable interest credit**

The Group has several loans at variable interest credit. Most of the credit was taken in Shekel currency linked to Prime or Bank of Israel interest, and the remainder in foreign currency linked to the LIBOR, plus a margin determined in relation to each loan. The foregoing credit changes in accordance with changes in the LIBOR interest or the Prime or Bank of Israel interest. Set forth below is a specification of the range of (nominal) interest for the periods of the Report, as well as the interest rate in proximity to the Report Release Date in respect of the loans at variable interest:

Credit type	Currency	Sum of credit shortly before the Report Release Date (NIS in millions)	Interest rate shortly before the Report Release Date (in %)	Interest range in the reporting periods (in %)	
				December 31, 2016	December 31, 2015
Non-bank credit	NIS	655	0.4%	0.4%	**0.4%**
Bank credit	**NIS**	41	2.7%	2.7%	2.7%
Bank credit	**GBP**	**20**	2.2%	2.2%	1.7%

In the estimation of the Company's management, the Company and/or the Group's companies will need to raise additional funds, as necessary, according the Company's decision, for the purpose of its business operations, the continued construction of projects under construction and investment in new projects.

19.16. **Regulatory Implications**

The instructions of the Supervisor of Banks in Israel include borrower group and "individual borrower" limits that affect the provision of credit beyond certain scopes, relative to the total liability of one group of borrowers and total liabilities of the six largest borrowers of the bank. Azrieli Group, together with Granite Hacarmel, and companies controlled thereby may be considered one "group of borrowers" for this purpose.

In accordance with Section 26 of the Promotion of Competition and Reduction of Concentration Law, 5774-2013, provisions are to be determined in respect of limitations on credit to be provided by financial entities to a corporation or a business group. A 'business group' is defined in said Section as the "controlling shareholder and the companies controlled thereby", notwithstanding the inclusion of any of such entities in the list of centralistic bodies. In the context of the report of the Committee to Assess Debt Restructuring Proceedings in Israel (the "Andorn Committee") that was released in November 2014, several recommendations were included regarding such matter, including a credit limit of business groups, whose effective credit exceeds 5% of the market business credit, and an imposition of a reporting obligation to the Committee for Reduction of Concentration on companies whose effective credit exceeds 3% of the scope of market business credit. As of the Report Date, such recommendations have yet to receive statutory or binding status and the Company is not aware of other new limitations deriving from the Concentration Law. It should be noted that insofar as is known to the Company's management, as of the Report Date, a borrower limit does not apply to the Azrieli Group and/or Granite Hacarmel.

19.17. **Financing of Granite Hacarmel Group**

19.17.1. Financing sources

As of the Report Date, Granite Hacarmel, Supergas and GES finance their activity from their own means, from short-term bank credit and from monies received from the issuance of non-negotiable bonds to institutional investors.

19.17.2. Loans and interest rates at Granite Hacarmel Group

Details of the average interest rate and the effective interest rate on long-term and short-term loans, from bank sources and non-bank sources, at Granite Hacarmel, Supergas and GES, as of December 31, 2016 and as of December 31, 2015:

As of December 31, 2016:

	Long-term			Short-term		
	Amount (NIS in thousands)	**Average interest rate**	**Effective interest rate**	**Amount (NIS in thousands)**	**Average interest rate**	**Effective interest rate**
Non-bank sources – Index linked	384,319	4.9%	5.26%	-	-	
Bank Sources – Index linked	37,418	3.77%	3.61%	-	-	
Bank sources – NIS	-	-	-	18,591	2.1-2.4%	
Total financial liabilities	421,737			18,591	2.1-2.4%	

As of December 31, 2015:

	Long-term			Short-term		
	Amount (NIS in thousands)	**Average interest rate**	**Effective interest rate**	**Amount (NIS in thousands)**	**Average interest rate**	**Effective interest rate**
Non-bank sources – Index linked	417,165*	4.9%	5.26%	-	-	
Bank Sources – Index linked	38,132	3.77%	3.61%	-	-	
Bank sources – Dollar linked	-	-	-	31,324	3.6%	
Bank sources – NIS	65,822	5.9%	-	27,349	-2.35% 2.85%	
Total financial liabilities	521,119		-	58,673		

* Net of the bonds issue expenses

19.17.3. Credit Facilities

In the Granite Segment, Supergas and GES have short-term credit facilities which are agreed with the banks in the amount of approx. NIS 240 million, some of which are secured and some are not due to the high credit allocation fees. The used credit balances as of the Report Date amount to approx. NIS 65 million (including use in respect of guarantees). Short-term credit from banks bears an unlinked variable Shekel interest rate, which is a function of the Prime interest rate. The Prime interest rate varies monthly according to the decision of the Bank of Israel.

To secure the bank credit extended to Supergas, a floating charge unlimited in amount and a fixed charge on its uncalled and/or unpaid share capital, its goodwill, securities and pledged documents, were registered in favor of the banks that finance its operations. As part of the floating charge, Supergas has undertaken not to create additional charges without the consent of the banks and subject to conditions as set forth in the bonds. To the best of the Company's knowledge, there is an inter-bank agreement between the charge-holding banks, according to which they hold a *pari passu* charge on the assets of Supergas. To secure the ban credit extended to GES, a guarantee was provided by Granite. In addition, GES has long-term loan agreements with banks, which are intended to finance the construction of desalination and water and wastewater plants. Such loan agreements are backed by revenues from the operation of such plants, which are pledged in favor of the financing banks and are partially backed by Granite's guarantee.

19.17.4. Bonds issued by Supergas

In July 2007, a consolidated company of Supergas, which was established for the purpose of the issue and to which were transferred the domestic gas activity and some of the commercial gas activity for marketing gas in portable gas containers, issued to institutional investors by way of a private placement, bonds with a total par value of approx. NIS 600 million. The bonds are rated Aa1 by Midroog Ltd., are for a period of 18 years and have been paid in quarterly principal installments since 2010. The bonds are linked to the CPI (principal and interest) and bear interest at an annual rate of 4.9%, which is paid once every calendar quarter. As of December 31, 2016, Supergas' liability in respect of the bonds amounts to approx. NIS 384 million.

In June 2014, Supergas completed a proceeding for changing the bonds issued thereby in 2007, which included the bringing forward of certain principal payments (constituting approx. 11.5% of the balance of the bonds), which in accordance with the original terms of the issue were due in the course of the next five years, and the flattening of quarterly principal payments such that they shall be uniform and equal. In this context, Supergas repaid 51,829,380 par value in the total amount of approx. NIS 75 million that includes approx. NIS 12.3 million paid due to the repayment due date being pushed forward. In addition, the company undertook, that in the event that Canit Hashalom Investments shall cease to be a controlling shareholder of Supergas, Granite Hacarmel shall make an offer to the bond holders for the purchase of bonds at a scope of no less than 45 million par value and at a price reflecting the adjusted value of the bonds on such date.

The bonds are secured by a first-ranking floating charge, unlimited in amount, on all of the assets of Supergas' consolidated company. In addition, Supergas charged, in a first-ranking fixed charge, unlimited in amount, all of the consolidated company's shares owned and held thereby, including the rights deriving from such shares. In accordance with the terms and conditions of the bonds, Supergas' consolidated company is required to meet financial covenants. Deviation from the financial covenants will allow the bondholders to demand acceleration or prepayment. As of December 31, 2016, Supergas' consolidated company meets the covenants determined. For further details, see Note 21B(6) to the Financial Statements.

19.17.5. For details regarding limitations, including financial covenants of Granite Hacarmel and its consolidated companies, see Notes 10B to the Financial Statements.

20. Insurance

The Company's insurance policies for the insurance of property and liability include insurance policies which cover certain risks in the Group's assets, up to the amounts set in such policies. These policies include: all-risks property insurance at reinstatement value, which includes coverage of fire, machinery breakdown, loss of rent and loss of profits from machinery breakdown, terror and war insurance, third party liability insurance, employers' liability insurance, contractor work insurance and crime insurance.

The amounts of the Group's property insurance were determined thereby according to its estimation, and the insurance policies are reviewed periodically by the internal auditor and the audit committee.

For details regarding the insurance coverage applicable to the Company's officers, see Note 37D to the Financial Statements.

21. Taxation

For details regarding the taxation applicable to the Company and the Group companies (including the Granite Group), see Note 30 to the Financial Statements.

22. Environmental risks and the management thereof

In the framework of its activities in the property segment, (including the development segment and the senior housing segment)the Group is required, *inter alia*, to meet the conditions and requirements of the Planning and Building Law, 5725-1965, including the Planning and Building Regulations (application for a permit, the conditions therein and fees), 5730-1970, the Planning and Building Regulations (Environmental Impact Surveys), 5763-2003 etc., *inter alia*, in the framework of approval of zoning plans, building permits, various licensing proceedings under the planning and building laws and the performance of building and construction work. The Group companies are responsible, by virtue of their owning or leasing land, under certain circumstances, pursuant to law, for compliance with the provisions of the environmental protection laws, including the Water Law, 5719-1959, the Business Licensing Law, 5728-1968 and the Hazardous Substances Law, 5753-1993, the Nuisance Prevention Law, 5721-1961, Sewage and Water Corporations Rules (Plant Wastewater Discharged into the Sewage System), 5771-2011, the Maintenance of Cleanliness Law, 5744-1984, the Senior Housing Law, 5772-2012 and more. A considerable tightening of the aforesaid regulation may have material implications for the Group’s business results and the amount of expenses required consequently thereto.

In this context it is noted, that as of the Report Release Date, several bills are pending which, if passed, will affect the Group’s business, including: the Prevention of Soil Pollution and Treatment of Polluted Soil Bill, 5771-2011 and the Senior Housing Bill whose chances of approval are not certain.

It shall be noted that in recent years, environmental activity, in Israel and worldwide, has significantly increased, as expressed, *inter alia*, in supervision and enforcement by government agencies and activity by environmental organizations. In the Group’s estimation, this trend is expected to continue in the coming years. The Group is investing many resources in ensuring its compliance with the provisions of the environmental laws that apply thereto, and is acting to prevent and minimize the environmental risks from its activity.

The Group's policy is to comply with the provisions and requirements of the law, including the environmental laws, as well as the requirements of the various supervisory bodies. For this purpose, professional environmental consultants are assigned to each project of the Group, who assist the Group and advise it throughout the project.

Complex at the Check Post Intersection in Haifa - In accordance with the information leaflet that was received from the City of Haifa, the lot that is located at the Check Post intersection in Haifa may be affected by hazardous substances, and the Company may be required by the Ministry of Environmental Protection to carry out various tests on the soil in the framework of the planning and building proceedings on the land. As of the Report Release Date, the Company has not yet received any update from the authorities with respect to such hazardous substances.

Cellular rental space - In some of the Group's income-producing properties, the Group leases space to the cellular companies (the "**Leased Space**") for the purpose of installing and operating cellular antennas and/or miniature transmitters (the "**Telecommunications Equipment**"). In accordance with most of the agreements between the Company and/or the Group's management companies and the cellular companies, responsibility for obtaining all of the approvals required by law to set up and operate the antennas and/or miniature transmitters, and responsibility for complying with the various environmental protection laws lies with the cellular companies, including holding, so long as they lease the Leased Space, the approval of the Radiation Commissioner at the Ministry of Environmental Protection regarding instructions and restrictions relating to the use of the Telecommunication Equipment, and acting in accordance with this approval, and they also undertake to comply with the safety instructions that shall be published by the Company or the management companies. Additionally, in the framework of these agreements, the cellular companies undertake to indemnify and compensate the Company and/or the management companies for any damage and/or expense that shall be caused as a result of the cellular companies' activities on the Leased Space, and for their liability by law for any act or omission of the cellular companies, and they undertake to insure their liability under the law for any damage and/or harm that may be caused to a third party. Finally, pursuant to the provisions of most of the agreements as stated above, each cellular company undertake to cooperate with the other cellular companies with which the Company has engaged, with respect to the operation of the Telecommunications Equipment in the Leased Space.

Water and Sewage Corporations (Plant Wastewater Discharged into the Sewage System) Rules, 5771-2011 – In the Report Period, the Company is acting in relation to several malls owned thereby vis-à-vis the water and sewage corporations at the relevant authorities in order to arrange the issue of the waste water discharged by certain businesses leasing space in such properties, which ostensibly result in deviations in the values of the waste water discharged into the municipal sewage system. The Company has retained professional consultants on the matter and places great importance on strict compliance in environmental issues.

23. Restrictions on and Supervision of the Corporation

Below is a brief overview of the laws, regulations, orders, restrictions and requirements with which the Group is obligated to comply in its various operating segments:

23.1. In Israel

23.1.1. Real estate operations

The Company's operations in Israel is subject to the land laws, including in relation to land taxation and lease and borrowing laws, as well as directives and contracts of the Israel Land Administration and Local Authorities, planning and building laws and environmental laws.

23.1.2. General laws concerning the Group's operating segments

In the framework of its activities, the Company and the Group companies are subject to municipal bylaws in each one of the local authorities in which the Group's income-producing properties are located, insofar as relevant, including regarding the opening and closing of businesses, the Prevention of Smoking and Exposure to Smoking in Public Places Law, 5743-1983, Equal Rights for Persons with Disabilities Regulations (Service Accessibility Adjustments), 5773-2013, Water and Sewage Corporations rules, the Privacy Protection Law, 5741-1981, the Communications Law (Telecommunications and Broadcasting), 5742-1982 (which includes clauses addressing "Spam") etc.

December 2013 saw the publication of the Promotion of Competition and Reduction of Concentration Law, 5774-2013 (the "**Concentration Law**"), which implements the main recommendations of the Committee for Increasing Competitiveness in the Economy. The law includes three main chapters, as follows: (a) limitation of control in companies in a pyramid structure; (b) separation between significant non-financial corporations and significant financial bodies; (c) weighing of economy-wide concentration considerations and sector-specific competition considerations in the allocation of rights. The last two chapters may be relevant to the Company, if no change occurs in the circumstances thereof, in the scope of its business and holdings, as being as of the Report Date.

Creation of separation between significant financial bodies and significant non-financial bodies (as such terms are defined in the Concentration Law).

The main restrictions set forth in the Concentration Law in respect of the separation of significant financial bodies and significant non-financial bodies are, *inter alia*: (1) generally, a significant non-financial corporation or the entity controlling it shall not control a significant financial body and shall not hold more than 10% of a certain type of means of control in a significant financial body, and shall not hold more than 5% of the means of control in a significant financial body which has no controlling shareholder; and (2) no person holding more than 5% of a certain type of means of control in a significant non-financial corporation shall control a significant financial body; all subject to the conditions, exceptions and restrictions as were determined in the provisions of the Concentration Law. The aforesaid notwithstanding, a significant non-financial corporation which, on the eve of publication of the Concentration Law, duly held means of control in a significant financial corporation, at a rate exceeding the holding rates specified above, may hold such means of control for 6 years from the date of publication of the Concentration Law (i.e. until December 11, 2019).

The Concentration Law prescribes that the Committee for the Reduction of Concentration shall release the list of the centralistic entities, which list includes the list of corporations included in the definition of a significant non-financial corporation[26] and the list of the entities included in the definition of a significant financial body. On December 11, 2014, the centralization committee released the list of centralistic entities in the market on the Ministry of Finance's website at: http://mof.gov.il/Committees/Pages/CentralizationDecreaseCommittee.aspx. According to the list, Azrieli Group was included in the list of the significant non-financial corporations. In April 2015, the Antitrust Commissioner published an updated list of the significant financial bodies according to the Concentration Law, and included Leumi Card (which was not included in the original list) therein. Insofar as the Group shall continue to be deemed as a significant non-financial corporation and insofar as Leumi Card shall continue to be deemed as a significant financial body, by December 11, 2019, the Group will be required to reduce its holdings in the shares of Leumi Card below a 10% holding rate.

Another chapter of the Concentration Law addresses the restrictions and considerations that a regulator is required to consider when seeking the allotment of a right in the area of vital infrastructure, as specified in the schedule to the law. The Committee for the Reduction of Concentration will release a list of centralistic bodies, for the purpose of whose participation in a tender for the allotment of such right in vital infrastructure, duty will apply to take into account economy-wide concentration considerations, in consultation with the Committee. It is noted that the extension or renewal of a right are deemed as the allotment of a right, if the entity holding the right holds it for a period exceeding 10 years (either in one consecutive period or in the aggregate) and the previous allotment or extension were not examined under the Concentration Law in the 10 years preceding the extension. The application of this chapter in respect of the allocation of right is one year from the date of publication of the law (i.e., December 11, 2017). On December 11, 2014, the Concentration Committee released the list of centralistic entities in the market. Azrieli Group and Granite Hacarmel Group are included in the aforesaid list. As of the Report Date, the Company is looking into the applicability of the provisions of the law as aforesaid, including the implications thereof, if any, in connection with participation of the companies of Granite Hacarmel Group in tenders for vital infrastructures, to the extent that on the applicable dates as aforesaid, the Company shall be included in the list of centralistic entities that shall be published, and to the extent that it shall hold such company.

Additionally, some of the Group companies purchase electricity from the IEC at high voltage according to the IEC's tariff for the purchase of high voltage electricity, and supplies the electricity to tenants according to the IEC's low voltage tariff. To the best of the Company's knowledge, as of the Report Date, the Ministry of National Infrastructures and the Public Utilities Authority are acting to regulate the licensing of electricity distribution in the commercial centers and malls throughout the country.

23.1.3. <u>Senior housing</u>

<u>Restrictions on and supervision of the senior housing operating segment</u>

Operations in the senior housing segment are mostly regulated by the provisions of the Senior Housing Law, which prescribes, *inter alia*, the duty to receive an operation license for the management and operation of a senior home, provisions in respect of the requirements and conditions for the receipt of a senior home operation license, the contractual relationship between the operator and the tenant, the duty to enter into a written engagement agreement, the provision of collateral to secure the repayment of the funds of the tenants' deposits, and more.

[26] The definition principally includes an effective sales turnover exceeding NIS 6 billion or effective credit exceeding NIS 6 billion. For the accurate definitions, the binding language of the Concentration Law must be consulted.

<u>The Senior Housing Law</u>

The Senior Housing Law prescribes, *inter alia*, that the operation of senior homes requires the receipt of an operation license on behalf of the Commissioner of Senior Homes at the Ministry of Social Affairs and Social Services and compliance with several conditions prescribed by the said law, including the applicant for the license being the owner or long-term leaseholder of the land of the senior home in respect of which the license is requested, there being no conviction of the license applicant and the senior home manager of certain offences, proof of the financial stability of the license applicant to ensure the proper operation of the senior home and so forth. The operation of a senior home without an operation license or other than according to the conditions of the license constitutes an offence that carries various fines and incarceration penalties.

Furthermore, the Senior Housing Law regulates additional matters, including the following: (1) The duty to make a written engagement agreement between the holder of the senior home operation license (the "**Operator**") and the person seeking to be a tenant of the senior home; (2) The specification of basic mandatory services the Operator is obligated to provide the tenants; (3) The duty to set up an LTC unit for senior homes consisting of at least 250 residential units[9]; (4) Limitation on arbitrary increases of the management fees and any other payment, which the tenant does not have the actual ability to waive; (5) The right of the tenants to set up a tenants' representative body at the senior home, and more.

In addition, the Senior Housing Law prescribes that in any case in which the tenant is required to deposit sums on account of the Deposit[10], which exceed a rate of 7% of the sum of the deposit or NIS 70,000, whichever is lower, the Operator will be required to provide the tenant collateral to secure the funds of the Deposit, according to the Operator's choice and pursuant to the following alternatives: (1) Bank guarantee; (2) Insurance of the tenant with an insurer and specification of the tenant as an irrevocable beneficiary in the insurance contract, provided that the insurance fees are paid in advance; (3) Transfer of 40% of the amount of the Deposit to a trustee under a trusteeship contract in which the tenant is specified as a beneficiary; or (4) Registration of a first-ranking mortgage on the real property in favor of the tenant. It is noted that the tenant may waive the receipt of such collateral, provided that the waiver is given in writing. Furthermore, the Operator is obligated to bear 20% of the cost of provision of the collateral, with the balance of the cost, at the rate of 80% as aforesaid, being borne by the tenant. The Senior Housing Law lists causes for enforcement of the collateral by the tenant, including the insolvency of the Operator, an order for stay of proceedings, an order for receipt of assets, a liquidation order, an order for appointment of a receiver, or circumstances wherein an absolute impediment to the repayment of the funds of the deposit is created.

<u>Bill for amendment of the Senior Housing Law</u>

On February 3, 2016, a bill for amendment of the Senior Housing Law (the "**Bill**") was approved in a preliminary reading by the Knesset, which Bill concerns the amendment of the provisions pertaining to the collateral serving to secure the funds of the tenants' deposits. According to the Bill, the provisions of the Senior Housing Law shall be amended as follows: (1) Imposition of a duty on the Operator to provide collateral to secure the full amount of the

[9] It is noted that the provisions of the Senior Housing Law concerning the setting up of an LTC unit are scheduled to take effect at the elapse of five years as of the date on which the law took effect, i.e., on December 3, 2017.

[10] "Deposit" – A payment made by a tenant to an operation license holder under an engagement agreement, including as collateral for compliance with the terms and conditions of the engagement agreement, which, under the terms and conditions of the engagement agreement the operation license holder must repay the tenant, in whole or in part, when the engagement comes to an end, after deduction of any sum deducted from such payment under the provisions of the engagement agreement and the law.

deposit deposited by the tenant (i.e., "from the first Shekel"); (2) The Operator will bear all of the costs involved in the provision of the guarantee (as opposed to the duty to bear 20% of such costs under the present provisions of the Senior Housing Law); (3) Cancellation of the third and fourth alternatives listed in the Senior Housing Law (which pertain to deposit with a trustee and registration of a mortgage) with two exclusive alternatives left as financial collateral: (a) Bank guarantee; or (b) Insurance of the tenant with an insurer, while specifying his name as an irrevocable beneficiary in the insurance contract and paying the insurance fees in advance; (4) Denial of a tenant's right to waive such collateral, such that the provision of collateral will be mandatory.

As arises from the explanatory notes to the Bill, the purpose of the amendment of the Law is to expand the protection of the sums of the Deposit deposited by the tenants when entering the senior home by obligating the Operators to provide financial collateral. As of the Report Date, and to the best of Palace's management knowledge, it appears that the relevant feasible alternative under the Bill, if and insofar as approved, is the bank guarantee.

It is clarified that the Bill is merely in preliminary legislation stages, has not yet been discussed by the Labor, Welfare and Health Committee of the Knesset and has not yet been prepared for first reading. As of the Report Date, Palace's management has no certainty that the Bill will be approved and Palace is unable to estimate the effect of such amendment (if passed) on its operations and cash flow needs.

<u>The Senior Housing Regulations</u>

As of the Report Date, secondary legislation under the provisions of the Senior Housing Law has not yet been completed. The following may be listed among the draft regulations prepared thus far:

Draft Senior Housing Regulations (Application for a Senior Home Operation License), which specify the conditions and the documents required for submitting an application for the grant or renewal of a senior home operation license;

Draft Senior Housing Regulations (Disclosure Document), which address the disclosure document the Operator is obligated to present to the tenant a reasonable time prior to their entering into an engagement agreement;

Draft Senior Housing Regulations (Tenants' Committee), which prescribe procedures for the purpose of establishment of a tenants' committee at the senior home and rules with respect to the manner of operation thereof;

Draft Senior Housing Regulations (Apartment Specifications), which obligate the Operator to attach an apartment specifications form to the engagement agreement with the person seeking to be a tenant;

<u>Invalids and the mentally frail– The People's Health Ordinance and Regulations</u>

The People's Health Ordinance, 1940, the People's Health Regulations (Registration of Hospitals), 5726-1966, and the People's Health Regulations (Nursing Staff in Clinics), 5741-1981, prescribe that the operation of hospitals, including units for invalids and the mentally frail, requires receipt of a permit from the Ministry of Health and is subject to supervision thereby. Such regulations include provisions with respect to the physical structure, the condition of the equipment, the manner of management, the rights of hospitalized patients and manpower capacities and training.

Labor law

Palace has employees in the senior housing operations and has also engaged with manpower agencies and manpower contractors for the receipt of various services in the senior homes, including cleaning, protection and security. Palace is therefore subject to the labor law and particularly to the law applicable to engagement of contractor employees, including the Employment of Workers by Manpower Contractors Law, 5756-1966, the regulations promulgated thereunder, and the Enhancement of Labor Law Enforcement Law, 5772-2011.

Planning and building laws, work safety and accessibility and consumer legislation

In the context of the planning, development and construction processes of senior homes, Palace is subject, *inter alia*, to the planning and building laws, including the decisions of local authorities and the various zoning committees, and is also subject to the Equal Rights for Persons with Disabilities Law, 5758-1998 and the secondary legislation thereunder, and to the work safety laws. Furthermore, the operation of senior homes is subject to consumer laws, such as: the Consumer Protection Law, 5741-1981 and the Control of Products and Services Law, 5718-1957.

23.1.4. Business Licensing

In the framework of the operations of the Group's companies, some of the Group's companies are required to obtain a business license pursuant to the Business Licensing Law, 5728-1968. To the best of the Company's knowledge, as of the Report Date, all of the Company's properties have a valid business license or are in the midst of proceedings for the renewal or issuance of a business license (including such which had expired), as required under the Business Licensing Law, 5728-1968. In addition, in the lease agreements in which the Group engages with the various lessees, the lessee is required to hold a business license as required by law for the operation of its business in the property.

23.1.5. Antitrust

In the framework of expansion of the Group's operations, *inter alia*, by acquiring shares in companies that are companies owning the rights in real properties, the Company and the Group's companies are required, under certain circumstances, to approve the merger pursuant to the Restrictive Trade Practices Law, 5748-1988.

For details regarding restrictions and supervision in the Granite Segment, see Sections 12.2.2 and 12.15 of Chapter A of the Report.

23.2. **Outside Israel**

The Group's operations in the U.S. and in England are subject to the laws and regulations in the said countries and *inter alia* in the field of land, planning and building and lease, the environment and laws on the municipal level and in connection with land taxation.

24. Material Agreements and Collaboration Agreements

The Group is a party to collaboration agreements with third parties with respect to some of the projects within the Group's activities.

Excluding agreements which were specified in this Chapter, in the Additional Details Chapter (Chapter D of the Report) and in the Notes to the Financial Statements, the Company is not a part of any material agreements which are not in the ordinary course of business or which were not described in this Chapter A.

25. Legal Proceedings

As of the Report Date, the Company and/or the Group companies are not a party to pending material legal proceedings, except as specified in this Report and in Note 33 to the Financial Statements. In addition, as of the date of this Report, the Company and/or the Group companies are conducting various proceedings, as determined by law, *inter alia*, for the resolution of demands received from the various local authorities in respect of mandatory payments and levies, in a total amount that is immaterial to the Company. In respect of part of the proceedings, the Company included provisions in the Financial Statements on the basis of the opinion of the Company's outside advisors, under the circumstances of each matter.

26. Goals and Business Strategy

As a leading company in its segments of activity, the Company focuses on the real estate industry, mainly in Israel. The Company focuses, on a current basis, on improving the Group's existing properties, and acts to optimize the utilization of its commercial space and create a suitable tenant mix according to the changing demand needs, increase the number of visitors while maintaining and even improving the attractiveness of its malls and retail centers, increasing the tenants' revenues, and continuing to offer management services to its properties through the Group's management teams, maintaining the level of its tenants and renewing the lease agreements therewith for additional long-term periods.

The Group's business strategy is mainly to continue to invest in expanding its widespread activity in retail centers and malls (including power centers) and office and other space for lease in Israel and overseas, through the purchase of lands for development and construction of assets and/or the purchase of additional assets. In addition, the Company emphasizes the betterment of existing assets, the advancement of building plans and expansions for optimal use of the rights in its assets. The Company insists on maintaining its high financial soundness and a relatively low level of leverage.

One of the Company's goals is investment of not more than approx. 15% of the value of the Company's investment property in Western countries (mainly the U.S.) with a high investment rating, subject to the right timing and appropriate cost.

The Company estimates that its main growth engines are, *inter alia*, the projects undergoing planning and construction, development and construction of new assets through the identification of lands for purchase while taking into account areas of demand, large population centers, central transportation junctions and high accessibility to public transportation.

Furthermore, the Company examines from time to time additional options to expand its segments of activity in other fields of business which are synergetic or tangential to the Company's business as additional growth engines, while taking advantage of market conditions and/or crisis conditions in leading, cash generating target companies. In the Report Period, the Company continued to develop the senior housing operations, following its purchase of land plots in 2014 with respect to which it has commenced the senior home development plans, and the purchase of the longstanding senior home "Palace Tel Aviv" in 2015, and the purchase of Palace Ra'anana (formerly Ahuzat Bayit Ra'anana) in 2016, and it is examining additional sites. The Company aspires to continue developing the senior housing business and to create a significant portfolio with national presence and a 4-5 star finishing standard. In the Report Period, the Company continued to examine various ventures for the construction of new senior homes, identification of suitable land and purchase of existing senior homes, aiming to be a leading player in the senior housing market, both in terms of the amount of residential units offered to tenants and in terms of the standard of the provided services.

As reported thereby, the Company regularly reviews the holdings which are not at the core of its business in the real estate sector. For details on a transaction that was closed for the sale of Sonol, see Section 1.3.5 above.

The Company's objectives as of the Report Release Date are based on the management's estimates in connection with the market conditions as of such date, and there is no certainty that the aforesaid will indeed materialize. For further details, see the Board of Directors' Report.

27. **Forecast for Development**

As the Company reported in the past, during the Report Period until the Report Release Date, the Group has continued exploring business opportunities, in Israel and overseas, in connection with the expansion of its business, mainly in the real estate sector, including related real estate sectors such as storage and logistics and the development of the senior housing business. These opportunities are examined both through the purchase of land reserves and the development of properties, and by way of purchase of properties and/or operations from third partiesand/or the betterment of the existing properties owned by the Group, some of which have materialized as stated in the Company's reports. The Company is regularly engaged in identifying opportunities for expanding retail and office space in its existing properties as an addition to existing projects and is pursuing the promotion of the betterment of such properties and is expected to continue pursuing such activity also in 2017. In addition, following the sale of Sonol, the Company continues to regularly look into the other holdings which are not in its core business of income-producing real estate, including the sale of its holdings in Granite Hacarmel (as a whole or its various parts) and/or its financial holdings, all according to its discretion as to the timing, structure and consideration of the transaction. As of the Report Date, there are no short-term plans which deviate from the Company's ordinary course of business and which may have a material influence on the Company's business and results.

28. **Discussion of Risk Factors**

In the Company's estimation, the Group is exposed to several fundamental risk factors deriving from the economic environment and the Group's unique characteristics. In addition to the aforesaid risk factors, the Group is exposed to general risk factors which affect the economy as a whole, without having any other unique effect on the Company, such as the condition of the economy and the market in the U.S. and Israel, and the security situation in Israel, 'which, should they adversely change, might harm Company's results. For further details regarding the market risks to which the Company is exposed, and the way of management thereof, see Note 34 to the Financial Statements.

The information concerning risk factors to which the Group is exposed is forward-looking information as defined in the Securities Law. The Company's expectations with respect to this issue are based on past experience, the Group's familiarity with the markets in which it is active and its estimations in relation to its economic and business development. However, the Group's expectations and forecasts may not be realized, inter alia due to dependence on external factors that are beyond the Group's control and which are detailed below:

28.1. **Macro economic and financial risks**

28.1.1. The growth and consumption rates in Israel – the Company's activity is dependent, *inter alia*, on the growth of the Israeli economy and the per capita consumption rates, which affect the demand for the Company's income-producing properties and the soundness of material tenants of the Group's properties and their ability to fulfill their undertakings thereto. For details of market risks entailed by the Group's business see Section 2 of Chapter B of this Report – the Board of Directors' Report.

28.1.2. A change in the building inputs index - An increase in the building inputs may affect the price of the Company's engagement with sub-contractors. While construction costs are usually linked to the building inputs index, income is usually linked to the consumer price index. Therefore, the Company may be exposed to negative effects in the event of changes in these indexes.

28.1.3. Changes in the economy's interest rates – A majority of the Group's undertakings and Group's development plans are affected by changes in the economy's interest rates and the banking corporations' conditions for provision of bank credit. A long-term increase in the market interest rates may affect the Group's financing costs in relation to each project, the yield from the properties, the value of the income-producing properties and the Group's profitability.

28.1.4. Security situation – Changes in and aggravation of the security and political situation may affect the Company's activity and business results, both from the perspective of the public's readiness to visits the Group's shopping centers and malls, in high-stress areas and in general, as well as from the perspective of demand for lease spaces, shortage in manpower in the construction industry, building cost appreciation, etc.

28.1.5. Regulatory changes in the Company's business environment – the Group's activity is exposed to various regulatory limitations, including in accordance with the antitrust law, the securities law, corporate law and the supervision on banks law. Stricter regulation in areas pertaining to the Company, as well as possible implications of further regulatory changes might reduce and/or limit the Company's activity through, *inter alia*, organizational changes and the imposition of conditions on the Company's business activity and financial holdings.

28.1.6. Changes in the value of financial investments available for sale – In view of the condition of the capital market in Israel, the Company is exposed, to a certain extent, to adverse changes in the value of the companies in which it has invested as a financial asset available for sale. Impairment of these companies may adversely affect the comprehensive income of the Company and its equity.

28.2. **Industry-specific risks**

28.2.1. A decline in the demand for rental space – A decline in the demand for rental space and/or renewal of existing lease agreements may lead to a decline in occupancy rates in the Group's properties and a decline in income from rent and in asset value and will necessarily harm the Company's business results.

28.2.2. A decline in the rent prices – A decline in the demand for rental space together with competition becoming fiercer in the industry may lead to erosion of the Company's rent, a decline in asset value, and harm its financial results.

28.2.3. Strength of main tenants – Damage to the financial strength of tenants, and particularly main tenants, may lead to an increase in provisions for doubtful debts or alternatively, termination of lease agreements and/or eviction of tenants from the Group's properties, and therefore to a decrease in the Group's income from rent and necessarily harm the Company's business results.

28.2.4. Competition - The income-producing commercial property segment in Israel is subject to significant competition. For details regarding the effect of the Group's competitors on its business results, see Sections 8.1.1 and 8.4 of the Report.

28.2.5. Approvals from the authorities – Activity in the income-producing property segment is characterized by the need to obtain permits from various entities at the different authorities, particularly in the area of usage and rights confirmations (zoning plans), obtaining building permits, business licenses etc. A delay in obtaining any permit or failure to obtain a permit could harm the profitability of the project or entail various financial expenses for the purpose of compliance with the requirements of the authorities for receipt of the approvals.

28.2.6. Legal and regulatory requirements, including with respect to environmental protection – the Group's companies are subject to legal and regulatory requirements from various aspects and, *inter alia* on issues pertaining to the environment (nuisance, underground and above ground pollution, toxic waste etc.), and they are required to bear the costs involved in meeting the same, such that it may have an adverse effect on their results. A toughening of such regulatory requirements may force the Group to allocate additional financial resources to this issue.

28.2.7. Changes in the tax burden – the Group's companies are subject to the tax laws in the jurisdictions in which they operate. Changes in the present or future tax rates, or other changes in tax laws that affect the tax liability of the companies, will cause a change in the Company's financial results.

28.3. **Company-specific risks**

28.3.1. Fluctuations in the Consumer Price Index - The Group has loans and bonds that are linked to the Consumer Price Index and therefore the Group is exposed to fluctuations in the Consumer Price Index. However, most of the Group's revenues from rent in the commercial centers and malls segment and the office and other rental space segment are linked to the Consumer Price Index, while a rise in the Consumer Price Index may lead to an increase in the revenue from rent and reduce the exposure in relation to this risk.

28.3.2. Foreign Currency Risks - The Company has assets and liabilities that are stated in various foreign currencies. In view of the fact that the total foreign currency liabilities are not always equal in value to the total foreign currency assets, the Company is exposed to possible changes in the exchange rate of the foreign currencies versus the NIS. However, the Group's revenues from rent in the income-producing property in the USA segment are stated in foreign currency, while a rise in the exchange rate of the foreign currency may lead to growth in revenues from rent and to reduction of the exposure due to this risk.

28.3.3. Dependency on Financing Sources - The Company's activity is also financed by external sources and an adverse change in the conditions for provision of credit and/or renewal of existing credit may materially harm the Company's results.

28.3.4. Debt raising costs - Changes in the market interest rates may affect the cost of debt raising by the Company as well as the financing expenses.

Notwithstanding the aforesaid, it is noted that the Group's business is characterized by a large number of tenants, multiple segments and geographic dispersion. These characteristics allow the Group to reduce its exposure to changes in a certain operating segment and to reduce its exposure to the business of a specific tenant.

28.4. Senior-housing specific risks:

28.4.1. Regulation in the senior housing business – the senior housing sector has developed significantly in recent years, along with the regulation of the sector. For details regarding the Senior Housing Law which provides, *inter alia*, the conditions for receipt of a senior home operation license see Section 23.1.3 of Part A of the Report. In February 2016, a bill was approved in a preliminary reading at the Knesset, seeking to make a significant change in the regulation of securing the deposit funds of tenants in senior housing. If and insofar as the said bill will be approved in the proposed form, senior homes will be obligated to provide financial collateral (bank guarantee) in a manner that is liable to increase the Company's financing expenses.

Set forth below are the main risk factors described above that were ranked, in accordance with the Company's estimate, according to the extent of the effect that they may have on the Company's business:

	The Extent of the Effect of the Risk Factor on the Company		
	Large Effect	**Medium Effect**	**Small Effect**
Macro-Economic Risks			
Growth and consumption rates in Israel	X		
The security condition in Israel	X		
Changes in the interest rates in the economy		X	
Changes in the Building Input Index			X
Regulatory changes		X	
Changes in the value of available for sale financial investments			X
Industry-Specific Risks			
Decline in the demand for rental space	X		
Decline in rent prices	X		
Strength of main tenants			X
Competitive environment	X		
Approvals from authorities			X
Environment and regulatory requirements		X	
Changes in tax burden		X	
Specific Risks			
Fluctuations in the CPI		X	
Foreign currency risks			X
Dependency on financing sources		X	
Debt raising costs		X	
Senior housing-specific risks			X

Danna Azrieli,
Chairman of the Board

Yuval Bronstein, CEO

Report Date: March 21, 2017

Azrieli Group

Part B

Board Report

Azrieli Group Ltd.

Board of Directors' Report on the State of the Company's Affairs

for the year ended December 31, 2016

The board of directors of Azrieli Group Ltd. hereby respectfully submits the Board of Directors' Report for the year ended December 31, 2016 and for the three-month period ended on December 31, 2016 (the "**Report Period**"), pursuant to the Securities Regulations (Periodic and Immediate Reports), 5730-1970 (the "**Regulations**").

Azrieli Group Ltd. (the "**Company**"; the Company together with all of the corporations held thereby, directly and/or indirectly, will be referred to below as the "**Group**" or "**Azrieli Group**"), engages mainly in the income-producing property in Israel segment, while most of the Group's business activity is in the retail centers and malls in Israel segment and in the office and other space for lease in Israel segment. In addition, the Company has income-producing property outside Israel, and mainly office space for lease in the U.S. In view of the closing of the transaction for the sale of the Group's holdings in Sonol Israel Ltd. ("**Sonol**"), commencing from the quarterly report as of June 30, 2016, Sonol's operations became discontinued operations, according to GAAP, and are presented in the Company's income statements separately from the continued operations (see Note 8 to the Financial Statements). Commencing from the report for Q3/2016 that was released on November 23, 2016 (Ref.: 2016-01-130792), the Company has begun reporting on its operations through Granite Hacarmel Investments Ltd. ("**Granite**" or "**Granite Hacarmel**"), a wholly owned subsidiary of the Company, which mainly engages in the fields of marketing alternative energy sources, water and wastewater and chemicals as a separate operating segment (the "**Granite Segment**"), as defined in GAAP. In addition, commencing from the report for Q3/2016 the Company's operations in the senior housing segment started to be described in the Company's Financial Statements as a separate operating segment in view of the establishment and expansion of the business and investment in development projects in the segment. The Group has additional operations of electronic commerce and minority holdings in financial corporations.

The data appearing in the Board of Directors' Report are based on the consolidated Financial Statements as of December 31, 2016. The financial data and the business results of the Company are affected by financial data and business results of the companies held thereby. In some cases, details are presented which review events that occurred after the date of the Financial Statements and in proximity to the date of releasing the Report, with such fact indicated alongside them (the "Report Release Date") or additional details and data on the Company level only. The materiality of the information included in this Report was examined from the Company's point of view. In some of the cases additional detailed description was provided in order to give a comprehensive picture of the described topic, which is, in the Company's view, material for the purpose of this Report.

The Financial Statements attached are prepared according to the International Financial Reporting Standards (IFRS). For further details see Note 2A to the Financial Statements as of December 31, 2016.

Extended standalone statement – the income-producing property business

The Company's management acknowledges the importance of transparency to the investors, the shareholders, the bondholders and analysts and deems all of the above as its partners. Therefore, the Company had decided to adopt a policy whereby, in the Company's Board of Directors' Report, disclosure shall be made regarding a summary of extended standalone financial statements of the Company, i.e. a summary of the Company's balance sheets and income statements on a consolidated basis, presented according to the IFRS, except for the Company's investment in Granite Hacarmel and in Azrieli E-Commerce Ltd.[1] ("Azrieli E-Commerce"), which are presented based on the book value instead of the consolidation of the statements thereof with the Company's statements (the other investments are presented with no change from the statement presented according to the IFRS). The Company's management believes that this Report adds considerable information which helps to understand the large contribution of the real estate business to the total profit of the Company, while excluding material items of the Consolidated Financial Statements, deriving from the consolidation of Granite Hacarmel and Azrieli E-Commerce, such as trade accounts receivable, inventory, sales etc. The extended standalone statement is attached hereto as Annex D. This Report is not audited or reviewed by the Company's auditors.

[1] Formerly Netex New Media Ltd., that was acquired by the Company in the framework of a transaction for the purchase of business in the eCommerce sector. For details, see Section 1.3 of Chapter A of the Report.

Highlights for the Report Period and for the Quarter ended December 31, 2016 until the Report Release Date[2]

Net Profit
• Net profit of approx. NIS 610 million in the quarter, compared with a net profit of approx. NIS 288 million in the same quarter last year. • Net profit of approx. NIS 1,808 million in the Report Period, compared with a net profit of approx. NIS 828 million in the same quarter last year.
Growth in NOI in the Report Period
• Approx. 5% additional growth in NOI (see Section 1.3.10 of the Report). • Approx. 3% additional growth in same property NOI in Israel (see Section 1.3.11 of the Report).
NOI Growth in the Quarter
• Approx. 5% additional growth in NOI (see Section 1.3.10 of the Report). • Approx. 2% additional growth in same property NOI in Israel (see Section 1.3.11 of the Report).
FFO from the Income-Producing Property Segment
• An increase of approx. 10% in the FFO attributed to the income-producing property segment in the quarter compared with the same quarter last year. • An increase of approx. 9% in the FFO attributed to the income-producing property segment in the Report Period compared with the previous year (see Section 1.3.13 of the Report).
Cap Rate
• Weighted cap rate of approx. 7.5% in the Company's statements from the income-producing properties (see Section 1.3.12 of the Report), similarly to the previous quarter and to the previous year.
Investment Properties
• In the Report Period, the total amount of the Company's investment properties increased by approx. NIS 3,207 million from the acquisition of properties, betterment of existing properties and development, and revaluation profits (approx. NIS 486 million in the quarter), an increase of approx. 83% compared with the previous year (of approx. 29% compared with the same quarter). • For further developments, see Section 1.3 of the Report.
Disposition of Granite Hacarmel Assets
• According to the Group’s strategy, the Company examines, on an ongoing basis, the holdings that are not in its core business in the real estate sector. For details regarding the closing of a transaction for the sale of all of Granite Hacarmel’s rights in Sonol, see Section 1.3.5 of Chapter A of the Report. As of the Report Release Date, the Company continues to conduct negotiations, from time to time, with various entities, for the disposition of its holdings in respect of Granite as a whole and/or its subsidiaries.

[2] In the above highlights, the Company included the main issues specified in this Report below. With respect to forward-looking information, including in respect of the progress of the projects under construction, see Section 1.3.9 below.

1. The Board’s Explanations for the State of the Corporation's Business

1.1 Key Data from the Description of the Corporation’s Business

1.1.1 Summary of the Group's operating segments

As of the Report Date, the Group's business activity focuses on the various real estate sectors, while the majority of the Group’s business activity is in the retail centers and malls in Israel segment and in the office and other space for lease segment both in Israel and overseas. The Group also operates in the senior housing segment, in the Granite Segment, which mainly includes activities in the fields of energy, water and wastewater, and the Group has other activities of eCommerce and minority holdings in financial corporations. In view of the closing of the transaction for the sale of the Group's holdings in Sonol, commencing from the quarterly report as of June 30, 2016, Sonol’s operations became discontinued operations, according to GAAP, and are presented in the Company’s income statements separately from the continued operations (see Note 8 to the Financial Statements). In view of the aforesaid, the Company has begun reporting on its operations in the Granite Segment as a separate operating segment, as defined in GAAP. In addition, commencing from the quarterly report for September 30, 2016, the Company's business in the senior housing segment has begun to be described in the Company's financial statements as a separate operating segment in view of the establishment and expansion of the business and investment in development projects in the segment. The senior housing segment and the Granite Segment are deemed as separate operating segments for the purpose of the Company's quarterly and periodic reports.

As of the Report Date, the Company reports five operating segments to the public:

☒ **The Retail Centers and Malls in Israel Segment** – The Company has 16 malls and retail centers in Israel, with a total leasable area of approx. 310 thousand sqm (consolidated and the Company’s share) leased to approx. 1,800 tenants;

☒ **Office and Other Space for Lease in Israel Segment** – The Company has 11 income-producing properties in this segment in Israel, with a total leasable area of approx. 392 thousand sqm (consolidated and the Company's share) leased to approx. 550 tenants;

☒ **Income-Producing Properties Segment in the U.S.**[3] – The

[3] The "Company's share" – net of minority holdings in a certain company.

Company has 7 income-producing properties in this segment, with a total leasable area of approx. 199 thousand sqm (consolidated) and approx. 189 thousand sqm (the Company's share[3]) leased to approx. 250 tenants;

- **Senior Housing Segment** – The Company has two active senior homes of a built-up above-ground area of approx. 49 thousand sqm which include approx. 559 senior housing units, and three projects under development and construction for the construction of approx. 840 residential units of a total area of approx. 107 thousand sqm;

- **Granite Segment** – The Company holds through Granite Hacarmel 100% of the rights in Supergas which engages in the marketing of alternative energy sources; and 100% (through Granite Hacarmel) of GES which engages in the treatment of water, wastewater and chemicals.

<u>The average occupancy rates in the income-producing properties as of the Report Date</u>:

- The retail centers and malls in Israel segment: approx. 98%;

- The office and other space for lease in Israel segment: approx. 99%[4];

- The income-producing property in the U.S. segment: approx. 85%[5].

- The senior housing segment in Israel: approx. 98%

<u>Additional operations</u>:

- The eCommerce business – see below in Section 1.1.2 a specification regarding the eCommerce business;

[4] Excluding the 2 buildings of Phase B in the Azrieli Holon Center, which were opened in late-2015 and at the end of Q1/2016 and are in lease-up stages.

[5] In view of the expiration of a contract with a tenant that held approx. 20 thousand sqm (approx. 10% of the space of the operating segment in the U.S.) in one of the office towers in Houston. As of the Report Date part of the space was leased and the Company is holding negotiations for leasing the rest of the space.

☒ Financial investments[6] - an investment in Bank Leumi Le-Israel Ltd. and in Leumi Card Ltd. See below changes in investments in the Report Period (NIS in millions):

	Investment value in the Financial Statements as of December 31, 2015	Investments (sales) during the year ended December 31, 2016	Total investment as of December 31, 2016 before adjustment to changes in fair value during the Report Period	Fair value* of the investment as presented in the Financial Statements as of December 31, 2016	Change in fair value in the Report Period	Dividend received in 2016
Investment in Bank Leumi Le'Israel Ltd. (*)	**954**	**(80)**	**874**	**,1040**	**166**	**-**
Investment in Leumi Card Ltd. (**)	**603**	**-**	**603**	**562**	**(41)**	**10**
Total	**1,557**	**(80)**	**,1477**	**,1602**	**125**	**10**

*Fair value of the investment in Bank Leumi Le'Israel is determined according to the value of the stock on the Stock Exchange as of December 31, 2016.

**Fair value of the investment in Leumi Card is determined by an independent valuator, according to the valuation as of December 31, 2016.

1.1.2 The Group's growth engines:

Development of income-producing properties - As the Company has reported in the past, the Company is focusing on its core business of real estate. The Group's main growth engine is the development of income-producing property projects: malls, offices and senior housing. As of the Report Date, the Company has 9 projects at various stages of development in Israel. The Azrieli Sarona project in Tel Aviv, whose construction is expected to be completed in Q3/2017, expected to include approx. 118,000 sqm of offices and a boutique mall of an area of approx. 11,500 sqm, whose construction is expected to be completed in 2018. As of the Report Release Date, the project is in advanced marketing stages, whereas in respect of 95% of the leasable office space, lease agreements were signed or advanced stage drafts were exchanged (out of which, contracts were signed in respect of approx. 60% of the leasable office space). In addition, shortly before the Report Release Date, the Company completed the construction of the office tower and mall in Azrieli Rishonim in Rishon LeZion, the mall opened to the general public and the possession was handed-over to several tenants towards the population of the office tower. Azrieli Rishonim is situated near to Route 431 and to the Rishonim train station, which allows considerable accessibility.

[6] In addition, the Company has negligible investments in venture capital companies, startups and investment funds as specified in Part A of this Report.

An additional project to be constructed on the artery of Menachem Begin North, close to the Azrieli towers, is the Azrieli Town project, while on August 31, 2016, the Company received the holding in the lot and it is expected to be completed in 2020. As of the Report Release Date, the Company has signed agreements to lease approx. 26 thousand sqm of office space at the project, constituting more than one half of the leasable office space in the project. As of the Report Release Date, the Company is advancing a zoning plan to add office and residential rights.

In addition, the Company has several additional projects at development and construction stages, for which no completion date has yet been scheduled: expansion of the Azrieli Tel Aviv Mall and construction of a fourth tower for the Azrieli Tel Aviv Center on the land which the Company purchased from Yedioth Ahronoth and which was handed over to the Company's possession in March 2016. In March 2017, the Company began the demolition of the building situated on the land. In addition, in Holon the Company purchased a number of plots of land for the development of the industrial and commercial area, close to the Azrieli Holon Center.

For details with respect to projects under construction, see Section 1.3.9 above and Section 7.7 of Chapter A of the Report.

Betterment of properties – The Company acts for the promotion and betterment of existing properties, including by way of the addition of retail space and leasable office space. For further details, see Section 7.7 of Chapter A of the Report.

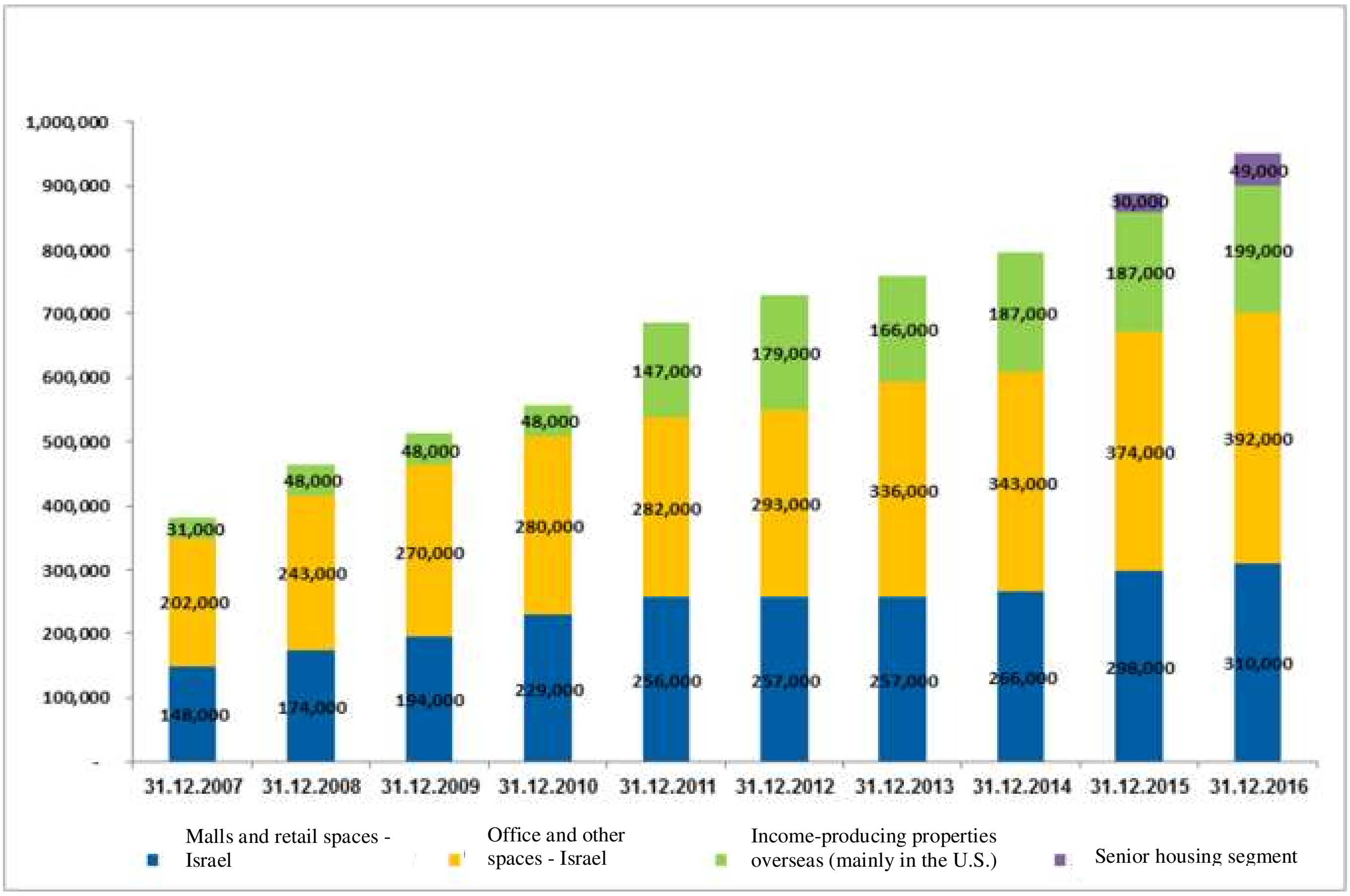
Senior Housing - As the Company has reported in the past, the Company from time to time looks into expanding its business, including entry into related real estate sectors. Thus, in 2014, the Company began to develop the senior housing segment, with the purchase of land for senior housing in Modi'in. The Company currently has two active senior homes: Palace Tel Aviv, which was purchased in 2015, and Palace Ra'anana (formerly Ahuzat Bayit, Ra'anana), whose purchase was closed in Q2/2016. In addition, the Company has three additional projects under development and construction for building approx. 840 residential units of a total area of approx. 107 thousand sqm. For further details about the senior housing segment, see Section 11 of Chapter A of the Report.

Expansion of the overseas office sector - As a development company, the Company from time to time examines growth targets for the expansion of its business, and explores opportunities, *inter alia* for the purchase of income-producing property and land for development also overseas. As part of this strategy, in August 2016, the Company purchased a property known as Aspen Lake II in Austin, Texas, in the U.S.

eCommerce Activity – Further to the Company's reports whereby it is continuing to look into business opportunities in connection with expansion of its business to additional segments which are in line with its business strategy, while gaining a foothold in the world of digital commerce which is gaining momentum in Israel and worldwide and creation of an additional growth engine, with the aim of creating a consumer experience, concurrently with the development of its core business in traditional commerce, the Company purchased business in the field of electronic commerce (eCommerce) from Buy2 Networks Ltd.

*The Company's estimates stated in this section, inter alia in connection with the dates for completion of the construction and the scopes of the projects, are forward-looking information, as defined in the Securities Law, 5728-1968 (the "**Securities Law**"), which is based on subjective estimates of the Company as of the Report Date, and there is no certainty that they will materialize, in whole or in part, or they may materialize in a materially different manner, inter alia due to factors beyond its control, including changes in market conditions, changes in the Company's plans, the time that shall be required for approval of the building plan for construction.*

Gross leasable area (GLA) on a consolidated basis as of December 31, 2016



The Company's management is acting to continue leading the income-producing property market, *inter alia*, through the acquisition of land reserves, the expansion of existing properties and the purchase of additional similar properties as aforesaid, in order to bring further growth in the operating cash flow of the Company in the future, insofar as the Company's board of directors shall deem fit, and to examine the development of tangential and/or synergetic segments.

1.2 Business Environment – Income Producing Real Estate Operation

In the estimation of the Company's board of directors, no material change has occurred in the business environment in which the Group operates, as described in the Board of Directors' Report as of December 31, 2015, except as specified below. The business indicators in 2016 show that the Israeli market is continuing to grow. The real gross domestic product and the gross domestic product per capita increased in 2016 by approx. 4.1% and approx. 2.3%, respectively. In addition, an increase of approx. 6.3% and approx. 4.2%, was recorded in private consumption and in private consumption per capita, respectively. The unemployment rate is low at 4.6%, and the average salary has risen. In the income-producing property sector in Israel, stability has been preserved both on the level of demand and on the level of rental prices and the occupancy rate, further to the trend that characterized 2015. CPI recorded a decrease of 0.2% in 2016 compared with a decrease of 1% in 2015. The Bank of Israel interest rate in 2016 remained unchanged at 0.1%. The Prime interest rate is 1.6%.

The Company's management estimates that the broad dispersion of the portfolio of properties owned thereby, the active current management and maintenance of the properties, their being located mainly in high-demand areas, the high business positioning of the properties and the Company's investments in the betterment of its properties to maintain such advantage, the high occupancy rates, the broad range of businesses existing in the malls and retail centers of the Group, the suitable mix of businesses and the stable capital structure of the Company contribute to reducing the scope of the exposure of the Group's business to significant crisis and/or instability due to the materialization of any of the Company's risk factors.

The Company's above estimations regarding changes in the income-producing property in Israel sector and their effect on the Company's results are merely subjective estimations and constitute forward-looking information within the definition of the term in the Securities Law. Actual effects and results may materially differ from the aforesaid estimations and what they imply, for various reasons, including the further intensification of competition, a decline in demand and a deterioration of the economic situation in Israel.

1.3 Main Developments in the Report Period and until the Release Date

1.3.1 Transactions in connection with investment property in the Report Period and until the Release Date

Agreement for the acquisition of a property in Holon

On April 13, 2016, the Company closed a transaction for the acquisition of all of the ownership rights of Lodzia-Rotex Investment Ltd. (the "**Seller**"), in a property of a registered area of approx. 53,000 sqm, with a built-up area of approx. 14,300 sqm of workshops and commercial buildings thereon, which are leased to various tenants, which is situated in the Holon industrial zone, in consideration for approx. NIS 280 million plus VAT. For further details see Section 1.3.1 of Chapter A of the Report and Note 14F to the Financial Statements.

Closing of the acquisition of "Yedioth Ahronoth House" (expansion of Azrieli Tel Aviv center)

On March 31, 2016, closing was performed of the acquisition of the full ownership of land of an area of approx. 8,400 sqm near the Azrieli Tel Aviv center, on which is currently built a building which is slated for demolition known as "Yedioth Ahronoth House". For further details see Section 1.3.1 of Chapter A of the Report and Note 14E to the Financial Statements.

Closing of the acquisition of Azrieli Town

On August 31, 2016, a transaction was closed for the acquisition of the land designated for the Azrieli Town project. For further details see Section 1.3.1 of Chapter A of the Report and Note 14D to the Financial Statements.

Purchase of an office building in Austin, Texas, U.S.A.

In August 2016, a consolidated company purchased an office building located in Austin, Texas, U.S.A., of approx. 128,990 sq. ft. (11,984 sqm) for U.S. $40.5 million. For further details see Section 1.3.1 of Chapter A of the Report and Note 14G to the Financial Statements.

1.3.2 Acquisition of eCommerce business

On June 2, 2016, a transaction was closed for the purchase of operations in the eCommerce sector from Buy2 Networks Ltd., a public company whose shares are listed on the Tel Aviv Stock Exchange, in for net consideration of approx. NIS 61 million. For further details see Section 1.3.2 of Chapter A of the Report and Note 10F to the Financial Statements

1.3.3 **<u>Financing transactions in the Report Period and until the Release Date</u>**

Date	**Type of financing**	**Total amount raised (NIS in millions)**	**Annual interest rate**	**Duration**	**Collateral**	**Comments**
July 2016	Bond issuance (Series D)	2,194	1.34	7.6	None	According to a shelf offering report published on July 5, 2016 (Ref.: 2016-01-075079), published under the Company's shelf prospectus that was published on May 10, 2016 (Ref.: 2016-01-063049). For further details regarding the Bonds (Series D), see Note 21B(5) to the Financial Statements.
May 2016	Private financing from an institutional entity	550	1.5	6.5	Yes	Immediate report dated May 2, 2016 (Ref.: 2016-01-057004) (included by way of reference) and Note 21B(9) to the Financial Statements.
May 2016	Private financing from an institutional entity	300	Prime (-)0.1%	0.3	Yes	Immediate report dated May 2, 2016 (Ref.: 2016-01-057553) (included by way of reference). In November 2016, the loan was repaid according to its original terms.
April 2016	Private financing from an institutional entity	250	1.35%	1.7	No	The Company has an undertaking to meet financial covenants identical to the covenants that were set forth in the indentures for the Company's Series B and Series C Bonds (the "**Indentures**"). The agreement includes standard grounds for acceleration, including grounds listed in the Indentures. In addition, the agreement includes an undertaking to not grant a floating charge on the Company's assets, in whole or in part, to any entity whatsoever, unless a floating charge is made at the same time in favor of the lender, identical in rank and scope (*pari passu*).

It is noted that in July and August 2016, the Group prepaid loans in the sum total of approx. NIS 900 million (of which approx. NIS 300 million were short-term loans and the balance mostly long-term loans which were due in March 2017). Some of the said loans were secured by various collateral which were removed after repayment of the loans.

1.3.4 **Publication of a shelf prospectus**

On May 10, 2016, the Company published a shelf prospectus after receiving a permit from the ISA (the "**Shelf Prospectus**").

1.3.5 **Transactions in connection with the Senior Housing Segment**

Closing of the acquisition of a senior home and retail center in Ra'anana

May 25, 2016 saw the closing of the acquisition of 100% of the shares of Ahuzat Bayit Raanana – Senior Housing Ltd., which holds and manages "Ahuzat Bayit" (currently "**Palace Ra'anana**"), a senior home, and "Park Mall", a retail center in Ra'anana, in consideration for NIS 55 million. For further details, see Section 1.3.4(2) of Chapter A of the Report and Note 14I(3) to the Financial Statements.

Winning a tender for the acquisition of lease rights designated for senior housing in Rishon LeZion

On March 13, 2016, a consolidated company won a tender conducted by the ILA for the acquisition of lease rights in a lot of an area of 3,400 sqm designated for senior housing in the Harakafot neighborhood in East Rishon LeZion, designated for the construction of at least 250 senior housing units and approx. 3,000 sqm of retail, in consideration for NIS 26.6 million. For further details, see Section 1.3.4(1) of Chapter A of the Report and Note 14I(1) to the Financial Statements.

1.3.6 **Transactions in connection with companies of the Granite Hacarmel group**

Closing of the sale of Sonol

On July 24, 2016, Granite Hacarmel closed a transaction for the sale of all of its holdings (100%) in Sonol to Israel Oil & Gas Fund L.P., a limited partnership incorporated in Israel whose general partner is controlled by Mr. David Weissman.

In addition, the Company and Granite sold to other third parties their holdings, including through Sonol, in the Pi Glilot land and in the shares of the Pi Glilot company, for total consideration of approx. NIS 130 million. These transactions in Pi Glilot have not yet been closed. For further details see Section 1.3.5 of Chapter A of the Report and Note 8 to the Financial Statements.

1.3.7 **Miscellaneous**

Class Action

In April 2016, a joint motion was filed with the court to enter a judgment approving a settlement agreement in connection with a motion that was filed with the Economic Department at the Tel Aviv District Court (in this Section, the "**Court**") against the Company and against the subsidiary, Canit Hashalom, for a class action concerning a full tender offer completed by the Company in September 2012, for shares of the public in Granite Hacarmel. On September 19, 2016, a hearing was held at the Court in which the parties accepted the Court's recommendation, according to which the petitioner would withdraw the motion for class action and the respondents (the Company and a subsidiary thereof) would pay the petitioner compensation in the amount of NIS 50,000 and legal fees to the petitioner's attorney in the amount of NIS 250,000 plus VAT, without recognizing any of the petitioner's claims. These agreements were sanctioned as a judgment. For further details see Section 1.3.6 of Chapter A of the Report and Note 33A(1) to the Financial Statements.

Receipt of a tax assessment

On December 5, 2016, the Tax Authority issued a tax assessments to the best of judgement to the Company and Canit Hashalom (the "**Assessment**") in a total sum of approx. NIS 170 million for 2011-2014 (inclusive). It is stated that a tax liability was included in the Company's Financial Statements in respect of portions of the sum of the Assessment.

The Company disputes the positions of the Tax Authority and believes, *inter alia*, in reliance on its legal counsel, that it has sound claims against said positions. Thus, the Company filed, in January 2017, an objection to the Assessment.

For further details see Section 1.3.6(3) of Chapter A of the Report and Note 30F to the Financial Statements.

1.3.8 For details regarding the Company's strategy and the forecast for its operations see Sections 26 and 27 of Chapter A of the Report.

1.3.9 Developments in Enterprise and Development

As of the date of this Report, the Company is acting for the development of several properties under construction. Set forth below is a summary of the data regarding properties under construction as of December 31, 2016

Name of property	Location	Date of purchase	Usage	Rate of holding	Area of land (in sqm)	Sqm for marketing	Date of commencement of construction	Estimated date of completion	Value of the project on the Company's books as of December 31, 2016 (NIS in millions)	Cost invested (without discounting and tenant adjustments) as of December 31, 2016 (NIS in millions)	Estimated cost of construction including land (NIS in millions)
Azrieli Sarona	Tel Aviv	May 2011	Retail and Offices	100%	9,400	11,500 118,000	May 2012	Y2018 (retail) Q3/2017 (offices)	,1766	1,448	1,600-1,660
Azrieli Rishonim	Rishon LeZion	August 2008	Retail and Offices	100%	19,000	50,000	December 2011	March 2017**	661	635	750-760
Azrieli Town[(1)]	Tel Aviv	October 2012	Retail, Offices and Residential	100%	10,000	75,000	September 2016	Y2020	482	297	1,000-1,050
Expansion of Azrieli Center Tel Aviv[(2)]	Tel Aviv	May 2013	Retail, Offices and Residential	100%	8,400	69,000	September 2016 [(3)]	Not yet determined	597	410	1,000-1,050
Palace senior housing Modi'in	Modi'in	June 2014	Senior Housing	100%	10,500	35,000*	April 2015	Y2018	174	169	360-370

Name of property	Location	Date of purchase	Usage	Rate of holding	Area of land (in sqm)	Sqm for marketing	Date of commencement of construction	Estimated date of completion	Value of the project on the Company's books as of December 31, 2016 (NIS in millions)	Cost invested (without discounting and tenant adjustments) as of December 31, 2016 (NIS in millions)	Estimated cost of construction including land (NIS in millions)
Holon Manor land	Holon	February 2015	Retail and offices	100%	6,200	28,000	Q2/2017 (estimated)	Y2020	35	37	210-230
Palace senior housing Lehavim	Lehavim	December 2014	Senior housing	100%	28,300	44,000*	August 2016	Y2019	33	31	320-340
Property in Holon Industrial Zone - Lodzia(4)	Holon	April 2016	Retail and offices	100%	59,200	220,000	Not yet determined	Not yet determined	323	344	Not yet determined
Rishon LeZion senior housing land	Rishon LeZion	March 2016	Senior housing and retail	100%	3,400	28,750*	Not yet determined	Not yet determined	50	50	390-400
Total						**679,250**			**4,121**	**,3421**	

(1) On August 31, 2016, the Company received possession of this property. The data presented relate to the existing zoning plan for the land.
(2) On March 31, 2016, the Company received possession of this property. The data presented relate to the existing zoning plan for the land.
(3) In September 2016, work has begun for clearance of the premises for the purpose of demolition of the building and in March 2017 work has begun for the demolition of the building.
(4) Includes another plot of land (approx. 6,200 sqm, in relation thereto approx. 27,000 sqm are for marketing) originally purchased in an ILA tender, which constituted part of the Holon Manor land. With respect to the property purchased from Lodzia, it was determined that until April 2017, income in respect thereof belongs to the Seller.
(*) The figure constitutes the scope of building rights in sqm. In relation to the Rishon LeZion senior housing land, the figure includes an area of approx. 3,000 for retail.
(**) As of the Report Release Date, the mall opened and the possession was handed-over to several tenants towards the population of the office tower.

During the Report Period, the Company continued the development and construction work of its properties which are specified above, and obtaining the certificates required for the purpose of the continued development thereof according to the scheduled timetables and with no significant delays. In addition, there has been progress in the negotiations for the lease of tens of thousands of sqm under construction. For further details, see Sections 7.7-7.8 of Chapter A of this Report, Description of the Corporation's Business

The Company's estimates stated in this Section 1.3.9, inter alia, in respect of the projected investments and costs for properties under construction, manner of financing the projects, dates for completion of construction, receipt of various regulatory approvals required for the progress of the projects under construction or the outcomes of administrative and legal proceedings, are forward-looking information as such term is defined in the Securities Law, 5728-1968, based on subjective estimations of the Company as of the Report Date and there is no certainty to their realization, in whole or in part, or they may realize in a materially different manner, inter alia due to causes which are beyond its control, including changes in market conditions, changes in the Company's plans, the duration of time required for approval of the construction plan for performance and in prices of construction inputs.

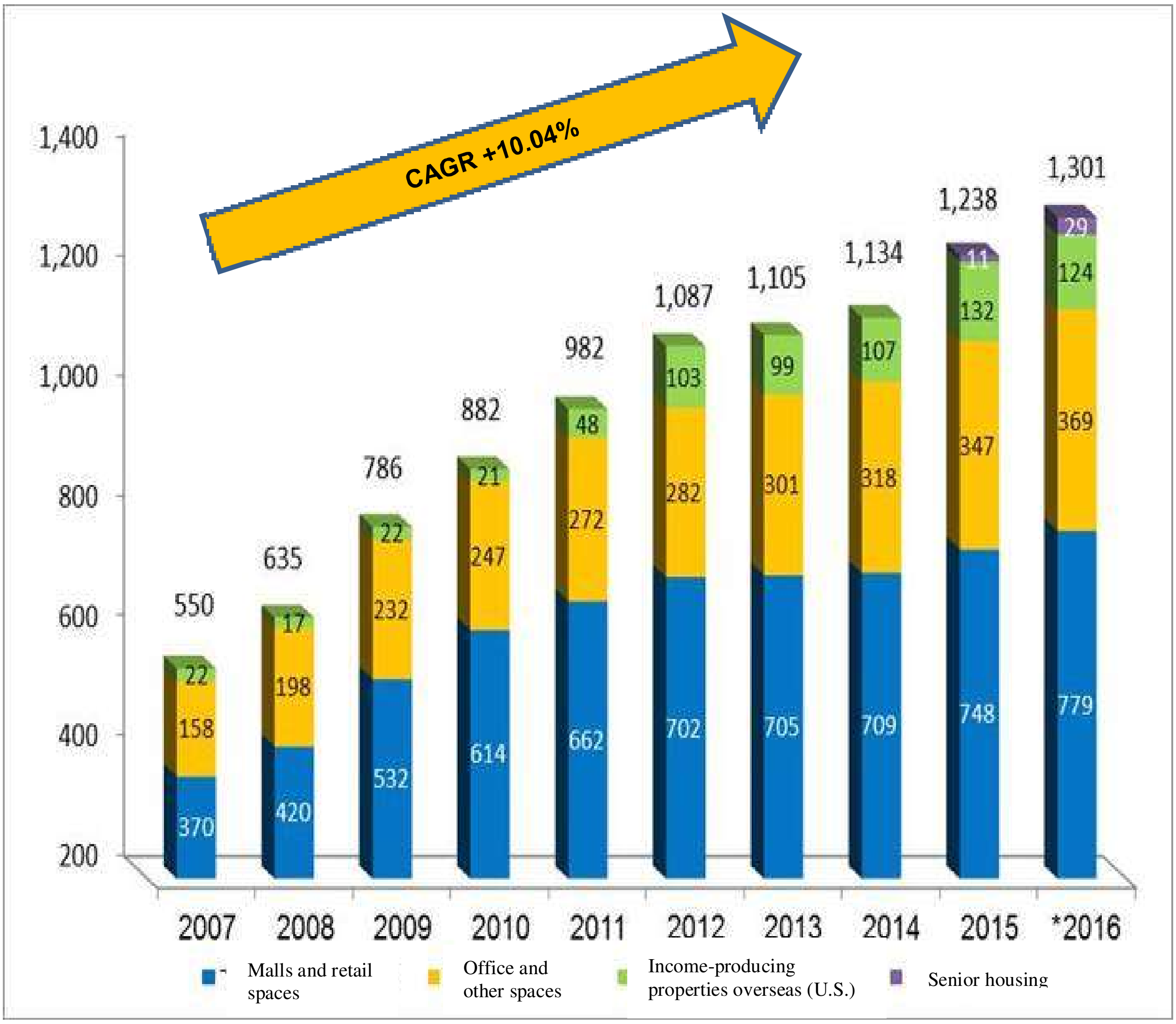
1.3.10 The NOI (Net Operating Income) index

The NOI figure is one of the important parameters in the valuation of income-producing property companies. The indication for determination of the value of income-producing property (over and above other indications such as: market value of similar properties in the same area, sale prices of similar properties in recent transactions that were performed etc.) is division of this figure by the accepted cap rate determined according to the character and location of the property. In addition, the NOI is used for measurement of the free cash flow available to service financial debt taken to finance the acquisition of the property, whereby current maintenance expenses for property preservation are offset against the total NOI.

We shall emphasize that these parameters do not present cash flows from current operations according to GAAP, do not reflect available cash for financing of all of the Group's cash flows (including its ability to perform a money distribution) and are not supposed to be deemed as a substitute for the net profit for assessment of the Group's results of operations.

For the purpose of calculation of the NOI, all revenues from tenants (including rent, management fees and other payments) were taken into account on the income side, and the calculation of costs takes into account all of the operating expenses in respect of the properties, including management, maintenance and other costs. The Group is preparing its financial statements on the basis of the international standardization and therefore, in the calculation of the cost of leasing and operating the properties which are classified as investment property, depreciation was not taken into account. In addition, for the purpose of calculation of the above parameters, profit from revaluation of properties was not taken into account.

During 2007-2016, the Group recorded continuous growth at an average rate of 10.04%, and in total, during 2007-2016, growth of approx. 137% in the actual NOI values in all of its income-producing property operating segments in Israel and abroad.



* CAGR = Compound Annual Growth Rate.

Below are the NOI figures regarding income-producing property, from the retail centers and malls in Israel segment, from the office and other space for lease in Israel segment, from the income-producing property in the U.S. segment and from the senior housing segment in 2015-2016 and in the three months ended December 31, 2016 and December 31, 2015.

	For the year ended		For the three months ended	
	December 31, 2016	**December 31, 2015**	**December 31, 2016**	**December 31, 2015**
	NIS in millions			
Retail centers and malls in Israel	779	748	200	192
Growth rate	4%		4%	
Office and other space for lease in Israel	369	347	95	94
Growth rate	6%		1%	
Income-producing property in the U.S.	124	132	33	31
Growth (reduction) rate	(6%)		6%	
Senior housing	29	11	10	6
Growth rate	164%		67%	
Total NOI	**1,301**	**1,238**	**338**	**323**
Growth rate	5%		5%	
For explanations regarding the change in the NOI see Sections 1.12.1, 1.12.2, 1.12.3 and 1.12.4 below.				

1.3.11 Same property NOI Index[7]

	For the year ended		For the three months ended	
	December 31, 2016	**December 31, 2015**	**December 31, 2016**	**December 31, 2015**
	NIS in millions			
Retail centers and malls in Israel segment	734	724	196	192
Office and other space for lease in Israel segment	369	347	95	94
Income-producing property in the US segment	119	132	30	31
Senior housing segment	-	-	6	6
Total	**1,222**	**1,203**	**327**	**323**
Growth rate	2%		1%	

[7] Same property NOI – NOI from same properties which were held by the Group throughout all of the reported periods.

Development of actual same property NOI, per quarters:

	2016				2015
	Q4	Q3	Q4	Q3	Q4
	NIS in millions				
Same property NOI in all of the periods (*)(**)	327	320	319	319	323
NOI from properties acquired/launched	11	8	2	-	-
NOI from properties sold during the period	-	-	-	-	-
Total NOI for the period	**338**	**328**	**321**	**319**	**323**

(*) In all of the Company's operating segments.
(**) Same-property NOI includes the figures of Azrieli Holon Center which is being populated throughout all of the relevant periods and has not been fully leased-up yet.

1.3.12 Weighted cap rate

Following is a calculation of the weighted cap rate derived from the entire income-producing property (excluding senior housing[8]) of the Group as of December 31, 2016**:**

	NIS in millions
Total Investment property in the "Extended Standalone" Statement (See Annex D) (*)	23,812
Net of value attributed to investment property under construction	3,720
Net of the value attributed to land reserves	506
Net of the value attributed to senior housing	1,086
Total value of income-producing investment properties (including fair value of the vacant space)	18,500
Actual NOI for the quarter ended on December 31, 2016 without senior housing	328
Addition to future quarterly NOI (**)	20
Total standardized NOI	348
Pro-forma annual NOI based on standardized NOI (excluding senior housing)	1,392
Weighted cap rate derived from income-producing investment property (including vacant space) (***)	7.5%

(*) In accordance with valuations received as of December 31, 2016. The figure includes receivables appearing in the balance sheet item "loans and receivables" in respect of averaging attributed to real estate.

(**) The figure mainly includes adjustments to the NOI as included in the valuations as of December 31, 2016, and therefore includes, *inter alia*, an addition of NOI for vacant spaces which have not yet been fully leased-up and spaces leased-up during Q4/2016 with full-year occupancy.

[8] Since the cap rate of senior housing properties derives from the FFO and not from the NOI, these properties were not included in this calculation. The weighted cap rate of the senior housing as of the Report Date is 8.75%.

(***) Annual standardized NOI rate out of the total income-producing investment property (including vacant space).
For the sensitivity test to changes in the interests of cap rates for investment property – see Annex A to this chapter

This figure does not constitute a forecast of the Company for the NOI of 2017 and its entire purpose is to reflect the NOI under the assumption of full lease-up for a whole year of all of the income-producing property. Furthermore, income-producing properties that will begin to produce income in 2017, such as Azrieli Rishonim and Sarona, were not included in the standardized NOI.

1.3.13 The FFO (Funds From Operations) index for the real estate business (Calculated in NIS in millions):

The FFO Index is an indicator commonly used around the world that provides an adequate basis for comparison between income-producing property companies. The index expresses net reported profit net of income and expenses of a capital nature, plus the Company's share in depreciation from real estate and other amortizations.

In this Report the FFO index is presented for the Group's income-producing property.

The Company's management believes that since the FFO index is an index customary in companies of which all of their business focuses on the income-producing property, therefore an adjustment of that index is required in companies of the Company's kind to better reflect the Group's income-producing property business while neutralizing influences which are not from the real estate business, such as in respect of non-operating items which are affected by revaluation of fair value of assets and liabilities, mainly various capital losses and gains, deferred tax expenses and financing expenses in respect of appreciation of financial liabilities, as specified in the basic assumptions underlying the table below.

It should be emphasized that the FFO index does not represent cash flow from current operations according to GAAP and does not reflect cash held by the Company and its ability to distribute the same and does not substitute the reported net profit. It is further clarified that this index is not a figure which is audited by the Company's auditors.

	For the year ended		
	December 31, 2016	December 31, 2015	December 31, 2014
	NIS in millions		
Net profit for the period attributed to shareholders	**1,810**	821	849
Discounting the net loss (profit) from Granite Hacarmel and from Azrieli E-Commerce attributed to shareholders (including amortization of surplus costs)	**(10)**	78	(141)
Adjustments to profit: [2]			
Appreciation of investment property	**(716)**	(179)	(38)
Depreciation and amortizations	**9**	6	4
Net non-cash flow financing and other revenues	**(80)**	(56)	(53)
Tax expenses (revenues)	**(117)**	171	134
Adjustments for associates	**-**	1	1
Plus benefit recorded for employee option plan	**-**	2	1
Net of dividend received from financial assets available for sale	**(10)**	(10)	(10)
Cash flow due to receipt of deposits from tenants net of return of deposits to tenants[3]	**59**	15	-
Net of revenues from forfeiture of tenants' deposits	**(17)**	(6)	-
Total adjustments to profit	**(872)**	(56)	39
Plus interest paid for real investments [4]	**20**	27	40
Total FFO attributed to income-producing property operations [1][5]	***948**	**870**	**787**

Notes and assumptions:

1. In 2016, including a one-time tax income for previous years in the amount of approx. NIS 5 million, compared with a negligible amount in 2015 and an amount of approx. NIS 6 million in 2014.
2. The adjustments to the profit below do not include the adjustments due to Granite Hacarmel and Azrieli E-Commerce since their results were discounted in full.
3. The FFO calculation changed such that deposits of the tenants in the senior housing shall be deemed as received or as repaid on the date of execution or expiration of the agreement, as the case may be.
4. Calculated according to weighted interest of the Group due to the real investments, which include: Granite Hacarmel, Azrieli E-Commerce Bank Leumi and Leumi Card, due to 65% of the investments' cost.
5. Which is attributed to shareholders only.
6. The FFO calculation also includes cash-flow financing expenses in connection with projects under construction.

(*) Including income of approx. NIS 18 million in respect of apartments in Palace Ra'anana which were leased-up for the first time. In addition, including growth in interest expenses in view of the scope of the financing round that was performed in Q3/2016 to refinance loans of the Group due in the upcoming period. Insofar as the debt raised will replace the existing loans, the FFO is expected to increase.

1.3.14 <u>The EPRA indices: Net Asset Value (EPRA NAV and EPRA NNNAV)</u>

The Company is included in the EPRA index and is also a member of this association (European Public Real Estate Association) which incorporates the large income-producing property companies. In view of the aforesaid, the Company decided to adopt the position statement which was published by the EPRA, the aim of which is to increase the transparency, uniformity and comparativeness of financial information which is released by the real estate companies.

The EPRA NAV reflects the Company's net asset value under the assumption of continued future activity which assumes the non-disposal of the real estate assets and therefore, various adjustments are required such as presentation by fair value of properties which are not so presented in the Financial Statements and cancellation of deferred taxes deriving from revaluation of investment property.

The EPRA NNNAV index reflects the Company's net asset value of the Company under an immediate liquidation assumption of the "Spot" real estate segment, and therefore certain adjustments are required, such as presentation at fair value of assets and liabilities which are not so presented in the Financial Statements and adjustments to the deferred taxes.

It should be emphasized that the indices specified above do not include the expected profit component in respect of the projects under construction which has not yet been recorded in the Financial Statements.

These figures do not constitute a valuation of the Company, are not audited by the Company's auditors and do not replace figures in the Financial Statements.

<u>EPRA NAV</u>	**For the year ended**	
	December 31, 2016	**December 31, 2016**
	NIS in millions	
Equity attributed to the Company's shareholders in the Financial Statements	15,273	13,771
Together with a tax reserve due to revaluation of investment property and fixed assets to fair value (net of the minority share)	2,826	3,005
EPRA NAV	**18,099**	**16,776**
EPRA NAV per share (NIS)	**149**	**138**

1.3.15 Summary of the Company's Results (Consolidated)

EPRA NNNAV	For the year ended	
	December 31, 2016	December 31, 2016
NIS in millions		
EPRA NAV	18,099	16,776
Adjustment of assets' value to fair value (net of the minority)	13	9
Adjustment of the value of financial liabilities to fair value (net of the minority)	(-)	(139)
Net of tax reserve due to revaluation of investment property and fixed assets to fair value (net of the minority share)	(2,826)	(3,005)
EPRA NNNAV	**15,286**	**13,641**
EPRA NNNAV per share (NIS)	**126**	**112**

a. Analysis of the net profit (consolidated) NIS in millions

	For the year ended		
	December 31, 2016	December 31, 2015	December 31, 2014
NIS in millions			
Net profit for the period attributed to the shareholders	1,810	821	849
Net profit attributed to the shareholders and non-controlling interests	1,808	828	860
Basic profit per share (in NIS)	14.93	6.77	7.01
Basic profit per share from continuing operations (in NIS)	15.00	7.59	6.11
Comprehensive income for shareholders and non-controlling interests	1,893	846	913

In the Report Period, the Company recorded growth in the NOI from the real estate operations, and growth in the profit from adjustment of the fair value of investment property. In addition, in view of the tax rate reduction, the Company's tax expenses decreased in the Report Period.

b. Comprehensive Income

The Company's capital and comprehensive income are also affected by various capital funds, mainly capital funds due to adjustment to the fair value of investments treated as financial assets available for sale and by funds due to translation differences from foreign operations.

The difference between the comprehensive income and the net profit as aforesaid mainly derives from an increase in the fair value of financial assets available for sale (mainly a change in the fair value of the investment in Bank Leumi Le'Israel and the investment in Leumi Card), net of tax of approx. NIS 96 million and net of a loss from translation differences from foreign operations of approx. NIS 11 million.

1.3.16 Major trends in the market in connection with the income-producing property segment

For details regarding the influence of major market trends on the Group's operations see Sections 6.1, 8.1, 9.1, 10.2 and 11.2 of Chapter A of the Report.

1.4 Business Results and Total Assets

Following is the contribution of the Group's operating segments to the business results:

	Segment profit for the year ended (NIS in millions):		Rate of the segment's profit from the total consolidated net profit in the year ended:	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
Retail centers and malls in Israel	**779**	**748**	**43%**	**90%**
Office and other space for lease in Israel	**369**	**347**	**20%**	**42%**
Income-producing property in the U.S.	**124**	**132**	**7%**	**16%**
Senior housing	**29**	**11**	**2%**	**1%**
Granite	**83**	**88**	**4%**	**11%**
Others	**(4)**	**1**	**-**	**-**
Total attributed profit	**1,380**	**1,327**	**76%**	**160%**
Changes in fair value	**711**	**179**	**39%**	**22%**
Net financing expenses	**(110)**	**(127)**	**(6%)**	**(15%)**
Tax expenses	**(49)**	**(356)**	**(3%)**	**(43%)**
Net administrative and other expenses	**(115)**	**(96)**	**(6%)**	**(12%)**
Income from continuing operations	**1,817**	**927**	**100%**	**112%**
Income (loss) from discontinued operations	**(9)**	**(99)**	**-**	**(12%)**
Net profit for the period	**1,808**	**828**	**100%**	**100%**

The Group's revenues for the Report Period amounted to approx. NIS 2,405 million, compared with approx. NIS 2,355 million in the same period last year, an increase of approx. NIS 50 million, deriving from an increase in the revenues of the income-producing property segments in Israel, offset against a decrease in the revenues of the Granite Segment, mainly as a result of the sale of Via

Maris in 2015. The Group's revenues for the three months ended on December 31, 2016, amounted to the sum of approx. NIS 642 million, compared with the sum of approx. NIS 596 million in the same period last year, an increase of approx. NIS 46 million, which derives mainly from an increase in the revenues of the income-producing property segments.

Following is the share of the assets of the operating segments from the total assets of the Group:

	The share of the segment's assets out of the total assets, on a consolidated basis, as of (NIS in millions)		The rate of the segment's assets out of the total assets, on a consolidated basis, as of	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
Retail centers and malls in Israel	12,074	11,056	42%	42%
Office and other space for lease in Israel	8,219	6,830	29%	26%
Income-producing property in the U.S.	2,176	2,052	8%	8%
Senior housing	1,495	803	5%	3%
Granite	1,298	1,175	4%	4%
Others and adjustments	3,321	4,529	12%	17%
Total	28,583	26,445	100%	100%

1.5 Summary of Balance Sheet Data from the Consolidated Statement:

	As of December 31, 2016	As of December 31, 2015
NIS in millions		
Current assets	1,877	2,438
Non-current assets	26,706	24,007
Current liabilities	3,315	3,523
Non-current liabilities	9,952	9,052
Capital attributed to the Company's shareholders	15,273	13,771
Capital attributed to the Company's shareholders from the total balance sheet (in percent)	53%	52%

The Group finances its business activity mostly by its equity, cash and cash equivalents and by using non-bank credit (mostly bonds and loans from institutional bodies), bank credit (short- and long-term) and commercial papers. In the Report Period, the Company issued Series D bonds to the public on the basis of a Shelf Prospectus. The Group's financial solidity, which is characterised by low leverage and significant non-mortgaged properties, provides the Group with available sources for obtaining finance under convenient terms. For further details see Section 19 of Chapter A of this Report and Section 1.6 below.

1.6 Financial Condition, Liquidity and Financing Sources (NIS in Millions)

The Item	December 31, 2016	December 31, 2015	Explanations and Comments
Total balance sheet	28,583	26,445	The increase derives mainly from an increase in investment property, growth in short-term deposits, net of a decline in assets as a result of the sale of Sonol's operations.
Current assets	1,877	2,438	The decrease derives from the write-off of the balances in respect of Sonol's business that was sold, offset against growth in short-term deposits.
Investment property	23,723	20,529	The increase derives from progress of the investments in the projects under construction and in the income-producing properties, from the purchase of land, an office building and a senior home and from revaluations.
Current maturities and short-term credit	2,083	2,030	The increase derives from an increase in the maturities of long term loans and bonds, offset against a decrease in credit as a result of the sale of Sonol's operations.
Loans from banks and from other credit providers	2,488	2,989	The decrease derives from payments and classification as current maturity, net of new loans taken.
Bonds, net	4,498	2,963	The increase derives from the issue of bonds, offset against current payments and classification as current maturity.
Capital	15,316	13,870	The increase derives from the comprehensive income for the period, net of the distribution of dividend.

(a) Liquid Means in the Group

As of December 31, 2016, the cumulative scope of liquid means (cash and cash equivalents, financial assets held for trading and short-term deposits and investments) held by the Group amounted to approx. NIS 1,373 million. The Company deems its liquid means, the considerable cash flow from current operations and its non-pledged assets (at a total value of approx. NIS 19.6 billion in addition to approx. NIS 1,373 million specified above) as significant for its financial strength and an indication thereof, for its high financial flexibility due to its non-dependency on the availability of external sources also for the purpose of returning debts and for the ability to use investment opportunities in different periods[9]. Regarding additional possible liquid sources, the Company estimates that the Group is able to raise financing under favorable terms, even under the currently prevailing financial conditions.

Following is a table of non-pledged assets that are available to serve as collateral against the receipt of credit:

Assets	Value of assets as of December 31, 2016 (NIS in millions) as presented in the Financial Statements
Properties in retail centers and malls in Israel segment	10,215
Properties in the office and other space for lease in Israel segment	6,801
Other Properties (mainly senior housing)	316
The Company's holdings in Leumi Card	562
Company's holdings in Granite Hacarmel	572
Company's holdings in Azrieli E-Commerce	74
Company's holdings in Bank Leumi	1,040
Total	**,19580**

In addition, the Company holds pledged income-producing properties, the loan rate for which is lower than their fair value.

(b) Dividends

	Date of Approval	Date of Payment	Sum
Azrieli Group	March 22, 2016	May 4, 2016	NIS 400 million[10]
Leumi Card	February 23, 2016	March 1, 2016	NIS 50 million[11]
Bank Leumi	---	---	---

[9] In Section 20 of the Description of the Corporation's Business Chapter in Chapter A of this Report, the Company specified additional issues in connection with the financing activity at the Group.
[10] As of December 31, 2016, the Company has retained earnings in the sum of approx. NIS 12.7 billion (including a revaluation fund for financial assets available for sale).
[11] The Company's share in the sum of the said dividend is NIS 10 million.

(c) Cash flows

	For the year ended December 31, 2016	For the year ended December 31, 2015	Explanations and comments
Net cash flows derived by the Group from current operations	1,290	1,261	During the period and the same period, resulted mainly from the operating profit of the income-producing property in the sum of approx. NIS 1,301 million (approx. NIS 1,238 million in the same period), and a current cash flow from Sonol until the sale thereof which was offset against income taxes paid.
Net cash flows used by the Group for investment activities	2,578	826	The cash flow in the Report Period was mainly used for the acquisition of and investment in investment property and investment property under construction in the sum of approx. NIS 2,015 million, for investment in short-term deposits and for the purchase of companies consolidated for the first time. This amount was offset against the proceeds from the sale of Sonol in the sum of approx. NIS 116 million and the proceeds from the disposition of part of the Company's holdings in Bank Leumi in consideration for a total sum of approx. NIS 80 million. The cash flow in the same period last year was mainly used for the acquisition of and investment in investment property and investment property under construction in the sum of approx. NIS 1,021, million and for the acquisition of the Palace Tel Aviv in the sum of approx. 255 million, offset against net proceeds received from the sale of Via Maris and the solar business in the sum of approx. NIS 531 million
Net cash flows derived by the Group from financing activities	1,070	286	The increase versus the same period last year mainly derived from an increase in the receipt of long-term loans in the sum of approx. NIS 1,028 million in the period versus last year, offset against an increase in the repayment of short-term credit of approx. NIS 106 million, offset against an increase of approx. NIS 80 million in the sum distributed as dividend, net of the purchase of non-controlling interests in the sum of approx. NIS 51 million in the current period.

	For the three months ended December 31, 2016	For the three months ended December 31, 2015	Explanations and comments
Net cash flows derived by the Group from current operations	287	354	During the quarter and the same quarter, resulted mainly from the operating profit of the income-producing property in the sum of approx. NIS 338 million (approx. NIS 323 million in the same period), which was offset from income taxes paid. In the same quarter, also included the current cash flow from Sonol's operations.

	For the three months ended December 31, 2016	For the three months ended December 31, 2015	Explanations and comments
Net cash flows used by the Group for investment activities	140	204	The cash flow in the Report Period was mainly used for the acquisition of and investment in investment property and investment property under construction in the sum of approx. NIS 207 million, offset against the proceeds from the disposition of a part of the Company's holdings in Bank Leumi for a total sum of approx. NIS 80 million. The cash flow in the same period last year was mainly used for the acquisition of and investment in investment property and investment property under construction in the sum of approx. NIS 184 million.
Net cash flows used by the Group for financing activities	384	279	The increase versus the same period last year mainly derived from an increase in repayment of short-term credit of approx. NIS 153, offset against of a decrease in repayments of long-term loans of approx. NIS 39 million.

<u>Following is the composition of the Group's financing sources</u>

	December 31, 2016		December 31, 2015	
	NIS in millions	% of total balance sheet	NIS in millions	% of total balance sheet
Short-term credit and current maturities of loans from banks and other credit providers	2,083	7%	2,030	8%
Long-term credit from banks and other credit providers	2,488	9%	2,989	11%
Long-term bonds	4,498	16%	2,963	11%
Total	**9,069**	**32%**	**7,982**	**30%**

The increase in the sum of approx. NIS 1,087 million in the Report Period mainly derives from the issue of bonds as set forth in Section 1.3.3 above, offset against current loan and bond repayments and offset against a decrease resulting from the sale of Sonol's operations. As of the Report Date, the Company has a deficit in the working capital in the sum of approx. NIS 1.5 billion on a consolidated basis and in the sum of approx. NIS 0.7 billion in the standalone statement, resulting, *inter alia*, from the decision of the Group's management, at this stage, to finance its business also through short-term credit in view of the business opportunity, due to the low interests for such credit.

The Company estimates that if it decides to exchange such credit with long-term credit at any time, it will be able to do so in light of its financial strength and/or the scope of its non-pledged assets, and therefore, the Company's board of directors determined, at its meeting of March 21, 2017, after having examined the cash flow sources and the financing of the Company both in the consolidated statement and standalone statement, that the said deficit in the working capital does not affect its ability to repay its liabilities on time and/or does not indicate a liquidity problem in the Company.

The Company's estimations mentioned in this Section 1.6 of the board of directors' report in relation to its liquidity and the availability of its financing resources, particularly with respect to the eventuality of converting the short-term debt into long-term debt, is forward-looking information, as defined in the Securities Law, 5728-2968, which is based on the Company's estimations with regards to developments in markets, inflation levels and projected cash flows and on the conditions and possibilities for credit raising on the Report Date. Such estimations may not materialize, in whole or in part, or may materialize in a manner that materially differs from the Company's estimations. The principal factors which may affect this are: changes in the capital market which will impact the conditions and possibilities for raising credit, changes in the Company's plans, including use of liquid balances that shall exist for the purpose of utilizing business opportunities, changes in the advantageousness of holding of the various investment avenues or the advantageousness of use of various financing avenues, exacerbation of the economic situation in Israel or in the U.S. and entry into severe recession, and the Company's or any of the Group's companies' encountering financing or other difficulties, in a manner affecting the Company's cash flow.

(d) Rating

As of the Report Date, the Company is rated AA+/stable/ilA-1+ by Ma'alot. For details regarding the rating of the bonds, the commercial paper and private loans of the Company, see Section 19.12 of Chapter A of this Report.

(e) Liabilities and Financing

Financial liabilities of the Group (except for Granite Hacarmel and Azrieli E-Commerce) as of December 31, 2016:

	Fixed Interest			Variable Interest		Total		Total
	Index linked	U.S. Dollar Linked	Not Linked	Sterling Linked	Not Linked	Fixed Interest	Variable Interest	
NIS in millions								
Short term loans	-	-	-	20	655	-	675	675
Long term loans and bonds	6,495	1,166	250	-	41	7,911	41	7,952
Total	6,495	1,166	250	20	696	7,911	716	8,627

The date of payment of the Group's financial liabilities (with the exception of Granite Hacarmel and Azrieli E-Commerce) as of December 31, 2016:

Year	Principal	Interest	Total
NIS in millions			
1	2,029	140	2,169
2	756	120	876
3	791	109	900
4	729	92	821
5 forth	4,358	235	4,593
Total	8,663	696	9,359

The Company's policy is to finance its operations, beyond the positive and stable cash flow from current operations and current assets, mainly by long-term loans, index-linked with a fixed interest, in order to minimize market risks resulting from changes in the interest rates in the economy and neutralize the market risk resulting from changes in the CPI, while using the fact that most of the Company's revenues are index-linked.

Nonetheless, in light of the low interest rates for short-term loans with variable interest, the Company decided to finance its activity also by using short-term loans as specified above.

As of December 31, 2016, short-term loans accounted for approx. 8% of the Group's total financial liabilities (except for Granite Hacarmel and Azrieli E-Commerce). In the Company's estimation, this rate is low and conservative in light of the low leverage ratio and the sum of the non-pledged assets as specified above.

According to the Company's policy, from time to time, it considers the opportunities for converting the short-term debt to a long-term debt with fixed interest. The Company's management considers on an on-going basis the payment sources for financing the existing and expected liabilities as they become due, including with respect to the cash flow and the sum of the non-pledged assets. For details regarding the offering of the Series D bonds which occurred during the Report Period, see Section 1.3.3 of Part A of the Report.

In the Report Period, the sources for financing the financial liabilities are mainly the following:

- The Group has a positive cash flow from current operations for many years. This cash flow amounted to the sum of approx. NIS 1,290 million in the year ended December 31, 2016, compared with the sum of approx. NIS 1,261 million in the same period last year.
- The liquid means and the non-pledged assets as specified in Section 1.6(a) above.
- In addition, the Group has income-producing pledged properties, the

amount of the loan for which is significantly lower than their fair value.

1.7 Quality of Profit

The Company’s net profit mainly includes and is affected by the following components:

- Profit from the income-producing property segment – the retail centers and malls in Israel segment, the office and other space for lease in Israel segment; the income-producing property in the U.S. segment; and the senior housing segment;
- Changes in the fair value of the Group’s investment property;
- The Company's share in the Granite Hacarmel segment profits;
- The Company’s HQ activity which includes net financing expenses, G&A expenses and marketing;
- Deferred and current tax expenses;
- The Company’s share in the results of Azrieli E-Commerce.

The profit from the real estate business is affected almost entirely by the rental income in the various properties, which is mainly affected by the supply and demand for rental space.

There may be high volatility in the Company’s profits between different report periods, mainly due to changes in the value of the income-producing property as aforesaid, which is affected, *inter alia*, by changes in the cap rates and changes in the scope of the income as a result of changes in market conditions and/or of a rise in the CPI. In addition, the financing expenses at the Company are affected by changes in variable interest and changes in the CPI.

At least once every six months, and whenever there are any indications of material changes in the value, the Company examines the fair value of the investment property in Israel. The fair value is principally determined based on valuations that were mostly performed by appraisers independent of the Company. The fair value is measured based on the discounting of cash flows based on signed contracts and market rent for vacant spaces as of the date of the examination, which are supported by comparison thereof with renewals made in locations similar to that of the property proximately to the date of the valuation, as well as usage of cap rates, examined, *inter ali*a, by analyzing comparison transactions proximately to the date of the valuation. The Company examines, each quarter, the need for updating the value of the investment properties by an examination of macro-economic changes, changes in the properties' surroundings and revenues deriving therefrom, and speaks with an independent real estate assessor to examine changes in the capitalization rates. In addition, with regard to investment properties under construction, the costs which were actually invested during the period, the updated forecast of costs for completion and the lease contracts that were executed during the period, are taken into account. In the event that the management estimates that there were material changes in the value of the properties, as defined in the Company's procedures, updated valuations are performed for the relevant properties, by the Company or an appraiser.

Changes in the assumptions that are being used by outside experts and/or changes in the estimates of the Company's management which relies on its aggregate experience may lead to changes in the fair value that was carried to the income statement, and thus affect the Company's financial condition and results of operations. For further details see Note 36 to the Financial Statements.

For details regarding the fair value of the investment property according to operating segments, see Section 7.4 of Chapter A of this Report, and also see Notes 14 and 38 to the attached Financial Statements.

1.8 General Administrative and Marketing Expenses (Extended Standalone)

The Company's consolidated administrative and marketing expenses (without Granite Hacarmel and Azrieli E-Commerce) amounted to approx. NIS 105 million in 2016, compared with approx. NIS 94 million in 2015. The increase in expenses in the sum of approx. NIS 11 million derives mainly from an increase in the sum of approx. NIS 6 million in marketing expenses and an increase of approx. NIS 3 million in the consultancy and legal expenses.

The total consolidated sum of contributions of the Company (including Granite Hacarmel and Azrieli E-Commerce) in 2016 amounted to approx. NIS 12.5 million.

The Company's consolidated marketing and administrative expenses (without Granite Hacarmel and Azrieli E-Commerce) amounted to approx. NIS 36 million in Q4/2016, compared with approx. NIS 31 million in the same period last year. The increase derives mainly from an increase in marketing expenses in the sum of approx. NIS 2 million.

1.9 Net Financing Expenses

The Group's net financing expenses as of the year ended on December 31, 2016, amounted to approx. NIS 110 million, compared with approx. NIS 127 million in the same period last year (a decrease of approx. NIS 17 million). The decrease in net financing expenses mainly derives from the profit from the sale of the Bank Leumi shares and from a real decrease in the interest rate on the Group's loans, offset against a rise in the interest expenses due to an increase in the credit amount, and a decline in revenues from linkage on loans and bonds resulting from a decrease in the known CPI rate in the Report Period by approx. 0.3% compared with a decrease of approx. 0.9% in the same period last year. The net financing revenues in the quarter amounted to approx. NIS 5 million, compared with expenses in the sum of approx. NIS 30 million in the same period last year. The decrease of approx. NIS 35 million in net financing expenses mainly derives from the profit from the sale of the Bank Leumi shares.

1.10 Other Net Revenues

Other net revenues derive mainly from a dividend from Leumi Card as set forth above.

1.11 Taxes on Income

The Group's income tax expenses for the year ended December 31, 2016, amounted to the sum of approx. NIS 49 million, compared with tax expenses in the sum of approx. NIS 356 million in the same period last year. The decline in tax expenses in the Report Period is mainly attributed to a decrease in the deferred tax liability as of December 31, 2016, due to a reduction of the corporate tax rate to 23% in the long-term (which resulted in the recording of tax income of approx. NIS 394 million) and a decrease in the rate of the current tax in the Report Period, offset against an increase in deferred tax expenses as a result from the rise in the gain from property revaluations.

1.12 Contribution to the Company's Results According to Operating Segments

The Company implemented in its Financial Statements the International Financial Reporting Standard 8 concerning Operating Segments (IFRS8). The Company's division into segments is based on the managerial and internal reports of the Company. With respect to the income-producing property segments, the NOI figure is one of the most important parameters in valuations of income-producing property companies (for the manner of calculation of the figure, see Section 1.3.10 above). In addition, the contribution to the results takes into account the Company's share in the results of the company held (indirectly) by the Company, Granite, which constitutes an operating segment.

1.12.1 Retail Centers and Malls in Israel Segment

Summary of the segment's business results:

	For the three-month period ended		For the year ended	
	December 31, 2016	**December 31, 2015**	**December 31, 2016**	**December 31, 2015**
	NIS in millions			
Revenues	**251**	**236**	**974**	**931**
% change	**6%**		**5%**	
NOI	**200**	**192**	**779**	**748**
% change	**4%**		**4%**	

* The NOI figure is one of the important parameters in valuations of income-producing property companies. For details concerning the manner of calculation of this figure, see Section 1.3.10 above.

The growth in the NOI in 2016 derives mainly from lease-up of the Ramla mall and from the lease-up of the second floor in the Ayalon mall that opened during 2015, and from the acquisition of the Lodzia center. The increase in the NOI in Q4/2016 derives mainly from the acquisition of Azrieli Ra'anana and the Lodzia center.

Following is the development of the segment's NOI:

	For the three-month period ended		For the year ended	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
	NIS in millions			
For the segment's properties owned by the Company as of the beginning of the period[12]	**196**	**192**	**734**	**724**
For properties whose construction was completed in 2015	**-**	**-**	**35**	**24**
For properties that were purchased or whose construction was completed in 2016	**4**	**-**	**10**	**-**
Total	**200**	**192**	**779**	**748**

The same property NOI in the malls and retail centers in Israel segment was favorably affected primarily by a real increase in the rent at the time of renewal of contracts in the various properties (pursuant to option exercise by the tenants and/or execution of new agreements) and from lease-up of the second floor of the Ayalon mall, and was adversely affected by space left vacant in periods of tenant turnover in some of the malls.

The balance of the assets of the retail centers and malls in Israel segment – amounted, on December 31, 2016, to the sum of approx. NIS 12.1 billion, compared with approx. NIS 11.1 billion on December 31, 2015. The change mainly derives from investments in the segment's properties, the purchase of the Lodzia land and the retail center in Ra'anana and revaluation profits.

Change due to the adjustment of fair value of investment property and investment property under construction of the segment

The gain from fair value adjustment of investment property and investment property under construction of the segment amounted, in the Report Period, to approx. NIS 220 million compared with a gain of approx. NIS 123 million in the same period last year. The assets are presented according to the valuations performed by an independent appraiser as of December 31, 2016. The profit from the fair value adjustment in the Report Period, derived mainly from an increase in the NOI and a slight reduction in the cap rate, offset against investments in

[12] Same property NOI – NOI from similar properties that were held by the Group throughout all of the reported periods.

properties, both performed and expected to be performed.

1.12.2 Office and other space for lease in Israel segment:

Summary of the segment's business results:

	For the three-month period ended		For the year ended	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
	NIS in millions			
Revenues	**113**	**111**	**447**	**420**
% change	**2%**		**6%**	
NOI	**95**	**94**	**369**	**347**
% change	**1%**		**6%**	

The increase in revenues and in the NOI derives mainly from growth in revenues from existing office space for lease (mainly the continued lease-up of the offices in the Azrieli Holon Center).

Following is the development of the segment's NOI:

	For the three-month period ended		For the year ended	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
	NIS in millions			
Due to the segment's properties owned by the Company as of the beginning of the period[13]	**95**	**94**	**369**	**347**
Due to properties which were purchased or whose construction was completed in 2015	**-**	**-**	**-**	**-**
Due to properties which were purchased or whose construction was completed in 2016	**-**	-	**-**	-
Total	**95**	**94**	**369**	**347**

The same property NOI in the office and others in Israel segment was favorably affected primarily by a real increase in the rent at the time of renewal of contracts in the various properties (pursuant to the exercise of options by the tenants and/or execution of new contracts) and

[13] Same property NOI – NOI from similar properties that were held by the Group throughout the reported periods.

continued lease-up of Azrieli Holon Center.

The balance of the Group's investment property in the office and other space for lease in Israel segment – amounted on December 31, 2016 to the sum of approx. NIS 8.2 billion compared with approx. NIS 6.8 billion on December 31, 2015. The change mainly derives from investments in the segment's properties and from revaluation profits.

Change from adjustment of fair value of investment property and investment property under construction, of the segment

The gain from the fair value adjustment of investment property and investment property under construction of the segment amounted, in the Report Period, to the sum of approx. NIS 517 million, compared with a profit of approx. NIS 70 million in the same period last year. The profit in the Report Period derived mainly from the first-time revaluation of properties under development. The assets are presented according to the valuations carried out by an independent appraiser as of December 31, 2016.

1.12.3 Income-producing property in the U.S. segment:

Summary of the business results of the segment:

	For the three-month period ended		For the year ended	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
	NIS in millions			
Revenues	62	57	229	236
% change	9%	-	(3%)	-
NOI	33	31	124	132
% change	6%	-	(6%)	-

Following is the development of the segment's NOI:

	For the three-month period ended		For the year ended	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
	NIS in millions			
Due to the segment's properties owned by the Company as of the beginning of the period[14]	**30**	**31**	**119**	**132**
Due to properties purchased in 2015	**-**	**-**	**-**	**-**
Due to properties purchased in 2016	**3**	**-**	**5**	**-**
Total	**33**	**31**	**124**	**132**

The same property NOI in the income-producing property in the U.S. segment was negatively affected mainly by the expiration of a contract with a tenant that held an area of approx. 20 thousand sqm in one of the office towers in Houston which was partly occupied by another tenant and from the effect of the average exchange rate of the U.S. dollar in the Report Period which was approx. 1% lower than the exchange rate in the same period last year.

The investment property balance of the Group in the segment – amounted, on December 31, 2016, to the sum of approx. NIS 2.2 billion, compared with approx. NIS 2.1 billion on December 31, 2015. The change mainly derives from the purchase of an additional office building, net of revaluation losses as set forth above.

Change from fair value adjustment of investment property of the segment -

The loss from fair value adjustment of investment property of the segment amounted, in the Report Period, to the sum of approx. NIS 82 million, compared with a loss of approx. NIS 28 million in the same period last year. The loss in the Report Period derived mainly from the amortization of investments performed in properties and an increase in the cap rate.

[14] Same property NOI – NOI from similar properties that were held by the Group throughout the reported periods.

1.12.4 Senior housing segment:

Summary of the segment's business results:

	For the three-month period ended		For the year ended	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
	NIS in millions			
Revenues	31	18	95	36
% change	72%	-	164%	-
NOI	10	6	29	11
% change	67%	-	164%	-

The increase in revenues and in the NOI derives mainly from the purchase of Palace Ra'anana in 2016 and from the fact that Palace Tel Aviv was acquired in July 2015 and was not fully included in the corresponding period.

Set forth below is the development of the segment's NOI (NIS in millions):

	For the three-month period ended		For the year ended	
	December 31, 2016	December 31, 2015	December 31, 2016	December 31, 2015
Due to the segment's properties owned by the Company as of the beginning of the period[15]	6	6	-	-
Due to properties purchased in 2015	-	-	23	11
Due to properties purchased in 2016	4	-	6	-
Total	10	6	29	11

The balance of the Group's investment property in the senior housing segment – amounted, on December 31, 2016, to approx. NIS 1.3 billion, compared with approx. NIS 0.7 billion on December 31, 2015. The change mainly derives from the purchase of Palace Ra'anana and investments in properties under construction.

Change from fair value adjustment of investment property and investment property under construction of the segment

The gain from fair value adjustment of investment property and

[15] Same property NOI – NOI from similar properties that were held by the Group throughout the reported periods.

investment property under construction of the segment amounted, in the Report Period, to approx. NIS 56 million (compared with a profit of approx. NIS 14 million in the same period last year). The properties are presented according to an update to the valuations that were carried out by an independent appraiser as of December 31, 2016.

1.12.5 Granite Segment:

Following is a summary of data from Granite's consolidated statement (NIS in millions):

	For the three-months ended		Increase/ decrease	For the year ended		Increase/ decrease
	December 31, 2016	December 31, 2015		December 31, 2016	December 31, 2015	
	NIS in millions		%	NIS in millions		%
Net revenues	**181**	**173**	**5%**	**653**	**731**	**(11%)**
Segment profit	**17**	**20**	**(15%)**	**83**	**88**	**(6%)**

Summary of the business results of the Granite Segment:

The decrease in the revenues and the profit in the Report Period mainly derives from the sale of Via Maris in 2015.

1.12.6 Profit from discontinued operations – Sonol:

In July 2016, Granite closed the sale of its entire holdings (100%) in Sonol. According to the provisions of IFRS 5, Sonol's results are presented as discontinued operations. Sonol's results were presented separately from the results of the continuing operations in the income statements and comparison figures in the income statement have been restated. For further details see Note 8 to the Financial Statements as of December 31, 2016.

1.13 Comment regarding forward-looking information

The Company's intentions mentioned in the introduction to the Board of Directors' Report, the main emphases for the Report and Sections 1.1 to 1.12 of the Board of Directors' Report, inter alia*, in connection with taking advantage of business opportunities and expanding the business, liquidity, financing sources and net financing expenses, the pace of the progress of the projects under construction, the projected costs for their construction, the effects of the economic situation on the Company's operating segments and with respect to the possibility of converting the short-term debt into long-term debt and/or raising debt, are forward-looking information, as defined in the Securities Law, based on the Company's plans as of the Report Date, the Company's estimates with respect to developments in the markets, inflation levels, expected cash flows, and on the conditions and the possibilities for raising credit on the Report Date.*

These estimates may not materialize, in whole or in part, or may materialize in a materially different manner than the Company estimated. The main factors which may have an effect thereon are: changes in the capital market which affect the conditions and the possibilities for raising credit, changes in the Company's plans, including use of liquid balances that shall exist for the purpose of taking advantage of business opportunities, changes in the advisability of the holding in various investment channels or the advisability of using various financing channels, delays in the granting of permits or approvals required for progress in the projects under construction, changes in the regulation relating to the Company's business, including in the field of zoning, raw materials used for construction becoming more expensive, changes in the CPI, worsening of the economic situation in Israel or in the U.S. and entering a harsh recession and the Company's or any of the Group's companies' facing financing or other difficulties, in a manner that affects the Company's cash flow.

2. Qualitative Report on the Exposure to and Management of Market risks

2.1 General

The specification below pertains to the Company and subsidiaries wholly owned thereby as well as material held companies of the Company, whose exposure to market risks may materially affect the Company. The person in charge of market risk management in the Company is the CFO, Ms. Irit Sekler-Pilosof. For details on her education, qualifications and business experience see Regulation 26A in Chapter D – Additional Details about the Corporation – of this Report.

Upon the sale of Sonol, the Group stopped buying and selling derivatives and assuming liabilities for the purpose of management of market risks. In addition, the Group stopped performing forward transactions in foreign currency that were intended to hedge cash flow exposure, and the exposure to changes in the price of oil distillates on the inventory value, was reduced.

2.2 Description of Market Risks

For details regarding the Company's market risks, see Notes 34 and 35 to the Financial Statements as of December 31, 2016.

2.3 The Company's Market Risk Management Policy

For details regarding the Company's market risk management, see Notes 34 and 35 to the Financial Statements as of December 31, 2016.

2.4 Means of Supervision and Implementation of the Policy

The finance committee and the board of directors deliberate, at least once every quarter, the Company's exposures to market risks and the actions which the Company's management has taken, and insofar as required determine quantitative criteria and limitations. The Company's management examines the scope of the business and the risk deriving from the business on an ongoing basis.

2.5 Analysis of sensitivity tests and fair value effects of protection transactions, exchange rates, interest and financial instruments

In accordance with the main market risks specified above and in accordance with the provisions of the Second Schedule to the Regulations, the Group is performing sensitivity tests regarding changes in market risks affecting the fair value of "financial instruments". In view of the sale of Sonol's business, changes in the prices of the oil distillates no longer affect the value of the inventory. In addition, dollar / shekel forward transactions no longer affect the sensitivity to the exchange rate of the dollar versus the shekel.

For details see Annex A to this Board of Directors' Report.

2.6 Linkage bases table

See Annex B to the Board of Directors' Report.

2.7 Designated Disclosure to Holders of Series B, Series C and Series D Bonds

For details regarding designated disclosure to the holders of the Company's Series B bonds, Series C bonds and Series D binds, see Annex E to this Chapter.

3. Corporate Governance Aspects

For details regarding the aspects of the corporate governance in the Company, including a corporate governance questionnaire and approval of the reports, compensation of senior officers, donation policy, details regarding the internal auditor and the auditor and the internal enforcement program at the Company, see the Corporate Governance chapter, which is attached hereto as Chapter E. For details with respect to directors of the Company, see the Additional Details about the Corporation chapter, which is attached hereto as Chapter D.

4. Provisions on Disclosure in connection with the Company's Financial Report

4.1 Disclosure pertaining to very material valuations

The guideline of ISA determines that a material valuation is a valuation which fulfills one of the tests: (1) The subject-matter of the valuation constitutes at least 5% of the Company's total assets as the same are presented in the Consolidated Statements of Financial Position as of the last day of the reporting period (the "**Balance Sheet Test**") (2) The effect of the change in value as the result of the valuation on the net or comprehensive income, as the case may be, constitutes at least 5% of the total amount of the net or comprehensive income, respectively, of the Company for the Report Period, and constitutes at least 2.5%[16]of the Company's equity as of the end of the Report Period[17] (the "**Effect Test**"). In addition, the guideline determines that a very material valuation, which should be attached to the financial statements of a reporting corporation, is a valuation which fulfills double materiality (10% instead of 5% and 5% instead of 2.5%).

ISA further determined that where the valuation fulfills the quantitative tests but qualitative considerations led to a different decision of the corporation and it was decided not to attach the same, the corporation will disclose its decision, specifying the results of the quantitative tests and the reasons and considerations which constituted the basis for this resolution.

As of the Report Date, the Company's board of directors has adopted the parameters determined by ISA, as specified above, in respect of the attachment of a very material valuation.

As of the Report Date and after the above determination was examined, attached is the very material valuation only in respect to the Azrieli Towers in Tel Aviv (which is included in the valuation of the entire Azrieli Center, along with its components – namely- including the Azrieli Mall) - attached as Annex C to this Report.

As of December 31, 2016, the value of the Company's assets whose fair value was determined through a very material valuation (made as of December 31, 2016) was in the sum of approx. NIS 5 billion (which is attributed both to the Azrieli Center Towers and the Azrieli Mall), out of a fair value of investment properties in the sum of approx. NIS 24 billion (approx. 21% of the Company's total investment properties).

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[16] Update of Legal Position 105-23 Parameters for Examination of the Materiality of Valuations, released by ISA in July 2014.

[17] Meaning the effect of the subject-matter of the valuation after the effect of tax, if any and in absolute values.

4.2 Report on the Group's liabilities

A report on the Group's liabilities pursuant to Sections 38E and 9D of the Regulations is attached on a separate reporting form concurrently with the release hereof.

4.3 Lawsuits

See Note 33 to the Financial Statements.

4.4 Subsequent events

See Note 39 to the Financial Statements.

4.5 Financial figures attributed to the Company as a parent company

Pursuant to Regulation 9C of the Regulations, financial figures from the Consolidated Financial Statements attributed to the Company as a parent company are hereby attached in Chapter C, together with an auditor's opinion.

The Company's Board of Directors and management express their great appreciation for the Company's officers, the managements of the Group's various companies and their employees, for their blessed contribution to the Group's achievements in the year ended December 31, 2016.

Danna Azrieli Chairman of the Board	Yuval Bronstein CEO

Date: March 21, 2017

Annexes to the Board of Directors' Report

December 31, 2016

Annex A

Sensitivity Tests

December 31, 2016

Annex A – Sensitivity Tests

The following tables should be read in view of the following remarks:

1. The recorded instruments are not necessarily presented in the financial statements at fair value.
2. For details regarding the interest rates used for determining the fair value, see also Note 36D(2) to the Financial Statements.
3. Sensitivity to 2% absolute change in the interest constitutes an extreme scenario in the Company's estimation, after reviewing severe but conceivable scenarios.

Table of Sensitivity to financial instruments as of December 31, 2016 according to changes in market factors:

Sensitivity to changes in the interest rates in US Dollar

	Profit from the changes in the market factor			Fair value of liability	Loss from changes in the market factor			Value determination method
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	
Change Rate	2% absolute increase	10% increase	5% increase		5% decrease	10% decrease	2% absolute decrease	
Loans received	68,445	14,392	7,238	(1,207,188)	(7,323)	(14,731)	(76,354)	DCF method

Annex A – Sensitivity Tests
(Contd.)

Table of Sensitivity to financial instruments as of December 31, 2016 according to changes in market factors:

Sensitivity to changes in the real interest rates

	Profit (loss) from the changes in the market factor			Fair value of asset (liability)	Profit (loss) from changes in the market factor			Value determination method
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	
Change Rate	2% absolute increase	10% increase	5% increase		5% decrease	10% decrease	2% absolute decrease	
Long-term loans granted	(6,198)	(3,212)	(1,868)	57,988	948	2,422	6,023	DCF method
Long-term loans received	105,430	9,703	4,865	(1,772,123)	(4,894)	(9,817)	(119,450)	DCF method
Bonds	491,651	42,801	21,496	(5,180,098)	(21,593)	(43,380)	(584,084)	DCF method
Receivables in respect of a franchise arrangement	(8,342)	(1,465)	(739)	70,812	754	2,046	10,490	DCF method
Total	582,541	47,827	23,754	(6,823,421)	(24,785)	(48,729)	(687,021)	

Sensitivity to Shekel/Dollar exchange rates

	Profit (loss) from the changes in the market factor		Fair value of asset (liability)	Profit (loss) from changes in the market factor		Value determination method
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	
Change Rate	10% increase	5% increase		5% decrease	10% decrease	
Exposure in the linkage balance	10,289	5,145	102,893	(5,145)	(10,289)	Book value
Receivables in respect of a franchise arrangement	419	209	4,188	(209)	(419)	DCF method
Long-term loans received	(120,719)	(60,359)	(1,207,188)	60,359	120,719	DCF method
Total	(110,011)	(55,005)	(1,100,107)	55,005	110,011	

Annex A – Sensitivity Tests
(Contd.)

Table of Sensitivity to financial instruments as of December 31, 2016 according to changes in market factors:

Sensitivity to changes in the interest rates of the cap Rates of investment property

	Loss from changes in market factor			Fair value of asset	Profit from changes in market factor			Value determination method
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	
Change Rate	Absolute 2% Increase	10% Increase	5% Increase		5% Decrease	10% Decrease	Absolute 2% Decrease	
Weighted Cap Rate								
5.75% - 6.50%	(205,694)	(77,800)	(40,743)	860,783	45,073	95,132	396,448	DCF method
6.51% - 7.50%	(2,871,914)	(1,181,253)	(618,152)	12,949,380	664,768	1,442,775	5,137,664	DCF method
7.51% - 8.00%	(844,909)	(373,785)	(195,728)	3,714,618	216,175	456,187	1,428,688	DCF method
8.01% - 8.50%	(726,142)	(332,500)	(173,867)	3,125,821	193,287	407,332	1,203,841	DCF method
8.51% - 8.75%	(74,481)	(31,895)	(12,799)	1,086,063	30,731	55,672	132,287	DCF method
Investment property and investment property under construction	(4,723,140)	(1,997,233)	(1,041,289)	21,736,665	1,150,034	2,457,098	8,298,928	

Annex A – Sensitivity Tests

The following tables should be read in view of the following remarks:

1. The recorded instruments are not necessarily presented in the financial statements at fair value.
2. For details regarding the interest rates used for determining the fair value, see also Note 36D(2) to the Financial Statements.
3. Sensitivity to 2% absolute change in the interest constitutes an extreme scenario in the Company's estimation, after reviewing severe but conceivable scenarios.

Table of Sensitivity to financial instruments as of December 31, 2015 according to changes in market factors:

Sensitivity to changes in US Dollar interest rate

	Profit (loss) from the changes in the market factor			Fair value of asset (liability)	Profit (loss) from changes in the market factor			Value determination method
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	
Change Rate	2% absolute increase	10% increase	5% increase		5% decrease	10% decrease	2% absolute decrease	
Forward purchase transaction Dollar/Shekel	(496)	(2,378)	(1,220)	1,528	1,289	2,657	507	Forward formula
Loans granted	(44)	(250)	(130)	1,273	218	483	94	DCF method
Loans received	80,517	15,730	7,912	(1,179,161)	(8,006)	(16,108)	(90,512)	DCF method
Total	79,977	13,102	6,562	(1,176,360)	(6,499)	(12,968)	(89,911)	

Annex A – Sensitivity Tests

Table of Sensitivity to financial instruments as of December 31, 2015 according to changes in market factors:

Sensitivity to changes in the real interest rate

	Profit (loss) from the changes in the market factor			Fair value of asset (liability)	Profit (loss) from changes in the market factor			Value determination method
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	
Change Rate	2% absolute increase	10% increase	5% increase		5% decrease	10% decrease	2% absolute decrease	
Long-term loans granted	(5,321)	(2,413)	(1,210)	75,317	1,303	2,613	5,730	DCF method
Long-term loans received	84,118	6,831	3,418	(2,022,034)	(3,424)	(6,856)	(90,800)	DCF method
Bonds	275,593	21,266	10,664	(3,264,573)	(10,727)	(21,517)	(321,560)	DCF method
Receivables in respect of a franchise arrangement (*)	(8,218)	(1,204)	(595)	55,074	582	1,151	6,240	DCF method
Total	346,172	24,480	12,277	(5,156,216)	(12,266)	(24,609)	(400,390)	

(*) Re-presented.

Annex A – Sensitivity Tests

(Contd.)

Table of Sensitivity to financial instruments as of December 31, 2015 according to changes in market factors:

Sensitivity to Shekel/Dollar exchange rates

	Profit (loss) from the changes in the market factor		Fair value of asset (liability)	Profit (loss) from changes in the market factor		Value determination method
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	
Change Rate	10% increase	5% increase		5% decrease	10% decrease	
Exposure in the linkage balance	(10,885)	(5,443)	(108,854)	5,443	10,885	Book value
Loans granted	332	166	3,322	(166)	(332)	DCF method
Receivables in respect of a franchise arrangement	223	112	2,230	(112)	(223)	DCF method
Long-term loans received	(111,720)	(55,860)	(1,117,200)	55,860	111,720	Book value
Forward purchase transactions Dollar/Shekel	41,945	19,778	1,528	(24,555)	(46,722)	Forward formula
Total	(80,105)	(41,247)	(1,218,974)	36,470	75,328	

Sensitivity to changes in oil distillates prices on the inventory in NIS in thousands (before tax)

	Profit (loss) from the changes		Fair value	Profit (loss) from the changes	
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Change Rate	10% increase	5% increase		5% decrease	10% decrease
Oil distillates inventory	7,024	3,512	70,239	(3,512)	(7,024)
	7,024	3,512	70,239	(3,512)	(7,024)

Table of Sensitivity to financial instruments as of December 31, 2015 according to changes in market factors:

Sensitivity to changes in the interest rates of the cap rates of investment property

	Loss from the changes in the market factor			Fair value of asset	Profit from changes in the market factor			Value determination method
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	
Change Rate	2% absolute increase	10% increase	5% increase		5% decrease	10% decrease	2% absolute decrease	
Weighted Cap Rate								
6.5%-5.75%	(276,090)	(98,747)	(47,691)	1,161,880	70,543	139,514	558,778	DCF method
7% - 7.5%	(2,652,744)	(1,103,157)	(581,845)	11,821,969	627,228	1,327,522	4,713,771	DCF method
8%-7.51%	(548,961)	(242,023)	(126,731)	2,657,677	139,956	295,341	931,386	DCF method
8.5%-8.01%	(403,516)	(184,956)	(96,826)	1,977,409	107,112	225,979	668,065	DCF method
8.51% - 9%	(74,883)	(36,584)	(19,042)	683,360	21,168	44,358	115,240	DCF method
Investment property and Investment property under construction	(3,956,194)	(1,665,467)	(872,135)	18,302,295	966,007	2,032,714	6,987,240	

Annex B

Reporting According to Linkage Bases

as of December 31, 2016

(IFRS 7)

Annex B
Reporting According to Linkage Bases
as of December 31, 2016 (IFRS 7)
(NIS in thousands)

	As of December 31, 2016					
	Israeli Currency		Foreign Currency		Others	Total
	Non-linked	Index linked	Dollar	Other (1)		
Current Assets						
Cash and cash equivalents	639,740	-	72,693	2,555	-	714,988
Short-term deposits and investments	658,141	145	-	-	-	658,286
Trade accounts receivable	286,859	-	1,517	-	-	288,376
Other receivables	33,855	4,820	31,833	-	66,584	137,092
Inventory	-	-	-	-	60,478	60,478
Current tax assets	-	-	-	-	17,201	17,201
Assets of a disposal group held for sale	-	-	781	-	-	781
Total Current Assets	1,618,595	4,965	106,824	2,555	144,263	1,877,202
Investments in and loans to associated companies	78,924	-	-	-	549	79,473
Investments, loans and receivables	133,662	42,540	-	-	163,566	339,768
Financial assets	1,689,636	-	23,700	-	-	1,713,336
Long-term receivables in respect of a franchise arrangement	-	45,271	3,606	-	3,606	52,483
Investment property and investment property under construction	-	-	-	-	23,722,736	23,722,736
Fixed assets	-	-	-	-	445,187	445,187
Intangible assets	-	-	-	-	333,097	333,097
Deferred tax assets	-	-	-	-	19,950	19,950
Total Non-Current Assets	1,902,222	87,811	27,306	-	24,688,691	26,706,030
Total Assets	3,520,817	92,776	134,130	2,555	24,832,954	28,583,232

(1) Mainly GBP.

Annex B
Reporting According to Linkage Bases
as of December 31, 2016 (IFRS 7)
(NIS in thousands)

(Contd.)

	As of December 31, 2016					
	Israeli Currency		Foreign Currency		Others	Total
	Non-linked	Index linked	Dollar	Other (1)		
Current Liabilities						
Current maturities and credit from banks and other credit providers	681,171	1,118,129	263,323	19,941	-	2,082,564
Trade payables	200,480	-	17,633	520	-	218,633
Payables and other current liabilities	58,954	35,684	5,528	210	99,542	199,918
Deposits from customers	28,556	735,447	-	-	-	764,003
Provisions	-	-	-	-	12,498	12,498
Current tax liabilities	-	-	-	-	37,428	37,428
Liabilities of a disposal group held for sale	-	-	169	-	-	169
Total Current Liabilities	969,161	1,889,260	286,653	20,671	149,468	3,315,213
Non-Current Liabilities						
Loans from banks and other credit providers	284,408	1,300,039	903,441	-	-	2,487,888
Bonds	-	4,498,260	-	-	-	4,498,260
Employee benefits	-	-	-	-	8,139	8,139
Other liabilities	1,430	40,063	3,719	-	38	45,250
Deferred tax liabilities	-	-	-	-	2,912,691	2,912,691
Total Non-Current Liabilities	285,838	5,838,362	907,160	-	2,920,868	9,952,228
Total Liabilities	1,254,999	7,727,622	1,193,813	20,671	3,070,336	13,267,441
Total Exposure in the Statement of Financial Position	2,265,818	(7,634,846)	(1,059,683)	(18,116)	21,762,618	15,315,791

(1) GBP.

Annex B
Reporting According to Linkage Bases
as of December 31, 2016 (IFRS 7)
(NIS in thousands)

(Contd.)

	As of December 31, 2015					
	Israeli Currency		Foreign Currency		Others	Total
	Non-linked	Index linked	Dollar	Other(1)		
Current Assets						
Cash and cash equivalents	821,494	-	105,567	7,663	-	934,724
Short-term deposits and investments	36,148	154	-	-	-	36,302
Trade accounts receivable	1,078,361	3,570	20,229	-	-	1,102,160
Other receivables	45,346	22,733	21,662	-	77,486	167,227
Inventory	-	-	-	-	173,450	173,450
Current tax assets	-	-	-	-	14,894	14,894
Assets of a disposal group held for sale	-	-	8,591	-	259	8,850
Total Current Assets	1,981,349	26,457	156,049	7,663	266,089	2,437,607
Investments in and loans to associated companies	61,509	9,246	-	-	-	70,755
Investments, loans and receivables	61,341	61,600	4,721	-	90,659	218,321
Financial assets	1,634,765	-	25,162	-	-	1,659,927
Long-term receivables in respect of a franchise arrangement	-	39,912	2,230	-	2,230	44,372
Investment property and investment property under construction	-	-	-	-	20,528,554	20,528,554
Fixed assets	-	-	-	-	1,059,657	1,059,657
Intangible assets	-	-	-	-	342,955	342,955
Pre-paid long-term rent	-	-	-	-	36,637	36,637
Deferred tax assets	-	-	-	-	46,320	46,320
Total Non-Current Assets	1,757,615	110,758	32,113	-	22,107,012	24,007,498
Total Assets	3,738,964	137,215	188,162	7,663	22,373,101	26,445,105

(1) Mainly Euro.

Annex B
Reporting According to Linkage Bases
as of December 31, 2016 (IFRS 7)

(Contd.)

	As of December 31, 2015					
	Israeli Currency		Foreign Currency		Others	Total
	Non-linked	Index linked	Dollar	Other(1)		
Current Liabilities						
Current maturities and credit from banks and other credit providers	1,539,403	418,459	47,961	24,382	-	2,030,205
Trade payables	261,205	16,681	240,643	6,109	-	524,638
Payables and other current liabilities	56,863	23,800	6,153	223	288,169	375,208
Deposits from customers	3,553	398,513	-	-	-	402,066
Provisions	-	-	-	-	77,515	77,515
Current tax liabilities	-	-	-	-	110,241	110,241
Liabilities of a disposal group held for sale	-	-	3,329	-	58	3,387
Total Current Liabilities	1,861,024	857,453	296,086	30,714	475,983	3,523,260
Non-Current Liabilities						
Loans from banks and other credit providers	119,835	1,770,615	1,099,006	-	-	2,989,456
Bonds	-	2,962,731	-	-	-	2,962,731
Employee benefits	-	-	-	-	18,981	18,981
Other liabilities	6,908	38,495	8,244	-	38	53,685
Deferred tax liabilities	-	-	-	-	3,027,164	3,027,164
Total Non-Current Liabilities	126,743	4,771,841	1,107,250	-	3,046,183	9,052,017
Total Liabilities	1,987,767	5,629,294	1,405,336	30,714	3,522,166	12,575,277
Total Exposure in the Statement of Financial Position	1,751,197	(5,492,079)	(1,217,174)	(23,051)	18,850,935	13,869,828

(1) GBP.

Annex C

Very Material Valuation

December 31, 2016

(Attached separately)

<u>Annex D</u>

Financial Statements

(Extended Standalone)

As of December 31, 2016

Azrieli Group Ltd.

Extended Standalone Financial Statements

December 31, 2016

Annex D

Azrieli Group Ltd.

Extended Standalone Financial Statements

Annex D

The Company's extended standalone financial statements are a summary of the Company's statements that are presented according to the IFRS rules, except for the investments in Granite and Azrieli E-Commerce, which are presented according to the equity method in lieu of consolidation of the statements thereof with the Company's statements (the remaining investments are presented with no change relative to the statement presented pursuant to the IFRS rules). These statements are not separate statements within the meaning thereof in IAS 27 nor separate financial statements pursuant to Regulation 9C of the Securities Regulations (Periodic and Immediate Reports), 5730-1970. The statements are not part of the information that is required to be published according to securities laws. However, the Company's management believes that analysts, investors, shareholders and bond holders may receive valuable information from the presentation of such figures.

The figures in this annex have not been audited or reviewed by the Company's auditors.

Balance sheet:

	As of December 31	
	2016	2015
	NIS in thousands	NIS in thousands
Assets		
Current Assets		
Cash and cash equivalents	667,334	860,618
Short-term deposits and investments	614,261	506
Trade accounts receivable	69,692	44,478
Other receivables	103,491	69,023
Current tax assets	7,480	5,505
Total Current Assets	1,462,258	980,130
Non-Current Assets		
Investment in investee companies	779,220	952,919
Loans and receivables	223,873	93,190
Financial assets	1,625,453	1,581,575
Investment property and investment property under construction	23,722,736	20,516,134
Fixed assets	127,556	111,491
Intangible assets	86,283	73,952
Deferred tax assets	615	835
Total Non-Current Assets	26,565,736	23,330,096
Total Assets	28,027,994	24,310,226

Azrieli Group Ltd.

Extended Standalone Financial Statements

Annex D

Balance Sheet - Contd.

	As of December 31	
	2016	2015
	NIS in thousands	NIS in thousands
Liabilities and Capital		
Current Liabilities		
Current maturities and credit from banks and other credit providers	2,025,643	1,068,409
Trade payables	155,475	125,455
Payables and other current liabilities	303,139	362,630
Deposits from senior housing tenants	659,024	295,241
Current tax liabilities	21,990	91,778
Total Current Liabilities	3,165,271	1,943,513
Non-Current Liabilities		
Loans from banks and other credit providers	2,451,115	2,872,842
Bonds	4,149,815	2,579,151
Other liabilities	45,250	42,421
Employee benefits	5,479	3,420
Deferred tax liabilities	2,897,567	3,001,313
Total Non-Current Liabilities	9,549,226	8,499,147
Capital		
Ordinary share capital	18,223	18,223
Share premium	2,518,015	2,518,015
Capital reserves	499,528	407,396
Retained earnings	12,237,592	10,827,591
Total equity attributable to the shareholders of the parent company	15,273,358	13,771,225
Non-controlling interests	40,139	96,341
Total Capital	15,313,497	13,867,566
Total Liabilities and Capital	28,027,994	24,310,226

Azrieli Group Ltd.

Extended Standalone Financial Statements

Annex D

Income Statement:

	For the year ended December 31	
	2016	**2015**
	NIS in Thousands	**NIS in thousands**
Revenues:		
From rent, management and maintenance fees	1,754,982	1,631,581
Net profit from adjustment of fair value of investment property and investment property under construction	710,578	179,071
Financing	39,188	8,640
Share in results of associates, net of tax (*)	21,781	21,447
Other	10,395	9,983
Total Revenues	2,536,924	1,850,722
Costs and Expenses		
Cost of revenues from rent, management and maintenance fees	445,613	385,222
Sales and Marketing	39,921	34,068
General and Administrative	64,621	60,030
Financing	134,697	110,239
Total Costs and Expenses	684,852	589,559
Income before income taxes	1,852,072	1,261,163
Expenses for taxes on income	(35,400)	(334,571)
Income from continuing operations per year, including the minority	1,816,672	926,592
Loss from discontinued operations per year, including the minority (*)	(8,501)	(98,927)
Net Profit for the year, including the minority	1,808,171	827,665

(*) The comparison figures were re-presented due to discontinued operations (for further details see Note 8 to the Consolidated Financial Statements).

Annex E

Designated Disclosure to the Bondholders

Annex E - Designated Disclosure to the Bondholders

Set forth below are details regarding the bonds of the Company that are held by the public

Series	Date of the Issue	Par Value on the Date of the Issue	Par Value on the Report Date	Par Value on the Report Date, including Linkage	Amount of Interest Accrued by the Report Date	Value in the Financial Statements	Market Cap	Type of Interest	Interest Rate	Principal Payment Dates	Interest Payment Dates	Linkage Terms	Details regarding the Trustee
	NIS in millions												
Series B	February 10, 2015	623.3	1,101.2	1,101.2	1.8	.1,0919	1,081.6	Fixed	0.65	April 1 in the years 2016 to 2025 (inclusive)	From October 1, 2015 and subsequently April 1st and October 1st in the years 2016 to 2025 (inclusive).	Linkage (principal and interest) to the rise in the CPI for December 2014*.	Name of the trust company: Hermetic Trust (1975) Ltd.; Address: 113 Hayarkon St., Tel Aviv; Tel: 03-5544553; Fax: 03-5271039; E-mail address: hermetic@hermetic.co.il Contact person at the trustee: Dan Avnon or Idan Knobel.
	June 23, 2015	600.3											
Series C	Sept. 6, 2015	1,005.1	1,005.1	1,005.1	8.3	997.8	1,021.2	Fixed	1.64	July 1 in the years 2018 to 2027 (inclusive)	From July 1, 2016, twice a year, on January 1st and July 1st in each of the years 2016 to 2027 (inclusive).	Linkage (principal and interest) to the rise in the CPI for July 2015*.	
Series D	July 7, 2016	2,194.1	2,194.1	2,196.4	14.3	2,179.4	2,136.4	Fixed	1.34	From July 5, 2018 twice a year on January 5 and July 5 of each of the years 2018 through 2030	From January 2017 twice a year on January 5 and July 5 of each of the years 2017 through 2030	Linkage (principal and interest) to the rise in the CPI for May 2016*.	
Total		4,422.8	4,300.4	4,302.7	24.4	4,269.1	4,239.2						

* The Series B, Series C and Series D Bonds are protected, such that if the known index on the relevant payment due date is lower than the base index (stated in the table), the payment index will be the base index.

Further details regarding the bonds of the Company held by the public:

1. The Series B Bonds, the Series C Bonds and the Series D Bond of the Company are material to the Company and are not secured by any collateral.

2. The Company will be entitled, at its sole discretion, to perform (partial or full) early redemption of the Series B Bonds, the Series C Bonds and the Series D Bonds. For details, see Section 9.2 of the terms and conditions overleaf in the indenture for the Series B Bonds (the "**Indenture for the Series B Bonds**"), which was attached to the shelf offering report that was published by the Company on February 8, 2015 (ref.: 2015-01-027136) and Section 9.2 of the terms and conditions overleaf in the indenture for the Series C Bonds (the "**Indenture for the Series C Bonds**"), which was attached to the shelf offering report that was published by the Company on September 3, 2015 (ref.: 2015-01-112788), and Section 9.2 of the Terms and Conditions Overleaf of the indenture for the Series D Bonds (the "**Indenture for the Series D Bonds**"), which was attached to the shelf offering report released by the Company on July 5, 2016 (ref.: 2016-01-075079), which are included (the said sections) herein by way of reference.

3. At the end of the Reporting Period and as of the Report Release Date, the Company has fulfilled all of the terms and conditions and undertakings according to the Indenture for the Series B Bonds, the Indenture for the Series C Bonds and the Indenture for the Series D Bonds, and no conditions establishing grounds for acceleration of the Series B, Series C Bonds and Series D Bonds have been fulfilled.

4. For details regarding an undertaking that the Company assumed in the framework of the Series B Bonds, the Series C Bonds and the Series D Bonds of the Company, see Sections 5.2-5.6 of the Indenture for the Series B Bonds, the Indenture for the Series C Bonds and the Indenture for the Series D Bonds.

5. For further details relating to the terms and conditions of Series B, Series C and Series D Bonds of the Company including an undertaking to meet financial covenants and restrictions in connection with dividend distribution, see Note 21B to Chapter C herein.

Rating of the bonds of the Company held by the public:

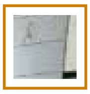
Series	Name of Rating Company	Rating Set on the Date of the Issue	Rating Set as of the Report Release Date	Date of Issuance of the Current Rating	Additional Ratings Set between the Date of the Issue and the Report Date	
					Rating	Date of Rating
Series B	Maalot	AA+ stable	AA+ stable	June 21, 2015[1]	-	-
Series C	Maalot	AA+ stable	AA+ stable	September 3, 2015[2]		
Series D	Midroog	Aa1/stable outlook	Aa1/stable outlook	July 20, 2016[3]		

[1] For Ma'alot's rating report on the Company's Series B Bonds, see the Company's immediate report of June 21, 2015 (Ref.: 2015-01-052239), which is included herein by way of reference.
[2] For Ma'alot's rating report on the Company's Series C Bonds, see the Company's immediate report of September 3, 2015 (Ref.: 2015-01-112698), which is included herein by way of reference.
[3] For Ma'alot's rating report on the Company's Series D Bonds, see the Company's immediate report of July 20, 2016 (Ref.: 2016-01-086899), which is included herein by way of reference.

Azrieli Group

Part C

Consolidated Financial Statements Dated 31 December 2016


Azrieli Group Ltd.

Consolidated Financial Statements
For the Year 2016

Azrieli Group Ltd.

Consolidated Financial Statements
For the Year 2016

Contents

[On letterhead of Deloitte]

March 21, 2017

The Board of Directors of Azrieli Group Ltd. (the "Company")
1 Azrieli
Tel Aviv

Dear Sir/Madam,

Re: <u>Consent to Inclusion in the Shelf Prospectus of Azrieli Group Ltd. that was Published on May 11, 2016</u>

We hereby notify you that we agree to the inclusion (including by way of reference), in the above-referenced shelf prospectus, of our reports specified below:

(1) The auditors' report of March 21, 2017 on the consolidated financial statements of the Company as of December 31, 2016 and 2015 and for each one of the three years in the period ended December 31, 2016.

(2) The auditors' report of March 21, 2017 on an audit of components of internal control of financial reporting of the Company as of December 31, 2016.

(3) Special auditors' report of March 21, 2017 on separate financial information pursuant to Section 9C of the Securities Regulations (Periodic and Immediate Reports), 5730-1970 as of December 31, 2016 and 2015 and for each one of the three years in the period ended December 31, 2016.

(4) Review report of November 22, 2016 on consolidated condensed financial information of the Company as of September 30, 2016, and for the nine- and three-month periods ended on the same date.

(5) Special auditors' report of November 22, 2016 on the separate interim condensed financial information of the Company as of September 30, 2016, and for the nine- and three-month periods ended on the same date pursuant to Section 38D of the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

(6) Review report of August 24, 2016 on consolidated condensed financial information of the Company as of June 30, 2016, and for the six- and three-month periods ended on the same date.

(7) Special auditors' report of August 24, 2016 on the separate interim condensed financial information of the Company as of June 30, 2016, and for the six- and three-month periods ended on the same date pursuant to Section 38D of the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

Sincerely,

Brightman Almagor Zohar & Co.
Certified Public Accountants
Member of Deloitte Touche Tohmatsu Limited

Independent Auditors' Report to the Shareholders of

Azrieli Group Ltd.

Regarding Audit of Components of Internal Control over Financial Reporting pursuant to
Section 9B(c) of the Securities Regulations (Periodic and Immediate Reports), 5730-1970

We have audited components of internal control over financial reporting of **Azrieli Group Ltd. and subsidiaries** (jointly, the "**Company**") as of December 31, 2016. These components of control were determined as explained in the following paragraph. The Company's Board of Directors ("**Board**") and Management are responsible for maintaining effective internal control over financial reporting and for their assessment of the effectiveness of the components of internal control over financial reporting, attached to the periodic report as of the above date. Our responsibility is to express an opinion on the components of internal control over financial reporting of the Company, based on our audit.

The components of the internal control over financial reporting that were audited were determined pursuant to Audit Standard 104 of the Institute of Certified Public Accountants in Israel "Audit of Components of Internal Control over Financial Reporting", including the amendments thereto ("**Audit Standard 104**"). These Components are: (1) Entity-level controls, including controls over the financial reporting and closing process and ITGCs; (2) Controls over investment property; (3) Controls over rent revenues from investment property; (4) Controls over revenues from gas customers of Supergas - Israeli Gas Distribution Company Ltd.; (all referred to hereafter jointly as the "**Audited Components of Control**").

We conducted our audit pursuant to Audit Standard 104. This Standard requires that we plan and perform the audit with the purpose of identifying the Audited Components of Control, and to obtain reasonable assurance about whether these components of control were effectively maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, identifying the Audited Components of Control, assessing the risk that a material weakness exists in the Audited Components of Control, and testing and evaluating the design and operating effectiveness of such components of control, based on the assessed risk. Our audit of such components of control also included performing such other procedures as we considered necessary in the circumstances. Our audit only referred to the Audited Components of Control, as opposed to internal control over all of the material processes in connection with the financial reporting, and therefore our opinion refers only to the Audited Components of Control. In addition, our audit did not address mutual effects between the Audited Components of Control and non-audited controls, and therefore, our opinion does not take into consideration such possible effects. We believe that our audit provides a reasonable basis for our opinion in the context described above.

Because of its inherent limitations, internal control over financial reporting in general and components thereof in particular, may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, based on our audit, the Company effectively maintained, in all material respects, the Audited Components of Control as of December 31, 2016.

We have also audited, based on Generally Accepted Auditing Standards in Israel, the Consolidated Financial Statements of the Company as of December 31, 2016 and 2015, and for each of the three years in the period ended December 31, 2016, and our report as of March 21, 2017, included an unqualified opinion on those financial statements based on our audit and on the other auditors' reports.

Brightman Almagor Zohar & Co.
Certified Public Accountants (Israel)
Member of Deloitte Touche Tohmatsu Limited

Tel Aviv, March 21, 2017

Independent Auditors' Report to the Shareholders of

<u>Azrieli Group Ltd.</u>

We have audited the accompanying Consolidated Statements of Financial Position of **Azrieli Group Ltd.** (the "**Company**") as of December 31, 2016 and 2015 and the Consolidated Statements of Comprehensive Income, of Changes in Capital, and of Cash Flows for each of the years in the three-year period ended December 31, 2016. The Company's Board and Management are responsible for these Financial Statements. Our responsibility is to express an opinion on these Financial Statements based on our audit.

We did not audit the financial statements of consolidated companies, whose consolidated assets constitute approx. 5% and approx. 15% of the total consolidated assets as of December 31, 2016 and 2015, and whose consolidated income from continuing operations constitute approx. 22%, approx. 31% and approx. 75% of the total consolidated income for the years ended December 31, 2016, 2015 and 2014, respectively. In addition, we did not audit the Group’s share in the results of the discontinued operations of formerly consolidated companies, the results of operations of which amounted to a loss of approx. NIS 9 million, approx. NIS 99 million and to a profit of approx. NIS 109 million for the years ended December 31, 2016, 2015 and 2014, respectively. The financial statements of such companies were audited by other auditors whose reports were provided to us, and our opinion, insofar as it relates to amounts that have been included in respect of such companies, is based on the reports of the other auditors.

We conducted our audit in accordance with Generally Accepted Auditing Standards in Israel, including standards set in the Accountants Regulations (Mode of Operation of Accountants) 5733-1973. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Financial Statements. An audit also includes assessing the accounting principles used and significant estimates made by the Board and Management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and on the reports of other auditors, the Financial Statements referred to above present fairly, in all material respects, the financial position of the Company and of its subsidiaries as of December 31, 2016 and 2015 and the results of their operations, the changes in their equity and their cash flows for each of the years in the three-year period ended December 31, 2016 in accordance with International Financial Reporting Standards (IFRS) and the provisions of the Securities Regulations (Annual Financial Statements), 5770-2010.

We have also audited, pursuant to Audit Standard 104 of the Institute of Certified Public Accountants in Israel “Audit of Components of Internal Control over Financial Reporting”, components of the Company’s internal control over financial reporting as of December 31, 2016 and our report as of March 21, 2017 included an unqualified opinion on the effective maintenance of such components.

Brightman Almagor Zohar & Co.
Certified Public Accountants (Israel)
Member of Deloitte Touche Tohmatsu Limited

Tel Aviv, March 21, 2017

Azrieli Group Ltd.
Consolidated Statements of Financial Position

	Note	As of December 31 2016 NIS in thousands	As of December 31 2015 NIS in thousands
ASSETS			
Current assets			
Cash and cash equivalents	4	714,988	934,724
Short-term deposits and investments	4	658,286	36,302
Trade accounts receivable	5	288,376	1,102,160
Other receivables	6	137,092	167,227
Inventory	7	60,478	173,450
Current tax assets	30	17,201	14,894
		1,876,421	2,428,757
Assets of disposal group held for sale	9	781	8,850
Total current assets		1,877,202	2,437,607
Non-current assets			
Investments and loans to associates		79,473	70,755
Investments, loans and other receivables	11	339,768	218,321
Financial assets	12	1,713,336	1,659,927
Long-term receivables in respect of franchise arrangement	13	52,483	44,372
Investment property and investment property under construction	14	23,722,736	20,528,554
Fixed assets	15	445,187	1,059,657
Intangible assets	16	333,097	342,955
Pre-paid long-term rent	17	-	36,637
Deferred tax assets	30	19,950	46,320
Total non-current assets		26,706,030	24,007,498
Total assets		28,583,232	26,445,105

The notes to the financial statements form an integral part thereof.

Azrieli Group Ltd.
Consolidated Statements of Financial Position
(Continued)

	Note	As of December 31 2016 NIS in thousands	2015 NIS in thousands
LIABILITIES AND CAPITAL			
Current liabilities			
Current maturities and credit from banks and other credit providers	21	2,082,564	2,030,205
Trade payables	18	218,633	524,638
Other payables	19	199,918	375,208
Deposits from customers	20	764,003	402,066
Provisions		12,498	77,515
Current tax liabilities	30	37,428	110,241
		3,315,044	3,519,873
Liabilities of disposal group held for sale	9	169	3,387
Total current liabilities		3,315,213	3,523,260
Non-current liabilities			
Loans from banks and other credit providers	21	2,487,888	2,989,456
Bonds	21	4,498,260	2,962,731
Employee benefits	22	8,139	18,981
Other liabilities		45,250	53,685
Deferred tax liabilities	30	2,912,691	3,027,164
Total Non-Current Liabilities		9,952,228	9,052,017
Capital	23		
Ordinary share capital		18,223	18,223
Share premium		2,518,015	2,518,015
Capital reserves		499,528	407,396
Retained earnings		12,237,592	10,827,591
Total equity attributable to the shareholders of the company		15,273,358	13,771,225
Non-controlling interests		42,433	98,603
Total Capital		15,315,791	13,869,828
Total Liabilities and Capital		28,583,232	26,445,105

March 21, 2017			
Date of approval of the Financial Statements	**Danna Azrieli Chairman of the Board**	**Yuval Bronstein CEO**	**Irit Sekler-Pilosof CFO**

The notes to the financial statements form an integral part thereof.

Azrieli Group Ltd.

Consolidated Statements of Income or Other Comprehensive Loss and Profit

	Note	As of the year ended December 31 2016 NIS in thousands	2015(*) NIS in thousands	2014(*) NIS in thousands
Revenues				
From sales, labor and services	24	660,795	732,349	857,428
From rent, management and maintenance fees	24	1,744,621	1,622,543	1,471,111
Net profit from adjustment to fair value of investment property and investment property under construction	14	710,578	179,071	26,060
Financing	29	49,061	18,144	81,547
Other	28	14,116	16,008	61,178
Total revenues		3,179,171	2,568,115	2,497,324
Costs and Expenses				
Costs of revenues from sales, labor and services	25	419,153	480,606	608,476
Costs of revenues from rent, management and maintenance fees	25	445,486	385,098	329,110
Sales and marketing	26	171,773	155,842	144,529
General and administrative	27	104,310	101,631	122,637
Share in results of associates, net of tax		8,439	8,562	9,545
Financing	29	159,124	145,210	216,532
Other	28	5,191	8,918	7,331
Total costs and expenses		1,313,476	1,285,867	1,438,160
Income before income taxes		1,865,695	1,282,248	1,059,164
Taxes on income	30	(49,023)	(355,656)	(308,834)
Income from continued operations		1,816,672	926,592	750,330
Income (loss) from discontinued operations, net of tax	8	(8,501)	(98,927)	109,209
Net profit for the year		1,808,171	827,665	859,539
Other comprehensive income:				
Amounts that will not be carried in the future to the income statement, net of tax:				
Actuarial profit (loss) due to defined benefit plan, net of tax		(17)	(977)	221
Amounts that were and carried will be carried in the future to the income statement, net of tax:				
Change in fair value of financial assets available for sale, net of tax		95,944	18,172	(38,471)
The effective share of the change in fair value of cash flow hedge, net of tax		-	-	(270)
Net change in fair value of cash flow hedge carried to profit and loss, net of tax		-	-	265
Carrying of balance of fair value of the cash flow hedge to the income statement as a result of disposition of a subsidiary, net of tax		-	-	102
Translation differences from foreign operations		(11,392)	1,506	91,239
Total		84,552	19,678	52,865
Other comprehensive income for the year, net of tax		84,535	18,701	53,086
Total comprehensive income for the year		1,892,706	846,366	912,625

(*) Re-presented due to discontinued operations, see Note 8.

The notes to the financial statements form an integral part thereof.

Azrieli Group Ltd.
Consolidated Statements of Income or Other Comprehensive Loss and Profit
(Continued)

	As of the year ended December 31		
	2016	**2015**	**2014**
	NIS in thousands	**NIS in thousands**	**NIS in thousands**
Net profit for the year attributable to:			
Shareholders of the company	1,810,018	820,991	849,487
Non-controlling interests	(1,847)	6,674	10,052
	1,808,171	827,665	859,539
Total comprehensive income for the year attributable to:			
Shareholders of the company	1,895,013	839,538	899,128
Non-controlling interests	(2,307)	6,828	13,497
	1,892,706	846,366	912,625
	NIS	**NIS**	**NIS**
Basic and diluted earnings (in NIS) per one ordinary share of par value NIS 0.1 each attributable to shareholders of the company:			
Continued operations	15.00	7.59	6.11
Discontinued operations	(0.07)	(0.82)	0.90
	14.93	6.77	7.01
Average weighted share capital used in calculating the basic and diluted earnings per share	121,272,760	121,272,760	121,272,760

The notes to the financial statements form an integral part thereof.

Azrieli Group Ltd.
Consolidated Statements of Changes in Capital

	For the year ended December 31, 2016										
	Share Capital	Share premium	Revaluation fund for financial assets available for sale	Capital reserve for translation differences from foreign operations	Capital reserve for transactions with related parties	Capital reserve from transactions with non-controlling interests in a consolidated company	Other capital reserves	Retained earnings	Total attributable to share-holders of the company	Non-controlling interests	Total
	NIS in thousands										
Balance as of January 1, 2016	18,223	2,518,015	391,356	30,469	(30,974)	18,641	(2,096)	10,827,591	13,771,225	98,603	13,869,828
Net profit for year	-	-	-	-	-	-	-	1,810,018	1,810,018	(1,847)	1,808,171
Change in fair value of financial assets available for sale, net of tax	-	-	95,859	-	-	-	-	-	95,859	85	95,944
Actuarial loss due to defined benefit plan, net of tax	-	-	-	-	-	-	-	(17)	(17)	-	(17)
Translation differences from foreign operations	-	-	-	(10,847)	-	-	-	-	(10,847)	(545)	(11,392)
Total comprehensive income for the year	-	-	95,859	(10,847)	-	-	-	1,810,001	1,895,013	(2,307)	1,892,706
Dividend to the shareholders of the Company	-	-	-	-	-	-	-	(400,000)	(400,000)	-	(400,000)
Dividend to the holders of non-controlling interests	-	-	-	-	-	-	-	-	-	(175)	(175)
Capital reserve for transactions with related parties	-	-	-	-	(28)	-	-	-	(28)	28	-
Investment of non-controlling rights in a subsidiary	-	-	-	-	-	-	-	-	-	4,432	4,432
Acquisition of non-controlling interest in a subsidiary	-	-	-	-	-	7,148	-	-	7,148	(58,148)	(51,000)
Total transactions with shareholders of the Company	-	-	-	-	(28)	7,148	-	(400,000)	(392,880)	(53,863)	(446,743)
Balance as of December 31, 2016	18,223	2,518,015	487,215	19,622	(31,002)	25,789	(2,096)	12,237,592	15,273,358	42,433	15,315,791

The notes to the Financial Statements form an integral part thereof.

Azrieli Group Ltd.
Consolidated Statements of Changes in Capital
(Continued)

	For the year ended December 31, 2015										
	Share Capital	Share premium	Revaluation fund for financial assets available for sale	Capital reserve for translation differences from foreign operations	Capital reserve for transactions with related parties	Capital reserve from transaction with non-controlling interests in a consolidated company	Other capital reserves	Retained earnings	Total attributable to shareholders of the company	Non-controlling interests	Total
	NIS in thousands										
Balance as of January 1, 2015	18,223	2,518,015	373,253	29,054	(30,974)	18,641	(2,096)	10,327,571	13,251,687	96,867	13,348,554
Net profit for year	-	-	-	-	-	-	-	820,991	820,991	6,674	827,665
Change in fair value of financial assets available for sale, net of tax	-	-	18,103	-	-	-	-	-	18,103	69	18,172
Actuarial loss due to defined benefit plan, net of tax	-	-	-	-	-	-	-	(971)	(971)	(6)	(977)
Translation differences from foreign operations	-	-	-	1,415	-	-	-	-	1,415	91	1,506
Total comprehensive income for the year	-	-	18,103	1,415	-	-	-	820,020	839,538	6,828	846,366
Dividend to the shareholders of the Company	-	-	-	-	-	-	-	(320,000)	(320,000)	-	(320,000)
Dividend to the holders of non-controlling interests	-	-	-	-	-	-	-	-	-	(312)	(312)
Write-off of non-controlling interests due to disposition of subsidiary	-	-	-	-	-	-	-	-	-	(4,780)	(4,780)
Total transactions with shareholders of the Company	-	-	-	-	-	-	-	(320,000)	(320,000)	(5,092)	(325,092)
Balance as of December 31, 2015	18,223	2,518,015	391,356	30,469	(30,974)	18,641	(2,096)	10,827,591	13,771,225	98,603	13,869,828

The notes to the Financial Statements form an integral part thereof.

Azrieli Group Ltd.

Consolidated Statements of Changes in Capital

(Continued)

	For the year ended December 31, 2014										
	Share Capital	Share premium	Revaluation fund for financial assets available for sale	Capital reserve for translation differences from foreign operations	Capital reserve for transactions with related parties	Capital reserve from transaction with non-controlling interests in a consolidated company	Other capital reserves	Retained earnings	Total attributable to share-holders of the company	Non-controlling interests	Total
	NIS in thousands										
Balance as of January 1, 2014	18,223	2,518,015	411,733	(58,755)	(30,981)	21,375	(2,191)	9,757,867	12,635,286	94,733	12,730,019
Net profit for year	-	-	-	-	-	-	-	849,487	849,487	10,052	859,539
Change in fair value of financial assets available for sale, net of tax	-	-	(38,480)	-	-	-	-	-	(38,480)	9	(38,471)
Actuarial profit due to defined benefit plan, net of tax	-	-	-	-	-	-	-	217	217	4	221
Translation differences from foreign operations	-	-	-	87,809	-	-	-	-	87,809	3,430	91,239
The effective share of the change in fair value of cash flow hedge, net of tax	-	-	-	-	-	-	(269)	-	(269)	(1)	(270)
Net change in fair value of cash flow hedge carried to profit and loss, net of tax	-	-	-	-	-	-	263	-	263	2	265
Carrying of balance of fair value of the cash flow hedge to the income statement as a result of disposition of a subsidiary, net of tax	-	-	-	-	-	-	101	-	101	1	102
Total comprehensive income for the year	-	-	(38,480)	87,809	-	-	95	849,704	899,128	13,497	912,625
Dividend to the shareholders of the Company	-	-	-	-	-	-	-	(280,000)	(280,000)	-	(280,000)
Dividend to the holders of non-controlling interests	-	-	-	-	-	-	-	-	-	(1,389)	(1,389)
Capital reserve for transactions with related parties	-	-	-	-	7	-	-	-	7	(7)	-
Acquisition of non-controlling interests in a consolidated company	-	-	-	-	-	(2,734)	-	-	(2,734)	(24)	(2,758)
Write-off of non-controlling interests due to disposition of subsidiary	-	-	-	-	-	-	-	-	-	(9,943)	(9,943)
Total transactions with shareholders of the Company	-	-	-	-	7	(2,734)	-	(280,000)	(282,727)	(11,363)	(294,090)
Balance as of December 31, 2014	18,223	2,518,015	373,253	29,054	(30,974)	18,641	(2,096)	10,327,571	13,251,687	96,867	13,348,554

The notes to the Financial Statements form an integral part thereof.

Azrieli Group Ltd.
Consolidated Statements of Cash Flows

	As of the year ended December 31		
	2016	2015	2014
	NIS in thousands	NIS in thousands	NIS in thousands
Cash Flows - Current Operations			
Net profit for the year	1,808,171	827,665	859,539
Depreciation and amortization	87,530	103,153	122,770
Impairment of intangible assets	32,199	103,000	765
Forfeiture of senior housing tenants' deposits	(16,835)	(6,311)	-
Net profit from adjustment to fair value of investment property and investment property under construction	(710,578)	(180,307)	(28,913)
Financing and other expenses, net	113,617	140,741	115,231
Impairment of financial assets available for sale	-	-	5,932
Profit from the sale of fixed assets, investment property and intangible assets, net	(529)	(1,846)	(6,218)
Share in losses of associates accounted for by the equity method	8,439	8,562	9,545
Change in recording of benefit in respect of share-based payment and employee benefits	-	2,493	902
Tax expenses recognized in the income statement	57,927	364,780	319,810
Change in financial assets	(66)	116	256
Profit from disposition of investments in associates	-	-	(587)
Loss (profit) from disposition of investment in a subsidiary (Annex A)	5,634	9,437	(96,937)
Income taxes paid, net	(241,560)	(197,601)	(102,756)
Revaluation of financial assets designated at fair value through profit and loss	(3,927)	(2,715)	(6,760)
Change in inventory	(1,764)	67,841	10,055
Change in trade and other receivables	(3,586)	137,504	95,445
Change in receivables in respect of franchise arrangement	(11,035)	6,566	37,103
Change in trade and other payables	92,904	(154,688)	(162,925)
Receipt of deposits from senior housing tenants	101,112	25,796	-
Return of deposits from senior housing tenants	(27,839)	(6,864)	-
Change in provisions and employee benefits	163	13,475	(18,246)
Net cash – current operations	1,289,977	1,260,797	1,154,011

The notes to the Financial Statements form an integral part thereof.

Azrieli Group Ltd.
Consolidated Statements of Cash Flows
(Continued)

	As of the year ended December 31		
	2016	**2015**	**2014**
	NIS in thousands	**NIS in thousands**	**NIS in thousands**
Cash Flows - Investment Activities			
Proceeds from the disposition of fixed assets and intangible assets	2,796	7,157	19,845
Proceeds from the disposition of investment property	4,536	2,836	2,174
Downpayments on account of investment property	-	(4,815)	(2,081)
Purchase and investment in investment property and investment property under construction	(2,007,517)	(1,016,466)	(1,202,168)
Purchase of fixed assets and intangible assets	(118,437)	(118,589)	(141,389)
Investment in and provision of loans to associates	(16,789)	(3,435)	(13,746)
Change in short-term deposits	(618,163)	10,049	4,704
Change in restricted investments	(301)	15,279	(31,764)
Grant received	-	-	6,126
Income (payment) for the disposition of derivative financial instruments, net	725	(5,304)	40,619
Investment in financial assets available for sale	-	-	(3,476)
Investment in financial assets designated at fair value through profit and loss, net	5,389	2,338	782
Change in marketable securities, net	-	14,874	(8,893)
Provision of long-term loans	(2,634)	(44,862)	(9,185)
Collection of long-term loans	16,350	15,593	20,921
Interest and dividend received	27,550	45,937	74,542
Proceeds from disposition of financial assets available for sale	79,714	-	37,296
Acquisition of companies consolidated for the first time (Annex B)	(61,294)	(254,661)	(54,589)
Proceeds from disposition of investments in investee companies, net (Annex A)	116,339	415,948	475,862
Institutions in respect of the purchase of real estate	(6,600)	-	-
Proceeds from sale of investments	-	115,174	-
Tax paid for sale of companies	-	(22,745)	-
Net cash - investment activities	(2,578,336)	(825,692)	(784,420)

The notes to the Financial Statements form an integral part thereof.

Azrieli Group Ltd.
Consolidated Statements of Cash Flows
(Continued)

	As of the year ended December 31		
	2016	2015	2014
	NIS in thousands	NIS in thousands	NIS in thousands
Cash Flows - Financing Activities			
Acquisition of non-controlling interests	(51,000)	-	(2,758)
Distribution of dividend to shareholders	(400,000)	(320,000)	(280,000)
Repayment of bonds	(409,867)	(406,994)	(215,210)
Issuance of bonds net of issue expenses	2,176,535	2,209,284	-
Receipt of long-term loans from banks and others	1,139,994	112,203	655,995
Repayment of long-term loans from banks and others	(885,117)	(876,330)	(516,783)
Short-term credit from banks and others, net	(308,757)	(202,735)	(1,747)
Repayment of deposits from customers	(4,145)	(6,034)	(6,705)
Deposits from customers that were received	5,802	8,802	7,954
Payment for settlement of derivatives used for cash flow hedge	-	-	(54)
Dividend to holders of non-controlling interests	(175)	(437)	(1,264)
Investment of non-controlling rights in a subsidiary	4,432	-	-
Interest paid	(198,180)	(231,501)	(286,758)
Net cash - financing activities	1,069,522	286,258	(647,330)
Increase (decrease) in cash and cash equivalents	(218,837)	721,363	(277,739)
Cash and cash equivalents at the beginning of the year	934,724	163,578	460,984
Change in net cash classified to disposal group held for sale	833	50,487	(23,528)
Effect of the changes in exchange rates on balances of cash held in foreign currency	(1,732)	(704)	3,861
Cash and cash equivalents at the end of the year	714,988	934,724	163,578

(*) In 2016, the non-cash activity included a change in receivables due to the sale of an investment in an investee in the sum of NIS 125,088 thousand. 2014 included liability for work in the sum of NIS 13,000 thousand, receivables due to the sale of an investment in a consolidated company in the sum of NIS 47,558 thousand, receivables due to the sale of shareholder loans in a consolidated company in the sum of NIS 99,630 thousand, and receivables due to the sale of an investment in an associate in the sum of NIS 14,254 thousand.

(**) On cash flows from discontinued operations, see Note 8.

The notes to the Financial Statements form an integral part thereof.

Azrieli Group Ltd.
Consolidated Statements of Cash Flows
(Continued)

	As of the year ended December 31		
	2016	2015	2014
	NIS in thousands	NIS in thousands	NIS in thousands
Annex A -			
Proceeds from sale of investment in previously-consolidated Sonol Israel Ltd. (see Note 8):			
Working capital (excluding cash and cash equivalents)	(183,085)	-	-
Investments and loans	73,246	-	-
Fixed and intangible assets, net	684,366	-	-
Prepaid long-term lease payments	37,045	-	-
Investment property	12,420	-	-
Deferred tax assets	7,100	-	-
Employee benefits and provisions	(72,094)	-	-
Long-term liabilities including current maturities	(311,938)	-	-
Loan provided due to sale of the investment	(97,500)	-	-
Receivables due to sale of the investment	(27,587)	-	-
Loss from liquidation of investment in subsidiary	(5,634)	-	-
	116,339	-	-
Proceeds from sale of investment in previously-consolidated Green Anchors Ltd.:			
Working capital (excluding cash and cash equivalents)	-	(2,975)	-
Fixed and intangible assets, net	-	105	-
Investment property	-	24,081	-
Long-term liabilities including current maturities	-	(7,317)	-
Deferred tax liabilities, net	-	(4,365)	-
Non-controlling interests	-	(4,780)	-
Loss from liquidation of investment in subsidiary	-	(42)	-
	-	4,707	-
Proceeds from sale of investment in previously-consolidated Via Maris Desalination (Holdings) Ltd. (see Note 9 below):			
Working capital (excluding cash and cash equivalents)	-	80,488	-
Investments and loans	-	3,799	-
Receivables in respect of franchise arrangement	-	822,932	-
Fixed and intangible assets, net	-	126,037	-
Long-term liabilities, net	-	(697,358)	-
Deferred tax liabilities, net	-	(23,481)	-
Restricted investments	-	60,661	-
Loss from liquidation of investment in subsidiary	-	(9,395)	-
	-	363,683	-

The notes to the Financial Statements form an integral part thereof.

	As of the year ended December 31		
	2016	**2015**	**2014**
	NIS in thousands	**NIS in thousands**	**NIS in thousands**
Proceeds from sale of investment in previously-consolidated Tambour, net (see Note 8):			
Working capital (excluding for cash and cash equivalents)	-	-	213,783
Investments and loans	-	-	7,582
Fixed and intangible assets, net	-	-	491,095
Employee benefits and provisions	-	-	(7,834)
Long-term liabilities including current maturities	-	-	(199,485)
Reserve for deferred taxes, net	-	-	(67,389)
Non-controlling interests	-	-	(4,255)
Profit from disposition of an investment in a subsidiary	-	-	54,815
	-	-	488,312
Proceeds from sale of investment in previously-consolidated S. Super Solar Ltd., net:			
Working capital (excluding for cash and cash equivalents)	-	-	(121,738)
Receivables in respect of franchise arrangement	-	-	245,665
Prepaid long-term lease payments	-	-	32,245
Restricted investments	-	-	4,900
Fixed and intangible assets, net	-	-	2,469
Long-term liabilities including current maturities	-	-	(160,932)
Reserve for deferred taxes, net	-	-	(3,935)
Non-controlling interests	-	-	(5,688)
Profit from disposition of an investment in a subsidiary	-	-	42,122
Receivables due to the sale of an investment in a consolidated company	-	47,558	(47,558)
	-	47,558	(12,450)
Total proceeds from sale of investments, net	116,339	415,948	475,862

Azrieli Group Ltd.
Consolidated Statements of Cash Flows
(Continued)

	As of the year ended December 31		
	2016	**2015**	**2014**
	NIS in thousands	**NIS in thousands**	**NIS in thousands**
Annex B -			
Purchase of a company consolidated for the first time – Ahuzat Bayit Raanana – Retirement Home Ltd. (see Note 14I(3)):			
Working capital (excluding cash and cash equivalents and short-term deposits)	(31,361)	-	-
Liabilities in respect of deposits from customers	327,655	-	-
Fixed and intangible assets, net	(13,460)	-	-
Investment property	(530,627)	-	-
Long-term liabilities including current maturities	212,454	-	-
	(35,339)	-	-
Purchase of a company consolidated for the first time – Azrieli E-Commerce Ltd. (formerly Netex New Media Ltd.) (see Note 10F):			
Working capital (excluding cash and cash equivalents)	5,025	-	-
Fixed and intangible assets, net	(79,510)	-	-
Long-term liabilities including current maturities	38,099	-	-
Payables due to purchase of an investment	10,653		
	(25,733)	-	-
Purchase of a company consolidated for the first time – Bio Clean Air Innovation Ltd.:			
Working capital (excluding cash and cash equivalents)	6,078	-	-
Fixed and intangible assets, net	(7,124)	-	-
Reserve for deferred taxes, net	824	-	-
	(222)	-	-
Purchase of a company consolidated for the first time – Palace America Senior Housing Ltd. (see Note 14I(1)):			
Working capital (excluding cash and cash equivalents and short-term deposits)	-	10,574	9
Liabilities due to short-term deposits	-	284,721	-
Fixed and intangible assets, net	-	(141,927)	-
Investment property	-	(552,083)	(54,598)
Long-term liabilities including current maturities	-	54,189	-
Reserve for deferred taxes, net	-	89,865	-
	-	(254,661)	(54,589)
	(61,294)	(254,661)	(54,589)

The notes to the Financial Statements form an integral part thereof.

Note 1 - General

A. General description of the Company and its operations:

Azrieli Group Ltd. (the "**Company**" and/or the "**Group**") is a company domiciled and incorporated in Israel and whose registered address is 1 Azrieli Center, Tel Aviv. The Company is traded on the TASE and is included in the Tel Aviv 35 Index. The Company has bonds (Series A) that are included in the TACT-institutional and bonds (Series B, Series C and Series D) that were issued to the public. The Group's Consolidated Financial Statements as of December 31, 2016 include those of the Company and of its subsidiaries (jointly, the "**Group**"), as well as the Group's rights in associates and in jointly-controlled entities.

As of the Report Release Date, Azrieli Holdings Inc., the controlling shareholder of the Company ("**Azrieli Holdings**"), directly and/or indirectly holds (through its holding of the entire share capital of Nadav Investments Inc. (the "**Parent Company**")) (both private companies registered in Canada), approx. 55.62% of the Company's share capital and approx. 61.31% of the Company's voting rights.

As the Company was informed, on April 13, 2015, shares of Mr. David Azrieli OBM in Azrieli Holdings and in a Canadian holding corporation controlled by him ("**David's Holding Corporation**") were distributed from his estate. Following such distribution, each one of Sharon Azrieli, Naomi Azrieli and Danna Azrieli, holds, directly and through David's Holding Corporation, approx. 27.24% of the capital rights in Azrieli Holdings and approx. 33.13% of the voting rights in Azrieli Holdings, and they jointly hold approx. 81.73% of the capital rights in Azrieli Holdings and approx. 99.39% of the voting rights therein. The remainder of Azrieli Holdings' shares are mainly held by the Azrieli Foundation of Canada (an interested party of the Company), which following the distribution of the estate holds (indirectly, through a holding of shares of David's Holding Corporation) approx. 15.93% of Azrieli Holdings' shares, with no voting rights (which constitutes, indirectly, a holding of approx. 8.86% of the capital rights of the Company), in addition to and separately from its direct holding of approx. 8.55% of the capital and voting rights in the Company.

As the Company was informed, on March 20, 2017, a shareholders' agreement (the "**2017 Agreement**") was signed between Sharon Azrieli, Naomi Azrieli and Danna Azrieli (by themselves and through companies controlled by them), the indirect controlling shareholders of the Company and directors thereof (the "**Controlling Shareholders**"). Additional parties to the 2017 Agreement are Azrieli Holdings, Nadav Investments and David's Holding Corporation (the three "**Holding Corporations**"). The 2017 Agreement replaces and substitutes the former shareholders agreement made by the parties in November 2012 (the "**2012 Agreement**"), and it regulates the relations between the Controlling Shareholders, by themselves, and through the Holding Corporations, in respect of their rights in the Company. Similarly to the 2012 Agreement, the terms of the 2017 Agreement include agreements regarding the sale and transfer of shares in the Company and in the Holding Corporations, including a lock-up period, right of first refusal, right of first offer, co-sale right and an exclusion in connection with certain sales of shares (drip) on TASE. The 2017 Agreement further prescribes that the manner of use of the voting rights in the Company will be determined by the Controlling Shareholders (by a majority vote), provided however, that in respect of resolutions to appoint directors of the Company, each one of the Controlling Shareholders shall have the right to use the voting rights to appoint one director who will be determined by her, whereas the manner of use of the voting rights in the Company regarding resolutions to appoint additional directors, will be adopted by a majority vote. It is clarified, that the 2017 Agreement does not change the identity of the Company's controlling shareholders (including of Azrieli Holdings) nor their percentage holdings in the capital and in the voting rights in the Company, and that as of the Report Date, Sharon Azrieli, Naomi Azrieli and Danna Azrieli are the Company's controlling shareholders

Note 1 – General (Cont.)

The Company engages (both directly and through investee companies in which it invests and which it develops) primarily in the following operating segments:

(1) In development, acquisition, management and lease in the retail centers and malls in Israel segment.
(2) In development, acquisition, management and lease in the office and other space for lease in Israel segment.
(3) In acquisition, management and lease in income-producing property in the USA segment.
(4) In development, acquisition and operation of senior housing.
(5) In activities of alternative energy sources, water and wastewater through its holding in Granite Hacarmel Investments Ltd.

For details regarding additional business activities of the Company, see Note 38A.

B. Definitions:

Interested Parties	-	As defined in the Securities Law, 5728-1968, and regulations thereunder.
Controlling Shareholder	-	As defined in the Securities Regulations (Annual Financial Statements), 5770-2010.
Canit Hashalom	-	Canit Hashalom Investments Ltd.
Granite	-	Granite Hacarmel Investments Ltd.
Sonol	-	Sonol Israel Ltd.
Tambour	-	Tambour Ltd.
GES	-	GES Global Environmental Solutions Ltd.
Supergas	-	Supergas - Israeli Gas Distribution Company Ltd.
Palace	-	Palace America Senior Housing Ltd.

Note 2 - Significant accounting policies

A. Declaration in respect of the application of the International Financial Reporting Standards (IFRS):

The Group's Consolidated Financial Statements have been prepared in accordance with the International Financial Reporting Standards (the "**IFRS Standards**") and the interpretations thereto, which have been published by the International Accounting Standards Board (IASB). The significant accounting policies that are detailed further on in this report have been applied in a consistent manner for all of the reporting periods that are presented in these Consolidated Financial Statements, except for changes in the accounting policies, which derived from the application of standards, amendments to standards and interpretation, which took effect or early adopted as of the date of the Financial Statements, as detailed in Note 2EE.

The consolidated Financial Statements were approved for publication by the Company's Board on March 21, 2017.

B. The Financial Statements include the disclosure requirements in accordance with the Securities Regulations (Annual Financial Statements), 5770-2010 (the "**Financial Statements Regulations**").

C. The operating cycle period:

The Group's operating cycle does not exceed 12 months.

D. The format for the analysis of the expenses that have been recognized in the Statement of Comprehensive Income:

The Company's expenses in the Statement of Comprehensive Income are presented in accordance with a method of classification based on the nature of the activity to which the expense relates.

E. Foreign currency:

(1) The functional currency and the presentation currency

The financial statements of each of the companies in the Group have been prepared in the currency of the main economic environment in which they operate, mainly NIS (the "**Functional Currency**"). For the purposes of the consolidation of the Financial Statements, the results and the financial position of each of the companies in the Group are presented in New Israeli Shekels (NIS), which is the Company's functional currency. The Company's Consolidated Financial Statements are presented in NIS in thousands. On exchange rates and the changes therein in the course of the periods that are presented, see Note 2DD.

Note 2 - Significant accounting policies (Cont.)

E. Foreign currency: (Cont.)

(2) The translation of transactions other than in the functional currency

In the preparation of the financial statements of each of the companies in the Group, transactions that were executed in currencies that are different from the Company's functional currency ("**Foreign Currency**") have been recorded in accordance with the exchange rates that were in force at the time of the transactions. At the end of each reporting period, monetary items that are stated in foreign currency are translated in accordance with the exchange rates in force as of that time. Non-monetary items that are measured at fair value and stated in foreign currency are translated in accordance with the exchange rate at the time at which the fair value was determined; non-monetary items that are measured in historical cost terms are translated in accordance with the exchange rates that were in force at the time of the execution of the transaction in respect of the non-monetary item.

(3) The manner in which exchange differences are recorded

Exchange differences are recognized in the income statement in the period in which they arise, except for the following cases:

- Exchange differences in respect of transactions that were designated for the hedging of certain foreign currency risks (On the Group's accounting policy in the matter of hedging transactions, see Note 2N).

- Exchange differences in respect of financial items receivable or payable from foreign operations, whose settlement is not planned or expected to occur and accordingly they constitute part of the net investment in foreign operations, are recognized in the statement of other comprehensive income under the 'exchange differences in respect of foreign operations' item, and are carried to profit and loss at the time of the disposition of the net investment in foreign operations and upon partial disposition of the net investment in foreign business entailing loss of control.

(4) The translation of the financial statements of foreign operations whose functional currency is different from the Shekel (the Group's functional currency) and is mainly U.S. dollars

For the purposes of the presentation of the Consolidated Financial statements, the assets and the liabilities of foreign operations are presented in accordance with the exchange rate in force at the end of the reporting period. Income and expense items are translated in accordance with the average exchange rate for the reporting period unless there shall have been significant fluctuations in the exchange rates in the course of the period. In such a case, the translation of these items is done using the exchange rates at the time of the execution of the transactions, the exchange differences are recognized in the statement of comprehensive income under "translation differences from foreign operations". These translation differences are carried to the income statement on the disposition of the foreign business in respect of which they were created and upon partial disposition of foreign business entailing loss of control.

F. Consolidated Financial Statements:

The Group's Consolidated Financial Statements include the financial statements of the Company and of entities that are directly or indirectly controlled by the Company. An investing company is controlling an investee company when it is exposed or has rights to variable yields deriving from its holding in the investee company and when it has the ability to have an effect on such yields through exercise of power on the investee company. This principle applies to all investee companies.

Note 2 - Significant accounting policies (Cont.)

F. Consolidated Financial Statements: (Cont.)

Financial statements of the consolidated companies that were prepared other than in accordance with the Group's accounting policies were adjusted, prior to their consolidation, to the accounting policies that have been implemented by the Group.

For the purposes of the consolidation, all inter-company transactions, balances, income and expenses have been eliminated in full.

G. Non-controlling interests:

Non-controlling interests are the capital in a subsidiary which cannot be attributed, either directly or indirectly, to the parent company.

Transactions with non-controlling interests, while retaining control (see Note 10C) - Transactions with non-controlling interests while retaining control are treated as equity transactions. Any difference between the consideration paid or received and the change in the non-controlling interests is carried to the share of the holders of the Company directly to a capital reserve from transactions with non-controlling interests in a consolidated company.

H. Business combinations:

The acquisition of activities and consolidated companies which constitute a business are presented while using the acquisition method. The cost of the business combination is presented as the aggregate fair value (as of the exchange date) of granted assets, incurred liabilities.

Transaction costs, which are directly related to the business combination are carried to the profit or loss when incurred.

The identified assets and liabilities of the purchased business, which meet the conditions for recognition under the (amended) IFRS 3 "Business Combinations", are recognized according to their fair value on the purchase date, other than a number of types of assets which are presented according to the provisions of the relevant standards.

Goodwill resulting from business combination is presented at the sum of the excess of the cost of the purchase over the Company's share in the net fair value of the identified assets, liabilities and contingent liabilities of the consolidated company that were recognized on the purchase date. If, after revaluation, the Group's rights in the net fair value of the identified assets, liabilities and contingent liabilities that were recognized, in total, exceed the cost of the business combination, the excess is immediately recognized in the profit or loss.

Non-controlling interest in the acquired entity are presented for the first time on the date of the business combination at the rate of their share in the fair value of the assets, liabilities and contingent liabilities of the acquired entity, excluding their share in goodwill.

I. Joint arrangements:

"Joint arrangement" is a contractual agreement whereby the Group and other parties perform financial activity that is subject to joint control. Joint control is in place where the contractual arrangement includes a requirement whereby decisions pertaining to the transaction's financial and operational strategy, must be adopted unanimously by the parties which jointly control the joint transaction.

Note 2 - Significant accounting policies (Cont.)

I. Joint arrangements: (Cont.)

Joint operation:

A joint operation is a joint arrangement wherein the parties thereto have interests in the assets, and commitments with regards to the liabilities that are attributed to the arrangement.

In joint arrangements that constitute joint operations, the Group recognizes in the Group’s Statement of Financial Position its pro-rata share in the joint operation’s assets and liabilities, including assets that are held and liabilities that were formed jointly. The income statement includes the Group’s pro-rata share in the income and expenses of the joint operation, including income derived and expenses incurred jointly.

J. Goodwill:

Goodwill that derives from the acquisition of a consolidated company is presented in the framework of intangible assets and is measured at the level of the surplus of the cost of the acquisition over the Company’s share in the net fair value of the identified assets, liabilities and contingent liabilities of the consolidated company, which were recognized at the time of the acquisition.

Goodwill is initially recognized as an asset at cost and is measured in following periods as cost net of accumulated losses from impairment.

For the purposes of the testing for impairment, goodwill is allocated to each of the Group's cash generating units, which derive benefits from the synergies from the business combination. Cash generating units to which Goodwill has been allocated are tested for impairment each year or more frequently, where signs exist, which evidence a possible impairment of the unit, as aforesaid. Where the recoverable amount of a cash generating unit is lower than the carrying value of that unit, the loss from impairment is allocated firstly to the writing down of the carrying value of any goodwill whatsoever in respect of the cash generating unit. Thereafter, the balance of the impairment loss, if any remains, is allocated to the other assets making up the cash generating unit, in proportion to their book value. A loss from impairment of goodwill is not cancelled in following periods.

Upon a disposition of a consolidated company, the amount of the goodwill that is attributed to it is included in the determination of the profit or loss on the disposition.

K. Non-current assets and disposal group held for sale:

A disposal group comprised of assets and liabilities is classified as assets held for sale if it is highly likely that their recovery will be mainly through a sale transaction and not through extended use. The same is true also when a company is bound to a sale plan which involves loss of control over a subsidiary, regardless if the company retains rights which do not confer control in the former subsidiary, after the sale.

Immediately prior to the classification thereof as held for sale, the components of the disposal group are measured according to the Group's accounting policy. Thereafter, the components of the disposal group are measured according to the lower of the book value and the fair value, net of sale costs.

Any loss from impairment of a group designated for disposition, is first attributed to goodwill, and thereafter, proportionately, to the remaining assets and liabilities, excluding the fact that no loss is attributed to assets which are not within the application of the IFRS 5 measurement instructions, such as: inventory, financial assets, deferred tax assets, employee benefit plan assets, investment property measured according to fair value, which continue to be measured according to the Group's accounting policy. Losses from impairment which are recognized upon the initial classification of an asset as held for sale, as well as subsequent profits or losses as a result of the remeasurement, are carried to profit and loss. Profits are recognized until the accrued amount of loss from impairment which was recorded in the past.

Note 2 - Significant accounting policies (Cont.)

K. Non-current assets and disposal group held for sale (Cont.)

In subsequent periods, depreciable assets classified as held for sale, are not depreciated periodically and investments in associates classified as held for sale, are not accounted by the equity method.

In these statements, assets and liabilities of the subsidiaries held for sale, are presented as a disposal group held for sale in the Statement of Financial Position. However, the companies' results in the income statements and cash flow statements are presented on a fully consolidated basis.

Non-current assets or disposal groups which are classified as held for sale, with the exception of investment property which is presented by fair value, are presented by the lower of their book value and their fair value net of disposal costs.

L. Discontinued Operations

Operations that were realized or are classified as held for sale, constitute discontinued operations when representing a business operating segment or an operations' geographic region which is significant and separate, or when they constitute part of a single and adjusted planning for the disposal of a business operating segment or of an operations' geographic region which is significant and separate. Revenues and expenses which belong to discontinued operations are presented in the Statements of Profit or Loss and Other Comprehensive Income, Net, net of taxes on income during all of the periods presented as part of the "Income from discontinued operations (net of tax)" item. The cash flows from discontinued operations are jointly presented in the Discontinued Operations Note in all of the report periods presented, according to the classification of current operations, investment activity and financing activity.

The comparison figures in Statements of Profit or Loss and Other Comprehensive Income from the results of the discontinued operations, are retroactively adjusted.

M. Loss of Control

Upon loss of control, the Group writes-off the assets and liabilities of the subsidiary, any non-controlling interest and other capital components attributable to the subsidiary. The difference between the consideration and the fair value of the investment balance and between the balances written-off, is recognized in profit and loss under the "Other income" item. The amounts recognized in equity through other comprehensive income in reference to such subsidiary are reclassified as profit or loss or as retained earnings, as would have been required had the subsidiary disposed of the relevant assets or liabilities itself.

N. Financial instruments:

(1) Financial assets

General

Financial assets are recognized in the Statement of Financial Position when the Group becomes a party to the contractual provisions of the instruments.

Investments in financial assets are initially recognized at their fair value, plus transaction costs, other than such financial assets that are classified at fair value through profit or loss, that are initially recognized at their fair value.

Financial assets are written off when the Group's contractual rights to cash flow deriving from the financial asset expire, or when the Group transfers the rights to receive the cash flow deriving from the financial asset in a transaction in which all the risks and benefits from the ownership of the financial asset are transferred in practice.

Note 2 - Significant accounting policies (Cont.)

N. Financial instruments: (Cont.)

(1) Financial assets (Cont.)

General (Cont.)

Financial assets are classified into the following categories. The classification to these categories depends on the nature and the purpose of the holding of the financial asset that is held, and it is determined on the initial recognition date of the financial asset, or on consecutive reporting periods if it is possible to reclassify the financial assets to another category:

- Financial assets designated at fair value through profit and loss;
- Loans and other receivables; and
- Financial assets available for sale.

On the publication of the final version of IFRS 9 “Financial Instruments”, see Note 2EE.

Loans and receivables

Trade accounts receivable, short-term deposits and investments and other receivables with fixed or determinable payments that are not quoted in an active market, are classified as loans and receivables. Loans and receivables are measured at amortized cost using the effective interest method, net of impairment, if any. Interest income is recognized by applying the effective interest method, other than short-term receivables when the interest amounts to be recognized are insignificant.

Cash and cash equivalents

Cash and cash equivalents include cash balances available for immediate use and deposits upon demand. Cash equivalents include short-term investments the duration of which from the original deposit date until the payment date is up to 3 months, at a high liquidity level, easily convertible into known amounts of cash and which are exposed to an insignificant risk of value changes.

Financial assets available for sale

Investments in marketable and non-marketable capital instruments (see Note 12), which are not derivative financial instruments, which have not been classified as financial assets at fair value through profit and loss or as loans and receivables, are classified as financial assets available for sale. Investment in capital instruments that are traded in an active market are presented at fair value. Profits or losses deriving from changes in the fair value are carried directly to the other comprehensive income under the ‘change in fair value of financial assets available for sale’ item, except for losses from impairment, which in certain circumstances are carried to the income statement.

Income from dividends due to investment in capital instruments available for sale is recognized in the income statement when the Group's entitlement to receive payments in respect thereof is created.

On the matter of determining the fair value of financial assets available for sale that are not traded in the active market, see Note 3B(4).

Note 2 - Significant accounting policies (Cont.)

N. Financial instruments (Cont.)

(2) Financial liabilities

The Group recognizes for the first time, debt instruments issued on the date of their creation. The remaining financial liabilities are first recognized on the trade date on which the Group becomes a party to the contractual terms of the instrument.

Financial liabilities are initially recognized at fair value with the addition of all of the attributable transaction costs. Following the initial recognition, the financial liabilities are measured at amortized cost in accordance with the effective interest method.

Financial liabilities are written-off when the Group's commitment, as specified in the agreement, expires, or when it had been settled or terminated.

The non-derivative financial liabilities include: bank overdrafts, loans and credit from banks and other credit providers, bonds, liabilities in respect of finance leases, deposits from customers and trade and other payables.

Financial assets and financial liabilities are setoff and the amounts are presented net in the Statement of Financial Position, where the Group has a current, enforceable legal right to offset the amounts that have been recognized and it intends to clear the asset and the liability on a net basis or to dispose of the asset and to clear the liability simultaneously.

(3) Derivative financial instruments and hedge accounts

The Group holds derivative financial instruments for the purpose of hedging foreign currency risks and interest rate risks, as well as derivatives not used for hedging, including separated embedded derivatives.

Measurement of derivative financial instruments

Derivatives are initially recognized at fair value. Attributable transaction costs are carried to the income statement when incurred. After the initial recognition, the derivatives are measured at fair value, whilst the changes in the fair value are treated as follows:

Economic hedge

Hedge accounting is not implemented in respect of derivative instruments that are used for the economic hedge of financial assets and liabilities that are stated in foreign currency. The changes in the fair value of these derivatives are carried to the income statement, as financing income or expenses.

Derivatives not used for hedging

Changes in the fair value of derivatives not used for hedging are carried immediately to the income statement, as financing income or expenses.

(4) Index-linked assets and liabilities that are not measured at fair value

The value of index-linked financial assets and liabilities, which are not measured at fair value, is revaluated in each period in accordance with the actual rise / fall in the index.

Note 2 - Significant accounting policies (Cont.)

N. Financial instruments (Cont.)

(5) Share capital

Additional costs, which relate directly to the issuance of ordinary shares and options for shares, are presented as a deduction from capital.

(6) Deposits from customers and senior housing tenants

Within the context of its operations, Supergas receives deposits from its customers in respect of containers and other equipment that are borrowed. The deposit will be returned in accordance with the prices of the deposit that the consolidated company collects from its customers, which is linked to the index from the day of the latest update. In accordance with IAS 39, the fair value of financial liabilities with a demand characteristic is not to be lower than the amount that is to be paid on demand, discounted from the first time at which it will be possible to demand the amount. Accordingly, the deposits are presented at their full value. Moreover, since Supergas has no irrevocable right to defer the clearance of the liabilities in respect of the deposits for a period of at least 12 months after the Report Date, and since the customers of the consolidated company are entitled to demand repayment of the deposit at any time, the deposits are presented as current liabilities, on the basis of their full value.

The senior housing tenants' deposits are a financial liability with a requirement characteristic and are therefore presented according at the fair value which is identical to the value of the liability as of the balance sheet date.

O. Fixed assets:

(1) Recognition and measurement

Fixed asset items are measured at cost net of accumulated depreciation and accumulated losses from impairment.

The cost includes expenses that are directly attributable to the acquisition of the asset. The cost of assets that were self-built includes the cost of the materials and the direct labor, as well as any additional cost that is directly attributable to bringing the asset to the location and condition that are required in order for it to operate in the manner intended by management, as well as capitalized credit costs. The cost of purchased software, which constitutes an integral part of the operation of the related equipment, is recognized as part of the cost of such equipment.

Spare parts, servicing equipment and standby equipment are classified as fixed assets when complying with the definition of fixed assets according to IAS 16. Otherwise, they are classified as inventory.

Where significant components of the fixed assets (including significant periodic inspection costs) have a different lifetime, they are accounted as separate items (significant components) of the fixed assets.

A profit or loss from the write-off of a fixed asset item is determined by a comparison of the net consideration from write-off of the asset to the book value, and is recognized in the income statement as other income or other expenses, as the case may be.

Note 2 - Significant accounting policies (Cont.)

Q. Fixed assets:

(2) Subsequent costs

The costs of the replacement of a part of a fixed asset item and other subsequent costs, are recognized as part of the book value of such item, if the Group is expected to gain the future economic benefit inherent therein and if its cost can be reliably measured. The book value of the replaced part is written-off. The cost of ongoing maintenance of fixed asset items are carried to the profit and loss as incurred.

(3) Depreciation

Depreciation is the systematic allocation of the depreciable amount of an asset over the length of its useful lifetime. The depreciable amount is the cost of the asset, or some other amount that replaces the cost, net of the residual value of the asset.

A depreciated asset, when usable, namely when in the location and condition required in order for it to operate in the manner intended by Management.

Depreciation is carried to the income statement in accordance with the straight line method in accordance with an estimate of the useful lifetime of each part of the fixed asset items, since this method reflects the manner of the forecast consumption of the future economic benefits that are inherent in an asset in the best way. Assets leased under finance leases, including lands, are amortized over the shorter of the lease period and the period in which the assets are used, unless it is reasonably expected that the Group shall acquire ownership over the asset at the end of the lease period. Lands under ownership are not amortized.

The estimated useful lifetime for the current period and for the comparative periods are as follows:

	Useful lifetime in years	Depreciation rate %
Buildings	10-50 (primarily 25-50)	2-10 (primarily 2-4)
Plant and equipment	3-30 (primarily 6-10)	3-33 (primarily 10-15)
Office furniture and equipment	3-17	6-33
Motor vehicles	5-6	15-20
Computers	3-5	20-33
Leasehold installments and improvements	Throughout the lease period, which does not exceed the economic lifetime of the asset.	

The estimates regarding the depreciation method, useful life and the residual value are reexamined at least in the end of each year and are adjusted when necessary.

On the cessation of the depreciation of fixed assets items which are classified as held for sale, see Section K above.

Note 2 - Significant accounting policies (Cont.)

P. Investment property:

Investment property is property (land or a building – or part of a building - or both of them), which is held by the Group for the purpose of the production of rent or for the purposes of a capital gain or both, and not for the purposes of use in the production or supply of goods or services or for administrative purposes or for sale in the ordinary course of business. Investment property, as aforesaid, also includes investment property that is under construction or development.

The Group's investment property includes buildings and land that is owned or held under finance lease, as well as rights in real estate that are held by the Group under operating leasing where otherwise the definition of investment property would be complied with. Investment property is initially measured at cost, which includes transaction costs. In periods following the initial recognition, investment property is measured at fair value. Gains or losses deriving from changes in the fair value of investment property, including those that are sources in changes in exchange rates, are recorded in the income statement in the period in which they were generated, under the 'net profit from adjustment to fair value of investment property and investment property under construction' item.

Investment property, as aforesaid, also includes investment property that is under construction or development. Investment property under construction is measured at fair value when the value thereof can be reliably measured. Costs of credit are capitalized to investment property under construction. When the fair value cannot be reliably measured, investment property under construction is measured according to cost in the construction period until the earlier of the date of completion of the construction and the date on which the fair value can be reliably measured.

The direct costs of the disposition of investment property are carried to the income statement at the time at which the asset is sold and are setoff against the gain on disposition. The difference between the consideration that is received on the disposition of investment property and the fair value, is the capital gain (loss) on disposition, which is carried to the income statement at the time of the completion of the disposition transaction under "net profit from adjustment to fair value of investment property and investment property under construction".

Q. Costs of credit:

Specific credit costs and non-specific credit costs are capitalized to qualifying assets and investment property under construction in the course of the period that is required for the completion and for the construction up to the time at which they are ready for their designated use. Non-specific credit costs are capitalized in the same manner for the same investment in qualifying assets and investment property under construction or to the part of it that is not financed by specific credit, using a rate which is a weighted average of the rates of the cost in respect of the sources of credit whose cost has not been capitalized in a specific manner.

All other credit costs are carried to the income statement as incurred.

In the cash flow statement the Group classifies cash flows for interest payments which are capitalized on qualified assets as cash flows used for financing activity, in a manner that is consistent with the Group's policy regarding interest payments in the cash flow statement, as stated in Note 2CC.

Note 2 - Significant accounting policies (Cont.)

R. Intangible assets, except for goodwill:

Intangible assets are non-financial assets that are not identifiable and which lack a physical presence. Intangible assets having an indefinite useful lifetime are not amortized and are tested for impairment once a year, or at any time at which a sign exists, which indicates the possibility that an impairment has occurred in accordance with the provisions of IAS 36. The estimate of the useful lifetimes of intangible assets having an indefinite lifetime is tested at the end of each reporting year. A change in the estimated useful lifetime of an intangible asset, which turns from being indefinite to being defined is treated by way of "prospective application".

Intangible assets having a defined useful lifetime are amortized on a straight line over the length of their estimated useful lives, subject to testing for impairment. A change in an estimate of the useful lifetime of an intangible asset with a defined lifetime is treated by way of "prospective application".

On the accounting treatment of goodwill - see Note 2J.

The useful lifetime that have been used in the amortization of intangible assets having a defined lifetime are as follows:

Distribution rights	-	20 years or in accordance with the period of the agreement.
Software	-	3-6 years.
Franchise arrangement		Over the period of the franchise.
Others	-	Over the period of the benefit.

Subsequent costs

Subsequent costs are recognized as an intangible asset solely and exclusively where they increase the future economic benefit that is inherent in an asset, in respect of which they were expended. All of the other costs, including costs that are connected to goodwill and to brands that have been developed independently, are carried to the income statement as incurred.

Intangible assets that were acquired in business combinations

Intangible assets that were acquired in business combinations are recognized separately from goodwill, where they meet the definition of an asset and identifiable. Intangible assets are identifiable when they are separable or deriving from contractual or other legal rights. Such intangible assets will be recognized at the time of the business combination at their fair value.

In the periods following the initial recognition, intangible assets that have been acquired within the framework of business combinations are presented in accordance with their cost, net of amortization and accumulated losses from impairment. The amortization of intangible assets, having a defined lifetime, is calculated on the straight line basis over the length of their estimated useful lifetimes. The estimate of the useful lifetime and the method of amortization are tested at the end of each reporting year, where the effect of a change in them is treated by way of "prospective application".

Note 2 - Significant accounting policies (Cont.)

S. Leased assets:

(1) Leases, including leases of land from the Israel Land Administration or from other third parties where the Group bears significantly all of the risks and the yields that derive from the asset, are classified as finance leases. On initial recognition, the leased assets are measured, and a liability recognized, in an amount that is equivalent to the lower of the fair value and the present value of the minimum future lease payments. In the measurement of the liability for the lease of land in a non-capitalized lease from the Israel Land Authority ("**ILA**"), the minimum future lease payments were capitalized at a real interest rate of 5% based on capitalization interest that was used by the ILA on the date of the engagement in the lease. Future payments for exercise of the option to extend the lease period vis-à-vis the Israel Land Administration are not recognized as part of the relevant asset and liability, since they constitute conditioned long-term rent, which derives from the fair value of the land on the future dates of renewal of the lease agreement. Following the initial recognition, the asset is treated in accordance with the accounting policy that is customary in respect of that asset.

The other leases are classified as operating leases, except for leases of real estate that is classified as an investment property, where the leased assets are not recognized in the Group's Statement of Financial Position. Real properties under operating lease, which have been classified by the Group as an investment property, are recognized in the Group's Statement of Financial Position at their fair value, and the lease is accounted as finance lease.

The lease period and the amounts of the amortization take into account any option to extend the lease period, in the event that at the time of the commitment under the lease it is reasonably certain that the option will be exercised.

In a lease of land and buildings the components of the land and the buildings are examined separately for lease classification purposes, with a significant consideration in the classification of the components of the land being the fact that land usually has an indefinite lifetime.

(2) Lease payments

Payments in the framework of an operational lease are carried to the income statement using the straight line method throughout the lease period.

Minimum lease payments which are paid in the framework of a financial lease are divided between the financing expenses and reduction of the liability balance. The financing expenditure is allocated to each lease period, so as to obtain a fixed periodic interest rate on the outstanding balance of the liability. The minimum lease payments are updated in respect of conditioned long-term rent, when the condition transpires.

In the matter of publication of a new standard on leases, IFRS 16 "Leases" – see Note 2EE.

T. Inventory:

(1) Inventory of gas

The inventory is presented at the lower of cost or market. The cost of the inventory is determined on the basis of "first in first out" (FIFO), and it includes the costs of the purchase of the inventory and of bringing it to its current location and condition. The net realizable value is an estimate of the selling price in the ordinary course of business, net of an estimate of the costs that are required in order to carry out the sale.

Note 2 - Significant accounting policies (Cont.)

T. Inventory: (Cont.)

(2) Other inventory

Is measured at the lower of cost and net realizable value. The cost of the inventory is determined primarily on the moving average basis.

U. Impairment of non-derivative financial assets:

Impairment of a financial asset that is not presented at fair value through profit and loss is tested where there is objective evidence that a loss event has occurred after the time of the initial recognition of the asset and that this loss event has had a negative impact on the estimated future cash flows from the asset, which can be measured in a reliable manner.

Objective evidence that an impairment of financial assets has occurred may include the breach of a contract by a debtor, the re-organization of an amount that is due to the Group based on terms that the Group would not have considered in other cases, the existence of indications that a debtor or debt issuer will become bankrupt, negative changes in the status of the payments of borrowers, changes in the economic environment which attest to insolvency of debt issuers or the absence of an active market for a security. Projected information which indicates that there is a measurable decline in the projected cash flow from a group of financial assets.

In the testing for impairment of financial assets available for sale, which are capital instruments, the Group also tests the difference between the fair value of the asset and its original cost, for the length of time in which the fair value of the asset is lower than its original cost and for changes in the technological, economic or legal environment or in the environment in the market in which the company that issued the instruments operates. In general, an impairment of 30% of the original cost will be considered to be material, where the impairment is over the face of a year. This policy was determined in according to the nature of two of the company's most significant investments, see Note 12(1)-(2).

The Group examines evidence of impairment in respect of loans, trade and other receivables both at the level of the individual asset and also on a Group-wide level. The balances of trade accounts receivable, loans and other receivables that are significant individually are tested specifically for impairment. The balances of trade accounts receivable, loans and other receivables, in respect of which no specific impairment has been identified, are grouped together and are tested on a Group-wide basis for impairment, with the objective of identifying any impairment that has occurred and has not yet been identified. In respect of the balances of the trade accounts receivable, loans and other receivables that are not individually significant, the Group-wide testing for impairment is carried out by grouping them together on the basis of similar risk characteristics.

In the Group-wide testing for impairment the Group makes use of historical trends of the probability of a breach, the timing of the receipt of the repayment and the total actual loss, in accordance with management's judgment in respect of the question of whether the actual losses are expected to be larger or smaller by comparison with the losses that arise from the historical trends, in the light of the economic situation and the existing credit terms.

A loss from the impairment of a financial asset, which is measured at amortized cost, is calculated as the difference between the book value of the asset and the present value of the estimated future cash flows, discounted at the asset's original effective interest rate. Losses are carried to the income statement and are presented as a provision for a loss against the balances of the trade accounts receivable, the other receivables and the loans. Interest income in respect of assets whose value has been impaired is recognized by means of the use of the interest rate used to discount the future cash flows for the purposes of measuring the loss from impairment.

Note 2 - Significant accounting policies (Cont.)

U. Impairment of non-derivative financial assets (Cont.):

Losses from impairment due to financial assets available for sale, are recognized by carrying the cumulative loss that was recorded under a capital reserve due to assets available for sale, to the income statement. The cumulative loss that is carried from the other comprehensive income to the income statement is the difference between the acquisition cost and the current fair value, net of impairments that were recognized in the past in the income statement. A loss from impairment is cancelled where it can be objectively attributed to an event that occurred after the recognition of the loss from the impairment. A cancellation of a loss from impairment due to financial assets, which are measured at depreciated cost, is carried to the income statement. A cancellation of a loss from impairment due to financial assets that are classified as available for sale, which are capital instruments, is carried directly to the other comprehensive income.

V. Impairment of non-financial assets:

At the end of each reporting period, the Group tests whether any signs whatsoever exist, which evidence an impairment of its tangible and intangible assets, other than inventory. In the event that signs exist, as aforesaid, an estimate is made of the recoverable amount of the asset, with the objective of determining the amount of the loss from impairment that has arisen, if any. Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash generating unit to which the asset belongs. Common assets are also allocated to the individual cash generating units in the event that it is possible to identify a reasonable and consistent basis for such an allocation.. In the event that it is not possible to allocate the common assets to the individual cash generating units on the said basis, the common assets are allocated to the smallest cash generating units in respect of which it is possible to identify a reasonable and consistent basis for the allocation.

A recoverable amount is the higher of the fair value of an asset net of sale costs and its value in use. In the evaluation of the value in use, estimated future cash flows are discounted to their present value, using a pre-tax discount rate, which reflects the market's present evaluation in respect of the time value of the money, and the specific risks that relate to the asset, in respect of which the estimated future cash flows have not been adjusted.

Where the recoverable amount of an asset (or of a cash generating unit) is estimated to be lower that the carrying value, the book value of the asset (or of the cash generating unit) is written down to its recoverable amount. A loss from impairment is recognized immediately as an expense in the income statement, unless the relevant asset is measured in accordance with the revaluation model. In that case, the loss from impairment is treated as a reduction of the revaluation reserve, until it is reduced to zero, and the balance of the reduction, if there is one, is recognized in the income statement.

Where a loss from impairment that has been recognized in previous periods is cancelled, the book value of the asset (or of the cash generating unit) is increased back to the updated estimated recoverable amount, but not more than the book value of the asset (or of the cash generating unit) that would have been set if it were not for the recognition of a loss from impairment in respect of its in previous periods. The cancellation of a loss from impairment is recognized immediately in the profit and loss.

Note 2 - Significant accounting policies (Cont.)

W. Provisions:

A provision is recognized where the Group has a current commitment, whether legal or implicit, as the result of an event that has taken place in the past, which can be reliably measured, and where it is expected that economic resources will be required in order to clear the commitment.

(1) Legal claims

A provision for claims is recognized where the Group has a present legal commitment or an implicit commitment as the result of an event that has taken place in the past, it being more likely than not that the Group will be required to use economic resources to settle the commitment and it may be reliably estimated. Where the impact of the time value is material, the provision is measured in accordance with its present value.

(2) Warranty

A provision for warranty is recognized when the products or the services for which the liability is provided, are sold. The provision is based on historic data and also on assessments of the management and the weighting all the possible outcomes by their probabilities.

X. Revenues:

(1) The sale of products

The Group recognizes income where there is convincing evidence (usually performance of a sale agreement) that the significant risks and benefits of the ownership of the product are transferred to the purchaser, the receipt of the consideration is expected, the possibility exists of reliably estimating the possibility that the goods will be returned, the costs that have been incurred, or which will be incurred in respect of the transaction may be reliably estimated, where the management has no continuing involvement with the goods, and also where the income can be reliably estimated. If it is expected that a discount will be provided and its amount can be reliably measured, the discount is deducted from the revenues from the sale of the products.

In the sale of the Group’s products in Israel, the transfer of the risks and the yields generally takes place on the date of delivery of the product to the customer. In respect of the sale of the Group’s products outside Israel, in general, the transfer of risks and yields exists on the date of loading the products on the transporter's means of transportation.

Income from the sale of products in the ordinary course of business is measured at the fair value of the consideration that is received or which is to be received, net of trade discounts and quantity discounts.

(2) Rent income

Rent income in respect of investment property is recognized on the straight line basis over the length of the relevant rent period.

(3) Income from management and maintenance fees and net income from the use of electricity

Income from management and maintenance fees and net income from the use of electricity is reflected pro-rata over the length of the period in which the relevant services are provided.

Note 2 - Significant accounting policies (Cont.)

X. Revenues: (Cont.)

(4) Dividend income

Dividend income in respect of investments is recognized at the time at which the shareholders' entitlement to receive the income is created.

(5) Senior housing revenues

(1) The revenues from management and maintenance fees are recorded in the income statement upon performance of the service.

(2) The revenues from forfeiture of deposits are recorded in the income statement as incurred.

(3) Financing revenues and expenses in respect of revaluation of the deposit balance are recorded in the income statement as incurred.

(6) Revenues from provision of senior housing services

The revenues from provision of services are recorded proportionately over the term of the agreement or upon provision of the service if the likelihood of the flow of the economic benefits attributed to provision of the service is certain.

Y. Franchise arrangements for provision of services:

Franchise arrangements for provision of services are arrangement in which the State (or the franchise issuer) engages in a contract with an entity from the private sector in which such operator undertakes to plan, build and finance some property or infrastructure for service to the public and in consideration for construction of such property, the operator receives a franchise from the State to operate the property for a defined period, and also to provide other services related to the property. Below are the Group's main franchise arrangements:

The Group, through Supergas, engaged in franchise arrangements for the provision of services with the Electricity Authority for the construction of midsize plants for the production of electricity through photovoltaic technology, which feed all of the energy produced at the plants to the distribution grid. Since the Electricity Authority controls and regulates the services which the franchiser-operator is required to provide through the infrastructure, the persons to whom he is required to provide them and the price at which they shall be provided, and since the franchise arrangement with the Electricity Authority obligates the same, through the Israel Electric Corporation Ltd., to purchase all of the electricity produced from the production plant, and the arrangement constitutes in essence an arrangement for the whole useful lifetime of the plant, considering that the discard value of the infrastructure at the end of the arrangement period is not significant, Supergas treated the said arrangements in accordance with interpretation provision number 12 (IFRIC 12) "Service Concession Arrangements". The arrangement period is divided in two: the construction period and the operating period, which applies from the completion of the infrastructure construction for the duration of the franchise period (approx. 20 years). The Group's rights for the franchise are recognized as a financial asset, receivables in respect of a franchise arrangement, which is handled as loans and receivables, since the Group has an unconditional right to receive revenues from the franchise grantor for the entire amount of electricity produced by the production facilities. The asset is recognized during the construction period with respect to the construction costs and with the addition of the contractor's margin which is estimated according to the Company's valuation, and settled through the revenues during the operations period. After the preliminary recognition, interest revenues are recognized during the arrangement period according to the effective interest method.

Note 2 - Significant accounting policies (Cont.)

Y. Franchise arrangements for provision of services: (Cont.)

In addition, the Group engaged, via GES Environmental Solutions Ltd., with authorities from the public sector, to provide BOT (Build, Operate, Transfer) services for construction of facilities, wastewater treatment, and improvement of wells.

In accordance with IFRIC 12, the infrastructure constructed is not recognized as a fixed asset in the financial statements of the Group. Some of the Group's franchise arrangements are treated according to a financial asset model and other part of the franchise arrangements are treated as according to an integrated model which includes both a financial asset and intangible asset. The period of the arrangement is divided into two periods: a construction period and an operation period which began upon completion of construction of the infrastructure. The Group's rights pertaining to the franchise are recognized in part as a financial asset, receivables in respect of franchise arrangement, under the application of IAS 39 (loans and receivables), since the Group has an unconditional right to receive from the entity granting the franchise guaranteed proceeds in consideration for the services. The asset is recognized during the construction period in respect of the construction costs, plus the accepted contractor margin according to the Group's estimation, and is repaid through the proceeds during the operation period. After initial recognition, interest income is recognized along the arrangement period according to the effective interest method.

The Group's rights for the franchises are recognized partly as an intangible asset, in respect of franchise arrangement, which reflect the right available to the Company to collect payment, which is not guaranteed by the franchisor, in accordance with the extent of the use by the public using the infrastructure. The intangible asset is recognized through the construction period and its cost is determined in reference to the construction costs plus the gross margin in the Company's estimation.

Z. Financing income and expenses:

Financing income includes interest income on amounts invested (including financial assets from franchise agreements), income from dividend on marketable shares, changes in the fair value of financial assets which are presented at fair value through profit or loss and profits from hedging instruments recognized in the profit or loss. Interest income is recognized upon its accrual through the effective interest method.

Income from dividends on marketable shares which is recognized as income on the X-date. Changes in the fair value of the financial assets which are presented at fair value through profit or loss also include income from dividends and interest.

Financing expenses include interest expenses on loans received, bonds issued, changes to the fair value of financial assets presented at fair value through profit or loss, and losses from hedge instruments recognized in the profit or loss. Credit costs, which are not discounted on qualifying assets are carried to the income statement according to the effective interest method.

Profits or losses from exchange rate differences on financial assets and liabilities are reported net as financing income or financing expenses, depending on the exchange rate fluctuations, and depending on the their position (net profit or loss).

AA. Taxes on income:

(1) General

Tax expenses (income) on income include the sum of the current tax as well as the change in the deferred tax balances, except in respect of deferred taxes that derive from transactions that are reflected directly under shareholders' equity.

Note 2 - Significant accounting policies (Cont.)

AA. Taxes on income: (Cont.)

(2) Current taxes

The current tax on income expenses is calculated based on the Company and the consolidated companies' chargeable income for tax purposes, during the course of the reporting period. The chargeable income is different from the income before taxes on income, as the result of the inclusion or the non-inclusion of income and expense items that are chargeable to taxation or which are allowable as a deduction in different reporting periods, or which are not chargeable to tax or allowable as a deduction. Current tax assets and liabilities have been calculated on the basis of the tax rates and the tax laws that have been legislated or whose legislation has been effectively completed as of the Date of the Statement of Financial Position.

A provision for uncertain tax positions including additional tax and interest expenses, is recognized when it is more likely than not that the Group will resort to its financial resources to settle the liability.

Current tax assets and liabilities are presented as offset, where the entity has an enforceable legal right to offset the amounts recognized as well as an intention to settle on a net basis, or to realize the asset and settle the liability at the same time.

(3) Deferred taxes

The companies in the Group record deferred taxes in respect of timing differences between the values of assets and liabilities for tax purposes and their values in the Financial Statements. Deferred tax balances (assets or liabilities) are calculated in accordance with the tax rates that are expected to apply at the time that they are realized, based on the tax rates and the tax laws that have been legislated or whose legislation has been effectively completed as of the Date of the Statement of Financial Position. Deferred tax liabilities are generally recognized in respect of all of the temporary differences between the value of assets and liabilities for tax purposes and their values in the Financial Statements. Deferred tax assets are recognized in respect of temporary differences that can be deducted up to the amount of the chargeable income against which it is expected that the deductible temporary differences can be exploited. The deferred taxes in respect of the structure component of investment property are calculated in accordance with a business model whose purpose is significant consumption over time of all of the economic benefits incorporated therein.

The calculation of the deferred taxes does not take into account the taxes that would have applied in the event of the disposition of the investments in investee companies, since in the Group's management estimate, the temporary differences which are the subject matter of such deferred taxes are under the control of the Group and are not expected to reverse in the foreseeable future.

Deferred tax assets and liabilities are presented as offset, where the entity has an enforceable legal right to offset current tax asset against current tax liabilities, and where they refer to income taxes that are imposed by such tax authority, and the Group intends to settle the current tax assets and liabilities on a net basis.

BB. Earnings per share:

The Company calculates the amounts of the basic earnings per share in respect of the profit or loss that is attributable to the shareholders in the Company by dividing the profit or loss that is attributable to the shareholders in the Company by the weighted average number of ordinary shares in circulation during the course of the reporting period.

Note 2 - Significant accounting policies (Cont.)

CC. Classification of interest paid, dividends paid, interest and dividends received and income taxes paid, net, in cash flow statement:

The Group classifies cash flows due to interest and dividends received thereby as cash flows from investment activity, as well as cash flows due to interest that was paid as cash flows used for the financing activity. Cash flows due to income taxes are classified in general as cash flows used for operating activities, other than cash flows that are easily identifiable with cash flows used for investment or financing activity. Dividends paid by the Group are classified as cash flows from financing activity.

DD. Exchange rates and linkage base:

(1) Balances that are stated in foreign currency or which are linked thereto are recorded in the Financial Statements in accordance with the representative exchange rates that were published by the Bank of Israel and which were in force as of the Date of the Statement of Financial Position.

(2) Balances that are linked to the CPI are presented in accordance with the last known index as of the Date of the Statement of Financial Position (the index for the month preceding the date of the Financial Statements), or in accordance with the index in respect of the last month of the reporting period (the index for the month in which the date of the Financial Statements lies), in accordance with the terms of the transaction.

(3) The following are details in respect of the exchange rates and Index:

	Representative exchange rate of		Index in Israel	
	Euro NIS to 1 Euro	Dollar NIS to 1 Dollar	Index for Basis 1993	Known index Basis 1993
The date of the Financial Statements:				
December 31, 2016	4.044	3.845	220.68	220.68
December 31, 2015	4.247	3.902	221.13	221.35
December 31, 2014	4.725	3.889	223.36	223.36
	%	%	%	%
Rates of the change as of the year ended:				
December 31, 2016	(4.78)	(1.46)	(0.20)	(0.30)
December 31, 2015	(10.11)	0.33	(1.00)	(0.90)
December 31, 2014	(1.20)	12.04	(0.20)	(0.10)

Note 2 - Significant accounting policies (Cont.)

EE. Standards, interpretation and amendments to standards that were released and are not invalid, and were not pre-adopted by the Group, that have or may have an effect on future periods:

- **IFRS 9 "Financial Instruments":**

General:

IFRS 9 (2014) "Financial Instruments" (the "**Standard**") is the final standard of the financial instruments project. The Standard cancels the previous stages of IFRS 9 which were published in 2009, 2010 and 2013. This final Standard includes the provisions for classification and measurement of financial assets, as published at the first stage in 2009 and amended in this version, and also includes the provisions for classification and measurement of financial liabilities, as published at the second stage in 2010, offers a more updated and principal-based model regarding hedge accounting and presents a new model for assessment of projected loss from impairment as specified below. In addition, the Standard cancels the IFRIC Interpretation 9 "Reassessment of Embedded Derivatives".

Financial assets

The Standard determines that the financial assets be recognized and measured as follows:

- Debt instruments will be classified and measured after initial recognition under one of the following alternatives: at depreciated cost, fair value through profit or loss or fair value through other comprehensive income. The measurement model will be determined in consideration of the business model of the entity regarding the management of financial assets, and according to the characteristics of the contractual cash flows deriving from the same financial assets.

- A debt instrument which, according to the tests, is measured at depreciated cost or at fair value through other comprehensive income, may be designated at fair value through profit or loss only when the designation cancels out an accounting mismatch in recognition and measurement that would have been created had the asset been measured at depreciated cost or at fair value through other comprehensive income.

- As a rule, capital instruments will be measured at fair value through profit or loss.

- At the time of initial recognition, capital instruments may be designated at fair value through other comprehensive income. Instruments so designated will no longer be subject to impairment tests, and profit or loss thereon will not be carried to profit and loss, including upon disposal.

- Embedded derivatives will not be separated from a host contract which is within the Standard's applicability. Instead, hybrid contracts will be measured in their entirety at depreciated cost or at fair value, according to the business model and contractual cash flow tests.

- Debt instruments will be reclassified only when the entity changes its business model to financial assets management.

- Investments in capital instruments having no quoted price in an active market, including derivatives of such instruments, will be measured at fair value. The alternative to measuring at cost in certain circumstances was eliminated. However, the Standard provides that in certain circumstances, cost may be an appropriate approximation of fair value.

Note 2 - Significant accounting policies (Cont.)

EE. Standards, interpretation and amendments to standards that were released and are not invalid, and were not pre-adopted by the Group, that have or may have an effect on future periods: (Cont.)

- **IFRS 9 "Financial Instruments": (Cont.)**

Financial liabilities

- The Standard also sets forth the following provisions regarding financial liabilities:
- The change in the fair value of a financial liability which was designated upon initial recognition as fair value through profit or loss, and which is attributable to changes in the credit risk of the liability, will be carried directly to other comprehensive income, unless doing so creates or increases an accounting mismatch.
- When the financial liability is repaid or discharged, amounts carried to other comprehensive income will not be classified to profit or loss.
- All of the derivatives, whether assets or liabilities, will be measured at fair value through profit or loss, including a derivative financial instrument which constitutes a liability and is related to an unquoted capital instrument, whose fair value cannot be reliably measured.

Hedging

The Standard sets forth new hedging provisions and provides the option to choose, as an accounting policy, whether to apply the new hedging provisions, which will be briefly specified below, or alternatively, the existing provisions under IAS 39. When the hedging project is completed in the future, the said policy choice option will be reexamined by the IASB.

The Standard retains the three types of hedge accounting: Cash flow hedging, fair value and net investment in foreign operations. However, material changes were made regarding the types of transactions eligible for hedge accounting, particularly expansion of the risks eligible for hedge accounting of non-financial items. In addition, changes occurred in the manner in which forward contracts and derivative options will be treated, when they constitute hedging instruments.

In addition, some of the hedge effectiveness tests have been replaced with a more fundamental test which is based on “economic relations”. Retroactive estimation of the hedge effectiveness will no longer be required.

The disclosure requirements in relation to the risk management activity of the Company have been expanded in the new Standard.

Impairment

The new impairment model, which is based on expected credit losses, will be implemented for debt instruments which are measured at depreciated cost or at fair value through other comprehensive income, receivables for lease, contract assets recognized according to IFRS 15 and written obligations to provide loans and financial guaranty contracts.

The provision for impairment will be in respect of projected losses according to the probability of insolvency in the coming 12 months (in the coming year), or according to the probability of insolvency over the lifetime of the instrument. Examination throughout the instrument’s lifetime is required if the credit risk significantly increased since the date of first recognition of the asset. Another approach applies if the financial asset was created or purchased credit-impaired.

The Standard adds presentation and disclosure requirements in connection with impairment of financial instruments.

Note 2 - Significant accounting policies (Cont.)

EE. Standards, interpretation and amendments to standards that were released and are not invalid, and were not pre-adopted by the Group, that have or may have an effect on future periods: (Cont.)

- **IFRS 9 "Financial Instruments": (Cont.)**

Commencement date and early adoption possibilities

The Standard will take binding effect in respect of annual reporting periods commencing on or after January 1, 2018. Early application is possible.

In general, the provisions of the Standard regarding financial assets and liabilities will be applied retroactively, except for certain exceptions which were set forth in the Standard's transition provisions. It was further determined, that despite the retroactive application, companies applying the Standard for the first time, will not be forced to amend their comparison figures for previous periods. Moreover, the comparison figures will be amendable only when the amendment as aforesaid will not use hindsight information. Provisions referring to hedging will be applied, as a general rule, by way of prospective application, with limited retroactive application.

At this stage, the Company's Management cannot estimate the effect of the Standard's application on the financial position and business results thereof.

- **IFRS 15 “Revenue from Contracts with Customers”:**

The new standard determines a comprehensive and uniform mechanism which regulates the accounting treatment of revenue deriving from contracts with customers. The standard cancels IAS 18 “Revenue” and IAS 11 “Construction Contracts” and their related interpretations. The core principle of the standard is that recognition of revenue shall depict the transfer of goods or services to customers in an amount that reflects the economic benefits that the entity expects to receive in consideration therefor. To this end, the standard determines that revenue be recognized when the entity transfers to the customer the goods and/or services listed in the contract therewith such that the customer obtains control of such goods or services.

The standard determines a five-step model for application of this principle:

1. Identify the contract(s) with the customer.
2. Identify the performance obligations in the contract.
3. Determine the transaction price.
4. Allocate the transaction price to each performance obligation.
5. Recognize revenue when a performance obligation is satisfied.

Implementation of the model is dependent on the facts and circumstances specific to the contract and sometimes requires the exercise of broad discretion.

In addition, the standard determines extensive disclosure requirements with respect to contracts with customers, the significant estimates and the changes thereto which were used at the time of application of the provisions of the standard, in order to enable users of the Financial Statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from the contracts with the customers.

Application of the standard is mandatory for annual reporting periods commencing on or after January 1, 2018. Early application is possible. As a rule, the standard will be applied retroactively, although entities will be entitled to choose certain adjustments in the framework of the standard’s transition provisions regarding its application to previous reporting periods.

The Group has studied the implications of the standard’s application, and to the Group’s estimation the standard’s application should not have a material effect on the financial statements.

Note 2 - Significant accounting policies (Cont.)

EE. Standards, interpretation and amendments to standards that were released and are not invalid, and were not pre-adopted by the Group, that have or may have an effect on future periods: (Cont.)

- **IFRS 16 "Leases":**

  The new standard which was published in January 2016 cancels IAS17 "Leases" and the commentaries related thereto, and sets forth the rules for recognition, measurement, presentation, and disclosure of leases with regards to both of the parties to the transaction, i.e. the customer ("**Lessee**") and the supplier ("**Lessor**").

  The new standard cancels the currently existing distinction relating to a Lessee, between finance leases operating leases and determines a uniform accounting model with regards to all types of leases. In accordance with the new model, for any leased asset, the lessee is required on the one hand to recognize an asset for the right of use and on the other hand, a financial liability for the lease payment.

  The directives on the recognition of an asset and liability, as aforesaid, shall not apply to assets which are leased for a term of up to only 12 month, and with regards to leases of low value assets (such as personal computers).

  The standard does not change the currently existing accounting treatment in the Lessor's books.

  The standard takes binding effect for the annual reporting periods which commence on January 1, 2019, or thereafter. Early implementation is possible, on condition that IFRS 15 "income from contracts with customers" is also implemented. As a rule, the standard will be implemented retroactively, however entities may choose certain adjustments in the framework of the transitional provisions of the standard for the purpose of its implementation for earlier reporting periods.

  The Company has not yet examined the effect of the standard on contracts for the lease of assets in its possession.

- **Amendment IAS 7 "Cash Flow Statement" (regarding disclosure with respect to changes in liabilities resulting from financing activities)**:

  The amendment stipulates that disclosure is required of information that will enable users of the financial statements to estimate the changes in liabilities which derive from financing activities, both changes that involve cash flows and changes which do not involve cash flows.

  The amendment was implemented by prospective application for annual reporting periods beginning on January 1, 2017 or thereafter. Early implementation is possible. On the date of the first implementation of the amendment, no comparison figures are required to be presented.

Note 3 - Critical estimates and the determination of the fair value

A. General:

In the implementation of the Group's accounting policy, which is described in Note 2 above, the managements of the companies in the Group are required to exercise broad accounting judgment in respect of estimates and assumptions, in connection with the carrying values of assets and liabilities, which cannot necessarily be found in other sources. The estimates and the related assumption are based on past experience and on other factors, which are considered to be relevant. The actual results may well be different from those estimates.

The estimates and assumptions that they are based on are reviewed routinely by the management of the companies in the Group. Changes in the accounting estimates are recognized only in the period in which the change is made in the estimates in the event that a change affects only one period or they are recognized in the said period and also in future periods in cases where the change affect both the current period and also the future periods.

B. Critical estimates:

The following is information in respect of critical estimates, which have been prepared whilst implementing the accounting policies, and which have a significant impact on the Financial |Statements:

(1) The revaluation of investment property and investment property under construction – (see Notes 14 and 36) in accordance with the IFRS and in accordance with the Company's selection, the Group presents investment property and investment property under construction in accordance with the fair value, based mainly on an evaluation by independent external appraisers, possessing the appropriate professional skills.

The fair value is examined at least once a year and at any time at which indications exist that there has been a significant change in value. Even in the case where the indications do not exist, the Company's management may, per its discretion, choose to perform valuations. In each case where the Company's management decides to update the fair value of all or part of the assets, as the case may be, the BOD report for such quarter shall include the Board's explanations in respect of the valuation that it made itself, as required by law.

Changes in the fair value are carried to the income statement and accordingly they may have a material effect on the Company's results.

(2) Contingent liabilities (see Note 33) – in the evaluation of the chances of the legal claims that have been filed against the Company, its consolidated companies and associates, the companies have relied on the opinions of their legal counsel as well as on estimates made by their managements. These evaluations by the legal counsel and the managements are based on their best professional judgment, taking into account the stage at which the proceedings are to be found, and also on the legal experience that has accumulated on various subjects. Since the results of the claims will be determined in the courts, those results may be different from those evaluations.

Note 3 - Critical estimates and the determination of the fair value (Cont.)

B. Critical estimates (Cont.)

(3) Impairment of assets (excluding goodwill) (see Note 16) – at each balance sheet date the Group tests if events have occurred or if changes have taken place in the circumstances that indicate that an impairment has occurred in the value of one or more of the non-monetary assets. If signs of impairment exist, a test is conducted as to whether the amount at which the investment in the asset is presented can be recovered out of the discounted cash flow that are expected from that asset, and in the event that it is necessary, a provision for impairment is recorded up to the level of the amount that is recoverable. The discount cash flows is calculated in accordance with a post-tax cap rate, which reflects the market's estimate in respect of the time value of the money and the specific risks that relate to that asset. The determination of the estimates of the cash flows is based on past experience with the asset or similar assets, and on the Company’s best estimate in respect of the economic conditions that will be extant during the course of the balance of the useful life of the asset. In the determination of the net selling price of some of the assets use was made of evaluations by a valuator.

In respect of real properties, the estimates also take into account the market conditions in the area in which the asset is located.

In respect of impairment of goodwill, see Note 2J.

Changes in the Group's estimates, as aforesaid, may lead to significant changes in the book value of the assets and in the operating results.

(4) Fair value of financial assets available for sale (see Note 12) – the fair value of financial instruments that are not traded on an active market (for example: investments in non-marketable instruments) is determined using evaluation techniques. The Group exercises judgment in the determination of the appropriate methodology and in the determination of the assumptions, based on generally accepted practice and the current conditions in the market and also based on calculations of fair value performed by appropriate independent external appraisers. Changes in the assumptions may lead to the recognition of impairment or losses in future periods.

(5) Income taxes (see Note 30) – the Group is subject to the tax laws. Broad judgment is required in order to determine the current tax liability for each of the companies in the Group.

The Group has many transactions, whose tax results are uncertain. The Group recognized liabilities in respect of the tax results of those transactions, based on management's estimates, which place reliance on professional advisors, in respect of the timing and the level of the tax liability that derives from those transactions. Where the tax results of those transactions is different from management's estimates, the tax expenses and the current tax liabilities will be reduced or increased at the time that the final assessments are determined.

(6) Distinction between investment property and business:

In every transaction for acquisition of an investment property, the Group examines whether the acquisition of an investment property constitutes an acquisition of an asset/group of assets or a business combination transaction. The Group’s discretion is based on the number of the acquired assets, the existence of associated services in a significant scope (maintenance, cleaning, security, bookkeeping, etc.) that are related to the operation of the asset and the complexity of the management of the asset.

Note 3 - Critical estimates and the determination of the fair value (Cont.)

C. Determination of fair value:

As part of the accounting principles and the disclosure requirements, the Group is required to determine the fair value of non-financial and financial assets and liabilities. The fair values have been determined for the purposes of measurement and/or disclosure on the basis of the methods that are described below. Additional information in respect of the assumptions that have been used in the determination of the fair value is provided in the noted that relate to this asset or liability.

(1) Investment property and investment property under construction – As aforesaid in Note 2P, the Group's investment property is presented at fair value, where changes in the fair value are carried to the income statement as income or as expenses.

For the purpose of the determination of the fair value of investment property, the Company's management bases itself, primarily, on evaluations that are performed once a year by independent appraisers of land, having the required knowledge, experience and expertise. The Company's management is in the habit of determining the fair value in accordance with generally accepted evaluation methods of real properties, primarily discounted cash flow and comparison with selling prices of similar assets and land and the Group's assets in the near environment. Where use has been made of the discounted cash flow method, the interest rate used in the discounting of the net cash flows that are expected from the asset can have a significant impact on the fair value.

In the determination of the fair value of investment property, the Company takes into account, *inter alia*, and so far as is relevant, the location of the property and its physical state, the quality of the tenants and their stability, the rent period, the rent prices in similar properties, the adjustments that are required to the existing rent prices, the actual and forecast occupancy levels for the property and the costs of operating it. In the determination of the fair value of investment property under construction, taken into account, *inter alia* and insofar as relevant, are the duration of the construction of the project, the amount of the rent, the additional cost required for construction thereof until the current operation thereof and the interest rate, the project's risk premium, deduction of developer profit and the required cap rate. In the determination of the fair value of land, the construction of which has not yet commenced by the Company, taken into account, *inter alia*, are the location of the land and comparison transactions of similar properties, while making the required adjustments. A change in the value of any of these components, or all of them, could have a significant impact on the fair value of the property as estimated by the Company's management.

The Group strives to determine as objective a fair value as possible, but at the same time, the process of estimating the fair value of investment property also includes subjective elements, which are sources, *inter alia*, in the past experience of the Company's management and its understanding of what is expected to take place in the investment property market at the time at which the estimate of the fair value is determined. In the light of what is stated in the previous paragraph, the determination of the fair value of the Group's investment property mandates the exercise of judgment. Changes in the assumptions that were used in the determination of the fair value could have a significant effect on the Group's state of affairs and the results of its activities.

The Company reviews in its quarterly reports the need to update the value of the investment property by examining macro-economic changes that may have a material effect on the fair value of the properties and/or upon the occurrence of a material event in an asset that was defined as a material or a very material asset in the Company's statements, due to population, material change in rent, etc. Also, with regard to investment property under construction, the costs actually invested during the period, the updated forecast of costs for completion and lease agreements signed during the period are taken into account. Upon initial classification of a property that was under construction as investment property, and insofar as no valuation was received therefor in the six months preceding the classification date, an external valuation will be performed therefor, as of the end of the quarter in which it was first classified as investment property.

Note 3 - Critical estimates and the determination of the fair value (Cont.)

C. Determination of fair value (Cont.)

(2) Impairment of goodwill – in order to determine whether an impairment has taken place in the value of goodwill, the Company's management prepares an estimate of the value in use of the cash generating units to which the goodwill has been allocated, for the purpose of the calculation of the value in use, the Group calculates an estimate of the future cash flows that are expected to derive from each of the cash generating units as well as the appropriate discount rate in order to calculate the present value.

(3) Investments in shares – the fair value, net of sale costs, of financial assets that are classified as available for sale (mainly investments in Bank Leumi and in Leumi Card) is determined whilst relating to their average quoted closing bid prices at the reporting date. In the absence of quoted prices, the evaluations are carried out using the discounted cash flow method under "going concern" assumption and/or the net asset value method.

(4) Loans and receivables including trade and other receivables – the fair value of loans and receivables including trade and other receivables, except for construction works in progress, but including receivables in respect of franchise arrangements, is determined on the basis of the current value of the future cash flow, discounted at the market interest rate, which takes into account, inter alia, the risk of the borrower as of the measurement date. Short term trade and other receivables without a stated interest rate, are measured at the original invoice amount, if the discounting effect is immaterial. The fair value of loans and receivables is determined on the initial recognition date. In the periods following the initial recognition date, the fair value is calculated solely for the purposes of providing disclosure.

(5) Financial liabilities which are not derivatives – the fair value, which is determined for the purpose of providing disclosure, is calculated on the basis of the current value of the future cash flows for the principal and interest component, which are discounted at the market interest rate as of the reporting date.

Note 4 - Cash and cash equivalents

The composition:

	As of December 31	
	2016	2015
	NIS in thousands	NIS in thousands
Balances with banks	210,380	132,740
Short-term deposits – unlinked	481,216	714,060
Short-term deposits – in dollars	23,392	62,919
Financial funds	-	25,005
Total cash and cash equivalents	714,988	934,724

(*) Short-term deposits exceeding 3 months at an interest at the range of 0.33%-0.45% are included in the short-term deposits and investments item.

Note 5 - Trade accounts receivable

The composition:

	As of December 31	
	2016	2015
	NIS in thousands	NIS in thousands
Open debts	269,665	1,233,861
Income receivable	29,753	30,237
Current maturities of long-term loans provided	-	8,937
	299,418	1,273,035
Net of – provision for doubtful debts	(11,042)	(170,875)
	288,376	1,102,160

For details regarding balances in respect of related and interested parties – see Note 37C.
For details regarding the credit risk management by the Group – see Note 34B.

Note 6 - Other receivables

The composition:

	As of December 31	
	2016	2015
	NIS in thousands	NIS in thousands
Institutions	43,094	22,952
Pre-paid expenses	20,773	40,958
Deposits in trust	34,923	19,222
Advances to suppliers	2,135	13,576
Current maturities of receivables in respect of franchise arrangement	4,943	1,267
Receivables for work in progress	5,428	19,206
Accounts receivable	5,415	3,974
Other receivables	20,381	50,322
	137,092	171,477
Net of – provision for doubtful debts	-	(4,250)
	137,092	167,227

For details regarding balances in respect of related and interested parties – see Note 37C.

Note 7 - Inventory

The composition:

	As of December 31	
	2016	2015
	NIS in thousands	NIS in thousands
Raw materials	3,033	11,251
Work in progress	9,205	9,828
Finished works	40,413	139,649
Servicing material, spare parts and installations	7,827	12,722
	60,478	173,450

Note 8 – Discontinued operations

A. On June 12, 2014 a consolidated company of the Company, Granite Hacarmel Investments Ltd., closed a transaction for the sale of all of its holdings (100%) in Tambour Ltd. to a third party, in accordance with an agreement signed on May 26, 2014.

The consideration for the sale is NIS 500 million before transaction expenses received in cash. As a result of the sale, the Company recognized a profit in the sum of approx. NIS 55 million, which was carried to the income statement in 2014 and is presented under the "Income from discontinued operations, net of tax" item.

In accordance with the provisions of IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations", Tambour's results are presented separately in the income statement as discontinued operations.

Below are the results attributable to the discontinued operations:

	As of the year ended December 31
	2014 NIS in thousands
Results of the discontinued operations	
Revenues	472,482
Expenses	446,296
Profit before income taxes	26,186
Income taxes	7,496
Profit after income taxes	18,690
Sales costs and expenses	(10,904)
Income from sale of discontinued operations, net of tax	65,719
Profit for the year	73,505
Cash flow from discontinued operations	
Net cash deriving from current operations	38,075
Net cash deriving from investment activity	472,181
Net cash used for financing activity	(21,484)
Effect of exchange rate fluctuations on cash balances and cash equivalents	(206)
Net cash deriving from discontinued operations	488,566

B. On April 14, 2016, Granite Hacarmel entered into an agreement with Israel Oil Gas Fund L.P., a limited partnership incorporated in Israel the general partner of which controlled by Mr. David Weissman (the "**Buyer**") for the sale of all of Granite Hacarmel's holdings (100%) in Sonol Israel Ltd. (the "**Agreement**" and "**Sonol**", respectively).

The total consideration amounts to NIS 363.5 million, of which NIS 187.5 million was paid in cash upon the closing of the transaction (subject to certain adjustments determined in the Agreement); a sum of NIS 21 million of the consideration shall be paid in cash within 18 months of the closing date; a sum of NIS 52.5 million was deducted from the consideration against dividends that were distributed by Sonol up to the closing of the transaction, and a sum of NIS 5 million will be paid against the repayment of certain debts of Sonol's debtors.

Note 8 – Discontinued operations (Cont.)

B. (Cont.)

Of the consideration, a sum of NIS 97.5 million was paid at the closing date through the assumption of a liability of the Buyer to repay a loan that is secured by a charge on all of the sold shares. The loan will bear an annual interest comprising Prime interest + 1% and shall be paid on a quarterly basis (the "**Loan**"). The principal of the Loan shall be paid in one installment within 60 months of the transaction closing date. To secure the repayment of the Loan, the Buyer undertook (1) not to effect distributions, as defined in the Companies Law, until the full repayment of the Loan (principal and interest), unless certain cumulative conditions agreed by the parties shall have been fulfilled; and (2) compliance with limitations on changes of control in the Buyer.

Conditions precedent – the closing of the transaction is contingent on conditions precedent which mainly include the receipt of the approval of the Antitrust Commissioner and receipt of third party approvals. The Agreement included customary terms for the termination thereof.

Buyer's guarantee – to secure the undertakings of the Buyer under the Agreement, other than in connection with the Loan as defined above, the seller was provided, at the execution date of the Agreement, a guarantee for the performance of the closing of the transaction.

Non-competition undertaking – it was further agreed that from the transaction closing date and for a 4-year period, the Company and Granite Hacarmel shall not compete with Sonol's business. The foregoing shall not apply to the activity and business plan of the Supergas group.

On July 24, 2016, the transaction was closed without material modifications, after receipt of the approval of the Antitrust Commissioner. On the closing date, and thereafter, the Buyer paid the portion of the consideration that was due on the closing date. The balance of the consideration will be paid in accordance with the terms and conditions determined in the Agreement.

The transaction does not include Pi Glilot's lands and the shares of Pi Glilot Oil and Pipe Terminals Co. Ltd. For additional details see Note 12(3).

In accordance with the provisions of IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations", Sonol's results are presented separately in the income statement as discontinued operations and comparative figures in the income statement have been re-presented according to Section 34 of IFRS 5.

As of December 31, 2015, Sonol operations were not discontinued operations. The comparative figures for 2015 and 2014 were re-presented in the consolidated income statements, in order to present the discontinued operations separately from the continuing operations.

Note 8 – Discontinued operations (Cont.)

B. (Cont.)

Set forth below are the results attributed to the discontinued operations:

	As of the year ended December 31		
	2016	2015	2014
	NIS in thousands	NIS in thousands	NIS in thousands
Results of the discontinued operations			
Revenues	1,595,571	3,740,421	4,786,298
Expenses	1,589,537	3,830,228	4,747,111
Income (loss) before income taxes	6,034	(89,807)	,39 187
Income taxes	8,901	9,120	3,483
Income (loss) after income taxes	(2,867)	(98,927)	35,704
Sale costs and expenses	(4,772)	-	-
Loss from sale of discontinued operations, net of tax	(862)	-	-
Income (loss) per year	(8,501)	(98,927)	35,704
Cash flows from discontinued operations			
Net cash which derived from current operations	186,602	268,603	49,809
Net cash (used for operations) which derived from investment activity	130,694	(39,070)	3,573
Net cash used for financing activity	(63,925)	(106,350)	(81,516)
Effect of exchange rate fluctuations on cash and cash equivalents balances	(14)	22	251
Net cash which derived from discontinued operations	253,357	123,205	(27,883)

Note 8 – Discontinued operations (Contd.)

B. (Cont.)

Effect of disposal on the Group's Statements of Financial Position:

	As of disposal date
	NIS in thousands
Cash and cash equivalents	54,729
Trade accounts receivable	817,176
Trade and other receivables	29,877
Inventory	116,577
Current tax assets	3,913
Long-term investments and loans	71,365
Investment property	12,420
Fixed assets, net	624,973
Intangible assets, net	59,393
Pre-paid long-term lease payments	37,045
Deferred tax assets	24,189
Credit from banks and other credit providers	(677,308)
Trade payables	(377,671)
Other payables, including derivatives	(233,794)
Current tax liabilities	(1,456)
Provisions	(66,637)
Long-term liabilities to banks and other credit providers	(151,797)
Other long-term liabilities	(12,254)
Employee benefits	(12,010)
Deferred tax liabilities	(17,089)
Assets and liabilities, net	301,641
Proceeds received in cash and cash equivalents (net of sale costs)	171,068
Cash and cash equivalents balance written off	(54,729)
Positive cash flow, net	116,339

(*) Inter-company transactions (between the Group and Sonol) were written-off from the results of the selling/service-providing company, as the case may be. In addition, an asset or a liability referring to an inter-company transaction was written-off from the assets or liabilities of the discontinued operations, as the case may be.

Note 9 – Disposal group held for sale

GES Latin America:

During 2016, GES completed the sale of its rights in the subsidiaries of GES Latin America Holding S.A ("**Latin America**") to third parties, following the activities that were performed in 2014 and 2015 for the purpose of selling and closing Latin America (entry of the holding companies into liquidation, execution of contracts for the sale of the companies in 2015 and the resolution of the Board of Directors in 2014).

The effect of the Latin American business on the results of operations and the financial position in the consolidated statements is negligible.

The assets and liabilities of Latin America as of December 31, 2016 were presented in the Financial Statements as a disposal group held for sale.

Note 9 – Disposal group held for sale (Cont.)

Via Maris Desalination (Holdings) Ltd. ("Via Maris"):

On August 6, 2014, the consolidated company, GES, signed an agreement with a third party SPV, unaffiliated with the Company or with any of the companies controlled thereby (the "**Buyer**"), whereby GES shall sell all of its rights in the Via Maris desalination plant in Palmachim (the "**Desalination Plant**"), in consideration for NIS 429 million, linked to the January 2014 index, subject to adjustments due to changes occurring during the period until the closing date of the transaction, by way of sale of the holdings of GES in Via Maris and Via Maris Desalination – Construction Partnership (further to the engagement in an MOU signed in December 2013).

In the transaction, GES committed to certain indemnities for warranties and for specific exposures specified in the agreement, and in addition GES or the Company, as the case may be, shall remain liable, under certain conditions, after the closing date, for certain guarantees and undertakings pertaining to the Desalination Plant and/or the Via Maris corporations, including the Construction Partnership's warranty for the construction of the plant, all subject to and in accordance with the provisions of the agreement.

Granite provided a full guarantee for all of the undertakings of GES under the agreement. Furthermore, upon the occurrence of certain events stipulated in the agreement, the Company undertook to guarantee the undertakings of GES under the agreement, in lieu of Granite.

On June 2, 2015, all of the conditions precedent set forth in the agreement were fulfilled and the transaction for the sale of the rights in Via Maris was closed.

The consideration amounted to approx. NIS 403 million and the Company recorded a loss in an insignificant amount in the income statement of 2015.

Via Maris's financial results were consolidated and included in the Financial Statements until the period ended June 30, 2015.

The results and cash flows of the disposal group classified as held for sale were fully consolidated in the income statement and the cash flow statement until the disposal date, as the case may be.

Set forth below is a table of material financial figures in connection with the disposal group's activity:

	For the year ended December 31	
	2015	2014
	NIS in thousands	NIS in thousands
Sales turnover	78,055	142,281
Income before tax	6,361	16,045
Income after tax	6,694	12,813

Note 10 - Investments in and loans to investee companies

A. Material consolidated companies and partnerships that are held directly by the Company:

	State of incorporation	Operating Segment	Rates of Ownership and Control of the Holding Company as of December 31, 2016
			%
Consolidated companies:			
Canit Hashalom Investments Ltd. (C)	Israel	Income-producing property	100.00
Gemel Tesua Investments Ltd.	Israel	Income-producing property	100.00
Otzma & Co. Investments Maccabim Ltd.	Israel	Income-producing property	100.00
Palace America Senior Housing Ltd. (D)	Israel	Senior housing	100.00
Ahuzat Bayit Raanana – Retirement Home Ltd. (E)	Israel	Senior housing	100.00
Otzem Enterprise and Investments (1991) Ltd.	Israel	Income-producing property	100.00
International Consultants (E-Consult) Ltd.	Israel	Income-producing property	100.00
AG Plaza at Enclave Inc.	U.S.	Income-producing property	100.00
Granite Hacarmel Investments Ltd. (B)	Israel	Holdings	100.00
GES Global Environmental Solutions Ltd.	Israel	Water treatment	100.00
Supergas Israel Gas Distribution Company Ltd.	Israel	Gas	100.00
Azrieli E-Commerce Ltd. (F)	Israel	e-commerce	100.00
Partnership – held by the Company, AG Galleria office buildings, LP	U.S.	Income-producing property	90.00
Assisted Living Modi'in Ltd.	Israel	Senior housing	100.00
AG 8 West Centre, LP	U.S.	Income-producing property	100.00
AG Two Aspen, LP	U.S.	Income-producing property	100.00

Note 10 - Investments in and loans to investee companies (Cont.)

B. Restrictions applicable to Granite Hacarmel Investments Ltd. ("**Granite**") with respect to its subsidiaries:

(1) The ability of Granite's subsidiaries to distribute dividends to Granite is contingent upon their compliance with financial covenants which they undertook with respect to credit received from banks or upon obtaining the banks' consent or upon the provisions of the law.

(2) In tenders which companies in the Granite Group had won and/or in relation to agreements for the receipt of credit, restrictions were imposed on Granite with respect to the transfer of control and/or ownership, whereby the transfer of control and/or ownership shall be subject to the approval of the financing bodies or relevant governmental authorities, as the case may be.

(3) With respect to the sale of all of Granite Hacarmel's holdings in Sonol, see Note 8 on discontinued operations.

C. On March 6, 2016, after receipt of the Audit Committee's approval, followed by the Company's Board on the same date, the Company's general meeting approved the Company's engagement in an agreement for the purchase of one share of Canit Hashalom Investments Ltd. ("**Canit Hashalom**"), a subsidiary in which the Company held approx. 99.1%, from Azrieli Foundation (Israel) (R.A.), in consideration for NIS 51 million. Following the purchase, the Company holds 100% of the issued share capital of Canit Hashalom.

The transaction had no effect on the Company's income statement.

D. For details on the purchase of Palace America Senior Housing Ltd. in 2015 – see Note 14I(1).

E. For details on the purchase of Ahuzat Bayit Raanana – Retirement Home Ltd. in 2016 – see Note 14I(3).

F. On May 2, 2016, the Company (the "**Buyer**"), entered into an agreement with Buy2 Networks Ltd., a public company whose shares are listed on TASE (the "**Seller**"), for the purchase of the Seller's business in the field of eCommerce (the "**Operating Segment**"), as specified below:

The purchased business – according to the agreement, the Company purchased 100% of the shares of Netex New Media Ltd. (whose name was changed on July 14, 2016 to "Azrieli E-Commerce Ltd."), a private company wholly owned by the Seller that is engaged in the Operating Segment (whose trade name is "Buy2"), as well as all of the rights in the assets (tangible and intangible) in the Operating Segment which are directly held by the Seller.

The consideration – in consideration for the purchased business and shares, the Buyer shall pay the Seller a sum of NIS 70 million, subject to adjustments. The net consideration, as of the Report Date, is approx. NIS 61 million.

In addition, a sum of approx. NIS 5 million per year will be paid for management services in the Operating Segment that will be provided by the Seller to the Buyer during a 24-month period from the closing date of the transaction, payable on a calendar quarter basis throughout the period of the services. It was further agreed that from the closing date of the transaction and for a 4-year period, the Seller shall not compete with the Operating Segment.

On May 18, 2016 the approval of the Antitrust Commissioner was received, and on June 2, 2016, the transaction was closed.

Note 11 – Long term investments, loans and receivables

A. The composition:

	As of December 31	
	2016	2015
	NIS in thousands	NIS in thousands
Loans provided (see B below)	116,217	82,281
Net of current maturities	(1,046)	(12,994)
	115,171	69,287
Outstanding checks	2,063	2,312
Prepaid expenses	1,806	3,813
Authorities (see C below)	70,000	-
Assets in respect of employee benefits	1,949	1,977
Receivables in respect of the averaging of income from rent	89,675	84,767
Restricted investments (see D below)	21,706	21,470
Other receivables (see E below)	37,398	34,695
	339,768	218,321

B. Additional information:

(1) For details with respect to a loan to the purchaser of Sonol, see Note 8 on Discontinued Operations.

(2) Unlinked loans in the amount of NIS 258 thousand extended at an interest at the range of 0%-2% and NIS 102,168 thousand at an interest at the range of 2%-10% (in 2015 – a sum of NIS 4,588 thousand extended at an interest at the range of 0%-2% and NIS 32,315 thousand at an interest at the range of 2%-10%).

In addition, index-linked loans in the amount of 3,277 thousand were extended at an interest at the range of 0%-4% and NIS 10,514 thousand at an interest at the range of 4%-8% (in 2015, an amount of NIS 28,486 thousand at the range of 0%-2% at the range of 0%-4% and NIS 11,771 thousand at an interest at the range of 4%-8%).

C. The sum is a part of an assessment of a betterment levy that the Company paid under protest. An appeal from the assessment was filed and a hearing with a deciding appraiser was scheduled.

D. As collateral for the payment of bonds issued by a consolidated company of Supergas (see Note 21B(6)), the consolidated company provided a deposit for the benefit of the bond trustee, in the amount of the highest quarterly payment (principal and interest) due according to the bond's payment schedule, until the repayment thereof. The deposits are Index-linked.

E. The balance of the other receivables includes mainly long term debts as in respect of the sale of Sonol (for further details, see Note 8 on Discontinued Operations).

Note 12 - Financial assets

The composition:

	As of December 31	
	2016	2015
	NIS in thousands	NIS in thousands
Financial assets available for sale	1,689,636	1,634,765
Financial assets designated at fair value through profit and loss	23,700	25,162
	1,713,336	1,659,927

Financial assets available for sale:

(1) Investment in Bank Leumi Le'Israel Ltd. ("Bank Leumi")

On April 30, 2009 the Company acquired approx. 4.8% of the shares in Bank Leumi (approx. 71 million shares) for a consideration that was equivalent to NIS 742 million. In 2016 the Company sold approx. 5 million shares in consideration for a sum of approx. NIS 80 million, and as of December 31, 2016, the Company holds approx. 4.3% of Bank Leumi's shares. As a result of the sale of the shares, financing income in the sum of approx. NIS 26 million was recorded in 2016.

As of the Date of the Statement of Financial Position, the balance of the Company's investment in Bank Leumi's shares is approx. NIS 1,040 million according to the value of Bank Leumi's shares on TASE.

(2) Investment in Leumi Card Ltd. ("Leumi Card")

As of the Report Date, the Company holds 20% of the issued and paid-up capital of Leumi Card and 18% of the voting rights therein.

Leumi Financial Holdings Ltd. ("**Leumi Holdings**") has the right of first refusal on the sale of the shares that are held by the Company to a third party which is not a permitted transferee of the Company, as defined in the agreement.

Commencing from May 26, 2008, Mr. Menachem Einan has served as the Company's representative on the Board of Directors of Leumi Card.

As of Date of the Statement of Financial Position, Leumi Card's Board is made up of 8 directors (of whom 3 are external directors).

In the light of the number of directors and the control structure in Leumi Card, the Company has reached the conclusion that it does not have material effect in Leumi Card and therefore the investment is presented as a "financial asset available for sale".

In April 2015, the Antitrust Commissioner released a list of the significant financial bodies under the Competition Promotion and Concentration Reduction Law, 5774-2013, and also listed Leumi Card thereon. Insofar as the Group continues to be deemed a significant real corporation, and insofar as Leumi Card continues to be deemed a significant financial body, by December 11, 2019, the Group shall be required to reduce its holdings of Leumi Card shares to below a holding rate of 10%.

As of Date of the Statement of Financial Position, the Company's investment balance in Leumi Card totaled at an amount of approx. NIS 562 million.

Note 12 - Financial assets (Cont.)

Financial assets available for sale: (Cont.)

(2) Investment in Leumi Card Ltd. ("Leumi Card") (Cont.)

The fair value has been determined by an independent external appraiser, where the evaluation is based on the discounted cash flow method (DCF), based on the net profit as extrapolated from the business plan, adjustments to the profit and net of investments. In the determination of the recoverable amount of the investment on the basis of cash flows, a weighted average cost of capital (WACC) of 9% has been taken into account and the long-term growth rate has been set at 2.5%.

In accordance with immediate reports released by Bank Leumi Le-Israel Ltd. ("**Bank Leumi**") on November 3, 2015 and December 23, 2015, Bank Leumi received notice from the companies Visa Inc. ("**Visa**") and Visa Europe Ltd. ("**Visa Europe**") regarding their engagement in an agreement, whereby Visa would acquire Visa Europe, and that the total consideration to be paid in the context of the transaction is estimated at up to approx. €21.2 billion, comprising payment in cash and in shares. Bank Leumi further updated in its various reports that the closing of the transaction was expected to take place in 2016.

It was further stated in the reports of Bank Leumi that Bank Leumi is a member of Visa Europe, and that according to the manner of distribution of the consideration between the members of Visa Europe, Bank Leumi is expected to receive consideration in the sum of approx. NIS 274 million in cash and approx. NIS 94 million in shares. It is stated that in Bank Leumi's consolidated financial statements as of June 30, 2016, released on August 15, 2016, Bank Leumi reported the recording of the receipt of cash consideration for the acquisition transaction in the sum of approx. €69 million (approx. NIS 300 million), as well as the recording of revenues of approx. NIS 78 million for the right to future payments in cash and convertible shares in favor or Bank Leumi only. The Company, as the holder of 20% of the shares of Leumi Card, disputes Bank Leumi's claims on the matter, and approached Bank Leumi and its representatives in Leumi Card, clarifying that the monies received by Bank Leumi following the transaction for the acquisition of Visa Europe by Visa, originate from the business of Leumi Card vis-à-vis Visa Europe, and therefore, Bank Leumi is required to transfer the consideration received thereby as aforesaid, to Leumi Card.

After the parties failed to reach an understanding on the matter, the parties turned to mediation. In January 2017 the mediation ended with no results. As of the Report Release Date the Company is considering its next steps in this matter.

In 2016, the Company received a dividend in the sum of approx. NIS 10 million from Leumi Card (in 2015 – approx. NIS 10 million). After the date of the Financial Statements, on March 1, 2017, the Company received an additional dividend in the sum of approx. NIS 10 million from Leumi Card.

(3) On May 10, 2016, the Company engaged, directly and indirectly through companies controlled thereby, in sale agreements for the sale of all of the Company's holdings in the Pi Glilot lands and the shares of Pi Glilot Oil and Pipe Terminals Co. Ltd. (which is the owner of lease rights with respect to land in the Pi Glilot site and presented in the balance sheet in the financial assets available for sale item), to third parties, for a total consideration of approx. NIS 130 million. As of the date of approval of the Financial Statements the transactions were not yet closed.

(4) Other financial assets available for sale include investments in company shares, which do not exceed 20% and over which the Group has no material influence.

Note 13 - Long-term receivables in respect of a franchise arrangement

A. A franchise arrangement for the planning, construction and operation of a wastewater treatment plant:

GES has franchise arrangements with local authorities which are defined according to IFRIC 12 as a financial asset – receivables in respect of franchise arrangements. Regarding one of the facilities, an agreement was signed in 2000 between a subsidiary of GES and a local authority for the planning, financing, building and maintenance of a wastewater treatment plant ("**WTP**"). Within the agreement, the Company undertook to build and operate the WTP for a term of 30 years, and in return the Company shall be entitled to an agreed payment per cubic meter, which is linked to the CPI. During 2012, an addendum to the agreement was signed, whereby the Company shall expand the existing WTP. In 2015, expansion of the WTP has been completed.

GES treats the expansion of the plant and its operation throughout its useful life, as a combined model which includes a financial asset - receivables in respect of a franchise arrangement and an intangible asset. GES recognizes income throughout the construction period in accordance with IAS11 and in respect of the services it provides in accordance with IAS18.

B. A franchise arrangement for the planning, construction and operation of a wastewater treatment facility for the recycling of water in production processes:

On April 2, 2015, an agreement was signed between the consolidated company GES Facility Operations Ltd. and a third party (the "**Customer**") for the rehabilitation, upgrade and operation of a facility for the recycling of wastewater.

In the agreement, after the completion of the construction, the Company undertook to operate the facility for a period of 10 years with an option for an extension of another 3 additional years.

GES Facility Operations Ltd. engages in rehabilitation, upgrade of the facility and the operation thereof throughout its useful life as a financial asset - receivables in respect of a franchise arrangement. GES Facility Operations recognizes income throughout the construction period pursuant to IAS 11 and for the services it provides pursuant to IAS I8. As of December 31, 2016, the upgrading of the facility has not yet completed.

C. The collection dates of the balances for the receivables in respect of franchise arrangement after the date of the Financial Statements are as follows:

	As of December 31, 2016					
	First year	Second year	Third year	Fourth year	Above five years	Total
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Receivables in respect of a franchise arrangement	4,943	5,434	4,554	3,978	38,517	57,426

	As of December 31, 2015					
	First year	Second year	Third year	Fourth year	Above five years	Total
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Receivables in respect of a franchise arrangement	1,267	2,995	3,072	2,694	35,611	45,639

Note 14 - Investment property and investment property under construction

A. Movements and composition:

	As of December 31, 2016			As of December 31, 2015		
	Land, buildings and leasable retail areas	Investment property under construction	Total	Land, buildings and leasable retail areas	Investment property under construction	Total
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Balance as at the beginning of the year	18,395,249	1,875,890	20,271,139	16,353,410	2,232,453	18,585,863
Additions during the year:						
Investments	827,300	1,176,391	2,003,691	321,758	654,165	975,923
Adjustments to fair value	164,580	545,998	710,578	181,781	(1,474)	180,307
Net translation differences deriving from the translation of the financial statements of foreign operations	(27,467)	-	(27,467)	6,516	-	6,516
Entry into consolidation (*)	530,627	-	530,627	552,083	-	552,083
Transfer from advance payments on account of investment property	-	257,415	257,415	-	-	-
Transfer from investment property under construction, net	135,609	(135,609)	-	1,009,254	(1,009,254)	-
Total additions	1,630,649	1,844,195	3,474,844	2,071,392	(356,563)	1,714,829
Write-offs during the year:						
Dispositions	-	-	-	5,472	-	5,472
Classification to fixed assets	10,827	-	10,827	-	-	-
Exit from consolidation	12,420	-	12,420	24,081	-	24,081
Total dispositions	23,247	-	23,247	29,553	-	29,553
Balance at the end of the year	20,002,651	3,720,085	23,722,736	18,395,249	1,875,890	20,271,139
Advance payments on account of investment property (see Notes 14D and 14E below)						257,415
						20,528,554

(*) See Notes 14I(1) and 14I(3).

B. Additional information:

(1) Canit Hashalom is leasing the land on which the "Azrieli Center" was built from the City of Tel Aviv-Jaffa under a capitalized lease for a period of 200 years. The lease period is until February 6, 2195. Mortgages apply to Canit Hashalom's lease rights in part of the lobby floor, the roof floor and floors 11-49 of the Round Tower, which constitutes part of Azrieli Center in Tel Aviv, in favor of an institutional body which provided the Company with a loan.

(2) From December 24, 2003, Canit Hashalom has been leasing the land on which the “Azrieli Modi'in" mall was built from the Israel Lands Authority (ILA) under a capitalized lease for a period of 98 years in respect of residential units and for a period of 49 years in respects of units with other designations (the mall and offices) with an option for additional periods of 98 years and of 49 years, respectively. As of the date of the approval of the Financial Statements, the lease agreement has not yet been actually signed.

Note 14 - Investment property and investment property under construction (Cont.)

B. Additional information: (Cont.)

(3) The Company is leasing the land on which the "Azrieli Jerusalem (Malha)" mall was built from the ILA under a capitalized lease for a period of 49 years, ending on August 15, 2039, with an option for an additional period of 49 years.

(4) The Company is leasing the land on which the "Azrieli Ayalon" mall was built from the ILA under a capitalized lease for a period of 49 years, ending on August 1, 2031, with an option for an additional period of 49 years.

(5) The Company is leasing the land on which the Azrieli Or Yehuda Outlet Mall was built from the ILA under a capitalized lease for a period of 49 years, ending on March 24, 2040, with an option for an additional period of 49 years.

(6) The Company is leasing the land on which the Azrieli Givatayim Mall was built from the ILA under a capitalized lease for periods of 49 years, ending on September 5, 2053 and February 9, 2051.

(7) The Company is leasing the land on which the Azrieli Haifa Mall was built from the ILA under a capitalized lease for periods of 49 years ending October 31, 2042 and March 2, 2035 with an option for an additional period of 49 years. The rights in the property are subject to pledges in favor of a bank that extended loans to the Company.

(8) The Company is leasing the land on which the industrial buildings in Caesarea Industrial Park were built from the Caesarea Edmond Benjamin de Rothschild Development Corporation Ltd. under a capitalized lease for a period of 49 years, ending on July 7, 2053 and March 12, 2049, with an option for an additional period of 49 years.

(9) The Group is leasing the land on which the Ramla Azrieli Mall was built from the ILA under a capitalized lease until January 14, 2050. As of the date of approval of the Financial Statements, the lease agreement has not yet been signed. The rights in the land are subject to pledges in favor of an institutional body which provided the Company with a loan.

(10) The Group is leasing parts of the land on which the Azrieli Holon Center is building from the City of Holon under a capitalized lease, in accordance with its share in the transaction for a period of 99 years, with an option for another 99 years for payment.

On the Group's engagement with the City of Holon through Canit Hashalom, see Note 31B(8).

(11) The consolidated company is entitled to be registered as the owner of sub-lease rights in the framework of a set of agreements with a third party, in Palace Tel Aviv Senior Housing, until 2097.

(12) The remaining income-producing properties are owned by the Group's companies.

(13) In respect of charges and guarantees, see Note 32.

Note 14 - Investment property and investment property under construction (Cont.)

B. Additional information: (Cont.)

(14) The Group has several additional development projects in the retail centers and malls segment and in the office space for lease segment and in the senior housing segment:

- **Azrieli Sarona** – in Tel Aviv of an area of approx. 9,400 sqm. The land on which the project is built is leased under a capitalized lease from the ILA for a period of 49 years, ending on May 29, 2060, with an option for another period of 49 years from the end of the lease period.

- **Azrieli Rishonim Center** – in Rishon LeZion with a net area of approx. 19,000 sqm, under ownership. The rights in the property are subject to pledges in favor of an institutional entity that extended a loan to the Company. As of the Report Release Date, the mall has opened and the possession was handed-over to several tenants in the office tower.

- **Lands Holon** – in Holon of an area of 12,400 sqm, under ownership.

- **Assisted Living Modi'in** – in Modi'in, of an area of 10,500 sqm. The land on which the project is built is leased under a capitalized lease from the ILA for 49 years, ending on January 25, 2063, with an option for another period of 49 years.

- **Lehavim Senior Housing** – in Lehavim, of an area of 28,000 sqm, leased under a capitalized lease from the ILA for 49 years, ending on November 30, 2063, with an option for another period of 49 years.

- **Azrieli Town project** – in Tel Aviv on an area of approx. 10,000 sqm. The land on which the project is built is partially owned and partially leased in a capitalized lease from the ILA for 49 years, ending on May 8, 2061 with an option for an additional period of 49 years.

- **Lodzia** – in Holon on an area of approx. 53,000 sqm, under ownership.

- **Rishon LeZion Senior Housing** – in Rishon LeZion on an area of approx. 3,400 sqm leased in a capitalized lease from the ILA for 49 years, ending on March 12, 2065 with an option for an additional period of 49 years.

- **A lot in Akko** – on an area of approx. 4,000 sqm, leased in a capitalized lease from Akko Municipality for a period ending on October 11, 2114.

- **Expansion of Azrieli Center Tel Aviv** – in Tel Aviv, on an area of approx. 8,400 sqm, under ownership.

(15) Some of the assets of consolidated companies are registered in their names in the Lands Registry. Another part has not yet been registered for technical reasons, the main reason for the non-registration deriving from the proceedings of the land arrangements and the reparcellation arrangements of the land have not yet been settled.

(16) With respect to techniques for the fair value estimation of the Group's investment property, see Note 36B(3). In addition, the fair value of the investment property is presented in the Company's books, with reconciliations for receivables in respect of the averaging of income from rent (see Note 11).

Note 14 - Investment property and investment property under construction (Cont.)

B. Additional information: (Cont.)

(17) The amounts recognized in the income statement:

	As of the year ended December 31		
	2016	2015	2014
	NIS in thousands	NIS in thousands	NIS in thousands
Rental, management and maintenance income	1,744,621	1,622,543	1,471,111
Direct operating expenses deriving from rent, management and maintenance	445,486	385,098	329,110

C. On February 24, 2015, the Company won a tender conducted by the ILA, for the purchase of 4 plots designated for industry in Holon's industrial zone of a total area of 12,400 sqm, in consideration for approx. NIS 64 million.

D. In December 2012, an agreement was signed with Clalit Health Services ("**Clalit**") whereby the Company purchased Clalit's rights in a lot of an area of approx. 10,000 sqm located at 146 Menachem Begin Road, in the Northern Tel Aviv Central Business District, in consideration for the sum of NIS 240 million (excluding V.A.T.). The purchased lot is designated for the construction of the Azrieli Town project of approx. 75 thousand sqm.

On August 31, 2016 the transaction was closed and the property was revaluated in the financial statements and recorded at its fair value.

E. On May 22, 2013, the Company engaged in an agreement for the purchase of the full rights of a non-related third party in a lot adjacent to the Azrieli Center in Tel Aviv, of an area of approx. 8,400 sqm, at the intersection of Menachem Begin Road and Noah Moses St. in Tel Aviv, in consideration for an amount of NIS 374 million, plus V.A.T. and linkage differentials on the December 2012 index.

On March 31, 2016 the Company paid the sum of NIS 302 million plus VAT, which constitutes the balance of the consideration. On such date, the possession of the lot was handed over to the Company. The property was revaluated in the financial statements and recorded at its fair value.

F. On April 13, 2016, the Company closed a transaction, that was signed on March 2, 2016, between the Company and Lodzia-Rotex Investment Ltd. (the "**Seller**"), after the Antitrust Commissioner's approval was received, which constituted a condition precedent to the transaction, in connection with the acquisition of all of the ownership rights of the Seller in a property of a registered area of approx. 53,000 sqm, situated in the Holon industrial zone, with a built-up area of approx. 14,300 sqm of workshops and commercial buildings thereon, which are leased to various tenants. In consideration for the property, the Company paid approx. NIS 280 million plus V.A.T. The designation of the land according to the valid zoning plan is a special employment area with a commercial front and it includes building rights for approx. 193 thousand sqm above-ground and as well as parking basements.

The Seller is entitled to all the revenues net of expenses for the management of the property (NOI) in the 12 months from the execution date of the agreement, in the estimated amount of NIS 10 million.

Note 14 - Investment property and investment property under construction (Cont.)

G. In August 2016, a consolidated company purchased an office building (the construction of which was completed in August 2015), located in Austin, Texas, U.S.A., for U.S. $40.5 million. The size of the property is 128,990 sq ft (11,984 sqm) and it is occupied by a single tenant with a lease until 2028, with no option for early exit.

For the purpose of the purchase of the property, the consolidated company took a loan in the amount of U.S. $22 million for a period of 7 years, bearing fixed dollar interest of 3.65%. As collateral, the purchaser's rights in the property were pledged and guarantees and indemnifications by the Company were provided in respect of exceptional events only, per the standard practice in transactions of this type.

H. With respect to an engagement in agreements for the sale of lands in Pi Glilot – see Note 12(3).

I. **Senior housing**

(1) On July 29, 2015, Canit Hashalom (the "**Buyer**"), a company controlled by the Company, completed the purchase of 100% of the shares of a private company which holds and manages "Palace Tel Aviv", a prestigious senior housing facility in central Tel Aviv (the "**Acquired Company**" and the "**Property**", respectively), which includes approx. 231 senior housing units and 4 nursing wings, after receiving the approval of the Antitrust Commissioner for the transaction on July 23, 2015.

In consideration for the Acquired Company's shares, the Buyer paid a total consideration of NIS 270 million, with approx. NIS 7 million thereof directly paid to the Acquired Company in repayment of a debt of the sellers to the Acquired Company.

(2) On March 13, 2016, a consolidated company of the Company's won a tender issued by the Israel Land Authority for the purchase of leasehold rights in a lot of 3,400 sqm, designated for senior housing, at HaRakafot neighborhood in Rishon LeZion East, designated for the construction of at least 250 senior housing units and approx. 3,000 sqm of retail spaces, in consideration for approx. NIS 26 million. According to the terms of the tender, the consolidated company paid development expenses in the sum of approx. NIS 22 million.

(3) On March 23, 2016, a consolidated company (the "**Buyer**") entered into a contingent agreement (the "**Agreement**" or the "**Transaction**") with unrelated third parties (the "**Sellers**"), for the purchase of 100% of the shares of a private company that as of the purchase date was a reporting corporation, as defined in the Securities Law, 5728-1968, which holds and manages the "Ahuzat Bayit" senior home and the "Park Mall" retail center in Ra'anana (the "**Purchased Company**").

Below are the main details of the engagement:

- The property – "Ahuzat Bayit" is an active senior home located at Ahuza Street in Ra'anana, in proximity of the route of Road 531, which included at the time of the engagement approx. 328 senior housing units and a long-term care unit.
  "Park Mall" is an active retail center located near the senior home, with approx. 20 tenants in an area of approx. 4,500 sqm.

- The consideration – for the shares of the Purchased Company, the Buyer will pay a total consideration of NIS 55 million. The full consideration amount will be paid at the closing date of the Transaction, as defined in the Agreement.

- Indemnification – in the context of the engagement, the Buyer undertook that it, jointly with others, will be liable to indemnify the Purchased Company and/or the Company for past activity of the Purchased Company that is unrelated to the senior home and the retail center.

Note 14 - Investment property and investment property under construction (Cont.)

I. Senior housing

(3) (Cont.)

- Condition precedent – the closing of the Transaction is conditioned on the approval of the Antitrust Commissioner, insofar as required, up to and by no later than 120 days of the execution date of the Agreement.

On April 13, 2016, the Antitrust Commissioner rendered notice of his consent for effecting the transaction and on May 25, 2016, the transaction was closed.

On June 29, 2016, the Purchased Company ceased to be a reporting corporation, as defined in the Securities Law, 5728-1968, following the early redemption by the Purchased Company of the Bonds (Series A) it issued to the public. For details see Note 21B(7) below.

J. Projected revenues due to signed lease contracts:

Set forth below are the minimal lease payments due to be received due to lease contracts for the agreement periods (including revenues from rent, management fee and parking and excluding extension options):

The revenue recognition period	Revenues from fixed components
	NIS in thousands
Up to one year	1,234,385
From one to four years	2,444,635
Over four years	1,692,218
	5,371,238

Note 15 - Fixed assets

A. The movement and composition:

	Land and buildings at cost	Machines and equipment	Furniture, equipment and computers	Vehicles	Installations and leasehold improve-ments	Total
	NIS in thousands					
Cost						
Balance as of January 1, 2015	911,784	914,896	185,495	79,040	11,848	2,103,063
Additions	33,040	48,012	7,894	12,932	632	102,510
Write-offs	(4,363)	(14,026)	(4,051)	(8,312)	(200)	(30,952)
Classification as held for sale	-	-	-	(534)	-	(534)
Entry into consolidation (2)	76,176	-	5,204	-	-	81,380
Exit from consolidation	-	-	(220)	-	(266)	(486)
Effect of changes in exchange rates	105	82	16	63	-	266
Balance as of December 31, 2015	1,016,742	948,964	194,338	83,189	12,014	2,255,247
Additions	17,630	31,243	7,386	11,063	451	67,773
Write-offs	(112)	(1,286)	(345)	(7,146)	-	(8,889)
Classified from investment property	10,827	-	-	-	-	10,827
Entry into consolidation	-	-	1,095	-	54	1,149
Exit from consolidation (3)	(866,478)	(307,668)	(90,720)	(36,820)	-	(1,301,686)
Effect of changes in exchange rates	(444)	(344)	(3)	(274)	-	(1,065)
Balance as of December 31, 2016	178,165	670,909	111,751	50,012	12,519	1,023,356
Accumulated depreciation and loss from impairment						
Balance as of January 1, 2015	352,824	592,649	132,401	34,173	9,642	1,121,689
Depreciation for the year (1)	24,195	43,394	7,747	9,030	787	85,153
Write-offs	(2,354)	(12,750)	(3,372)	(6,113)	(199)	(24,788)
Classification as held for sale	-	-	-	(355)	-	(355)
Entry into consolidation (2)	10,599	-	3,462	-	-	14,061
Exit from consolidation	-	-	(209)	-	(194)	(403)
Effect of changes in exchange rates	96	75	54	9	(1)	233
Balance as of December 31, 2015	385,360	623,368	140,083	36,744	10,035	1,195,590
Depreciation for the year (1)	14,093	34,260	7,979	7,508	634	64,474
Write-offs	(10)	(1,209)	(138)	(4,565)	-	(5,922)
Entry into consolidation	-	-	798	-	15	813
Exit from consolidation (3)	(367,069)	(213,548)	(73,641)	(22,455)	-	(676,713)
Effect of changes in exchange rates	(28)	(24)	(1)	(23)	3	(73)
Balance as of December 31, 2016	32,346	442,847	75,080	17,209	10,687	578,169
Depreciated Cost:						
As of December 31, 2016	145,819	228,062	36,671	32,803	1,832	445,187
As of December 31, 2015	631,382	325,596	54,255	46,445	1,979	1,059,657

(1) The depreciation expenses for 2016 include expenses in the sum of NIS 25,336 thousand from discontinued operations (2015 – NIS 50,140 thousand) (see also Note 8).

(2) See Note 14I(1).

(3) Sale of Sonol Israel Ltd. – for further details see Note 8.

Note 15 - Fixed assets (Cont.)

B. In the matter of charges - see Note 32.

C. Details in respect of interests in land used by the Group as fixed assets

(1) Consolidated companies in the Granite Group have buildings on lands held under capitalized lease from the ILA for various periods until 2059. The depreciated cost of the buildings on leased lands and the leased lands, as of December 31, 2016 is NIS 58,806 thousand (2015 - NIS 62,211 thousand).

(2) For consolidated companies in the Granite Group the land and buildings item includes leasehold improvements at a depreciated cost as of December 31, 2016 of NIS 1,117 thousands (2015 - NIS 156,070 thousand).

Note 16 - Intangible assets

A. The movement and composition:

	Goodwill	Customer relations	Rights to supply and distribution rights to oil distillates and others	Franchise arrangements	Software	Others (a)	Total
	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands
Cost							
Balance as of December 31, 2015	244,328	134,930	99,546	18,599	61,069	62,327	620,799
Additions	-	-	6,877	21	2,964	1,342	11,204
Write-offs	(12,185)	-	-	-	-	(18,597)	(30,782)
Entry into consolidation (b)	64,046	-	-	-	-	10,427	74,473
Exit from consolidation	-	-	-	-	(65)	-	(65)
Effect of changes in exchange rates	-	-	-	-	-	48	48
Balance as of December 31, 2015	296,189	134,930	106,423	18,620	63,968	55,547	675,677
Additions	-	-	400	818	2,171	2,379	5,768
Entry into consolidation (d)	43,393	8,426	-	-	40,894	9,121	101,834
Exit from consolidation (c)	(169,086)	(27,838)	18,477	-	(37,467)	(37,239)	(253,153)
Effect of changes in exchange rates	-	-	-	-	-	(178)	(178)
Balance as of December 31, 2016	170,496	115,518	125,300	19,438	69,566	29,630	529,948

(a) The 'Others' item includes primarily amounts in respect of a brand, trademarks and licenses and rights for the supply of natural gas.
(b) For further details - see Notes 14I(1).
(c) For further details - see Note 8 on Discontinued Operations.
(d) For further details - see Notes 14I(3) and 10F.

Note 16 - Intangible assets (Cont.)

A. The movement and composition (Cont.):

	Goodwill	Customer relations	Rights to supply and distribution rights to oil distillates and others	Franchise arrange-ments	Software	Others	Total
	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands	NIS in Thousands
Amortizations and losses from impairment							
Balance as of January 1, 2015	22,669	95,822	19,378	654	53,314	44,561	236,398
Amortization for the year (1)	-	6,131	4,642	858	3,944	2,332	17,907
Write-offs	(5,944)	-	-	-	-	(18,597)	(24,541)
Impairment (Section B(1))	103,000	-	-	-	-	-	103,000
Exit from consolidation	-	-	-	-	(43)	-	(43)
Effect of changes in exchange rates	-	-	-	-	-	1	1
Balance as of December 31, 2015	119,725	101,953	24,020	1,512	57,215	28,297	332,722
Amortization for the year (1)	-	5,465	5,018	857	6,747	4,886	22,973
Entry into consolidation (2)	-	1,041	-	-	1,130	553	2,724
Exit from consolidation (3)	(144,952)	(21,970)	33,436	-	(34,419)	(25,855)	(193,760)
Impairment	29,320	118	-	-	-	2,761	32,199
Effect of changes in exchange rates	-	-	-	-	-	(7)	(7)
Balance as of December 31, 2016	4,093	86,607	62,474	2,369	30,673	10,635	196,851
Book value							
As of December 31, 2016	166,403	28,911	62,826	17,069	38,893	18,995	333,097
As of December 31, 2015	176,464	32,977	82,403	17,108	6,753	27,250	342,955

(1) The amortization expenses for 2016 include expenses in the sum of NIS 2,523 thousand due to discontinued operations (2015 – NIS 5,047 thousand) (see also Note 8).
(2) For further details – see Notes 14I(3) and 10F.
(3) For further details – see Note 8 on Discontinued Operations.

Original Amount of Goodwill	
As of December 31, 2014	227,694
As of December 31, 2015	291,740
As of December 31, 2016	176,089

Note 16 - Intangible assets (Cont.)

B. Allocation of goodwill to cash generating units:

The goodwill has been allocated to cash generating units for the purposes of the testing for impairment, as follows:

	As of December 31		
	2016	2015	2014
	NIS in Thousands	NIS in Thousands	NIS in Thousands
A operations – Fuels (1)	-	49,361	152,361
B operations – Gas (2)	63,057	63,057	63,057
C operations – Ecology	-	-	6,241
D operations – Senior Housing	77,420	64,046	-
E operations – eCommerce (3)	25,926	-	-
	166,403	176,464	221,659

Key assumptions used to calculate a recoverable amount:

(1) For details on the sale of Sonol Israel Ltd. – see Note 8.

The testing for impairment of the main part of the goodwill attributed to the fuels operations in 2015 was determined based on the expected fair value, net of sale costs, of the unit, following which an impairment of NIS 103 million was made, in view of indications received during the attempts made to sell Sonol.

(2) The testing for impairment is determined based on the capitalization of the future cash flows, which will be generated from the continuing use of the units, based on the following assumptions:

(a) The cash flows are estimated based primarily on the actual results of activities and on the business plans for the coming five years.

(b) The main forecast annual rate of growth that is included in the forecast cash flows in the representative year is 2.5% (last year – 2.6%), in accordance with management's evaluation. This growth rate is based on the long-term growth rate of the GDP, the rate of population growth in Israel, business trends in operations in each sector and on the expected increase in competition for the various products.

(c) For the purposes of the estimation of the cost of capital for the activities, an estimate has been made of the pre-tax weighted average cost of capital (WACC), whilst using the CAPM model for the calculation of the price of the capital and additional assumptions in respect of the price of debt and its appropriate debt structure. In the determination of the recoverable amount of the units, a cap rate of 11.25% (2015 – 12.30%) was taken into account. The estimate of the cap rate was made in reliance, *inter alia*, on the price of the capital for each activity, including the taking into consideration of the risk free interest rate, the market premium and the beta, the price of debt and comparison to similar public companies and other competing companies, as the case may be.

The evaluations and the assumptions were determined in accordance with the estimations of the managements in the Group in respect of future trends in the sector, and they are based on both external and internal sources (historical data) and in accordance with economic evaluations by independent appraisers.

Note 16 - Intangible assets (Cont.)

Key assumptions used to calculate a recoverable amount: (Cont.)

(3) For further details – see Note 10F.

Note 17 – Pre-paid long-term lease payments

Leases in which the Group is the lessee:

A consolidated company has lease agreements for approx. 3 years. For details regarding the sale of Sonol – see Note 8.

The following are details of the lease payments and income from sub-lease that were carried to the income statement:

	For the year ended December 31		
	2016	2015	2014
	NIS in Thousands	NIS in Thousands	NIS in Thousands
Minimal lease payments recognized as an expense	2,171	178,693	188,617
Conditioned lease payments recognized as an expense	793	21,407	20,200
Income in respect of sub-lease	-	(6,929)	(20,371)
	2,964	193,171	188,446

Note 18 - Trade payables

The composition:

	As of December 31	
	2016	2015
	NIS in Thousands	NIS in Thousands
Open debts	150,056	480,252
Checks payable	68,577	44,386
	218,633	524,638

Note 19 - Other payables

The composition:

	As of December 31	
	2016	2015
	NIS in Thousands	NIS in Thousands
Advance payments from customers and income in advance	44,090	41,991
Liabilities for the completion of work in progress	13,748	16,291
Liabilities to employees and other liabilities in respect of salaries and wages	31,436	48,421
Interest and expenses payable	76,832	55,005
Institutions	26,570	197,756
Others	7,242	15,744
	199,918	375,208

For further information regarding payables that constitute related and interested parties, see Note 37C.

Note 20 - Deposits from customers

A. Supergas Israeli Gas Distribution Company Ltd. collects from its customers a deposit for ensuring the recovery of the equipment provided to them at the time of the engagement therewith, which it is required to return upon the end of the engagement and the recovery of the equipment, in accordance with the Products and Services Price Control Order (Determination of the Level of Control and Maximum Deposit Prices for Gas Equipment) 5776-2015.

B. Liability due to senior housing deposits and liabilities due to apartment keeping deposits

The Group has liabilities due to Shekel deposits received from tenants with whom contracts were signed in senior housing projects, which are operated by the Group. The liabilities due to the Shekel deposits are linked to the CPI and are presented after erosion pursuant to the agreements signed by the Group’s companies with tenants.

According to agreements with some of the tenants, a certain percentage of the balance of the deposits is used as an advance payment for the tenant’s rights of usage of the property and is not repaid to the tenant. The “income received in advance” component is included as part of the liability due to the deposits and is carried to the income statement as an income from usage fees throughout the term of the agreement.

Furthermore, there are liabilities due to apartment keeping deposits.

The Senior Housing Law, 5772-2012 (the "**Law**"), which took effect in 2012, has regulated operations in the Israeli senior housing sector for the first time. The Law prescribes, *inter alia*, rules and arrangements on the following matters: the duty to obtain a senior home operation license and the conditions to receipt thereof, the duty to make a written engagement agreement between the holder of the senior home operation license (the “**Operator**”) and the tenants, a specification of basic mandatory services that the Operator is obligated to provide, the duty to set up an LTC unit, a limitation on arbitrary increases of the maintenance fees and other payments, the determination of collateral to secure the repayment of the tenants' deposits, etc. Under the provisions of the Law, in any case in which a tenant is required to deposit sums on account of the deposit, which sums exceed 7% of the sum of the deposit or NIS 70,000, whichever is lower, the Operator will be required to provide the tenant with collateral, according to the Operator’s choice and the following alternatives (the "**Collateral**"): [a] Bank guarantee; [b] Insurance of the tenant with an insurer stating the tenant as an irrevocable beneficiary in the insurance contract, provided that the insurance premiums are paid in advance; [c] Transfer of 40% of the amount of the deposit to a trustee under a trusteeship contract in which the tenant is specified as a beneficiary; or [d] Registration of a first-ranking mortgage on the real property in favor of the tenant. Furthermore, the Operator is obligated to bear 20% of the cost of provision of the collateral, with the balance of the cost being borne by the tenant. The Law lists causes for enforcement of the Collateral by the tenant.

Note 21 - Loans from banks and other credit providers

A. Current liabilities:

	As of December 31	
	2016	2015
	NIS in Thousands	NIS in Thousands
Credit from banks		
Overdrafts	962	18,277
Short-term loans	38,284	881,928
	39,246	900,205
Credit from other credit providers		
Commercial paper	655,370	629,992
Short-term loans	742	716
	656,112	630,708
Current maturities of long-term liabilities		
Current maturities of loans from banks	392,044	(*)193,916
Current maturities of loans from others	352,073	(*)106,943
Current maturities of bonds	643,089	198,433
	1,387,206	499,292
Total current liabilities	2,082,564	2,030,205

(*) Reclassified.

On June 23, 2014, the Company raised a (rated) series of commercial paper for investors listed in the First Schedule to the Securities Law, 5728-1968, with a total par value of NIS 480 million. The commercial paper principal bears variable NIS interest comprising Prime interest less 1.2%, payable after the earlier of twenty 90-day terms or at maturity or at an exit point. The commercial paper will not be listed on TASE.

The commercial paper received an “ilA-1+” rating from Maalot.

Since then the Company has paid par value of approx. NIS 15 million out of this series, and the balance of the rated commercial paper series as of December 31, 2016 is par value of approx. NIS 465 million.

In March 2015, the Company issued a new un-rated series of commercial paper with a total par value of NIS 116 million. In June 2015 and March 2016, the Company expanded this series to a total par value of approx. NIS 190 million. The commercial paper principal bears variable NIS interest comprising Prime interest less 1.2%, and shall be paid after the earlier of twenty 90-day terms or at maturity or at an exit point.

Note 21 - Loans from banks and other credit providers (Cont.)

B. Non-current liabilities:

	As of December 31	
	2016	**2015**
	NIS in thousands	**NIS in thousands**
Bonds		
Bonds (1), (2), (3), (4), (5), (6)	5,141,349	3,161,164
Loans from banks	602,374	(*)1,381,597
Other long-term liabilities		
Long-term loans from others	2,629,416	(*)1,908,503
Capital notes	215	215
	2,629,631	1,908,718
	8,373,354	6,451,479
Net of current maturities	(1,387,206)	(499,292)
Total non-current liabilities	6,986,148	5,952,187
Presented under the following items:		
Loans from banks and other credit providers	2,487,888	2,989,456
Bonds	4,498,260	2,962,731
	6,986,148	5,952,187

(*) Reclassified.

(1) In 2007, the Company performed a private placement to institutional investors of Series A bonds, with a par value of 740 million bonds of par value NIS 1 each. The bonds are linked to the CPI (principal and interest) and bear interest at a rate of 4.8% a year. The Company will repay an amount equivalent to 5% of the amount of the principal (NIS 37 million) in the month of March in each of the years 2008 to 2016 and in March 2017 it will repay an amount that is equivalent to 55% of the amount of the principal (NIS 407 million). The interest payments will be executed once every three months.

For the purposes of this issue, the bonds were rated Aa2 by Midroog and AA/Stable by Standard & Poors Maalot ("**Maalot**").

On January 20, 2015, Maalot upgraded the Company's rating to AA+/Stable and the Company's Series A Bonds rating to AA+.

On November 1, 2015, Midroog announced the upgrade of the Company's Series A Bonds rating to Aa1 with a stable outlook. On July 20, 2016, Midroog ratified this rating.

The Series A Bonds have listed on the TACT-institutional on the TASE, where the Company is entitled to list the Series A Bonds on the TASE, at its sole discretion. The bonds will be accelerated upon certain conditions, including on receivership, arrears in payments, a change in control, the sale of rights in at least two of the following assets: the Ayalon Mall, Hanegev Mall or the Jerusalem Mall, where as the result of the sale there is a lowering of the rating of the bonds is lowered, as it may be from time to time. The grounds for immediate repayment in respect of a change in control, the sale of at least two of the Group's assets, as aforesaid, and the lowering of the rating of the bonds below BBB+ or an equivalent rating thereof, will be cancelled when the Company's bonds are registered for trading. Within the framework of the issuance of the Series A bonds, the Company has undertaken not to distribute a dividend to its shareholders, so long as such a distribution would cause a lowering of the rating for the bonds.

Note 21 - Loans from banks and other credit providers (Cont.)

(1) (Cont.)

The balance, the principal and linkage differentials of the Series A Bonds (net of issue expenses) as of December 31, 2016 is approx. NIS 487,935 thousand (as of December 31, 2015 – NIS 533,746 thousand). As of the date of the Financial Statements the Company is in compliance with the contractual restrictions that have been set.

(2) In June 2005, the subsidiary Canit Hashalom issued Series A Bonds with a total par value of NIS 500 million. In July 2009, Canit Hashalom increased the Series A Bonds to institutions by approx. NIS 89.5 million par value. In June 2015, the balance of the bonds was paid and consequently all charges registered and guarantees given in favor of the holders of Series A bonds of Canit Hashalom were removed.

(3) In February 2015, the Company made a public offering of approx. NIS 623.3 million par value of registered Series B Bonds, based on the Company's shelf prospectus. The bonds are linked (principal and interest) to the CPI and bear interest at a fixed rate of 0.65% per year.

The principal payments will be paid in 10 equal annual installments on April 1 of each one of the years 2016 to 2025 (each installment will be 10% of the principal's par value). The interest will be paid in semiannual installments from October 1, 2015 and on April 1 and October 1 of each one of the years 2016 to 2025. The bonds were issued without a discount.

The issue proceeds totaled approx. NIS 623.3 million, and after attributing the issue expenses, the net proceeds amounted to approx. NIS 618.9 million. The effective interest rate in respect of the bonds is 0.78% per annum.

On January 20, 2015, Maalot rated the Series B Bonds as ilAA+ (stable outlook).

The bonds are not secured by any collateral.

At the time of the offering, the Company undertook to meet financial covenants and undertakings, the main ones being:

(a) So long as the Series B Bonds are not fully paid-up, the Company shall neither encumber nor pledge by way of a floating charge all of the Company’s existing or future assets and rights, except under certain conditions set forth in the Indenture.

(b) Maintaining minimal equity (equity attributable to the Company’s shareholders, excluding minority rights) of at least NIS 5 billion for two or more consecutive calendar quarters, according to its last consolidated financial statements.

The net financial debt to net assets ratio, according to the definitions in the Indenture, exceeded 60% for two or more consecutive calendar quarters.

The Indenture determines that in lieu of the said financial covenants, the Company may, at its sole discretion, pledge (either itself or through an investee company) in favor of the trustee for the Series B bondholders, by way of a fixed charge, Permitted Assets as defined in the Indenture (i.e., insofar as the Company pledges Permitted Assets as aforesaid, and the pledges are in force and effect, the Company shall not be bound by the said financial covenants).

Note 21 - Loans from banks and other credit providers (Cont.)

B. Non-current liabilities: (Cont.)

(3) (Cont.)

(c) The Company shall not perform a Distribution (as defined in the Companies Law) to its shareholders, if: (1) the Company's equity (equity attributable to the Company's shareholders, excluding minority rights) according to its last published consolidated financial statements, net of the amount of the Distribution, is less than NIS 6 billion; (2) the Company's net financial debt to net assets ratio (as defined in the Indenture), net of the amount of the Distribution, exceeds 50%; (3) there are grounds for acceleration according to the definitions in the Indenture of the Series B Bonds on the date of the decision to perform the Distribution or as a result thereof.

As of the balance sheet date, the Company meets the financial covenants, while the Company's equity as of the balance sheet date is approx. NIS 15.3 billion and the net financial debt to net assets ratio is approx. 27%.

It was further determined that in the event that the rating of the Company's Series B Bonds falls below Maalot's ilAA rating, or a corresponding rating determined by another company that rates the bonds, the rate of the annual interest borne by the unpaid balance of the bond principal shall rise, in which case, the annual interest rate that shall be added to the annual interest in respect of the bonds will range between 0.25% and 1%, according to the bonds' rating.

In addition, the Series B Bonds shall be accelerated upon fulfillment of certain conditions, including: delisting or dissolution of the Company, receivership, delinquency in payments under the bonds, attachments on all or most of the Company's assets, changes in control, a fundamental breach of the terms and conditions of the bonds or the Indenture, non-compliance with the above financial covenants, performance of a distribution contrary to the above restriction on the performance of a distribution, suspension of trading of the bonds (except on grounds of ambiguity), a demand for acceleration by financial creditors above NIS 200 million or another bond series of the Company, discontinuation of rating of the bonds due to circumstances within the Company's control, a bond rating lower than BBB-, or the sale of most of the Company's assets.

In June 2015, the Company made another public offering of approx. NIS 600.3 million par value by way of expansion of the Series B Bonds, based on a shelf prospectus of the Company. The gross issue proceeds amounted to approx. NIS 599.1 million, and the net proceeds after the attribution of the issue expenses amounted to approx. NIS 593.6 million.

As of September 22, 2015, the adjusted value of the Series B Bonds was approx. 100.24 *Agorot* per each NIS 1 par value of the Series B Bonds.

The additional Series B Bonds were issued at a discount at a rate of approx. 0.44% relative to their adjusted value.

On June 21, 2015, Maalot gave the expansion of the Series B Bonds in the amount of up to NIS 685 million par value a rating of ilAA+ (stable outlook).

The balance of the Series B Bonds, principal and linkage differentials (net of issue expenses and discounting) as of December 31, 2016 is NIS 1,091,946 thousand (as of December 31, 2015 – NIS 1,213,177 thousand).

Note 21 - Loans from banks and other credit providers (Cont.)

B. Non-current liabilities: (Cont.)

(4) In September 2015, the Company made a public offering of approx. NIS 1,005.1 million par value registered Series C Bonds based on a shelf prospectus of the Company. The bonds are linked (principal and interest) to the CPI and bear fixed interest at a rate of 1.64% per annum.

The principal payments will be made in 10 equal annual installments on July 1 of each one of the years 2018-2027 (each installment will be 10% of the principal's par value). The interest will be paid in semi-annual installments from July 1, 2016 and on January 1 and July 1 of each one of the years 2017-2027. The bonds were issued without any discount.

The issue proceeds totaled approx. NIS 1,005.1 million, and after attributing the issue expenses, the net proceeds amounted to approx. NIS 996.9 million. The effective interest rate in respect of the bonds is 1.78% per annum.

On September 3, 2015, Maalot rated the Series C Bonds as ilAA+.

The bonds are not secured by any collateral.

At the time of the offering, the Company undertook to meet financial covenants and undertakings, similar to the financial covenants to which it committed in respect of the Series B Bonds (for a description of the terms and conditions and the meeting of the financial covenants, see Section 3 above).

It was further determined that in the event that the rating of the Company's Series C Bonds falls below Maalot's ilAA rating, or a corresponding rating determined by another company that rates the bonds, the annual interest rate borne by the unpaid balance of the bond principal shall rise, in which case, the annual interest rate that shall be added to the annual interest in respect of the bonds will range between 0.25% and 1%, according to the bonds' rating.

In addition, the Series C Bonds shall be accelerated upon fulfillment of certain conditions, similar to the terms that were determined in respect of the Series B Bonds (for a description of the terms and conditions, see Section 3 above).

The balance of the Series C Bonds, principal and linkage differentials (net of issue expenses) as of December 31, 2016 is NIS 997,780 thousand (as of December 31, 2015 is NIS 997,076 thousand).

(5) In July 2016, the Company issued approx. NIS 2,194.1 million par value registered Series D bonds to the public, on the basis of a shelf prospectus of the Company. The bonds are linked (principal and interest) to the CPI and bear fixed interest at the rate of 1.34% per annum.

The principal payments shall be made in 25 equal semi-annual installments on January 5 and July 5 of each of the years 2018 to 2030 (each payment being at the rate of 4% of the par value of the principal from July 5, 2018). The interest will be paid in semi-annual payments from January 5, 2017 of each of the years 2017 to 2030. The bonds were issued without a discount.

The issue proceeds amounted to approx. NIS 2,194 million, and after recording the issue expenses, the net proceeds amounted to approx. NIS 2,177 million. The effective interest rate on the bonds is 1.45% per annum.

Note 21 - Loans from banks and other credit providers (Cont.)

B. Non-current liabilities: (Cont.)

(5) (Cont.)

On July 5, 2016, Midroog assigned the Series D bonds a stable Aa1 rating, and on July 20, 2016, Midroog ratified this rating.

The bonds are not secured by any collateral.

At the time of the offering, the Company undertook to meet financial covenants and undertakings similar to the financial covenants undertakings to which it committed in respect of the Series B and C Bonds (for a description of the terms and conditions – see Section 3 above).

It was further determined that in the event that the rating of the Company's Series D Bonds falls below Midroog's Aa2 rating, or a corresponding rating that is determined by another company that rates the bonds, the annual interest rate borne by the unpaid balance of the bond principal shall rise, in which case, the annual interest rate that shall be added to the annual interest in respect of the bonds will range between 0.25% and 1%, according to the bonds' rating.

In addition, the Series D Bonds shall be accelerated upon fulfillment of certain conditions, similar to the conditions that were determined in respect of the Series B and C Bonds (for a description of the terms and conditions and the meeting of the financial covenants – see Section 3 above).

The balance of the Series D Bonds, principal and linkage differentials (net of issue expenses) as of December 31, 2016 is NIS 2,179,368 thousand.

(6) In July 2007, a consolidated company of Supergas which was established for the purpose of the issuance, and to which, primarily, the domestic gas operations were transferred, executed an issue of bonds to institutional investors through a private placement, with a total par value of NIS 600 million. The bonds, which are rated with a rating of Aa1 by Midroog Ltd., are for a period of 18 years, and are repaid in quarterly installments of the principal from 2010. The bonds are linked to the CPI (principal and interest) and bear interest at a rate of 4.9% a year, which is paid once every calendar quarter. The balance of the bonds is presented net of net issue expenses, which amount to NIS 0.6 million as of December 31, 2016 (December 31, 2015 – NIS 0.8 million). The effective rate of interest for the bonds is 5.26% a year.

In June 2014, the consolidated company of Supergas completed a process to modify the bonds, which includes prepayment of certain principal payments (which constitute approx. 11.5% of the bond balance), which, according to the original terms of the issuance, were due to be paid over the coming five years, and in fixed quarterly principal payments such that they will be uniform and equal. Accordingly, the consolidated company of Supergas paid 51,829,380 par value in total of approx. NIS 75 million, which includes the sum of approx. NIS 12.3 million that was paid due to the prepayment. In addition, it was determined that in the event that Canit Hashalom ceases to be a controlling shareholder of the Company, then Granite shall make an offer to the bondholders to purchase the bonds at a scope of no less than 45 million par value.

The bonds are secured by a first-ranking floating charge, in an unlimited amount, on all of the assets of the consolidated company of Supergas, in addition, Supergas charged by a first ranking fixed charge in an unlimited amount all of the shares of the consolidated company owned and held thereby, including the rights deriving from such shares.

According to the bond terms, the consolidated company of Supergas is required to meet financial covenants. Deviation from the financial covenants would allow the holders of the bonds to demand the acceleration of repayment or early repayment as described below.

Note 21 - Loans from banks and other credit providers (Cont.)

B. Non-current liabilities: (Cont.)

(6) (Cont.)

In the event that the ratio between the available cash flow of the domestic operations (the quarterly income flow from domestic operations net of expenses (gas and other) on an annual average), and the quarterly bond debt (the "**Debt Coverage**") shall fall below 126.5%, it will not be possible to withdraw surpluses from the reserve account in which cash surpluses which exceed the service charges and gas purchases are deposited.

In accordance with the terms and conditions of the bonds, the consolidated company is required to meet financial covenants. Any deviation from the financial covenants will allow the bondholders to demand acceleration of the payment or prepayment, as described below.

Acceleration of payments:

(a) If the ratio between the average quarterly free cash flows from the domestic gas operations (the cash flow of the receipts from the domestic operations net of actual purchases of gas and expenses in respect of the services agreement in respect of the domestic gas operations), for the past year and the quarterly installment (principal and interest) which are expected to be paid to the bondholders at the time of the next expected payment (the "**Debt Coverage Ratio**") falls below 111%.

(b) If the rate of the margin on the commercial gas operations in containers falls below 12% (as of the date of the Financial Statements, the rate of the margin is materially higher than such rate).

Acceleration and realization of collateral:

1. If the Debt Coverage Ratio falls below 103%.
2. In the event of insolvency.
3. The non-payment of a payment of principal or interest.
4. A decision for dissolution or receivership of Supergas' consolidated company.
5. The imposition of an attachment or execution of the entire or material assets of Supergas' consolidated company.
6. A fundamental breach of the terms of the bonds.
7. In the event that Supergas' consolidated company loses the gas license.
8. In the event of a change in control such that Granite ceases, under certain conditions, to control Supergas.
9. The lowering of the rating of the bonds rating below Baa1 or if the rating is not monitored.

In addition, there are grounds for the replacement of Supergas as a provider of services in the transaction, the main ones being: if the debt cover ratio falls below 106%; events in which Supergas becomes insolvent or if it loses its gas supplier license.

As of the date of the Financial Statements, Supergas's consolidated company meets the covenants while the debt service coverage ratio as of the Report Date is 357%.

Note 21 - Loans from banks and other credit providers (Cont.)

B. Non-current liabilities: (Cont.)

(7) On June 7, 2016, the board of directors of consolidated company Ahuzat Bayit Raanana – Retirement Home Ltd. resolved to perform full early redemption of its Series A bonds. The total amount paid to the bondholders is in the sum of NIS 209,813 thousand.

Payment of the early redemption was made on June 29, 2016 for the entire balance of the principal of the bonds in circulation. The early redemption of the bonds had a marginal effect on the Group's results.

For details regarding the acquisition of Ahuzat Bayit Raanana – Retirement Home Ltd. in 2016 – see Note 14I(3).

(8) On May 21, 2014, the Company entered into a loan agreement with several companies in an institutional body group affiliated neither with the Company nor with its controlling shareholders, to receive a loan of NIS 300 million, linked to the CPI, bearing annual interest at the rate of 0.74%. The loan (principal and interest) will be repaid in 36 equal quarterly installments linked to the rate of increase in the Index from the end of three months from the date of provision of the loan. To secure repayment of the loan, a consolidated company has pledged, in favor of the lender, its rights in the land on which the Azrieli Ramla Mall is being built, including its rights to receive rent from tenants in the Mall, and the Company's rights by virtue of the insurance policy in connection with the Mall will also be pledged. The lender will be entitled to accelerate the loan on accepted grounds that are set forth in the loan agreement, including, *inter alia*, upon the occurrence of a change of control, the acceleration of a debt of the Company to other financial institutions, or the imposition of an attachment in the amounts and under the conditions as are defined in the loan agreement, and also if after the population of the Mall and the opening thereof to the public, the LTV is higher than the ratio set forth in the loan agreement and no other or supplementary collateral was provided. It was further determined that if the Company grants a floating charge to another entity in the future, it shall grant the lender, on the same date, a floating charge of identical ranking and scope (*pari passu*).

As of December 31, 2016, the Company meets the financial covenants, with the LTV ratio required in accordance with the agreement on this date being 65%, and amounting, in practice, to 45%.

(9) On May 24, 2016, a loan was provided to the Company in the sum of NIS 550 million from an institutional body affiliated neither with the Company nor with its controlling shareholders, linked to the CPI, at annual interest at the rate of 1.5%.The repayment of the loan's principal shall commence from the second anniversary of the date of provision of the loan and shall be made in 40 equal quarterly installments (the last principal payment shall be made 12 years after the date of provision of the loan). The interest on the loan shall be paid on a quarterly basis, until the final repayment date. The Company is entitled to prepay the loan (in whole or in part) against a prepayment fee according to a mechanism defined in the agreement.

To secure repayment of the loan, Canit Hashalom Investments Ltd., a subsidiary wholly owned by the Company, pledged in favor of the lender, by way of a first-ranking fixed pledge unlimited in amount, the Azrieli Rishonim Center in Rishon LeZion (which as of the Date of the Statement of Financial Position is under construction), including its rights to receive rent from the property's tenants and its rights under the insurance policies in connection with the property.

Note 21 - Loans from banks and other credit providers (Cont.)

B. Non-current liabilities: (Cont.)

(9) (Cont.)

In the context of the loan agreement, the Company undertook to meet the financial covenants that were set forth in the indentures of the Company's Series B and C bonds (the "**Bonds**"), i.e. a net debt to assets ratio that shall not exceed 60% and equity of no less than NIS 5 billion (the "**Financial Covenants**"), and it further undertook to maintain an LTV ratio that shall not exceed 80%, commencing from April 1, 2018. In addition, the agreement includes limitations on the distribution of a dividend that correspond with the undertaking set forth in the Bonds' indentures (i.e. that no distributions shall be made if, as a consequence thereof, the equity shall be less than NIS 6 billion and the debt to assets ratio shall exceed 50%). In addition, the Company undertook not to create a floating charge on all or part of the Company's assets, to any entity, unless it shall create in favor of the lender, on the same date, a floating charge of identical ranking and scope (*pari passu*) (such an undertaking also exists in the Bonds' indentures). The causes for acceleration are as customary in agreements of this type and in the Bonds' indentures, including a cause pertaining to the acceleration of another substantial debt of the Company.

As of the date of the financial statements, the Company meets the contractual limitations determined, with the Company's equity being approx. NIS 15.3 billion and the net financial debt to net assets ratio being approx. 27%.

(10) In July and August 2016, the Group prepaid loans in the sum of approx. NIS 900 million, some of which were secured by collateral, approx. NIS 300 million of which short-term loans and the balance is mostly long-term loans that were due in March 2017.

Note 21 - Loans from banks and other credit providers (Cont.)

C. Details in respect of interest and linkage:

	Currency	As of December 31 2016 Nominal interest %	As of December 31 2016 Par value	2016 Book value NIS in thousands	2015 Par value	2015 Book value NIS in thousands
Overdrafts from banks	Unlinked	2.10-2.95		962		18,277
Short-term loans from banks (*)	Unlinked	2.10-2.95		18,343		827,779
Short-term loans from banks	Foreign currency	2.22		19,941		54,149
Short-term loans from other credit providers	Index	4.00		742		716
Commercial paper	Unlinked	Bank of Israel + 0.3		655,370		629,992
Bonds that are not convertible into shares	Index	0.65-4.90	5,037,322	5,141,349	3,030,673	3,161,164
Long-term loans from banks	Index	3.77-5.80		561,686		1,207,425
Long-term loans from banks (*)	Unlinked	2.12-5.50		40,688		174,172
Liability in respect of finance lease	Index	-		-		508
Liability in respect of finance lease	Unlinked	-		-		6,908
Liability in respect of finance lease	Linked to the Dollar	-		-		3,846
Capital notes	Unlinked	-		215		215
Long-term loans from others	Index	0.74-1.50		1,212,652		782,500
Long-term loans from others (*)	Unlinked	1.35		250,000		8,804
Long-term loans from others	Linked to the Dollar	3.16-5.998		1,166,764		1,117,199 (**)
Other long-term payables	Unlinked	8.75		1,430		-
Total loans and credit from banks and other credit providers			5,037,322	9,070,142	3,030,673	7,993,654

(*) Some of the Shekel loans bear variable interest which is dependent on the Prime interest. The Prime interest rate as of December 31, 2016 is 1.60% (2015 - 1.60%).

(**) Reclassified.

For details on loans that are secured by charges – see Note 32.

Note 21 - Loans from banks and other credit providers (Cont.)

D. Contractual restrictions and financial covenants in the Company:

If certain conditions exist, as detailed in the loan agreements (primarily at the time of a change in the structure and the control in the Company, arrears in payments, receivership and a reduction in the value of the collateral), the loan providers are entitled to accelerate the loans. The total sum of credit for which the Company committed for the aforesaid terms amounted as of December 31, 2016 to approx. NIS 1,987 million. As of the date of the Financial Statements, the Company is in compliance with the contractual restrictions that have been set.

In addition, for a loan whose balance, as of the date of the Financial Statements, is in the sum of NIS 444 million, in accordance with the agreement the LTV ratio is required to be lower than 60%. As of the date of the Financial Statements, the Company meets the contractual restriction that was determined, with the LTV ratio being, in practice, 37%, and for an additional loan whose balance, as of the date of the Financial Statements, is in the sum of NIS 250 million. There is a commitment to meet financial covenants and undertakings that are similar to those prescribed in respect of the Series B bonds (for a description of the conditions and compliance with the financial covenants – see Section B(3) above).

Note 22 - Employee benefits

Employee benefits include post-employment benefits, other long-term benefits, benefits upon the termination of employment, short-term benefits, including due to wages and salary.

In respect of post-employment employee benefits, the Group has defined benefits plans, in respect of which it deposits amounts in appropriate severance pay funds and insurance policies. Moreover, the Group has a defined deposit plan in respect of some of its employees, with regard to whom section 14 of the Severance Pay Law, 5723-1963 applies.

	As of December 31	
	2016	**2015**
	NIS in thousands	**NIS in thousands**
Present value of unfunded liability	1,845	9,100
Present value of funded liability	42,279	58,420
Total present value of liability	44,124	67,520
Fair value of the plan assets	42,511	57,403
Liability recognized due to defined benefit plan	1,613	10,117
Liability due to other short-term benefits	18,386	32,348
Liability due to other long-term benefits	5,473	4,158
Liability due to termination of employment (early pensions)	-	6,821
Total employee benefits	25,472	53,444

Note 23 - Capital

A. The share capital and share rights as of December 31, 2016 and 2015:

	Authorized		Issued and paid-up	
	As of December 31		As of December 31	
	2016	2015	2016	2015
	NIS	NIS	NIS	NIS
Ordinary shares of par value NIS 0.1	12,750,150	12,750,150	12,127,276	12,127,276

Each fully paid-up ordinary share of par value NIS 0.1 grants the right to participate and vote at general meetings. Each shareholder will have one vote for every fully paid-up share he owns. All the shares have equal rights relating to the amounts of capital paid or credited as paid on their par value, and everything connected with distribution of dividend, bonus shares and any other distribution, repayment of capital and participation in the distribution of the Company's surplus assets upon liquidation.

B. Dividend:

The Company’s Board discusses the issue of the distribution of a dividend at the Company (following the recommendation of the Finance Committee) on an annual basis. In such context, the desire and intention of the Company to share the Company’s profits with its shareholders, versus the Company’s being a development company on a significant scale and its investment needs in view of its existing activity and its future plans, were examined, while taking into account the gamut of business considerations.

In this framework, the Company’s Board and the Finance Committee examine whether the dividend distribution meets the profit test and the solvency test set forth in Section 302 of the Companies Law. In addition, restrictions on distribution within the Company are examined, including the Company’s undertaking to the trustee in the indenture for the Company’s Series A Bonds, not to distribute a dividend to its shareholders, insofar as such a distribution will lead to a downgrade of the bond rating, and restrictions on a distribution at the Company, in connection with the indentures for the Company’s Series B, C and D Bonds, see Notes 21B(3), (4) and (5).

C. On March 16, 2015, the Company’s Board decided upon the distribution of a NIS 320 million dividend (which reflects NIS 2.64 per share), for 2014 which was paid on May 4, 2015.

On March 22, 2016, the Company’s Board decided upon the distribution of a NIS 400 million dividend (which reflects NIS 3.30 per share) for 2015, which was paid on May 4, 2016.

With respect to the decision of the Company’s Board regarding the distribution of a dividend for 2016 in the sum of NIS 480 million after the Date of the Statement of Financial Position, see Note 39A.

D. The retained earnings available for distribution as of December 31, 2016 is NIS 12,724,807 thousand (this retained earnings also include the revaluation fund for financial assets available for sale and revaluation of real property profits).

Note 24 - Income

Composition of the income:

	For the year ended December 31		
	2016	2015(*)	2014(*)
	NIS in thousands	NIS in thousands	NIS in thousands
Sales	537,056	538,001	579,684
Performance of work and services	68,361	51,884	47,320
Construction contracts	40,870	42,209	57,715
Franchise agreements	14,508	100,255	172,709
Total income from sales, work and services (**)	660,795	732,349	857,428
Rent, management and maintenance and senior housing fees	1,744,621	1,622,543	1,471,111
Total income	2,405,416	2,354,892	2,328,539

(*) Re-presented due to discontinued operations, see Note 8.

(**) Including income from marketing alternative energy sources for 2016 in the sum of NIS 505 million (for 2015 and 2014, NIS 499 million and NIS 562 million, respectively).

Note 25 - Cost of income

The composition:

	For the year ended December 31		
	2016	2015(*)	2014(*)
	NIS in thousands	NIS in thousands	NIS in thousands
A. According to the sources of income:			
Sales	295,335	307,939	360,085
Performance of work and services	71,590	52,374	45,370
Construction contracts	39,551	38,140	69,630
Franchise agreements	12,677	82,153	133,391
	419,153	480,606	608,476
Rent, management and maintenance fees	445,486	385,098	329,110
Total cost of income	864,639	865,704	937,586
B. According to its components:			
Oil distillates, gas and other material consumed	260,274	348,042	484,531
Labor and external work salary	189,787	130,074	113,399
Depreciation and amortization	20,898	14,555	11,266
Production expenses and others	393,948	358,498	328,042
	864,907	851,169	937,238
Net of increase/plus decrease in inventory of work in progress	623	(284)	(1,009)
Net of increase/plus decrease in inventory of finished products	(891)	14,819	1,357
	864,639	865,704	937,586

(*) Re-presented due to discontinued operations, see Note 8.

Note 26 - Sales and marketing expenses

The composition:

	For the year ended December 31		
	2016	2015(*)	2014(*)
	NIS in thousands	NIS in thousands	NIS in thousands
Wages, salaries and related expenses	72,699	62,329	56,697
Advertising	34,308	31,587	20,058
Depreciation and amortization	31,209	27,019	30,653
Maintenance of buildings and facilities	4,993	5,209	4,479
Rent and municipal taxes	4,280	4,266	4,052
Haulage and maintenance of commercial motor vehicles	10,551	11,050	11,726
Other sales and marketing expenses	13,733	14,382	16,864
	171,773	155,842	144,529

(*) Re-presented due to discontinued operations, see Note 8.

Note 27 - General & administrative expenses

The composition:

	For the year ended December 31		
	2016	2015(*)	2014(*)
	NIS in thousands	NIS in thousands	NIS in thousands
Management fees, wages, salaries and related expenses (**)	34,395	34,057	43,407
Share-based payments (**)	-	2,742	1,197
Consultancy, legal and audit fees	34,878	33,307	32,205
Provision for doubtful and lost debts	2,194	1,493	11,273
Depreciation and amortization	7,564	6,169	6,292
Other general and administrative expenses	25,279	23,863	28,263
	104,310	101,631	122,637

(*) Re-presented due to discontinued operations, see Note 8.
(**) For details in respect of transactions with related and interested parties - see Note 37B.

Note 28 - Other income (expenses)

“Other income” includes primarily dividends received from investments in financial assets available for sale (Leumi Card) in the sum of NIS 10,000 thousand (in 2015 and 2014 - NIS 10,000 thousand).

In 2014, “Other income” includes profit from the sale of shares in investee companies of Granite in the sum of NIS 42,709 thousand and mainly from the sale of shares of S. Super Solar Ltd. which were held by Supergas Israeli Gas Distribution Company Ltd.

Note 29 - Financing revenues and expenses

The composition:

	For the year ended December 31		
	2016	2015(*)	2014(*)
	NIS in thousands	NIS in thousands	NIS in thousands
Financing revenues			
Revenues from interest on loans and receivables	14,927	10,885	5,178
Financing revenues from a financial asset in respect of franchise arrangement	2,313	-	55,723
Profit from a change in exchange rates, net	2,735	2,119	8,533
Revenues from interest on deposits in banks	1,768	765	1,456
Classification as profit or loss of profits that were recognized in other comprehensive income upon the disposition of financial assets available for sale	26,429	-	-
Other financing revenues	889	4,375	10,657
Financing revenues carried to profit and loss	49,061	18,144	81,547
Financing expenses			
Financing expenses on loans and liabilities	116,941	123,267	196,598
Financing expenses on bonds	85,551	52,286	53,188
Miscellaneous bank expenses and charges	7,628	9,788	10,050
Linkage on deposits from customers	(664)	(743)	177
Other financing expenses	5,945	660	3,409
Financing expenses	215,401	185,258	263,422
Net of capitalized credit costs	(56,277)	(40,048)	(46,890)
Financing expenses carried to the income statement	159,124	145,210	216,532
Net financing expenses carried to the income statement	110,063	127,066	134,985

(*) Re-presented due to discontinued operations, see Note 8.

Note 30 – Taxes on income

A. Details in respect of the tax environment in which the Group operates:

(1) Amendments to the Income Tax Ordinance and the Land Appreciation Tax Law

(a) In August 2013, the "Arrangements Law" (the "**Law**") was published in the Official Gazette.

Following are the main significant tax changes that were set forth in the Law:

[1] Increase of the corporate tax from the tax year 2014 to 26.5% (a 1.5% increase).

[2] Revaluation profits (surpluses not subject to corporate tax of the type determined by the Minister of Finance in an amount exceeding one million New Israeli Shekels, calculated on an aggregate basis from the date of purchase of the asset), will be taxable, based on a mechanism of a notional sale and purchase of an asset at any time for which a revaluation thereof was performed, from which revaluation profits were also distributed. Accordingly, a parallel provision was set forth in the Land Taxation Law (Appreciation and Purchase) with respect to appreciation tax on a right in land or a right in a land association for which a distribution from revaluation profits was recorded in the Company's financial statements, as if the right was sold on the date of distribution of the revaluation profits, and re-purchased on the same day.

Note 30 – Taxes on income (Cont.)

A. Details in respect of the tax environment in which the Group operates: (Cont.)

(1) Amendments to the Income Tax Ordinance and the Land Appreciation Tax Law (Cont.)

(a) In August 2013, the "Arrangements Law" (the "**Law**") was published in the Official Gazette (Cont.)

[2] (Cont.)

The applicability provisions determine that they shall apply to assets outside of Israel on the effective date of regulations to be promulgated by the Minister of Finance, and provisions shall be set for the avoidance of double taxation within the meaning thereof in Section 200 of the Income Tax Ordinance. Furthermore, the definition of "Revaluation Profits" determined that they are "surpluses not subject to corporate tax of the type determined by the Minister of Finance". As of the date of approval of these Financial Statements, not such regulations have been published.

In view of the Company's dividend policy, as stated in Note 23B, such legislation has no significant tax implications for the Company.

(b) On January 4, 2016, the plenum of the Knesset approved the Law for Amendment of the Income Tax Ordinance (No. 216) 5776-2016, which determined, *inter alia* a decrease in the corporate tax rate, commencing 2016 and onwards, by a rate of 1.5%, to 25%.

On December 29, 2016, the Economic Arrangements Law (Legislative Amendments to Achieve the Budget Targets for 2017 and 2018), 5777-2016 was published in the Official Gazette, in the framework of which the corporate tax rate will be reduced from 25% to 24% in 2017 on income generated or accrued from January 1, 2017 and shall continue to be reduced to 23% in 2018 forth on income generated or accrued from January 1, 2018.

As a result of the said legislation, there is a decrease in the deferred tax liabilities of the Company as of December 31, 2016 in the sum of approx. NIS 420 million and a decrease in the balances of the deferred tax assets in the sum of NIS 12 million which was recorded against other comprehensive income for 2016 in the sum of approx. NIS 408 million, of which a sum of approx. NIS 393 million was recorded against tax income.

(c) On September 17, 2009, the Income Tax Regulations (Determination of interest rate for purposes of Section 3(j)) (Amendment), 5769-2009 were published, in the framework of which the provisions in the Income Tax Regulations (Determination of interest rate for purposes of Section 3(j)), 5746-1986 were changed comprehensively.

The regulations determined a mechanism for the annual update of the interest rate. In view of the aforesaid, notices of the Minister of Finance in respect of determining the interest rate for the purposes of Section 3(j) of the Tax Ordinance, are published in the Official Gazette, as follows:

Note 30 – Taxes on income (Cont.)

A. Details in respect of the tax environment in which the Group operates: (Cont.)

(1) Amendments to the Income Tax Ordinance and the Land Appreciation Tax Law (Cont.)

(c) (Cont.)

The interest rate for purposes of Section 3(j) of the Ordinance for 2016 was set at 2.56% (2015 – 3.05%, 2014 – 3.23%).

On January 1, 2017, a notice of the Minister of Finance in respect of determining the interest rate for the purposes of Section 3(j) of the Ordinance for 2017 at the rate of 2.56%, was published in the Official Gazette.

Conversely, where the loans are extended in foreign currency (as defined in the Regulations), the interest rate for purposes of Section 3(j) has been set as the rate of the change of the exchange rate for that currency plus 3%.

(2) The Company and a subsidiary have a holding (90%-99%) in American partnerships, which hold real property. The profits (losses) of the American partnerships from the rental of the real properties and from the sale thereof are attributable directly to the partners, in accordance with their shares in the capital, because under American tax law, a partnership which has been registered in the USA is considered to be transparent for tax purposes.

Accordingly, the Group will be attributed the profits (losses) of the American partnerships in which it serves as a limited partner and accordingly will be liable for tax in the USA in respect of the profits, attributed thereto as aforesaid in accordance with the Federal corporate tax rate (at a rate of 15%- 35%) and Texas state tax (whose rate on December 31, 2016 was 0.75% of the “taxable margin”, as defined in the law), which constitutes an expense for the purposes of the calculation of the Federal tax. In addition, under certain circumstances, a "branch tax" at the rate of 12.5% may be levied on part of the profits of the partnerships (even if not yet actually distributed). If such profits are reinvested for business in the USA and subject to compliance with additional conditions, the "branch tax" may be deferred.

In a similar manner, the general partners in the American partnerships will be liable for tax in the USA in respect of their share (1%) of the profits (losses) from the rental of the real properties and/or from the sale thereof, in accordance with the tax rates that are mentioned above (with the exclusion of "branch tax").

In accordance with the provisions of Section 63 of the Ordinance, the limited partners (the Company and its subsidiary), will be liable for corporate tax in Israel in respect of their share of the profits from the rental of the land in the USA and in the real capital gain that is derived from their sale by the American partnerships.

In the case of tax payable in the USA, in respect of which it is not possible to obtain a tax credit in Israel in the tax year in which it was paid, *inter alia*, by reason of losses for tax purposes incurred by the subsidiary - a credit may be obtained in respect thereof (in adjusted values, in accordance with the rate of the rise in the CPI) against the tax imposed on the subsidiary in Israel in respect of revenues from lease overseas in the 5 subsequent years.

(3) The Company has a holding (100%) in U.S. subsidiaries that are liable for tax in the USA. The subsidiaries are liable for Federal Tax rate on the companies’ current income and capital gains from the sale of the real properties of 35%, and for Texas state tax.

Note 30 – Taxes on income (Cont.)

B. Tax revenues (expenses) on income recognized in the income statement:

	For the year ended December 31		
	2016	**2015(*)**	**2014(*)**
	NIS in thousands	**NIS in Thousands**	**NIS in thousands**
Current tax revenues (expenses)			
For the current period	(171,090)	(194,446)	(183,105)
Net taxes in respect of previous years	3,728	1,072	(4,782)
	(167,362)	(193,374)	(187,887)
Deferred tax income (expenses)	118,339	(162,282)	(120,947)
Total expenses of taxes on income	(49,023)	(355,656)	(308,834)

(*) Re-presented due to discontinued operations, see Note 8.

Note 30 – Taxes on income (Cont.)

C. Taxes on income in respect of the components of other comprehensive income:

	2016			2015			2014		
	Amounts before tax	Tax income (expenses) (*)	Amounts net of tax	Amounts before tax	Tax income (expenses) (*)	Amounts net of tax	Amounts before tax	Tax income (expenses) (*)	Amounts net of tax
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Translation differences from foreign operations	(11,392)	-	(11,392)	1,506	-	1,506	91,239	-	91,239
Profit (loss) for cash flow hedge	-	-	-	-	-	-	95	2	97
Change in the fair value of financial assets available for sale (**)	108,114	(12,170)	95,944	30,677	(12,505)	18,172	(51,865)	13,394	(38,471)
Actuarial profits (losses) due to defined benefit plan	(15)	(2)	(17)	(1,327)	350	(977)	310	(89)	221
Total other comprehensive income	96,707	(12,172)	84,535	30,856	(12,155)	18,701	39,779	13,307	53,086

(*) The deferred taxes have been calculated in accordance with a tax rate of 23%-24% (in 2014 and 2015 according to 26.5%).
(**) In 2016, the sum is net of disposition of financial assets available for sale in the sum of NIS 26,429 thousand (NIS 19,822 thousand net of tax).

Note 30 – Taxes on income (Cont.)

D. Compatibility between the theoretical tax on the income before income taxes and the tax expenses:

	For the year ended December 31		
	2016	2015(*)	2014(*)
	NIS in thousands	NIS in thousands	NIS in thousands
Income before income taxes	1,865,695	1,282,248	1,059,164
The Company's principle tax rate	25%	26.50%	26.50%
Tax calculated at the Company's principle tax rate	466,424	339,796	280,678
Addition (saving) in the tax liability in respect of:			
Different tax rates and laws in subsidiaries that operate outside of Israel	(12,670)	4,312	21,000
Net of tax calculated in respect of the Company's share in the losses of associates accounted for by the equity method	2,109	2,268	2,529
Exempt income	(3,457)	(3,584)	(2,895)
Recording of a reserve for tax on an investment in a consolidated company	-	2,754	3,410
Expenses not recognized	2,333	2,246	4,732
Company's share in partnerships	(1,182)	(1,615)	(1,674)
Utilization and creation of deferred taxes in respect of losses and benefits from previous years, in respect of which deferred taxes were not recorded	(11,498)	(9,492)	(13,598)
Losses and benefits for tax purposes from the period in respect of which deferred taxes were not recorded	5,540	14,385	7,291
Taxes in respect of previous years	(3,728)	(1,072)	4,782
Differences in the definition of capital, assets and expenses for tax purposes and others	901	5,535	649
Effect of the change in the statutory tax rate	(392,816)	-	-
Other differences	(2,933)	123	1,930
Tax expenses on income	49,023	355,656	308,834

(*) Re-presented due to discontinued operations, see Note 8.

Note 30 – Taxes on income (Cont.)

E. Deferred tax assets and liabilities:

(1) Deferred tax assets and liabilities that have been recognized

The deferred taxes in respect of companies in Israel have been calculated in accordance with the tax rates that are expected to apply at the time of the reversal, as detailed above. Deferred taxes in respect of subsidiaries that operate outside of Israel have been calculated in accordance with the relevant tax rates in each country.

The deferred tax assets and liabilities are attributed to the following items:

	Real estate	Employee benefits	Financial instruments (1)	Deductions and losses to be carried forward for tax purposes	Others (2)	Total
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Deferred tax as of January 1, 2015	(2,768,373)	14,347	(93,008)	65,201	64,880	(2,716,953)
Changes carried to profit and loss (3)	(170,015)	(4,426)	(777)	5,658	3,425	(166,135)
Changes carried to other comprehensive income	-	350	(12,505)	-	-	(12,155)
Others	-	12	-	215	(328)	(101)
Exit from consolidation	4,365	-	-	-	-	4,365
Entry into consolidation	(86,229)	543	-	2,826	(7,005)	(89,865)
Deferred tax as of December 31, 2015	(3,020,252)	10,826	(106,290)	73,900	60,972	(2,980,844)
Changes carried to profit and loss (3)	(285,311)	(2,508)	(950)	8,191	(2,559)	(283,137)
Changes carried to other comprehensive income	-	-	(25,896)	-	-	(25,896)
Effect of the change in the tax rate carried to profit and loss	406,161	(82)	36	(10,847)	(810)	394,458
Effect of the change in the tax rate carried to other comprehensive income	-	(2)	13,726	-	-	13,724
Others	35	-	-	(87)	-	(52)
Exit from consolidation	48,548	(4,489)	13,485	(16,826)	(47,818)	(7,100)
Entry into consolidation	(81,838)	835	-	76,689	420	(3,894)
Deferred tax as of December 31, 2016	(2,932,657)	4,580	(105,889)	131,020	10,205	(2,892,741)

(1) Primarily for financial assets available for sale and financial asset – receivables in respect of franchise arrangement.

(2) Primarily doubtful debts and linkage differentials on deposits from customers.

Note 30 – Taxes on income (Cont.)

E. Deferred tax assets and liabilities: (Cont.)

(1) Deferred tax assets and liabilities that have been recognized: (Cont.)

(3) In 2015, including deferred tax income in the sum of NIS 1,883 thousand in respect of a disposal group classified as held for sale.

In 2016, including deferred tax income in the sum of NIS 7,018 thousand due to discontinued operations (in 2015 – NIS 1,970 thousand).

(*) The deferred taxes have been calculated mainly at a tax rate of 23% (for details regarding changes in the tax rate – see Note 30A(1)B).

(2) Deferred tax assets that have not been recognized

Deferred taxes not recognized in respect of the following items:

	As of December 31	
	2016	2015
	NIS in thousands	NIS in thousands
Losses for tax purposes	107,540	82,998
Capital loss for tax purposes	151,801	217,973
Real difference from securities	6,905	6,905
	266,246	307,876

(3) Losses and deductions for tax purposes that are available to be carried forward to the coming years

(a) The current business losses for tax purposes of consolidated companies, which are carried forward to the following year amount as of December 31, 2016 to approx. NIS 492 million (December 31, 2015: approx. NIS 254 million).

As of December 31, 2016, consolidated companies have recorded a deferred tax asset in an amount of NIS 94 million in respect of the accumulated business losses (December 31, 2015 – NIS 51 million) in accordance with the management's evaluation that there is a high level of confidence that these losses will be realized in the coming years.

(b) A consolidated company has a real difference on marketable securities that have not been allowed as a deduction in the reporting year and which are available to be carried forward to the coming years, whose balance is approx. NIS 7 million as of December 31, 2016 (December 31, 2015 – NIS 7 million). This difference will be allowable as a deduction in the coming years only against income from marketable securities, if there is such income in those years. Deferred taxes assets have not been created in respect of these accumulated losses.

(c) The Company and consolidated companies have accumulated capital losses for tax purposes in an amount of approx. NIS 302 million (December 31, 2015 – approx. NIS 306 million). The Company and consolidated companies recorded deferred tax assets in the sum of NIS 35 million in respect of the accumulated capital losses (December 31, 2015 – NIS 23 million).

Note 30 – Taxes on income (Cont.)

E. Deferred tax assets and liabilities: (Cont.)

(3) Losses and deductions for tax purposes that are available to be carried forward to the coming years (Cont.)

(d) According to the existing tax laws, there is no time restriction for the exploitation of losses for tax purposes, or on the exploitation of the deductible temporary differences. Deferred tax assets have not been recognized in respect of such losses and differences, in cases where it is not expected that there will be sufficient chargeable income in the coming years against which it will be possible to exploit the tax benefits.

(e) The Group does not create deferred taxes that relate to investments in consolidated companies in respect of which the decision as to the disposition thereof is in the Group's hands whenever there is no decision to realize them in the foreseeable future.

F. Tax assessments:

The Company and some of the consolidated companies have final tax assessments until tax year 2010 inclusive.

On December 5, 2016 the Israel Tax Authority issued to the Company and Canit Hashalom Investments Ltd., a subsidiary wholly owned by the Company, tax assessments to the best of judgment (the "**Assessment**") in the sum total of approx. NIS 170 million for the years 2011-2014 (inclusive). It is noted that with respect to parts of the amount of the Assessment, the Company's financial statements include a liability for taxes.

The Company disputes the Israel Tax Authority's positions and is of the opinion, inter alia in reliance on its professional advisors, that it has good arguments against these positions. Therefore, the Company submitted, in January 2017, an objection to the Assessment. In the Company's estimation, no material effect on the Company's financial statements is expected.

Some of the consolidated companies have tax assessments to the best of judgement in immaterial amounts and several other companies have final tax assessments up to and including the tax years 2011- 2014.

Save for the above mentioned companies, the Group's other companies have final tax assessments up to and including the 2013 tax year, in the framework of Section 145(a)(2) of the Income Tax Ordinance (Prescription).

Note 31 – Engagements

The consolidated companies have engagements and liabilities as of the Date of the Statement of Financial Position, as follows:

A. Material engagements:

	NIS in thousands
(1) For the purchase of fixed assets	258
For the performance of projects	1,319,060
For rentals and leases (*)	31,301
For operating leasing agreements for motor vehicles	6,269
(*) Following are the repayment times for rental and leasing undertakings:	
2017	11,437
2018	8,588
2019	6,982
2020	3,528
2021 forth	766
	31,301

(2) With respect to the engagements with related and interested parties, see Note 37.

B. Additional engagements:

(1) The Company and its subsidiaries engaged with OPC Rotem Ltd. ("**OPC**"), a private electricity producer, in an agreement to purchase electricity. In addition, the companies of the Group engaged in a parallel agreement between them, which regulates the relationship between the companies of the Group in relation to the aforesaid agreement. Pursuant to the agreement, OPC shall sell electricity to the companies of the Group in the volume that is set forth in the agreement, in consideration for a tariff which varies according to actual consumption which is based on the tariffs of the Israel Electric Corporation Ltd. (the "**IEC**"), net of various discount rates determined in the agreement, which depend on the companies' volumes of consumption. The agreement is effective for a 15-year period, commencing from July 2013. The agreement sets forth special conditions that allow the parties to terminate it by giving an advance notice. In the event that OPC's power plant does not work and does not supply electricity for any reason whatsoever, electricity shall be supplied directly from the IEC. The agreement sets forth maximum and minimum volumes of electricity consumption by the companies of the Group. In the event of failure to meet the minimum volumes, the discount shall be gradually reduced.

The Company reserves the right to purchase 100 megawatt hour more, in the event of the construction of an additional power plant by OPC's parent company.

(2) In July 2013, Supergas Natural Ltd., a consolidated company of Supergas, signed an agreement with the partners in the Tamar holding for the supply of natural gas for a period of 5 years, whereby Supergas Natural Ltd. shall purchase natural gas from the sellers for the marketing thereof to its customers. Due to non-fulfillment of conditions that were defined in the agreement, Supergas Natural is not subject to an obligation to purchase natural gas.

Note 31 – Engagements (Cont.)

B. Additional engagements: (Cont.)

(3) Investee companies of Supergas (50%), hold licenses for the establishment and operation of a natural gas distribution network in the center of Israel and in the Hadera and valleys area. The licenses for the center of Israel and for Hadera and the valleys were received in November 2009 and April 2013, respectively, and are for a 25-year period. Pursuant to the terms of the licenses, the companies are required to invest approx. NIS 160 million in the establishment of the distribution network in the center of Israel and approx. NIS 218 million the in Hadera and the valleys area, according to the milestones determined in the licenses. Until December 31, 2016 a total amount of approx. NIS 134 million was invested. According to the terms and conditions of the licenses, the companies will receive their income from one-time connection fees and from a distribution fee tariff, as specified in the license. As of the Report Date, the companies are still at the stages of setting up the distribution network. In view of bureaucratic and regulatory difficulties which are delaying the progress of the chain's rollout and connection of the consumers, the distribution companies are working to update the timetables that were determined in the licenses. Supergas' management estimates that in view of the fact that the delays described above are not controlled and/or caused by Supergas, the terms and conditions determined in the licenses will be updated.

(4) Supergas engaged with a third party company in an agreement for cooperation respect to natural gas, in which it was agreed, *inter alia*, that:
(1) The third party company would be entitled to 30% of the profit from the marketing of the natural gas of Supergas to be supplied through the distribution network to customers in areas in which Supergas and the third party company have licenses to set up and operate a natural gas distribution network; (2) a company would be established which would act as the contractor to set up the distribution networks which would be held 70% by the third party company and 30% by Supergas.

(5) Azrieli E-Commerce Ltd. ("**Azrieli E-Commerce**") cooperates with several commercial companies in the internet industry, which contributes to Azrieli E-Commerce's operations and the services which it provides to internet users and its customers.

(6) On May 20, 2015, a consolidated company, Ahuzat Bayit Raanana – Retirement Home Ltd., entered into a trust agreement with a trust company, whereby it will serve as the trustee of the residents of the retirement home for the purpose of registration of the mortgages in their favor. Pursuant to the agreement, the consolidated company registered a first ranking mortgage in favor of the trust company at the Land Registry, on a majority of the sub-parcels that constitute the land of the retirement home. The consolidated company is acting to complete the registration of the mortgage in favor of the trust company on all of the sub-parcels of the retirement home.

(7) On November 16, 2014 Ahuzat Bayit Raanana – Retirement Home Ltd. ("**Ahuzat Bayit**") entered into a contract with former controlling shareholders thereof to separate the past activities (the "**Separation of Past Activities Contract**"), in which its former controlling shareholders undertook to indemnify Ahuzat Bayit for all Past Debts, such that Ahuzat Bayit will not be required to itself bear any Past Debt, and that Ahuzat Bayit shall transfer to its former controlling shareholders assets deriving from past activities.

Note 31 – Engagements (Cont.)

B. Engagements for investments: (Cont.)

(7) (Cont.)

For this purpose, Past Debts – any liability of any kind whatsoever which applies to Ahuzat Bayit and which derives, directly or indirectly, from the known debts, the existing legal proceedings and the additional debts, without exception, and including legal costs, consultants' costs and any additional liability payment and/or expense relating thereto, and all with the exception of: (1) Debts in connection with the land, the "Ahuzat Bayit" senior home business and the "Park Mall" shopping center, directly and/or indirectly, whether the cause thereof precedes or is subsequent to the date of signing of the Separation of Past Activities Contract; (2) Undertakings for payment of loans/capital notes of any kind whatsoever, including banks and other third parties – and all as provided in the contract. It is clarified that in the context of transfer of control of Ahuzat Bayit, an investee company of the Company and Ahuzat Bayit received a letter of undertaking from the former controlling shareholders, whereby the liability of the former controlling shareholders for the past activities in Ahuzat Bayit, remains in effect.

To secure the said indemnity, the seller placed a deposit in escrow in the sum of approx. NIS 5.2 million.

(8) Azrieli Holon Center

The Group, via Canit Hashalom, is the owner of leaseholds in a reserve of land of a total area of approx. 34,000 sqm in the East Holon Industrial Area (in this section: the "**Land Reserve**") under an agreement that was signed between the City of Holon and Canit Hashalom on June 5, 2008 (in this section: the "**Agreement**") and approved by the Minster of the Interior in December 2008. Within the framework of the Agreement, Canit Hashalom made guarantees available to the Economic Company for the Development of Holon Ltd., which is intended to ensure the compliance with Canit Hashalom's undertakings under the Agreement. As of the date of the financial statement, the balance of the inspection guarantee is NIS 1.1 million.

The entire Land Reserve is owned by the City of Holon, without any known charges or mortgages. In accordance with the Agreement the project is for the construction of a business park (with no more than four sub-stages), including buildings for hi-tech offices, display halls and retail, service areas and parking areas as well as for additional uses (the "**Project**"). The Project will be built and operated as an income-producing property (for rental) by way of a joint venture, where the material terms of the transaction are as follows:

Note 31 - Engagements (Cont.)

B. Engagements for investments: (Cont.)

(8) Azrieli Holon Center (Cont.)

(a) The City of Holon is leasing to Canit Hashalom, in accordance with the Agreement, for a period of 99 years with an option for an additional 99 years for a payment, 83% of the areas and land of the Project.

(b) The Project is managed and operated by the Company as an income-producing property that is held jointly by the two parties, where the areas of the Project are leased as a common reserve for the two parties. The areas are leased through a management company wholly owned by the Company, and the division of the rent is carried out using a mechanism that has been agreed by the two parties.

(c) The Project is managed by a management company. Management is executed on the basis of cost +15%, which constitute the fees of the management company.

(d) The Agreement sets various restrictions on the transfer of rights in areas in the Project and/or in the rights and undertakings of Canit Hashalom thereupon. It is further determined in the Agreement that the transfer of shares, including by way of a public offering, in shares of Canit Hashalom in an amount of up to 25% will be permitted. It is further clarified that the provisions relating the transfer of rights and a change in the ownership structure will not apply to the parent company or to a subsidiary or an affiliate of Canit Hashalom.

(e) The Group treats this Project as a joint operation.

Note 32 - Charges and guarantees

A. Fixed and floating charges:

	As of December 31, 2016 NIS in thousands	As of December 31, 2015 NIS in thousands	Secured by
Short-term credit from banks	9,085	818,699	In a consolidated company a floating charge on credit cards. In another consolidated company, floating charges on all the assets of the consolidated company and fixed charges on shares of an investee company thereof, goodwill and an asset of its investee company. In addition, fixed and floating charges have been registered on assets of consolidated companies thereof, including on the rights existing in any agreements.
Long-term loans from banks and others (including accumulated interest that is presented as short-term)	2,663,590	2,837,239	A charge on the rights to receive monies in respect of investment property of the Company and of some of the investee companies. The book value of the pledged assets – approx. NIS 5.4 billion. In a consolidated company, a floating charge was registered on all the assets of a consolidated company thereof, including rights deriving therefrom and a fixed charge on shares of an investee company thereof, insurance rights and rights deriving from an asset of a consolidated company. The value of the pledged asset of the consolidated company is approx. NIS 0.1 billion. In another consolidated company, a fixed charge on the consolidated company's assets, including real properties, deposits in banks and revenues from customers. The value of the pledged real properties of the consolidated company is approx. NIS 0.7 billion.
Bonds (including accumulated interest)	397,530	432,724	In a consolidated company, the bonds are collateralized by a first ranking floating charge, in an unlimited amount, on all of the assets of the consolidated company. In addition, the investee company has created a first ranking fixed charge in an unlimited amount over all of the shares in the consolidated company that it owns and in its holding, including the rights that derive from those shares. The value of the pledged assets of the consolidated company is approx. NIS 0.4 billion.

Note 32 - Charges and guarantees (Cont.)

A. Fixed and floating charges: (Cont.)

	As of December 31,		
	2016	2015	
	NIS in thousands	NIS in thousands	Secured by
Tenant deposits	630,436	291,688	On the date of the entrance of tenants, the consolidated company registered a caveat in favor of the tenants or the depositors, the purpose of which is to ensure the refund of the deposit balance. Currently, the land is in a process of registration of the condominium. Upon the completion of the process, the consolidated company will register a mortgage for every tenant on his apartment, in lieu of the caveat. Pursuant to the provisions of the Senior Housing Law which took effect on June 3, 2015, the consolidated company is required to provide the tenants with collateral. The options for collateral include, *inter alia*, a bank guarantee or a mortgage. The consolidated company is acting, as stated, to register mortgages in favor of the tenants. Insofar as the condominium registration process will not be completed, and it will not be possible to register mortgages in favor of the tenants, the consolidated company will examine additional options as required by law. In a consolidated company, a first-ranking mortgage was registered in favor of the tenants during the Report Period at the Land Registry. In addition, to secure some of the undertakings of the consolidated company in respect of deposits, caveats were registered at the Land Registry in favor of the tenants.

(*) The Company committed to banks, financial institutions and in the indentures to the bonds that it would not create floating charges over its entire assets. The Company may create a floating charge as aforesaid, provided that concurrently with the creation thereof, it will create a floating charge to the benefit of the lender as well. The Company also committed, irrevocably, to a bank that it had not created and will not create a floating charge over its entire property and assets, whether they are owned thereby or will be owned thereby in the future, including over the goodwill and share capital thereof, and it also committed towards another bank not to commit in any manner to create a floating charge as aforesaid, without the advance written agreement of the bank.

(**) In addition, to secure the conditions relating to a certificate of approval of the Investment Center, a floating charge was registered at a consolidated company on all of the machines, equipment, facilities and land thereof in favor of the State of Israel.

Note 32 - Charges and guarantees (Cont.)

B. The Company and consolidated companies have contingent liabilities:

		As of December 31	
		2016	2015
		NIS in thousands	NIS in thousands
(1)	Financial guarantees to banks:		
	Financial guarantees to banks for associates and third parties	3,281	5,534
	Financial guarantees to banks extended by a consolidated company for a consolidated company thereof	60,000	66,000
(2)	Performance guarantees and others:		
	- Performance guarantees for customers and others, including tender guarantees	42,442	59,892
	- Guarantees to authorities - of which sum of c. NIS 74 million due to demands for betterment levies.	130,092	162,407
(3)	Guarantees to suppliers	-	20,000
(4)	Guarantees to lessor in respect of usage rights for LTC units.	1,200	-
(5)	Guarantees for undertakings in respect of tenants.	5,628	-
(6)	A guarantee extended by a consolidated company in favor of a consolidated company thereof in respect of its liabilities to banks.	40,549	46,787
(7)	A guarantee extended by a consolidated company in favor of a consolidated company thereof in respect of its liabilities to its customers.	24,000	24,000
(8)	Guarantees and letters of indemnification given by a consolidated company to banks financing projects of former controlling shareholders of the consolidated company, which shall remain in effect until the completion of such projects. For such guarantees, the consolidated company received an indemnity from the former controlling shareholders (see Note 31B(7)).	2,814	-

(*) In addition to details regarding guarantees in connection with the sale of Sonol, see Note 8 regarding discontinued operations.

(**) In addition, guarantees given by the Company and an investee company to consolidated limited partnerships thereof overseas and to consolidated companies thereof overseas, for their liabilities to financial corporations, which are enforceable only in several specific cases defined in the loan agreements (Bad Boy).

Note 33 - Contingent liabilities

A. Class actions and claims in respect of which motions for class certification were filed:

The parties	Amount of claim	Nature of claim	Prospects of claim
1. Claim against the Company and a consolidated company.	If not certified as a class action – NIS 4,561. If certified as a class action only in relation to the class of offerees whose shares were subject to a forced purchase – approx. NIS 18 million. If certified as a class action in relation to all offerees – approx. NIS 157 million.	In August 2013, a motion for an appraisal remedy pursuant to Section 338 of the Companies Law, 5759-1999, and a motion for cancelation of the tender offer, as well as a motion for class certification thereof were filed against the Company and against Canit Hashalom with the Economic Division of the Tel Aviv District Court by a petitioner alleging to have been an offeree in the framework of a full tender offer that was completed by the Company at the end of September 2012, for shares that were held by the public in Granite Hacarmel Investments Ltd. (despite the lapse of the six (6) month period set forth in the law for the filing of a claim for an appraisal remedy). The claim alleges, *inter alia*, that the petitioner was forced to sell his shares to the Company in the tender offer at a price lower than the value of the shares and that the conditions for performance of a forced purchase pursuant to the tender offer were not fulfilled and that therefore it was not possible to delist Granite Hacarmel Investments Ltd.	During the Report Period the parties reached a settlement in immaterial amounts, on which a judgment was entered.

Note 33 - Contingent liabilities (Cont.)

A. Class actions and claims in respect of which motions for class certification were filed: (Cont.)

The parties	Amount of claim	Nature of claim	Prospects of claim
2. Claim against Supergas	A claim in the sum total of approx. NIS 40 million	A claim and a motion for class certification of March 2014. The action concerns a claim of collection of money by Supergas contrary to law and/or to agreement by Supergas raising gas rates per cubic meter and the fixed usage fees, without detailing the manner of calculation and/or informing the customers of the price rise. In addition, it was claimed in the action that Supergas is raising prices to which it committed in discount agreements vis-à-vis the petitioners, contrary to the agreements and without updating the petitioners regarding the price rise in advance and/or retroactively.	On February 2, 2017 the court granted class certification only on the grounds of a breach of the duty of announcing the raising of gas prices or fixed usage fees, starting 7 years prior to the filing of the claim. In the estimation of the Company, based on the estimation of Supergas' management, in reliance on its legal counsel, with respect to the majority of Supergas' customers, the chances of Supergas having the monetary remedy in the claim dismissed, exceed 50%. With respect to a minority of customers, in accordance with Supergas' calculations, Supergas' management believes that the exposure to a monetary remedy, if any, is immaterial.
3. Claim against three gas companies, including Supergas	Claim and motion for class certification from November 2016. Amongst the remedies sought is the demand to refund amounts collected, allegedly in excess, from the customers of the defendant companies. The motion does not state an amount.	Claim and motion for class certification with the argument that Supergas and additional gas companies allegedly breached the Restrictive Trade Practices Law, by being a party to a restrictive arrangement, and the existence of a cartel between Supergas and other gas companies.	In the Company's estimation, based on the estimation of Supergas, in reliance on the legal counsel thereof, the chances of the motion for class certification are less than 50%.

Note 33 - Contingent liabilities (Cont.)

A. Class actions and claims in respect of which motions for class certification were filed: (Cont.)

The parties	Amount of claim	Nature of claim	Prospects of claim
4. Claim Against Azrieli E-Commerce	Claim and motion for class certification from January 2017 in the amount of approx. NIS 10 million.	Claim and motion for class certification. Underlying the claim, are arguments on the presentation of a price per measurement unit according to the regulations under the Consumer Protection Law.	In the Company’s estimation, in reliance on the estimation of Azrieli E-Commerce, in reliance on the legal counsel thereof, at this stage it is impossible to estimate the chances of the claim.

B. Other actions:

The parties	Amount of claim	Nature of claim	Prospects of claim
1. A municipality against Supergas	Approx. NIS 13 million.	A demand for the amendment of a municipal tax assessment (including interest and linkage differentials) for a gas container farm, for the years from 1997 through 2004. In addition, Supergas received additional payment demands up to and including 2016.	In the Company's estimation, based on the estimation of Supergas’ management, in reliance on Supergas’ legal counsel, with respect to the claim for retroactive payment, the chances of defeating the city’s demand for payment of municipal tax for past years are higher than 50%. With respect to the challenging of the amended assessment on the merits, from the date of submission thereof, at this preliminary stage it is difficult to estimate the claim’s chances, but in the opinion of the Company’s management, based on the estimation of Supergas’ management, in reliance on Supergas’ legal counsel, Supergas has justified defence claims due to which the chances of the claim are lower than 50%.

Note 33 - Contingent liabilities (Cont.)

B. Other actions: (Cont.)

The parties	Amount of claim	Nature of claim	Prospects of claim
2. An agency operator against Supergas	Approx. NIS 34 million.	A claim from 2004 for monetary refunds in respect of investments made in an agency that was operated for several years by the claimant, and thereafter was returned to Supergas.	Deliberation of the claim was transferred to arbitration. In the Company's estimation, based on the estimation of Supergas' management, based on Supergas' legal counsel, the chances of the claim being accepted over and above the amount paid and for which a provision was made on the books, are lower than 50%.
3. An agency operator against Supergas	Approx. NIS 16.4 million.	A claim from October 2012 filed by a former agent of Supergas and companies owned by him, alleging that Supergas owes them money for work done by them, payments and additional alleged damage.	In the Company's estimation, based on the estimation of Supergas' management, in reliance on Supergas' legal counsel, the chances of the claim are lower than 50%.
4. Payment demand of Supergas	A demand in the sum total of approx. NIS 117.2 million.	In the years 2011-2012, the Local Committee of the City of Kiryat Ata issued betterment levy assessments for the approval of NOP 32/C, following Supergas' application for a building permit for Supergas' gas facility site in Kiryat Ata.	In December 2012, a decision was made by the Appeals Committee whereby the subject matter of the claim does not present a planning event which establishes a betterment levy liability. The City of Kiryat Ata filed a motion for leave to appeal with the court, which granted its motion to file an appeal in November 2015. In January 2016, a counter-appeal was filed according to which, prior to the approval of NOP 32 the gas farm was not subject to the burial obligation and therefore the compensation due to Supergas is higher. In the estimation of the Company's management, based on the estimation of the management of Supergas, in reliance on Supergas' legal counsel, the chances that Supergas will be charged a betterment levy are lower than 50%.

Note 33 - Contingent liabilities (Cont.)

B. Other actions: (Cont.)

The parties	Amount of claim	Nature of claim	Prospects of claim
5. Indictment against Supergas and directors thereof.	Criminal.	In October 2011, the City of Kiryat Ata filed two proceedings against Supergas with the Local Affairs Court in Krayot – (1) an indictment pursuant to the Business Licensing Law in respect of the operation of the gas farm in Kiryat Ata without a business license. This proceeding was filed both against Supergas and against the directors thereof. (2) A motion for a cessation of occupation in a business order, in the context of which the granting of an order against Supergas was sought to order it to immediately halt the gas farm's activity due to the absence of a business license. This motion was filed as an interim motion in the framework of the abovementioned indictment proceeding.	With respect to the motion for a cessation of occupation order – in January 2012, the Court's decision was issued, in which the City's motion was denied. With respect to the indictment proceeding, negotiations are being held between the parties in an attempt to end the proceeding out of court. In the Company's estimation, in reliance on the estimation of Supergas' management, at this stage, and in view of the type of the proceeding, it is impossible to estimate the chances thereof.
6. Claim of a supplier against GES and others.	Approx. NIS 19 million (GES's share NIS 9.5 million).	A subcontractor's claim of December 2013 for a debt allegedly owed to him by GES and additional parties in respect of a settlement of accounts in a project in which GES served as lead contractor together with an additional third party (the "**Lead Contractors**").	In the estimation of the Company's management, based on the estimation of GES's management, in reliance on GES's legal counsel, after the drafting and filing of the Answer, the chances of the amount with which the Lead Contractors will be charged exceeding the sum reserved in the project account are lower than 50%.

Note 33 - Contingent liabilities (Cont.)

B. Other actions: (Cont.)

The parties	Amount of claim	Nature of claim	Prospects of claim
7. Claim in tort against Supergas	A claim in tort in the sum of approx. NIS 36 million which was amended and set at a sum of approx. NIS 70 million.	In August 2015, a claim in tort was filed against Supergas due to alleged damage that occurred in the customer's plant as a result of an alleged failure in the gas system.	Supergas filed an Answer and a third party notice against the plaintiff's insurer. In the estimation of Supergas' management, its exposure in this claim does not exceed its deductible (in an immaterial amount) according to its insurance policy.
8. Investigation Against Supergas	Criminal	In January 2014 an investigation was launched against Supergas and against holders of positions therein, in connection with a gas event which occurred in the same month in an apartment in the Gilo neighbourhood in Jerusalem.	In view of the fact that the investigation of the event has not yet ended, it is impossible to estimate, at this stage, the exposure of Supergas and/or any of the holders of position therein, to any criminal proceeding.
9. A claim against Ahuzat Bayit	Approx. NIS 10 million	Claims for building defects caused, according to the Plaintiffs, in connection with projects previously built by Ahuzat Bayit.	In the Company's estimation, based on the estimation of Ahuzat Bayit, in reliance on the legal counsel of Ahuzat Bayit, Ahuzat Bayit will be required to pay a partial amount out of the said claims. Accordingly, Ahuzat Bayit recorded a provision on its books against the said claims, opposite an asset of an indemnity from the former controlling shareholders of Ahuzat Bayit (see Note 31 B(7)).

C. Additional claims (mostly legal and in insignificant amounts) arising from the ordinary course of business have been submitted against the Group companies.

D. The Group recorded provisions against the claims in the sum of approx. NIS 8 million (December 31, 2015 – NIS 65 million). In the estimation of the Company's management (and in respect of the Granite Group companies, based on the estimation of the management of the companies in the Granite Group), the provisions recorded to settle the results of the claims outlined above are fair.

Note 34 - Management of financial risks

A. General:

The Group is exposed to the following risks, which derive from the use of financial instruments:

- Credit risk.
- Liquidity risk.
- Market risk (including currency risk, interest risk and other price risks).

Information is provided in this Note in respect of the Group's exposure to each of the abovementioned risks, the Group's objectives, its policy and its processes in respect of the measurement and management of the risk. Additional, quantitative disclosure is provided throughout these Consolidated Financial Statements (the note does not include quantitative information regarding liquidity risk, interest risk and credit risk exposures of balances in respect of assets and liabilities of a disposal group which is classified as held for sale).

The comprehensive responsibility for the institution of the framework for the management of the financial risks of the Company and of its subsidiaries (except for the management of the risks of Granite and of its subsidiaries, of Palace, Ahuzat Bayit Ra'anana and Azrieli E-Commerce which is executed by them) (the "**Company**") and for the supervision thereof lies in the hands of the Company's management.

The Company's Finance Committee is responsible, *inter alia*, for supervision and monitoring of the management of the Company's financial risks, and supervises the management of implementation of its resolutions.

The person in charge of financial risks management in the Company is Ms. Irit Sekler-Pilosof, the Company's CFO.

The Company's managers routinely examine the market risks in the fields of interest, the index and the exchange rates and act to reduce the economic exposure that is inherent in those risks, whilst taking cost-benefit considerations, such as changes in the composition of the long-term and short-term bank credit, into account.

B. Credit risk:

Credit risk is the risk of a financial loss that would be caused to the Group if a customer or a counter party to a financial instrument does not meet its contractual commitments, and it derives primarily from the debts of customers and other receivables, from the long-term loans that have been extended and from investments in securities.

The Group has no significant credit risk from its customers in the retail centers and malls segment, the office and other space for lease segment and the income-producing property in the USA segment, since the Group collects its income in respect of rent and management fees in advance. Moreover, in most cases, as collateral for the rent, the tenants are required to prove personal guarantees from third parties and/or bank guarantees and/or deposits, to the Company's satisfaction.

The Group has no significant credit risk from its customers in the senior housing segment, since the Group collects a significant portion of the deposit required of the tenant prior to his entrance to the apartment.

The Group has a credit risk deriving from companies in the Granite Group. The income of the companies in the Granite Group derives primarily from sales in Israel to customers in the gas segment and from sales to customers in the water and wastewater segment.

Note 34 - Management of financial risks (Cont.)

B. Credit risk: (Cont.)

The companies in the Granite Group have a procedure for the extension of credit to a customer, which includes guidelines in respect of what is to be done when a new customer is opened, the procedure includes, *inter alia*, a check on its financial position, a check on stability and control over the credit extended to the customer, which relies on past experience and external raisings, as well as, where possible, the receipt of collateral, such as: bank guarantees, personal guarantees, charges on land, motor vehicles, and debt notes.

Moreover, the procedure includes a hierarchy of authority for the approval of the maximum amount of a customer's credit, which starts with the credit manager and going up to the credit committee, which is headed by the Chief Executive Officer of each subsidiary. The procedure on authorities for the approval of credit is presented to the financial forum of the boards of directors of each of the subsidiaries for approval. The procedure determines and defines a framework of responsibility for the collection of the payment from customers and also the ways in which customers' balances that are in arrears are to be dealt with. The routine monitoring of the receipts from customers is conducted by the credit and collection departments and by the credit committees and management in each subsidiary.

The Companies in the Granite Group recognize provisions for doubtful debts, which reflect their evaluation made in respect of the loss that is contained in the debts whose collection is in doubt. This provision is made up of specific balances as well as a general component of the loss, which is determined for certain groups of similar customers, in respect of losses that have occurred, but which have not yet been identified.

The abovementioned general provision for a loss is determined on the basis of historical information in respect of the payments statistics in respect of similar financial assets.

C. Liquidity risk:

Liquidity risk finds expression in the non-ability to meet the Group's financial commitments when they are due for payment. The Group's approach to the management of its liquidity risk is to ensure, in so far as it is possible, that there is a sufficient level of liquidity to meet its commitments on time. The Group verifies the existence of sufficient levels of cash and/or credit lines in accordance with the expected needs for the payment of the operating expenses, including the amounts that are required to meet the financial liabilities; the aforesaid does not take into account the potential impact of extreme occurrences, which it is not reasonably possible to forecast.

The Group is of the opinion that at the time of need, financing entities will grant it the credit required thereby for the purposes of its business.

D. Market risks:

Market risk is the risk that changes in market prices, such as the exchange rates of foreign currencies, the CPI, interest rates, the prices of capital instruments and risks associated with the prices of goods, will have an impact on the Group's income or on the value of its holdings in financial instruments and on inventory balances.

The objective of the management of the market risks is to manage and to supervise the exposure to market risk within the framework of generally accepted parameters.

Note 34 - Management of financial risks (Cont.)

D. Market risks: (Cont.)

Currency risk

The Company's functional currency is the New Israeli Shekel (NIS).

The Group has loans in U.S. dollars, therefore its financial results are exposed to the risk of a change in the dollar exchange rate. Most of the Group's income in the income-producing property in the USA segment is stated in U.S. dollars, such that a rise in the exchange rate as aforesaid leads to an increase in income from rent and in the value of the property and reduces this risk.

Companies in the Granite Group are exposed to currency risk in respect of the purchase of raw materials, fixed assets and export sales, which are stated in currencies that are different from the functional currency. The currencies in which most of the transactions are stated which are not NIS are the Euro and the US Dollar (most of the purchases of oil distillates are linked to the US Dollar). The companies examine, on an ongoing basis, the assets and the financial liabilities stated in foreign currency in order to mitigate the risks deriving from the changes in the exchange rates. The companies examine use of forward transactions for the purpose of hedging their currency risk.

Interest rates risk

The Group has short-term and long-term credit at variable interest rates. Accordingly, its financial results (financing income/expenses) are exposed to the risk of a change in the interest rates.

Index risks

The Group has loans and bonds that are Index-linked, and therefore its financial results (financing income/expenses) are exposed to the risk of a change in the Index.

Most of the Group's income in the retail centers and malls segment and in the office and other space for lease segment are linked to the CPI, such that an increase in the Index, as aforesaid, will lead to an increase in the rent income and a reduction in this risk.
Furthermore, the index rise bears an impact on the calculation of the value of investment properties due to the increase in rent revenues.

Companies in the Granite Group purchase from time to time forward transactions on the CPI, in accordance with the outline that was approved by their boards of directors. As of the date of the Financial Statements, there are no forward contracts on the CPI.

The companies in the senior housing sector have exposure in respect of the effect of changes in the CPI on the deposits of the tenants in the retirement home, which are linked to the CPI.

Currency risk - cash

As of December 31, 2016, a small part of the cash is managed overseas in the dollar currency, and therefore the Company may be exposed to fluctuations in the currency exchange rates. In general, and other than as specified by the Company in the 2010 Prospectus, the Company takes no protective measures against such exposures.

In addition, the Company has a material holding in Bank Leumi’s shares that are traded in TASE. Changes in the rate of Bank Leumi’s share may affect the equity. The Company does hedge against such exposures (see also Note 2U).

Note 34 - Management of financial risks (Cont.)

D. Market risks: (Cont.)

Risks associated with the prices of goods

The inventory in Supergas is comprised primarily of oil distillates and accordingly they are exposed to changes in the prices of oil distillates. Supergas acts to reduce the quantity of inventory that is exposed and adjusts the quantities of the inventory of distillates in accordance with the sales forecasts.

Note 35 - Financial instruments

A. Credit risk:

(1) Exposure to credit risk

The book value of the financial assets represents the maximum credit exposure. The maximum exposure to credit risk, as of the Date of the Statement of Financial Position, was as follows:

	Book Value	
	As of December 31	
	2016	2015
	NIS in thousands	NIS in thousands
Financial assets at fair value through profit and loss:		
Financial assets held for trading	572	506
Derivative financial instruments	-	1,584
Financial assets at amortized cost:		
Short-term deposits and investments	657,714	35,796
Trade accounts receivable	288,376	1,102,160
Other receivables	60,719	67,684
Receivables for work in progress	5,428	19,206
Non-current loans	154,513	106,189
Restricted investments	21,706	21,470
Loans to associates	78,924	70,535
Receivables in respect of franchise arrangement	57,426	45,639
	1,325,378	1,470,769

The maximum exposure to credit risk in respect of trade accounts receivable, other receivables, including derivative financial instruments, receivables for work in progress, long-term loans , as of the Report Date, by geographical region, is mainly local and the exposure overseas is negligible.

Note 35 - Financial instruments (Cont.)

A. Credit risk (Cont.):

(2) The aging of debts and losses from impairment

The following is the aging of the trade accounts receivable, other receivables, including derivative financial instruments, receivables for work in progress, long-term loans:

	As of December 31 2016		As of December 31 2015	
	Gross	Impairment	Gross	Impairment
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Not in arrears	492,355	500	1,194,169	3,939
0–30 days in arrears	5,916	93	29,708	160
31-120 days in arrears	7,924	295	19,486	709
121 days to one year in arrears	2,506	1,214	21,027	7,403
More than one year in arrears	11,369	8,940	207,558	162,914
	520,070	11,042	1,471,948	175,125

The movements in the provision for impairment in respect of trade receivables, other receivables and non-current loans during the year were as follows:

	As of December 31	
	2016	2015
	NIS in thousands	NIS in thousands
Balance as of January 1	175,125	181,722
Recovery of impairment loss recognized	5,314	5,869
Entry into consolidation	219	-
Exit from consolidation	(158,509)	-
Doubtful debts that became bad debts	(11,107)	(12,466)
Balance as of December 31	11,042	175,125

Several times in each reporting period, the Group reviews the impairment and takes into account the period of the debt, the collateral that is available thereto, the financial of the debtors and the chances of legal proceedings against them.

Note 35 - Financial instruments (Cont.)

B. Liquidity risk:

Set forth below are the projected repayment dates of the financial liabilities, including an estimate of interest payments:

	As of December 31, 2016							
	Book value	**Forecasted cash flow**	**2017**	**2018**	**2019**	**2020**	**2021 forth**	**No repayment date /upon demand**
	NIS in thousands	**NIS in thousands**	**NIS in thousands**	**NIS in thousands**	**NIS in thousands**	**NIS in thousands**	**NIS in thousands**	**NIS in thousands**
Non-derivative financial liabilities								
Short-term credit from banks and other credit providers (1)	695,358	695,358	695,358	-	-	-	-	-
Trade accounts payable	218,633	218,633	218,633	-	-	-	-	-
Other payables	56,410	56,410	56,410	-	-	-	-	-
Deposits from customers	764,003	764,003	-	-	-	-	-	764,003
Loans from banks and other credit providers (2)	3,244,009	3,562,205	827,078	515,747	456,686	382,910	1,379,784	-
Bonds (2)	5,170,542	5,614,731	719,714	414,381	500,926	498,522	3,481,188	-
Long-term deposits from customers	43,782	43,782	-	-	43,782	-	-	-
Capital notes	215	215	-	-	-	-	215	-
	10,192,952	10,955,337	2,517,193	930,128	1,001,394	881,432	4,861,187	764,003

Note 35 - Financial instruments (Cont.)

B. Liquidity risk: (Cont.)

Set forth below are the projected repayment dates of the financial liabilities, including an estimate of interest payments: (Cont.)

	As of December 31, 2015							
	Book value	Forecasted cash flow	2016	2017	2018	2019	2020 forth	No repayment date/upon demand
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Non-derivative financial liabilities								
Short-term credit from banks and other credit providers (1)	1,531,146	1,531,146	1,531,146	-	-	-	-	-
Trade accounts payable	524,638	524,638	524,638	-	-	-	-	-
Other payables	62,365	62,365	62,365	-	-	-	-	-
Deposits from customers	402,066	402,066	-	-	-	-	-	402,066
Loans from banks and other credit providers (2)	3,291,923	3,644,875	408,121	1,400,625	257,957	399,619	1,178,553	-
Bonds (2)	3,173,645	3,473,090	263,850	693,736	298,950	299,376	1,917,178	-
Liability for finance lease	12,488	17,743	1,772	1,731	1,744	1,575	10,921	-
Long-term deposits from customers	42,383	42,383	-	-	42,383	-	-	-
Other long-term liabilities	8,857	9,216	2,632	2,633	2,634	1,317	-	-
Capital notes	215	215	-	-	-	-	215	-
Financial liabilities - Derivatives								
Forward contracts on exchange rates not used for hedge accounting	56	56	56	-	-	-	-	-
	9,049,782	9,707,793	2,794,580	2,098,725	603,668	701,887	3,106,867	402,066

(*) In the matter of guarantees, see Note 32B.

(1) The book value includes the accumulated interest as of December 31, 2016 and 2015.

(2) The book value includes current maturities and accumulated interest as of December 31, 2016 and 2015.

Note 35 - Financial instruments (Cont.)

C. Index and foreign currency risks:

(1) Exposure to Index and foreign currency risk

The Group's exposure to Index and foreign currency risk, based on nominal values, is as follows:

	As of December 31, 2016		
	Israeli currency	Foreign currency	
	Index-linked	Dollar	Other (*)
	NIS in thousands	NIS in thousands	NIS in thousands
Assets	92,776	134,130	2,555
Liabilities	(7,727,622)	(1,193,813)	(20,671)
Total balance of balance sheet, net	(7,634,846)	(1,059,683)	(18,116)

(*) Mainly Euro and GBP.

	As of December 31, 2015		
	Israeli currency	Foreign currency	
	Index-linked	Dollar	Other (*)
	NIS in thousands	NIS in thousands	NIS in thousands
Assets	137,215	188,161	7,663
Liabilities	(5,629,294)	(1,405,336)	(30,714)
Total balance of balance sheet, net	(5,492,079)	(1,217,175)	(23,051)

(*) Mainly Euro and GBP.

Note 35 - Financial instruments (Cont.)

C. Index and foreign currency risks: (Cont.)

(2) Sensitivity analysis

The strengthening of the New Israeli Shekel against the following currencies as of December 31, 2016 and an increase in the CPI would increase (decrease) the capital and the profit or loss, net of tax, by the amounts that are presented below. This analysis has been made on the assumption that the other variables, and especially the interest rates, remain fixed. The analysis in respect of the year 2015 was made on the same basis.

	As of December 31, 2016	
	Capital	Profit (loss)
	NIS in thousands	NIS in thousands
1% rise in the CPI	(57,261)	(57,261)
3% rise in the exchange rate of the US Dollar	(23,843)	(23,843)

	As of December 31, 2015	
	Capital	Profit (loss)
	NIS in thousands	NIS in thousands
1% rise in the CPI	(40,366)	(40,366)
3% rise in the exchange rate of the US Dollar	(18,150)	(18,150)

A decrease in the exchange rate of the US Dollar by a similar rate and a decrease in the CPI by a similar rate as of December 31, 2016 would have had an identical effect, although in an opposite direction, in the same amount, assuming that all of the other variables remain constant.

Note 35 - Financial instruments (Cont.)

C. Index and foreign currency risks: (Cont.)

(3) Derivative instruments

a. Following are details of the Group's derivative financial instruments:

	As of December 31, 2015				
	Par value	Currency receivable	Currency payable	Expiry/ repayment/ exercise date	Fair value
	Thousands				NIS in thousands
Instruments that are not used for hedge accounting:					
Forward transactions on exchange rates	79,538	Dollar	NIS	January-February 2016	1,528

b. Following is a sensitivity analysis in respect of the Group's derivative instruments. A change in the CPI or the exchange rate of the Dollar and the Euro, would have increased (decreased) the profit and loss and the equity by the amounts that are presented below. This analysis is made on the assumption that all of the other variables remain constant and is ignoring the effect of tax.

	December 31, 2015								
	An increase of 10%		An increase of 5%			A decrease of 5%		A decrease of 10%	
	Capital	Profit (loss)	Capital	Profit (loss)	Fair Value	Capital	Profit (loss)	Capital	Profit (loss)
	NIS in thousands								
Instruments that are not used for hedge accounting:									
Change in the Dollar exchange rate									
Forward transactions	30,830	30,830	14,537	14,537	1,528	(14,537)	(14,537)	(30,830)	(30,830)

Note 35 - Financial instruments (Cont.)

D. Interest rate risk:

Type of interest

Following are details in respect of the types of interest in the Group's interest bearing financial instruments:

	Book value	
	As of December 31	
	2016	2015
	NIS in thousands	NIS in thousands
Fixed interest instruments		
Financial assets	743,250	170,471
Financial liabilities	8,404,906	6,441,809
Variable interest instruments		
Financial assets	158,194	77,699
Financial liabilities	733,676	1,591,212

(1) Sensitivity analysis for the fair value in respect of fixed interest instruments

The Group's assets and liabilities at fixed interest are not measured at fair value through profit and loss, therefore, a change in the interest rates as of the Report Date is not expected to have any impact on the profit or loss in respect of changes in the value of assets and liabilities with fixed interest rates.

(2) Sensitivity analysis for variable interest instruments

A change of 1% in the interest rates on the reporting date would increase or reduce the capital and the profit or loss, net of tax, by the sum of NIS 4,339 thousand. This analysis was made assuming that the other variables remained fixed.

E. Other price risk:

Sensitivity analysis of the security price

If the prices of the held securities (other than bonds with fixed interest rates) were higher/lower by 1%, the effect after tax would be as follows:

Financial assets available for sale – (see Note 12(1))

The net income for the year ending on December 31, 2016 would not be affected since these investments are treated as available for sale and they were not disposed of and their value does not decline.

The other comprehensive income would increase by NIS 7,801 thousand as of December 31, 2016 as a result of the change in the fair value of the shares.

Note 35 - Financial instruments (Cont.)

F. Offsetting financial assets and liabilities:

	As of December 31, 2015		
	Gross amounts of financial assets (liabilities) recognized	Gross amounts of financial assets (liabilities) recognized and offset in the Statement of Financial Position	Net amounts of financial assets (liabilities) presented in the Statement of Financial Position
	NIS in thousands	NIS in thousands	NIS in thousands
Financial Assets:			
Forward contracts on foreign currency	319,964	(318,380)	1,584
Financial Liabilities:			
Forward contracts on foreign currency	(9,607)	9,551	(56)

Note 36 – Fair value

A. Assets and liabilities measured at fair value in the Statement of Financial Position:

For the purpose of measurement of the fair value of the assets or liabilities, the Group classifies them in accordance with the rating that includes the following three levels:

Level 1: Quoted (not adjusted) prices in active markets for identical assets or identical liabilities to which the entity has access at the time of measurement.

Level 2: Data, other than quoted prices included in level 1, that are directly or indirectly observable for the asset or liability.

Level 3: Non-observable data for the asset or liability.

The classification of the assets or liabilities that are measured at fair value is based on the lowest level significantly used for measuring the fair value of the entire asset or liability.

Note 36 – Fair value (Cont.)

A. Assets and liabilities measured at fair value in the Statement of Financial Position: (Cont.)

Below are the Group's assets and liabilities measured at fair value in the Company's Statement of Financial Position as of December 31, according to their measurement levels.

Fair value of items measured at fair value on a periodic basis

	As of December 31, 2016		
	Level 2	Level 3	Total
	NIS in thousands	NIS in thousands	NIS in thousands
Investment property:			
Retail centers and malls in Israel	181,469	10,921,670	11,103,139
Land and office and other space for lease in Israel	362,581	5,267,331	5,629,912
Investment property under construction in Israel	-	3,720,085	3,720,085
Senior housing	49,804	1,086,064	1,135,868
Total investment property in Israel	593,854	20,995,150	21,589,004
Income-producing property in the USA	174,005	1,959,727	2,133,732
Total investment property	767,859	22,954,877	23,722,736

	As of December 31, 2015		
	Level 2	Level 3	Total
	NIS in thousands	NIS in thousands	NIS in thousands
Investment property (without downpayments):			
Retail centers and malls in Israel	-	10,590,618	10,590,618
Land and office and other space for lease in Israel	208,825	4,996,370	5,205,195
Investment property under construction in Israel	-	1,875,890	1,875,890
Senior housing	-	588,667	588,667
Total investment property in Israel	208,825	18,051,545	18,260,370
Income-producing property in the USA	-	2,010,769	2,010,769
Total investment property	208,825	20,062,314	20,271,139

Note 36 – Fair value (Cont.)

A. Assets and liabilities measured at fair value in the Statement of Financial Position (Cont.)

Financial assets and liabilities:

	As of December 31, 2016			
	Level 1	Level 2	Level 3	Total
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Financial assets held for trading:				
Securities	572	-	-	572
Financial assets available for sale:				
Marketable shares	1,040,093	-	-	1,040,093
Non-marketable shares	-	87,842	561,701	649,543
Financial assets designated at fair value through profit and loss:				
Non-marketable investments	-	23,700	-	23,700
Total fair value of financial assets	1,040,665	111,542	561,701	1,713,908

	As of December 31, 2015			
	Level 1	Level 2	Level 3	Total
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Financial assets held for trading:				
Securities	506	-	-	506
Derivatives not used for hedging:				
Forward contracts on foreign currency	-	1,584	-	1,584
Financial assets available for sale:				
Marketable shares	953,652	-	-	953,652
Non-marketable shares	-	-	681,113	681,113
Financial assets designated at fair value through profit and loss:				
Non-marketable investments	-	25,162	-	25,162
Total financial assets	954,158	26,746	681,113	1,662,017
Financial liabilities:				
Forward contracts on foreign currency not used for hedging	-	56	-	56
Total financial liabilities	-	56	-	56
Total fair value of financial assets and liabilities	954,158	26,690	681,113	1,661,961

Note 36 – Fair value (Cont.)

B. Assets and liabilities measured at fair value at level 3 in the Statement of Financial Position:

(1) Movement in investment property measured at fair value

	Real estate in Israel					Real estate in the U.S.	
	Retail centers and malls	Offices and other	Senior housing (*)	Under construction	Others (*)	Income-producing property	Total
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Balance as of January 1, 2015	9,529,066	4,614,901	-	2,232,453	24,081	1,690,198	18,090,699
Profits or losses recognized:							
in profit or loss	122,971	63,099	14,099	(1,474)	-	(28,294)	170,401
Entry into consolidation (**)	-	-	552,083	-	-	-	552,083
Purchases	153,588	43,202	3,062	654,165	-	48,387	902,404
Write-offs	-	(5,300)	(172)	-	(24,081)	-	(29,553)
Classifications	784,993	280,468	-	(1,065,461)	-	-	-
Carried from level 2	-	-	19,595	56,207	-	293,962	369,764
Net translation differences deriving from the translation of the financial statements of foreign operations	-	-	-	-	-	6,516	6,516
Balance as of December 31, 2015	10,590,618	4,996,370	588,667	1,875,890	-	2,010,769	20,062,314
Profits or losses recognized:							
in profit or loss	97,571	106,017	55,716	545,998	-	(80,907)	724,395
Entry into consolidation (***)	68,920	-	461,707	-	-	-	530,627
Purchases	165,180	62,251	1,951	1,176,391	-	58,564	1,464,337
Exit from consolidation (****)	-	(12,420)	-	-	-	-	(12,420)
Classifications	(619)	160,940	(21,977)	(138,344)	-	-	-
Carried from level 2	-	(35,000)	-	2,735	-	-	(32,265)
Carried from down payments on account of investment property	-	-	-	257,415	-	-	257,415
Carried to fixed assets	-	(10,827)	-	-	-	-	(10,827)
Net translation differences deriving from the translation of the financial statements of foreign operations	-	-	-	-	-	(28,699)	(28,699)
Balance as of December 31, 2016	10,921,670	5,267,331	1,086,064	3,720,085	-	1,959,727	22,954,877

(*) The figures for 2015 have been reclassified.
(**) See Note 14I(1).
(***) See Note 14I(3).
(****) See Note 8 regarding discontinued operations.

Note 36 – Fair value (Cont.)

B. Assets and liabilities measured at fair value at level 3 in the Statement of Financial Position (Cont.):

(2) Movement in assets and liabilities measured at fair value

	For the year ended December 31	
	2016	2015
	NIS in thousands	NIS in thousands
Financial assets available for sale:		
Balance as of beginning of the year	681,113	658,912
Total profits (losses) recognized:		
In other comprehensive income	(31,529)	22,201
Carried to Level 2	(87,842)	-
Sales	(41)	-
	561,701	681,113

Note 36 – Fair value (Cont.)

B. Assets and liabilities measured at fair value at level 3 in the Statement of Financial Position (Cont.)

(3) Description of evaluation techniques

Description of the measured instrument	Fair value as of December 31, 2016	Evaluation technique	Description of significant non-observable data	Range	Other data	Range
	NIS in Thousands					
Financial assets available for sale	561,701 (1)	Discounted cash flow	Weighted average cost of capital (WACC)	9%		
			Growth rate	2.5%		
Retail centers and malls in Israel	10,921,670 (2)(3)	Income approach - discounted cash flow (DCF)	Estimated average rent per sqm in NIS (*)	NIS 85-293	Marketable space (in sqm in thousands)	5-40 sqm in thousands
			Primary cap rate	6.75% - 8%		
			Fair value per sqm in NIS in thousands (4)	NIS 13-53 thousand		
			Occupancy rate (**) (4)	79% - 100%		
Offices and others in Israel:						
Space for lease for existing offices	5,143,510 (2)(3)	Income approach - discounted cash flow (DCF)	Estimated average rent per sqm in NIS (*)	NIS 35-101	Marketable space (in sqm in thousands)	2-151 sqm in thousands
			Primary cap rate (4)	7% - 8.5%		
			Fair value per sqm in NIS in thousands	NIS 6-17 thousand		
			Occupancy rate (**) (4)	81%-100%		
Other space for lease	91,820 (2)	Income approach - discounted cash flow (DCF)	Estimated average rent per sqm in NIS (*)	NIS 28		
			Primary cap rate	7.75%		
Land	32,001	Comparison method	Specific adjustment for estimated rate of betterment levy			

Note 36 – Fair value (Cont.)

B. Assets and liabilities measured at fair value at level 3 in the Statement of Financial Position (Cont.)

(3) Description of evaluation techniques (Cont.)

Description of the measured instrument	Fair value as of December 31, 2016	Evaluation technique	Description of significant non-observable data	Range	Other data	Range
	NIS in Thousands					
Buildings under construction in Israel	2,427,858	Discounted cash flow (DCF), net of the estimated construction costs expected for the completion thereof	Estimated average rent per sqm in NIS (*) Primary cap rate	Offices NIS 62-100 Retail NIS 177-233 7.75% - 8.5%	Estimate of balance of expected building cost per sqm	740-1,040 per sqm
	1,078,670	Comparison method	Specific adjustment for location, size and standard Estimated betterment levy			
	213,557	Cost approach				
Income-producing property in the USA	1,959,727 (3)	Income approach – discounted cash flow (DCF)	Estimated average rent per sqm in NIS (*) Estimated average rent per sqm in Dollars (*) Primary cap rate Fair value per sqm in NIS in thousands Occupancy rate (**)	NIS 68-79 $16-20 5.75% - 7.75% NIS 9 - 14 thousand 73% - 100%	Marketable space (in sqm in thousands)	3-89 sqm in thousands
Senior housing	1,086,064 (3)	Income approach – discounted cash flow (DCF)	Estimate of tenants' deposit against a residential unit Cap rate Annual tenant turnover	NIS 0.7-3.6 million 8.75% 10%		

(*) Calculated on the basis of average rent per marketable meter in each property separately.
(**) Calculated on the basis of each property separately.

Note 36 – Fair value (Cont.)

B. Assets and liabilities measured at fair value at level 3 in the Statement of Financial Position (Cont.)

(3) Description of evaluation techniques (Cont.)

(1) The fair value estimate will increase if the growth rate increases and/or the weighted cap rate decreases.

(2) The fair value estimate will increase if the rent payments increase and/or the weighted cap rate decreases. A 5% increase or decrease in the average rent per sqm, will increase or reduce the market value of the offices at Azrieli Center by approx. NIS 126 million, respectively. In addition, a 0.25% decrease or increase in the cap rate will increase their market value by approx. NIS 103 million or reduce the same by approx. NIS 97 million, respectively.

(3) The fair value estimate will increase if the building costs per sqm decrease, the rent payments increase, the weighted cap rate decreases and/or in the case of appreciation of senior housing units.

(4) Including properties under lease-up.

Note 36 – Fair value (Cont.)

B. Assets and liabilities measured at fair value at level 3 in the Statement of Financial Position (Cont.)

(3) Description of evaluation techniques (Cont.)

Description of the measured instrument	Fair value as of December 31, 2015	Evaluation technique	Description of significant non-observable data	Range	Other data	Range
	NIS in Thousands					
Financial assets available for sale	681,113 (1)	Discounted cash flow	Weighted average cost of capital (WACC)	Mainly 9%		
			Growth rate	2.5%		
Retail centers and malls in Israel	10,590,618 (2)(3)	Income approach - discounted cash flow (DCF)	Estimated average rent per sqm in NIS (*)	NIS 82-297	Marketable space (in sqm in thousands)	6-40 sqm in thousands
			Primary cap rate	6.75% - 8%		
			Fair value per sqm in NIS in thousands (4)	NIS 12-52 thousand		
			Occupancy rate (**) (4)	77% - 100%		
Offices and others in Israel:						
Space for lease for existing offices	4,850,214 (2)	Income approach - discounted cash flow (DCF)	Estimated average rent per sqm in NIS (*)	NIS 41-101	Marketable space (in sqm in thousands)	2-151 sqm in thousands
			Primary cap rate (4)	7% - 8.5%		
			Fair value per sqm in NIS in thousands	NIS 6-17 thousand		
			Occupancy rate (**) (4)	82%-100%		
Other space for lease	73,835 (2)	Income approach - discounted cash flow (DCF)	Estimated average rent per sqm in NIS (*)	NIS 28		
			Primary cap rate	8%		
Land	72,321	Comparison method	Specific adjustment for estimated rate of betterment levy			

Note 36 – Fair value (Cont.)

B. Assets and liabilities measured at fair value at level 3 in the Statement of Financial Position (Cont.)

(3) Description of evaluation techniques (Cont.)

Description of the measured instrument	Fair value as of December 31, 2015 NIS in Thousands	Evaluation technique	Description of significant non-observable data	Range	Other data	Range
Buildings under construction in Israel	130,268	Discounted cash flow (DCF), net of the estimated construction costs expected for the completion thereof	Estimated average rent per sqm in NIS (*) Primary cap rate	NIS 27-60 8% - 8.75%	Estimate of balance of expected building cost per sqm	540-620 per sqm
	1,745,622	Cost approach				
Income-producing property in the USA	2,010,769	Income approach – discounted cash flow (DCF)	Estimated average rent per sqm in NIS (*) Estimated average rent per sqm in Dollars (*) Primary cap rate Fair value per sqm in NIS in thousands Occupancy rate (**)	NIS 68-80 $17-20 5.75% - 7.25% NIS 9-16 thousand 70% - 100%	Marketable space (in sqm in thousands)	3-89 sqm in thousands
Senior housing	588,667	Income approach – discounted cash flow (DCF)	Cap rate Annual tenant turnover	9% 10%		

(*) Calculated on the basis of rent per marketable meter for each asset separately.
(**) Calculated on the basis of each asset separately.

Note 36 – Fair value (Cont.)

B. Assets and liabilities measured at fair value at level 3 in the Statement of Financial Position (Cont.)

(3) Description of evaluation techniques (Cont.)

(1) The fair value estimate will increase if the growth rate increases and/or the weighted cap rate decreases.

(2) The fair value estimate will increase if the rent payments increase and/or the weighted cap rate decreases. A 5% increase or decrease in the average rent per sqm, will increase or decrease the market value of the offices at Azrieli Center by approx. NIS 125 million, respectively. In addition, a 0.25% decrease or increase in the cap rate will increase their market value by approx. NIS 101 million or decrease the same by approx. NIS 95 million, respectively.

(3) The fair value estimate will increase if the building costs per sqm decrease, the rent payments increase and/or the weighted cap rate decreases.

(4) Including properties under lease-up.

Note 36 – Fair value (Cont.)

C. For a description of the evaluation processes used in determining the fair value – see Note 3C.

D. Fair value of items that are not measured at fair value in the Statement of Financial Position:

(1) Fair value by comparison to the book value

Following are details regarding the fair value of certain items that are not measured at fair value in the Statement of Financial Position.

		As of December 31			
		2016		2015	
	Level of fair value	Book value	Fair value	Book Value	Fair value
		NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Non-current assets:					
Receivables in respect of franchise arrangement (1)	2	57,426	70,812	45,639	55,074
Current liabilities:					
Deposits from customers of Supergas		104,979	71,181	106,825	72,433
Non-current liabilities:					
Loans from banks and other credit providers (1)	2	3,243,078	3,271,487	3,300,780	3,388,536
Bonds (2)	2	5,170,542	5,180,098	3,173,645	3,264,573
		8,413,620	8,451,585	6,474,425	6,653,109
Surplus of liabilities over assets		(8,461,173)	(8,451,954)	(6,535,611)	(6,670,468)

(1) The book value includes current maturities and accrued interest.
(2) See Note 3C in the matter of the basis of the determination of the fair value.

Note 36 – Fair value (Cont.)

D. Fair value of items that are not measured at fair value in the Statement of Financial Position: (Cont.)

(2) The interest rates used in the determination of the fair value

The interest's rates used in the discounting of the expected cash flows, where relevant, are based on the government yield curve for each individual type of loan, as of the Report Date, with the addition of an appropriate fixed credit margin, as follows:

	As of December 31	
	2016	2015
	%	%
Non-current assets:		
Receivables in respect of franchise arrangement	3.1	3.31-5.7
Current liabilities:		
Deposits from customers	1.37	1.45
Non-current liabilities:		
Loans from banks and other credit providers	1.15 - 4.63	1.0-4.2
Bonds	1.13 - 1.83	1.2-1.6

Note 37 – Related and interested parties

A. Parent company, controlling shareholder and subsidiary:

As aforesaid in Note 1A, the Company is a company that is held by Nadav Investments (a company that is resident in Canada) (the "**Parent Company**"), a company controlled by Ms. Sharon Azrieli, Naomi Azrieli and Danna Azrieli. On material subsidiaries, see Note 10A in respect of the Group's entities.

B. Benefits for key managerial personnel (including directors who are employed by the Company):

Benefits in respect of the employment of key management personnel (including directors who are employed in the Company) include:

	For the year ended December 31					
	2016		2015		2014	
	No. of persons	Amount	No. of persons	Amount	No. of persons	Amount
		NIS in thousands		NIS in thousands		NIS in thousands
Short-term benefits (1) (2)	15	21,360	12	15,822	15	26,068
Other long-term benefits	2	480	1	34	3	(1,558)
Share-based payments		-	3	2,332	3	858
		21,840		18,188		25,368

(1) See also Note 37C below.

(2) Including 7 directors who are not employed by the Company.

Note 37 – Related and interested parties (Cont.)

C. Transactions and balances with related and interested parties:

	For the year ended December 31			As of December 31	
	2016	2015	2014	2016	2015
	Amounts of transactions			Balance in balance sheet	
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Interested party and affiliates owned by interested party					
Rent income	970	1,438	532		
Financing income, net	-	6	30		
Donations (7)	12,386	12,492	13,943		
Trade and other payables				626	1,267
Associates					
Financing income	5,756	5,169	3,670		
Loans and capital notes to associates				216,152	199,445

	For the year ended December 31		
	2016	2015	2014
	Amounts of Transactions		
	NIS in thousands		
Key management personnel (including directors) in the Company (*)			
Interested parties who are employed by the Company	8,456	8,613	15,315
Number of persons to whom the benefit relates	2	2	4
Director remuneration for interested parties who are not employed by the Company	240	212	204
Number of persons to whom the benefit relates	2	2	2
Remuneration for directors who are not employed by the Company (**)	2,652	1,458	1,149
Number of persons to whom the benefit relates	6	5	5

(*) This information is included in Section B above.
(**) See Note 37C(5).

Note 37 – Related and interested parties (Cont.)

C. Transactions and balances with related and interested parties: (Cont.)

(1) On July 9, 2014, upon the passing of the Company's founder, Mr. David Azrieli, OBM, the Chairman of the Board and controlling shareholder of the Company, his office as Chairman of the Board came to an end, and the management agreement with the companies controlled by him ended as well.

According to the management agreement, the annual bonus was calculated according to the proportionate part of the year, based on the annual financial statements. Accordingly, appropriate provisions were made in the Financial Statements for 2014 for an estimate of the annual bonus until the date of termination of the management agreement.

The Management Fee in 2014, until the passing of Mr. David Azrieli, OBM, amounted to the sum of approx. NIS 4,913 thousand.

(2) On July 3, 2014, in view of the deterioration in Mr. David Azrieli's health, Ms. Danna Azrieli was appointed as Active Chairman of the Board, and on July 21, 2014, after his passing, the Company's Board of Directors appointed Ms. Danna Azrieli as Chairman of the Company's Board.

On December 28, 2014, after receiving the approval of the Company's Compensation Committee and Board of Directors, the general meeting of the Company approved the engagement in a new management agreement with Ms. Danna Azrieli with respect to the terms and conditions of her office and employment as Active Chairman of the Board of the Company, an agreement which took effect on January 1, 2015, and the principles of which are specified below:

The Management Services, as hereinafter defined, shall be provided to the Company by Ms. Danna Azrieli through a company wholly-owned by Ms. Danna Azrieli (the "**Management Company**"), in the framework of which services, Ms. Danna Azrieli shall serve as the Active Chairman of the Board of the Company on a full-time basis (100% position) (it is clarified that Ms. Danna Azrieli may continue to take additional actions, including philanthropic activities in which she is involved, from time to time, provided that the performance thereof does not affect the discharge of her duties in the Company) and shall provide the following services to the Company, through the Management Company: chairman of the executive board of the Company's management, overseeing the implementation of strategic decisions, formulating business and managerial decisions related to the development and management of the Company's properties, business development, financing and budget, targets and the examination of new operating segments, providing ongoing managerial and professional advice to the Company's management and the managers of the principal operating segments, overseeing, accompanying and analyzing business opportunities and leading transactions and acquisitions in Israel and overseas, overseeing existing projects and monitoring their progress, overseeing development and construction and business development abroad, responsibility for outlining the Company's community relations and representing the Company in conferences in Israel and abroad (the "**Management Services**").

In consideration for the provision of the Management Services, the Company shall pay Ms. Danna Azrieli (through the Management Company) the following consideration:

Fixed component – Annual management fee in the amount of approx. NIS 2.7 million (in nominal terms) (constituting, as of December 2014, monthly management fee of approx. NIS 225,000), plus V.A.T. as required by law, linked to the rise in the CPI for November 2014, which was published on December 15, 2014 (the "**Fixed Management Fee**") (in the event of a decline in the Index in a particular month, the consideration will not be reduced, but the reduction will be offset against future index rises). The Fixed Management Fee will be paid every current calendar month.

Note 37 – Related and interested parties (Cont.)

C. Transactions and balances with related and interested parties: (Cont.)

(2) (Cont.)

Variable component – for the Management Services, the Management Company shall be entitled to an annual bonus, for each calendar year, deriving from the Adjusted Profit, as specified below:

The “Adjusted Profit” for purposes of this section, for every calendar year – the annual pre-tax profit, according to the Company’s audited consolidated annual financial statements, net of the following amounts: (1) a dividend received from financial assets available for sale included in the annual pre-tax profit; (2) profit (loss) deriving from the revaluation of real estate properties; (3) results of companies which do not engage in the Company’s core business segments (real estate) and were included in the annual pre-tax profit; (4) linkage differentials accrued on financial liabilities; (5) interest expenses, at the actual weighted effective interest rate for such year, of the Company and companies controlled thereby, which engage in the Company’s core business, on loans (regardless of whether or not they were taken) at a financing rate of 65% on the historical purchase cost in the books of the investment in companies which are not in the core business; (6) the sum total of the management fee (including bonus) to Ms. Danna Azrieli for such year, as included in the annual pre-tax profit; and (7) profit (loss) from financial assets (marketable securities) held for trading, including interest and dividend in respect thereof.

Bonus threshold and brackets – in a year in which the Adjusted Profit is less than NIS 925 million – there is no bonus entitlement. In a year in which the Adjusted Profit ranges between NIS 925 million and NIS 1,050 million – a bonus shall be paid at the rate of 0.5% of the difference between the bonus threshold and the actual Adjusted Profit; in a year in which the Adjusted Profit exceeds NIS 1,050 million – for the portion of the Adjusted Profit exceeding NIS 1,050 million – the amount paid shall be 0.75% of the amount in excess of NIS 1,050 million, plus 0.5% of the difference between NIS 925 million and NIS 1,050 million.

Bonus cap and payment for a partial year –the sum total of the annual bonus for any calendar year as aforesaid shall not exceed NIS 1.5 million. If the Management Services shall have been rendered during part of a calendar year, the Management Company shall be entitled to a bonus calculated according to the relative part in the annual calculation results, on the basis of a 365 day year, in accordance with the part of the year during which the Management Services were rendered and based on the consolidated annual statements for such year in which the Management Agreement commenced or ended.

Repayment clause – if and insofar as it transpires *post factum* that the data on which the Company relied when granting the annual bonus as aforesaid to Ms. Danna Azrieli are incorrect and that re-presentation thereof is required in the Company’s Financial Statements, Ms. Danna Azrieli shall repay the Company the difference between the amount of the bonus paid to her based on such incorrect data and the amount of the annual bonus to which she is entitled based on the data after such re-presentation thereof.

Note 37 – Related and interested parties (Cont.)

C. Transactions and balances with related and interested parties: (Cont.)

(2) (Cont.)

Reimbursement of expenses, car and telecommunication – the Company shall bear all of the expenses of the Management Company in the context of the provision of the Management Services, including entertaining expenses, travel and *per diem* expenses in Israel and abroad, all in accordance with the Company's procedures and against presentation of appropriate evidence up to a maximum amount as shall be determined by the Company's Board of Directors from time to time and which shall be determined appropriate thereby, taking into account the Company's business and the scope thereof. The Company shall further bear the costs of making available and maintaining a car for the purpose of providing the Management Services, the costs of use of telephony and telecommunication, and may also, from time to time and in accordance with the compensation policy, grant Ms. Danna Azrieli additional related benefits, such as a laptop, internet connection, subscriptions to financial newspapers and daily newspapers, payment for participation in professional conferences, professional literature, seminars, etc. Reimbursement of car and telecommunication expenses shall not exceed a maximum amount as shall be determined from time to time by the Audit Committee and which shall be determined appropriate thereby, considering the Company's business and the scope thereof.

The agreement also includes the Company’s undertaking of inclusion within an officers’ insurance policy, and the grant of letters of exemption and indemnification in the standard language granted to the other officers of the Company, all subject to the provisions of the Companies Law and the approvals required thereunder, the Company's articles of association and the Company's compensation policy.

Term of the agreement and termination thereof – the management agreement took effect on January 1, 2015, and shall be in force and effect for a three-year period as of such date, unless extended prior thereto by agreement between the parties and subject to receipt of all of the approvals required under law. The management agreement may be terminated by the Management Company, on the one hand, and by the Company, by way of a board resolution, on the other hand, subject to a prior notice of 6 months in advance (with no adjustment period), other than in exceptional events in which it may be terminated by the Company with immediate effect.

The total management fee for 2016 amounted to NIS 3,745 thousand (in 2015 - NIS 3,418 thousand).

On October 6, 2016, the general meeting of the Company’s shareholders approved the extension of the management agreement with Ms. Danna Azrieli, for a three-year period, from the aforesaid meeting approval date, with no change to the effective agreement.

Following is a specification of the main terms and conditions of the management agreement between the Company and a company controlled by Danna Azrieli until December 31, 2014 in respect of her terms of office and employment as Active Vice Chairman of the Company’s Board of Directors (the “**Vice Chairman Management Agreement**”).

The Management Services that included, in accordance with the parties’ agreements, as being from time to time, services of active vice chairman of the board and/or substitute chairman of the board and/or chairman of the board and/or director and/or a managerial position in the Company.

The Management Services were granted at an 80% position. The Management Company was entitled to a fixed monthly payment of NIS 164,711 (the “**Monthly Consideration**”), linked to the rise of the CPI, from the known index for September 2009. The Management Company was entitled to related benefits, including the provision of a Grade 7 or higher car, landline and mobile telephone (including the expenses thereof), and reimbursement of expenses.

Note 37 – Related and interested parties (Cont.)

C. Transactions and balances with related and interested parties: (Cont.)

(2) (Cont.)

In addition to an advance notice period of 90 days, the Management Company was entitled to an adjustment period of 270 days, and in any event of termination of the engagement, the Management Company was paid the full Monthly Consideration, plus all of the aforesaid consideration components, for the adjustment period.

(3) Granite's general meeting has approved:

(a) The provision of an indemnification in advance to all of the officers who are so entitled in Granite and in its consolidated companies, including officers who are considered to be controlling interests, in the past, present and future. The commitment to indemnification is limited to certain types of events and to amounts as detailed in the decision that was passed. The indemnification is in respect of the period in which Granite was a public company (until September 2012) and in connection with the office of the officers at such time.

The cumulative maximum amount of the indemnification, for all of the officers, may not exceed 20% of Granite's equity in accordance with the last financial statements that are known at the time of the passing of the decision in respect of the indemnification, with the addition of amounts that will be received from the insurance company.

(b) The granting of an exemption in advance to all of the officers who are so entitled in Granite and in its consolidated companies, including officers who are considered to be controlling interests, from liability in respect of damage caused as the result of a breach of the duty of care vis-à-vis the Company.

(c) Directors and officers liability insurance in Granite and in its subsidiaries, for a period of 12 months from August 9, 2016 and with limits of overall liability per case and for a period of U.S. $40 million.

(d) Expansion of the indemnification granted to Granite's directors and officers to apply also to events arising from the Improvement of Enforcement Law, within the limits of the law. Granite further limited the retroactive indemnification amount to 20% of its equity according to the Financial Statements, as being on the date of actual granting of the indemnification. Further approved was the granting of indemnification also to Ms. Danna Azrieli, who is deemed a controlling shareholder of the Company. The granting of an exemption to Ms. Danna Azrieli is subject to approval by the general meeting of Granite's shareholders.

(4) With respect to the guarantees that the Group has made available to companies in the Group, see Note 32B.

(5) On November 18, 2014, Mr. Menachem Einan updated the Company and the Board of his retirement from his office as a director of the Company and from his duties as Active Deputy Chairman of the Board and as Chairman of Granite Hacarmel, upon expiration of the agreement effective as of February 28, 2015.

Note 37 – Related and interested parties (Cont.)

C. Transactions and balances with related and interested parties: (Cont.)

(5) (Cont.)

On March 18, 2015, the Company's Board approved, after the Audit Committee's approval, for the sake of caution only, engagement in an agreement to receive consulting services from a company wholly owned and fully controlled by Mr. Menachem Einan (the "**Management Company**") (the "**Consulting Agreement**"). According to the Consulting Agreement, the Management Company will provide consulting services on various strategic matters according to the Company's requirement and up to a scope of 40 monthly hours, in consideration for monthly consulting fees of approx. NIS 60 thousand, linked to the Index, plus reimbursement of reasonable expenses. In addition, it was determined that insofar as the process of disposition of Sonol Israel Ltd. and/or Supergas Israel Gas Co. Ltd., from Granite Hacarmel Investments Ltd. group, which is controlled by the Company, is completed, the Management Company will be entitled to a one-time bonus of NIS 500 thousand in respect of each one of the dispositions, in accordance with the date set forth in the agreement. The agreement is for a period of 24 months from March 1, 2015 (the "**Term of the Agreement**"), while each party is entitled to terminate the Consulting Agreement at any time after a period of 12 months from the date of its taking effect, in which case, the Company will continue to pay the Management Company monthly consulting fees for the entire remainder of the Term of the Agreement (all unless the agreement is breached). In the framework of the agreement, the Management Company committed to confidentiality and non-competition. On February 28, 2017 this agreement ended.

In 2016 Mr. Einan received a bonus in the amount of NIS 400 thousand, in accordance with the agreement between the parties, following the disposition of Sonol Israel Ltd.

Since March 2016, Mr. Einan serves as a director of the Company. In August 2016, the Company's general meeting approved his appointment as a director.

In accordance with the resolutions of the Compensation Committee and the Board of Directors of the Company, since March 1, 2017, Mr. Einan receives director compensation in accordance with the Companies Regulations (Rules on Compensation and Expenses for an Outside Director), 5760-2000, following the approval of the Compensation Committee and the Board of Directors of the Company, which were received on March 19 and 21, 2016 (respectively).

Following are details on the management agreements between the Company and the Management Company until February 28, 2015:

Since January 2011, Mr. Einan has served as Active Deputy Chairman of the Company's Board. The Management Company owned by him was entitled to a fixed monthly payment of NIS 300,000, linked to the CPI, which was published on June 15, 2009 and it is entitled to ancillary benefits, including the making available of a motor vehicle (up to Group 7), cellular telephones (including the expenses in respect thereof, reimbursement of expenses and the tax gross-up therefor).

In addition, the Management Company was entitled once a year to fixed annual remuneration in an amount of NIS 1,000,000. The said amount was linked to the CPI, where the base index will be the Index for May 2009.

In addition, in 2010, the Management Company was granted 395,778 phantom units.

In addition, Mr. Einan also held office as the Chairman of Granite Hacarmel.

Note 37 – Related and interested parties (Cont.)

C. Transactions and balances with related and interested parties: (Cont.)

(6) On April 2, 2013, the Company's Board approved the appointment of Mr. Yuval Bronstein ("**Mr. Bronstein**") as the Company's CEO as of May 1, 2013, in lieu of his office as the Company's CFO.

On June 20, 2013, the general meeting approved the terms of the Company's engagement in an agreement with a Company wholly-owned by Mr. Bronstein (the "**Management Company**").

The Management Company is entitled to a fixed monthly payment in the amount of NIS 255,000, linked to the rate of increase of the CPI for February 2013, as released on March 15, 2013, and is entitled to related benefits, including the provision of a vehicle (Group 7) and a mobile phone.

Each of the parties to the agreement may terminate the agreement, for any reason whatsoever, by a prior written notice of three months.

Furthermore, the Management Company will be entitled to adjustment compensation in an amount equal to 9 monthly payments.

On October 6, 2016, the general meeting of the Company's shareholders approved an update to the management agreement with Mr. Bronstein, updating the monthly management fees that are paid to his wholly-owned management company to the sum of NIS 313 thousand, linked to the June 2016 index. The remaining terms and conditions of Mr. Bronstein's engagement remain unchanged.

Mr. Bronstein was granted 82,454 phantom units during his service as the Company's CFO, in accordance with the approval by the Company's Board and general meeting of May 2010. Upon approval of the terms and conditions of the engagement as the Company's CEO, the terms and conditions of the phantom units remained unchanged. The total cost carried to the income statement in the year ended on December 31, 2015, amounted to approx. NIS 1.1 million.

In addition, in 2016, Mr. Bronstein received a bonus in the sum of NIS 941 thousand (2015 – NIS 652 thousand).

(7)

a. On May 5, 2010, shortly before the Company's IPO, the Company's general meeting, after the approval of the Company's Board had been received on May 5, 2010, gave its approval that within the framework of the annual contributions which are given to NPO's by the Company, whose scope shall be determined by the Company's Board from time to time, the Company shall remit, *inter alia*, through contributions to the Azrieli Foundation (Israel) (R.A.), ("**AFI**"). The resolution was adopted based on an examination of the main objectives of AFI which are to act to promote education and culture in Israel, through projects in the field of education, culture, welfare and science, the execution of project and the conducting of research alone and/or in conjunction with other organizations, including by means of awarding grants to organizations and/or individuals for the purpose of the performance of projects and/or research work that accords with the objectives of the Foundation, which have been examined and found to accord with the Company's policy on contributions. There is nothing in the said decision that prevents the Company's Board from resolving to make contributions to other charitable entities, whose objectives accord with the Company's policy on contributions, as they may be from time to time.

Within the framework of the said decision by the general meeting, it was determined that during the period until May 2015, the company will donate to the Foundation, in each calendar year, by itself or by means of companies that it controls (except for Granite), an amount that constitutes 1.5% of the Company's annual profit and in any event not more than an amount of NIS 14 million.

Note 37 - Related and interested parties (Cont.)

C. Transactions and balances with related and interested parties: (Cont.)

(7) (Cont.)

a. (Cont.)

The contributions remitted by the Company to AFI were used for the making of donations and for the current needs of the AFI. This contribution is deemed as a contribution out of the Company’s annual contribution budget, as determined by the Company’s Board from time to time.

The Company’s internal auditor was appointed by the Company's Board, to examine in each calendar year and prior to the time of the signing of the financial statements for that year, the total scope of the contributions that AFI has contributed in that year, and the correlation between the contribution that stood at the basis of the decision by the general meeting that approved the annual contribution, as aforesaid and shall submit a written report to the Audit Committee. In view of Amendment 16 to the Companies Law that shortened the transaction to 3 years, on March 14, 2013, the Company's Audit Committee approved the reasonableness of the period which was set at 5 years (namely – May 2015).

In May 2015, the general meeting (after the approval of the Audit Committee and the Company’s Board) approved the Company’s engagement with AFI in a new contribution arrangement, which extended the arrangement for contribution to AFI by another five years commencing on June 1, 2015 and ending on May 31, 2020.

b. On March 13, 2014, a contribution agreement (the "**Contribution Agreement**") was signed between Azrieli Holdings and the Azrieli Foundation (Israel) (R.A.) (“AFI”), a non-profit association registered in Israel, which works, *inter alia*, to promote education and culture through projects in the fields of culture, welfare and science.

According to the terms of the Contribution Agreement, Azrieli Holdings granted AFI, by way of a contribution, for no consideration, 6,902,000 ordinary shares of par value NIS 0.1 each of the Company (the “**Contribution Shares**”), which constitute approx. 5.69% of the Company’s issued capital.

According to the provisions of the Contribution Agreement, the contribution of the Contribution Shares to AFI was made subject to the following 3 conditions:

(a) AFI shall hold the Contribution Shares, shall not transfer the same nor make any other disposition therein, for a period of at least 10 years from the date of execution of the contribution agreement (the “**Limitation Period**”); upon expiration of the Limitation Period, any transfer of the Contribution Shares by AFI will require a resolution by a special majority of at least 75% of the members of the board (or any other required organ), who are entitled to participate in a vote on such resolution (“**Special Approval**”);

(b) Upon expiration of the Limitation Period and subject to receipt of the Special Approval as aforesaid, any future transfer of the Contribution Shares will be subject to a right of first refusal in favor of Azrieli Holdings;

(c) Azrieli Holdings shall retain all of the voting rights under the Contribution Shares, to which end AFI has signed the necessary powers of attorney. In the case of a future sale of the Contribution Shares by AFI, the voting rights under the Contribution Shares shall pass to the buyer.

Note 37 - Related and interested parties (Cont.)

C. Transactions and balances with related and interested parties: (Cont.)

(7) (Cont.)

b. (Cont.)

As a result of receipt of the Contribution Shares, AFI became an interested party, as this term is defined in the Securities Law, 5728-1968 (the "**Securities Law**"), in the Company. Pursuant to the provisions of the Contribution Agreement, Azrieli Holdings and AFI are considered "Joint Holders" within the definition thereof in the Securities Law. In the matter of duties applying or relating, according to the Companies Law, to controlling shareholders of a company, the Company chose to relate to AFI as if it is the controlling shareholder of the Company, even if this is not required according the provisions of the law, so long as the Company did not give another reporting.

On the Company's engagement in an agreement for the purchase of one share of Canit Hashalom from AFI – see Note 10C.

c. On March 24, 2014, Azrieli Holdings transferred to The Azrieli Foundation, a registered Canadian philanthropic foundation whose assets are designated for donations and to fund philanthropic activity in Israel and in Canada (the "**Azrieli Foundation Canada**"), 460,000 shares of the Company as a contribution for no consideration, constituting approx. 0.38% of the Company's issued capital. After the transfer of the Company's shares, the Azrieli Foundation Canada held 13.68% of the Company's share capital.

In 2015 and 2016, Azrieli Foundation Canada sold some of the Company's shares that were held thereby, and after the sale of the shares and as of the Report Date, Azrieli Foundation Canada holds 8.55% of the Company's share capital.

(8) In November 2014, Gemel Tesua Investments Ltd. ("**Gemel Tesua**") entered into an agreement with Azrieli Foundation (Israel) R.A. ("**AFI**") (see Section 7 above), according to which Gemel Tesua will lease to AFI, under market conditions, from January 2015, an area of approx. 457 sqm out of the office space in the Herzliya Business Park project, which is owned by the Group, and will also provide AFI with management and maintenance services as it provides to the other tenants in the project, which include, *inter alia*, cleaning, maintenance, building insurance and third party insurance for the public areas, payments of municipal taxes in respect of the public areas and gardening, for a period of five years, with an option to extend the period for an additional five years, in consideration for a monthly payment of approx. NIS 58 thousand.

It was further agreed that Gemel Tesua will receive one-time compensation from AFI in respect of the investment budget provided in relation to the old area in the sum of NIS 313 thousand, linked to the index according to the previous agreement of 2010.

In October 2013, Gemel Tesua entered into an agreement with Candan Residences Ltd. ("**Candan Residences**"), a company controlled by the controlling shareholder and chairman of the Board of Directors, Ms. Danna Azrieli, whereby Gemel Tesua will lease to Candan Residences, at arm's length conditions, effective from October 2013, an area of approx. 190 sqm of the office space in the Herzliya Business Park project that is owned by the Group, and will provide to Candan Residences management and maintenance services as it does to the other tenants in the project which include, *inter alia*, cleaning, maintenance, building insurance, third party insurance for public areas, payment of municipal taxes for public areas and gardening, for a two-year period with an option to extend the period by two more years until October 14, 2017, in consideration for a monthly payment of approx. NIS 22 thousand.

Note 37 - Related and interested parties (Cont.)

C. Transactions and balances with related and interested parties: (Cont.)

(8) (Cont.)

The Company classified the transactions as negligible transactions, under market conditions and in the ordinary course of business, and that they are not transactions which require special approvals pursuant to the Companies Law (the classification was made in relation to each transaction separately).

(9) Remuneration of the directors - in accordance with the decision of the Company's Board and the Company’s general meeting, from May 10, 2010 and August 24, 2010, the remuneration of the external directors, who are appointed in the Company, to be in accordance with the Companies Regulations (Principles for the remuneration and expenses for an external director) – 2000 (the “**Remuneration**”). The annual remuneration and the remuneration for participation (including remuneration as an expert outside director) will be paid in accordance with the maximum amount that is set in the remuneration regulation, in accordance with the Company’s capital grade, as it may be from time to time.

In accordance with the decision of the Company’s Board and general meeting as of May 6, 2010, the payment to the Company’s directors, except for the independent external directors and except for directors who receive fees from the Company (whether themselves or by means of management companies that they control), in an amount of NIS 65 thousand and remuneration for participation in meetings in an amount of NIS 2,300. The amounts of the Remuneration will be Index-linked in accordance with the provisions of the Remuneration Regulations, In addition, the provisions of Sections 5 (B) and 6 (A) of the Remuneration Regulations will apply to the Remuneration paid to the directors, *mutatis mutandis*. On May 13, 2013, following Amendment 16 to the Companies Law, after the approval of the Company’s Compensation Committee had been received, the Company’s Board approved the continued payment of the annual remuneration and the said participation remuneration to Naomi Azrieli and Sharon Azrieli under the same terms and conditions as specified above. On May 24, 2016, the Company’s Board of Directors, following receipt of the approval of the Company’s Audit Committee in its capacity as the Compensation Committee of May 22, 2016, approved the continuation of the payment of the annual compensation and participation compensation as aforesaid to Naomi Azrieli and Sharon Azrieli under the same terms and conditions as specified above. The approval of the compensation as aforesaid is for a three-year period, effective from June 3, 2016.

Such approvals were reported to the public in accordance with Regulation 1B(3) of the Companies Regulations (Relief in Transactions with Interested Parties), 5760-2000.

D. Exemption, insurance and indemnification for officers and directors:

(1) Exemption:

In accordance with the decision passed by the Board and the Company’s shareholders meeting on May 6, 2010, the Company has granted officers and the directors, as they may be from time to time, with the exception of the indirect controlling shareholder directors, Sharon Azrieli, Naomi Azrieli and Danna Azrieli, an exemption in advance and retrospectively from their responsibility, in whole or in part, as a result of any damage that may be caused to it and/or that has been caused to it, whether directly or indirectly, as a result of a breach of a duty of care of the directors and the officers to it and to its subsidiaries, and as officers and/or as directors in the Company or officers and/or directors acting on the Company's behalf in the subsidiaries. For details regarding an amendment to the Company’s articles with respect to the exemption, see Note 37D(3).

Note 37 – Related and interested parties (Cont.)

D. Exemption, insurance and indemnification for officers and directors: (Cont.)

(2) Indemnification:

On May 6, 2010, the Company's Board and general meeting approved the grant of indemnification to all of the officers in the Company and the directors of the Company, as being from time to time, for any liability or expenses as specified below, imposed thereon as a result of actions made (including actions made prior to the grant of letter of indemnification) and/or will make in their capacity as officers and/or directors of the Company and/or as officers and/or directors acting on the Company's behalf in the subsidiaries or affiliates of the Company or any other company in which the Company has an interest: (a) a financial indebtedness that is placed on an officer and/or director in favor of another person under a judgment, including a judgment issued by way of compromise or an arbitration award that is approved by a court and solely that those actions relate to one or more of the events that are detailed in the letter of indemnification; (b) reasonable litigation expenses, including lawyers' fees, which are expended by an officer and/or a director or that they were charged to pay by a court, in proceedings that were presented against them by the Company or in its name or in the name of another person, or on a criminal indictment that they are acquitted of, or on a criminal indictment on which they are found guilty and which does not require proof of criminal intent; (c) reasonable litigation expenses, including lawyers' fees that have been expended by an officer and/or a director, as the result of an investigation or proceedings that are conducted against them by an authority that is authorized to conduct the investigation or proceedings, and which ended without the presentation of an indictment against them and without any financial liability being placed upon them as an alternative to criminal proceedings, or which ended without the presentation of an indictment against them but with the placement of a financial liability as an alternative to criminal proceedings in a transgression which does not require proof of criminal intent.

The amount of the indemnification that the Company will pay to each officer (including directors), cumulatively in accordance with each letter of indemnification that is issued to them by the Company in accordance with the indemnification decision, in respect of one or more of the events that are detailed in the letter of indemnification, may not exceed 20% of the capital that is attributed to the shareholders in the Company in accordance with the last financial statements of the Company (audited or reviewed), which were published before the date of the indemnification.

After receipt of the approval of the Company's Board and the Audit Committee dated June 28, 2011, the general meeting approved the amendment to the language of the letters of exemption and indemnification which the Company granted and grants to the Company's officers and directors, including officers and directors of the Company who are deemed controlling shareholders and/or in the granting of which the controlling shareholders of the Company have a personal interest, as shall hold office from time to time, in order to adjust the same to the provisions of Section 56H of the Securities Law, such that they shall include an indemnification undertaking with respect to payments to persons injured by a breach and expenses in connection with administrative enforcement proceedings, including reasonable litigation expenses.

On December 28, 2014, after receipt of approval from the Company's Compensation Committee and Board, the Company's general meeting approved the extension of the letters of indemnification to the directors who are indirect controlling shareholders of the Company (Mmes. Danna, Sharon and Naomi Azrieli) for an additional three-year term from August 15, 2014, with no change in the terms and conditions of the letter of indemnification (whose language is identical to that to which the other directors are entitled as described in the Note), with the exception of the exemption component, which was not included in the letter of indemnification whose extension was approved as aforesaid. For details regarding an amendment to the Company's articles with respect to the indemnification, see Note 37D(3).

Note 37 – Related and interested parties (Cont.)

D. Exemption, insurance and indemnification for officers and directors: (Cont.)

(3) Insurance:

On May 24, 2016, the Company's Board approved (after the Compensation Committee's approval of the same date) engagement for renewal of the Company's insurance policy for directors and officers (including from among the Company's controlling shareholders) of the Company and the Company's subsidiaries, except in relation to the Granite Hacarmel group which holds an independent D&O insurance policy, from June 3, 2016 until June 2, 2017 (the "**Engagement**"). The approval was issued pursuant to the provisions of Sections 1B(5) and 1B1 of the Companies Regulations (Relief in Transactions with Interested Parties), 5760-2000. The engagement is in accordance with the Company's compensation policy (as being at such time).

The Engagement will be on the basis of the main terms of engagement specified in the Company's compensation policy and below:

(1) The limits of liability in the insurance policy shall not exceed U.S. $100 million per event and for the period of the insurance, plus reasonable legal defense costs in Israel, over and above the limits of liability, and in respect of claims filed outside of Israel – reasonable legal defense costs over and above the limits of liability, in accordance with trial costs customary in Israel and pursuant to the Israeli law.

(2) The deductible per claim for the Company alone shall not exceed U.S. $150 thousand, in accordance with the cause of action and the place of filing thereof, and at an annual premium which has been and/or shall be paid which shall not exceed U.S. $250 thousand.

(3) The insurance policy was extended to cover claims that are filed against the Company (as distinguished from claims against directors and/or officers thereof), which concern the violation of securities law at least in Israel (entity coverage for securities claims), and procedures for the payment of insurance benefits shall be determined, whereby the right of the directors and/or officers to receive indemnification from the insurer pursuant to the policy shall precede the right of the Company.

(4) The policy covers also the liability of the controlling shareholders in their capacity as directors and/or officers of the Company, and the terms of the coverage with respect thereto do not exceed those of the other directors and/or officers of the Company.

POSI type policy – On June 3, 2010 the Company purchased a POSI (Public Offering of Securities Insurance) type insurance policy, which covers the responsibility of the Company, the directors and the officers in it, the controlling interests and additional parties, who have taken part in public offering of the Company's shares in accordance with the prospectus that was issued in May 2010 (the "**Offering**"), against claims that may be filed against them in connection with the Offering and this for a period of 7 years from the time of the Offering. The maximum limits of liability of the insurer in accordance with this policy will not exceed U.S. $100 million per event and for the period of the insurance, plus reasonable legal defense costs over and above the limits of liability pursuant to the Israeli law. The annual premium is U.S. $250 thousand. The deductible per claim for the Company in respect of claims under this policy will not exceed U.S. $35 thousand.

Note 37 – Related and interested parties (Cont.)

D. Exemption, insurance and indemnification for officers and directors: (Cont.)

On August 9, 2016, the general meeting of the Company's shareholders approved amendments to the Company's articles of association, concerning mainly updates in accordance with legislative provisions that have changed, expansion of the liabilities and/or expenses for which the Company will be entitled to grant indemnification and/or insurance to directors and officers, *inter alia*, pursuant to the Restrictive Trade Practices Law, 5748-1988, and expansion of the term "Party Injured by a Breach" such that the aforesaid definition will apply to any and all acts of legislation pursuant to which an administrative proceeding may be held.

On October 6, 2016, the general meeting of the Company's shareholders approved an amendment to the exemption clause in the Company's articles of association such that following the amendment to the articles the Company may exempt, in advance and retrospectively, an officer thereof, of his liability, in whole or in part, for damage pursuant to a breach of the duty of care towards it, to the maximum extent permissible under any law, subject to the exemption not applying to a resolution or transaction in which the controlling shareholder or an officer of the Company have a personal interest.

E. Negligible transactions:

On November 24, 2010, the Company's Board decided to adopt guidelines and rules regarding the classification of transactions which are not irregular transactions, of the Company or of a consolidated company thereof with interested parties therein or controlling shareholders, as a negligible transactions. Such guidelines were prescribed, *inter alia*, considering the scope of the Company's assets, the diversity of its businesses, the nature of the transactions performed thereby and the level of effect thereof on the Company's business and results. In May 2015, the Company's Board adopted a master procedure for transactions with related parties, which consolidated and incorporated procedures that were approved at the Company in the years preceding the approval thereof, including in respect of classification of negligible transactions.

Such rules and guidelines will serve on the one hand for examining the need to approve the transaction at the relevant institutions in the Company, and on the other hand, for examining the duty and/or scope of disclosure in the periodic report and the prospectus (including in shelf offer reports), and/or the provision of an immediate report in respect of such a transaction. It is noted that the transactions are examined at the group level, including material companies controlled by the Company.

The Company's Board determined that a negligible transaction at the Company is a transaction of the Company with controlling shareholders or another person in which the controlling shareholder has a personal interest, which is not irregular (i.e. is in the ordinary course of business, under market conditions and not material), and meets the following tests:

(1) In respect of the duty to provide an immediate report in connection with a negligible transaction – a single transaction in a company or a subsidiary controlled thereby is a negligible transaction if the financial scope thereof does not exceed the rate of 0.1% of the Company's consolidated equity according to the last financial statements; in case of ongoing transactions (including rent, leases and so forth), according to the monthly transaction amount, or the total sum of the transaction for the whole duration of the engagement, according to the shorter/lower between them. For the purpose of immediate report, the negligibility of a transaction will be examined on the basis of the specific single transaction, and to the extent such will pass the negligibility threshold, the Company will report such transaction through an immediate report.

Note 37 - Related and interested parties (Cont.)

E. Negligible transactions: (Cont.)

(2) In respect of providing specification in the annual report in connection with negligible transactions – the total sum of all of the transactions of a certain type in the Company or a subsidiary controlled thereby, in a calendar year has not exceeded a rate of 0.5% of the Company's consolidated equity according to the last annual reports. The Company will include the types of transactions and aggregate amount thereof within its annual report only if the total amount exceeds the rate stated above. For the purpose of reporting within a periodic report, financial statements and a prospectus (including a shelf proposition report), the negligibility of the aggregate of all of the transactions of the same type of the Company with the controlling shareholder or with corporations controlled by the controlling shareholder, will be examined on an annual basis.

(3) Integrated transactions - upon the classification of transactions as negligible or non-negligible, each transaction will be examined in itself, however, the negligibility of integrated transactions, or such that are contingent upon each other or transactions of the same type, will be examined in the aggregate as one transaction. In respect of multiannual transactions (agreements for a period of several years), the scope of transaction will be calculated for examination of the negligibility threshold on an annual basis (i.e. – the total monetary amount deriving from the transaction exceeding the negligibility threshold as aforesaid). In insurance transactions, the premium will be examined as the transaction amount. Regardless of the insurance coverage provided, multiannual insurance transactions will be measured on the basis of the annual insurance fees paid or collected.

(4) Negligible transactions at the subsidiaries – the transactions classified as negligible by the Company's investees will be deemed as negligible at the Company level too, while those classified by them as non-negligible, will be examined on the Company level. In case that the Company does not have available information allowing the examination of the classification of transactions as negligible or non-negligible transactions, then the aggregate of all of the transactions of the same type will be deemed as a negligible or non-negligible transaction, except if according to the figures in the Company's possession, one of the two conditions has been fulfilled: (1) According to the quantitative parameter above, the transaction in itself as a single transaction is not negligible; (2) the aggregate of the transactions is material to the Company.

(5) Non-quantitative examination – notwithstanding the aforesaid, the examination of the qualitative considerations of a negligible transaction from the quantitative aspect, may lead to the classification thereof as a transaction which is not negligible, if due to its nature, materiality and effect on the Company it is perceived as a significant event by the Company's management and serves as a basis for adoption of important managerial decisions or if within the context of the Company's transaction with controlling shareholders or another person in which the controlling shareholder has a personal interest, the other party is expected to receive benefits with regards to which there is significance in the reporting thereof to the investor public. It is clarified that even if a transaction of the Company with controlling shareholders or another person in which the controlling shareholder has a personal interest meets the quantitative test below, it will not be deemed negligible if such qualitative considerations indicate a material aspect thereof.

The approving entity

Pursuant to Section 22.3 of the Company's articles of association, the Board determined that the classification of an interested parties' transaction as a negligible transaction will be examined by the CFO in cooperation with the General Counsel, to the extent required, and in any approval of a transaction as negligible the examination and classification proceeding will be documented.

Note 37 - Related and interested parties (Cont.)

E. Negligible transactions: (Cont.)

(5) (Cont.)

The approving entity (Cont.)

In accordance with the Company’s master procedure, the classification of a transaction of the Company with controlling shareholders or with another person in which the Controlling Shareholder has a personal interest as a negligible transaction will be examined by the CFO and the General Counsel, to the extent required, and in every approval of a transaction as a negligible transaction, the examination and classification proceeding will be documented. In addition, the Board has authorized the Company's CEO or the CFO to approve the performance of transactions which meet the definition of negligibility according to this procedure, subject to the following two exceptions: (a) a situation in which both of the said persons have a personal interest in the same transaction, in which case such person will be replaced by another senior officer at the Company; and (b) a transaction concerning the terms of office and employment of an officer, or an engagement with a controlling shareholder or his relative, directly or indirectly, including through a company controlled by him, in respect of receipt of services from him by the Company, and if he is an employee of the Company and not an officer thereof – in respect of his employment at the Company, in which case the approval proceeding will be carried out pursuant to the Companies Law.

Competitive proceeding or another proceeding

In May 2015, the Audit Committee approved an amendment to the procedure, whereby unless decided otherwise by the Audit Committee, for Irregular Transactions and Non-negligible Transactions specified in Section 270(4) of the Companies Law, the Company's management shall conduct a competitive proceeding or another proceeding at the Company under the supervision of the Audit Committee, in accordance with the following principles.

In transactions for the purchase of services and/or the purchase of equipment and systems, the amount of annual expense in respect of which exceeds the quantitative threshold set for in the procedure, proposals from at least 3 different relevant suppliers in the required field, which were given in accordance with a specification of requirements to be determined thereby according to its needs and in accordance with the Group's procurement procedures, as being from time to time, will be presented to the Audit Committee with a recommendation to the Audit Committee of the chosen bidder and the reasons for the choice. The invitation to submit proposals will be supervised by the CFO of the Company who may instruct, according to his discretion, the performance of changes and/or improvements in the proceeding and/or negotiations with the bidders.

Note 37 - Related and interested parties (Cont.)

E. Negligible transactions: (Cont.)

(5) (Cont.)

Competitive proceeding or another proceeding (Cont.)

With respect to transactions for the lease of income-producing spaces, which are the Company's core business, and in view of the fact that during the regular course of business the proper proceeding is not necessarily a competitive proceeding, especially when such proceeding may create a business advantage for competing companies vis-à-vis potential lessees who are good for the Company, and the length of time for conducting such proceeding may jeopardize good transactions, the Company has adopted another proceeding, whereby a transaction, the amount of annual expense in respect of which exceeds the quantitative threshold set for in the procedure, and assuming that the marketing stages for such asset shall have commenced (i.e., pricing, hiring brokers etc.), the Company shall act to collect comparative data for the transaction (price per sqm, benefits and investments, lessees and their characterization, fittingness to the mix) in similar properties of the Company and similar properties of third parties in that area, and, to the extent required, shall be assisted by external consultants for this purpose. The Audit Committee and/or Board of Directors may request the Company's management to provide additional details or a comparison from other aspects. The Company's management shall present the Audit Committee with the details of the transaction proposed for approval and the reasons with respect to its advantageousness relative to the comparative transactions. It is clarified, that if it is a transaction which the Audit Committee determines to be uncharacteristic of the Company due to its scope and content (such as the construction or purchase of an entire building for the purpose of leasing it to one lessee which is a Related Party), the Audit Committee shall determine the procedures and the transaction shall be approved according to the requirements of the law.

Related Party Transactions for the purchase of products from companies owned by Granite Hacarmel, whose activity is not in the core business of the Group and their products are mostly sold "over the counter", will not be deemed a transaction under the procedure.

Transactions with respect to terms of office and employment, other transactions with companies in the Granite Group and/or the contribution to bodies in which the Controlling Shareholder has a Personal Interest, shall be discussed at the Audit Committee, which shall determine, for every transaction, the suitable procedure for approval thereof. Nothing in the aforesaid shall derogate from the duties of approval of such engagements under any law.

In types of transactions in respect of which this chapter does not stipulate whether there is a duty to conduct a competitive proceeding or another proceeding, the Audit Committee shall determine in advance, ad hoc, for any concrete future transaction, whether the competitive proceeding or another proceeding will be conducted and the nature thereof as aforesaid.

Supervision and audit

Internal bi-quarterly review – until July 15 and January 15 of each year, a report shall be made to the Company's CFO on transactions as stated in the procedure (including negligible and non-negligible transactions) in which the Company engaged in the two quarters that lapsed, and in respect of transactions with affiliates in which other companies in the Group engaged, stating the terms and conditions of each transaction (annual financial volume, general financial volume, nature of the transaction, identity of the related party and other material conditions).

Note 37 - Related and interested parties (Cont.)

E. Negligible transactions: (Cont.)

(5) (Cont.)

Annual follow-up

Once a year, before the deliberation on the Company's annual financial statements, or in special cases if the Audit Committee so requests prior thereto, the coordinator will report to the Audit Committee on transactions as stated in the procedure (including negligible and non-negligible transactions and including the Company's engagements in lease agreements with related parties in view of the Company's undertaking in the Company's IPO prospectus released in May 2010) and in which the Company engaged during the previous year and during the months until the date of approval of the financial statement at the Company's institutions, insofar as relevant. The report will also include related party transactions in other companies of the Group which were brought to the coordinator’s attention during such period, stating the terms and conditions of each transaction (annual financial volume, general financial volume, nature of the transaction, identity of the related party and other material conditions), and regarding the sum total of the related party transactions in such year. In the framework of the annual follow-up as aforesaid, the officer shall attach a statement signed by him, whereby to the best of his knowledge and understanding, all of the relevant processes for mapping and identifying transactions with related parties were carried out at the Company and that all of the checks required by virtue of the undertaking in the prospectus were carried out, all in accordance with the provisions of the procedure, and that the transactions he reported were duly disclosed in the annual financial statements.

The Company's Board of Directors will examine, from time to time and at least once every three years, after receipt of the Audit Committee's recommendation, the implementation of the procedure by the Company and the need to update the procedure and/or the criteria therein and/or the proceedings prescribed for approval of the transactions, considering related party transactions in which the Company engages, material changes in the scope of the business of the Company and the Company’s investee companies, and the relevant financial figures, and changes in the relevant statutory provisions. The provisions of the procedure do not derogate from the authority of the Audit Committee to decide to hold a discussion, from time to time, on various aspects relating to interested party transactions and to invite to such discussions the relevant entities, including the Company's management, the coordinator, the internal auditor and the General Counsel.

After discussing the implementation of the provisions of the negligible transactions procedure and reviewing the consideration for the negligible transactions signed in 2016 and their other characteristics vis-à-vis the market conditions, that was held on March 19, 2017 and March 21, 2017, the Audit Committee and the Board determined, respectively, that they were all transactions duly approved in 2016, including at the material companies controlled by the Company, and made under accepted market conditions and they have no material effect on the Company’s business position and results of operations. They further determined that all of the transactions examined as aforesaid were found to be transactions that meet the definition of “negligible transaction” in accordance with the Company’s procedure in respect of negligible transactions, and that this procedure was adequately implemented by the Company.

Note 38 – Segment reporting

A. General:

The Company applies IFRS 8, "Operating Segments" ("**IFRS 8**"). In accordance with the provisions of the standard, operating segments are identified on the basis of the internal reporting in respect of the components of the Group, which are reviewed on a regular basis by the Group's Chief Operational Decision Makers ("**CODM**") for the purpose of the allocation of resources and the evaluation of the performance of the operating segments.

The Company's business activities focus primarily on the various property segments, while most of the Group's business activity is in the retail centers and malls in Israel segment, and in the office and other space for lease segment, and land designated for residential lease in Israel. In addition, the Company engages in the income-producing property in the USA segment (office space for lease). The Company engages also in the senior housing segment after having completed the purchase of the "Palace" senior home in Tel Aviv, and in May 2016 purchased the "Palace" senior home in Ra'anana (formerly - "Ahuzat Bayit"), and it purchased rights in three sites on which it is planning and building additional senior homes which are at various stages of development and construction. Starting from the quarterly statement for September 30, 2016, in view of the establishment and expansion of activity and investment in development projects in this segment, the Company is reporting its activity in the senior housing segment as a separate business segment, as this term is defined in GAAP. In addition, the Company engages, through its holding (100%) in Granite in the marketing of energy substitutes (through Supergas Israeli Gas Distribution Company Ltd., held 100% by Granite), and through its holding (through Granite) in GES Global Environmental Solutions Ltd. in the field of the treatment of water, wastewater and chemicals. In view of the closing of the transaction for the sale of the Group's holdings in Sonol (commencing from the quarterly report as of June 30, 2016, Sonol's activity became discontinued operations according to GAAP (for further details, see Note 8)), starting from the quarterly statement for September 30, 2016, the Company began reporting its business in the Granite segment as a separate business segment, as this term is defined in GAAP. In view of the aforesaid, the comparison figures for 2014 and 2015 have been adjusted to reflect therein the Company's method of segment presentation in 2016.

The Company engages in additional activities which are classified as other operating segments, including financial investments and activity in the eCommerce sector which was recently acquired.

The following are the Company's operating segments:

Segment A – Retail centers and malls in Israel.

Segment B – Office and other space for lease in Israel.

Segment C – Income-producing property in the USA.

Segment D – Senior housing.

Segment E – Granite.

In the following business segments: the retail centers and malls in Israel, office and other space for lease in Israel, income-producing property in the USA and senior housing, the data of each one of the segments was aggregated.

Following are the considerations exercised by the management in implementing the criteria for aggregation of each one of these segment:

Note 38 – Segment reporting (Cont.)

A. General (Cont.)

The Group's management examined the financial characteristics of each one of these segments and reached the conclusion that the financial characteristics in each one of them are similar, due to the fact that each one of the segments is managed in the same geographical region (Israel or the USA), stated in the same currency (NIS or USD), subject to similar political and legal conditions, and has similar profitability rates. In addition, the Group's management considered that each one of these segments is similar in all of the following characteristics:

- The nature of the projects – all of the projects in each one these segments are in the same operating segment.
- The nature of the development and enterprise processes – all of the projects in each one of these segments involve similar development and enterprise processes.
- Type of customers – all of the projects in each one of these segments, are marketed to similar clientele (business customers, the senior population).
- The methods used for marketing the projects – the methods for marketing all of the projects in each one of these segments are similar and include identical advertising and marketing processes.
- The nature of the supervisory environment – similar laws, regulations and rules apply to all of the projects in each one of these segments, including in respect of real property, planning, construction, and leasing, environmental protection, laws on the municipal level and in respect of land taxation, and laws and regulations in the field of senior housing.

Based on the considerations specified above, the Group's management believes that the aggregation of each one of the segments: the retail centers and malls in Israel, office and other space for lease in Israel, income-producing property in the USA and senior housing are in accordance with IFRS 8.

Note 38 – Segment reporting (Cont.)

B. Operating segments:

	For the year ended December 31, 2016						
	Retail centers and malls in Israel	Office and other space for lease Israel	Income-producing property in the USA	Senior housing	Granite	Others	Consolidated
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Income:							
Total external income	973,971	446,810	228,906	94,934	653,249	7,546	2,405,416
Total segment expenses	195,455	77,645	105,354	65,634	570,179	11,597	1,025,864
Segment profit (loss) (NOI)	778,516	369,165	123,552	29,300	83,070	(4,051)	1,379,525
Net profit (loss) from adjustment to fair value of investment property and investment property under construction	220,001	517,076	(82,245)	55,746	-	-	710,578
Unallocated costs							(114,858)
Financing expenses, net							(110,063)
Other income, net							8,925
Company's share in the results of associates, net of tax							(8,439)
Income before taxes on income							1,865,695
Additional information as of December 31, 2016:							
Segment assets	12,074,258	8,218,829	2,176,253	1,494,520	1,297,992	-	25,261,852
Unallocated assets (1)							3,321,380
Total consolidated assets							28,583,232
Capital investments	639,122	1,037,855	232,676	638,041	43,428		

(1) Mainly financial assets available for sale in the sum of approx. NIS 1.6 billion and cash and short-term deposits in the sum of NIS 1.3 billion.

Note 38 – Segment reporting (Cont.)

B. Operating segments: (Cont.)

	For the year ended December 31, 2015							
	Retail centers and malls in Israel	Office and other space for lease Israel	Income-producing property in the USA	Senior housing	Granite	Others	Adjustments (**)	Consolidated
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Income:								
Total external income	931,135	419,607	236,247	35,556	731,309	1,038	-	2,354,892
Total segment expenses	183,508	72,122	104,602	23,819	643,854	124	-	1,028,029
Segment profit (NOI)	747,627	347,485	131,645	11,737	87,455	914	-	1,326,863
Net profit (loss) from adjustment to fair value of investment property and investment property under construction	122,972	70,294	(28,294)	14,099	-	-	-	179,071
Unallocated costs								(95,148)
Financing expenses, net								(127,066)
Other income, net								7,090
Company's share in the results of associates, net of tax								(8,562)
Income before taxes on income								1,282,248
Additional information as of December 31, 2015:								
Segment assets	11,055,969	6,829,670	2,052,023	803,266	1,175,267	-	1,912,532	23,828,727
Unallocated assets (*)								2,616,378
Total consolidated assets								26,445,105
Capital investments	373,734	535,870	48,387	716,738	48,706	-		

(*) Mainly financial assets available for sale in the sum of approx. NIS 1.6 billion and cash and short-term deposits in the sum of approx. NIS 0.9 billion.

(**) Segment assets and capital investments of discontinued operations.

Note 38 – Segment reporting (Cont.)

C. Operating segments: (Cont.)

	For the year ended December 31, 2014							
	Retail centers and malls in Israel	Office and other space for lease Israel	Income-producing property in the USA	Senior housing	Granite	Others	Adjustments (**)	Consolidated
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Income:								
Total external income	877,464	386,954	191,467	-	871,699	955	-	2,328,539
Total segment expenses	167,995	69,039	84,163	-	799,564	54	-	1,120,815
Segment profit (NOI)	709,469	317,915	107,304	-	72,135	901	-	1,207,724
Net profit (loss) from adjustment to fair value of investment property and investment property under construction	(89,278)	117,106	8,873	-	(10,641)	-	-	26,060
Unallocated costs								(83,937)
Financing expenses, net								(134,985)
Other income, net								53,847
Company's share in the results of associates, net of tax								(9,545)
Income before taxes on income								1,059,164
Additional information as of December 31, 2014:								
Segment assets	10,595,488	6,134,174	2,026,057	75,801	2,578,984	-	2,207,961	23,618,465
Unallocated assets (*)								1,810,646
Total consolidated assets								25,429,111
Capital investments	512,049	458,497	291,282	75,801	71,386	-		

(*) Mainly financial assets available for sale in the sum of approx. NIS 1.6 billion.

Note 39 - Material subsequent events

A. Pursuant to a resolution of the Board on March 21, 2017, it has been resolved to distribute a dividend in the total amount of NIS 480 million.

B. For updates on claims after the Date of the Statement of Financial Position - see Note 33 regarding contingent liabilities.

Azrieli Group Ltd.

Separate Financial Information
For Year 2016

Prepared pursuant to the provisions of Section 9C of the Securities Regulations
(Periodic and Immediate Reports), 5730-1970

Azrieli Group Ltd.

Separate Financial Information
For year 2016

Contents

Deloitte.

To
The Shareholders of
Azrieli Group Ltd.
1 Azrieli Center
Tel Aviv

Dear Sir/Madam,

Re: Special report of the Auditor on separate financial information pursuant to Regulation 9C of the Securities Regulations (Periodic and Immediate Reports), 5730-1970

We have audited the separate financial information, which is presented according to Regulation 9C of the Securities Regulations (Periodic and Immediate Reports), 5730-1970, of Azrieli Group Ltd. (the "**Company**") as of December 31, 2016 and 2015 and for each of the years in the three-year period ended December 31, 2016. The Company's Board and Management are responsible for this separate financial information. Our responsibility is to express an opinion on this separate financial information based on our audit.

We did not audit the separate financial information from the financial statements of investee companies, the total investments in which amounted to approx. NIS 756 million and approx. NIS 1,037 million as of December 31, 2016 and 2015, respectively, and the income from continuing operations from such investee companies amounted to approx. NIS 48 million, approx. NIS 196 million and approx. NIS 49 million for the years ended on December 31, 2016, 2015 and 2014, respectively, and results from discontinued operations which amounted to a total loss of approx. NIS 9 million, a loss of approx. NIS 99 million and to an income of approx. NIS 109 million for the years ended on December 31, 2016, 2015 and 2014, respectively. The financial statements of such companies were audited by other auditors whose reports were furnished to us, and our opinion, insofar as it relates to the amounts that have been included in respect of such companies, is based upon the reports of the other auditors.

We performed our audit in accordance with generally accepted auditing standards in Israel. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the separate financial information is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and details included in the separate financial information. An audit also includes assessing the accounting principles used in the preparation of the separate financial information and significant estimates made by the Company's Board and Management, as well as evaluating the overall separate financial information presentation. We believe that our audit and the other auditors' reports provide a reasonable basis for our opinion.

In our opinion, based on our audit and on the reports of other auditors, the separate financial information was prepared, in all material respects, according to the provisions of Regulation 9C of the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

Brightman, Almagor, Zohar & Co.
Certified Public Accountants
Member of Deloitte Touche Tohmatsu Limited

Tel Aviv, March 21, 2017

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Azrieli Group Ltd.

Information on the Financial Position

	As of December 31	
	2016	2015
	NIS in thousands	NIS in thousands
Assets		
Current assets		
Cash and cash equivalents	453,911	761,281
Short-term deposits and investments	611,540	506
Trade accounts receivable	9,658	7,375
Other receivables	100,594	142,801
Total current assets	1,175,703	911,963
Non-current assets		
Financial assets	1,625,453	1,581,575
Investment property and investment property under construction	9,480,072	7,565,747
Investments in investee companies	7,931,264	6,909,576
Loans to investee companies	3,831,713	3,413,982
Fixed assets	8,290	7,147
Receivables	8,214	5,915
Total non-current assets	22,885,006	19,483,942
Total assets	24,060,709	20,395,905
Liabilities and capital		
Current liabilities		
Current maturities and credit from banks and other credit providers	1,755,858	1,019,599
Trade payables	59,087	51,417
Payables and other current liabilities	73,341	33,778
Deposits from senior housing tenants	2,100	-
Current tax liabilities	14,427	37,683
Total current liabilities	1,904,813	1,142,477
Non-current liabilities		
Loans from banks and other credit providers	1,513,587	1,733,284
Bonds	4,149,815	2,579,151
Other liabilities	16,430	15,595
Deferred tax liabilities	1,199,334	1,151,592
Employee benefits	3,372	2,581
Total non-current liabilities	6,882,538	5,482,203
Capital		
Share capital	18,223	18,223
Premium	2,477,664	2,477,664
Capital reserves	539,879	447,747
Retained earnings	12,237,592	10,827,591
Total capital attributed to shareholders of the Company	15,273,358	13,771,225
Total liabilities and capital	24,060,709	20,395,905

March 21, 2017			
Date of approval of the separate financial information	**Danna Azrieli Chairman of the Board of Directors**	**Yuval Bronstein CEO**	**Irit Sekler-Pilosof Chief Financial Officer**

Azrieli Group Ltd.

Information on the Income or Other Comprehensive Loss and Profit

	For the year ended December 31		
	2016	2015	2014
	NIS in thousands	NIS in thousands	NIS in thousands
Revenues			
From rent and management and maintenance fees	470,795	458,981	444,446
Net profit (loss) from adjustment to fair value of investment property and investment property under construction	614,127	(18,693)	(85,688)
Financing	188,248	145,406	154,510
Other	10,005	10,042	9,914
Total revenues	1,283,175	595,736	523,182
Costs and expenses			
Cost of revenues from rent and management and maintenance fees	13,541	14,395	15,365
Sales and marketing	23,275	25,087	14,538
General and administrative	51,486	49,072	47,133
Financing	90,868	68,307	70,357
Total costs and expenses	179,170	156,861	147,393
Profit before Company's share in the profits of investee companies	1,104,005	438,875	375,789
Share in profits of investee companies, net of tax (*)	813,933	591,037	448,268
Profit before income taxes	1,917,938	1,029,912	824,057
Taxes on income	(99,419)	(109,994)	(83,779)
Profit from continuing operations	1,818,519	919,918	740,278
Profit (loss) from discontinued operations (after tax) (*)	(8,501)	(98,927)	109,209
Net profit for the year	1,810,018	820,991	849,487
Other comprehensive income:			
Amounts that were or will be classified in the future to income or loss, net of tax:			
Change in fair value of financial assets available for sale, net of tax	86,312	10,286	(39,724)
Translation differences due to foreign operations	(8,950)	2,940	65,532
Share in the other comprehensive income of investee companies, net of tax.	7,633	5,399	23,887
Total	84,995	18,625	49,695
Amounts that will not be classified in the future to income or loss, net of tax:			
Actuarial loss due to defined benefit plan, net of tax	-	(78)	(54)
Other comprehensive income for the year, net of tax	84,995	18,547	49,641
Total comprehensive income for the year	1,895,013	839,538	899,128

(*) Comparison figures were re-presented due to discontinued operations (for further details, see Note 8 to the Consolidated Financial Statements).

Azrieli Group Ltd.

Information on the Cash Flows

	For the year ended December 31		
	2016	2015	2014
	NIS in thousands	NIS in thousands	NIS in thousands
Cash flows - current operations			
Net profit for the year	1,810,018	820,991	849,487
Depreciation and amortization	1,327	894	939
Loss (profit) from the liquidation of fixed assets	(5)	(20)	5
Net loss (profit) from adjustment of fair value of investment property and investment property under construction	(614,127)	18,693	85,688
Financing and other income, net	(103,380)	(84,014)	(87,115)
Share in profits of investee companies, net of tax	(805,432)	(492,110)	(557,477)
Tax expenses recognized in the income statement	99,419	109,994	83,779
Income tax paid, net	(87,904)	(70,709)	(49,033)
Change in financial assets	(66)	151	554
Change in trade and other receivables	51,069	(34,996)	937
Change in trade and other payables	13,549	(6,151)	1,333
Change in employee provisions and benefits	791	(11,288)	(3,104)
Revaluation of financial assets designated at fair value through profit and loss	(3,927)	(2,715)	(6,760)
Change in benefit recorded in respect of share based payment and employee benefits	-	2,637	1,089
Receipt of deposits from senior housing tenants	2,100	-	-
Net cash – current operations	363,432	251,357	320,322
Cash flows - investment activities			
Proceeds from the liquidation of fixed and intangible assets	35,595	436	319
Acquisition and investment in investment property and investment property under construction	(1,262,940)	(445,891)	(367,159)
Down payments on account of investment property	-	(4,815)	(2,081)
Purchase of fixed and intangible assets	(38,060)	(3,468)	(895)
Investments in investee companies	(110,202)	(781)	(1,036)
Investment in financial assets designated at fair value through profit and loss, net	5,389	2,338	782
Receipt (Granting) of long-term loans to investee companies, net	(290,088)	(163,590)	152,247
Acquisition of investee companies	(99,110)	-	(82,439)
Interest and dividend received	34,494	31,021	16,193
Return of investment in an investee company	2,312	1,962	4,436
Proceeds from liquidation of financial assets available for sale	79,674	-	-
Change in short-term deposits	(610,968)	-	-
Net cash - investment activities	(2,253,904)	(582,788)	(279,633)

Azrieli Group Ltd.

Information on the Cash Flows
(Continued)

	For the year ended December 31		
	2016	2015	2014
	NIS in thousands	NIS in thousands	NIS in thousands
Cash flows - financing activities			
Issue of bonds net of issue expenses	2,176,535	2,209,284	-
Dividend distribution to the shareholders	(400,000)	(320,000)	(280,000)
Repayment of bonds	(166,541)	(44,183)	(44,636)
Receipt of long-term loans from banks and other corporations	800,000	-	300,000
Repayment of long-term loans from banks and other corporations	(769,842)	(624,913)	(208,948)
Short-term credit from banks and other corporations, net	45,319	(53,116)	(12,962)
Customer deposits, net	873	223	(1,618)
Interest paid	(102,905)	(91,927)	(100,930)
Net cash - financing activities	1,583,439	1,075,368	(349,094)
Increase (decrease) in cash and cash equivalents	(307,033)	743,937	(308,405)
Cash and cash equivalents at the beginning of the year	761,281	19,330	327,837
Effect of exchange rates changes on cash balances held in foreign currency	(337)	(1,986)	(102)
Cash and cash equivalents at the end of the year	453,911	761,281	19,330

(*) Non-cash activities include increase in payables balances due to credit purchases of non-current assets in the amount of NIS 4,712 thousand.

Azrieli Group Ltd.

Additional Information for the Separate Financial Statements

A. General:

Definitions

The Company	-	Azrieli Group Ltd.
Investee company	-	See Note 10 to the Company's Consolidated Financial Statements as of December 31, 2016.

B. Form of Preparation of the Financial Information:

The financial information out of the Consolidated Statements, attributed to the Company itself as a parent company (the "Financial Information") were prepared according to the provisions of Regulations 9C of and the 10th Schedule to the Securities Regulations (Periodic and Immediate Reports), 5730-1970.

The Notes specified below also include disclosures pertaining to additional material information, according to the disclosure requirements specified in the said Regulation and as specified in the 10th Schedule, insofar as such information is not included in the Consolidated Statements in a manner which explicitly addresses the Company itself as a parent company.

(1) Accounting policy

The Company's separate financial information is prepared according to the accounting policy specified in Note 2 to the Company's Consolidated Financial Statements except for the amounts of the assets, liabilities, revenues, expenses and cash flows in respect of investee companies, as specified below:

a. The assets and liabilities are presented at their value in the consolidated statements attributed to the Company itself as a parent company, except for investments in investee companies.

b. Investments in investee companies are presented as the net sum amount of the total assets net of the total liabilities which present in the Company's consolidated statements financial information regarding the investee companies, including goodwill.

c. The revenues and expenses amounts reflect the revenues and expenses included in the consolidated statements attributed to the Company itself as a parent company, segmented between profit or loss and other comprehensive income, except for amounts of revenues and expenses in respect of investee companies.

d. The Company's share in the results of investee companies is presented as the net amount of the total revenues net of the total expenses presenting in the consolidated statements of the Company business results in respect of investee companies, including impairment of goodwill or the reversal thereof, in segmentation between profit or loss and other comprehensive income.

e. The cash flow amounts reflect the amounts included in the consolidated statements attributed to the Company itself as a parent company, except for amounts of the cash flows in respect of investee companies.

f. Loans given and/or received from investee companies are presented at the amount attributed to the Company itself as a parent company.

g. Balances, revenues and expenses in respect of transactions with investee companies which were written off within the consolidated statements, are measured and presented within the relevant clauses in the information on the financial position and the comprehensive income, in the same manner that such transactions would have been measured and presented had they been performed vis-à-vis third parties. Profits (losses) in respect of such transactions until the level that they are not recognized in the Company's consolidated statements, which were deferred, are presented net of (as an addition) of the items of the Company's share in the profits (losses) of investee companies and investments in investee companies so that the Company's separate profit (loss) is identical to the Company's consolidated profit (loss) attributed to the owners of the parent company.

C. Financial Assets and Liabilities:

(1) Liquidity risk management

Financial liabilities which do not constitute derivative financial instruments:

The following tables specify the Company's remaining contractual maturity dates in respect of financial liabilities which do not constitute a derivative financial instrument. The tables were prepared based on the non-discounted cash flows of the financial liabilities based on the earliest date on which the Company might be required to repay them. The table includes cash flows in respect of both interest and principal.

	As of December 31, 2016						
	Book Value	Projected cash flow	2017	2018	2019	2020 forth	Without maturity date / per demand
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Financial liabilities which are not derivatives							
Short-term credit from banks and other credit providers (1)	675,311	675,311	675,311	-	-	-	-
Trade accounts payable	59,087	59,087	59,087	-	-	-	-
Other payables	26,469	26,469	26,469	-	-	-	-
Deposits from senior housing tenants	2,100	2,100	-	-	-	-	2,100
Loans from banks and other credit providers (2)	1,994,254	2,105,574	507,345	443,327	216,904	937,998	-
Bonds (2)	4,781,412	5,131,330	665,226	359,094	442,778	3,664,232	-
Long-term customer deposits	16,403	16,403	-	-	16,403	-	-
Total	7,555,036	8,016,274	1,933,438	802,421	676,085	4,602,230	2,100

	As of December 31, 2015					
	Book Value	Projected cash flow	2016	2017	2018	2019 forth
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Financial liabilities which are not derivatives						
Short-term credit from banks and other credit providers (1)	629,992	629,992	629,992	-	-	-
Trade accounts payable	51,417	51,417	51,417	-	-	-
Other payables	13,355	13,355	13,355	-	-	-
Loans from banks and other credit providers (2)	1,964,216	2,060,040	274,151	1,045,721	155,902	584,266
Bonds (2)	2,751,243	2,934,315	209,935	639,083	243,496	1,841,801
Long-term customer deposits	15,578	15,578	-	-	15,578	-
Total	5,425,801	5,704,697	1,178,850	1,684,804	414,976	2,426,067

(1) Book value includes interest accrued as of December 31, 2016 and 2015.
(2) Book value includes current maturities and interest accrued as of December 31, 2016 and 2015.

C. Financial Assets and Liabilities (Contd.):

(2) Details regarding investments in other companies:

Details regarding investments in financial assets available for sale

For details pertaining to the Company's investments in Bank Leumi Le-Israel Ltd. and Leumi Card Ltd., see Note 12 to the Consolidated Financial Statements as of December 31, 2016.

D. Taxes on Income:

(1) Details regarding the tax environment in which the Group operates and changes in the tax rates:

For details pertaining to the tax environment in which the Company operates and changes in the tax rates, see Note 30A to the Consolidated Financial Statements for the year ended on December 31, 2016.

(2) Taxes on income recognized in profit and loss:

	For the year ended on December 31		
	2016	2015	2014
	NIS in thousands	NIS in thousands	NIS in thousands
Current taxes:			
For the current period	(63,854)	(74,854)	(74,344)
Adjustments for previous years, net	-	892	1,301
	(63,854)	(73,962)	(73,043)
Deferred taxes expenses:	(35,565)	(36,032)	(10,736)
Total income tax expenses	(99,419)	(109,994)	(83,779)

(3) Tax Assessments:

See Note 31F to the Consolidated Financial Statements of the year ended on December 31, 2016.

D. Taxes on Income: (Cont.)

(4) Taxes on income due to other comprehensive income components:

	2016			2015			2014		
	Amounts before tax	Tax income (expense)	Amounts net of tax	Amounts before tax	Tax income (expense)	Amounts net of tax	Amounts before tax	Tax income (expense)	Amounts net of tax
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Change in the fair value of financial assets available for sale	98,587	(12,275)	86,312	18,017	(7,731)	10,286	(53,607)	13,883	(39,724)
Actuarial losses for a defined benefit plan	-	-	-	(106)	28	(78)	(74)	20	(54)
Translation differences due to foreign operations	(8,950)	-	(8,950)	2,940	-	2,940	65,532	-	65,532
Share in the other comprehensive income (loss) of investee companies, net of tax	7,535	98	7,633	9,809	(4,410)	5,399	24,468	(581)	23,887
Total other comprehensive income (loss)	97,172	(12,177)	84,995	30,660	(12,113)	18,547	36,319	13,322	49,641

(*) The deferred taxes were calculated in 2016 according to a tax rate of 23% whereas in the years 2014-2015 according to a tax rate of 26.5%.

D. Taxes on Income: (Cont.)

(5) Deferred taxes note:

Deferred taxes assets and liabilities which were recognized

The deferred taxes are calculated according to the tax rate expected to apply on the reversal date as specified above.

Deferred taxes assets and liabilities are attributed to the following items:

	Real estate assets and fixed assets	Employee benefits	Financial instruments (1)	Carry forward deductions and losses for tax purposes	Others (2)	Total
	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands	NIS in thousands
Deferred tax asset (liability) balance as of December 31, 2014	(1,109,743)	3,366	(74,097)	12,936	55,877	(1,111,661)
Changes carried to profit and loss	(25,959)	(2,194)	(2,800)	879	(5,958)	(36,032)
Changes carried to other comprehensive income	-	28	(7,731)	-	(4,410)	(12,113)
Other changes	-	-	-	-	8,214	8,214
Deferred tax asset (liability) balance as of December 31, 2015	(1,135,702)	1,200	(84,628)	13,815	53,723	(1,151,592)
Changes carried to profit and loss	(191,055)	366	(1,001)	(3,552)	(5,818)	(201,060)
Changes carried to other comprehensive income	-	-	(25,558)	-	8,075	(17,483)
Effect of tax rate changes recognized in profit and loss	164,858	(161)	19	(1,539)	2,318	165,495
Effect of tax rate changes recognized in other comprehensive income	-	-	13,283	-	(7,977)	5,306
Deferred tax asset (liability) balance as of December 31, 2016	(1,161,899)	1,405	(97,885)	8,724	50,321	(1,199,334)

(1) Mainly due to financial assets available for sale.

(2) Mainly due to the capital reserve created due to credit given to subsidiaries other than at arm's length.

(3) The deferred taxes were calculated in 2016 mainly according to a tax rate of 23% whereas in 2015according to a tax rate of 26.5%.

E. Material Engagements and Transactions with Investee Companies:

(1) On material investments in companies directly held by the Company, see Note 10A to the Consolidated Financial Statements as of December 31, 2016.

(2) **a.** Canit Hashalom Investments Ltd. ("**Canit Hashalom**") issued to the Company bonds in the amount of NIS 1,220 million, linked to the Consumer Price Index. The linkage differentials in respect of the loan will not be lower, in any case, than the interest set in respect of Section 3(j) of the Income Tax Ordinance. The principal and the linkage differentials will be repaid in one sum on December 31, 2016 and in case that Canit Hashalom will not pay the principal, the interest and the linkage differentials until the maturity date, the bonds shall be deemed as having been paid and reissued on the day following the maturity date. The balance, as of December 31, 2016, is NIS 1,377 million.

b. Canit Hashalom issued to the Company bonds in the amount of NIS 1,080 million linked to the Consumer Price Index and bearing interest at a rate of 4.8% a year. The principal, interest and linkage differentials will be repaid in one sum on December 31, 2016. In case that Canit Hashalom will not pay the principal, interest and linkage differentials until the maturity date, the bonds shall be deemed as having been paid and reissued on the day following the maturity date. The balance as of December 31, 2016 is NIS 1,372 million.

In addition, the Company granted loans without a maturity date to Canit Hashalom, the balance of which as of December 31, 2016, is approx. NIS 188 million, which are not linked to the Index and bear interest according to the Income Tax Regulations.

The credit as of December 31, 2016 is presented and measured at fair value on the first recognition date, according to the current value of the projected returns. The difference between the fair value measured on the first recognition date and the loan amount actually granted, is carried to capital reserve from transactions with a controlling shareholder, and is in the amount of approx. NIS 139 million (December 31, 2015 – approx. NIS 150 million).

(3) Material arrangements between the Company and Investee Companies

a. The Company and several companies held thereby and other companies in the Group have agreements, according to which the Company is entitled to management fees at a fixed rate out of those companies' total expenses. In the years 2016 and 2015, the Company received management fees as aforesaid at a total sum of approx. NIS 19,262 thousand and approx. NIS 20,580 thousand, respectively.

b. The Company and several companies held thereby have agreements, according to which the Company is entitled to amounts for a depreciation and replacement fund for the replacement and/or fundamental repair of facilities and equipment serving all of the tenants in the Company's real estate. In the years 2016 and 2015, the Company received proceeds as aforesaid in a total amount of approx. NIS 4,663 thousand and approx. NIS 8,377 thousand, respectively.

c. The Company and several companies held thereby have agreements, according to which the Company is entitled to amounts for rent due to the companies' use of areas owned thereby. In the years 2016 and 2015, the Company received rent as aforesaid at a total amount of NIS 1,616 thousand and NIS 785 thousand.

E. Material engagements and transactions with investee companies: (Cont.)

(3) Material arrangements between the Company and Investee Companies (Cont.)

d. The Company provided loans to several investee companies thereof, as detailed below:

Loans in an amount of approx. NIS 158 million linked to the USD and bearing interest at a rate of approx. 10% per annum.

A loan in an amount of approx. NIS 46 million linked to the USD and bearing interest at a rate of approx. 6.5% per annum.

Capital notes in the amount of approx. NIS 820 million linked to the Index and bearing no interest for a period of 5 years. The balance is presented net of capital reserve.

With regards to the loans to Canit Hashalom, see Section 2 above.

The remaining loans bear interest pursuant to the Income Tax Regulations.

The interest and linkage differentials which were accrued due to such loans and presented in the Statements of Comprehensive Income of the Company for the years ended on December 31, 2016 and 2015 are in a total amount of approx. NIS 148 million and approx. NIS 137 million, respectively.

e. The Company bears expenses for office, insurance, compensation and benefits of senior employees at the group (the "**Group's Expenses**"). The Company and several companies held thereby and other companies in the Group have agreements, according to which the Company is entitled to reimbursement for amounts paid thereby for the companies. In the years 2016 and 2015 the Company received such proceeds in a total amount of approx. NIS 27,299 thousand and approx. NIS 25,455 thousand, respectively.

f. The Company and companies held thereby have an agreement, according to which the investee companies are entitled to rent, management fee and parking fees for areas owned thereby. In the years 2016 and 2015, the Company paid rent, management fees and parking fees as aforesaid in a total amount of approx. NIS 5,767 thousand and approx. NIS 4,229 thousand, respectively.

(4) With regards to the purchase of one share of an investee company, see Note 10C to the Consolidated Financial Statements as of December 31, 2016.

F. Guarantees:

(1) On February 4, 2011, the Company provided an American financial institution a guarantee in the amount of the loan taken by a consolidated limited entity thereof, enforceable only under certain cases defined in the loan agreement. The loan balance as of December 31, 2016 is NIS 472 million.

(2) On January 1, 2012, the Company provided an American financial institution, a guarantee in the amount of the loan taken by a consolidated limited entity thereof, enforceable only under certain cases defined in the loan agreement. The loan balance as of December 31, 2016 is NIS 249 million.

(3) On September 21, 2014, the Company provided an American financial institution, a guarantee in the amount of the loan taken by a consolidated limited entity thereof, enforceable only under certain cases defined in the loan agreement. The loan balance as of December 31, 2016 is NIS 180 million.

(4) On August 1, 2016, the Company provided an American financial institution, guarantees in the amount of the loan taken by a consolidated limited entity thereof, enforceable only under certain cases defined in the loan agreement. The loan balance as of December 31, 2016 is NIS 84 million.

G. Contractual Restrictions and Financial Covenants:

For details regarding contractual restrictions undertaken by the Company, see Note 21 to the Consolidated Financial Statements as of December 31, 2016.

H. Dividends from Companies Directly held by the Company:

Companies directly held by the Company have no contractual restrictions on dividend distribution.

I. Pledges:

(1) The Company committed to banks, financial institutions and in the indentures to the bonds that it would not create floating charges over its entire assets. The Company may create a floating charge as aforesaid, provided that concurrently with the creation thereof, it will create a floating charge to the benefit of the lender as well. The Company also committed, irrevocably, to a bank that it had not created and will not create a floating charge over its entire property and assets, whether they are owned thereby or will be owned thereby in the future, including over the goodwill and share capital thereof, and it also committed towards another bank not to commit in any manner to create a floating charge as aforesaid, without the advance written agreement of the bank.

(2) As of December 31, 2016, the Company has investment property and investment property under construction which are not pledged in an amount of approx. NIS 8,549 million and a balance of approx. NIS 931 million charged by a fixed charge for securing loans from banks and other corporations, the balance of which as of December 31, 2016 is in an amount of approx. NIS 196 million. Furthermore, against loans of the Company in the sum of NIS 1,217 million, assets of investee companies in the sum of NIS 2,342 million are pledged. For further details, see Note 14B to the Consolidated Financial Statements as of December 31, 2016.

(3) As of December 31, 2016, the Company has financial assets available for sale which are not pledged in an amount of approx. NIS 6 billion, see also Note 12 to the Consolidated Financial Statements as of December 31, 2016.

(4) With respect to pledges – see Note 32 to the Consolidated Financial Statements as of December 31, 2016.

J. Engagements with Affiliated and Interested Parties:

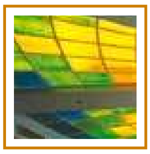
Regarding engagements with related and interested parties, see Note 37 to the Consolidated Financial Statements as of December 31, 2016.

K. Subsequent Events:

Regarding subsequent material events, see Note 39 to the Consolidated Financial Statements as of December 31, 2016.

Part D

Further Details about the Corporation



Chapter D: Additional Details about the Corporation ....D

Chapter D: Additional Details about the Corporation

Regulation 25A – Registered Address

Company Name: Azrieli Group Ltd.

Address: 1 Azrieli Center, Tel Aviv, 6702101
Telephone: 03-6081400

Company Number in the Registrar of Companies: 51-096071-9

Facsimile: 03-6081380

email: rant@azrieli.com

Date of the Statement of Financial Position: December 31, 2016

The Report Date: March 21, 2017

Regulation 10A - Summary of the Reports on Outcomes of the Company's Operations for Each Quarter of 2016 (NIS in thousands)

	1-3/2016	4-6/2016	7-9/2016	10-12/2016	1-12/2016
Income					
From sales, work and services	189,421	147,526	139,173	184,675	660,795
From rent, management and maintenance fees	416,224	420,268	451,064	457,065	1,744,62
Profit, net of fair value adjustment of investment properties and properties under construction	357,011	33,455	127,261	192,851	710,578
Financing	9,518	4,286	3,331	31,926	49,061
Other	10,966	975	1,134	1,041	14,116
Total Income	983,140	606,510	721,963	867,558	3,179,171
Costs and Expenses					
Cost of income from sales, work and services	112,935	90,066	89,150	127,002	419,153
Cost of income from rent, management and maintenance fees	98,847	101,388	124,505	120,746	445,486
Sale and marketing	36,787	37,401	44,914	52,671	171,773
General and administrative	23,337	23,890	25,418	31,665	104,310
Portion of results of included companies, net of tax	2,053	1,787	2,452	2,147	8,439
Financing expenses	23,395	49,207	59,602	26,920	159,124
Other	-	41	843	4,307	5,191
Total Costs and Expenses	297,354	303,780	346,884	365,458	1,313,476
Profit before tax on income	685,786	302,730	375,079	502,100	1,865,695
Tax on income	(8,148)	(58,646)	(90,436)	108,207	(49,023)
Income from continuing operations	677,638	244,084	284,643	610,307	1,816,672
Income (loss) from discontinued operations net of tax	(3,257)	390	(5,634)	-	(8,501)
Net profit per period	**674,381**	**244,474**	**279,009**	**610,307**	**1,808,171**
Attributed to owners of the Company	672,044	244,134	278,999	614,841	1,810,018
Non-controlling interests	2,337	340	10	(4,534)	(1,847)
	674,381	244,474	279,009	610,307	1,808,171

Regulation 10C - Use of Proceeds from Securities

On July 7, 2016, approx. NIS 2,194 million par value of Series D bonds were issued in consideration for approx. NIS 2,194 million (NIS 2,177 million net of attribution of issue expenses), in accordance with a shelf offering report released on July 5, 2016 (Ref. No.: 2016-01-075079), released under the Company's shelf prospectus released on May 10, 2016 (Ref. No.: 2016-01-063049).

The proceeds received from this issue were used and shall be used by the Company, *inter alia*, for the refinancing of an existing financial debt and for current financing needs, from time to time, according to the Company's goals and business plans.

Regulation 11 - List of Investments in Material Subsidiaries and Affiliates as of the Date of the Statement of Financial Position

See **Annex A** to this chapter.

Regulation 12 - Changes in Investments in Material Subsidiaries and Affiliates, Directly and Indirectly, in the Report Period

a. On March 6, 2016, the Company's general meeting (after the approval of the Audit Committee and the Board of Directors of the Company) approved the Company's engagement with the Azrieli Foundation (Israel) in an agreement for the purchase of the share of Canit Hashalom from the foundation in consideration for NIS 51 million. For details, see Part B of the notice of meeting report, as released by the Company on January 27, 2016 (ref. no.: 2016-01-018823), included herein by way of reference, and Note 10C to the financial statements.

b. In May 2016, the acquisition of 100% of the shares of Ahuzat Bayit Raanana – Senior Housing Ltd. was completed, for details see Section 1.3.4(2) of Chapter A of this Report.

c. In June 2016, a transaction was closed for the purchase of activity in the eCommerce sector from Buy2 Networks Ltd. For details, see Section 1.3.2 of Chapter A of this Report.

d. In July 2016, Granite Hacarmel closed a transaction for the sale of all of its holdings (100%) in Sonol to Israel Oil & Gas Fund L.P., a limited partnership that was incorporated in Israel, and whose general partner is controlled by Mr. David Weissman. For details, see Section 1.3.5 of Chapter A of this Report. In view of the closing of the transaction for the sale of the Group's holdings in Sonol, Sonol's operations became discontinued operations. For details, see Section 13 of Chapter A of this Report.

Date of Change	Nature of Change	Name of Company	Name of Holder	Notes
March 2016	Purchase of shares of a consolidated company	Canit Hashalom Investments Ltd.	Azrieli Foundation (Israel)(R.A.)	See Part B of the notice of meeting report, as released by the Company on January 27, 2016 (ref. no.: 2016-01-018823),

Date of Change	Nature of Change	Name of Company	Name of Holder	Notes
				included herein by way of reference.
May 2016	Purchase of 100% of the shares of Ahuzat Bayit Ra'anana – Senior Housing Ltd.	Ahuzat Bayit Ra'anana – Senior Housing Ltd.	Palace Senior Housing Group Ltd.	See Section 1.3.4 (2) of Chapter A hereof
June 2016	Purchase of activity in the eCommerce sector	Netex New Media Ltd. (currently Azrieli E-Commerce Ltd.)	Azrieli Group Ltd.	See Section 1.3.2 of Chapter A hereof
July 2016	Sale of shares of a consolidated company	Sonol Israel Ltd.	Granite Hacarmel Ltd.	See Section 1.3.5 of Chapter A hereof
August 2016	Establishment of a new partnership for the purpose of purchasing a property	AG Two Aspen LLC	Azrieli Group Ltd. (indirectly, via companies and/or partnerships)	See Section 1.3.1(4) of Chapter A hereof

Regulation 13 - Profit of Material Subsidiaries and Affiliates and the Corporation's Income therefrom as of the Date of the Statement of Financial Position (NIS in Thousands)

Investee Company	Main Business	Profit (Loss) (NIS in thousands)		Company's Income from the Affiliate		
		Before Provision for Tax	After Provision for Tax*	Dividend	Management Fee	Interest and Linkage Differentials
Canit Hashalom Investments Ltd.	Development, management, construction, acquisition and lease of commercial and office buildings in Israel and in the US. Holding in Granite Hacarmel.	460,258	521,232	-	-	**110,898
International Consultants (Iconsult) Ltd.	Development, construction and lease of offices and industrial buildings.	3,633	5,337	-	-	1,361
Otzem Initiation & Investments (1991) Ltd.	Development, construction and lease of commercial buildings (Or Yehuda and Ramla).	27,800	21,793	-	-	13,870

Investee Company	Main Business	Profit (Loss) (NIS in thousands)		Company's Income from the Affiliate		
		Before Provision for Tax	After Provision for Tax*	Dividend	Management Fee	Interest and Linkage Differentials
AG Galleria Office Buildings, LP	Holding of 90% of the rights in office buildings situated in Houston, Texas, USA, which are known by the name Galleria.	(55,697)	(30,435)	-	4,915	-
Gemel Tesua Investments Ltd.	Development, management, construction, acquisition and lease of commercial and office buildings in Israel.	176,828	162,203	-	420	968
Otzma & Co. Investments Maccabim Ltd.	Development, management, construction, acquisition and lease of office buildings in Israel	6,855	6,422	-	180	2,968
AG Plaza at Enclave	Holding of 100% of the rights in an office building in Houston, Texas, USA - "Houston Dow Center".	7,885	4,828	-	-	8,195
AG 8 West Centre	Holding of 100% of the rights in an office building in Houston, Texas, USA, known as "8 West Centre"	7,451	5,248	-	-	5,852
Granite Hacarmel Investments Ltd.	Private holding company which holds, *inter alia*, Supergas and GES	55,364	22,810	-	-	-
G.E.S. Global Environmental Solutions Ltd.	See Section 12.17 of Chapter A.	(6,141)	(5,488)	-	-	-
Supergas Israel Gas Distribution Company Ltd.	See Section 12.2.1 of Chapter A of the Report.	61,207	43,314	-	-	-
Palace America Senior Housing Company Ltd.	Operation of a senior home for nursing and recuperation	53,866	54,331	-	-	-

Investee Company	Main Business	Profit (Loss) (NIS in thousands)		Company's Income from the Affiliate		
		Before Provision for Tax	After Provision for Tax*	Dividend	Management Fee	Interest and Linkage Differentials
Ahuzat Bayit Raanana – Senior Housing Ltd.***	Operation of a senior home and a retail center	36,388	39,657	-	-	2,754
Azrieli E-Commerce Ltd.***	The eCommerce segment	(14,410)	(12,231)	-	-	528
AG Two Aspen LLC	Was established for the purpose of holding 100% of the rights in an office building located in Austin, Texas, USA, known as "Aspen Lake 2".	1,292	1,080	-	-	1,717

* Before results based on the book value.

** Including capital reserve.

*** The figures are presented for the period beginning on the purchase date.

Regulation 20 - Trading on the Stock Exchange – Listed Securities / Trading Suspensions - Dates and Reasons

a. Securities / Shares

On July 11, 2016, trade on TASE was opened in a new bond series (Series D) issued by the Company under a shelf offering report released on July 5, 2016 (Ref. No.: 2016-01-063049) at approx. NIS 2,194 million par value.

b. Trading Suspensions

During the Report Period, there was no suspension of trading in the securities issued by the Company.

Regulation 21 - Payments to Senior Officers

For a specification of the compensation granted in the Report Period, as specified in Schedule 6 of the Securities Regulations (Periodic and Immediate Reports), 5730-1970, see Section 1 of Chapter E of this Report – Corporate Governance.

Regulation 21A - Control of the Company

As of the Report Release Date, Azrieli Holdings Inc. ("**Azrieli Holdings**"), a private company incorporated under Canadian law, holds, directly and indirectly, through its holding of the entire share capital of Nadav Investments Inc. ("**Nadav Investments**"), which is the direct controlling shareholder of the Company, 55.62% of the share capital and 61.31%[1] of the voting rights of the Company *de facto* and on a fully-diluted basis.

[1] Which include all of the voting rights by virtue of the Contribution Shares. See Section 3.1 of Chapter A of the Report.

As the Company has been informed, Azrieli Holdings is controlled by Sharon Azrieli, Naomi Azrieli and Danna Azrieli, either directly or through Canadian holding corporations.

Until his death, in July 2014, Mr. David Azrieli OBM directly and indirectly held approx. 44.77% of the share capital of Azrieli Holdings and all of the voting rights in Azrieli Holdings (including the voting rights of his children's shares, which were held by him in trust). Following the passing of Mr. David Azrieli OBM, the shares of Azrieli Holdings that had been held by him and his shares in David's Holding Corporation were transferred to his estate, and Sharon Azrieli, Naomi Azrieli and Danna Azrieli were appointed as the 3 directors of Azrieli Holdings and of Nadav Investments. As the Company has been informed, on April 13, 2015, shares of Mr. David Azrieli OBM in Azrieli Holdings and in a Canadian holding corporation controlled by him ("**David's Holding Corporation**") were distributed from his estate. Following such distribution, each one of Sharon Azrieli, Naomi Azrieli and Danna Azrieli, holds, directly and through David's Holding Corporation, approx. 27.24% of the capital rights in Azrieli Holdings and approx. 33.13% of the voting rights in Azrieli Holdings, and together they hold approx. 81.73% of the capital rights in Azrieli Holdings and approx. 99.39% of the voting rights therein. The remainder of Azrieli Holdings' shares are mainly held by the Azrieli Foundation of Canada (an interested party in the Company), which, following the distribution of the estate, holds (indirectly, through a holding of shares of David's Holding Corporation) 15.93% of Azrieli Holdings' shares, with no voting rights (which holding indirectly constitutes a holding of approx. 8.86% of the capital rights of the Company), in addition to and separately from its direct holding of 8.55% of the capital and voting rights in the Company. As the Company has been informed, on March 20, 2017, a shareholders' agreement (the "**2017 Agreement**") was signed between Sharon Azrieli, Naomi Azrieli and Danna Azrieli (by themselves and through companies controlled by them), the indirect controlling shareholders of the Company and directors thereof (the "**Controlling Shareholders**"). Additional parties to the 2017 Agreement are Azrieli Holdings, Nadav Investments and David's Holding Corporation (the three "**Holding Corporations**"). The 2017 Agreement replaces and substitutes the former shareholders agreement made by the parties in November 2012 (the "**2012 Agreement**"), and it regulates the relations between the Controlling Shareholders, by themselves, and through the Holding Corporations, in respect of their rights in the Company. Similarly to the 2012 Agreement, the terms of the 2017 Agreement include agreements regarding the sale and transfer of shares in the Company and in the Holding Corporations, including a lock-up period, right of first refusal, right of first offer, co-sale right and an exclusion in connection with certain sales of shares (drip) on TASE. The 2017 Agreement further prescribes that the manner of use of the voting rights in the Company will be determined by the Controlling Shareholders (by a majority vote), provided however, that in respect of resolutions to appoint directors of the Company, each one of the Controlling Shareholders shall have the right to use the voting rights to appoint one director who will be determined by her, whereas the manner of use of the voting rights in the Company regarding resolutions to appoint additional directors, will be adopted by a majority vote. It is clarified, that the 2017 Agreement does not change the identity of the Company's controlling shareholders (including of Azrieli Holdings) nor their percentage holdings in the capital and in the voting rights in the Company, and that as of the Report Release Date, Sharon Azrieli, Naomi Azrieli and Danna Azrieli are the Company's controlling shareholders. For further details see the immediate report of March 21, 2017 (ref. no.: 2017-01-026388), which is included herein by way of reference.

Regulation 22 - Transactions with Controlling Shareholders

For details with respect to transactions with the controlling shareholder or in the approval of which the controlling shareholder has a personal interest, in which the Company or a corporation controlled thereby or an affiliate thereof engaged, see Section 2 of the Company's Corporate Governance Report, which is attached as Chapter E hereof.

Regulation 24 - Holdings of Interested Parties and Senior Officers

For details regarding the holdings of interested parties and senior officers of the Company, see the immediate report regarding the holdings of interested parties and officers released by the Company on January 5, 2017 (Ref. No.: 2017-01-002916), which is included herein by way of reference.

Regulation 24A - Authorized Capital, Issued Capital and Convertible Securities

As of December 31, 2016, the registered share capital of the Company is 127,501,500 ordinary shares par value NIS 0.1 each, and the issued share capital of the Company is 121,272,760 ordinary shares par value NIS 0.1.

Regulation 24B -The Company's Shareholders' Register

Name of shareholder	Company	Address	Shares' type	Shares' amount	Par value
Registration Co. of Bank Hapoalim Ltd.	510356603	62 Yehuda Halevi, Tel Aviv	Ordinary par value NIS 0.1	121,272,760	NIS 0.1

Regulation 26 –Directors of the Corporation (as of the Report Date)

Below are personal and professional details with regard to the Company's directors:

(1)	**Director's name:**	Danna Azrieli, Active Chairman of the Board
	Identification number:	321657744
	Date of Birth:	June 3, 1967
	Address for service of process:	Azrieli Center 1, Tel Aviv
	Citizenship:	Israeli
	Membership on board of directors' committees	None
	Outside Director/Independent Director:	No
	Position filled at the Company/Subsidiary/Affiliate of the Company or of an interested party therein:	Active Chairman of the Board
	Date of commencement of service as director of the Company:	June 1, 2010
	Education:	BA in Sociology and Anthropology from Swarthmore College; Juris Doctor of Law from Vermont Law School; member of the Massachusetts State Bar Association in the U.S. and the Israel Bar Association.
	Occupation in the past five years and other corporations in which he holds office as director:	Active Vice Chairman of the Board of the Company; Serves as a director of the companies: Nadav Investments Inc., Azrieli Holdings Inc., Candan Residences Ltd., Dan Squared Ltd., Candan Constructions' Maintenance and Management Ltd., Candan Management Services Ltd. and Candan Holdings Ltd.; Chair of Azrieli Foundation (Israel), R.A., and Director of Azrieli Foundation (Canada), a Canadian nonprofit organization.
	Family relation to an interested party:	Controlling shareholder. For details see Regulation 21A above.
	Accounting and Financial Expertise or Professional Qualification:	Professional Qualification

(2)	**<u>Director's name</u>:**	<u>Sharon Azrieli</u>
	Identification number:	HM841817
	Date of Birth:	August 4, 1960
	Address for service of process:	Azrieli Center 1, Tel Aviv
	Citizenship:	Canadian
	Membership on board of directors' committees	None
	Outside Director/Independent Director:	No
	Position filled at the Company/Subsidiary/Affiliate of the Company or of an interested party therein:	None
	Date of commencement of service as director of the Company:	June 1, 2010
	Education:	PhD in Music from the University of Montreal; MA in Music from the University of Montreal; BA in Art from Vassar College; Certificate from the Juilliard School of Music; Associate degree from the Parsons School of Design.
	Occupation in the past five years and other corporations in which he holds office as director:	Opera singer, cantor and artist; Conductor at several congregations. Member of the board of Azrieli Foundation (Israel), R.A., and director of Azrieli Foundation (Canada), a Canadian nonprofit organization. Serves as President of the Directors Board of the Mcgill Chamber Orchestra; Sharon Azrieli Foundation for the Arts (SAFA); Opera Cares Foundation; Shir Chadash Synagogue. A director of the following organizations: McCord Museum (Montreal); Canadian Vocal Arts Institute; America-Israel Cultural Foundation (AICF). Owner and manager of foreign private companies.

	Family relation to an interested party:	Controlling shareholder. For details see Regulation 21A above.
	Accounting and Financial Expertise or Professional Qualification:	No
(3)	**Director's name:**	Naomi Azrieli
	Identification number:	HB510031
	Date of Birth:	September 26, 1965
	Address for service of process:	Azrieli Center 1, Tel Aviv
	Citizenship:	Canadian
	Membership on board of directors' committees	None
	Outside Director/Independent Director:	No
	Position filled at the Company/Subsidiary/Affiliate of the Company or of an interested party therein:	None
	Date of commencement of service as director of the Company:	June 1, 2010
	Education:	PhD (D. Phil) in International History from Oxford University, England; Master of International Affairs in International Relations, Finance and Economics from Columbia University, New York; BA from the University of Pennsylvania in Political Science and Russian Studies.
	Occupation in the past five years and other corporations in which he holds office as director:	CEO and Director of the Azrieli Foundation (Canada), a Canadian nonprofit organization. Member of the board of Azrieli Foundation (Israel), R.A. Owner and manager of foreign private companies. Director and president of the corporations: Canpro Investments Ltd., Omico Investments Ltd.
	Family relation to an interested party:	Controlling shareholder. For details see Regulation 21A above.

	Accounting and Financial Expertise or Professional Qualification:	Professional Qualification
(4)	**Director's name:**	Joseph Ciechanover
	Identification number:	5991468
	Date of Birth:	October 1, 1933
	Address for service of process:	Azrieli Center 1, Tel Aviv
	Citizenship:	Israeli
	Membership on board of directors' committees	Yes, Audit Committee, Compensation Committee, FSRC and Enforcement Committee ("**All of the Committees**")
	Outside Director/Independent Director:	Independent Director
	Position filled at the Company/Subsidiary/Affiliate of the Company or of an interested party therein:	None
	Date of commencement of service as director of the Company:	May 6, 2010
	Education:	PhD in Philosophy from Boston University; LLM from the Hebrew University; Completed his studies towards an MBA at the Hebrew University (missing final paper); LLM from the University of Berkeley California.
	Occupation in the past five years and other corporations in which he holds office as director:	Consultant for Etgar 2 Fund by way of the Atidim Funds Management Co. Ltd. Director at Harel Investments, Insurance and Financial Services Ltd., Mifal HaPayis and at the Israel Museum. Chairman and CEO of Atidim Funds Management Ltd., IYZ Investment Management Ltd. and J.C. Atara Ventures Ltd. Member of the associations: the Jacob Isler Foundation, the Dayan Center – Tel Aviv University, the Elie Wiesel Foundation, RA and the Israel Science Foundation, the Clinical Genetics Society. Served as a director of Azrieli

		Foundation (Israel), R.A.
	Family relation to an interested party:	No
	Accounting and Financial Expertise or Professional Qualification:	Expert director; has accounting and financial expertise
(5)	**Director's name:**	Tzipora Carmon
	Identification number:	51528933
	Date of Birth:	December 7, 1952
	Address for service of process:	Azrieli Center 1, Tel Aviv
	Citizenship:	Israeli
	Membership on board of directors' committees	Yes, on all of the Committees.
	Outside Director/Independent Director:	Independent
	Position filled at the Company/Subsidiary/Affiliate of the Company or of an interested party therein:	None
	Date of commencement of service as director of the Company:	May 19, 2013
	Education:	BA in Sociology and Education, the Hebrew University, Jerusalem; MBA, UCLA, California, USA.
	Occupation in the past five years and other corporations in which he holds office as director:	Manager and owner of T.C. Exports Ltd. in the last 21 years; Director of Delta Galil Industries Ltd.
	Family relation to an interested party:	No
	Accounting and Financial Expertise or Professional Qualification:	Expert director; has accounting and financial expertise.
(6)	**Director's name:**	Efraim Halevy, Outside Director
	Identification number:	49871718
	Date of Birth:	December 2, 1934
	Address for service of process:	Azrieli Center 1, Tel Aviv
	Citizenship:	Israeli

	Membership on board of directors' committees	Yes (on All of the Committees)
	Outside Director/Independent Director:	Outside Director
	Position filled at the Company/Subsidiary/Affiliate of the Company or of an interested party therein:	None
	Date of commencement of service as director of the Company:	August 24, 2010
	Education:	LL.M. - The Hebrew University in Jerusalem. Management studies of process leadership for senior executives –the Tel Aviv University.
	Occupation in the past five years and other corporations in which he holds office as director:	2003-2011: Head of the Shasha Center for Strategic Studies in the Hebrew University.
	Family relation to an interested party:	No
	Accounting and Financial Expertise or Professional Qualification:	Professional qualifications.
(7)	**<u>Director's name</u>:**	<u>Niv Ahituv, Outside Director</u>
	Identification number:	008115693
	Date of Birth:	August 16, 1943
	Address for service of process:	Azrieli Center 1, Tel Aviv
	Citizenship:	Israeli and Canadian
	Membership on board of directors' committees	Yes (on All of the Committees)
	Outside Director/Independent Director:	Outside Director
	Position filled at the Company/Subsidiary/Affiliate of the Company or of an interested party therein:	None
	Date of commencement of service as director of the Company:	August 24, 2010

	Education:	BA in Mathematics and Physics from the Hebrew University. MBA from Tel Aviv University MA in Information Systems from Tel Aviv University. PhD in Management (specialization in Information Systems) from Tel Aviv University.
	Occupation in the past five years and other corporations in which he holds office as director:	Dean of the Dan School for HiTech Studies, the Academic Studies Center; Professor Emeritus of the Faculty of Management at Tel Aviv University; Chairman of the management at Beit Lessin Theatre; member of the management of Keshet Eilon; President of the Dan Academic Center; Member of the “Profit-Sharing” Investments Committee at Migdal Insurance; Outside Director of Rapac Communication & Infrastructure Ltd.; Outside Director of Discount Investments.
	Family relation to an interested party:	No
	Accounting and Financial Expertise or Professional Qualification:	Expert director; has accounting and financial expertise
(8)	**<u>Director’s name</u>:**	<u>Oran Dror</u>
	Identification number:	024973315
	Date of Birth:	August 2, 1970
	Address for service of process:	Azrieli Center 1, Tel Aviv
	Citizenship:	Israeli
	Membership on board of directors’ committees	Yes (on all of the Committees)
	Outside Director/Independent Director:	Independent Director
	Position filled at the Company/Subsidiary/Affiliate of the Company or of an interested party therein:	None
	Date of commencement of service as director of the Company:	November 18, 2014

	Education:	BA in Economics and East Asian Studies from the Hebrew University, Jerusalem. Research studies in the field of management and marketing for two years at the Waseda University, Tokyo, Japan – School of Commerce.
	Occupation in the past five years and other corporations in which he holds office as director:	CEO and director of Dror Liat Investment Ltd. (a company he controls); executive director and VP Telecom – MEA Regional Management of Microsoft International; executive director and VP Sales at Microsoft Israel; CEO and director at N.B.X. e-Service Solutions Ltd. (a company he controls); VP at VATBox Ltd. (through Dror Liat Investment Ltd.).
	Family relation to an interested party:	Fourth level cousin of the directors Danna, Sharon and Naomi Azrieli.
	Accounting and Financial Expertise or Professional Qualification:	Expert director; has accounting and financial expertise
(9)	**Director's name**:	Menachem Einan
	Identification number:	008995383
	Date of Birth:	June 17, 1939
	Address for service of process:	Azrieli Center 1, Tel Aviv
	Citizenship:	Israeli
	Membership on board of directors' committees	Finance Committee (which also serves as the Financial Statements Review Committee)
	Outside Director/Independent Director:	No
	Position filled at the Company/Subsidiary/Affiliate of the Company or of an interested party therein:	In addition to his being a director of the Company, Mr. Einan served as an external consultant of the Company until February 28, 2017.
	Date of commencement of service as a director of the Company:	March 22, 2016
	Education:	BA in Humanities from Tel Aviv University; degree in Business Administration from UCLA.

	Occupation in the past five years and other corporations in which he holds office as director:	Director and Active Deputy Chairman of the Board of the Company until February 2015; formerly the Company's CEO and the CEO of Canit Hashalom Investments Ltd. until March 31, 2011; Served as Chairman of the Board of Granite Hacarmel Investments Ltd. and as a director at Tambour Ltd., Sonol Israel Ltd., Supergas Israel Gas Distribution Company. Ltd. and GES Global Environmental Solutions Co. Ltd. until February 2015. Serves as a director of Leumi Card Ltd., member of the board of Azrieli Foundation (Israel), R.A.
	Family relation to an interested party:	No
	Accounting and Financial Expertise or Professional Qualification:	Professional qualifications

Regulation 26A: Senior Officers of the Corporation as of the Report Release Date

Name	Yuval Bronstein	Irit Sekler-Pilosof	Arnon Toren	Gideon Avrami	Ran Tal	Israel Keren	Avraham Jacoby	Moshe Cohen	Rafi Wunsh	Dor Lev-Ran	Yoram Polak Ben Porat
Identity Number	024297996	025710542	054121678	56524325	027474824	003105657	052253747	051209971	028145738	029444668	056000813
Date of Birth	March 24, 1969	October 31, 1973	July 14, 1957	July 6, 1960	May 22, 1974	September 17, 1947	March 31, 1954	April 3, 1952	February 15, 1971	April 13, 1972	July 29, 1959
Office Commence-ment Date	May 1, 2013	May 1, 2013	November 1, 2013	May 15, 2016	August 1, 2016	July 1, 2002	July 1, 1987	March 22, 2017	October 15, 2010	March 16, 2015	March 22, 2016
Position held in the Company/ Subsidiary/ Affiliate or in an interested party	CEO of the Company. CEO of Canit Hashalom Investments Ltd. Chairman of the Board of Directors of Granite Hacarmel, and subsidiaries thereof from March 1, 2015 (in lieu of Mr. Menachem Einan whose office ended).	CFO and in charge of market risk management at the Company, and a director of Mini Israel and of SONAPCO	Deputy CEO and Head of Malls	VP, Head of Office Segment	VP, General Counsel and Company Secretary	CEO of asset companies Gemel Tesua Investments Ltd., Otzma & Co. Investments-Maccabim Ltd., Urban A.A.R. Ltd., Azrieli Raanana and Herzliya Business Park Operations Ltd.	Chief Comptroller, Azrieli Group Ltd.	The internal auditor	Business Development Manager	VP Engineering and Construction	VP, Head of Senior Housing Sector
Education	B.A. in Economics and Accounting from the Hebrew University; MBA, major in Finance and Accounting, Hebrew University; Licensed as a CPA (Israel)	B.A. in Business Administration, major in Accounting, The College of Management; LL.M., Bar Ilan University; Licensed as a CPA (Israel)	B.A. in Economics and Sociology, Hebrew University	B.A. in History and International Relations, the Hebrew University 1986. Diploma in Hotel Management 1994.	LL.B from Haifa University; LL.M from the Hebrew University of Jerusalem	B.A. in General History, Tel Aviv University	B.A. in Accounting and Economics, Bar Ilan University; Licensed as a CPA (Israel)	CPA, B.A. in Economics and Accounting, Tel Aviv University	B.A. in Economics and Accounting, Hebrew University of Jerusalem	B.Sc. Master of Science in Civil Engineering from the Technion, Haifa	Technion graduate of studies of Business Administration and Hotel Management

Name	Yuval Bronstein	Irit Sekler-Pilosof	Arnon Toren	Gideon Avrami	Ran Tal	Israel Keren	Avraham Jacoby	Moshe Cohen	Rafi Wunsh	Dor Lev-Ran	Yoram Polak Ben Porat
Business experience in the last five years	CFO, Azrieli Group Ltd. in the six years prior to his appointment as CEO	Comptroller in Azrieli Group in the 13 years preceding the office commencemen t date.	Manager of the office segment in Azrieli Group and CEO of Azrieli Center in Tel Aviv in the six years prior to his current appointment; Director of Vardinon Real Estate and Investments Ltd.	CEO of Azrieli Towers 2001-2004. CEO of Jerusalem mall, Malcha 2005-2016	VP, General Counsel, Gilat Satellite Networks Ltd. VP, General Counsel, Netafim Ltd.	Manager of properties, property marketing and management of logistics projects and property construction in Azrieli Group	Managing comptroller, Azrieli Group	Managing partner at Chaikin Cohen Rubin & Co.; director and manager at private companies affiliated with Chaikin Cohen Rubin & Co., CPA; internal auditor at a large number of public companies; director of Zoko Enterprises Ltd.	VP Quebec Region, Elad Group Canada Inc. CFO, Elad Group Canada Inc.	Chief Engineer, Azrieli Group	Head of Senior Housing Development at the Group for the past three years. Previously CEO and director of Hon, a real estate management company of the Property & Building Group and the CEO of the chain Mediterranean Towers – Senior Housing for 14 years.

None of the officers is an interested party in the Company or has a family relation to another officer of the Company or to another interested party in the Company.

<u>Senior officers whose office ended during the Report Period and in the subsequent period until the Report Date</u>:

Name	**Ofer Avram**	**Michal Kamir**	**Gali Gana**
I.D. No.	024895229	022802110	059674770
Position that he held at the corporation	VP, Head of Office Segment	General Counsel, Company Secretary	Internal Auditor
Date of commencement of term of office	January 1, 2014	June 20, 2010	November 2009
Date of conclusion of term of office	June 15, 2016	July 31, 2016	March 21, 2017

Regulation 26B – Authorized Signatories of the Corporation

See Section 8 of Chapter E of this Report - Corporate Governance.

Regulation 27 - The Company's Accountants

The Company's auditors are Brightman Almagor Zohar & Co., CPA, 1 Azrieli Center, Tel Aviv.

Regulation 28 – Changes in the Memorandum or Articles of Association

On August 9, 2016, a special general meeting of the Company's shareholders approved amendments to the Company's articles, which mainly concern updates in accordance with the legislative provisions that changed, expansion of the liabilities and/or the expenses in respect of which the Company will be entitled to grant indemnification and/or insurance to directors and officers, *inter alia* pursuant to the Restrictive Trade Practices Law, 5748-1988, and expansion of the definition of the term "party injured by the breach" such that this definition shall apply to any legislation in respect of which an administrative proceeding may be held. For further details, see the immediate report of August 9, 2016 (ref. no.: 2016-01-100267), which is included herein by way of reference.

On October 6, 2016, a special general meeting of the Company's shareholders approved an amendment to the Company's articles of association on the issue of exemption. For further details, see the immediate report of October 6, 2016 (ref. no.: 2016-01-060735), which is included herein by way of reference.

Regulation 29 - Resolutions and Recommendations of the Board of Directors

See Section 4 of Chapter E of this Report - Corporate Governance.

Regulation 29A -The Company's Resolutions

See Section 4 of Chapter E of this Report - Corporate Governance.

Exemption, Indemnification and Insurance of Officers:

For a description of the applicable arrangements with regard to exemption, indemnification and insurance for Directors and Officers in the Company, see Note 37D to the Financial Statements as of December 31, 2016.

Danna Azrieli, Chairman of the Board of Directors	**Yuval Bronstein, CEO**

Date: March 21, 2017

Annex A – Regulation 11

List of Investments in Material Subsidiaries and Affiliates as of the Date of the Statement of the Financial Position

				Rate in %			NIS in thousands						
Company name	**Shares' class**	**Total par value of shares in NIS**	**Total par value of held shares in NIS**	**Of the capital**	**Of voting**	**Authority to appoint Directors**	**Cost of the held shares**	**Book value of investment (*)**	**Balance of the loans from the Company**	**Manner of presentation in the financial statements**	**Company's country of incorporation**	**Securities exercisable into capital rights or voting rights in the Company's investee company**	**Guaranties the Company provided to the investee company**
Directly held companies													
Canit Hashalom Investments Ltd.	ordinary	114	114	100%	100%	100%	51,000	7,254,629	2,798,310(1)	Consolidated Company	Israel	-	-
International Consultants (Iconsult) Ltd.	ordinary	3,900	3,900	100%	100%	100%	30,307	71,384	47,046(2)	Consolidated Company	Israel	-	
Otzem Initiation & Investments (1991) Ltd.	Management ordinary A ordinary B	80 21,330,220 4,999 21,335,299	80 21,330,220 4,999 21,335,299	100%	100%	100% 100%	- -	173,780	371,214(3)	Consolidated Company	Israel	-	-
Azrieli E-Commerce Ltd.	ordinary	1,600	1,600	100%	100%	100%	24,744	17,667	50,470	Consolidated Company	Israel		
Modiin Senior Housing	ordinary	1,000	1,000	100%	100%	100%	32,035	37,945	51,734	Consolidated Company	Israel		

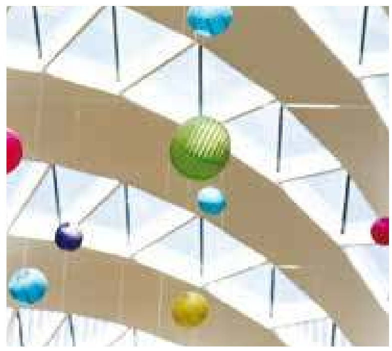
AG Galleria Office Buildings, LP (4)		-	-	100%	100%	-	71,064	133,520	-	Consolidated Company	USA	-	Guarantee in several cases which were defined in the loan agreement
AG Plaza at Enclave,LLC (4)		-	-	100%	100%	-	50,705	134,507	90,934	Consolidated Company	USA	-	Guarantee in several cases which were defined in the loan agreement
AG 8 West Center(4)		-	-	100%	100%	-	55,588	46,601	67,288	Consolidated Company	USA	-	Guarantee in several cases which were defined in the loan agreement
AG Two Aspen (4)		-	-	100%	100%	-	21,848	28,887	46,140	Consolidated Company	USA	-	Guarantee in several cases which were defined in the loan agreement
Companies held by Canit Hashalom													
Granite Hacarmel Investments Ltd.	ordinary	147,146,834	147,146,834	100%	100%	100%	1,059,192	-	-	Consolidated Company	Israel	-	-
Gemel Tesua Investments Ltd.	ordinary	53,750,000	53,721,650	99.9%	99.9%		346	-	-	Consolidated Company	Israel	-	-
Otzma & Co. Investments Maccabim Ltd.	ordinary	16,100,000	16,091,764	99.9%	99.9%	100%	112	-	45,369 (3)	Consolidated Company	Israel	-	-

Palace America Senior Housing Company Ltd.	ordinary	100	100	100%	100%	100%	269,851	-	-	Consolidated Company	Israel	-	-
Ahuzat Bayit Ra'anana Senior Housing Ltd.	ordinary	15,000,000	15,000,000	100%	100%	100%	55,000		254,159	Consolidated Company	Israel		
Companies held by Granit HaCarmel Investments Ltd.													
GES Global Environmental Solutions Ltd.	ordinary	17,304,169	17,304,169	100%	100%	100%	57,078	-	-	Consolidated Company	Israel	-	-
Supergas Israel Gas Distribution Co. Ltd.	ordinary	252	252	100%	100%	100%	32,289	-	-	Consolidated Company	Israel	-	-

(*) The data refers solely to the companies directly held by the Company.
(1) After deduction of capital reserve
(2) After deduction of capital reserve
(3) Capital bills after deduction of capital reserve
(4) Foreign partnership

Part E

Corporate Governance



Chapter E – Corporate Governance Report

Part A – Aspects of Corporate Governance

Following are details regarding corporate governance processes in the Company for 2016, which include both issues relating to corporate governance in accordance with the Securities Regulations (Periodic and Immediate Reports), 5730-1970 (the "**Report Regulations**"), and a corporate governance questionnaire in accordance with the version included in the document on proposed legislative amendments regarding improvement of the reports which was published by the Israel Securities Authority on March 16, 2014.

1. **Regulation 21 - Payments to Interested Parties and Senior Officers – 2016**

The compensation as recognized in the Company's financial statements in 2016 for the five highest paid individuals among the senior officers of the corporation or a corporation controlled thereby, in connection with their office at the corporation or a corporation controlled thereby, are as follows (in terms of annual costs to the corporation, NIS in thousands, for the twelve-month period that ended on December 31, 2016 (as specified in the Sixth Schedule of the Reports Regulations):

Details of the Compensation Recipient				Compensation					
Name	**Position**	**Position Scope**	**Rate of Holding in the Corporation's Capital**	**Management Fee (a)**	**Bonus**		**Other**		**Total**
(1) Danna Azrieli	Active Chairman of the Board	100%*	(b)	2,810	1,045		---		3,855
(2) Yuval Bronstein	CEO of the Company	100%	---	3,364	941		296(c)		4,601
(3) Arnon Toren	Deputy CEO and Head of Malls Segment	100%	---	2,691	603		---		3,293
(4) Eyal Hankin	CEO of Supergas Israeli Gas Distribution Co. Ltd.	100%	---	2,167	525		192(c)		2,884
(5) Irit Sekler-Pilosof	CFO	100%	---	1,674	364		184(d)		2,222

*It is clarified that Ms. Danna Azrieli may continue to perform additional activities, including philanthropic activities in which she is involved, from time to time, provided that performance thereof does not compromise the fulfillment of her duties at the Company.

a) The management fee component includes the following components: cost of monthly management fees and/or cost of monthly salary, social rights, social and related benefits as customary, car maintenance and reimbursement of communication and other expenses.

b) For details regarding control of the Company on the Report Date see Regulation 21A of Chapter D of the Report.

c) Reflecting an expense in 2016 due to updated months of adjustment upon retirement.

d) Reflecting severance pay.

1) <u>Ms. Danna Azrieli</u> – Ms. Danna Azrieli has been serving as the Company's Active Chairman of the Board since July 2014. For details with respect to the management agreement of Ms. Danna Azrieli, which took effect on January 1, 2015, see Note 37C(2) to the financial statements and the transaction report of November 20, 2014 (Ref. No. 2014-01-199977), as amended on December 21, 2014 (Ref. No. 2014-01-225993) and December 23, 2014 (Ref. No. 2014-01-228996), respectively. On October 6, 2016, the general meeting of the Company’s shareholders (after the approval of the Compensation Committee and the Board of Directors of the Company on August 22, 2016 and August 24, 2016, respectively) approved extension of the said management agreement of Ms. Danna Azrieli as chairman of the Company’s Board for another three years from the date of the meeting’s approval as aforesaid (ref. no.: 2016-01-060735). It is emphasized that there is no change in the terms and conditions of the agreement which was approved in October 2016 versus the agreement that was approved in December 2014. The reports mentioned in this Paragraph (1) are included herein by way of reference.

According to the provisions of the Company’s Compensation Policy, the Chairman of the Board is entitled to an annual bonus for meeting an adjusted profit target[1]. In 2016, the adjusted profit was approx. NIS 1,106 million, and therefore the sum of the variable bonus to which Ms. Danna Azrieli is entitled for the 2016 results was NIS 1,045 thousand.

2) <u>Mr. Yuval Bronstein</u> – Mr. Bronstein serves as the Company's CEO, through a company owned by him. For details regarding the management agreement with Mr. Bronstein, see Section 2.4 of Part A of the notice of meeting report which was published by the Company on June 6, 2013 (Ref. No.: 2013-01-058431), included herein by way of reference, and an update to the management agreement, as specified in Section 4 of the notice of meeting report, as published on August 28, 2016 (ref. no.: 2016-01-111643), which is included herein by way of reference, and Note 37C(6) to the financial statements. According to the Company’s approved compensation policy, the Company’s CEO will be entitled to an annual bonus, according to the following criteria: first criterion – measurement of the officer’s contribution – the Compensation Committee and the Board of Directors will examine (after receipt of the recommendation of the chairman of the Company’s board) the CEO’s meeting of criteria that shall mainly be based on the CEO’s contribution to the Company in accordance with his duties and responsibilities; second criterion – amount of the bonus – upon fulfillment of the aforesaid, the Compensation Committee and the Board of

[1] “The Adjusted Profit for the Chairman” for this purpose, in respect of each calendar year – annual pre-tax profit, in accordance with the audited consolidated annual financial statements of the Company, net of the following amounts: (1) a dividend that it received from financial assets available for sale which was included in the annual pre-tax profit; (2) profit (loss) deriving from revaluation of real properties; (3) results of companies which do not engage in the core segments (real estate) of the Company and were included in the annual pre-tax profit; (4) linkage differentials accrued on financial liabilities; (5) interest expenses at the actual weighted effective interest rate for such year, of the Company and companies controlled thereby which engage in the Company’s core business, in respect of loans (regardless of whether or not they were taken), at a financing rate of 65% on the historic purchase cost on the books of the investment in companies which are not in the core business; (6) the sum total of management fees (including bonus) for the (active) Chairman of the Board for such year, as included in the annual pre-tax profit; and (7) profit (loss) from financial assets (marketable securities) held for trading, including any interest and dividend in respect thereof.

Directors will be entitled to decide, in relation to the CEO, on the granting of a bonus in an amount that shall not exceed the sum of up to three times the monthly payment.

In accordance with the aforesaid, on March 19, 2017, the Compensation Committee examined, and on March 21, 2017 the Company's Board of Directors examined the CEO's contribution (after the recommendation of the Chairman of the Board was received), and it was resolved that on the basis of his contribution as aforesaid and the Company's results for 2016, Mr. Bronstein will be granted a bonus in the sum of NIS 941 thousand.

3) Mr. Arnon Toren – As of June 1, 2014, Mr. Toren holds the office of Deputy CEO of Azrieli Group and Head of the Mall Segment (following his former office as CEO of Azrieli Malls), through a company he owns. In consideration for his services, Mr. Toren is entitled to index linked, fixed, monthly management fees which, as of December 31, 2016, amounted to approx. NIS 241 thousand and standard related benefits, including the provision of a (Grade 6) vehicle, cellular telephones, expense reimbursements and advance notice of 6 months. The Company bears the full cost of all the benefits (including the cost of use and gross-up of the tax value).

According to the Compensation Policy, an officer who does not serve as the CEO of the Company or as a director thereof will be entitled to an annual bonus in accordance with the following criteria: first criterion – measurement of the officer's contribution – the Chairman of the Board and the CEO of the Company will examine the officer's meeting of criteria that shall mainly be based on the officer's contribution to the Company in accordance with his position and responsibilities.

Second criterion – amount of the bonus – upon fulfillment of the aforesaid, the Chairman of the Board and the CEO will be entitled to decide on the granting of an annual bonus, if it is decided to grant the same, in an amount that shall not exceed a sum of up to three times the monthly cost of employment of such officer.

In accordance with the aforesaid, it was resolved to grant Mr. Toren a bonus in the sum of NIS 603 thousand for 2016.

4) Mr. Eyal Hankin – As the Company has been informed by Supergas Israeli Gas Distribution Co. Ltd. ("**Supergas**"), since September 1, 2010, Mr. Hankin, through a company owned by him, has served as CEO of Supergas (after previously serving as Deputy CEO of Supergas for approx. eight months). In consideration for his services, Mr. Hankin is entitled to a fixed monthly management fee, linked to the index, which, as of December 31, 2016, amounted to approx. NIS 175 thousand (the said consideration includes the cost of a car and includes the tax value for use of the car), and standard related benefits, including use of a cellular telephone, expense reimbursement and prior notice of 90 days, and, in the event of termination of the agreement by either party, entitlement to 6 monthly payments in the amount of the last consideration payment in effect on the termination date. In addition, according to a resolution

of Supergas' board, Mr. Hankin is entitled to an annual bonus in an amount of up to 5 times the monthly management fee paid to him as aforesaid.

5) Ms. Irit Sekler-Pilosof – Ms. Irit Sekler-Pilosof has been serving as the Company's CFO since May 1, 2013. For her work, Ms. Sekler-Pilosof is entitled to a gross fixed index-linked monthly salary which, as of December 31, 2016, amounts to approx. NIS 162 thousand, and standard related benefits, including the provision of a (Grade 6) vehicle, cellular telephones, expense reimbursements and advance notice of 6 months. The Company bears the full cost of all the benefits (including the cost of use and gross-up of the tax value). In accordance with the provisions of Section 3 above, it was resolved to grant Ms. Sekler-Pilosof a bonus in the sum of NIS 364 thousand for 2016.

The compensation which was paid during the year prior to the Report Release Date to interested parties in the Company who are not listed in the table above, in relation to services they provided as functionaries in the corporation or a corporation controlled thereby, are as follows (in terms of annual cost for the corporation, in NIS in thousand, for the period of the twelve months ended on December 31, 2016 (as specified in the Sixth Schedule to the Reports Regulations)):

Name of compensation recipient					**Compensation**				
Name	**Position**	**Scope of position**	**Rate of holding in corporation's capital**	**Salary**	**Bonus**	**Share-based payment**	**Management fee(*)**	**Other**	**Total**
Seven directors	Directors of the Company (a)	---		---	---	---	---	1,725 (b)	1,672
Menachem Einan (*)	Consulting services				400		767		1,130

a) Five independent directors and two directors who are controlling shareholders.
b) Directors' compensation.
(*) Since March 2015, Mr. Einan has provided the Company with consulting services by virtue of a consulting agreement with a company owned by him, which agreement ended on February 28, 2017 (the "**Consulting Agreement**"). For further details, see the Company's immediate report of March 18, 2015 (ref. no.: 2015-01-053536), included herein by way of reference. According to the Consulting Agreement, the consulting firm provided consulting services on various strategic matters, upon the Company's request, and up to a scope of 40 monthly hours, in consideration for monthly consulting fees in the sum of approx. NIS 60 thousand, linked to the index and plus reimbursement of reasonable expenses. In addition, in the Report Period, Mr. Einan was paid a one-time bonus for the disposition of the Group's holdings in Sonol. Throughout the term of the agreement, Mr. Einan was not entitled to additional compensation for his office as director. Mr. Einan was included in the D&O liability insurance policy and was granted a letter of exemption and indemnification as accepted in the Company in relation to the other directors and officers. On February 28, 2017, in proximity to the report release date, the term of the agreement ended according to the resolution of the Compensation Committee and the Company's Board, from March 1, 2017 Mr. Einan is entitled to director's compensation like the other directors of the Company (who are not controlling shareholders) as specified in Section (6) below. In proximity to the date of this report, the Company shall release an immediate report pursuant to the Companies Regulations (Relaxations in Transactions with Interested Parties), 5760-2000, in relation to the aforesaid.

(6) Directors of the Company – In accordance with the Company's compensation policy, the compensation for outside directors and other directors of the Company who are not controlling shareholders of the Company and do not receive a salary or management fee as will hold office from time to time, shall be the compensation in the amount of the "maximum amount" per director, according to the rating of the Company as provided in the Companies Regulations (Rules on Compensation and Expenses for the Outside Director), 5760-2000 (the "**Compensation Regulations**") and the classification of such director. In addition, the directors may be included in an insurance policy for officers of the Company and shall receive an undertaking of indemnification, or indemnification pursuant to an indemnification permit and receive an exemption from liability subject to the provisions of the Companies Law. In 2016, the compensation paid by the Company to all of the independent directors (two outside directors and three independent directors), amounted to a total of approx. NIS 1,485 thousand. For further details, see Note 37C(9) and 37D to the financial statements. In addition, the directors are entitled to the reimbursement of expenses as accepted at the Company and in accordance with the Compensation Regulations.

Compensation of additional directors of the Company who are controlling shareholders: For details see Regulation 22 below – Compensation for additional directors who are controlling shareholders of the Company.

2. **Regulation 22 - Controlling Shareholder Transactions**

Following are details, to the Company's best knowledge, with regard to transactions with the controlling party or in the approval of which the controlling party has a personal interest, in which the Company or a corporation controlled by it or a company related to it engaged in the Report Period, and which are still in force as of the Report Date:

Transactions listed in Section 270(4) of the Companies Law

- Engagement in a Management Agreement with a Management Company Controlled by Ms. Danna Azrieli

  On December 28, 2014, the Company's general meeting approved the Company's engagement with a Company controlled by Ms. Danna Azrieli in a management agreement through which Ms. Danna Azrieli provides to the Company Active Chairman of the Board services (the "**Management Agreement**"). For details, see Part C of the notice of meeting report as published by the Company on December 23, 2014 (Ref. No.: 2014-01-228996). On October 6, 2016, the general meeting of the Company's shareholders approved extension of the Management Agreement, with no change to the terms and conditions of the engagement between Ms. Danna Azrieli and the Company, for another three years from the date of the meeting's approval (ref. no.: 2016-01-060735). The reports mentioned in this paragraph are included herein by way of reference, and see Note 37C(2) to the financial statements.

- <u>Compensation of Additional Directors who are Controlling Shareholders of the Company</u>

  Ms. Sharon Azrieli and Ms. Naomi Azrieli, controlling shareholders of the Company, are entitled to directors' compensation as approved by the Board and general meeting of the Company on May 6, 2010 and ratified by the Company's Board on May 13, 2013 and on May 24, 2016 (following receipt of the approvals of the Company's compensation committee) and reported to the public on May 14, 2013 and May 25, 2016, respectively, and pursuant to Section 1B(3) of the Companies Regulations (Relief in Transactions with Interested Parties), 5760-2000. The aforesaid compensation approval of May 25, 2016 was granted for a 3-year period commencing from June 3, 2016. In addition, the provisions of Sections 5(b) and 6(a) of the Compensation Regulations pertaining to reimbursement of expenses to directors, including flights, *per diems* and hospitality, shall apply also with regard to such directors, *mutatis mutandis*. The audit committee and board of directors approved a framework for such expenses, which is examined from time to time. In 2016, the compensation paid by the Company to Naomi Azrieli and Sharon Azrieli as aforesaid amounted to a total of approx. NIS 242 thousand. For details see immediate report published by the Company on May 25, 2016 (Ref. No.: 2016-01-033138), included herein by way of reference, Regulation 21(6) of this part above and Note 37C(9) to the financial statements.

- <u>Insurance and Indemnification of Controlling Shareholders in the Company</u>

  Ms. Danna Azrieli, Chairwoman of the Board of the Company, Ms. Naomi Azrieli, Director, and Ms. Sharon Azrieli, Director, are entitled to an officers' insurance arrangement to which all of the directors and officers of the Company are entitled. For details see immediate report published by the Company on May 25, 2016 (Ref. No.: 2016-01-033144), included herein by way of reference. In addition, Ms. Danna Azrieli, Ms. Naomi Azrieli and Ms. Sharon Azrieli are entitled to letters of indemnification and exemption according to the Company's Compensation Policy, that was approved by the Company's general meeting on October 6, 2016. For details, see Section 3 of the notice of meeting report as published on August 28, 2016 (Ref. No.: 2016-01-111643), included herein by way of reference, and Note 37D to the financial statements. It is noted that in proximity to the release of this report, the Company is summoning a general meeting for the granting of updated letters of exemption and indemnification to the Company's directors, including to the directors who are the Company's controlling shareholders.

- <u>Contributions to the Azrieli Foundation (Israel), a Registered Association</u>

  In May 2010 (following approval by the board of directors), the general meeting, approved the Company's policy on contributions to the Azrieli

Foundation (Israel) R.A. (the "**Azrieli Foundation**"). On March 14, 2013, the Company's audit committee determined that the length of time which was originally set forth by the general meeting of the Company in respect of the Company's contributions to the Azrieli Foundation, i.e. 5 years, is reasonable under the circumstances. For details see the Company's immediate report dated March 14, 2013 (Ref. No.: 2013-01-005851), which is included herein by way of reference. In May 2015, the general meeting approved (after approval by the audit committee and board of directors of the Company) the Company's engagement with the Azrieli Foundation in a new contribution arrangement, whereby the arrangement for contribution to the Azrieli Foundation would be extended for an additional period of five years, commencing on June 1, 2015 and ending on May 31, 2020. For details about the contribution arrangement, see the invitation to a meeting report of April 16, 2015 (Ref. No. 2015-01-000186), which is included herein by way of reference, and Note 37C(7) to the financial statements. Sharon Azrieli, Naomi Azrieli and Danna Azrieli may be deemed as having a personal interest in the contribution to the Azrieli Foundation due to their office on the Company's Board and the Board of the Azrieli Foundation. It is further clarified that following the receipt of the contribution shares (for details with respect to the contribution shares, see the definitions section in Part A of the Report), the Foundation became an interested party in the Company, within the definition of such term in the Securities Law, and following the provisions of the aforesaid contribution arrangement, Azrieli Holdings and the Azrieli Foundation are deemed as "co-holders", within the definition of such term in the Securities Law; for the purpose of duties applicable or relating under the Companies Law to the controlling shareholders of the Company, the Company has chosen to treat the Azrieli Foundation as if it were a controlling shareholder of the Company, together with Azrieli Holdings, even if not required under the provisions of the law, and for as long as no other notice is given by the Company in an immediate report.

- Purchase of a Share of Canit Hashalom

  On March 6, 2016, the general meeting of the Company approved (following approval by the audit committee and board of directors of the Company) the Company's engagement with the Azrieli Foundation in an agreement for the purchase of the share of Canit Hashalom from the Azrieli Foundation in consideration for NIS 51 million. For details, see Part B of the invitation to a meeting report as released by the Company on January 27, 2016 (Ref. No. 2016-01-018823), which is included herein by way of reference, and Note 10C to the financial statements.

- Amendments to the Company's articles

  On August 9, 2016, a special general meeting of the Company's shareholders approved amendments to the Company's articles, which mainly concern updates in accordance with the legislative provisions that changed, expansion of the liabilities and/or the expenses in respect of which the Company will be entitled to grant indemnification and/or insurance to directors and officers, *inter alia* pursuant to the Restrictive Trade Practices Law, 5748-1988, and expansion of the definition of the term "party injured by the breach" such that this definition shall apply to any legislation in respect of which an administrative proceeding may be held. For further details, see the immediate report of August 9, 2016 (ref. no.: 2016-01-100267), which is included herein by way of reference.

On October 6, 2016, a special general meeting of the Company's shareholders approved an amendment to the Company's articles of association on the issue of exemption, such that the Company shall be entitled to exempt in advance and retroactively an officer thereof from his liability, in whole or in part, for damage due to a breach of the duty of care thereto, to the maximum extent permitted by law, subject to the exemption not applying to a decision or transaction in which the Company's controlling shareholder or an officer of the Company has a personal interest. For further details, see the immediate report of October 6, 2016 (ref. no.: 2016-01-060735), which is included herein by way of reference. These reports in connection with amendments that were approved to the Company's articles are specified in this section for the sake of fair disclosure only, even though it is not a transaction according to the definition thereof in the Companies Law, since the directors who are controlling shareholders of the Company may be beneficiaries of letters of indemnification and exemption that shall be granted by virtue of the Company's articles.

Negligible Transactions

In the Report Period, the Group performed negligible transactions with the controlling parties thereof, or that the controlling parties thereof had an interest in their approval, of the kinds and characteristics in accordance with a negligible transactions procedure approved by the Board of Directors of the Company, as specified in Note 37E to the financial statements, including:

- Lease Agreements with Related Parties: The Company, companies controlled by the Company and related companies thereof, have engaged in lease agreements with lessees, in the engagement with whom the controlling party has a personal interest, pursuant to which part of the aforesaid companies lease out for several years now and/or leased out during 2016, in the ordinary course of business and at market conditions, areas in some of the income producing properties of the Company. The income with respect to the aforesaid rentals in the year ending on December 31, 2016, totaled approx. NIS 1,592 thousand (about four lessees, including the Foundation). The Audit Committee and the Board of Directors of the Company examined in their meetings on March 19, 2017 and March 21, 2017, respectively, that these engagements, which were made during 2016, were negligible transactions which are carried out in the ordinary course of business of the Company and at market conditions. For details, see Note 37E to the financial statements.

- Employees of the Group who are Related to Controlling Shareholders: During the Report Period, the Group employed one employee who is related to a controlling shareholder of the Company (and does not amount to the definition of "relative" in the Companies Law) in an employment agreement which is not irregular and is also negligible, in a total cumulative annual amount of approx. NIS 639 thousand. As of the Report Release Date, the aforesaid employee is employed.

- Ties with the community: From time to time the Company makes, either itself or through companies which are among the members of the Group, direct contributions as well as contributions through the Foundation as specified in Section 2 above. In addition, to the Company's best understanding, the Foundation may donate to the community and to bodies or entities which require assistance, including bodies to which interested parties of the Company may have a link, or in which interested parties of the Company are volunteer members.

3. **Additional Issues in Relation to the Control of the Company**

3.1. **Restructuring**

In the context of a process of restructuring of the companies in the Group and primarily, steps for the consolidation of similar activities of the Group which were performed in fellow subsidiaries, and streamlining of the Group's current operation, the Company engaged, in November 2008, in an agreement with Nadav Investments whereby Nadav Investments transferred its shares in some of the Group's companies to the Company, as is, in consideration for an allotment of shares of the Company (the "**Restructuring Agreement**"). As of the Report Date, the restriction period by virtue of Section 104A of the Income Tax Ordinance (New Version), 5721-1961, pertaining to the sale of shares which have been transferred, has expired.

Due to it being a company which is incorporated under Canadian law, Nadav Investments is governed, *inter alia*, in connection with its operations or investments in Israel, by the rules of taxation which are set forth in the treaty between the State of Israel and Canada pertaining to the prevention of double taxation and tax evasion with regard to taxes on income and capital (the "**Treaty**"), including with regard to the sale of shares in companies whose assets are mainly real properties. For purposes of clarification and interpretation of the sections of the Treaty which contemplate this issue, various tax ramifications and provisions regarding the sale of the Company's shares were set forth in the context of an agreement between the Israel Tax Authority and the Company, Canit Hashalom and Nadav Investments, dated November 2008, in accordance with the rate of the Company's holdings in real properties in Israel. In addition, the aforesaid agreement set forth provisions whereby Nadav Investments shall not act towards receiving any tax benefits in Canada which are not in accordance with the provisions of the law in Canada or the Treaty, provisions pertaining to the possibility to terminate the agreement if in the future the provisions of the Treaty and/or Chapter E of the Ordinance will be materially modified in the manner which has an effect on the manner of taxation of the sale, and additional provisions whereby in any event where there will be a tax liability in Canada due to the sale of the shares, the same shall have no effect on the tax liability which is set forth in the agreement.

Any restructuring in accordance with the provisions of the second part of the Ordinance which addresses the Company's shares and/or the shares of Canit Hashalom shall be performed solely after the receipt of the advance consent of the Mergers and Splits Department of the Tax Authority.

3.2. **<u>Definition of Business</u>**

On May 24, 2016, the Company's Board, after the approval of the Audit Committee of May 22, 2016, approved the Company's Definition of Business Procedure (the "**Procedure**") which shall apply to the Company's directors and to the Company's controlling shareholders. The Procedure determines the types of business in which they will not be able to engage in transactions in Israel and overseas, and the manner of disclosure to the Company, prior to engagement in such transactions, and the how the Company shall make the decision as to whether such transactions are relevant to the Company. The Procedure shall apply to controlling shareholders and board members at the Company and will be in effect throughout the period of their being controlling shareholders of the Company and/or their term of office as members of the Company's Board, whichever is later, and with respect to directors for an additional period of six months from the end of the said timeframe, so long as no other resolution shall have been adopted by the Company's Board, after receipt of the resolution of the Company's Audit Committee. The Procedure determines that a controlling shareholder and/or director of the Company is prohibited from being involved, either directly or indirectly, in business activity which may, according to the Companies Law, fall under the definition of a business opportunity of the Company, and in any event which falls within one or more of the activities to which the Procedure applies.

The Procedure regulates the process of approval of performance of the transaction by a controlling shareholder and/or director, if the Company chooses not to perform such transaction itself. According to the Procedure, a controlling shareholder and/or director is required to present, in writing, to the Company's management and subsequently to the Audit Committee, an outline of the transaction in connection with a property and/or activity which fall within any of the activities according to the Procedure which he is interested in performing, and to forward all of the material relevant to the transaction for their perusal. Only if the Company's management, and subsequently the Audit Committee, decide that the proposed activity does not interest the Company, will the controlling shareholder and/or director of the Company be free to engage in such transaction.

Due to the complexity of the issues covered by the Procedure, the timetables for performance of transactions and the concern of other bodies which may frustrate the transaction, decisions must be made under the Procedure on short notice and even immediately, all as specified in the Procedure. Therefore, the decision of the Audit Committee as to whether to approve the proposed activity or alternatively to seek supplementary details from the Company's management, shall be given no later than up to 10 business days after the date of presentation of the proposal by such person and receipt of the material and information required, such decision being made by a majority of members who do not have a personal interest in the decision.

It is clarified that the provisions of the Companies Law and the provisions of supplementary laws such as securities law prevail over the provisions of the Procedure, and therefore the Company is required to seek advice in each case according to the special circumstances thereof from the legal aspect, as applicable at such time.

In addition, there is a definition of business procedure for the Chairman of the Board, Ms. Danna Azrieli, which applies to her in addition to the provisions of the Procedure.

4. **Regulation 29 and Regulation 29A - Recommendations and Resolutions of the Board of Directors**

For details on resolutions of the board of directors with regards to dividend distributions see Section 4 of Chapter A of this Report and Notes 23 and 39A to the financial statements.

Board resolutions regarding early redemption of bonds

On June 7, 2016, the board of directors of subsidiary Ahuzat Bayit Raanana – Senior Housing Ltd., decided on the performance of full early redemption of the Series A bonds thereof. The sum total that was paid to the bondholders was NIS 209,813 thousand. For further details, see Section 1.3.4 of Chapter A, and Note 21B(7) to the financial statements.

Resolutions of the Special General Meeting

Set forth below is a specification of resolutions which were approved in special general meetings of the Company's shareholders:

Date of resolution	Subject of resolution	Ref.[2]
March 6, 2016	Approval of the Company's engagement in an agreement for the purchase of one share of Canit Hashalom Investments Ltd. from Azrieli Foundation (Israel) (R.A.).	2016-01-000756
August 9, 2016	1. Reappointment of Prof. Niv Ahituv as an outside director of the Company for an additional term of office of three years commencing on August 24, 2016. 2. Reappointment of Mr. Efraim Halevy as an outside director of the Company for an additional term of office of three years commencing on August 24, 2016. 3. Amendment of the Company's articles regarding indemnification, exemption and/or insurance.	2016-01-100267
October 6, 2016	1. Approval of a current compensation policy for the Company's officers pursuant to Section 267A of the Companies Law. 2. Amendment of the Company's articles regarding the exemption clause. 3. Approval of an update to the monthly management fees in the framework of the management agreement with the Company's CEO, Mr. Yuval Bronstein. 4. Approval of extension of the existing management agreement between the Company and a company controlled by the Active Chairman of the Company's Board, Ms. Danna Azrieli (with no change from the valid chairman's agreement).	2016-01-060735

Resolutions of the Company – Regulation 29A

In the Report Period, and until the Report Release Date, no Company resolutions were adopted on the issues specified in Regulation 29A of the Report Regulations, other than as specified below:

For details in relation to the resolution to renew the Company's insurance policy for directors and officers (including from among the controlling shareholders of the Company) of the Company and the Company's subsidiaries, with the exception of Granite Hacarmel Group, which holds an independent officers' insurance policy, from June 3, 2016 until June 2, 2017, which was adopted on the Report Date, see the Company's immediate report pursuant to the provisions of Sections 1B(5) and 1B1 of the Companies Regulations (Relief in

[2] The reports in this table are included herein by way of reference.

Transactions with Interested Parties), 5760-2000 (ref. no.: 2016-01-033144), included herein by way of reference, and Note 37D to the financial statements.

5. **Compensation of Senior Officers**

The Company's compensation policy which was approved by the general meeting of the Company in October 2016, for a period of three years, determines a personal compensation plan for a small group of officers of the Company, including directors of the Company who are controlling shareholders.

For details on the Company's Compensation Policy, see the immediate report for convening a meeting dated August 28, 2016 (Ref. No.: 2016-01-111643), which is included herein by way of reference.

At the Compensation Committee's meeting of March 19, 2017 and at the board meeting of March 21, 2017, a discussion was held on the terms of employment and the compensation granted to the senior officers and the interested parties of the Company in 2016 which are specified in Regulation 21 of this chapter with respect to each one of the said senior officers and interested parties separately.

The Company's board of directors determined, after having received the recommendation of the compensation committee, *inter alia*, that all of the compensation terms of the officers are consistent with the Company's Compensation Policy. The board of directors noted that the CEO of Supergas, a company wholly owned by Granite Hacarmel, was included in the disclosure under Regulation 21 of the Report Regulations, in view of his being, during the Report Period, a senior officer of a corporation controlled by the Company, albeit not material to the Company. This being the case, in view of the fact that he is not included in the definition of a senior officer of the Company, the provisions of the Company's Compensation Policy are not applicable to him. Accordingly, in the estimation of the Company's Compensation Committee and Board, the compensation granted as specified in Regulations 21 and 22 above is consistent with the Company's Compensation Policy and/or is reasonable and fair.

6. **Internal Audit**

In 2010 the Company adopted an internal audit procedure (the "Internal Audit Procedure"), whose purpose is to define the status and scope of activity of the internal auditing of the Company, as well as the methods and means for fulfillment of its tasks. This Procedure was approved by the audit committee in its meeting of November 15, 2010 and by the Company's board of directors in its meeting of November 24, 2010.

Identity of the Internal Auditor: Mr. Gali Gana, CPA, partner at Rosenblum-Holtzman (the "**Internal Auditor**") was appointed to the position of the internal auditor of the Company and the Group's companies (excluding Granite Hacarmel) and began his service at the Company in November 2009. Since 2013, subsequently to Granite Hacarmel being turned into a private company, no separate internal auditor holds office therein. An outside internal auditor who is separate from the company's internal auditor holds office in each of the material subsidiaries of Granite Hacarmel.

Compliance of the Internal Auditor with Legal Requirements: To the best of the knowledge of the Company's management, according to the Internal Auditor's statement, he complies with the requirements of Section 146 (b) of the Companies Law and the provisions of Section 3(a) and 8 of the Internal Audit Law, 5752-1992 (the "**Internal Audit Law**").

Holding Securities of the Company or a Body Related Thereto: As of this Report Date, as the Internal Auditor informed the Company, he does not hold securities of the Company or a body related thereto.

Ties of the Internal Auditor with the Company or a Body Related Thereto: To the best of the knowledge of the Company's management, as the Internal Auditor informed the Company, the Internal Auditor does not have material business or other ties with the Company, and nothing in other business ties of the Internal Auditor creates a conflict of interest with his duties as an Internal Auditor of the Company.

Additional Positions of the Internal Auditor in the Company: The internal auditor is an external service provider to the Company on behalf of Rosenblum-Holtzman, CPAs. According to the Internal Audit Procedure, the auditor and the audit workers will not hold a position in the Company in addition to the internal audit. As of the Report Date, except for his position as the Company's internal auditor, the internal auditor is neither employed by the Company nor provides any other external services thereto.

Other positions of the Internal Auditor Outside the Company: Mr. Gali Gana is a partner at Rosenblum-Holtzman & Co., CPAs.

The Method of Appointment of the Internal Auditor: Mr. Gali Gana was appointed to serve as the internal auditor of the Company by the Company's CEO in November 2009 and was approved by the Company's audit committee on November 15, 2010, after an in-depth review of his education, qualifications and experience of many years in internal auditing while considering the obligations, authorities and duties imposed on the internal auditor according to law.

Mr. Gana was found suitable to serve as the internal auditor of the Company, *inter alia* considering the scope of business and complexity of the company. Within the framework of the Internal Audit Procedure which was approved by the audit committee and board of directors of the Company in November 2010, the Company's board of directors shall appoint the internal auditor and determine his status and compensation terms.

Conclusion of term of office: According to the Internal Audit Procedure which determines that the term of office of the Company’s Internal Auditor shall not exceed 6 years, on March 21, 2017 Mr. Gali Gana ended his term of office as the Company’s Internal Auditor, and CPA Moshe Cohen of Chaikin Cohen Rubin & Co., CPAs, was appointed in his stead (the “**Incoming Internal**

Auditor”). It is clarified that the details included in this section relate to the term of office of Mr. Gali Gana and Rosenblum-Holtzman & Co., CPAs, as the case may be.

The Identity of the Supervisor of the Internal Auditor: The organizational supervisor of the internal auditor is, as of the Report Date, the chairman of the Company's board of directors, in coordination with the Company's audit committee.

The Audit Plans: According to the Internal Audit Procedure, the internal auditor submits a proposal for an annual work plan, in coordination with the chairman of the board and the Company's CEO. The audit committee must discuss the plan and approve it, and thereafter the plan is forwarded for the board's approval. In August 2012, the audit committee adopted the report of the outgoing internal auditor regarding a multi-annual risk survey, according to which the audit committee laid down a multi-annual plan for the years 2012-2016 for determination of the audit objectives, which served as an outline for laying down the annual work plan of the internal audit. The audit plan of the internal auditor is an annual plan, derived from a multi-annual work plan, *inter alia*, according to the following considerations: potential for streamlining and saving, risks inherent to the Company's business, rules and regulations applicable to the Company and weaknesses which the Company's board of directors, management or internal auditor observe on an ongoing basis. The Incoming Internal Auditor is expected to carry out a multi-annual risk survey, upon his appointment during March 2017, and according thereto will prepare the audit plan for 2017 and for the coming years.

The annual work plan of the internal audit includes also the performance of an audit of the follow up on implementation of the internal auditor and audit committee's recommendations by the Company's management. The audit is carried out according to the plan under the supervision of the internal auditor and is adapted, according to developments and findings which are discovered during the audit. The work plan leaves discretion with the auditor for change in the audited issues, after a discussion on the subject with the relevant parties.

Material Transactions: The internal auditor receives an invitation, including background material for meetings of the Company's audit committee in which transactions are examined and approved, as specified in Section 270 of the Companies Law, 5759-1999. According to his choice, after receiving proper details, he is present at the meetings or is updated in respect thereof. Also, the internal auditor receives, upon his request, minutes of the Company's board meetings in which such transactions had been approved.

Investee Corporations: The internal auditor also serves as the internal auditor of the subsidiaries in the Group, excluding the Granite Hacarmel Group, senior housing and Azrieli eCommerce. The audit plan also refers to material investee corporations of the Company in which no internal auditor had been appointed, including overseas.

Scope of Retaining of the Internal Auditor: The scope of retaining of the internal auditor had been approved by the audit committee according to the audit plan which was approved thereby.

In respect of the audit plan for 2016, the hours of the internal audit in the Company and in its investee companies (excluding Granite Hacarmel) amounted to approx. 1,100 hours. The management has the option to expand the scope of retaining according to circumstances.

In the Company's estimate, the scope of the internal auditor's work in respect of 2016 is appropriate.

The scope of hours for the audit work in the Company and in the subsidiaries is determined according to the audit plan proposed by the internal auditor in coordination with the management and is approved by the audit committees of the various boards of directors. In 2016, the internal audit hours in Granite Hacarmel Group amounted to approx. 972 working hours and the internal audit hours at Palace America Senior Housing Ltd., amounted to approx. 215 working hours.

According to the Internal Audit Procedure, the period of office of an internal auditor in the Company will not exceed six years, unless the audit committee and the board of directors have decided otherwise.

Guideline Professional Standards in the Performance of the Audit: The internal auditor and the team of employees reporting to him perform the audit work in meticulous compliance with necessary standards for the performance of professional, reliable, autonomous audit, independent of the auditee. Pursuant to information provided to the Company's management by the internal auditor, the audit reports rely on the audit findings and the facts recorded in the audit are carried out according to accepted professional standards according to professional guidelines on internal auditing, including standards of the Institute of Internal Auditors in Israel (IIA), and in accordance with the Internal Audit Law, 5752-1992 and the Companies Law. The board of directors relied on the reports of the internal auditor regarding his compliance with the professional standards according to which he performs the audit.

Free Access to the Internal Auditor: The internal auditor of the Company has free, unlimited and direct access, in coordination, to documents, information and the relevant information systems of the Company, and of investee companies, including financial data, as well as an independent status. The internal auditor undertakes to keep in confidence, not to provide to others and not to make any use for his own use or for the use of others, of any information pertaining to the Company.

The Report of the Internal Auditor: The internal audit reports are submitted in writing and discussed on an ongoing basis with the Company's management and the CEO. The dates on which a report was submitted regarding the findings of the internal auditor to the CEO are: January 20, 2016, March 8, 2016 (3 reports), May 17, 2016, July 31, 2016 (2 reports), August 7, 2016, August 30, 2016, September 29, 2016, October 26, 2016 and November 10, 2016.

The dates on which a discussion was held at the Audit Committee on the findings of the Internal Auditor are as follows: January 12, 2016 (2 reports), March 20, 2016 (2 reports), May 22, 2016 (2 reports), August 22, 2016 (3 reports), March 19, 2017 (one report).

The Evaluation by the Company's Board of Directors of the Activity of the Internal Auditor: According to the evaluation of the board of directors, the qualifications of the internal auditor and his team, the scope, nature and continuity of the activity of the internal auditor and his work plan are reasonable in the circumstances of the matter, and fulfill the purposes of the internal audit at the Company. On March 19, 2017, the chairman of the audit committee held a meeting with the internal auditor of the Company, in the absence of the Company's management, for discussion of the internal auditor's work and found that there are no restrictions on his work, as aforesaid.

Compensation of the Internal Auditor: The payment to the internal auditor of the Company and of subsidiaries in Israel is done according to actual working hours and according to the work plan approved by the audit committee and the progress in the audit work of each and every subject. In the beginning of each year the auditor submits a proposal for an annual audit plan which will include a planned hourly framework.

The audit committee determines the audit plan and the hour quota. The auditor will not deviate from the hour quota without the approval of the audit committee. In case that further tasks will be imposed on the auditor during the audit year – the audit committee will determine the hour quota for the further tasks.

In respect of 2016, the cost of the fee to the internal auditor and his team amounted approx. NIS 228 thousand (plus VAT). The cost of the internal audit in the Granite Hacarmel Group for 2016, including the cost of external entities, amounted to approx. NIS 162 thousand, the cost of the internal audit at Palace America Senior Housing Ltd. amounted to approx. NIS 33 thousand.

According to the Company's estimation, due to the fact that the remuneration is based on working hours, the aforesaid remuneration cannot affect the exercise of the internal auditor's professional discretion. The Company determined as a matter of essential policy the independence of the internal audit, and therefore, the internal auditor is not dependent at all upon the Company and the management thereof.

7. **<u>The Outside Auditor</u>**

<u>The Auditor's Identity</u>

The primary outside auditors of the Company and of the investee companies (excluding Granite Hacarmel and excluding Ahuzat Bayit Raanana - Retirement Home and Azrieli E-Commerce Ltd.) are the accounting firm of Brightman Almagor Zohar (the "**Auditor**"). It shall be stated that the firm leases offices from the Company at the Azrieli Center in Tel Aviv for amounts which are immaterial to the Company. However, in order to ensure the independence thereof is not prejudiced, the Auditor has assumed (within the framework of an agreement with the Israel Securities Authority) parameters which will be examined from time to time in respect of the engagement, including with respect to the specificity of the terms of the lease agreement and non-modification thereof; written – at arm's length fee agreements; separation between the identity of the service providers and the decision makers in respect of the lease agreement; restrictions regarding the settling of accounts between the lease agreement and the services and agreement that in case of dispute the auditor shall act for termination of his office. The Company confirms with the Auditor the fulfillment of such parameters and the validity thereof on an annual basis.

The Auditor's Fee

In the years 2015 and 2016, the accountant fee for audit services, audit-related services and tax services and consultation services totaled as follows:

2016:		**Audit Services, Audit-Related Services and Tax Services**		**Other Services**		**Total**	
Company	**Auditor**	**NIS in thousands**	**Hours**	**NIS in thousands**	**Hours**	**NIS in thousands**	**Hours**
Azrieli Group Ltd.	Brightman Almagor Zohar & Co.	1,674	8,966	108	522	1,900	10,322
Ahuzat Bayit Raanana – Retirement Home Ltd.	Ziv Haft	126	900	-	-	126	900
Azrieli E-Commerce Ltd.	Strauss Lazer & Co.	85	680	-	-	85	680
Granite Hacarmel	Somekh Chaikin KPMG (auditors)	981	4,950	373	1,290	1,354	6,240
2015:		**Audit Services, Audit-Related Services and Tax Services**		**Other Services**		**Total**	
Company	**Auditor**	**NIS in thousands**	**Hours**	**NIS in thousands**	**Hours**	**NIS in thousands**	**Hours**
Azrieli Group Ltd.	Brightman Almagor Zohar & Co., CPAs	1,450	7,630	430	606	1,880	8,236
Granite Hacarmel	Somekh Chaikin KPMG (auditors)	1,400	8,600	700	1,800	2,100	10,400

Pursuant to the sale of part of the companies that were held by Granite in 2015 and 2016 (Sonol, the desalination plant and the solar systems) the audit hours were reduced.

Determination of the Auditor's Fee

The Company's board of directors, after receiving the recommendation of the Company's audit committee, was authorized in the Company's articles of association to determine the fee of the outside auditor. The fee is determined based on the work required and past experience, while adjusting such to changes in regulation and scope of work, development of the Company and events which occurred during the passing year. Accordingly, on March 21, 2017, after receiving the recommendation of the audit committee, the Company's board of directors approved an update to the outside auditor's fee for 2016.

8. **Independent Authorized Signatory**

As of the Report Release Date, the Company does not have an independent authorized signatory.

9. **Contributions**

The Company has a deep commitment to the improvement and promotion of the community in Israel. The social accountability, the integration and giving to the community are strategic objectives which constitute an integral part of the Company's business work plan, which allocates financial resources to the matter, in the annual work plan, mainly under the contribution agreement, as specified in Section 2 of this chapter.

Over the course of 2016 the Company made contributions, itself and through consolidated companies (excluding Granite Carmel), in money and in finished products, at a total value of approx. NIS 12 million.

For resolutions adopted by the Company in respect of its contribution policy, through the Azrieli Foundation (Israel) (R.A.), which also includes undertakings to grant future contributions, see Regulation 2 above and Note 37C(7) to the financial statements.

10. **Internal Enforcement Plan in the Company**

In 2012, the Company has adopted an internal enforcement plan. Within the framework of the internal enforcement plan, the Company's board of directors appointed a board committee designated for the issue of internal enforcement in the Company (the "**Enforcement Committee**") which held a series of discussions regarding required adjustments for an enforcement outline and an enforcement system procedure for the needs of the Company, the unique structure of the Company and its field of business. The supervisor of internal enforcement in the Company is Adv. Ran Tal, General Counsel and Company Secretary.

In the context of the enforcement plan, the Company updated and adopted several procedures regarding corporate governance in the Company, which constitute part of the overall enforcement system in the Company, including: (a) Procedure for the work of the board and its committees; (b) Procedure for identifying transactions with related parties (which also addresses the identification of transactions with interested parties, the classification of irregular and negligible transactions and criteria for types of transactions and acts as being irregular); (c) Immediate reports procedure (for examination of the materiality and the need for submitting an immediate report upon the occurrence of various events); (d) Insider information procedure; (e) Whistleblower employees procedure; (f) Ethical code; (g) Officer holdings procedure; (h)

Cluster of companies procedure; (j) Definition of business for directors and controlling shareholders of the Company procedure and other procedures designated to support and regulate the work of the different organs in the Company and its management.

In 2016, the Company implemented the enforcement plan and acted in accordance therewith, in the context of which it also held the annual training day, which compiles the relevant updates for the managers and employees of the Group. A report for 2016 and an enforcement plan for 2017 are expected to be deliberated shortly after the Report's release.

Part B – Corporate Governance Questionnaire[3]

To clarify, for the avoidance of doubt, the questionnaire is not intended to exhaust all corporate governance aspects relevant to the Company, but only addresses several aspects; for receipt of further information, please inspect the Company's reports, including in this periodic report.

Independence of the Board of Directors			
		Correct	**Incorrect**
1.	Throughout the entire report year, two or more outside directors held office in the corporation. In this question you may reply "Correct" if the period of time in which two outside directors did not hold office does not exceed 90 days, as provided in Section 363A(b)(10) of the Companies Law however, any reply which is (Correct/Incorrect) shall state the period (in days) in which two or more outside directors did not hold office in the corporation in the report year (including also a term of office which was retroactively approved, while distinguishing between the different outside directors): Director A: Prof. Niv Ahituv Director B: Mr. Efraim Halevy Number of outside directors holding office in the corporation as of the date of release of this questionnaire: 2.	✓	
2.	The rate[4] of independent directors[5] holding office in the corporation as of the date of release of this questionnaire: 5/9 The rate of independent directors determined in the articles of association[6] of the corporation[7]: ______. ☒ Irrelevant (no provision set in the articles of association).		
3. .	In the report year, an examination was held vis-à-vis the outside directors (and the independent directors) and it was found that in the report year they complied with the provision of Section 240(b) and (f) of the Companies Law regarding the absence of a link of the outside (and independent) directors holding office in the corporation, and that they also fulfill the conditions required for holding offi ce as an outside (or independent) director.	✓	
4.	All of the directors who held office in the corporation during the report year do not, directly or indirectly, report[8] to the CEO (excluding a director who is a workers' representative, if there is a workers' representative body in the corporation).If your answer is "Incorrect", (i.e., the director reports to the CEO as aforesaid) – state the number of directors not complying with the aforesaid restriction: ______.	✓	

[3] According to the language included in the document on proposed legislative amendments regarding improvement of the reports which was published by the Israel Securities Authority on March 16, 2014.

[4] In this questionnaire, "rate" – a specific number out of the total. For example 3/8.

[5] Including "outside directors" as defined in the Companies Law.

[6] In the context of this question – "articles of association" including pursuant to a specific legal provision that applies to the corporation (for example, in a banking corporation – the guidelines of the Supervisor of Banks).

[7] A bond company is not required to answer this section.

[8] For purposes of this question – the mere holding of office as a director in a held corporation which is controlled by the corporation, shall not be deemed as "reporting", conversely, a director's office in a corporation acting as an officer (other than a director) and/or employee in the held corporation which is controlled by the corporation, shall be deemed as "reporting" for purposes of this question.

5.	All of the directors who notified of the existence of a personal interest they have in the approval of a transaction on the meeting's agenda, neither attended the deliberation nor participated in a vote as aforesaid (other than a deliberation and/or vote in circumstances as stated in Section 278(b) of the Companies Law): If your answer is "Incorrect" – Was it for the purpose of presentation of a specific issue by him pursuant to the provisions of the last part of Section 278(a): ☐ Yes ☐ No (check the appropriate box). State the number of meetings in which such directors were present at the deliberation and/or participated in the vote, other than in circumstances as provided in Subsection a.: _____________.	✓	
6.	The controlling shareholder (including his relative and/or anyone on his behalf), who is not a director or another senior officer of the corporation, did not attend the board meetings held in the report year. If your answer is "Incorrect" (i.e., the controlling shareholder and/or his relative and/or anyone on his behalf who is not a board member and/or a senior officer of the corporation attended such board meetings) - the following details regarding the attendance of any additional person in such board meetings shall be stated: Identity: Ms. Stephanie Azrieli; Holds no position at the Corporation; the wife of Mr. David Azrieli OBM and the mother of Danna Azrieli, Chairman of the Board, Naomi and Sharon Azrieli, directors. Was it for the purpose of presentation of a certain issue by him: ☐ Yes ☒ **No** (check the appropriate box) The rate of his attendance[9] at board meetings held in the report year for the purpose of presentation of a specific issue by him: ____________. Other presence: Ms. Stephanie Azrieli, accompanies her daughters, Danna Azrieli, Chairman of the Board, Naomi and Sharon Azrieli, directors; however, she does not take an active part in the discussions and resolutions.		✓
Directors' qualifications and skills			
		Correct	**Incorrect**
7.	In the corporation's articles of association there is no provision limiting the possibility to immediately terminate the office of all of the directors of the corporation who are not outside directors (in this context - a determination by a regular majority is not deemed a limitation)[10]. If your answer is "Incorrect" (i.e., such limitation exists), state -	✓	
	a. The period prescribed in the articles of association for the office of a director: ______.		
	b. The required majority prescribed in the articles of association for the termination of office of the directors: ______.		
	c. The legal quorum at the general meeting prescribed in the articles of association for the termination of office of the directors: ______.		

[9] While separating the controlling shareholder, his relative and/or another on his behalf.
[10] A bond company is not required to answer this section.

	d.	The majority required for amending these provisions in the articles of association: ______.		
8.		The corporation has a training plan for new directors, in the field of the corporation's business and in the field of the law applicable to the corporation and the directors, as well as a continuing plan for the training of incumbent directors, which is adjusted, *inter alia*, to the position held by the director in the corporation. If your answer is "Correct" - state whether the plan was implemented in the report year: ☒**Yes** ☐ No (check the appropriate box)	✓	
9.	a.	The corporation determined a required minimum number of directors on the board who must have accounting and financial expertise. If your answer is "Correct" – state the minimum number which was determined: 1 (apart from the outside director having accounting expertise).	✓	
	b.	Number of directors holding office in the corporation during the report year - Having accounting and financial expertise[11]: 4. Having professional qualifications: 6. If there were changes in the number of directors as aforesaid in the report year, provide the figure of the lowest number (other than in the 60-day period from the change) of directors of any kind who held office in the report year.	✓	
10.	a.	Throughout the report year, the composition of the board included members of both genders. If your answer is "Incorrect" – state the period (in days) in which the aforesaid was not met: ______. In this question, you may answer "Correct" if the period in which directors of both genders did not hold office does not exceed 60 days. However, in any answer (Correct/Incorrect), state the period (in days) in which directors of both genders did not hold office in the corporation: 0.	✓	
	b.	Number of directors of each gender holding office on the board of the corporation as of the date of publication of this questionnaire: Men: 5 Women: 4.		
Board Meetings				
			Correct	**Incorrect**
11.	a.	Number of board meetings held during each quarter in the report year: Q1:6. Q2:7. Q3:2. Q4:3.		

[11] After the board's estimation, in accordance with the provisions of the Companies Regulations (Conditions and Tests for Directors Having Accounting and Financial Expertise and Directors with Professional Qualifications), 5766-2005.

b.	Alongside each of the names of the directors holding office in the corporation during the report year, state their participation rate [12] in the board meetings (in this subsection - including meetings of the board committees of which they are members, and as stated below) held during the report year (in reference to his term of office): (Add extra lines according to number of directors)

Name of Director	Rate of Participation in the Board Meetings (18 meetings, of which one meeting without the controlling shareholders due to their being interested parties)	Rate of Participation in the Meetings of the Audit Committee[15] (6 meetings)	Rate of Participation in the Meetings of the Financial Statements Review Committee[14] (4 meetings)	Rate of Participation in Meetings of Compensation Committee[13] (5 meetings)	Rate of Participation in Meetings of Additional Board Committees of which he is a Member (state the committee's name)
Danna Azrieli	17/18	----	----	----	----
Naomi Azrieli	17/18	----	----	----	----
Sharon Azrieli	15/18	----	----	----	----
Joseph Ciechanover	18/18	6/6	4/4	5/5	Enforcement Committee – 1/1
Oran Dror	18/18	6/6	4/4	5/5	Enforcement Committee – 1/1
Niv Ahituv	18/18	6/6	4/4	5/5	Enforcement Committee – 1/1
Efraim Halevy	17/18	5/6	3/4	4/5	Enforcement Committee – 1/1
Tzipora Carmon	17/18	6/6	4/4	5/5	Enforcement Committee – 1/1

[12] See footnote 9.
[13] With regard to a director who is a member of this committee.
[14] With regard to a director who is a member of this committee.
[15] With regard to a director who is a member of this committee.

		Menachem Einan	12/18		1/4				
12.	. In the report year, the board held at least one deliberation on the management of the corporation's business by the CEO and the officers reporting to him, in their absence, and they were afforded the opportunity to express their position.							✓	

Separation between the Positions of the CEO and the Chairman of the Board				
			Correct	**Incorrect**
13.	.	Throughout the entire report year, a chairman of the board held office in the corporation. In this question, you may answer "Correct" if the period in which a chairman of the board did not hold office in the corporation does not exceed 60 days, as provided in Section 363A(2) of the Companies Law). However, in any (Correct/Incorrect) answer, state – The period (in days) during which there was no chairman of the board holding office in the corporation as aforesaid: ______.	✓	
14.	.	Throughout the entire report year, a CEO held office in the corporation. In this question, you may answer "Correct" if the period during which there was no acting CEO in the corporation does not exceed 90 days as provided in Section 363A.(6) of the Companies Law, however, in any (Correct/Incorrect) answer, state the period (in days) during which there was no CEO holding office in the corporation as aforesaid: ______.	✓	
15.	.	In a corporation in which the chairman of the board also serves as the CEO of the corporation and/or exercises his powers, the dual office was approved in accordance with Section 121(c) of the Companies Law[16]. ☒Irrelevant (insofar as such dual office does not exist in the corporation).		
16.		The CEO is not a relative of the chairman of the board.	✓	
17.	.	A controlling shareholder or his relative do not serve as the CEO or as a senior officer in the corporation, other than as a director.	✓	

[16] In a bond company – an approval pursuant to Section 121(d) of the Companies Law.

The Audit Committee				
			Correct	Incorrect
18.		The following did not hold office in the audit committee during the report year -		
	a.	The controlling shareholder or his relative.	✓	
	b.	The chairman of the board.	✓	
	c.	A director who is employed by the corporation or by the controlling shareholder of the corporation or by a corporation controlled by him.	✓	
	d.	A director who regularly provides services to the corporation or to the controlling shareholder of the corporation or a corporation controlled by him.	✓	
	e.	A director whose primary livelihood depends on the controlling shareholder.	✓	
19.		No one who is not entitled to be a member of the audit committee, including a controlling shareholder or his relative, was present, in the report year, in the audit committee meetings, other than pursuant to the provisions of Section 115 (e) of the Companies Law.	✓	
20.		The Legal quorum for deliberation and adoption of resolutions in all of the audit committee's meetings held during the report year was a majority of the committee members, where the majority of the attendees were independent directors and at least one of them was an outside director. If your answer is "Incorrect" - state the rate of the meetings in which the said requirement was not met: ______.	✓	
21.		In the report year, the audit committee held at least one meeting in the presence of the internal auditor and the outside auditor, and in the absence of officers of the corporation who are not members of the committee, regarding deficiencies in the business managemen t of the corporation.	✓	was held on February 2, 2014, and with the internal auditor on February 16, 2014, while the previous discussion was held on December 31, 2012)

22.		In all of the audit committee's meetings in which a person who is not entitled to be a committee member was present, it was with the approval of the chairman of the committee and/or at the request of the committee (regarding the general counsel and secretary of the corporation who is not a controlling shareholder or his relative).	✓	
23.		In the report year, there were valid arrangements which were set forth by the audit committee regarding the manner of handling complaints of employees of the corporation in relation to flaws in the management of its business and with regard to the protection that will be provided to employees who complained as aforesaid.	✓	
24.		The audit committee (and/or the Financial Statements Review Committee) is satisfied that the scope of work of the auditor and his fee with respect to the financial statements in the report year were appropriate for the performance of proper audit and review work.	✓	

The Duties of the Financial Statements Review Committee (hereinafter - FSRC) in its Preliminary Work for the Approval of the Financial Statements				
			Correct	**Incorrect**
25.				
	a.	State the period (in days) prescribed by the board of directors as reasonable time for delivery of the committee's recommendations in contemplation of the board's deliberation for the approval of the financial statements: 2 business days apart from cases in which it is otherwise determined under the circumstances.		
	b.	The number of days actually elapsed between the date of delivery of the recommendations to the board and the date of the board's deliberation for the approval of the financial statements: Q1 statement (for 2016): 2 business days. Q2 statement: 2 business days. Q3 statement: 2 business days. Annual Statement: 2.		
	c.	The number of days elapsed between the date of delivery of the draft financial statements to the directors and the date of the board's deliberation for the approval of the financial statements: Q1 statement (2016): 6 days. Q2 statement: 6 days. Q3 statement: 5 days.		

		Annual statement: 5 days.	
26.		The Corporation's outside auditor was invited to all of the FSRC and board meetings, in which the financial statements of the corporation referring to periods included in the report year were deliberated.	✓
27.		All of the conditions specified below were fulfilled at the FSRC throughout the entire report year and until the release of the annual statement:	
	a.	The number of its members was not less than three (on the date of the deliberation by the FSRC and approval of the statements as aforesaid).	✓
	b.	All of the conditions specified in Section 115 (b) and (c) of the Companies Law (in respect of the office of audit committee members) were met thereby.	✓
	c.	The chairman of the FSRC is an outside director.	✓
	d.	All of its members are directors and most of its members are independent directors.	✓
	e.	All of its members have the ability to read and understand financial statements and at least one of the independent directors has accounting and financial expertise.	✓
	f.	The members of the FSRC provided a statement prior to their appointment.	✓
	g.	The legal quorum for discussion and decision making on the FSRC was the majority of its members provided that most of those present were independent directors including at least one outside director.	✓

Compensation Committee				
			Correct	**Incorrect**
28.		In the report year, the FSRC consisted of at least three members and the outside directors constituted a majority therein (on the date of the deliberation by the FSRC).	✓	
29.		The terms of office and employment of all of the members of the compensation committee in the report year are in accordance with the Companies Regulations (Rules on Compensation and Expenses for an Outside Director), 5760-2000.	✓	
30.		The following did not hold office in the compensation committee during the report year -	✓	
	a.	The controlling shareholder or his relative.	✓	
	b.	The chairman of the board.	✓	
	c.	A director who is employed by the corporation or by the controlling shareholder of the corporation or by a corporation controlled by him	✓	
	d.	A director who regularly provides services to the corporation or to the controlling shareholder of the corporation or a corporation controlled by him.	✓	
	e.	A director whose primary livelihood depends on the controlling shareholder.	✓	
31.		In the report year, a controlling shareholder or his relative did not attend meetings of the compensation committee, unless the chairman of the board determined that any one of them is required in order to present a specific issue.	✓	
32.		The compensation committee and the board did not exercise their power pursuant to Sections 267A(c), 272(c)(3) and 272(C1)(1)(c) to approve a transaction or compensation policy, despite the objection of the general meeting.	✓	
Internal Auditor				
33.		The chairman of the board or the CEO of the corporation is the organizational supervisor of the internal auditor in the corporation.	✓	
34.		The chairman of the board or the audit committee approved the work plan in the report year. In addition, specify the audit issues addressed by the internal auditor in the report year: In the year of the report, as in every year, the audit plan was preapproved by the audit committee and the board of directors of the Company, and as of the Report Release Date, the internal auditor has completed the reports according to plan, including on financial, operational and corporate governance issues.	✓ ✓	
35.		Scope of employment of the internal auditor in the corporation in the report year (in hours[17]): According to the specification in Section 6 of Chapter E of the annual report above.	✓	

[17] Including working hours invested in held companies and in auditing overseas, and as the case may be.

		In the report year a deliberation was held (by the audit committee or the board) on the internal auditor’s findings.		
36.		The internal auditor is neither an interested party in the corporation, nor its relative, auditor or another on its behalf, nor maintains material business ties with the corporation, its controlling shareholder, relative or corporations controlled thereby.	✓	
Transactions with Interested Parties				
			Correct	**Incorrect**
37.		The controlling shareholder or his relative (including a company controlled by him) is neither employed by the corporation nor provides management services thereto.		✓
		If you answer is "Incorrect" (i.e. the controlling shareholder or his relative is employed by the corporation or provides management services thereto) state - – The number of relatives (including the controlling shareholder) employed by the corporation (including companies controlled by them and/or through management companies): 1 (Ms. Danna Azrieli). – Have the agreements for such employment and/or management services been approved by the organs specified in the law: ☒ Yes (the management agreement with Ms. Danna Azrieli, who serves as the Company's Active Chairman of the Board, was approved by the compensation committee, the board of directors and the general meeting of the Company held in October 2016). □ No		
38.		To the best knowledge of the corporation, the controlling shareholder does not have other businesses in the operating segment of the corporation (in one or more segments). If your answer is “Incorrect” - state whether an arrangement was prescribed to define activities between the corporation and the controlling shareholder thereof: ☒Yes, see specification in Section 3.2 above. □ No		✓

Chairman of the Board: Ms. Danna Azrieli

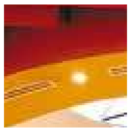
Chairman of the Audit Committee: Efraim Halevy

Chairman of the FSRC: Prof. Niv Ahituv

Azrieli Group

Part F

Effectiveness of Internal Control over the Financial Reporting and Disclosure



Attached hereto is an annual report on the effectiveness of internal control over financial reporting and disclosure pursuant to Regulation 9B(a) for 2016:

The management, under the supervision of the Board of Directors of Azrieli Group Ltd. (the "Corporation"), is responsible for setting and maintaining proper internal control over financial reporting and disclosure at the Corporation.

For this purpose, the members of management are:

1. Yuval Bronstein, CEO;

2. Irit Sekler-Pilosof, CFO;

3. Ran Tal, VP, General Counsel and Corporate Secretary;

4. Yair Horesh, Chief Comptroller for Accounting and Financial Statements.

Internal control over financial reporting and disclosure consists of controls and procedures existing at the Corporation, designed by, or under the supervision of, the CEO and the most senior financial officer, or by anyone actually performing such functions, under supervision of the Board of Directors of the Corporation, which are designed to provide reasonable assurance regarding the reliability of the financial reporting and the preparation of the reports according to the provisions of the law, and to ensure that information which the Corporation is required to disclose in reports released thereby according to the law is gathered, processed, summarized and reported within the time frames and in the format set forth by the law.

Internal control includes, *inter alia*, controls and procedures designed to ensure that information which the Corporation is thus required to disclose, is gathered and transferred to the management of the Corporation, including the CEO and the most senior financial officer, or anyone actually performing such functions, in order to enable the timely decision making in reference to the disclosure requirement.

Due to its inherent limitations, internal control over financial reporting and disclosure is not designed to provide absolute assurance that misrepresentation or omission of information in the reports is avoided or discovered.

The management, under the supervision of the Board of Directors, carried out an examination and evaluation of internal control over financial reporting and disclosure at the Corporation, and the effectiveness thereof. The evaluation of the effectiveness of internal control over financial reporting and disclosure carried out by the management under the supervision of the Board of Directors included: .

- ✓ Mapping and documentation of the controls and identification of the very material processes at the Company and at the main consolidated companies according to the reporting risks, in respect of each of the Company or the main consolidated companies, as the case may be.

  The processes which were defined as very material are: <u>in the Company</u>: revenues from rent in investment property, investment property; <u>in</u> Supergas: the revenues from sales process.

- ✓ Examination of the actual performance and documentation of the controls defined in the control processes on the organization level (ELC), the information systems (ITGC), the financial statements preparation process and the processes which were identified as very material to the financial reporting and disclosure.

- ✓ General evaluation of the internal control effectiveness.

Based on the effectiveness evaluation performed by the management with the supervision of the Board of Directors as specified above, the Board of Directors and management of the Corporation reached the conclusion that internal control over financial reporting and disclosure in the Corporation, as of December 31, 2016 is effective.

Attached please find the statements of the CEO and the CFO, who is responsible for the financial reporting in the Company.

Date: March 21, 2017

Statement of Managers:

Statement of CEO pursuant to Regulation 9B(d)(1):

I, Yuval Bronstein, represent that:

1. I have reviewed the periodic report of Azrieli Group Ltd. (the "Corporation") for the year 2016 (the "Reports").

2. To my knowledge, the Reports do not contain any misrepresentation nor omission of a material fact required for the representations included therein, given the circumstances under which such representations were included, not to be misleading with regard to the period of the Reports.

3. To my knowledge, the Financial Statements and other financial information included in the Reports adequately reflect, in all material respects, the financial position, operating results and cash flows of the Corporation for the periods and as of the dates covered by the Reports.

4. I have disclosed to the Corporation's auditor and to the Corporation's Board of Directors and the Audit Committee and Financial Statement Committee, based on my most current evaluation of internal control over financial reporting and disclosure:

   a. Any and all significant flaws and material weaknesses in the setting or maintaining internal control over financial reporting and disclosure which may reasonably adversely affect the Corporation's ability to gather, process, summarize or report financial information in a manner which casts doubt on the reliability of the financial reporting and preparation of the Financial Statements in conformity with the provisions of the law; and -

   b. Any fraud, either material or immaterial, which involves the CEO or anyone reporting to him directly or which involves other employees who play a significant role in internal control over financial reporting and disclosure;

5. I, myself or jointly with others at the Corporation:

   a. Have set controls and procedures, or confirmed that such controls and procedures have been set and maintained under my supervision, which are designed to ensure that material information in reference to the Corporation, including consolidated companies thereof as defined in the Securities Regulations (Annual Financial Statements), 5770-2010, is presented to me by others at the Corporation and the consolidated companies, particularly during the preparation of the Reports; and -

   b. Have set controls and procedures, or confirmed that such controls and procedures have been set and maintained under my supervision, which are designed to reasonably ensure reliability of financial reporting and preparation of the Financial Statements in conformity with the provisions of the law, including in conformity with GAAP.

c. Have evaluated the effectiveness of internal control over financial reporting and disclosure and presented in this report the conclusions of the Board of Directors and management with regard to the effectiveness of internal control as aforesaid as of the date of the Reports.

The aforesaid does not derogate from my responsibility or from the responsibility of any other person, pursuant to any law.

March 21, 2017

____

Yuval Bronstein, CEO

Statement of Managers:

Statement of the most senior financial officer pursuant to Regulation 9B(d)(2):

I, Irit Sekler-Pilosof, represent that:

1. I have reviewed the Financial Statements and other financial information included in the reports of Azrieli Group Ltd. (the "Corporation") for year 2016 (the "Reports");

2. To my knowledge, the Financial Statements and the other financial information included in the Reports do not contain any misrepresentation nor omission of a material fact required for the representations included therein, given the circumstances under which such representations were included, not to be misleading with regard to the period of the Reports.

3. To my knowledge, the Financial Statements and other financial information included in the Reports adequately reflect, in all material respects, the financial position, operating results and cash flows of the Corporation for the periods and as of the dates covered by the Reports;

4. I have disclosed to the Corporation's auditor and to the Corporation's Board of Directors and the Audit Committee and Financial Statement Committee, based on my most current evaluation of internal control over financial reporting and disclosure:

    a. Any and all significant flaws and material weaknesses in the setting or maintaining internal control over financial reporting and disclosure insofar as it relates to the Financial Statements and the other information included in the Reports, which may reasonably adversely affect the Corporation's ability to gather, process, summarize or report financial information in a manner which casts doubt on the reliability of financial reporting and preparation of the Financial Statements in conformity with the provisions of the law; and -

    b. Any fraud, either material or immaterial, which involves the CEO or anyone reporting to him directly or which involves other employees who play a significant role in internal control over financial reporting and disclosure;

5. I, myself or jointly with others at the Corporation:

    a. Have set controls and procedures, or that such controls and procedures have been set and maintained under my supervision, which are designed to ensure that material information in reference to the Corporation, including consolidated companies thereof as defined in the Securities Regulations (Annual Financial Statements), 5770-2010, insofar that it is relevant to the financial statements and other financial information included in the Reports, is presented to me by others at the Corporation and the consolidated companies, particularly during the preparation of the Reports; and -

b. Have set controls and procedures, or confirmed that such controls and procedures have been set and maintained under my supervision, which are designed to reasonably ensure reliability of financial reporting and preparation of the Financial Statements in conformity with the provisions of the law, including in conformity with GAAP;

c. Have evaluated the effectiveness of internal control over financial reporting and disclosure, insofar as it relates to the Financial Statements and the other financial information included in the Reports, as of the date of the Reports. My conclusions in respect of my evaluation as aforesaid were presented to the Board of Directors and management and are incorporated in this Report.

The aforesaid does not derogate from my responsibility or from the responsibility of any other person, pursuant to any law.

March 21, 2017

Irit Sekler-Pilosof , CFO