MIDROOG

AZRIELI GROUP LTD.

Monitoring Report | July 2016

Contacts

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AZRIELI GROUP LTD.

Series rating (issue)	Aa1.il	Outlook: stable

Midroog affirms a Aa1.il stable outlook for Series A and Series D bonds issued by Azrieli Group Ltd. ("the Company" or "Azrieli Group").

Bond series	Security no.	Rating	Outlook	Date of final repayment
A	Non-marketable	Aa1.il	Stable	March 31, 2017
D	1138650	Aa1.il	Stable	July 5, 2030

** The Company also has Series B and C bonds that are not rated by Midroog (Series B in the amount of ILS 1.2 billion, and Series C in the amount of ILS 1 billion).

The rating is supported, among other things, by the portfolio of high-quality income-producing properties, which include some of the major malls and office towers in Israel. The Company maintains very high occupancy rates in its properties, while producing a significant NOI debt service coverage ratio; significant growth in operations in recent years, due to the acquisition and construction of properties, mainly in Israel, but to some extent also in other countries, contributing to the risk profile. For example, since the last rating report in November 2015, the Company completed the acquisition of 'Yediot Hacharonot House' in Q1/2016, has made progress in the occupancy process for the office complex in Holon, the Ramla mall, and an additional floor in the Ayalon mall in Ramat Gan, and has completed the acquisition of two assisted living facilities in Tel Aviv and Raanana (In Raanana through the acquisition of shares followed by notice of redemption of bonds of the company holding the property). The Company has also made progress in the lease and construction of the Azrieli Sarona office building (to date, close to 50% of the office space in the building has been leased; construction is expected to be completed in the second half of 2017), and recently 26 thousand square meters out of 50 thousand square meters of office space in the Azrieli Town project has also been pre-leased, even before construction starts. These properties, in addition to the expected populating of the Rishonim mall in the first quarter of 2017 (which also includes 30 thousand square meters of office space, the construction of which is expected to be completed towards the end of 2016, yet only one third of the space has been leased to date), is expected to generate significant annual cash flows (before financing and tax expenses) that will support growth in NOI and FFO. Moreover, in recent years, the Company has benefited from debt raising and from borrowings (sometimes through public bonds and sometimes through private loans from institutional investors) at interest rates that are significantly lower than the interest rate on the debt repaid in these years, in a way that also supports the NOI to debt service coverage ratio. For example, in July 2016, the Company raised ILS 2.2 billion with an average duration of 7.5 years, at an interest rate of 1.34% linked to the CPI; regarding coverage ratios, the ratio for the industry and FFO from income-producing real estate is noticeable, and based on information published by the Company, exceeds ILS 900 million per year.[1] Based on current financial assets and liabilities, Midroog estimates that the cash flow is expected to continue to grow in the short- to medium-term, partially due to a full annual yield of properties whose construction was completed or is expected to be completed, notwithstanding the private loans that were taken out subsequent to the balance sheet date and notwithstanding the issue of Series D bonds (part of the amount raised through Series D is expected to be used to repay debts); to the extensive experience of the Company and its qualified management, which has operated in Israel for over 30 years in management, development, and construction of income-producing commercial real estate and office space, and in particular, commercial property, with high operational efficiency compared to the industry; and to the noticeable accessibility to financing sources and very high financial flexibility, including non-pledged properties worth close to ILS 18 billion (of which, ILS 15 billion is attributed to real estate property and the remainder to other assets such as Bank Leumi and Leumi Card shares etc). The Company also owns pledged income-producing properties with reasonable to low LTV rates. Midroog positively notes the Company's operations to dispose of holdings that are not in the real estate field. The Company disposed of some of the companies held by Granite, including completion of the sale of Tambour for ILS 500 million, disposal of the Palmachim desalination plants for ILS 430 million, and the sale of the solar business of Supergas for ILS 175 million. The Company also signed an agreement for the disposal of Sonol for ILS 495 million (the amount includes a seller's loan, deferred payments, and the expected disposal of land in the Pi Glilot complex); the Company's leverage level is considered to be one of the lowest leverage levels in the industry, and is supported by conservative financial and distribution of dividends policies. In addition, the amount of equity is noticeable in the industry and increased even more in the past year; the level of liquidity is good compared to debt maturities and the Company's cash flow.

On the other hand, Midroog estimates that there is medium-scale dispersion of the Company's properties, due to certain exposure, to significant complexes. For example, Azrieli Center in Tel Aviv (both the office towers and the mall) is a major asset in its portfolio, representing 28% of annual NOI that the Company is expected to generate (without additional properties under construction).[2] To be noted, the Company has 2,500 lease agreements, but there is no tenant with exposure exceeding 10% of the Company's revenue, contributing to dispersion of the risk in its operations; the Company may be subject to exposure to the change in the value of its holding in Bank Leumi (4.6%), which amounted to ILS 950 million in the Company's financial statements as of March 31, 2016. In addition, similar to earlier reports, Midroog estimates that the Company may be exposed to some extent to a significant

1 Unless otherwise stated, the Company is assessed on the basis of the extended standalone statement, as reported in the financial statements, which include a presentation of subsidiaries held in accordance with IFRS. This does not include Granite Hacarmel, which does not operate in real estate, where the investment is presented on an equity basis.

2 Based on Midroog's calculations, assuming multiplication of NOI results in the first quarter of 2016 over four quarters.

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slowdown in private consumption in Israel, and/or to significant damage to the mall industry, due to the opening of additional malls by competitors and/or due to changes in the population's preferences and consumption habits, such as a shift to online purchases of products, and due to a deterioration in the security situation, although in recent years these have not adversely affected the Company's results, other than in the Beersheba and Kiryat Ata malls; the Company also has land for the construction of a number of significant retail and office projects, as well as certain residential areas, on Menachem Begin Street in Tel Aviv, the success of which depends, among other things, on the supply and demand in the Tel Aviv office market, taking into account the expected significant increase in rental space in the area. However, the number of preleased of some of these projects, the Company's financial strength, the amount of cash flow, and its past success in the occupancy of significant properties, all these offset these risks.

The baseline scenario of Midroog assumes that the average occupancy rates for the Company's existing properties in recent years will be maintained, with possible minor deviations from the average due to routine tenant turnover. The baseline scenario also assumes growth in NOI due to the completion of development of properties under construction with sensitivity scenarios for the date and scope of NOI. From the aspect of the Company's total debt, Midroog routinely takes into account the debt cycle, with emphasis on loans with a "bullet" component, and even a certain increase in the debt amount for the purpose of continuing the investments in investment real estate properties and assisted living. Nevertheless, in view of the significant current cash flow generated by the Company, the baseline scenario assumes that the Company will continue to present noticeably stable ratios, compared to rated companies, of about 29%-33% of the net debt to net CAP. Midroog's baseline scenario assumes that in the short- to medium-term, the Company is expected to maintain quick ratios for its rating level (net debt to FFO of 6-8 years) and FFO is expected to reach over ILS 900 million per year and to grow when the Rishonim mall, assisted living facility in Raanana, and other properties start to generate full annual revenue, in addition to a decrease in the interest rate for debts raised by the Company compared to debts that are repayable in the coming year. Midroog took into account NOI sensitivity scenarios, partially due to the growing competition in retail and office space in Israel. However, these ratios are still expected to be compatible with the rating.

Key rating factors

A substantial growing portfolio of income-producing properties, including leading properties in high-demand areas, contributes to high and stable FFO

The portfolio of income-producing properties includes 946 thousand square meters of retail and office space for rent and assisted living, with a total value of ILS 18 billion. The leased properties in Israel have a high occupancy rate (98%) while leased properties in other countries have an occupancy rate of 82% (in view of the termination of a contract with a tenant who leased 10% of the Company's space in the United States and in accordance with the Company's financial statements, negotiations are underway for the lease of the vacated spaces at a higher fee; About a third of the space is already leased to a significant tenant, the rest of the space has yet to be leased). The Company presented growth at the NOI rate in recent years, due to the acquisition of income-producing properties, development and population of income-producing properties, and due to organic growth in NOI from existing assets, mainly due to updated contracts with existing tenants and improvement in contracts terms when changing tenants. Beyond the growth reflected in the reports (an increase of 3% between March 31, 2016 figures, in a yearly presentation compared to 2015 figures), Midroog estimates that significant additional growth is expected (mainly in 2017-2018) due to properties that have not yet produced income reflecting current rental contracts for a full year and for properties under development, to the extent that the Company succeeds in their populating, such as completion of population of the mall and offices in Rishon Lezion and the continued rental of space in the Azrieli Sarona project. In addition, subsequent to the balance sheet date, the Company completed the acquisition of an active assisted living facility in Raanana, which is also expected to contribute to annual FFO. After completion of all the above and without the acquisition of additional properties, Midroog estimates that NOI from income-producing properties and cash flows from assisted living facilities together are expected to grow (before completing Azrieli Sarona). In addition, in the long term, the Company expects to establish significant space on Menachem Begin Street in Tel Aviv (most of the rental space is attributed to office space, however there are also commercial and residential areas). It is noted that the zoning plan that was deposited was approved, subject to the District Committee's stipulation that one of these centers should be increased by an additional 70 thousand square meters. The Company also has land reserves in Holon, which include significant building rights zoned for retail and office space. These land reserves are close to the site that the Company finished building over the last two years and is in the advanced stage of occupancy. Although the development portfolio includes projects that involve very substantial investments, which are exposed to supply and demand trends in the area, the Company's financial strength, the significant cash flow generated by the current income-producing properties, and its proven ability to complete the population of complex projects in Israel and the fact that there is no financial debt against the land, offset the risk arising from these land reserves. The Company has also acquired additional land and is in the initial stages of construction of assisted-living properties in Modi'in, as well as in Rishon Lezion and Lehavim, where the Company has not yet started construction works.

Although the Company has several income-producing properties abroad and major office complexes in Israel, over 50% of the value of investment property and NOI generated by the Company is attributed to rental space for retail use, mainly for malls in Israel. Midroog estimates that continued construction and significant expansion of malls and retail centers in Israel (such as the increase in retail space in Beersheba and Krayot) as well as significant changes in shopping habits, may generate pressure to reduce rental fees that will ease the tenant load (rental fees from store revenue). It is noted that the tenant load for the Company's properties has been relatively stable and has amounted to an average of 12% (not including management fees paid for leasing the space) in the past decade.

More than the increase in operations, this growth contributes to dispersion of the Company's assets, so that the contribution of Azrieli Center in Tel Aviv (three office towers, the mall and the parking lot together) to total NOI has diminished in recent years, although a significant part of NOI from Azrieli Group properties is attributed to this property. To the extent that the Company succeeds in populating existing income-producing properties under construction, the rate is expected to continue to decline (with the exception of expected growth in NOI from the center over time to the extent that the center is expanded). Nevertheless, the complex is positioned on a high level and is rented out at to a large number of tenants at full capacity in the long term. In addition, the high positioning of assets and high dispersion of lease agreements positively affect the Company's risk profile.

Liquidity is very high considering the volume of maturities, access to financing sources, and current NOI generated by the Company; financial flexibility is noticeably positive.

As of March 31, 2016, the Group has a liquidity balance of ILS 576 million. However, subsequent to the balance sheet date, the Company has completed the purchase of several properties and lands, including land in Holon, e-commerce activity – "Buy 2", an assisted living facility in Raanana (including early redemption of bonds), distribution of a dividend in the amount of ILS 400 million (the amount is reflected in the balance sheet as a liability as of March 31, 2016), and the expected completion of the purchase of land in the Clalit Health Fund complex ("Azrieli Town"). These transactions were partially financed by the liquidity balance and from private loans from financial institutions. As reported, the Company invests and is expected to continue to invest significant amounts in the construction of new income-producing properties and the development of existing income-producing properties, which, as of the reporting date, are from independent sources. These investments were made through equity and as a result, these properties are not pledged. This significantly contributes to the Company's financial flexibility and helps to maintain quick coverage ratios.

In addition, subsequent to the balance sheet date, the Company raised bonds by issuing Series D (in the amount of ILS 2.2 billion), which supports its liquidity. The annual repayment of the bond principal amounts to ILS 607 million in 2017, ILS 318 million in 2018, ILS 399 million per year in 2019-2025, and a lower amount in 2026-2030. It is noted that in the next two years, there are a number of bank loans in addition to the bonds due for repayment, therefore the debt that was raised is a liquidity cushion for these repayments. In addition to the above, the Company's liquidity will be positively affected by completion of the Sonol transaction, to the extent that the transaction is completed in accordance with the published outline.

The Group has very good financial flexibility, arising from real estate assets and non-pledged shares worth ILS 18 billion, as of the date of the rating report. In addition, the Company's pledged real estate assets are pledged at a reasonable LTV ratio in accordance with Midroog's assessment. Taking into account liquidity, access to financing sources, the noticeably positive financial flexibility, and the permanent FFO, Midroog estimates that the Company's liquidity is very good in relation to the repayment schedule.

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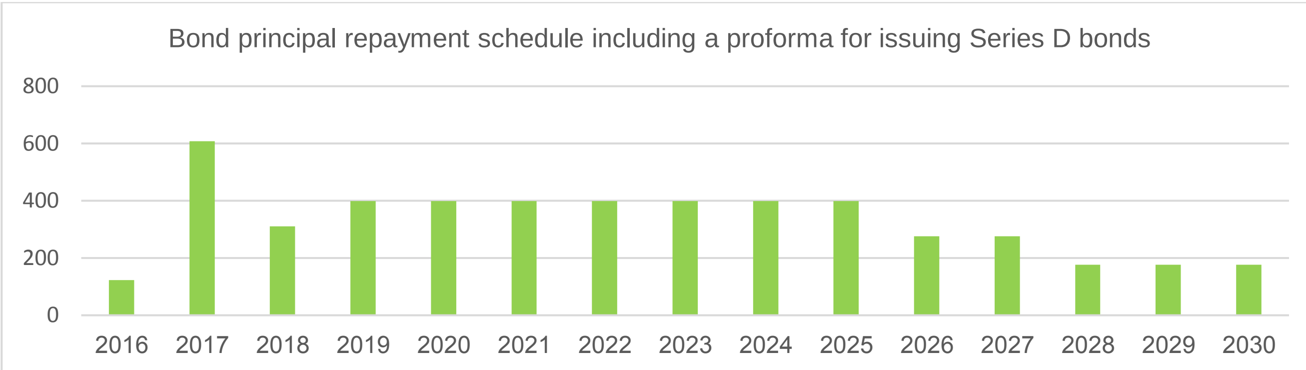

* Including the Company's rated bonds and Series B and C

Coverage and financial strength ratios are noticeably favorable in comparison to the industry over time, notwithstanding the increase in the scope of activity.

The Company's coverage and financial strength ratios are noticeably favorable in comparison to the industry in the long term, and according to Midroog's calculations, these are expected to continue as such in the coming years as well. Moreover, there are several trends that are expected to support an increase in the permanent FFO, in the short- to medium-term: first, part of the Company's debts that are repayable in the coming years were taken at interest rates that were significantly higher than the interest rate that the Company receives today for new debts (debts that were taken several years ago). Second, relatively low interest rates were set for the issue of bonds and private borrowings from institutions in recent years, in the medium- to long-term as well. In addition, as noted, the Company is expected to complete the construction of several properties under construction in the coming years, the construction of which has been financed by equity.

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Azrieli Group Ltd. - Key financial ratios (expanded standalone statement)

Key information and financial ratios	March 31, 2016 (ILS thousands)	December 31, 2015 (ILS thousands)	March 31, 2015 (ILS thousands)	December 31, 2014 (ILS thousands)	December 31, 2013 (ILS thousands)
NOI***	319,000	1,238,000	298,000	1,134,000	1,105,000
Adjusted fair value gain (loss) of investment property	357,011	179,071	-12,929	36,701	427,899
EBITDA less revaluations	**312,792**	**1,164,494**	**276,775**	**1,069,541**	**1,023,946**
Net income	**674,381**	**827,665**	**191,193**	**859,539**	**943,802**
Investment property and investment property under construction	21,469,356	20,516,134	19,151,144	18,763,462	17,190,757
Investments and loans to investees	1,072,329	1,046,109	1,218,428	1,238,572	1,375,581
Financial debt****	7,049,301	6,815,643	5,903,790	5,310,977	5,059,259
Liquidity balances	576,330	861,124	507,943	110,886	377,653
Net financial debt	6,472,971	5,954,519	5,395,847	5,200,091	4,681,606
CAP	24,074,161	23,683,687	22,009,223	21,387,554	20,398,047
Net CAP	23,497,831	22,822,563	21,501,280	21,276,668	20,020,394
Shareholders' equity and non-controlling interests	**14,067,495**	**13,867,566**	**13,300,691**	**13,342,831**	**12,712,933**
Total balance sheet	25,088,891	24,310,226	22,712,018	21,840,144	20,706,404
Equity and non-controlling interests to accounting balance sheet	**56.1%**	**57.0%**	**58.6%**	**61.1%**	**61.4%**
Debt to CAP	29.3%	28.8%	26.8%	24.8%	24.8%
Net debt to net CAP	**27.5%**	**26.1%**	**25.1%**	**24.4%**	**23.4%**
FFO based on the Company's calculation + revenue from interest and dividends *	**232,000**	**884,000**	**205,000**	**797,000**	**770,000**
FFO based on the Company's calculation without revenue from interest and dividends**	**194,000**	**874,000**	**205,000**	**787,000**	**759,000**
Financial debt to FFO**		7.7		6.7	6.6
Net financial debt to FFO**		**6.7**		**6.5**	**6.1**

According to Midroog's calculations based on information published in the Company reports: * Since the Company does not publish a cash flow statement as part of the extended standalone statement, adjusted FFO was based on the Company's calculation for FFO from real estate operations, plus revenue from interest and dividends from real estate assets held for trading and from investees. *** Adjusted FFO from real estate operations only offsets revenue from dividends and financial assets other than real estate. *** NOI is calculated by Midroog on the basis of the Company's calculation as presented in the Directors Report. **** The financial debt includes deposits from assisted-living customers amounting to ILS 297 million and ILS 295 million as of March 31, 2016 and December 31, 2015, respectively, as published by the Company in its most recent reports. Since at this stage, these amounts are immaterial for the financial ratios, the ratios offset by these deposits were not presented.*

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Rating outlook

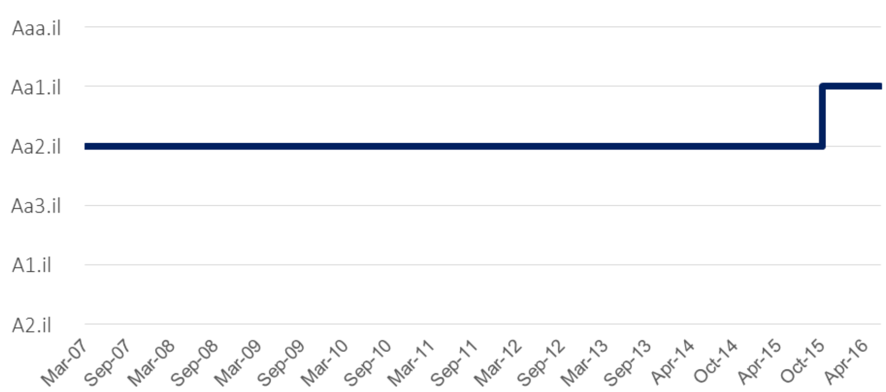
Factors that may raise the rating and rating outlook

- A significant increase in the Company's operations in a way that contributes to dispersion, while improving financial strength ratios and coverage ratios, in accordance with their current level.

Factors that may lower the Company's rating and outlook

- A significant decrease in financial flexibility, alongside a significant decrease in non-pledged assets
- Implementation of an exceptional dividend policy that will significantly affect financial stability and liquidity
- Significant changes in the core business and financial characteristics, if the Company enters into significant new investments
- A significant change in the operations mix between development operations and ownership and operation of income-producing properties, in a way that increases business risk

Rating history



Company profile

Azrieli Group Ltd. operates, by itself and through its subsidiaries and investees, mainly in income-producing real estate in Israel. Most of the Group's business activity is in retail centers and malls in Israel and in rental of office and other space in Israel. The Company was established in 1983 by the late David Azrieli, who died in July 2014.

In addition, Azrieli Group owns 100% of Granite Hacarmel (which was a public company until September 2012, and since then some of the companies and activities under it have been sold). In May 2008, the Company acquired 20% of the share capital of Leumi Card Ltd. In April 2009, the Company acquired 4.8% of the issued and paid up share capital of Bank Leumi Ltd.

Related reports

Azrieli Group Ltd. Update to Rating Action, July 2016

Azrieli Group Ltd., Rating Action, June 2016

Rating of Income-Producing Real Estate Companies, February 2016

Midroog's Definitions and Rating Scales

The reports are published on Midroog's website: www.midroog.co.il

General

Date of the rating report:	July 20, 2016
Date of the previous report:	July 5, 2016
Date of the initial rating:	March 1, 2007
Rating initiated by:	Azrieli Group Ltd.
Rating paid for by:	Azrieli Group Ltd.

Information from the issuer

Midroog's rating is based, among other things, on information received from the authorized parties of the issuer.

Local long-term rating scale

Aaa.il	**Issuers or issues rated Aaa.il are those that, in Midroog's judgment, have highest creditworthiness compared to other local issuers.**
Aa.il	**Issuers or issues rated Aa.il have, in Midroog's judgment, very high creditworthiness compared to other local issuers.**
A.il	**Issuers or issues rated A.il have, in Midroog's judgment, high creditworthiness compared to other local issuers.**
Baa.il	**Issuers or issues rated Baa.il have, in Midroog's judgment, moderate creditworthiness compared to other local issuers, and could involve certain speculative characteristics.**
Ba.il	**Issuers or issues rated Ba.il have, in Midroog's judgment, weak creditworthiness compared to other local issuers, and they involve certain speculative characteristics.**
B.il	**Issuers or issues rated B.il have, in Midroog's judgment, very weak creditworthiness compared to other local issuers, and they involve significant speculative characteristics.**
Caa.il	**Issuers or issues rated Caa.il have, in Midroog's judgment, very weak creditworthiness compared to other local issuers, and they involve significant speculative characteristics.**
Ca.il	**Issuers or issues rated Ca.il have, in Midroog's judgment, extremely weak creditworthiness compared to other local issuers, and they are very near to insolvency, with some prospect of recovery of principal and interest.**
C.il	**Issuers or issues rated C.il have, in Midroog's judgment, the weakest creditworthiness, and are usually insolvent with little prospect of recovery of principal and interest.**

Note: Midroog uses numeric modifiers 1, 2, and 3 for each rating category from Aa.il to Caa.il. The modifier '1' indicates that the obligation ranks in the higher end of its rating category, which is denoted by letters. The modifier '2' indicates that it ranks in the middle of its rating category and the modifier '3' indicates that the obligation ranks in the lower end of that category, denoted by letters.

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