

**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 20-F**

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2012

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 000-29992

**OPTIBASE LTD.**

(Exact name of Registrant as specified in its charter)

N/A  
(Translation of Registrant's  
name into English)

Israel  
(Jurisdiction of incorporation  
or organization)

10 Hasadnaot Street  
Herzliya 4672837, Israel  
+972-73-7073700  
(Address of principal executive offices)

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10 Hasadnaot Street  
Herzliya 4672837, Israel

(Name, Telephone, E-Mail and/or Facsimile and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Each Class  
Ordinary Shares,  
par-value NIS 0.65 each

Name of Each Exchange on Which Registered  
The Nasdaq Global Market

Securities registered pursuant to Section 12(g) of the Act:

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

Not Applicable

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report: **3,882,945 Ordinary Shares, par value NIS 0.65 per share, including 57,895 Ordinary Shares held by the Registrant and 6,000 Ordinary Shares held by a trustee for the benefit of the Registrant's employees and directors under the Registrant's incentive plan which have not vested on March 1, 2013 or within 60 days thereafter, both awarding their holders no voting or equity rights.**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes  No

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP

International Financing Reporting Standards as issued by the International Accounting Standards Board

Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow:

Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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#### CERTAIN DEFINED TERMS

In this annual report, unless otherwise provided, references to the "Company," "Optibase", "we", "us" or "our" are to Optibase Ltd., a company organized under the laws of Israel, and its wholly owned subsidiaries. In addition, references to our financial statements are to our consolidated financial statements, except as the context otherwise requires. References to "U.S." or "United States" are to the United States of America, its territories and its possessions.

In this annual report, references to "\$" or "dollars" or "U.S. dollars" or "USD" are to the legal currency of the United States, references to "CHF" are to Swiss Francs and references to "NIS" are to New Israeli Shekels, the legal currency of Israel. The Company's financial statements are presented in accordance with United States generally accepted accounting principles, or U.S. GAAP. Except as otherwise specified, financial information is presented in U.S. dollars. References to a particular "fiscal" year are to the Company's fiscal year ended December 31 of such year.

#### FORWARD-LOOKING STATEMENTS

IN ADDITION TO HISTORICAL INFORMATION, THIS ANNUAL REPORT CONTAINS CERTAIN FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933, AS AMENDED, AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED. THE FORWARD-LOOKING STATEMENTS CONTAINED HEREIN ARE SUBJECT TO CERTAIN RISKS AND UNCERTAINTIES THAT COULD CAUSE ACTUAL RESULTS TO DIFFER MATERIALLY FROM THOSE REFLECTED IN THE FORWARD-LOOKING STATEMENTS. FACTORS THAT MIGHT CAUSE SUCH A DIFFERENCE INCLUDE, BUT ARE NOT LIMITED TO, THOSE DISCUSSED IN THE SECTIONS ENTITLED "RISK FACTORS", "INFORMATION ON THE COMPANY" AND "OPERATING AND FINANCIAL REVIEW AND PROSPECTS" AND ELSEWHERE IN THIS REPORT. READERS ARE CAUTIONED NOT TO PLACE UNDUE RELIANCE ON THESE FORWARD-LOOKING STATEMENTS, WHICH REFLECT MANAGEMENT'S BELIEFS, ASSUMPTIONS AND EXPECTATIONS OF OUR FUTURE OPERATIONS AND ECONOMIC PERFORMANCE, TAKING INTO ACCOUNT CURRENTLY AVAILABLE INFORMATION. IN ADDITION, READERS SHOULD CAREFULLY REVIEW THE OTHER INFORMATION IN THIS ANNUAL REPORT AND IN THE COMPANY'S PERIODIC REPORTS AND OTHER DOCUMENTS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION FROM TIME TO TIME. WE DO NOT UNDERTAKE ANY OBLIGATION TO UPDATE ANY FORWARD-LOOKING STATEMENTS, WHETHER AS A RESULT OF NEW INFORMATION, FUTURE EVENTS OR OTHERWISE, EXCEPT AS MAY BE REQUIRED UNDER APPLICABLE SECURITIES LAWS AND REGULATIONS.

#### REVERSE SHARE SPLIT

Unless otherwise indicated, we have adjusted all of the numbers and prices relating to our ordinary shares in this annual report on Form 20-F to reflect a one-for-five reverse share split of our ordinary shares that we effected on September 27, 2012. See "Item 4.A. History and Development of the Company - Reverse Share Split".

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

Introduction

Since our incorporation, we engaged, directly and indirectly, in digital video and streaming based products and services, or the Video Solutions Business.

On March 16, 2010, we and our subsidiary, Optibase Inc., entered into an asset purchase agreement, or APA, with Optibase Technologies Ltd. and Stradis Inc., wholly owned subsidiaries of S.A. Vitec (also known as Vitec Multimedia) or, collectively, Vitec, according to which Optibase Technologies Ltd. purchased all of the assets and liabilities related to our Video Solutions Business, or the Vitec Transaction. The closing of the Vitec Transaction occurred on July 1, 2010. For further details see Item 10.C "Material Contracts". For details regarding arbitration proceedings in connection with the Vitec Transaction, see Item 8. "Financial Information - Legal Proceedings".

During 2009, we resolved, to expand and diversify our field of operations and enter into the fixed-income real estate sector. For further details, see Item 4.A "History and Development of The Company".

Currently, we, directly and indirectly, engage solely in the real estate sector and hold interest in five real estate properties. For further details, see Item 4.B. "Business Overview".

3.A. SELECTED CONSOLIDATED FINANCIAL DATA

We derived the consolidated statement of operations data for the years ended December 31, 2010, 2011 and 2012, and consolidated balance sheet data as of December 31, 2011 and 2012 from the audited consolidated financial statements appearing elsewhere in this annual report. These financial statements have been prepared in accordance with U.S generally accepted accounting principles, or U.S. GAAP. We derived the consolidated statement of operations data for the years ended December 31, 2008 and 2009 and the consolidated balance sheet data as of December 31, 2008, 2009 and 2010 from audited consolidated financial statements that are not included in this annual report, which statements have also been prepared in accordance with U.S. GAAP. The selected financial data set forth below should be read in conjunction with "Item 5. Operating and Financial Review and Prospects" below and the financial statements, including the notes thereto, included elsewhere in this annual report.

The results of operations for the Video Solution Business for the years ended December 31, 2008, 2009 and 2010, were reported separately and retroactively as discontinued operations.

Consolidated Statement of Operations Data:	Year Ended December 31,				
	2008	2009	2010	2011	2012
	(U.S. dollars in thousands, except per share data)				
Fixed income from real estate	-	\$ 272	\$ 1,650	\$ 12,479	\$ 13,676
<b>Costs and expenses:</b>					
Cost of real estate operation	-	11	59	1,869	1,966
Real estate depreciation and amortization	-	115	695	2,153	2,569
General and Administrative	1,347	1,175	1,502	3,057	2,068
Total costs and expenses	1,347	1,301	2,256	7,079	6,603
Operating income (loss)	(1,347)	(1,029)	(606)	5,400	7,073
Gain on bargain purchase	-	-	-	4,412	-
Equity share in earnings (losses) of associates, net	-	-	-	-	(32)
Other loss	-	-	(600)	-	(100)
Financial income (loss), net	270	617	304	(7,481)	(1,243)
Net income (loss) before taxes on income	(1,077)	(412)	(902)	2,331	5,698
Taxes on income	-	-	(43)	(481)	(1,643)
Net income (loss) from continuing operations	(1,077)	(412)	(945)	1,850	4,055
Net income (loss) from discontinued operations	(8,468)	472	5,399	(51)	-
Net income (loss)	\$ (9,545)	\$ 60	\$ 4,454	\$ 1,799	\$ 4,055
Net income attributable to non-controlling interest	-	-	-	2,038	2,478
Net income (loss) attributable to Optibase LTD	\$ (9,545)	\$ 60	\$ 4,454	\$ (239)	\$ 1,577
Net earnings (loss) per share :					
Basic and Diluted net earnings (loss) per share from continuing operations	\$ (0.35)	\$ (0.12)	\$ (0.3)	\$ (0.07)	\$ 0.41
Basic and diluted net earnings (loss) per share from discontinued operations	\$ (2.8)	\$ 0.145	\$ 1.65	\$ (0.00)	\$ 0.00
Basic and diluted net earnings (loss) per share	\$ (3.15)	\$ 0.02	\$ 1.35	\$ (0.07)	\$ 0.41
Weighted average number of shares used in computing basic and diluted net earnings (loss) per share (in thousands):					
Basic	3,032	3,307	3,311	3,642	3,818
Diluted	3,032	3,308	3,311	3,642	3,820

**Consolidated Balance Sheet Data:**

	Year Ended December 31,				
	2008	2009	2010	2011	2012
	(U.S. dollars in thousands)				
Cash, cash equivalents and short term investment in marketable securities net	\$ 11,386	\$ 28,651	\$ 30,260	\$ 22,945	\$ 19,142
Working capital	34,200	29,621	26,415	16,361	11,985
Real estate property net	-	22,080	32,353	192,173	194,826
Total assets	47,306	63,350	64,726	219,885	224,882
Long term loans, including current maturities	-	18,262	19,589	126,135	126,895
Capital Stock	126,142	126,299	126,378	131,478	131,568
Total shareholders' equity	\$ 35,011	\$ 35,238	\$ 40,392	\$ 61,261	\$ 66,552

**3.B. CAPITALIZATION AND INDEBTEDNESS**

Not applicable.

**3.C. REASONS FOR THE OFFER AND USE OF PROCEEDS**

Not applicable.

### 3.D. RISK FACTORS

*Our business operations are subject to various risks resulting from changing economic, political, industry, business and financial conditions. In addition, this annual report contains various forward-looking statements that reflect our current views with respect to future events and financial results. Below we attempt to identify and describe the principal uncertainties and risk factors that in our view at the present time may affect our financial condition, cash flows and results of operations and our forward-looking statements. Readers are reminded that the uncertainties and risks identified below in this annual report do not purport to constitute a comprehensive list of all the uncertainties and risks, which may affect our business and the forward-looking statements in this annual report. In addition, we do not undertake any obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise.*

#### **Risks Relating to the Economy, Our Financial Condition and Shareholdings**

***We have a history of losses and we might not be able to reach profitability.***

In recent years, except for several non-continuous quarters during 2010 and 2011, we have been operating at a loss. During 2012, except for the second quarter, we have been profitable. As of December 31, 2012, we have accumulated losses of \$84.2 million. Given current market conditions, the recent economic downturn, the uncertainty regarding rent and sale prices, the demand for our real estate properties and other expenses, we may operate at a loss and may not be able to reach profitability in the future, and our operating results for future periods will continue to be subject to numerous uncertainties and risks. We cannot assure you that we will be able to increase our revenues and sustain profitability. For further details regarding our cash flow, see Item 5.B. "Liquidity and Capital Resources".

***We have experienced significant fluctuations in our results of operations at times in the past and expect these fluctuations to continue. These fluctuations may result in volatility in our share price.***

We have experienced at times in the past, and may in the future experience, significant fluctuations in our quarterly and annual results. Factors that may contribute to the fluctuations in our quarterly results of operations include:

- ❖ The purchase or failure to purchase real-estate assets;
- ❖ Changes in rent prices for our properties;
- ❖ Changes in presence of tenants and tenants' insolvency;
- ❖ Changes in the availability, cost and terms of financing;
- ❖ The ongoing need for capital improvements;
- ❖ Changes in foreign exchange rates;
- ❖ Changes in interest rates; and
- ❖ General economic conditions, particularly in those countries or regions in which we operate.

Historically, our results of operations derived mainly from our Video Solutions Business which was sold pursuant to the Vitec Transaction. More recently and to date, our results of operations are derived mainly from our real estate business. Accordingly, investors should not rely on the results of any past periods as an indication of our future performance. It is likely that in some future periods, our operating results may be below expectations of public market analysts or investors. If this occurs, the market price of our ordinary shares may drop.

***A large percentage of our ordinary shares are held by a relatively small number of shareholders who could significantly influence the outcome of actions.***

The Capri Family Foundation, or Capri, a foundation organized under the laws of the Republic of Panama, beneficially own, directly and indirectly through its subsidiaries, approximately 63.48% of our outstanding ordinary shares. According to Amendment No. 4 to Schedule 13D filed with the SEC on November 21, 2012, the beneficiaries of Capri are the children of Mr. Shlomo (Tom) Wyler, our president and a member of our board of directors. For further information, see Item 4.A. "History and Development of The Company" and Item 7.A. "Major Shareholders" below. As a result of such holdings in our ordinary shares, Capri would be able to significantly influence the outcome of corporate actions requiring an ordinary majority approval by our shareholders, including the election of directors and the approval of mergers or other business combination transactions.

***We manage our available cash through investments in interest bearing bank deposits and money market funds with leading banks. We are exposed to the credit risk of such banks.***

During 2012, our available cash was invested in interest bearing bank deposits and money market funds with various banks. Our available cash is subject to the credit risk of the banks with which the funds are deposited and as such we may suffer losses if those banks fail to repay those deposits.

***We may be affected by instability in the global economy, including the recent European economic and financial turmoil.***

Instability in the global credit markets, including the recent European economic and financial turmoil related to sovereign debt issues in certain countries, the instability in the geopolitical environment in many parts of the world and other disruptions, such as changes in energy costs, may continue to put pressure on global economic conditions. The world has recently experienced a global macroeconomic downturn, and if global economic and market conditions, or economic conditions in key markets, remain uncertain or deteriorate further, we may experience material adverse impacts on our business, operating results, and financial condition.

***The trading price of our ordinary shares has been volatile, and may continue to fluctuate due to factors beyond our control.***

The trading price of our ordinary shares is and will continue to be subject to significant fluctuations in response to numerous factors, including:

- ❖ Availability of funding resources for the acquisition of new real estate assets;
- ❖ General market conditions and other factors, including factors unrelated to our operating performance or the operating performance of our competitors;
- ❖ Seizure of a substantial business opportunity by our competitors or us;
- ❖ Changes in interest rates;
- ❖ Changes in foreign exchange rates;
- ❖ The entering into new businesses;
- ❖ Quarterly variations in our results of operations or in our competitors' results of operations; and
- ❖ Changes in earnings estimates or recommendations by securities analysts.

This volatility may continue in the future. In addition, any shortfall or changes in our revenues, operating income, earnings or other financial results could cause the market price of our ordinary shares to fluctuate significantly. In recent years, the stock market has experienced significant price and trading volume fluctuations, which have particularly affected the market price of many companies and which may not be related to the operating performance of those companies. These broad market fluctuations have affected and may continue to affect adversely the market price of our ordinary shares. In recent years, the trading price of our ordinary shares has been highly volatile. From January 2011 through March 1, 2013, the closing price of our ordinary shares fluctuated reaching a high of \$8.75 and decreasing to a low of \$4.51. The fluctuations and factors listed above, as well as general economic, political and market conditions may further materially adversely affect the market price of our ordinary shares.



***Holders of our ordinary shares who are United States residents face income tax risks.***

There is a substantial risk that we are a passive foreign investment company, commonly referred to as PFIC. Our treatment as a PFIC could result in a reduction in the after-tax return to the holders of our ordinary shares and would likely cause a reduction in the value of such ordinary shares. For U.S. federal income tax purposes, we will be classified as a PFIC for any taxable year in which either (i) 75% or more of our gross income is passive income, or (ii) at least 50% of the average value of all of our assets for the taxable year produce or are held for the production of passive income. For this purpose, cash is considered to be an asset, which produces passive income. As a result of our substantial cash position and the decline in the value of our stock, we believe that there is a substantial risk that we became a PFIC during the taxable year ended December 31, 2012, under a literal application of the asset test described above, which looks solely to the market value. If we are classified as a PFIC for U.S. federal income tax purposes, highly complex rules would apply to U.S. holders owning ordinary shares. Accordingly, you are urged to consult your tax advisors regarding the application of such rules. In addition, there can be no assurance that we will not be classified as a PFIC in the future, because the determination of whether we are a PFIC is based upon the composition of our income and assets from time to time, and such determination cannot be made with certainty until the end of a calendar year. United States residents should carefully read "Item 10.E. Taxation" under the heading "United States Federal Income Tax Consequences" below for a more complete discussion of the U.S. federal income tax risks related to owning and disposing of our ordinary shares.

***We may continue to seek to expand our business through acquisitions that could result in a diversion of resources and our incurring additional expenses, which could disrupt our business and harm our financial condition.***

As we have done in the past, we may in the future continue to pursue acquisitions of businesses, or the establishment of joint ventures, that could expand our business. The negotiation of potential acquisitions or joint ventures as well as the integration of an acquired or jointly developed business, could cause diversion of management's time as well as our resources. Future acquisitions could result in:

- ❖ Additional operating expenses without additional revenues;
- ❖ Potential dilutive issuances of equity securities;
- ❖ The incurrence of debt and contingent liabilities;
- ❖ Amortization of bargain purchase gain and other intangibles;
- ❖ Impairment charges; and
- ❖ Other acquisition-related expenses.

Acquired businesses or joint ventures may not be successfully integrated with our operations. If any acquisition or joint venture were to occur, we may not receive the intended benefits of the acquisition or joint venture. If future acquisitions disrupt our operations, our business may suffer.

***We may in the future be the target of securities class action or other litigation, which could be costly and time consuming to defend.***

In the past, following a period of volatility in the market price of a company's securities, securities class action lawsuits have often been instituted against such companies. We may in the future be the target of similar litigation. If such a lawsuit were brought against us, regardless of its outcome, we would incur substantial costs and our management resources would be diverted to defending such litigation.

***We do not intend to pay dividends.***

We have never declared or paid any cash dividends on our ordinary shares. We currently intend to retain any future earnings to finance operations and expand our business and, therefore, do not expect to pay any dividends in the foreseeable future.

***The impact of the extenuations given to us as a foreign private issuer.***

As a foreign private issuer, we are permitted to file less information with the SEC than a company incorporated in the United States. Accordingly, there may be less publicly available information concerning us than there is for companies incorporated in the United States.

***We may fail to maintain effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002.***

The Sarbanes-Oxley Act of 2002 imposes certain duties on us and our executives and directors. Our efforts to comply with the requirements of Section 404 have resulted in increased general and administrative expense and a diversion of management time and attention, and we expect these efforts to require the continued commitment of resources. We have documented and tested our internal control systems and procedures in order to comply with the requirements of Section 404. While our assessment of our internal control over financial reporting resulted in our conclusion that as of December 31, 2012, our internal control over financial reporting was effective, we cannot predict the outcome of our testing in future periods. If we fail to maintain the adequacy of our internal controls, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal controls over financial reporting. Failure to maintain effective internal control over financial reporting could result in investigation or sanctions by regulatory authorities, and could have a material adverse effect on our operating results, investor confidence in our reported financial information, and the market price of our ordinary shares.

**Risks Relating to our Real Estate Business**

***The real estate sector continues to be cyclical and affected by changes in general economic, or other business conditions that could materially adversely affect our business or financial results.***

The real estate sector has been cyclical historically and continues to be significantly affected by changes in industry conditions, as well as in general and local economic conditions, such as:

- employment levels;
- availability of financing for homebuyers and for real estate investors/funds;
- interest rates;
- consumer confidence and expenditure;
- levels of new and existing homes for sale;
- demographic trends;
- urban development and changes;
- housing demand;
- local laws and regulations; and
- acts of terror, floods or earthquakes.

These may occur on a global scale, like the recent housing downturn, or may affect some of the regions or markets in which we operate. An oversupply of alternatives to our real estate properties can also reduce our ability to lease spaces and depress lease prices, thus reducing our margins.

As a result of the foregoing matters, we may face difficulties in the leasing of our projects and we may not be able to recapture any increased costs by raising lease payments.

***We rely on one large property for a significant portion of our revenue.***

As of December 31, 2012, our commercial property in Geneva, Switzerland, accounted for approximately 82% of our portfolio annualized rent. Our revenue would be materially adversely affected if this property was materially damaged or destroyed. Additionally, our revenue would be materially adversely affected if tenants at this property fail to timely make rental payments due to adverse financial conditions or otherwise, default under their leases or file for bankruptcy. For further information regarding our property in Geneva, Switzerland, see Item 4.B. "Business Overview - Properties".

*With respect to our commercial properties, we are dependent on the continued tenant demand for our properties. If there is a decrease in tenant demand and an increase in vacancy of our commercial properties, it would adversely affect our financial condition and results of operations.*

We own, through our subsidiaries, certain holdings in several commercial real estate properties, which are currently leased to third parties. In all of our commercial properties we rely on a few tenants which occupy a significant portion of the available rentable area in such properties. For further details regarding the leases of tenants in our properties see Item 4.B. "Business Overview - Properties". If the lease agreements with such tenants are terminated, there is no assurance that we will be able to attract new lessees in favorable terms or at all, which would materially adversely affect our financial condition and results of operations.

Economic recession, pressures that affect consumer confidence, job growth, energy costs and income gains can affect the financial condition of prospective tenants, and a continuing soft economic cycle may impact our ability to find tenants for our properties. Failure to attract tenants, the termination of a tenant's lease, or the bankruptcy or economic decline of a tenant may adversely affect the rent fees for our properties and adversely affect our financial condition and results of operations.

*We may have difficulties leasing real-estate properties.*

The fixed income real-estate sector relies on the presence of tenants in the real-estate assets. The failure of a tenant to renew its lease, the termination of a tenant's lease, or the bankruptcy or economic decline of a tenant can have a material adverse effect on the economic performance of the real-estate asset. There can be no assurance that if a tenant were to fail to renew its lease, we would be able to replace such tenant in a timely manner or that we could do so without incurring material additional costs. In addition, we are dependent on our ability to enter into new leases on favorable terms with third parties, in order to receive a profitable price for each real-estate property. We may find it more difficult to engage tenants to enter into leases during periods when market rents are increasing, or when general consumer activity is decreasing, or if there is competition for tenants from competing properties. The existence of competitive alternatives could have a material adverse effect on our ability to lease space and on the level of rents we can obtain. The recent global economic recession, pressures that affect consumer confidence, job growth, energy costs and income gains can affect retail sales growth, and a continuing soft economic cycle, may impact our ability to find tenants for our properties. Failure to attract tenants, the termination of a tenant's lease, or the bankruptcy or economic decline of a tenant may adversely affect the price obtainable for our real estate projects and adversely affect our financial condition and results of operations. The failure of tenants to abide by the terms of their agreements may cause delays or result in a temporary or long term decline in rental income, the effects of which we may not be able to offset due to difficulties in finding a suitable replacement tenant.

*We are depended on the solvency of our tenants and may lease properties at below expected rental rates.*

Rental leases may decrease below our expectations. In the case of such decrease, or if circumstances arise beyond our control, such as market prices, market demand and negative trends, we may have to sell a project at a price below our projections. In addition, we could be in a position where there would be no demand at acceptable prices and we would be required to hold, operate and maintain the project until the financial environment would improve and allow its disposal.

In addition, the ability to collect rents depends on the solvency of the tenants. Tenants may be in default or not pay on time, or we may need to reduce the amount of rents invoiced by lease incentives, to align lease payments with the financial situation of some tenants. In all of these cases, tenant insolvency may hurt our operational results.

***We may experience future unanticipated expenses.***

Our performance depends, among others, on our ability to pay for adequate maintenance, insurance and other operating costs, including real estate taxes. All of these expenditures could increase over time, and may be more expensive than anticipated. Sources of labor and materials required for maintenance, repair, capital expenditure or development may also be more expensive than we expected. An unplanned deviation from one of the above expenditures, and other, could increase our operating costs.

***The fair value of our real estate may be harmed by certain factors, which may entail impairment losses not previously recorded which, in turn, will affect our financial results.***

Certain circumstances may affect the fair value of our real estate assets, including, among other things, (i) the absence of or modifications to permits or approvals required for the operation of any real estate asset; (ii) lawsuits that are pending, whether or not we are a party thereto, may have a significant impact on our real estate assets and/or on certain of our shareholding rights in the companies owning such assets. In addition, certain laws and regulations, applicable to our business in certain countries where the legislation process undergoes constant changes, may be subject to frequent and substantially different interpretations; (iii) agreements which may be interpreted by governmental authorities so as to shorten the term of use of real estate, and which may be accompanied with a demolition order with or without compensation, may significantly affect the value of such real estate asset. The fair value of our real estate assets may be significantly decreased, thereby resulting in potential impairment losses not previously recorded in our financial results.

Since market conditions and other parameters (such as macroeconomic environment trends, and others), which affect the fair value of our real estate, vary from time to time, the fair value may not be adequate on a date other than the date the measurement was executed (in general, immediately after the annual balance sheet date). In the event the projected forecasts regarding the future cash flows generated by those assets are not met, we may have to record an additional impairment loss not previously recorded.

In addition, any change in the yield rate of any of our real estate assets may cause a significant decrease to the fair value of such assets, thereby resulting in potential impairment losses not previously recorded in our financial results.

***We may experience difficulties in finding suitable real-estate properties for investment, either at all or at viable prices.***

Being a company that engages in investments in real-estate, finding a suitable real-estate property for investment is critical to our income. Such finding becomes difficult as the demand for real-estates in the markets we are involved in grows, and the supply decreases. Therefore, difficulties in finding suitable real-estate properties for investment may affect our growth and the number of assets we have to offer, and therefore materially affect our potential profit and our business and results of operation.

The choice of suitable locations for real estate projects is an important factor in the success of the individual projects. For example, office space should ideally be located within, or near, the city center, with well-developed transportation infrastructure (road and rail) located in close proximity to facilitate customer access. If we are not able to find sites in the target cities which meet our criteria or which meet our price range, this may materially adversely affect our business and results of operation.

In addition, we may be unable to proceed with the acquisition of properties because we cannot obtain financing on favorable terms or at all. We may require substantial up-front expenditures for property acquisition. Accordingly, we may require substantial amounts of cash and financing from banks and other capital resources (such as institutional investors and/or the public) for our real estate operations. We cannot be certain that such external financing would be available on favorable terms or on a timely basis or at all.

***We face risks associated with property acquisitions.***

We may acquire individual properties and portfolios of properties, including large portfolios that could significantly increase our size and alter our capital structure. Our acquisition activities may be exposed to, and their success may be adversely affected by, the following risks:

- even if we enter into an acquisition agreement for a property, it is usually subject to customary conditions to closing, including due diligence investigations to our satisfaction;
- we may be unable to finance acquisitions on favorable terms or at all;
- acquired properties may fail to perform as we expected;
- we may not be able to obtain adequate insurance coverage for new properties; and
- we may be unable to quickly and efficiently integrate new acquisitions, particularly acquisitions of portfolios of properties, into our existing operations, and therefore our results of operations and financial condition could be adversely affected.

We may acquire properties or property holding companies subject to liabilities and without any recourse, or with only limited recourse, with respect to unknown liabilities. As a result, if a liability were asserted against us arising from our ownership of those properties, we might have to pay substantial sums to settle it, which could adversely affect our cash flow. Unknown liabilities with respect to properties acquired might include:

- liabilities for clean-up of undisclosed environmental contamination;
- claims by tenants, vendors or other persons arising from dealing with the former owners of the properties;
- liabilities incurred in the ordinary course of business; and
- claims for indemnification by general partners, directors, officers and others indemnified by the former owners of the properties.

***We may not be able to raise additional financing for our future capital needs on favorable terms, or at all, which could limit our growth and increase our costs and could adversely affect the price of our ordinary shares.***

Real estate activities are largely financed from external sources. We cannot be certain that we will be able to obtain financing on favorable terms for our future real estate activities, or at all. In addition, an adverse change can occur in the terms of the financing that we receive. Any such occurrence could increase our financing costs and/or result in a material adverse effect on our results and ability to develop our real estate business. The amount of long term loans currently outstanding may inhibit our ability to obtain additional financing for our future capital needs, inhibit our long-term expansion plans, increase our costs and adversely affect the price of our ordinary shares.

We received net proceeds in the amount of approximately \$67 million from our secondary public offering in March 2000, and we spent approximately \$37 million in cash as a component of the consideration paid to acquire Viewgraphics Inc. and certain other assets, see also "Item 4.A. History and Development of the Company" below. Since then, we have only raised a total of \$10 million from Mr. Wyler, our president and member of our board of directors, in two private placements, which took place in June 2008 and in May 2011. For further details on such placements see Item 7.B "Related Party Agreements".

It is probable that we will need to raise additional capital in the future to support our longer-term strategic plans. We cannot be certain that we will be able to obtain additional financing on commercially reasonable terms or at all. If we are unable to obtain additional financing, this could inhibit our growth and increase our operating costs.

***An adverse change in the Swiss real estate market will adversely affect our results of operations.***

Two out of our five investments, including our most significant property (the CTN complex in Geneva), are located in Switzerland. The Swiss economy led to a slight increase in demand in the office property market. In particular, Switzerland remains an attractive location for international service providers and corporate headquarters. There is also an ever-increasing demand for high-quality, modern spaces, which ultimately also has a positive impact on the rent level. However, while jobs were still being created at the beginning of 2011, the Swiss economy slowed down and consumer sentiment dimmed somewhat in the second half of 2011. Towards the end of 2011, the demand for office space slowed down due to announced and expected job losses. During 2012, as Swiss interest rates remained low, the Swiss real estate prices remained stable but at the same time there was no increase in the demand for new rental spaces and the rental market appears to be slowing down further.

Any significant adverse change in the real estate market in Switzerland, such as decline in the real estate rates or decrease in demand for the type of properties we own, will adversely affect our results of operations.

***An adverse change in the U.S. real estate market will adversely affect our results of operations.***

During 2012 we have invested approximately \$4 million to acquire a 19.66% indirect beneficial interest in the owner of the property located at Two Penn Center Plaza in Philadelphia, and we have acquired an approximately 4% beneficial interest in a portfolio of Texas shopping centers. During 2012 the pressure on properties' pricing appears to have eased somewhat and the real estate market was showing some tentative signs of stabilization. Economically, that had been supported by moderate job growth, record housing affordability and fewer distressed property sales. For further information, see Item 4.B. "Business Overview".

Any significant adverse change in the real estate market in the United States, such as decline in the real estate rates or decrease in demand for the type of properties we own, will adversely affect our results of operations.

***With respect to our residential property in Miami, Florida, the success of our investment will depend on market conditions.***

We own, through our wholly-owned subsidiary, 21 luxury condominium units in the Marquis Residences in Miami, Florida. To date, the units have been fully constructed and are in rentable condition. Currently 18 of the units are occupied by tenants and the remaining units are being marketed to potential tenants. For further information, see Item 4.B. "Business Overview - Real Estate Business".

We intend to keep holding the units for investment purposes and will consider renting or selling the units in accordance with our business considerations and market conditions. Depending on our decision, we may be unable to sell or lease up these condominium properties on schedule or on favorable terms, which may result in a decrease in expected rental revenues and/or lower yields, if any.

***The illiquidity of real-estate properties may affect our ability to sell our properties.***

Real estate properties in general are relatively illiquid. Such illiquidity may affect the ability to dispose of or liquidate part of real-estate assets in a timely fashion and at satisfactory prices in response to changes in the economic environment, the real estate market or other conditions.

***Cause of physical damages and other nature losses may affect our properties.***

Properties could suffer physical damage caused by fire or other causes, resulting in losses which may not be fully compensated by insurance. In addition, there are certain types of losses, generally of a catastrophic nature, such as earthquakes, floods, terrorism or acts of war that may be uninsurable or are not economically insurable. Inflation, changes in building codes and ordinances, environmental considerations and other factors, including terrorism or acts of war, also might result in insurance proceeds being insufficient to repair or replace a property if it is damaged or destroyed. Under such circumstances, the insurance proceeds may be inadequate to restore the economic position with respect to the affected properties. Should an uninsured loss or a loss in excess of insured limits occur, we could lose capital invested in the affected property as well as anticipated profits from that property. No assurance can be given that material losses in excess of insurance proceeds will not occur in the future.

***Environmental discoveries may have a significant impact on the budget, schedule, viability and marketability of our assets.***

We may encounter unforeseen compliance defaults due to factors beyond our control such as delays or defaults caused by previously unknown soil contamination or the discovery of archaeological findings which may have a significant impact on development budget and schedules and which may, in turn, have a detrimental effect on the viability or marketability of the development or cause legal liability in connection with real properties. We may be liable for the costs of removal, investigation or remedy of hazardous or toxic substances located on or in a site owned or leased by us, regardless of whether we were responsible for the presence of such hazardous or toxic substances. The costs of any required removal, investigation or remedy of such substances may be substantial and/or may result in significant budget overruns. The presence of such substances, or the failure to remedy such substances properly, may also adversely affect our ability to sell or lease such property or to obtain financing using the real estate as security. Additionally, any future sale of such property will be generally subject to indemnities and warranties to be provided by us to the purchaser against such environmental liabilities. Accordingly, we may continue to face potential environmental liabilities with respect to a particular property even after such property has been sold. Laws and regulations may also impose liability for the release of certain materials into the air or water from a property, and such release can form the basis for liability to third persons for personal injury or other damages. Other laws and regulations can limit the development of, and impose liability for, the disturbance of wetlands or the habitats of threatened or endangered species. Any environmental issue may significantly cause delays, which could have a material adverse effect on the profitability of that development and our results of operations and cash flows.

***We may depend on partners in our partnerships and collaborative arrangements.***

We are currently, with respect to our real-estate properties in Geneva, Switzerland, Philadelphia and Texas, and we may, in the future, own interests in real-estate assets or real-estate holding companies in partnership with other entities. Our investments in these partnerships may, under certain circumstances, be subject to (i) the risk that one of our partners may become bankrupt or insolvent or may not fulfill its financial obligations under our partnership agreements, which may cause us to provide financing in excess of our ownership share or which may cause us to be unable to fulfill our financial obligations, possibly triggering a default under our bank financing agreements or, in the event of a liquidation, preventing us from managing or administering our business or entail a compulsory sale of the asset at less favorable terms; (ii) the risk that one of our partners may have economic or other interests or goals that are inconsistent with our interests and goals, and that such partner may be in a position to veto actions which may be in our best interests; and (iii) the possibility that disputes may arise regarding the continued operational requirements of our assets that are jointly owned. In addition, we hold approximately 20% and approximately 4%, respectively, of the beneficial interest in the real-estate properties located in Philadelphia and Texas. Our minority interest causes us to rely on our partners to manage the properties, and our influence over decisions regarding the properties and their management is limited.

***We may suffer adverse consequences if our revenues decline since our operating costs do not necessarily decline in proportion to our revenue.***

We earn a significant portion of our income from renting our properties. Our operating costs, however, do not fluctuate in relation to changes in our rental revenue. As a result, our costs will not necessarily decline even if our revenues do. Similarly, our operating costs could increase while our revenues stay flat or decline. In either such event, we may be forced to borrow to cover our costs or we may incur losses.

***Competition for acquisitions may reduce the number of acquisition opportunities available to us and increase the costs of those acquisitions.***

We plan to continue acquiring properties as we are presented with attractive opportunities. We may face competition for acquisition opportunities from other investors, particularly private investors who can incur more leverage, and this competition may adversely affect us by subjecting us to the following risks:

- an inability to acquire a desired property because of competition from well-capitalized real estate investors, including publicly traded and privately held REITs, private real estate funds, domestic and foreign financial institutions, life insurance companies, sovereign wealth funds, pension trusts, partnerships and individual investors; and
- an increase in the purchase price for such acquisition property, in the event we are able to acquire such desired property.

**Risks Relating to the Sale of our Video Solutions Business**

On March 16, 2010 we and our subsidiary, Optibase Inc., entered into an asset purchase agreement with Vitec for the sale of all of the assets and liabilities related to our Video Solutions Business. Closing of the transaction occurred on July 1, 2010. For further details see Item 10.C "Material Contracts".

The following are risks related to the sale of our Video Solutions Business to Vitec:

***We are currently undergoing arbitration proceedings in connection with the sale of our Video Solutions Business to Vitec.***

As of this date, Vitec and us have been unable to come to an agreement as to several disputes which arose between us and which relate, *inter alia*, to the adjustment amount to be added to the consideration, the collection of sums payable from past clients services and maintenance contracts and other obligations made towards us by Vitec. To date, we and Vitec are parties to arbitration proceedings in which Vitec submitted its statement of Claim against us demanding us to pay Vitec approximately \$23 million and we submitted our statement of claim against Vitec demanding that Vitec pay us an aggregate sum of approximately \$1.5 million. In addition, in connection with the Vitec transaction, we filed a personal claim against Adv. Doron Afik, who acted as a trustee in a consortium escrow agreement with Vitec. For further information, see Item 8. "Financial Information - Legal Proceedings". In case the arbitration proceedings are decided against us, such decision could materially adversely affect our cash flow.

In addition, in connection with the sale of our Video Solutions Business to Vitec, both parties agreed on mutual indemnification for a period of two years until July 2012 for damages arising or resulting from, *inter alia*, breach or material inaccuracy relating to the representations, warranties and covenants and the liabilities that Vitec may incur which are part of the excluded liabilities arising or resulting therefrom such as the breach or material inaccuracy of any representation or warranty, and for that purpose \$1 million out of the aggregate consideration in the Vitec Transaction was put in escrow as security for such understanding. In light of the existing arbitration proceedings between Vitec and us, and following the refusal of Vitec to the release of such indemnification escrow funds, the decision regarding the release of the escrow funds was brought before the arbitrator, who ordered not to release the indemnification escrow funds until a final award in the arbitration process is issued. In case the arbitration proceedings are decided against us, such decision could influence our chances to release the indemnification escrow funds and therefore could adversely affect our cash flow. In addition, indemnification provisions will apply for longer periods in case of damages resulting from fraud or willful misconduct, a period of three years from closing for non-competition provisions and an indefinite confidentiality undertaking). The mutual indemnification will be limited to a maximum amount of \$6 million. A claim against us could result in substantial cost which would have a negative impact on our financial condition.

***We have been and may, in the future, be subject to further review in connection with government programs that we participated in or received.***

During our activities in the Vitec Solutions Business, we received grants from the Office of the Chief Scientist, or the OCS, in the Israeli Ministry of Industry, Trade and Labor for research and development programs that meet specified criteria. In addition, we were also involved in joint research projects with European Companies under the auspices of, and with financial assistance from, the European Union Research and Development Framework Programs. We have been active contributors in many such projects and have been the coordinator of three: VideoGateway, MUFFINS and TIRAMISU.



In that respect, during 2009 and 2010 we were audited by the European Union, or the EU, for grants received under three FP6 contracts. The results of the audit reflected an over payment by the EU of approximately Euro 280,000 to be repaid. In addition, the EU has imposed a fine in the amount of Euro 115,000 and required us to review the non-audited FP6 contracts and analyze whether there is a need for any implementation of the audit findings for these contracts as well. As a result of the audit findings implementation, during 2012, we paid an aggregate amount of approximately Euro 340,000 which settled and concluded the financial audit.

Furthermore, we are currently undergoing an audit by the OCS for royalties paid before the sale of our Video Solutions Business. A payment to the OCS will adversely affect our cash flow, although from financial prospective, at this time, we believe that we have sufficient provisions to cover the final outcome of such review processes. For further details see Item 4.B "Business Overview - Remaining items of the Video Solution Business".

#### **Risks Relating to Operations in Israel**

*The rights and responsibilities of our shareholders are governed by Israeli law and differ in some respects from the rights and responsibilities of shareholders under U.S. law.*

We are incorporated under Israeli law. The rights and responsibilities of holders of our ordinary shares are governed by our articles of association and by the Israeli Companies Law, 1999, or the Companies Law. These rights and responsibilities differ in some respects from the rights and responsibilities of shareholders in typical U.S. corporations. In particular, pursuant to the Companies Law each shareholder of an Israeli company has to act in good faith in exercising his or her rights and fulfilling his or her obligations toward the company and other shareholders and refrain from abusing his or her power in the company, including, among other things, in voting at the general meeting of shareholders and class meetings, on amendments to a company's articles of association, increases in a company's authorized share capital, mergers, and transactions requiring shareholders' approval under the Companies Law. In addition, a controlling shareholder of an Israeli company or a shareholder who knows that it possesses the power to determine the outcome of a shareholder vote, or who has the power to appoint or prevent the appointment of a director or officer in the company, or has other powers toward the company, has a duty of fairness toward the company. However, Israeli law does not define the substance of this duty of fairness. Because Israeli corporate law has undergone extensive revision in recent years, there is little case law available to assist in understanding the implications of these provisions that govern shareholder behavior.

*Because most of our revenues are generated in Swiss Francs but a portion of our expenses are incurred in New Israeli Shekels and in US dollars, our results of operations may be harmed by currency fluctuations.*

We generate most of our revenues in CHF (Swiss Franc) but incur a portion of our expenses in NIS and in U.S. dollars. As a result, we are exposed to currency fluctuation of the U.S. dollars and the CHF against the NIS, and to the CHF corresponding interest rate.

The fluctuations in the dollar costs of our operations in Israel related primarily to the costs of salaries in Israel, which are paid in NIS and constitute a portion of our expenses. We cannot assure you that we will not be adversely affected in the future if inflation in Israel exceeds the fluctuation of NIS against the U.S. dollars and against the CHF or if the timing of such fluctuation lags behind increases in inflation in Israel.

Our operations could also be adversely affected if we are unable to guard against currency fluctuations in the future. Accordingly, we may enter into currency hedging transactions to decrease the risk of financial exposure from fluctuations. These measures, however, may not adequately protect us from adverse effects due to the impact of inflation in Israel.

The inflation rate in Israel was approximately 2.7% in 2010, approximately 2.2% in 2011, and approximately 1.6% in 2012. The appreciation of the NIS against the dollar was approximately, 6% in 2010, a devaluation of 7.2% in 2011 and an appreciation of 1.4% in 2012 and the devaluation of the NIS against the CHF was approximately 3.3% in 2010, 7.5% in 2011, and 0.4% in 2012. The appreciation of the CHF against the dollar was 9.4% in 2010, 0.1% in 2011, and 2.7% in 2012.

***Potential political and military instability in Israel may adversely affect our results of operations.***

The political and military conditions in Israel directly influence us. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its Arab neighbors, and a state of hostility, varying from time to time in intensity and degree, has led to security and economic problems for Israel. Although Israel has entered into various agreements with Egypt, Jordan and the Palestinian Authority, since September 2000, there has been a high level of violence between Israel and the Palestinians. In July 2006, the Israeli army was engaged in extensive hostilities along Israel's northern border with Lebanon and to a lesser extent in the Gaza Strip. Recently, there has been a further escalation in violence among Israel by Hamas, a militant group responsible for many attacks into Israel, the Palestinian Authority and other groups. Since June 2007, the Hamas militant group has taken over the Gaza Strip from the Palestinian Authority, and the hostilities along Israel's border with the Gaza Strip have increased, escalating to a wide scale attack by Israel in December 2008 and an additional attack by Israel in November 2012, in retaliation to rocket attacks into southern Israel. These developments have further strained relations between Israel and the Palestinian Authority. Moreover, since December 2010, there has been a wave of protests and civil resistance demonstrations in several countries in the Middle East and North Africa, including Egypt and Syria, which share a border with Israel. The demonstrations and acts of civil resistance in Egypt led to the resignation of the former Egyptian president Hosni Mubarak and to extensive revisions in the Egyptian governmental structure. It is not clear how this revolutionary wave, also known as the Arab Spring, will develop and how it will affect the political and security situation in the Middle East. It is also not clear how it will affect Israel and its relationship with its Arab neighbors. It is also widely believed that Iran, which has previously threatened to attack Israel, has been stepping up its efforts to achieve nuclear capability. Iran is also believed to have a strong influence among extremist groups in the region, such as Hamas in Gaza and Hezbollah in Lebanon. The tension between Israel and Iran may escalate in the future and turn violent, which could affect the Israeli economy generally and us in particular. Any armed conflict, political instability or violence in the region may have a negative effect on our business condition, harm our results of operations and adversely affect our share price. No predictions can be made as to whether or when a final resolution of the area's problems will be achieved or the nature thereof and to what extent the situation will impact Israel's economic development or our operations.

***Anti-takeover provisions could negatively impact our shareholders.***

The Companies Law provides that certain purchases of securities of a public company are subject to tender offer rules. As a general rule, the Companies Law prohibits any acquisition of shares in a public company that would result in the purchaser holding 25% or more, or more than 45% of the voting power in the company, if there is no other person holding 25% or more, or more than 45% of the voting power in a company, respectively, without conducting a special tender offer.

The Companies Law further provides that a purchase of shares or voting rights of a public company or a class of shares of a public company, which will result in the purchaser's holding 90% or more of the company's shares or class of shares, is prohibited unless the purchaser conducts a full tender offer for all of the company's shares or class of shares. The purchaser will be allowed to purchase all of the company's shares or class of shares (including those shares held by shareholders who did not respond to the offer), if either (i) the shareholders who do not accept the offer hold less than 5% of the issued and outstanding share capital of the company or of the applicable class, and more than half of the shareholders who do not have a personal interest in the offer accept the offer, or (ii) the shareholder who do not accept the offer hold less than 2% of the issued and outstanding share capital of the company or of the applicable class. The shareholders, including those who indicated their acceptance of the tender offer (except if otherwise detailed in the tender offer document), may, at any time within six months following the completion of the tender offer, petition the court to alter the consideration for the acquisition. At the request of an offeree of a full tender offer which was accepted, the court may determine that the consideration for the shares purchased under the tender offer, was lower than their fair value and compel the offeror to pay to the offerees the fair value of the shares. Such application to the court may be filed as a class action.

In addition, the Companies Law provides for certain limitations on a shareholder that holds more than 90% of the company's shares, or class of shares.

*Israeli courts might not enforce judgments rendered outside of Israel, which may make it difficult to collect on judgments rendered against us.*

We are incorporated in Israel. Our directors and officers are not residents of the United States and some of their assets and our assets are located outside the United States. Service of process upon our non-U.S. resident directors and officers and enforcement of judgments obtained in the United States against us, and our directors and executive officers may be difficult to obtain within the United States.

We have been informed by our Israeli legal counsel, that there is doubt as to the enforceability of civil liabilities under U.S. securities laws in original actions instituted in Israel. However, subject to certain time limitations, an Israeli court may declare a foreign civil judgment enforceable if it finds that all of the following terms are met:

- ❖ The judgment was rendered by a court which was, according to the laws of the state of the court, competent to render the judgment;
- ❖ The judgment can no longer be appealed;
- ❖ The obligation imposed by the judgment is enforceable according to the rules relating to the enforceability of judgments in Israel and the substance of the judgment is not contrary to public policy; and
- ❖ The judgment is executory in the state in which it was given.

Even if the above conditions are satisfied, an Israeli court will not enforce a foreign judgment if it was given in a state whose laws do not provide for the enforcement of judgments of Israeli courts (subject to exceptional cases) or if its enforcement is likely to prejudice the sovereignty or security of the State of Israel. An Israeli court will also not declare a foreign judgment enforceable in the occurrence of any of the following:

- ❖ The judgment was obtained by fraud;
- ❖ There was no due process;
- ❖ The judgment was rendered by a court not competent to render it according to the laws of private international law in Israel;
- ❖ The judgment is at variance with another judgment that was given in the same matter between the same parties and which is still valid; or
- ❖ At the time the action was brought in the foreign court a suit in the same matter and between the same parties was pending before a court or tribunal in Israel.

#### **ITEM 4. INFORMATION ON THE COMPANY**

##### **4.A. HISTORY AND DEVELOPMENT OF THE COMPANY**

###### **History**

Optibase was founded and incorporated in the State of Israel in 1990 under the name of Optibase Advanced Systems (1990) Ltd. In November 1993 we changed our name to Optibase Ltd. Our principal executive offices are located at 10 Hasadnaot Street, Herzliya 46728, Israel, and our telephone number at that location is +972-73-7073700. Our website is located at [www.optibase-holdings.com](http://www.optibase-holdings.com). We use a local agent in California for administrative purposes and domestic filings, which is Formation Solutions Inc. 400 Continental Boulevard, 6th Floor El Segundo, CA 90245.

Since our foundation we were engaged in the Video Solution Business. We sold that business to Vitec in March 2010 and we are currently engaged in the real estate sector. For further details, see below.

The following is a short description of our history since our foundation:

Commencing in February 2001, Festin Management Corp., a British Virgin Island corporation jointly owned by Shlomo (Tom) Wyler and Arthur Mayer-Sommer started to acquire our ordinary shares on the open market. On September 10, 2004, Festin Management Corp. transferred all of its holdings in us to its shareholders. In addition, during 2008 and 2011, we issued an aggregate number of 1,063,381 ordinary shares in a private placement to Mr. Wyler, who was considered, until September 12, 2012, our controlling shareholder, and as of the date of this annual report, serves as our president and a member of our board of directors. Based on the information provided in the Amendment No. 4 to Schedule 13D filed with the SEC on November 21, 2012, on September 12, 2012, Capri and Gesafi Real Estate S.A., a Panama Corporation, or Gesafi, acquired 1,297,290 and 500,000 of our ordinary shares, respectively, from Mr. Wyler, in order to terminate loan agreements with Mr. Wyler entered into in connection with his acquisition of such shares. For additional information see Item 7.A. "Major Shareholders".

In December 2000, we acquired Viewgraphics Inc., a privately held company based in Mountain View, California, and a provider of hardware and software products for video solutions infrastructure application which was merged with and into our subsidiary Optibase, Inc. in June 2001. In connection with the acquisition, we paid an aggregate consideration of approximately \$43.6 million, of which \$11.8 million (net of issuance expenses) was paid in 274,000 newly issued ordinary shares of the Company.

In June 2004, we acquired certain assets and liabilities of Media 100 Inc. as part of a pre-packaged bankruptcy filing of Media 100, in consideration for \$2.5 million in cash and costs incurred by us totaling \$401,000. In September 2005, we entered into an agreement for the sale of our Digital Non-Linear Editing product line activity.

We listed our ordinary shares for trade on the Tel Aviv Stock Exchange, or the TASE, on August 6, 2007. On September 23, 2008, we decided to delist our ordinary shares from trade on the TASE. The delisting of our ordinary shares from trade on the TASE was effective on September 28, 2008. The last day for trading of our ordinary shares on the TASE was September 24, 2008.

On May 11, 2009, our board of directors resolved to expand and diversify our operations and enter into the fixed-income real estate sector. Our board of directors believed that due to the global financial crisis, the fixed-income real estate sector has become attractive and presents new business opportunities, and determined that there are opportunities, especially in Central and Western Europe and North America that are potentially beneficial for us and our shareholders that should be pursued. At a special shareholders meeting held on June 25, 2009 our shareholders approved the diversification of our operations by entering into the fixed income real-estate sector. Such approval was sought solely for cautionary purposes and without any obligation to do so. As of the date hereof, we have entered into certain agreements for the purchase of real estate assets. For further information, see Item 4.B "Business Overview".

In 2010, we sold our Video Solution Business for an aggregate consideration of \$8 million. For further details regarding such sale and the arbitration proceedings entered into between us, the purchasers and their attorney, see Item 3.D. "Risk Factors" and Item 8. "Financial Information - Legal Proceedings".

Following the above-mentioned decision to diversify our operations and to date, we are engaged in investments in the real estate sector.

For additional information see Item 4.B "Business Overview" and Item 10.C "Material Contracts".

In addition, we hold, on a fully diluted basis, approximately 2.04% of the issued and outstanding share capital of Mobixell Networks Inc., a private company which designs, develops and markets solutions for mobile rich media adaptation, optimization and delivery. As of December 31, 2012, such investment was written off completely in our financial reports for 2012.

#### ***Reverse Share Split***

On August 16, 2012, and following the approval by our board of directors, our shareholders approved a one-for-five reverse share split of our ordinary shares, or the Reverse Share Split. The Reverse Share Split was effective on September 27, 2012 and reduced our ordinary shares to 6,000,000 authorized shares. The exercise price and the number of shares issuable pursuant to our outstanding options have been adjusted pursuant to the terms of such instruments in connection with the Reverse Share Split. No fractional ordinary shares were issued in connection with the Reverse Share Split, and all such fractional shares were rounded to the nearest whole number of ordinary shares.

#### **4.B. BUSINESS OVERVIEW**

The real estate market includes the purchasing and operating of real estate properties intended for leasing and resale primarily for the purpose of commercial, industrial, office space, parking garage, warehouse use as well as for residential purposes. The real estate market is affected by growth or slowdown in the economy, and by changes in the demand and the available supply of commercial and/or residential properties, as well as the construction of additional commercial and/or residential properties. The real estate market is also affected by governmental, municipal and tax authority policies regarding planning, building, marketing and taxation of land.

Commencing in the fourth quarter of 2008 and as a result of the global economic and financial market crisis, there has been a slowdown in the real estate market which is evidenced by a decline in the number of real estate transactions, a reduction in the availability of credit sources, an increase in financing costs and stricter requirements by banks for providing such financing.

Our strategy in our real estate activities is to become a substantial owner of properties. To achieve this goal, we intend to pursue a number of operating and growth strategies, which include:

- purchase of real estate mainly in Central and Western Europe, North America and Israel.
- developing and improving existing real estate;
- maximize the leasing of existing properties to commercial users;
- increase and develop unused building rights in our existing properties; and
- acquire additional commercial, residential and other real estate assets in light of market conditions, while diversifying our real estate property base.

As of the date of this annual report, our portfolio includes the holdings of interests in four operating commercial properties as well as condominium units in one residential project.

*Properties*

The following table provides details regarding real-estate assets properties wholly owned or controlled by us or by our subsidiaries, as of the date of this annual report:

<u>Property</u>	<u>Location</u>	<u>Acquisition date</u>	<u>Company Stake</u>	<u>Nature of Rights</u>	<u>Property Type</u>	<u>Net Rentable Square Meters Excluding Redevelopment Space<sup>(1)</sup></u>	<u>Annualized Rent (\$000)<sup>(2)</sup></u>	<u>Rate of Occupancy<sup>(3)</sup></u>	<u>Annualized Rent per Occupied Square Meter (\$)<sup>(4)</sup></u>	<u>NOI (\$000)<sup>(5)</sup></u>
Centre des Technologies Nouvelles (CTN)	Geneva, Switzerland	March 2, 2011	51%	Ownership with land lease	Commercial	34,238	11,444	96	348	9,953
Rümlang	Rümlang, Switzerland	October 29, 2009	100%	Ownership	Commercial	12,500	1,860	100	149	1,662
Marquis Residences	Miami, Florida	December 30, 2010	100%	Ownership	Residential - Condominium Units	3,229	749	86	271	95
<b>Portfolio Total/ Weighted Average</b>	-	-	-	-	-	<b>49,967</b>	<b>14,053</b>	<b>96</b>	<b>292</b>	<b>11,710</b>

(1) Net rentable square meters at a building represents the current square meter at that building under lease as specified in the lease agreements plus management's estimate of space available for lease based on engineering drawings. Net rentable square meter includes tenants' proportional share of common areas but excludes space held for redevelopment.

(2) Annualized rent represents the monthly contractual rent under existing leases as of December 31, 2012 multiplied by 12.

(3) Excludes space held for redevelopment. Includes unoccupied space for which we are receiving rent and excludes space for which leases had been executed as of December 31, 2012, but for which we are not receiving rent. We estimate the total square meter available for lease based on a number of factors in addition to contractually leased square meter, including available power, required support space and common area.

(4) Annualized rent per square meter represents annualized rent as computed above, divided by the total square meter under lease as of the same date.

(5) Net Operating Income, or NOI, is a non-GAAP financial measure. The most directly comparable GAAP financial measure is income from continuing operations before tax and discontinued operation, plus interest expenses, general and administrative expenses, equity share in earnings (losses) of associates, net and other loss. We use NOI internally as a performance measure and believe that NOI provides useful information to investors regarding our financial condition and results of operations because it reflects only those income and expense item that are incurred at the property level.

A reconciliation of the income before tax on income to NOI is as follows:

	<u>Thousands US\$</u>
Net operating income NOI (Non-GAAP):	
CTN	9,953
Rumlang	1,662
Marquis	95
Total ("NOI") (Non-GAAP)	11,710
less:	
General and administrative	2,068
Real estate depreciation and amortization	2,569
Financial expenses, net	1,243
Equity share in earnings (losses) of associates, net	32
Other loss	100
Income before tax on income	5,698

We consider the NOI to be an appropriate supplemental non-GAAP measure to operating income because it assists management, and thereby investors, to understand the core property operations prior to the allocation of any corporate-level property management overhead or general and administrative costs. In addition, because prospective buyers of real estate have different overhead structures, with varying marginal impact to overhead by acquiring real estate, we consider the NOI to be a useful measure for determining the value of a real estate asset or groups of assets.

The metric NOI should only be considered as supplemental to the metric operating income as a measure of our performance. NOI should not be used as a measure of our liquidity, nor is it indicative of funds available to fund our cash needs, including our ability to pay dividends or make distributions. NOI should also not be used as a supplement to, or substitute for, cash flow from operating activities (computed in accordance with generally accepted accounting principles in the United States).

The following table provides details regarding our non-controlled real-estate assets or projects in which we indirectly own a minority stake, as of the date of this annual report:

<u>Property</u>	<u>Location</u>	<u>Acquisition date</u>	<u>Company Stake</u>	<u>Nature of Rights</u>	<u>Property Type</u>	<u>Net Rentable Square Meters Excluding Redevelopment Space<sup>(1)</sup></u>	<u>Annualized Rent (\$000)<sup>(2)</sup></u>	<u>Rate of Occupancy<sup>(3)</sup></u>	<u>Annualized Rent per Occupied Square Meter (\$)<sup>(4)</sup></u>
2 Penn Center Plaza	Philadelphia, Pennsylvania	October 12, 2012	19.66%	Beneficial interest in the owner of the property	Commercial	502,633	9,565	76	25
Texas Shopping Centers Portfolio	Houston, Dallas, San Antonio, Texas	December 31, 2012	4%	Beneficial interest in the portfolio	Commercial	2,402,465	27,090	93	12
<b>Portfolio Total/Weighted Average</b>	-	-	-	-	-	<b>2,905,098</b>	<b>36,655</b>	<b>90</b>	<b>14</b>

(1) Net rentable square meters at a building represents the current square meter at that building under lease as specified in the lease agreements plus management's estimate of space available for lease based on engineering drawings. Net rentable square meter includes tenants' proportional share of common areas but excludes space held for redevelopment.

(2) Annualized rent represents the monthly contractual rent under existing leases as of December 31, 2012 multiplied by 12.

(3) Excludes space held for redevelopment. Includes unoccupied space for which we are receiving rent and excludes space for which leases had been executed as of December 31, 2012, but for which we are not receiving rent. We estimate the total square meter available for lease based on a number of factors in addition to contractually leased square meter, including available power, required support space and common area.

(4) Annualized rent per square meter represents annualized rent as computed above, divided by the total square meter under lease as of the same date.



Set forth below is additional information with respect to our projects:

*Geneva, Switzerland*

On March 3, 2011, we acquired, through our newly owned subsidiary, an office building complex in Geneva, Switzerland known as Centre des Technologies Nouvelles, or CTN complex. The acquisition was undertaken by OPCTN S.A., or OPCTN, a Luxembourg company owned 51% by Optibase and 49% by The Phoenix Insurance Company Ltd and The Phoenix Comprehensive Pension, or, collectively, the Phoenix. OPCTN undertook the transaction by acquiring all of the shares of the property owner, Eldista. The seller, Apollo CTN. S.a.r.l, is an entity majority owned by area property partners.

The CTN complex is a six-building complex located in the Plan-Les-Ouates business park in the outskirts of Geneva. The complex includes approximately 35,000 square meters of leasable space (approximately 377,000 square feet), is currently leased to 43 tenants, primarily in the field of advanced industries including biotech electronic and information technology industries, and is currently 100% occupied.

The following table sets forth certain information regarding leases of tenants in the CTN Complex, as of December 31, 2012:

	<b>Number of tenants whose leases will expire*</b>	<b>Total area covered by these leases</b>	<b>Area covered by these leases (%)</b>	<b>Annual rent at expiration (\$000)</b>	<b>Percent of Annual rent at expiration (%)</b>
2013	10	2,093	6.1	647	5.7
2014	2	220	0.6	84	0.7
2015	6	5,347	15.6	1,890	16.5
2016	9	9,969	29.1	3,463	30.3
2017	8	5,032	14.7	1,478	12.9
Thereafter	8	10,193	29.9	3,882	33.9
Sub-total	43	32,854	96	11,444	100
Vacant	-	1,384	4	N.A	N.A
Total	43	34,238	100	11,444	100

\* The leases with the tenants described in the above table include notice periods ranging from one to twelve months and some leases with no break options at all.

On the date of the agreement, we paid to the seller, Apollo CTN S.a.r.l, CHF 37.4 million and additional CHF 300,000 as post-closing price adjustment for the Eldista shares (approximately \$40.2 million and \$319,000, respectively, as of the purchase date).

In connection with the transaction, Optibase and The Phoenix entered into an agreement regarding their shareholdings in OPCTN. The agreement provides that Optibase will make day-to-day decisions and provide The Phoenix with customary protective rights.

Following the transaction, Eldista entered into a Consultancy Agreement with Swiss Pro Capital Limited, or Swiss Pro, a Cypriot company formerly known as Chessell Holdings which had introduced Optibase and The Phoenix to the Property. Under the Consultancy Agreement, Swiss Pro will provide consultancy services to Eldista regarding the administration and supervision of the Property and its management. Swiss Pro will receive a monthly fee for its services and will also be entitled to a bonus based on future performance above a certain return on the investment. The term of the Consultancy Agreement is for two years, and ends on May 19, 2013. At the conclusion of the term, Swiss Pro may cease performing the consultancy services and Eldista may cease paying Swiss Pro an ongoing monthly fee. In addition, beginning on May 19, 2013, Eldista will have the right to prepay the full amount of the bonus that would be due to Swiss Pro according to the mechanism set forth in the Consultancy Agreement.

In September, 2010, Eldista was granted a mortgage loan from a financial institution in Switzerland, in the amount of CHF 85.3 million for the purpose of purchasing its real estate property located in Geneva, Switzerland. The loan bears an adjustable interest rate based on current money and capital markets in Switzerland plus the bank's customary margins (1.8%). Principal and interest of the loan are payable quarterly. The mortgage loan may be repaid at any time with a three months prior written notice by Eldista. Eldista has the option to convert the mortgage into another mortgage product offered by the bank until April 30, 2015. The mortgage loan is governed by the laws of Switzerland and bears other terms and conditions customary for that type of mortgage loans. Eldista pledged to the bank the property and all of its accounts and assets which are deposited with the bank against the loan received.

On October 28, 2011, we entered into a refinancing arrangement with Credit Suisse for the CTN complex. The refinancing involved a new mezzanine loan that Credit Suisse provided to OPCTN and a refinancing of the existing mortgage loan of OPCTN's subsidiary, Eldista. Under the new financing agreement, Credit Suisse provided a new loan to OPCTN and Eldista which replaced the mortgage loan that Credit Suisse provided to Eldista. The combined interest rate of the new loans is 0.83% compared with 1.8% that Credit Suisse charged on the previous mortgage loan. The loans are repaid at a rate of CHF two million per year and are secured by a first mortgage over the property and by a pledge of Eldista's shares. For further information regarding the refinancing agreement, see Item 10.C. "Material Contracts".

*Rümlang, Switzerland*

On October 29, 2009, our wholly-owned subsidiary, Optibase RE 1 s.a.r.l., acquired a commercial building located at Riedmattstrasse 9, Rümlang from the Swiss property company Zublin Immobilien AG. Rümlang is situated 15 km from Zurich and as many commercial buildings due to its strategic location in proximity to Zurich international airport. The purchase price for the transaction was approximately CHF 23.5 million of which CHF 18.8 million (approximately \$22.8 million and \$18.1 million respectively, as of the purchase date) was financed by a local Swiss bank pursuant to a mortgage agreement.

The five-story building includes 12,500 square meters (approximately 135,000 square feet) of rentable space with office, laboratory and retail uses. The office building in Rümlang is currently leased to 16 tenants, and is currently 100% occupied.

The following table sets forth certain information regarding leases of tenants in the Rümlang property, as of December 31, 2012:

	<b>Number of tenants whose leases will expire*</b>	<b>Total area covered by these leases</b>	<b>Area covered by these leases (%)</b>	<b>Annual rent at expiration (\$000)</b>	<b>Percent of Annual rent at expiration (%)</b>
2013	9	5,561	44.4	859	46.2
2014	2	1,682	13.5	310	16.7
2015	2	4,211	33.8	557	29.9
2016	1	192	1.5	24	1.3
2017	-	-	-	-	-
Thereafter	2	854	6.8	110	5.9
Sub-total	16	12,500	100	1,860	100
Vacant	-	-	-	N.A	N.A
Total	16	12,500	100	1,860	100

\* The leases with the tenants described in the above table include notice periods ranging from March 2013 and through May 2018, with notice periods ranging from three to six months and one lease with no break options at all.

Swiss Pro introduced us to the Rümmlang property through its beneficial owner. Swiss Pro also facilitated Optibase's acquisition and financing of the property. In connection with such services, our subsidiary in Luxembourg entered into an option agreement dated March 1, 2010 with Swiss Pro pursuant to which Swiss Pro was granted an option to purchase twenty percent (20%) of the shares of Optibase RE 1 s.a.r.l, the owner of the property. For further information, see Item 10.C. "Material Contracts".

#### *Two Penn Center Plaza*

On October 12, 2012, our wholly-owned subsidiary, Optibase 2 Penn, LLC, acquired an approximately twenty percent (20%) beneficial interest in the owner of a Class A twenty story commercial office building in Philadelphia known as Two Penn Center Plaza.

The transaction was based on a valuation of Two Penn Center Plaza of approximately \$66 million including existing nonrecourse mortgage financing in the principal amount of approximately \$51.7 million provided by UBS Real Estate Securities, or UBS. The UBS mortgage loan has a fixed interest rate of 5.61%, maturing in May 2021, and requiring monthly payments of principal and interest of approximately \$300,000. We made a capital contribution of approximately \$4 million to acquire a 19.66% indirect beneficial interest in the owner of the property. For further information, see Item 7.B. "Related Party Transactions".

Optibase 2 Penn, LLC is a limited partner in a larger joint venture that acquired 88% of the beneficial interests in the owner of the Two Penn Center Plaza. Two Penn Center Plaza has approximately 500,000 rentable square feet and is located in the Center City neighborhood of Philadelphia opposite City Hall and Love Park. The building is currently leased to 118 tenants, primarily in the field of biotech, electronic, information technology and other advanced industries, and is currently 76% occupied. As of December 31, 2012, the Two Penn Center Plaza annual rental income totaled to approximately \$ 9.6 million.

#### *Texas Shopping Centers Portfolio*

On December 31, 2012, our wholly-owned subsidiary, OPTX Equity LLC, acquired an approximately 4% beneficial interest in a portfolio of Texas shopping centers. OPTX Equity LLC undertook this investment as an approximately 16.5% limited partner in Global Texas, LP a Florida limited partnership that is controlled by Global Fund Investments. Global Texas, LP is a limited partner in Global Texas Portfolio, LP a joint venture that acquired 49% of the beneficial interests in the shopping center portfolio. The partnership agreement of Global Texas, LP provides for contributions of capital and distributions of proceeds pro rata among the partners according to their respective partnership interests. OPTX Equity LLC has the right to participate in certain major decisions of Global Texas, LP that require the approval of 51% of the Global Texas, LP partnership interests.

In connection with the transaction, our wholly-owned subsidiary, OPTX Lender LLC, became an owner of approximately 16.5% of the partnership interests in Global Texas Lender, LP a Florida limited partnership. Global Texas Lender, LP provided a loan to Global Texas Portfolio, LP to finance the purchase price paid by Global Texas Portfolio, LP to acquire its 49% beneficial interest in the shopping center portfolio. The terms of the partnership agreement of Global Texas Lender, LP are substantially similar to the terms of the partnership agreement of Global Texas, LP.

The transaction was based on a portfolio valuation of approximately \$342 million including existing nonrecourse mortgage financing in the principal amount of approximately \$252 million. The primary mortgage loan has a fixed interest rate of 5.73% and matures in April 2016.

At the closing of the transaction, which occurred on December 31, 2012, we made an aggregate capital contribution of approximately \$4 million to OPTX Equity LLC and OPTX Lender LLC in order to fund our share in the transaction.

The shopping centers portfolio includes more than two million square feet of leasable area and is located in Houston, Dallas, and San Antonio areas of Texas. The leasable area is currently leased to 487 tenants, and is currently 93% occupied. As of December 31, 2012, Texas shopping centers portfolio annual rental income totaled to approximately \$27.1 million.

#### *Marquis Residences in Miami, Florida*

On December 30, 2010, our wholly-owned subsidiary, Optibase Real Estate Miami LLC, had acquired 21 luxury condominium units in the Marquis Residences in Miami, Florida. The condominium units were sold by Leviev Boymelgreen Marquis Developers, L.L.C., a Florida limited liability company. In consideration for the 21 condominium units, we paid a net purchase price of approximately \$8.6 million. In addition to the purchase price, we have invested approximately \$781,000 in finishing the units.

The Marquis Residences is a 67-story tower with 292 luxury residential units ranging from 1,477 to 4,200 square feet, a hotel offering seventy suites, a spa and fitness center.

To date, 19 of the 21 units are rented out and the remaining units are being offered for rental or sale. We intend to hold the units for investment purposes and will consider to continue renting or selling the units in accordance with our business considerations and market conditions. For further information, see Item 10.C. "Material Contracts".

#### **Material Tenants**

Our commercial properties in Switzerland are supported by anchor tenants who, due to size, reputation and other factors are considered as such. Our largest tenants in Switzerland are Lem SA, Addex Therapeutics, and Novimune SA located in the CTN complex, and Polymed Medical Center, located in Rumleng. As of December 31, 2012 these tenants occupied approximately 22,000 square meters and accounted for approximately \$7.2 million of rent income, or approximately 47% of our gross leasable area in Switzerland and approximately 54%, of our annual rent in Switzerland. No other tenant accounted for over 5% of our annual rent.

#### **Competition**

The real estate market is highly competitive and is characterized by a large number of competitors. The main factor affecting competition in this market is geographic location of property. There are properties in close proximity to some of our properties that are similar in purpose and use, which has the effect of increasing competition for the leasing of those properties as well as reducing the rental rates for those properties. Other factors affecting competition are the leasing price, the physical condition of the properties, the finishing of the properties and the level of the management services provided to tenants. Furthermore, the economic and financial market crisis may further increase competition, leading to a reduction of rental fees and a decline in demand for properties. However, as most of our real estate is leased under long term agreements, we believe that we have limited exposure to the effects of the slowdown in the real estate market.

#### **Remaining items of the Video Solution Business**

In connection with the Vitec transaction, Vitec and us have been unable to come to an agreement as to several disputes which arose between the parties and which relate, *inter alia*, to the adjustment amount to be added to the consideration, the collection of sums payable from past clients services and maintenance contracts and other obligations made towards us by Vitec. As of the date of this report, we are in the midst of arbitration proceedings with Vitec, in which Vitec has submitted a statement of claim against us demanding of us to pay Vitec approximately \$23 million, and we submitted our statement of claim against Vitec demanding that Vitec pay us an aggregate sum of approximately \$1.5 million. In addition, in connection with the Vitec transaction, we filed a personal claim against Adv. Doron Afik, who acted as a trustee in a consortium escrow agreement with Vitec. For further information, see Item 8. "Financial Information - Legal Proceedings".

In addition, in connection with the sale of our Video Solutions Business to Vitec, both parties agreed on mutual indemnification for a period of two years until July 2012 for damages arising or resulting from, *inter alia*, breach or material inaccuracy relating to the representations, warranties and covenants and the liabilities that Vitec may incur which are part of the excluded liabilities arising or resulting therefrom such as the breach or material inaccuracy of any representation or warranty, and for that purpose \$1 million out of the aggregate consideration in the Vitec Transaction was put in escrow as security for such understanding. In light of the existing arbitration proceedings between Vitec and us, and following the refusal of Vitec to the release of such indemnification escrow funds, the decision regarding the release of the escrow funds was brought in front of the arbitrator, who decided to restrain us from releasing the indemnification escrow funds until a final award in the arbitration process.

In connection with the sale of our Video Solutions Business to Vitec, we transferred all rights related to the support of the OCS for the period ending on the date of the closing of the Vitec Transaction to Vitec. Although we have no further obligation to pay royalties on revenues generated by our Video Solutions Business subsequent to its sale, we are currently undergoing an audit by the OCS, for royalties paid before the sale of our Video Solution Business. We believe we have sufficient provisions to cover the outcome of such review process.

We were also involved in joint research projects with large European companies under the auspices of, and with financial assistance from, the European Union Research and Development Framework Programs. In connection with the sale of our Video Solutions Business to Vitec, we transferred all rights related to our involvement in joint research projects with the European Union for the period ending on the date of the closing of the Vitec Transaction to Vitec. Under the Vitec Transaction, Vitec undertook to deposit in escrow a sum of \$100,000 per each of the three projects which were to be transferred to Vitec. To date, we have yet to receive the remaining \$200,000 still in escrow and have consequently filed a motion in the Tel-Aviv District Court against the escrow agent. For additional information see Item 8. "Financial Information - Legal Proceedings". During 2009 and 2010 we were audited by the European Union for grants received under three FP6 contracts. The results of the audit reflect an over payment by the EU of approximately Euro 280,000 to be repaid. In addition, the EU has inflicted a fine in the amount of Euro 115,000. We were also requested to review the non-audited FP6 contracts and analyze whether there is a need for any implementation of the audit findings for these contracts as well. As a result of the audit findings implementation, during 2012 we paid an aggregate amount of approximately Euro 340,000 which settled and concluded the financial audit.

#### **4.C. ORGANIZATIONAL STRUCTURE**

As of December 31, 2012, we manage our activity through our two wholly-owned direct subsidiaries: Optibase Inc. which was incorporated in California, the United States in 1991, Optibase Real Estate Europe SARL, or Optibase SARL, which was incorporated in Luxembourg in October 2009, and through our 51% held subsidiary OPCTN S.A., which was incorporated in Luxembourg on February 24, 2011.

Our subsidiaries hold the following companies: Optibase Inc. wholly owns Optibase Real Estate Miami LLC, Optibase 2Penn LLC, OPTX Equity LLC and OPTX Lender LLC, all limited liability companies which were incorporated in Delaware, United States. Optibase SARL wholly owns Optibase RE1 SARL, which was incorporated in Luxembourg and OPCTN S.A. wholly owns Eldista GmbH, which was incorporated in Switzerland.

Prior to the closing of the Vitec Transaction, our sales activities of the Video Solutions Business in the United States operated directly and through Optibase Inc., which managed our North American sales, marketing and customer support activities and the sales activities in Europe (including Israel) were conducted through sales managers. Our real estate activity is managed through several subsidiaries held directly and indirectly by Optibase Ltd. or its abovementioned subsidiaries.

In addition, we held approximately 2.04% of Mobixell's issued and outstanding share capital. As of December 31, 2012, such investment was written off completely in our financial reports for 2012. For additional information, see Item 4.A. "History and Development of the Company" above.

#### **4.D. PROPERTY, PLANTS AND EQUIPMENT**

Since December 2011, our headquarters are located in offices occupying approximately 1,399 square feet in Herzliya Pituach, Israel. Our lease for this space expires on December 24, 2013 with four consecutive 24-month extension options.

Our European subsidiaries occupy offices totaling approximately 646 square feet in Luxembourg. The current leases do not have an expiration date and can be terminated at any time with a three months prior notice.

#### **ITEM 4A. UNRESOLVED STAFF COMMENTS**

None.

#### **ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

*The following discussion and analysis about our financial condition and results of operations contain forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from the results discussed in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those set forth under "Item 3.D. Risk Factors" above and "Item 5.D. Trend Information" below, as well as those discussed elsewhere in this annual report. You should read the following discussion and analysis in conjunction with the "Selected Consolidated Financial Data" and the Consolidated Financial Statements included elsewhere in this annual report.*

##### **Overview**

Since our foundation we were engaged in the Video Solution Business. We sold that business to Vitec in July 2010 and we are currently engaged in the real estate sector.

Since then, we have entered into six real estate transactions:

- the acquisition of a stake in an office building located at 485 Lexington Avenue in Manhattan, New York, which was terminated;
- the acquisition of a commercial building located in Rümlang, Switzerland;
- the acquisition of 21 apartments in a residential property located in Miami, Florida;
- the acquisition of a 51% stake in a Swiss company holding a commercial property in Geneva, Switzerland;
- the acquisition of approximately 20% beneficial interest in the owner of a commercial office building in Philadelphia;
- the acquisition of an approximately 4% beneficial interest in a portfolio of shopping centers in Texas.

For further information, see Item 4.B "Business Overview".

Our consolidated financial statements are presented in accordance with generally accepted accounting principles in the U.S., or U.S. GAAP.

Our functional currency is the U.S dollar.

The functional currencies of our subsidiaries are CHF and U.S dollar. We have elected to use the U.S. dollar as our reporting currency for all years presented.

While the functional currency of our subsidiaries in the United States is the U.S dollars, the functional currency of the subsidiaries in Switzerland is their lead currency, *i.e.* CHF. Since our functional and reporting currency is the U.S dollars, the financial statements of Optibase Real Estate SARL and OPCTN S.A whose functional currency has been determined to be CHF have been translated into U.S. dollars. Assets and liabilities of this subsidiary are translated at the year-end exchange rates and their statement of operations items are translated using the actual exchange rates at the dates on which those items are recognized. Such translation adjustments are recorded as a separate component of accumulated other comprehensive income in shareholders' equity.

As of December 31, 2012, we had available cash, cash equivalents, long term investments, restricted cash and other financial investments net of approximately \$19.3 million. As of March 5, 2013, we have available cash, cash equivalents, long term investments, restricted cash and other financial investments net of approximately \$20.6 million. For information regarding the investment of our available cash, see Item 5.B. "Liquidity and Capital Resources" below.

Our business may be affected by the condition in Israel, see Item 3.D. "Risk Factors".

*Fixed income from real estate rent*

Fixed income real-estate consists primarily of revenues derived from real estate properties, held through our subsidiaries, in Switzerland (Rümlang and Geneva) and Miami.

*Cost of real estate operations*

Cost of real estate operations consist primarily of direct costs associated with operating the real estate properties such as building insurance, management company fees and property tax.

*Real estate depreciation and amortization*

Real estate depreciation and amortization consist primarily of depreciation expenses related to the value of properties net of amounts accounted for land, as well as amortization expenses associated with intangible assets derived from the purchase of real estate properties.

*General and administrative expenses*

General and administrative expenses consist primarily of fees to outside consultants, legal and accounting fees, expenses related to the purchase of real estate assets, stock option compensation charges and certain office maintenance costs.

*Bargain purchase gain*

Bargain purchase gain consists of bargain purchase gain represents the excess of 100% of the recognized bases of identifiable assets acquired, net of assumed liabilities, over the aggregate of the acquisition-date fair values of (1) the acquirer's interest in the acquiree, (2) any noncontrolling interests in the acquiree and (3) any equity interest held in the acquiree by the acquirer immediately before the acquisition date.

*Equity share in earnings (losses) of associates, net*

Associates in which we have significant influence over the financial and operating policies without having control are accounted for using the equity method of accounting, accordingly we recorded during 2012 an equity loss in associate of our holdings of Two Penn Center Plaza in Philadelphia, Pennsylvania.

#### Other loss

Other income (expenses), net, consists of impairment expenses.

#### Financial income (expenses), Net

Financial expenses consist primarily of interest we paid in connection with bank loans and credit lines, currency hedging transactions, and losses from realization of securities and financial instruments. Financial income consists mainly of interest received on deposits and other financial assets held in our bank accounts and gains from realization of securities and financial instruments. Our exchange differences occur primarily as a result of the change of the NIS value relative to the U.S. dollar and to the CHF.

#### Taxes

As of 2012, Israeli companies are generally subject to a corporate income tax rate of 25%. The income tax rate for Israeli companies was increased to 25% in 2012 and thereafter.

Taxable income of Luxemburg, Switzerland and the United States is subject to tax at the rate of approximately 29%, 24% and 35% respectively in 2012.

We have final tax assessments through the tax year 2008.

As of December 31, 2012, we had approximately \$67.5 million of net operating loss carry-forwards for Israeli tax purposes. These net operating loss carry-forwards have no expiration date. Optibase Inc. had U.S. federal net operating loss carry-forward of approximately \$28.5 million that can be carried forward and offset against taxable income for 20 years, no later than 2012 to 2032. Utilization of U.S. net operating losses may be subject to the substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code of 1986, and similar state provisions. The annual limitation may result in the expiration of net operating losses before utilization.

#### Discontinued operations

The results of operations of Video Solutions Business which was sold pursuant to the Vitec Transaction were reported separately and retroactively as discontinued operations in the consolidated statements of income.

#### Net Income Attributable to Non-Controlling Interest.

Net income attributed to non-controlling interest following the acquisition of the CTN property in Geneva, Switzerland in March 2011. We have entered the said transaction with The Phoenix group, who owns 49% of the property. Thus, 49% of the net operating results of the property are attributed to them.

#### 5.A. OPERATING RESULTS

The following table sets forth, for the years ended December 31, 2010, 2011 and 2012 statements of operations data as percentages of our total revenues:

	Year Ended December 31		
	2010	2011	2012
Fixed income real estate	100.0%	100.0%	100.0%
Costs and expenses:			
Cost of real estate operations	3.6	15	14.4
Real estate depreciation and amortization	42.1	17.3	18.8
General and administrative	91	24.5	15.1
Total costs and expenses	136.7	56.8	48.3
Operating income (loss)	(36.7)	43.2	51.7
Gain on bargain purchase	-	35.5	-
Equity share in earnings (losses) of associates, net	-	-	(0.2)
Other income (expenses), net	(36.4)	-	(0.7)
Financial (expenses) income, net	18.4	(60)	(9.1)
Income (loss) before provision for tax	(54.7)	18.7	41.7
Provision for tax	(2.6)	(3.9)	(12)
Net income (loss) from continuing operations	(57.3)	14.8	29.7
(Loss) income from Discontinued Operations	327.2	(0.4)	-
Net income	269.9	14.4	29.7
Attributable to non controlling interest	-	16.3	18.1
Net income (loss) attributable to Optibase	269.9	(1.9)	11.6



## Results of Operations for the Years Ended 2012 and 2011

*Fixed income from real estate rent.* Our fixed income real estate revenues increased to \$13.7 million in 2012 compared to \$12.5 million in 2011, mainly due to the fact that since the purchase date of the CTN complex in Geneva which occurred in March 2011, our results of operations from the CTN complex during 2011 were accounted for a period of 10 months only, compared to a 12 months period during 2012.

*Cost of real estate operations.* Our cost of real estate operation increased in 2012 to \$2 million compared to \$1.9 million in 2011. Such costs increased in 2012 mainly due to the fact that since the purchase date of the CTN complex in Geneva which occurred in March 2011, our results of operations from the CTN complex during 2011 were accounted for a period of 10 months only, compared to a 12 months period during 2012.

*Real estate depreciation and amortization.* Our real estate depreciation and amortization in 2012 increased to \$2.6 million compared to \$2.2 million in 2011. Such costs increased in 2012 mainly due to the fact that since the purchase date of the CTN complex in Geneva which occurred in March 2011, our results of operations from the CTN complex during 2011 were accounted for a period of 10 months only, compared to a 12 months period during 2012.

*General and Administrative Expenses.* General and administrative expenses decreased to \$2.1 million in 2012 from \$3.1 million in 2011. The decrease can be mainly attributed to costs associated with the purchase of the CTN complex in Geneva, Switzerland in March 2011.

*Operating Income.* As a result of the foregoing, we recorded operating income of \$7.1 million in 2012 compared with an operating income of \$5.4 in 2011. The increase in our operating income in 2012 is mainly due to the fact that since the purchase date of the CTN complex in Geneva which occurred in March 2011, our results of operations from the CTN complex during 2011 were accounted for a period of 10 months only, compared to a 12 months period during 2012.

*Gain on bargain purchase.* We recorded a \$4.4 million gain on bargain purchase associated with the acquisition of the CTN complex in Geneva, Switzerland in March 2011.

*Equity share in earnings (losses) of associates, net.* We recorded \$32,000 equity loss associated with the acquisition of the Two Penn Center Plaza in Philadelphia, Pennsylvania in October 2012.

*Other loss.* We recorded other loss, net of \$100,000 in 2012 related to the impairment of our remaining investment in Mobixell.

*Financial Expenses, Net.* We recorded financial expenses, net of \$1.2 million in 2012, compared with financial expenses, net of \$7.5 million in 2011. The change can be mainly attributed to decreases payments of loans, interest SWAP transaction, currency SWAP transaction as well as foreign currency translation differences.

*Taxes on Income.* We and our subsidiaries account for income taxes in accordance with ASC Topic 740 "Income Taxes", or ASC 740. Under the requirements of ASC 740, we reviewed all of our tax positions and determined whether the position is more-likely-than-not to be sustained upon examination by regulatory authorities. Accordingly, we recorded tax expenses of \$1.6 million and \$481,000 in 2012 and 2011 respectively, both related to our Luxemburg subsidiaries. The increase in our tax expenses in 2012 compared to 2011, is mainly due to the increase in deferred taxes expenses associated with the purchase of the CTN complex in Geneva, Switzerland in March 2011.

*Net Income from Continuing Operations.* We recorded net income of \$4.1 million in 2012, compared with a net loss of \$1.9 million in 2011. The increase in our net income from continuing operations is mainly due to the fact that since the purchase date of the CTN complex in Geneva which occurred in March 2011, our results of operations from the CTN complex during 2011 were accounted for a period of 10 months only, compared to a 12 months period during 2012.

*Discontinued Operation.* We present the results of our previous operations in the Video Solutions Business which was sold pursuant to the Vitec Transaction as discontinued operations. We recorded net loss of \$51,000 from discontinued operations in 2011. Our net loss from discontinued operations in 2011 is mainly attributed to finalizing matters related to our previous headquarters lease agreement.

*Net Income.* We recorded net income of \$4.1 million in 2012, compared with a net income of \$1.8 million in 2011. The increase in our net income is mainly due to the fact that since the purchase date of the CTN complex in Geneva which occurred in March 2011, our results of operations from the CTN complex during 2011 were accounted for a period of 10 months only, compared to a 12 months period during 2012.

*Net Income Attributable to Non-Controlling Interest.* Net income attributed to non-controlling interest was first recorded in 2011 following the acquisition of the CTN property in Geneva, Switzerland in March 2011. We have entered the said transaction with The Phoenix group, who owns 49% of the property. Thus, 49% of the net operating results of the property are attributed to them.

*Net income (loss) attributable to Optibase Ltd.* Net income (loss) attributed to Optibase Ltd., is the result of net income as effected by net income attributed to non-controlling interest.

#### **Results of Operations for the Years Ended 2011 and 2010**

*Fixed income from real estate rent.* Our fixed income real estate revenues increased substantially to \$12.5 million in 2011 compared to \$1.65 million in 2010 (principally, due to the purchase of the CTN complex in Geneva, Switzerland in March 2011).

*Cost of real estate operations.* Our cost of real estate operation increased substantially in 2011 at \$1.9 million compared to \$59,000 in 2010. Such costs increased substantially in 2011 following the purchase of the CTN complex in Geneva, Switzerland in March 2011.

*Real estate depreciation and amortization.* Our real estate depreciation and amortization in 2011 increased significantly to \$2.2 million compared to \$695,000 in 2010. Such costs increased substantially in 2011 following the purchase of the CTN complex in Geneva, Switzerland in March 2011.

*General and Administrative Expenses.* General and administrative expenses increased to \$3.1 million in 2011 from \$1.5 million in 2010. The increase in dollar amount can be mainly attributed to general and administrative expenses related to the real estate operation as well as costs associated with the purchase of the CTN complex in Geneva, Switzerland in March 2011.

*Operating Income.* As a result of the foregoing, we recorded operating income of \$5.4 million in 2011 compared with an operating loss of \$606,000 in 2010. The decrease in the operational loss and the turn to operating income can be primarily attributed to the overall increase in our revenues.

*Gain on bargain purchase and Other Income.* We recorded \$4.4 million gain on bargain purchase associated with the acquisition of the CTN complex in Geneva, Switzerland in March 2011.

*Other Income.* We recorded other loss, net of \$600,000 in 2010 related to the impairment of our investment in Mobixell.

*Financial Expenses, Net.* We recorded financial expenses, net of \$7.5 million in 2011, compared with financial income, net of \$304,000 in 2010. The change can be mainly attributed to interest payments of loans, interest SWAP transaction, currency SWAP transaction as well as foreign currency translation differences.

*Taxes on Income.* We and our subsidiaries account for income taxes in accordance with ASC Topic 740 "Income Taxes", or ASC 740. Under the requirements of ASC 740, we reviewed all of our tax positions and determined whether the position is more-likely-than-not to be sustained upon examination by regulatory authorities. Accordingly, we recorded tax expenses of \$481,000 and \$43,000 in 2011 and 2010 respectively, both related to our Luxemburg subsidiaries. The increase in our tax expenses in 2011 compared to 2010, is mainly due to the increase in taxable income associated with the purchase of the CTN complex in Geneva, Switzerland in March 2011.

*Net Income from Continuing Operations.* We recorded net income of \$1.9 million in 2011, compared with a net loss of \$945,000 in 2010. The increase in our net loss from continuing operations and our turn to net income, can be mainly attributed to the overall increase in revenues in 2011 as well as gain on bargain purchase which was offset by increased financial expenses.

*Discontinued Operation.* We present the results of our previous operations in the Video Solutions Business which was sold pursuant to the Vitec Transaction as discontinued operations. We recorded net loss of \$51,000 from discontinued operations in 2011 compared with net income of \$5.4 million from discontinued operation in 2010. Our net loss from discontinued operations in 2011 is mainly attributed to finalizing matters related to our previous business, whereas our net operation income from discontinuing operation in 2010 was mainly attributed to the capital gain resulting from this transaction of approximately \$6.3 million.

*Net Income.* We recorded net income of \$1.8 million in 2011, compared with a net income of \$4.5 million in 2010. The decrease in our net income can be mainly attributed to the capital gain of approximately \$6.3 million in 2010 resulting from the Vitec Transaction.

*Net Income Attributable to Non-Controlling Interest.* Net income attributed to non-controlling interest was first recorded in 2011 following the acquisition of the CTN property in Geneva, Switzerland in March 2011. We have entered the said transaction with The Phoenix group, who owns 49% of the property. Thus, 49% of the net operating results of the property are attributed to them.

*Net income (loss) attributable to Optibase Ltd.* Net income (loss) attributed to Optibase Ltd., is the result of net income as effected by net income attributed to non-controlling interest.

#### **Critical Accounting Policies**

Our consolidated financial statements are prepared in accordance with U.S. GAAP. These accounting principles require management to make certain estimates, judgments and assumptions based upon information available at the time that they are made, historical experience and various other factors that are believed to be reasonable under the circumstances. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenues and expenses during the periods presented.

In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management's judgment in its application. There are also areas in which management's judgment in selecting among available alternatives would not produce a materially different result. Our management reviewed these critical accounting policies and related disclosures with our audit committee. See Note 2 to our Consolidated Financial Statements, which contain additional information regarding our accounting policies and other disclosures required by U.S. GAAP.

Our management believes the significant accounting policies which affect management's more significant judgments and estimates used in the preparation of our consolidated financial statements and which are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

- ❖ Long-lived assets including intangible assets
- ❖ Investment in companies
- ❖ Goodwill and bargain purchase gain
- ❖ Contingencies; and
- ❖ Income Taxes.

*Long-Lived Assets including intangible assets*

The Company and its subsidiaries long-lived assets are reviewed for impairment in accordance with ASC 360, "Property, Plant and Equipment", whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

The Company reviewed assets on a component-level basis, which is the lowest level of assets for which there are identifiable cash flows that can be distinguished operationally and for financial reporting purposes. The carrying amount of the asset group was compared with the related expected undiscounted future cash flows to be generated by those assets over the estimated remaining useful life of the primary asset. In cases where the expected future cash flows were less than the carrying amounts of the assets, those assets were considered impaired and written down to their fair values. Fair value was established based on discounted cash flows. As of December 31, 2010 and 2011, no impairment losses have been identified.

*Investment in companies*

Investments in non-marketable equity securities of companies in which the Company does not have control or the ability to exercise significant influence over their operation and financial policies are recorded at cost.

Management evaluates investments in non-marketable equity securities for evidence of other-than temporary declines in value. When relevant factors indicate a decline in value that is other-than temporary the Company recognizes an impairment loss for the decline in value.

*Goodwill and bargain purchase gain*

Goodwill reflects the excess of the fair value of the acquired business over the fair value of net identifiable assets acquired in various business acquisitions. The Company accounts for goodwill in accordance with the Intangibles - Goodwill and Other Topic of the FASB ASC 350. A bargain purchase gain, represents the excess of 100% of the recognized bases of identifiable assets acquired, net of assumed liabilities, over the aggregate of the acquisition-date fair values of (1) the acquirer's interest in the acquiree, (2) any noncontrolling interests in the acquiree and (3) any equity interest held in the acquiree by the acquirer immediately before the acquisition date.

### *Business Combinations*

We allocate the purchase price of acquired properties to land, building, intangible assets and other liabilities in accordance with the Business Combinations Topic of the FASB ASC 805-10. We allocate the initial purchase price of assets acquired (net tangible and identifiable intangible assets) and liabilities assumed based on their relative fair values at the date of acquisition. There are two categories of intangible assets to be considered: (1) in-place leases; (2) above and below-market value of in-place leases. The aggregate value of other acquired intangible assets, consisting of in-place leases, is measured by the excess of (i) the purchase price paid for a property after adjusting existing in-place leases to market rental rates over (ii) the estimated fair value of the property as-if-vacant, determined as set forth above. The value of in-place leases exclusive of the value of above-market and below-market in-place leases is amortized to depreciation expense over the estimated remaining term of the respective leases. The value of above-market and below-market in-place leases is amortized to rental revenue over the estimated remaining term of the leases. If a lease were to be terminated prior to its stated expiration, all unamortized amounts relating to that lease would be written off. Other than as discussed above, we have determined that our real estate properties do not have any other significant identifiable intangibles. The results of operations of acquired properties are included in our financial statements as of the dates they are acquired. The intangible assets and liabilities associated with property acquisitions are included in other assets and other liabilities in our consolidated balance sheets.

### *Contingencies*

We periodically estimate the impact of various conditions, situations and/or circumstances involving uncertain outcomes to our financial condition and operating results. These events are called "contingencies", and the accounting treatment for such events is prescribed by the ASC 450 "Contingencies". ASC 450 defines a contingency as "an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur". Legal proceedings are a form of such contingencies.

In accordance with ASC 450, accruals for exposures or contingencies are being provided when the expected outcome is probable. It is possible, however, that future results of operations for any particular quarter or annual period could be materially affected by changes in our assumptions, the actual outcome of such proceedings or as a result of the effectiveness of our strategies related to these proceedings.

### *Income Taxes*

The Company and its subsidiaries accounts for income taxes in accordance with ASC Topic 740, "Income Taxes" or ASC 740, which prescribes the use of the liability method, whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company and its subsidiaries provide a valuation allowance, if necessary, to reduce deferred tax assets to amounts more likely than not to be realized.

ASC 740 clarifies the accounting for uncertainties in income taxes by establishing minimum standards for the recognition and measurement of tax positions taken or expected to be taken in a tax return. Under the requirements of ASC 740, the Company must review all of its tax positions and make a determination as to whether its position is more-likely-than-not to be sustained upon examination by regulatory authorities. If a tax position meets the more-likely-than-not standard, then the related tax benefit is measured based on a cumulative probability analysis of the amount that is more-likely-than-not to be realized upon ultimate settlement or disposition of the underlying issue. Our policy is to accrue interest and penalties related to unrecognized tax benefits in its financial expenses. No adjustments were required upon the initial implementation of this guidance.

## Recent Accounting Pronouncements

There was no impact of new accounting standards during 2012.

## 5.B. LIQUIDITY AND CAPITAL RESOURCES

We have funded our operations primarily through private and public sales of our equity securities, banks credit, and until closing of the Vitec Transaction we also received research and development grants from, among others, the Commission of the European Union and the OCS. As of December 31, 2012, we had cash and cash equivalents, long term investments, restricted cash and other financial investments net of \$19.3 million.

As of March 5, 2013, we have available cash, and cash equivalents of approximately \$20.6 million.

Net cash provided by our operating activities was \$6.8 million, \$1.8 million and \$183,000 in December 31 of each of the years 2012, 2011 and 2010, respectively.

Net cash provided by operating activities in 2012 was primarily the result of our net income for the period, as adjusted for, depreciation and amortization, minority interests in earnings of a subsidiary, decrease in other accounts receivable and prepaid expenses and trade receivables, net, partially offset by the decrease in long term liabilities and decrease in accrued expenses and other accounts payables. Net cash provided by operating activities in 2011 was primarily the result of our net loss for the period, as adjusted for discontinued operations, depreciation and amortization, minority interests in earnings of a subsidiary, increase in trade receivables, net, increase in other long-term liabilities, decrease in other accounts receivable and prepaid expenses partially offset by a gain from a bargain purchase, increase in deferred tax liabilities and a decrease in accrued expenses and other accounts payables. Net cash provided by operating activities in 2010 was primarily the result of our net income for the period, as adjusted for discontinued operations including capital gain resulting from completion of the Vitec Transactions, transaction compensation related to the grant of option and unvested shares, depreciation and amortization, impairment of an investment in Mobixell partially offset by the decrease in accrued expenses and other accounts payables.

Net cash used in investing activities in 2012 totaling \$8.2 million reflects primarily the two additional investments we have entered into during 2012, the acquisition of an approximately 20% beneficial interest in the owner of a Class A 20-story commercial office building in Philadelphia known as Two Penn Center Plaza, and the acquisition of approximately 4% beneficial interest in a portfolio of shopping centers in Texas. Net cash used in investing activities in 2011 totaling \$23 million reflects primarily the acquisition of Eldista, the owner of the CTN complex in Geneva, Switzerland, totaling \$20.7 million, investment in real estate properties totaling \$1.2 million and investment in short term deposits totaling \$1.1 million. Net cash provided from investing activities in 2010 reflects primarily the proceeds from Vitec Transaction totaling \$6.8 million, proceeds from short term deposit repayment totaling \$3.8 million primarily offset by investment in real estate totaling \$8.8 million.

Net cash provided from financial activities in 2012 was primarily the result of a repayment of a long term loan totaling \$2.55 million and of a repayment of loan to non-controlling interest totaling \$53,000. Net cash provided from financial activities in 2011 was primarily the result of proceeds of a long term loan totaling \$106.4 million received for re-financing of our investment in real estate in Geneva, Switzerland, a private placement of 500,000 of our ordinary shares to Mr. Shlomo (Tom) Wyler, our president and a member of our board of directors, in consideration for \$5 million in cash, offset by repayment of a long term loan totaling \$91.8 million and by repayment of loan to non-controlling interest totaling \$5.6 million. Net cash used in financial activities in 2010 totaling \$ 406,000 was primarily the result of repayments of a long term loan.

During 2012, we invested our available cash solely in interest bearing bank deposits and money market funds with various banks. As of the date hereof, we do not have any material contractual commitments related to capital expenditure.

On October 28, 2011, we entered into a CHF 100 million bank loan refinancing with Credit Suisse for the CTN office building complex in Geneva, Switzerland. The refinancing was undertaken by OPCTN and by OPCTN's subsidiary, Eldista which is the owner of the CTN Complex. As of the refinancing date the refinancing increased our overall liquidity and reduced principal payments by a total of CHF 3.75 million over the next four years period. Based on current interest rates and net of loan expenses, we also expect a reduction of interest expenses by approximately CHF 2.1 million, resulting in an overall expected improvement to cash flows due to the refinancing of approximately CHF 5.8 million for the four years period.

We believe that, considering the use of cash in our ongoing operations, together with the existing sources of liquidity described above, our current cash, cash equivalents and marketable securities will be sufficient to meet our needs for cash for at least the next 12 months. However, our liquidity and capital requirements are affected by many factors, some of which are based on the normal ongoing operations of our businesses and some of which arise from uncertainties related to global economies and the markets that we target for our services. In addition, we routinely review potential acquisitions. If we grow more rapidly than currently anticipated, it is possible that we would require more funds than anticipated. In that event, we would likely seek additional equity or debt financing, although we cannot assure you that we would be successful in obtaining such financing on favorable terms or at all.

#### **5.C. RESEARCH AND DEVELOPMENT**

For grants received from certain entities, see Item 4.B. "Business Overview - Research and Development" above.

#### **5.D. TREND INFORMATION**

Starting in 2008 the global economic downturn caused a slowdown in the real estate market. In the later part of 2008 and through 2010, banks have lowered interest rates, but at the same time were reluctant to provide financing or perform refinancing of existing debt. Although interest rates have increased during 2011, banks are still reluctant to provide financing or perform refinancing of existing debt. Moreover, in the past few years, several European countries were experiencing difficulties refinancing their governmental debts. Such difficulties influenced the European and entire world economy, and eventually brought to a sovereign debt crisis in Europe during 2011.

In 2012, the economy showed signs of improvement, but recovery has been slow and volatile. Furthermore, severe financial and structural strains on the banking and financial systems have led to significant lack of trust and confidence in the global credit and financial system. Consumers and money managers have liquidated and may liquidate equity investments, and consumers and banks have held and may hold cash and other lower-risk investments, resulting in significant declines in the equity capitalization of companies and failures of financial institutions.

Recent U.S. debt ceiling and budget deficit concerns have increased the possibility of additional downgrades of sovereign credit ratings and economic slowdowns. In August 2011, Standard & Poor's Ratings Services lowered its long-term sovereign credit rating on the U.S. from "AAA" to "AA+". The impact of this or any further downgrades to the U.S. government's sovereign credit rating, or its perceived creditworthiness, is inherently unpredictable and could adversely affect the U.S. and global financial markets and economic conditions. These developments, and the U.S. government's credit concerns in general, could cause interest rates and borrowing costs to rise. In addition, the lowered credit rating could create broader financial turmoil and uncertainty. In addition, during 2012 the pressure on properties pricing appears to have eased somewhat and the real estate market was showing some tentative signs of stabilization. Economically, that had been supported by moderate job growth, record housing affordability and fewer distressed property sales.

In addition, the Swiss economy led to a slight increase in demand in the office property market in 2011. In particular, Switzerland remains an attractive location for international service providers and corporate headquarters. There is also still a demand for high-quality, modern spaces, which ultimately allows for a certain stability on the rent level. However, while jobs were still being created at the beginning of 2011, the Swiss economy slowed down and consumer sentiment dimmed somewhat in the second half of the year. Towards the end of the year, the demand for office space slowed down due to announced and expected job losses. During 2012, as Swiss interest rates remained low, the Swiss real estate prices remained stable but at the same time there was no increase in the demand for new rental spaces and the rental market seems to be slowing down.

Our financial income is affected by changes in the 6-month Libor rate, see Item 3.D. "Risk Factors - Risks Relating to the Economy, Our Financial Condition and Shareholdings" above.

Since the quarter ended June 30, 2004 and except for several non-continuous quarters during 2009 and 2010 and 2011, we operated at a loss. During 2012, except for the second quarter, we have been profitable.

#### 5.E. OFF-BALANCE SHEET ARRANGEMENTS

There are no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

#### 5.F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

Set forth below are our contractual obligations and other commercial commitments as of December 31, 2012:

Contractual Obligations	Payments Due by Period (USD in thousands)				
	Total	Less than 1 year	1- 3 years	4-5 years	After 5 years
Long-Term Debt	126,895	2,597	7,791	5,194	111,313
Capital Lease Obligations	7,289	78	235	156	6,819
Lease Obligations	67	57	10	--	--
Purchase Obligations	--	--	--	--	--
Severance pay	--	--	--	--	--
Other Long-Term Obligations	--	--	--	--	--
Total Contractual Cash Obligations	134,251	2,732	8,036	5,350	118,132

Other Commercial Commitments	Amount of Commitment Expiration Per Period (USD in thousands)				
	Total	Less than 1 year	1- 3 years	4-5 years	After 5 years
Lines of Credit	--	--	--	--	--
Standby Letters of Credit	--	--	--	--	--
Guarantees	134	--	134	--	--
Standby Repurchase Obligations	--	--	--	--	--
Other Commercial Commitments	--	--	--	--	--
Total Commercial Commitments	134	--	134	--	--



## ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

### 6.A. DIRECTORS AND SENIOR MANAGEMENT

The following table sets forth information with respect to the individuals who are currently our directors and executive officers. All of these individuals are presently serving in the respective capacities described below:

Name	Age	Position
Alex Hilman	60	Executive Chairman of the board of directors
Shlomo (Tom) Wyler	61	President and Director
Amir Philips	45	Chief Executive Officer
Yakir Ben-Naim	41	Chief Financial Officer
Orli Garti Seroussi (1)(2)(3)	52	Director
Danny Lustiger(1)(3)	45	Director
Chaim Labenski(1)(2)(3)	65	Director

- (1) Member of our audit committee  
(2) External director  
(3) Member of our compensation committee

On August 16, 2012 our shareholders approved the re-election of Shlomo (Tom) Wyler, Alex Hilman and Danny Lustiger, as directors of the Company.

**Shlomo (Tom) Wyler** serves as a president and a member our board of directors. Since his investment in us in September 2001 (then through Festin Management Corp.), Mr. Wyler has served in various senior executive positions. His other areas of involvement include investment banking, foreign exchange, financial futures and real-estate. In the early 1990s, Mr. Wyler turned his efforts to real estate interests. Mr. Wyler holds a Masters degree in Business Economics from the University of Zurich.

**Amir Philips** serves as our Chief Executive Officer. Mr. Philips has been serving in this position since June 2011. Prior to this position, Mr. Philips served as our Chief Financial Officer from May 2007, and as Vice President Finance of Optibase Inc. from July 2004. From 2000 until 2004, Mr. Philips held the position of Group Controller and Financial Manager at Optibase Ltd. Before joining Optibase, Mr. Philips was an accountant and auditor at Lotker Stein Toledano and Co., currently a member of BDO Ziv Haft. Mr. Philips is a Certified Public Accountant in Israel. He holds an MBA from the Kellogg-Recanati School of Business and a B.B. degree in Accounting and Business Management from the Israeli College of Management.

**Yakir Ben-Naim** serves as our Chief Financial Officer. Ms. Ben-Naim has been serving in this position since June 2011. From 2004 until May 2011, Ms. Ben-Naim held the position of Corporate Controller and Financial Manager at Optibase Ltd. Before joining Optibase, Ms. Ben-Naim was a controller at V.Box Communications Ltd., and an accountant at Ernst & Young. Ms. Ben-Naim is a Certified Public Accountant in Israel.

**Alex Hilman** serves as Executive Chairman of our board of directors since September 2009. He has joined our board of directors in February 2002. Mr. Hilman is a partner in Hilman & Co., which provides auditing, tax and business consulting services to corporations. Mr. Hilman serves as a board member in other companies in Israel and abroad. Mr. Hilman was the president of the Israeli Institute of Certified Public Accountants in Israel, served on the board of IFAC, and is a member of the Small & Medium Practices committee in IFAC. Mr. Hilman has published professional works on tax and accounting, among them, The Israel Tax Guide. Mr. Hilman has also held professional and management positions at the Income Tax Department (Ministry of Finance) and lectured Taxation in Tel Aviv University. Mr. Hilman holds a B.A. in Accountancy and Economics from Tel-Aviv University.

**Orli Garti Seroussi** joined our board of directors on January 31, 2008 as an external director. Ms. Garti-Seroussi serves as Deputy Director and CFO of the Jerusalem Cinematheque - Israel Film Archive and as an external director of Athelon Ltd.. From August 2001 until June 2011, Ms. Garti-Seroussi served as the General Manager of the Bureau of Municipal Corporation in the municipality of Tel-Aviv Jaffa since August 2001. From June 1999 until July 2001 Ms. Garti-Seroussi served as manager of consulting department in Shif-Hazenfrats & Associates, CPA firm. Prior to that, Ms. Garti-Seroussi served as Deputy Director of the Department of Market Regulation in the Israel Securities Authority and as an Auditor in the Tel Aviv Stock Exchange. Ms. Garti-Seroussi holds an M.P.A from Harvard University and M.B.A degree and a B.A degree in economics and accounting from Tel Aviv University.

**Danny Lustiger** joined our board of directors in October 2009. Mr. Lustiger is the president and Chief Executive Officer of Cupron Inc. and has over 18 years of experience in various aspects of Hi-Tech industry at senior positions together with Real estate and infrastructure industries, experience at senior position in public companies. From 2007 until 2009, Mr. Lustiger served as the Chief Financial officer of Shikun & Binui Holdings Ltd. From 1996 and until 2005, Mr. Lustiger served at different managerial positions at Optibase including Chief Financial Officer. From 1993 to 1996 Mr. Lustiger held the position of an accountant and auditor at Igal Brightman & Co. (currently Brightman Almagor & Co., a member of Deloitte & Touche Tomatsu International). Mr. Lustiger is a Certified Public Accountant in Israel. Mr. Lustiger holds a B.A. degree in Accounting and Economics and an MBA in Finance and International management from the Tel-Aviv University.

**Chaim Labenski** joined our board of directors in December 2010. From 1977 to 1999, Mr. Labenski held a number of positions at Securities Division of Bank Hapoalim BM, including being First Vice president and Head of Foreign Securities and was involved in consulting, securities research, trading and I.P.O coordination with global investment houses. Since 1999 he acts as a private investor. Mr. Labenski holds a B.Sc degree in Civil Engineering from Astor University, U.K, a M.Sc degree in Engineering Management from Leeds University and D.B.A degree in Business Administration from Manchester Business School.

## **6.B. COMPENSATION**

The aggregate remuneration we paid to all directors as a group (five persons) who served in the capacity of director in the year ended December 31, 2012, was approximately \$134,000. Pursuant to the requirements of the Israeli Companies Law, remuneration of our directors generally requires shareholder approval.

Following the approval by our shareholders, each of our directors is entitled to an annual amount of US \$18,000. This remuneration is paid plus value added tax (as applicable). Directors are reimbursed for expenses incurred as part of their service as directors. None of the directors have agreements with us that provide for benefits upon termination of service.

Compensation and reimbursement of our external directors is determined pursuant to the Israeli Companies Law.

The aggregate direct cash compensation paid to our executive officers as a group (two persons) during 2012 was approximately \$326,000, including amounts paid to provide pension, retirement or similar benefits pursuant to standard Israeli plans but excluding amounts expended by us for vehicles made available to all of our officers, expenses reimbursed to officers and other fringe benefits commonly reimbursed or paid by companies in Israel.

As of December 31, 2012, seven persons served in the capacity as directors or executive officers in our Company and beneficially owned as of such date, options to purchase an aggregate of 57,786 ordinary shares which have not vested on December 31, 2012 or within 60 days thereafter. The exercise price of the options was between \$5.96 and \$10 per option, the vesting period is spread out over a 4-year period and the expiration date of such options is generally seven years as of their date of grant. In addition, as of March 1, 2013, our directors and executive officers beneficially owned 244,279 shares (of which 69,214 shares are issuable upon exercise of options that are currently vested or will vest within 60 days as of March 1, 2013). For further information, see item 6.E. "Share Ownership".

*Indemnification, exemption and insurance of Directors and Officers*

The Companies Law permits a company to insure its directors and officers, provide them with indemnification, either in advance or retroactively, and exempt its directors and officers from liability resulting from their breach of their duty of care towards the company, all in accordance with the terms and conditions specified under Israeli law. Our articles of association include clauses allowing us to provide our directors and officers with insurance, indemnification and to exempt them from liability subject to the terms and conditions set forth by the Companies Law, as described below.

In addition, the Israeli Securities Law of 1968, or the Securities Law, was recently amended to make the enforcement of violations of the Securities Law and certain provisions of the Companies Law more efficient by the Israel Securities Authority, or the ISA. Under these amendments, the ISA is allowed to initiate administrative proceedings against entities and individuals with respect to such violations, and to impose various sanctions, including fines, payment of damages to the person or entities harmed as a result of such violations, limitations on the service of any individual as director or officer and suspension or cancellation of certain permits granted to the entity. Under these amendments, a company is not allowed to indemnify or insure its directors and officers in connection with administrative proceedings initiated against them by the ISA, except that a company is allowed to insure and indemnify its directors and officers for any of the following: (i) financial liability imposed on any director or officer for payment to persons or entities harmed as a result of any violation for which an administrative proceedings has been initiated; (ii) expenses incurred by any director or officer in connection with administrative proceedings, including reasonable litigation fees, and including attorney fees.

Subject to statutory limitations, our articles of association provide that we may insure the liability of our directors and offices to the fullest extent permitted by the Companies Law. Without derogating from the aforesaid we may enter into a contract to insure the liability of our directors and officer for an obligation or payment imposed on such director or officer in consequence of an act done in his capacity as a director or officer of Optibase, in any of the following cases:

- ❖ A breach of the duty of care vis-a-vis us or vis-a-vis another person;
- ❖ A breach of the fiduciary duty vis-a-vis us, provided that the director or officer acted in good faith and had a reasonable basis to believe that the act would not harm us;
- ❖ A monetary obligation imposed on him or her in favor of another person;
- ❖ Financial liability imposed on him for payment to persons or entities harmed as a result of violations in Administrative Proceedings, as detailed in section 52(54)(A)(1)(a) of the Israeli Securities Law;
- ❖ Expenses incurred by him in connection with Administrative Proceedings (as defined above) he was involved in, including reasonable litigation fees, and including attorney fees; or
- ❖ Any other matter in respect of which it is permitted or will be permitted under applicable law to insure the liability of our director or officer.

Our articles of association further provide that we may indemnify our directors and officers, to the fullest extent permitted by the Companies Law. Without derogating from the aforesaid, we may indemnify our directors and officers for liability or expense imposed on them in consequence of an action made by them in the capacity of their position as directors or officers of Optibase, as follows:

- ❖ Any financial liability he or she incurs or imposed on him or her in favor of another person in accordance with a judgment, including a judgment given in a settlement or a judgment of an arbitrator, approved by a court.
- ❖ Reasonable litigation expenses, including legal fees, incurred by the director or officer or which he or she was ordered to pay by a court, within the framework of proceedings filed against him or her by or on behalf of Optibase, or by a third party, or in a criminal proceeding in which he or she was acquitted, or in a criminal proceeding in which he or she was convicted of a felony which does not require a finding of criminal intent.

- ❖ Reasonable litigation expenses, including legal fees he or she incurs due to an investigation or proceeding conducted against him or her by an authority authorized to conduct such an investigation or proceeding, and which was ended without filing an indictment against him or her and without being subject to a financial obligation as a substitute for a criminal proceeding, or that was ended without filing an indictment against him, but with the imposition of a financial obligation, as a substitute for a criminal proceeding relating to an offence which does not require criminal intent, within the meaning of the relevant terms in the Companies Law.
- ❖ Financial liability he or she incurs for payment to persons or entities harmed as a result of violations in Administrative Proceedings, as detailed in section 52(54)(A)(1)(a) of the Securities Law. For this purpose "Administrative Proceeding" shall mean a proceeding pursuant to Chapters H3 (Imposition of Monetary Sanction by the Israel Securities Authority), H4 (Imposition of Administrative Enforcement Means by the Administrative Enforcement Committee) or I1 (Settlement for the Avoidance of Commencing Proceedings or Cessation of Proceedings, Conditioned upon Conditions) of the Securities Law, as shall be amended from time to time.
- ❖ Expenses that he or she incurs in connection with Administrative Proceedings (as defined above) he was involved in, including reasonable litigation fees, and including attorney fees.
- ❖ Any other obligation or expense in respect of which it is permitted or will be permitted under law to indemnify a director or officer of Optibase.

In addition, our articles of association provide that we may give an advance undertaking to indemnify a director and/or an officer in respect of all of the matters above, provided that with respect to the first matter above, the undertaking is restricted to events, which in the opinion of our board of directors, are anticipated in light of our actual activity at the time of granting the obligation to indemnify and is limited to a sum or measurement determined by our board of directors as reasonable under the circumstances. We may further indemnify an officer therein, save for the events subject to any applicable law.

Our articles of association further provide that we may exempt a director in advance and retroactively for all or any of his or her liability for damage in consequence of a breach of the duty of care vis-a-vis Optibase, to the fullest extent permitted by the Companies Law. Notwithstanding the foregoing, the Companies Law prohibits a company to exempt any of its directors and officers in advance from their liability towards such company for the breach of its duty of care in distribution, as defined in the Companies Law, for such company's shareholders (including distribution of dividend and purchase of such company's shares by the company or an entity held by it).

The above provisions with regard to insurance, exemption and indemnity are not and shall not limit the Company in any way with regard to its entering into an insurance contract and/or with regard to the grant of indemnity and/or exemption in connection with a person who is not an officer of the Company, including employees, contractors or consultants of the Company, all subject to any applicable law.

All of the above shall apply *mutatis mutandis* in respect of the grant of insurance, exemption and/or indemnification for persons serving on behalf of the Company as officers in companies controlled by the Company, or in which the Company has an interest.

The Companies Law provides that companies may not give insurance, indemnification (including advance indemnification), or exempt their directors and/or officers from their liability in the following events:

- ❖ a breach of the fiduciary duty, except for a breach of the fiduciary duty vis-à-vis the company with respect to indemnification and insurance if the director or officer acted in good faith and had a reasonable basis to believe that the act would not harm the company;
- ❖ an intentional or reckless breach of the duty of care, except for if such breach was made in negligence;

- ❖ an act done with the intention of unduly deriving a personal profit; or
- ❖ a fine imposed on the directors or officers.

We have a directors and officers liability insurance policy, as described below.

On August 16, 2012, following the approval by our audit committee and board of directors, our shareholders approved the future purchase by the Company of an insurance policy for directors' and officers' liability, including as directors or officers of the Company's subsidiaries, in substantially the same terms and conditions as the existing policy, for the period commencing on August 1, 2013 and ending on July 31, 2014. The maximum coverage amount under such policy and the maximum yearly premium to be paid by the Company for such policy shall not exceed US \$10,000,000 and US \$80,000, respectively.

We have undertaken to indemnify our directors and officers to the fullest extent permitted by the Companies Law and our articles of association and entered into an indemnity letter with each of our directors and executive officers. The aggregate indemnification amount shall not exceed the higher of: (i) 25% of our shareholders' equity, as set forth in our financial statements prior to such payment; or (ii) \$7.5 million.

On November 17, 2011, our shareholders approved an amendment to the letters of indemnification issued by us to all of our directors and officers, with respect to recent amendments to the Israeli Securities Law, in connection with administrative proceedings.

Optibase, Inc. has also undertaken to indemnify its directors and officers to the maximum extent and in a manner permitted by the California Corporation Code and entered into an indemnity letter with each of its directors and officers, subject to similar limitations. The aggregate indemnification amount shall not exceed the higher of: (i) 25% of the shareholders' equity of Optibase, Inc., as set forth in Optibase, Inc.'s financial statements prior to such payment; or (ii) \$7.5 million.

## **6.C. BOARD PRACTICES**

Pursuant to our articles of association, our board of directors is required to consist of three to nine members. Directors are elected at the annual general meeting of our shareholders by a vote of the holders of a majority of the voting power represented at such meeting. Each director holds office until the annual general meeting of shareholders following the annual general meeting at which the director was elected or until his or her earlier resignation or removal. A director may be re-elected for subsequent terms. At present, our board of directors consists of five members, including two external directors appointed in accordance with the Israeli law requirements, as detailed herein. Our articles of association provide that our directors may at any time and from time to time, appoint any other person as a director, either to fill in a vacancy or to increase the number of members of our board of directors.

Under the Companies Law, each Israeli public company is required to determine the minimum number of directors with "accounting and financial expertise" that such company believes is appropriate in light of the particulars of such company and its activities. A director with "accounting and financial expertise" is a person that, due to education, experience and qualifications, is highly skilled and has an understanding of business-accounting issues and financial statements in a manner that enables him/her to understand in depth the company's financial statements and stimulate discussion regarding the manner of presentation of the financial data. Our board of directors resolved on March 30, 2006 and on June 27, 2010 that the minimum number of directors with accounting and financial expertise appropriate for us in light of the size of the board of directors and nature and volume of the Company's operations is one director (such director may serve as an external director, see below).

### **External Directors**

Under the Companies Law, Israeli public companies are required to appoint at least two external directors to serve on their board of directors. Our shareholders approved in December 2010 the appointment of Mr. Chaim Labenski and the reappointment of Ms. Orli Garti-Seroussi as our external directors as of December 29, 2010 and as of January 31, 2011, respectively, for a three-year term. In addition, each committee of the board of directors entitled to exercise any powers of the board is required to include at least one external director. The audit committee must include all the external directors, see "Committees of the Board of Directors" below.

Pursuant to the Companies Law at least one external director is required to have "accounting and financial expertise" and the other is required to have "professional qualification" or "accounting and financial expertise". A director has "professional qualification" if he or she satisfies one of the following:

- (i) the director holds an academic degree in one of these areas: economics, business administration, accounting, law or public administration;
- (ii) the director holds an academic degree or has other higher education, all in the main business sector of the company or in a relevant area for the board position; or
- (iii) the director has at least five years' experience in one or more of the following or an aggregate five years' experience in at least two or more of these: (a) senior management position in a corporation of significant business scope; (b) senior public office or senior position in the public sector; or (c) senior position in the main business sector of the company.

A director with "accounting and financial expertise" is a person that in light of his or her education, experience and skills has high skills and understanding of business-accounting issues and financial reports which allow him or her to deeply understand the financial reports of the company and hold a discussion relating to the presentation of financial information. The company's board of directors will take into consideration in determining whether a director has "accounting and financial expertise", among other things, his or her education, experience and knowledge in any of the following:

- (i) accounting issues and accounting control issues characteristic to the segment in which the company operates and to companies of the size and complexity of the company;
- (ii) the functions of the external auditor and the obligations imposed on such auditor;
- (iii) preparation of financial reports and their approval in accordance with the companies law and the securities law.

A company whose shares are traded in certain exchanges outside of Israel, including The NASDAQ Global Market, such as our company, is not required to nominate at least one external director who has accounting and financial expertise so long as another independent director for audit committee purposes who has such expertise serves on board of directors pursuant to the applicable foreign securities laws. In such case, all external directors will have professional qualification.

Under Israeli law, a person may not serve as an external director if he or she is a relative of any of the controlling shareholders or at the date of the person's appointment or within the prior two years the person, or his or her relatives, partners, employers or entities under the person's control or entities which he or she are subject to their control, have or had any affiliation with us, with our controlling shareholder, or its relative or any entity controlling, controlled by or under common control with us. Under the Companies Law, "affiliation" includes an employment relationship, a business or professional relationship maintained on a regular basis or control or service as an office holder, excluding service as a director in anticipation of serving as an external director in a company that is about to offer its shares to the public for the first time.

Furthermore, under Israeli law, a person may not serve as an external director if he or she, or his or her relatives, partners, employers or a person or entity he or she is subordinate to directly or indirectly, or an entity controlled by the external director has business or professional relations (excluding insignificant relations) with a person or entity whose affiliation with such external director is forbidden.

A person may not serve as an external director if that person's position or other business activities create, or may create, a conflict of interest with the person's service as an external director or may otherwise interfere with the person's ability to serve as an external director. If at the time any external director is appointed, all members of the board (who are not a controlling shareholder or its relative) are the same gender, then the external director to be appointed must be of the other gender.

External directors are elected by a majority vote at a shareholders' meeting, so long as either:

- (i) the majority of shares voted for the election includes the majority of the shares of non-controlling shareholders or with no personal interest excluding a personal interest not resulting from relation with controlling shareholders, voted at the meeting; or
- (ii) the total number of shares to total amount of shareholders listed in subsection (i) above, who voted against the election of the external director does not exceed two percent (2%) of the aggregate voting rights of the company.

The Companies Law provides for an initial three-year term for an external director which may be extended, for two additional three-year terms subject to provision specified in the Companies Law. In the case of a company whose shares are traded in certain exchanges outside of Israel, including The Nasdaq Global Market, such as our company, regulations promulgated under the Companies Law provide that the service of an external director can be extended to additional three-year terms, if both the audit committee and the board of directors confirm that in light of the expertise and contribution of the external director, the extension of such external director's term would be in the interest of the company. Election of external directors requires a special majority, as described above and that the period which that person served as an external director together with the reasons for the extension given by the audit committee presented to the shareholders prior to such approval. External directors may be removed only by the same special majority required for their election or by a court, and then only if the external directors cease to meet the statutory qualifications for their appointment or if they violate their duty of loyalty to the company. In the event the number of external directors is less than two external directors, our board of directors is required under the Companies Law to call a shareholders' meeting to appoint a new external director.

External directors may be compensated only in accordance with regulations adopted under the Companies Law.

Our board of directors has a majority of independent directors required pursuant to the NASDAQ Global Market rules.

#### **Independent Directors**

Under the Companies Law, the majority of the members of the audit committee must be independent directors. In addition, the Companies Law includes a corporate governance recommendation according to which the majority of the members of the board of directors in a public company that does not have a controlling shareholder should be independent directors, and in a company without a controlling shareholder at least third of the board of directors should be independent directors. A public company may classify an external director or an individual serving as a director, as an independent director only if (i) the audit committee has determined that he or she is qualified to serve as an external director (with the exception that such director does not have to have professional qualifications or accounting and financial expertise in order to serve as an independent director), and (ii) he or she is not serving as a director in the company for more than consecutive nine years (only a period of two or more years, in which such person did not serve as a director in the company, shall be deemed to discontinue the nine year sequence).

## Committees of the Board of Directors

As of the date of this annual report, we have two committees of the board of directors, which includes our audit committee and our compensation committee, as described below.

### *The Audit Committee*

The Companies Law requires public companies to appoint an audit committee. The responsibilities of the audit committee include, among others, identifying irregularities and deficiencies in the management of the company's business and approval of related party transactions as required by law. An audit committee must consist of at least three members, and include all of the company's external directors. In addition, the majority of its members shall be independent directors in accordance with the requirements of The Companies Law. However, the chairman of the board of directors, any director employed by the company or by its controlling shareholder or by any other entity controlled by such controlling shareholder or a director providing, on a regular basis, services to the company, to any controlling shareholder or to other entity controlled by such controlling shareholder, or any director whose livelihood relies on any controlling shareholder, may not be a member of the audit committee, or any controlling shareholder and any relative of a controlling shareholder may also not be a member of the audit committee. The chairman of the audit committee must be an external director, who has not been serving as a chairman of the audit committee for more than nine years.

An audit committee recommends approval of transactions that are deemed interested party transactions, including directors' compensation and transactions between a company and its controlling shareholder or transactions between a company and another person in which its controlling shareholder has a personal interest. The audit committee must also determine whether a transaction constitute an extraordinary transaction. An audit committee may not approve an action or a transaction with an officer or director, a transaction in which an officer or director has a personal interest, a transaction with a controlling shareholder and certain other transactions specified in the Companies Law, unless at the time of approval two external directors are serving as members of the audit committee and at least one of the external directors was present at the meeting in which an approval was granted.

Subject to the exceptions specified in the Companies Law, any person who is not eligible to serve in the audit committee shall not participate in its meetings.

Legal quorum shall be constituted when the majority members of the audit committee shall be present at the meeting, provided that: (a) the majority of the present members are independent directors; and, (b) at least one of the present members is an external director.

Under the Companies Law there are restrictions regarding engagement or benefits with a person who served as an external director (or his or her relative) for period of two years commencing the time when such external director leaves office.

In accordance with the Sarbanes-Oxley Act of 2002 and NASDAQ requirements, our audit committee reviews our internal accounting procedures and consults with and reviews the services provided by our independent auditors.

The rules of NASDAQ currently applicable to foreign private issuers, such as us, require us to establish an audit committee of at least three members, comprised solely of independent directors. All of the members of the audit committee must be able to read and understand basic financial statements, and at least one member must have experience in finance or accounting, requisite professional certification in accounting or comparable experience or background. The board has determined that Ms. Orli Garti-Seroussi is an audit committee financial expert as defined by applicable Securities and Exchange Commission, or the "SEC" or "Commission" regulation. The responsibilities of the audit committee under the NASDAQ rules include the selection and evaluation of the outside auditors and evaluation of their independence.

The members of our audit committee are Mr. Chaim Labenski, Mr. Danny Lustiger and Ms. Orli Garti-Seroussi. These include our two external directors as required under the Companies Law, and we believe that all of the members of our audit committee are independent of management, and satisfy the requirements of Companies Law, the SEC's rules and NASDAQ rules.



### *The Compensation Committee*

Under the Companies Law (as recently amended, see Item 10.B. "Memorandum and Articles of Association – Compensation of Officers and Directors"), a public company is required to appoint a compensation committee. The compensation committee must consist of at least three directors, must include all the external directors, the majority of its members must be external directors, and its chairman must be an external director. In addition, all members of the compensation committee must meet the requirements under the Companies Law for membership in the audit committee, as described above.

Under the Companies Law and our compensation committee charter, our compensation committee is responsible, among others, for (i) recommending to the board of directors regarding its approval of a compensation policy in accordance with the requirements of the Companies Law, and any other compensation policies, incentive-based compensation plans and equity-based plans; (ii) overseeing the development and implementation of such compensation plans and policies that are appropriate in light of all relevant circumstances and recommending to the board of directors regarding any amendments or modifications that the compensation committee deems appropriate; (iii) determining whether to approve transactions concerning the terms of engagement and employment of our officers and directors that require compensation committee approval under the Companies Law or our compensation plans and policies; and (iv) taking any further actions as the compensation committee is required or allowed to under the Companies Law or the compensation plans and policies.

The members of our compensation committee are Mr. Chaim Labenski, Mr. Danny Lustiger and Ms. Orli Garti-Seroussi.

We do not have a nomination committee. The actions ordinarily taken by such committee are resolved by the majority of our independent directors, in accordance with the Companies Law and the NASDAQ Global Market listing requirements.

### **Internal auditor**

The Companies Law requires the board of directors of a public company to appoint an internal auditor pursuant to the audit committee's proposal. The internal auditor must satisfy certain independence requirements as required by the law. The role of the internal auditor is to examine, among other things, the compliance of the company's conduct with applicable law and orderly business procedures. Our internal auditor is Mr. Doron Cohen of Fahn Kanne & Co., a member firm of Grant Thornton International Ltd.

### *Employment Agreements*

Each of our executive officers entered into a written employment agreement with us that provides, among other things, that such officers be paid a monthly salary and bonuses. Each such agreement can be terminated either by us, or by the employee, upon prior notice, which ranges between 30 to 120 days for most of the management team. The employment agreements also provide that each executive officer will maintain confidentiality of matters relating to us and will not compete with us during the period of the officer's employment and for a certain period thereafter.

### **6.D. EMPLOYEES**

Since the sale of our Video Solutions Business on July 1, 2010 and as of the date of this annual report, we have six employees, including employees in our subsidiaries, all of them employed in our general and administrative, finance and human resources divisions.

All of our employees are currently employed pursuant to personal employment agreements.

#### 6.E. SHARE OWNERSHIP

As of March 1, 2013, our current directors and executive officers (seven persons) beneficially owned an aggregate of 244,279 ordinary shares of our Company of which 69,214 shares are issuable upon exercise of options that may be currently exercisable or exercisable within 60 days of March 1, 2013. Such number excludes 6,000 ordinary shares held by a trustee for the benefit of directors and executive officers under the Company's incentive plan which have not vested as of March 1, 2013 or 60 days thereafter, and award their holder no voting and equity rights. Other than Shlomo (Tom) Wyler, all of our directors or executive officers hold less than 1% of our shares. See Item 7.A. "Major Shareholders" for more information regarding Mr. Wyler's holdings.

##### Incentive Plans

As of March 1, 2013, options and warrants to purchase 127,000 of our ordinary shares were outstanding, with exercise prices ranging from \$6.3 to \$19.14 per share. As of March 1, 2013, 104,961 of the options described above have vested or are exercisable within 60 days of such date. The expiration date of the aforementioned options is generally seven years from the date of their grant. As of December 31, 2011 and 2012, the number of options outstanding and reserved for issuance under our plans was 565,255 and 467,722, respectively.

As of March 1, 2013 or within 60 days thereafter, an aggregate of 14,890 ordinary shares has been reserved for issuance under the 2006 Plan, and 9,200 were granted and are outstanding. As of December 31, 2011 and 2012, the number of ordinary shares outstanding and reserved for issuance under our plans was 15,690 and 11,690, respectively.

The following table shows the number of options and restricted shares outstanding and reserved for issuance under each of our incentive plans, as of March 1, 2013 or within 60 days thereafter.

Plan	Number of options outstanding	Number of options reserved for issuance
1999 Plans	127,000	467,722

Plan	Number of shares outstanding	Number of shares reserved for issuance
2006 Israeli Incentive Compensation Plan	9,200	14,890

The following is a description of our incentive plans currently in effect.

##### 1999 Plans

In January 1999, our shareholders approved the adoption of an Israeli option plan, or the 1999 Israeli Plan, and a U.S. option plan, or the 1999 U.S. Plan, collectively the "1999 Plans" both plans have a joint pool of underlying shares to be granted thereunder. The 1999 Plans were amended from time to time to include different tax tracks. The purpose of the 1999 Plans is to attract and retain the best available personnel, to provide additional incentive to employees, directors and consultants and to promote the success of our business. In December 1999, our board of directors adopted a resolution to amend the 1999 Plans in a manner that as of April 1, 2000, the number of shares made available for grant under the 1999 Plans will be automatically increased annually, to equal 5% of our outstanding share capital at the relevant time. In May 2003 we amended our 1999 Plan to provide for the grant of options to Israeli optionees under the new capital gains track provisions of the Israeli Tax Ordinance. As of March 1, 2013, or within 60 days thereafter, an aggregate of 467,722 ordinary shares has been reserved for issuance under this plan, and 127,000 were granted and are outstanding. Unless specifically changed for a certain grantee, options vest monthly over a period of four years, starting one year after the date of grant, subject to the continued employment of the grantee. The exercise price of the options is determined by our board of directors, subject to limitations. Generally, options granted under each of the 1999 Plans will have a term of no more than seven years from the date of grant. All options are subject to earlier termination upon termination of the grantee's employment or other relationship with us, generally no less than three months from termination. We may make certain exceptions, from time to time, in the vesting and expiration terms of options granted to certain grantees.

In May 2006, our board of directors approved the adoption of the 2006 Israeli Incentive Compensation Plan, or the 2006 Plan, the purpose of which is to secure the benefits arising from ownership of share capital by our employees, officers and directors who are expected to contribute to the Company's future growth and success. The 2006 Plan provides for the grant of options, restricted shares and restricted share units in accordance with various Israeli tax tracks. We currently use the 2006 Plan for the grant of restricted shares only. The restricted shares are granted for no consideration and with a vesting schedule of two years (50% each year). The restricted shares are granted in accordance with the Israeli capital gains tax track. Termination of employment of a grantee for any reason will result in the forfeiture of such grantee's unvested restricted shares. All restricted shares are subject to earlier termination upon termination of the grantee's employment or other relationship with us, generally no less than 90 days from termination. We may make certain exceptions, from time to time, in the vesting and expiration terms of the securities granted to certain grantees. As of March 1, 2013 or within 60 days thereafter, an aggregate of 14,890 ordinary shares has been reserved for issuance under the 2006 Plan, and 9,200 were granted and are outstanding.

NASDAQ Listing Rules permit foreign private issuers to follow home country practices in regard to certain requirements, including the requirement to obtain shareholder approval in connection with the establishment of certain incentive plans. In June and September 2006, we notified NASDAQ that we elected to follow home practices with regard to the adoption of, and the amendment to, the 2006 Plan. Accordingly, the adoption of, and the amendment to, the 2006 Plan were not approved by our shareholders.

## ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

### 7.A. MAJOR SHAREHOLDERS

The following table sets forth certain information known to us regarding the beneficial ownership of our outstanding ordinary shares as of March 1, 2013 of (i) each person or group known by us to beneficially own 5% or more of the outstanding ordinary shares and (ii) the beneficial ownership of all officers and directors as a group, in each case as reported by such persons:

Name of Beneficial Owner	No. of Ordinary Shares Beneficially Owned (1)	Percentage of Ordinary Shares Beneficially Owned
Arthur Mayer – Sommer <sup>(2)</sup>	240,000	6.28
The Capri Family Foundation <sup>(3)</sup>	2,424,475	63.48
Shareholding of all directors and officers as a group (7 persons) <sup>(4)</sup>	244,279	6.28

(1) Number of shares and percentage ownership is based on 3,819,051 ordinary shares outstanding as of March 1, 2013. Such number excludes: (i) 54,695 ordinary shares held by us or for our benefit, and (ii) 9,200 ordinary shares granted under our 2006 Plan held by a trustee for the benefit of the grantees thereunder, both have no voting or equity rights as of the date hereof or within 60 days thereafter. Beneficial ownership is determined in accordance with rules of the SEC and includes voting and investment power with respect to such shares. Shares subject to options that are currently exercisable or exercisable within 60 days of March 1, 2013 are deemed to be outstanding and to be beneficially owned by the person holding such options for the purpose of computing the percentage ownership of such person, but are not deemed to be outstanding and to be beneficially owned for the purpose of computing the percentage ownership of any other person. All information with respect to the beneficial ownership of any principal shareholder has been furnished by such shareholder and, unless otherwise indicated below, we believe that persons named in the table have sole voting and sole investment power with respect to all the shares shown as beneficially owned, subject to community property laws, where applicable. The shares beneficially owned by the directors include the ordinary shares owned by their family members to which such directors disclaim beneficial ownership.

(2) To our knowledge, the information is accurate as of March 1, 2013.

(3) The information is accurate as of November 21, 2012, and based on Amendment No. 4 to Schedule 13D filed with the SEC on November 21, 2012, by: (i) Gesafi Real Estate S.A., a Panama Corporation, (ii) The Capri Family Foundation, (iii) Filippone Business S.A., a company organized under the laws of the Republic of Panama, or Filippone, and (iv) PZ Nominees II S.A., a company organized under the laws of the Republic of Panama, or PZ Nominees. According to such Amendment No. 4 to Schedule 13D, Gesafi directly owns 1,127,185 of our ordinary shares and Capri directly owns 1,297,290 of our ordinary shares. The core activity of both Gesafi and Capri is the holding of investments. In addition, Capri is the holder of 100% of the equity interest of Gesafi, and the beneficiaries of Capri are the children of Mr. Tom Wyler, our president and a member of our board of directors. By virtue of its holdings in Gesafi, Capri may be deemed the beneficial owner of an additional 1,127,185 ordinary shares owned by Gesafi, for total direct or beneficial ownership of 2,424,475 of our ordinary shares. Filippone is the Corporate Councillor of Capri, and its sole activity is acting as Corporate Councillor for Capri. PZ Nominees is the holder of 100% of the equity interest of Filippone, and its core activity is the holding of other companies.

(4) Includes 175,065 ordinary shares and 69,214 ordinary shares issuable upon exercise of options exercisable within 60 days of March 1, 2013. Excludes 6,000 ordinary shares held by a trustee for the benefit of our directors and executive officers under our 2006 Plan, which have not vested on March 1, 2013 or within 60 days thereafter and do not acquire any voting or equity rights.

**Significant changes in the ownership of our shares.**

All numbers of ordinary shares below was adjusted to reflect a one-for-five reverse share split of our ordinary shares that we effected on September 27, 2012. See Item 4.A. "History and Development of the Company - Reverse Share Split".

The following table specifies significant changes in the ownership of our shares held by Shlomo (Tom) Wyler. This information is based on Schedules 13D filed by Shlomo (Tom) Wyler during the period beginning on January 1, 2010, regarding ownership of our shares, and to date:

<b>Beneficial Owner –</b>	<b>Date of filing</b>	<b>No. Of Shares Beneficially Held</b>
Shlomo (Tom) Wyler	June 30, 2011	1,976,107*
Shlomo (Tom) Wyler	November 21, 2012	159,218**

\* Including outstanding options to purchase 20,000 Ordinary Shares and 2,000 vested restricted shares.

\*\* Excluding outstanding options to purchase 20,000 Ordinary Shares which have expired on December 16, 2011, and including 2,400 vested restricted shares.

For further information regarding a private placement to Shlomo (Tom) Wyler, see Item 7.B "Related Party Agreements".

The following table specifies significant changes in the ownership of our shares by Prescott Group Capital Management, L.L.C. This information is based on Schedule 13G filed by Prescott Group Capital Management, L.L.C. during the period beginning on January 1, 2010, regarding ownership of our shares, and to date:

<b>Beneficial Owner –</b>	<b>Date of filing</b>	<b>No. Of Shares Beneficially Held</b>
Prescott Group Capital Management, L.L.C.	February 12, 2010	*401,220

\*To the best of our knowledge, all such shares were sold to Gesafi Real Estate S.A., see below.

The following table specifies significant changes in the ownership of our shares held by Gesafi Real Estate S.A. This information is based on Schedules 13D filed by Gesafi Real Estate S.A during the period beginning on January 1, 2010, regarding ownership of our shares, and to date:

<b>Beneficial Owner –</b>	<b>Date of filing</b>	<b>No. Of Shares Beneficially Held</b>
Gesafi Real Estate S.A.*	September 8, 2011	401,220
Gesafi Real Estate S.A	August 12, 2011	488,220
Gesafi Real Estate S.A	June 14, 2012	627,185
Gesafi Real Estate S.A	November 21, 2012	1,127,185

\*To the best of our knowledge, 100% of the equity interest of Gesafi Real Estate S.A is held by The Capri Family Foundation. The beneficiaries of The Capri Family Foundation are the children of Mr. Shlomo (Tom) Wyler, our president and a member of our board of directors.

The following table specifies significant changes in the ownership of our shares held by The Capri Family Foundation. This information is based on Schedules 13D filed by The Capri Family Foundation during the period beginning on January 1, 2010, regarding ownership of our shares, and to date:

Beneficial Owner –	Date of filing	No. Of Shares Beneficially Held
The Capri Family Foundation*	November 21, 2012	1,297,290

\*To the best of our knowledge, the beneficiaries of The Capri Family Foundation are the children of Mr. Shlomo (Tom) Wyler, our president and a member of our board of directors.

All of our shares have the same voting rights.

On March 1, 2013, registered holders in the United States hold approximately 78% of our ordinary shares. To the best of our knowledge, except as described above, we are not owned or controlled directly or indirectly by any government or by any other corporation. We are not aware of any arrangement, the operation of which may at a subsequent date result in a change in control of the Company.

#### 7.B. RELATED PARTY TRANSACTIONS

All numbers and prices of ordinary shares below was adjusted to reflect a one-for-five reverse share split of our ordinary shares that we effected on September 27, 2012. See "Item 4.A. "History and Development of the Company - Reverse Share Split".

For a description of the insurance, indemnification and exemption granted to our directors and officers, see Item 6.B. "Compensation" above.

For a description of the grant of options to our directors and officers, see Item 6.E. "Share Ownership", above. In addition, each member of our board of directors is paid an annual fee of \$18,000 for his/her service as a director.

On December 20, 2007, our shareholders approved an employment agreement, or the Employment Agreement, between Optibase and Mr. Shlomo (Tom) Wyler with respect to Mr. Wyler's service as Chief Executive Officer of the Company. Under the agreement, Mr. Wyler will continue to serve as Chief Executive Officer of the Company in consideration for a gross monthly payment of NIS 40,000. In addition, Mr. Wyler will be entitled to managers' insurance, educational fund (keren hishtalmut), 24 days annual vacation, sick leave and 10 days replenishment fees (dmev havraa). The Company has also undertaken to provide Mr. Wyler with a telephone, facsimile, mobile phone, internet connection, laptop and printer and bear all installation costs and all expenses related thereto. The agreement further provides that Mr. Wyler shall be entitled to a one-time bonus in the amount of \$10,000 upon the execution of the employment agreement. In addition, our board of directors, at its sole discretion, may grant Mr. Wyler an annual bonus for each year commencing in 2008 (for the year 2007) which shall not exceed twice Mr. Wyler's monthly salary. At the Company's discretion, Mr. Wyler shall be obligated to continue working during the first two months of such 4-month advance notice period. During the next two months Mr. Wyler shall be free to practice any other business without the receipt of the Company's approval. The Company may elect to pay Mr. Wyler a one-time payment for such advance notice period. Notwithstanding the above, the Company may terminate the agreement and Mr. Wyler's employment immediately for Cause, as such term is defined in the agreement. The agreement is for a three-year term commencing retroactively on October 1, 2007. Any party to the agreement may terminate it by providing the other party with a 4-month advance written notice. On December 29, 2010, our shareholders approved the terms of an agreement with substantially the same terms as the Employment Agreement. Mr. Amir Philips was appointed as the Company's Chief Executive Officer effective from June 1, 2011, and consequently, at such time, the Company and Mr. Wyler agreed to terminate the Employment Agreement as of May 31, 2011. In the Company's shareholders annual general meeting, held on November 17, 2011, and following the approval by the Company's audit committee and board of directors, the shareholders of the Company approved and ratified the Employment Agreement for the period commencing on October 1, 2010 and ending on May 31, 2011. The cost to the Company of Mr. Wyler's employment during such eight-month period is NIS 350,657.

On October 19, 2009, our shareholders approved the compensation of Mr. Alex Hilman, a director of the Company, who was appointed on September 1, 2009 as Executive Chairman of the board of directors. The principal terms of such compensation are as follows: a monthly payment of NIS 20,000 plus applicable value added tax, against the receipt of a tax invoice. The Company will also reimburse Mr. Hilman for his reasonable expenses directly incurred by him in the performance of his duties against the production of appropriate receipts. In addition, Mr. Hilman was granted on October 19, 2009, 20,000 options exercisable into 20,000 ordinary shares NIS 0.65 nominal value each of the Company under the Company's 1999 Israeli Share Option Plan. The options were granted under the Section 102 of the Israeli Tax Ordinance, through the capital gains tax track. The exercise price of each option is \$5.96. The options vest over a period of four years in equal parts, and may be exercisable until their 10<sup>th</sup> anniversary. All other terms of the options are as stated in the Company's 1999 Israeli Share Option Plan.

On May 6, 2010, our shareholders approved the compensation of Mr. Danny Lustiger as a director of the Company. Mr. Lustiger is entitled to an annual amount of US \$18,000, plus reimbursement of expenses, with a retroactive effect as of the date Mr. Lustiger was appointed as a director of the Company (*i.e.* October 28, 2009), 50,000 options exercisable into 10,000 ordinary shares NIS 0.65 nominal value each of the Company under the Company's 1999 Israeli Share Option Plan. The options were granted under Section 102 of the Israeli Tax Ordinance, through the capital gains tax track. The exercise price of each option is \$10. The options vest over a period of four years in four equal parts, and may be exercisable until their 10<sup>th</sup> anniversary. All other terms of the options are as stated in the Company's 1999 Israeli Share Option Plan. Mr. Lustiger is also entitled to 800 restricted shares, which vest over two years in two equal parts, and which were granted pursuant to the Company's 2006 Israeli Incentive Compensation Plan.

On December 29, 2010, our shareholders approved the grant by the Company of 2,400 restricted shares of the Company, in three equal consecutive annual grants, to each of Mr. Alex Hilman, Ms. Dana Tamir-Tavor and Mr. Danny Lustiger, or the Recipients, who served at that time as directors of the Company, under the Company's 2006 Israeli Incentive Compensation Plan. The restricted shares were granted to the Recipients for no consideration, and vest after a two-year period (50% each year) from their date of grant, subject to the continued employment or service of the Recipients in the Company.

Our shareholders have further approved on December 29, 2010, the compensation terms of Ms. Garti-Seroussi and Mr. Labenski as external directors of the Company, including the grant by the Company of 2,400 restricted shares of the Company, in three equal consecutive annual grants, under the Company's 2006 Israeli Incentive Compensation Plan. The restricted shares were granted for no consideration and vest after a two-year period (50% each year) from their date of grant, subject to the continued employment or service in the Company. The compensation of Ms. Garti-Seroussi and Mr. Labenski for their service as external directors of the Company is an annual amount of US \$18,000, plus reimbursement of expenses, as approved by the Company's shareholders on December 5, 2002.

On May 5, 2011, Following the approval of our audit committee and board of directors, our shareholders approved a private placement of 500,000 newly issued ordinary shares of the Company, to Mr. Wyler, president of the Company and a member of our board of directors, in consideration for \$5 million. For further details see Item 10.C "Material Contracts".

On December 20, 2007, the Company's shareholders approved the grant of 2,400 restricted shares of the Company to each of the then serving directors of the Company, including Ms. Dana Tamir-Tavor, a former member of our board of directors, for no consideration. As of April 18, 2011, the effective date of Ms. Tamir-Tavor's resignation from her service as a director of the Company, the vesting of 2,000 restricted shares (out of 2,400 restricted shares granted to Ms. Tamir-Tavor) had already lapsed and Ms. Tamir-Tavor was entitled to such 2,000 restricted shares. The vesting of the remaining 400 restricted shares, that were granted to Ms. Tamir-Tavor on February 1, 2010, was due on January 31, 2012 only. Since Ms. Tamir-Tavor had resigned from our board of directors under the terms of grant of such restricted shares, she was not entitled to the remaining 400 restricted shares. In spite of the above, acknowledging the great contribution of Ms. Tamir-Tavor to the Company during her service as a director, and following the approval of the Company's audit committee and board of directors, on November 17, 2011 our shareholders resolved to accelerate the vesting of the 400 remaining restricted shares granted to Ms. Tamir-Tavor as of the termination date of her service as a director of the Company, thus allowing Ms. Tamir-Tavor to receive such 400 restricted shares.

On November 17, 2011, and following the approval by our audit committee and board of directors, our shareholders approved a grant of 20,000 options exercisable into 20,000 ordinary shares NIS 0.65 nominal value each of the Company to Mr. Hilman, the Executive Chairman of the board of directors, under the Company's 1999 Israeli Share Option Plan, without consideration. The Options were granted to a trustee for the benefit of Mr. Hilman in accordance with the requirements of the capital gains tax track chosen by the Company. The exercise price of each option is \$10. The options vest during a four-year period as of their date of grant (25% each year), and may not be exercised following their 10<sup>th</sup> anniversary. All other terms of the options are as stated in the Company's 1999 Israeli Share Option Plan. Along with the approval of the grant of options to Mr. Hilman, the Company's shareholders approved a similar grant of 20,000 options exercisable into 20,000 ordinary shares to Mr. Shlomo (Tom) Wyler, the Company's president and member of the board of directors, under the Company's 1999 Israeli Share Option Plan. The terms of grant of such options to Mr. Wyler are identical to the terms of grant of the options to Mr. Hilman as described above, except that the tax track available to Mr. Wyler, who considered to be the controlling shareholder of the Company as of the date grant of such options, is different from the capital gains tax track afforded to all other directors and officers of the Company. Under this tax track, the Company will also not be able to recognize expenses pertaining to this grant.

On November 17, 2011, and following the approval by our audit committee and board of directors, our shareholders approved an agreement between the Company and BN Finance AG, or BN Finance, a company affiliated with Mr. Shlomo (Tom) Wyler, the Company's president and member of the board of directors, for the provision of business and financial consulting services to the Company and its subsidiaries and affiliates. According to the agreement, BN Finance will provide the Company with business and financial consulting services, or the services, which will include advising the Company on its financing agreements, negotiations with the financing banks and the service of directors and officers of BN Finance as directors of the Company's subsidiaries and affiliates, as requested by the Company and/or its subsidiaries and affiliates from time to time and at the sole discretion of the Company. BN Finance will render the services faithfully and diligently for the benefit of the Company, its subsidiaries and affiliates, and will devote all necessary time and attention for the performance of the services. BN Finance will also use its best efforts to implement the policies established by the Company, its subsidiaries and affiliates in the performance of the services. In consideration for the services, the Company will pay BN Finance a monthly fee of CHF 10,000 plus applicable value added tax. In the event the agreement is terminated during a certain month, BN Finance will be entitled for a pro rata fee based on the number of days that has lapsed until the termination date of this agreement. The agreement has taken effect since November 1, 2011 and for a period of three years thereafter. Each of BN Finance and the Company may terminate the agreement by giving a prior written notice of 30 days. During such advance notice period, BN Finance will be required to continue the provision of the services (unless the Company has instructed it otherwise) and in any event BN Finance will be entitled to receive the consideration for such period.

On November 17, 2011, and following the approval by our audit committee and board of directors, our shareholders approved the reimbursement of expenses incurred by Mr. Shlomo (Tom) Wyler in an aggregate annual amount not to exceed \$50,000, beginning in 2012. The reimbursement of expenses will be made against receipts only. The expenses with respect to which Mr. Wyler is and will be reimbursed are expenses directly incurred in connection with the performance of Mr. Wyler's duties in the Company. The Company's audit committee will receive a quarterly report reviewing the reimbursement of Mr. Wyler's expenses during the preceding quarter.

#### ***Commercial Office Building in Philadelphia***

On October 12, 2012, following the approval of our audit committee and board of directors, and the approval of our shareholders during an annual general meeting of our shareholders held on August 16, 2012, our wholly-owned subsidiary, Optibase 2 Penn, LLC, became a limited partner of 2 Penn Philadelphia LP, a Pennsylvania limited partnership, or the Partnership, which acquired an approximately 20% beneficial interest in the owner of a Class A 20-story commercial office building in Philadelphia known as Two Penn Center Plaza, or the 2 Penn Property, and entered into the Limited Partnership Agreement of the Partnership, or the 2 Penn LPA. The general partner of the partnership and certain other limited partners of the Partnership, are persons or entities affiliated with Mr. Shlomo (Tom) Wyler, our president and member of our board of directors, who was then considered the controlling shareholder of the Company, as detailed herein. The 2 Penn LPA sets forth the terms and conditions of the investment in the Partnership. According to the 2 Penn LPA our subsidiary acquired approximately 26% of the limited partnership interests in the Partnership in consideration for \$4,025,000.

The Partnership owns a beneficial interest in the owner of the 2 Penn Property by being issued a 85.76% partnership interest in Two Penn Investor LP, a Pennsylvania limited partnership, or the 2 Penn Investor, which acquired 88% of the limited partnership interests in Crown Two Penn Center Associates Limited Partnership, or the Property Owner, and Two Penn General LLC from Crown Penn Associates, L.P., or Crown Penn. Two Penn General LLC, a Delaware limited liability company controlled by Mr. Alex Schwartz acquired a 1% general partner interest in the Property Owner from Two Penn Center GP Corp., a Pennsylvania corporation, or the Existing General Partner, for the aggregate sum of approximately \$12.8 million.

In connection with the closing of the sale agreement transaction, 2 Penn Investor provided a loan to Crown Penn in the original principal amount of \$1,573,357, or the Purchaser Loan. The Purchaser Loan will bear interest at a rate of 12% per annum and will mature in slightly more than 3 years and will be secured by a pledge of Crown Penn's remaining 11% of the interests in the Partnership.

The 2 Penn Property has existing mortgage financing of approximately \$51.7 million from UBS Real Estate Securities Inc., or UBS. The mortgage loan has a fixed interest rate of 5.61% and matures in May 2021, and requires monthly payments of principal and interest of approximately \$300,000. The acquisition of the partnership interests in the Property Owner from Existing General Partner and Crown Penn and the performance of the transactions as a whole were conditioned on UBS consenting to the change in ownership of the Property Owner.

Below is a description of the main provisions of the 2 Penn LPA setting forth the terms and conditions of our subsidiary's investment in the Partnership:

#### ***Purpose of the Partnership***

The stated purpose of the Partnership is solely to acquire, own, operate and ultimately sell beneficial interests in the 2 Penn Investor (which directly owns partnership interests in the Property Owner) and transact any lawful business that is necessary to accomplish this.



#### *Capital Contributions*

The partners will contribute initial capital contributions to the Partnership in the aggregate amount of approximately \$15,500,000 (of which our subsidiary's share is \$4,025,000). The Partnership will contribute the initial capital contribution to 2 Penn Investor which will use the funds to acquire the limited partnership interests in the Property Owner, to provide the Purchaser Loan, to pay closing costs for the transaction, and to establish reserves for improvements to the 2 Penn Property.

Additional capital contributions may be requested of limited partners at any time that Two Penn Philadelphia GP LLC (which is the general partner of the Partnership, controlled by Mr. Alex Schwartz, who is affiliated with Mr. Wyler as set forth below, or the General Partner) determines that the Partnership requires additional funds. The General Partner may request loans or capital contributions from the limited partners, provided that if the General Partner requests loans or capital calls exceeding \$2,000,000 during any four-year period it must obtain the approval of partners owning at least 65% of the interests in the Partnership.

If a limited partner does not provide its capital contributions, the other limited partners will have the option to fund the failed contribution in proportion to their relative percentage interests. The portion of the deficiency funded shall be treated as a loan from the lending non-defaulting partners to the defaulting limited partner and shall bear a floating interest rate equal to the prime rate of PNC Bank plus 9% (which shall be compounded annually to the extent not paid). The loan shall be repaid directly on a first priority basis out of any subsequent distributions to the defaulting limited partner. A limited partner's liability for a default loan shall be limited to its share of future distributions from the Partnership.

#### *Limited Partner Approval Rights*

The General Partner has full management authority over the Partnership, subject to certain major decisions which require the approval of partners owning 65% of the interests in the Partnership. These decisions include: (a) sale or transfer of any asset of the Partnership or granting approval for the sale of the 2 Penn Property; (b) borrowing money from itself or third parties for Partnership purposes or to mortgage, pledge or assign any of the Partnerships assets; (c) requesting capital contributions or borrowing money from the partners in an amount exceeding \$2,000,000 during any four year period; (d) admission of any new partners; (e) removal of the General Partner; (f) termination and dissolution of the Partnership; (g) amendment of the Partnership agreement; (h) merger or consolidation into or with another entity; (i) amendment of the Partnership certificate in a material manner; or (j) entering into a new line of business.

#### *Fees Paid to the General Partner*

The General Partner or its affiliates may receive an annual management fee of four percent (4%) of gross revenues from the Property from the Property Owner in connection with management of the 2 Penn Property and shall be entitled to be reimbursed for expenses incurred in the management of the Partnership business. The General Partner and its affiliates may not receive any other fees or payments from the Partnership, 2 Penn Investor or from the Property Owner without the consent of limited partners owning at least 65% of the interests in the Partnership.

#### *Distributions*

All revenue of the Partnership, less the operating expenses and any reserves established by the GP, or Net Cash Flow, will be distributed as follows:

- (a) First, to repay partners who loaned sums to other limited partners who defaulted on their capital contributions;
- (b) Second, to partners that have made voluntary loans to the Partnership;
- (c) Third, to repay the partners their capital contributions; and
- (d) Fourth, to the partners in accordance with their percentage interests in the Partnership.

The General Partner has undertaken to cause Two Penn Investor and Crown 2 Penn LLC to distribute all net cash flow received from the 2 Penn Property to their limited partners. Other than with the consent of partners holding at least 65% of the interests in the Partnership, Crown 2 Penn LLC may only withhold net cash flow in order to: (1) establish reserves not exceeding one million dollars (\$1,000,000) for future expenses of the 2 Penn Property, (2) reserve funds to service debt or loan document obligations of the Property Owner, and (3) avoid the violation of applicable laws and avoid the imposition of transfer taxes.

#### *Transfer Restrictions*

*General Partner Consent to Transfer of the Company's Percentage Interest:* After a three year and one month so long as there has not been a change in the controlling shareholder of the Company, our subsidiary shall be permitted to transfer all or part of its interests in the Partnership without obtaining the General Partner's prior consent unless:

- (1) the proposed transferee is subject to trade restrictions under US law,
- (2) the transfer would violate federal or state securities laws, or
- (3) the transfer would violate terms of debt obligations which the Property Owner has incurred.

*LP Consent to GP Transfer:* The General Partner must receive the consent of partners owning at least sixty five percent (65%) of the interests in the Partnership to transfer the General Partner interest. Any transfer of the General Partner must be to a person who or which agrees to serve as a replacement General Partner. So long as the Company is a limited partner, unless otherwise consented to by Partners owning at least 65% of the Partnership interests, the General Partner will ensure that, as long as it is controlled by Alex Schwartz (a) at least 20% of the percentage interests of the Partnership will at all times be held or controlled by Alex Schwartz and his family members and (b) the general partners of Two Penn Investor and the Property Owner shall be solely controlled by Alex Schwartz.

*Right of First Offer:* Transfers by partners of their interests in the Partnership are generally subject to a right of first offer in favor of the other partners. The selling party must first offer the portion of its percentage interest that it is looking to sell to the General Partner and other limited partners, before selling such portion to a third party. If the other partners do not send the selling party a notice of acceptance within the prescribed time or do not agree to purchase all of the percentage interest contained in the offer, the selling party shall have the right to sell such percentage interest to a third party.

*Tag Along:* If the General Partner or Alex Schwartz receive an offer to sell all or a portion of their percentage interests, after which Alex and his family members or entities under his control would collectively own less than 20% of the percentage interests, the other Partners shall have the right to sell to the offering third party the same portion of their percentage interests that such third party is willing to purchase from the General Partner and/or Alex Schwartz, on the same terms. If the third party refuses to purchase the other Partners' percentage interests, the General Partner and/or Alex Schwartz may not sell.

*Bring Along:* If the Partners receive a bona fide offer from a third party to acquire all of the percentage interests of the Partnership and the General Partner and partners holding at least 65% of the interests in the Partnership agree to accept the offer, then the other limited partners will be obligated to sell their percentage interests on the same terms as the other Partners.

#### *Removal of the General Partner*

For as long as Alex Schwartz is controlling the General Partner, a vote by partners holding 65% or more of the interests in the Partnership is necessary to remove the General Partner. If the General Partner is no longer controlled by Alex Schwartz, a vote of partners owning at least 51% of the interests in the Partnership is required to remove the General Partner. Appointment of a new General Partner requires the consent of 51% of the limited partners. If the General Partner is removed, the replacement General Partner must buy-out the General Partner's interest at fair market value.

#### *Amendment of the LPA*

Amendment of the LPA requires approval of limited partners owning at least 65% of the Partnership interests provided that any change affecting a Partner's rights must be approved by the affected Partner.

#### *Undertaking Ensuring Limited Partner Rights*

Together with the signing of the LPA, Alex Schwartz, the General Partner and the general partner of Two Penn Investor will sign an undertaking according to which they shall (1) not permit Two Penn Investor or the Property Owner to take any of the actions set forth in the Section entitled "Limited Partner Approval Rights" above without obtaining the prior written consent of 65% of the limited partners of the Partnership, and (2) not to permit Two Penn Investor or the Property Owner to withhold distributions other than as set forth in the Section entitled "Distributions" above without the consent of partners owning at least 65% of the interests in the Partnership, and (3) not to permit a change in the ownership of the general partner of the 2 Penn Investor or the Property Owner as long as Alex Schwartz controls the General Partner interest.

#### *Indemnification*

The Partnership will indemnify the General Partner and its members from any claim, judgment or liability and from any loss or expense which may be imposed on the General Partner as a result of (i) an act performed by the General Partner on behalf of the Partnership or (ii) the inaction of the General Partner or from (iii) any liabilities arising under federal and state securities laws so long as the General Partner acts in good faith in the best interest of the Partnership and the conduct of the General Partner does not constitute gross negligence or willful misconduct.

### **7.C. INTERESTS OF EXPERTS AND COUNSEL**

Not applicable.

## **ITEM 8. FINANCIAL INFORMATION**

### **8.A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION**

See Item 18 "Financial Statements" for a list of financial statements filed as part of this annual report on Form 20-F.

#### **Legal proceedings**

##### *Vsoft*

In September 2005, we were served with a lawsuit filed by Vsoft Ltd., or Vsoft, a company that is undergoing liquidation proceedings and which has claimed that during 2002 we negotiated with Vsoft in bad faith regarding a potential purchase of its share capital, which led to Vsoft's entering into bankruptcy proceedings. Vsoft demanded damages in the amount of \$2.1 million as well as the payment of reimbursement of expenses, legal fees and applicable VAT. On January 1, 2006, we filed a motion to dismiss the lawsuit based on our claim that Vsoft's receiver did not approve the lawsuit as determined by the liquidation court. As of June 23, 2010, our motion to dismiss was denied.

On August 19, 2011 the Tel-Aviv District Court dismissed the lawsuit filed against the Company by Vsoft. Vsoft's claims were rejected by the Tel-Aviv District Court. In addition to the dismissal of the lawsuit, the Tel-Aviv District Court awarded the Company with expenses in the sum of NIS 150,000, which was paid to us during 2012.

Vitec

On March 16, 2010, the Company and its subsidiary, Optibase Inc., entered into an APA with Optibase Technologies Ltd. and Stradis Inc., wholly owned subsidiaries of S.A. Vitec (also known as Vitec Multimedia) (or, collectively, Vitec) pursuant to which Optibase Technologies Ltd. and Stradis Inc. undertook to purchase all of the assets and liabilities related to the Company's Video Solutions Business, or the Business, against an aggregate consideration of \$8 million in cash, subject to certain adjustments and an earn-out mechanism pursuant to which 45% of Vitec's revenues deriving from the Business exceeding \$14 million in the year following the closing of the transaction would be paid to the Company. Closing of the transaction occurred on July 1, 2010. Additionally, the agreement contained an arbitration clause, stipulating that disputes under the agreement will be resolved by arbitration.

Under the agreement, it was agreed that Vitec would collect from customers the payments still owed to the Company, pay amounts due to vendors and also collect other amounts due from the OCS and the EU, and at the closing, Vitec would pay the Company, the amount estimated by the Company to be owed to it, or the Adjustment Amount. The overall consideration would then be adjusted accordingly. On June 30, 2010, a side letter was signed pursuant to which the Company would provide a calculation of the Adjustment Amount within five days following closing and Vitec would deposit in escrow an amount equal to the Adjustment Amount, to be released over a period of 12 months as Vitec collects amounts owed to the Company from customers.

Until today, Vitec has refrained from depositing any amount in escrow.

Under these circumstances, some customers of the Business continued sending payments addressed to the Company. Additionally, the Company informed the customers (that had an open balance at closing) that despite the existence of the agreement, Vitec has not fulfilled its obligations towards the Company, and therefore, the Company would collect the payment owed to it.

At this point, Vitec claimed that the fact that the Company contacted its customers and the fact that the Company continued to hold the above payments, caused damage to Vitec. Vitec's claim at that point was that the Company held approximately \$1.3 million that belong to Vitec.

The Company claims that Vitec holds approximately \$1 million which belong to it, and that it is now holding on to the payments sent by customers as a security against the money owed to it. Additionally, the Company claims that it was within its rights in contacting the customers, as Vitec breached its obligations towards the company.

In addition, a dispute arose between the Company and Vitec with respect to the classification of previously paid sums by the Company's clients for service and maintenance to be provided by Vitec following the closing of the transaction. Such sums amounted to \$1.1 million at closing and are currently estimated at \$923,000.

In that respect, since October 17, 2010, both parties have filed several and separate motions with the Tel-Aviv District Court, seeking, *inter alia*, fixed and temporary injunctions. Since then the motions filed by both parties have been dismissed by the court and were transferred to arbitration proceedings.

On November 10, 2011, the Company submitted its Statement of Claim in the arbitration proceedings against Vitec demanding that Vitec pay an aggregate sum of \$1,505,966 for the Adjustment Amount owed to the Company, for sums received by Vitec from the Chief Scientist and that the Company was due to receive, for the Consortium Amounts (as detailed below) and breach by Stradis, Inc. of its Lease Agreement with Optibase, Inc.

On November 13, 2011, Vitec submitted its Statement of Claim against Vitec demanding that the Company pay Optibase \$20,166,598.91, €135,875.74 and NIS 9,451,616.78. The Statement of Claim brought by Vitec is based, *inter alia*, on the following main causes of action: (i) loss of business opportunities (mainly Merges and Acquisitions transactions) for lack of available cash; (ii) mail fraud; (iii) defamation; (iv) expenditures related to the legal proceedings between the parties; and (v) several additional causes of action, among others, based on Vitec's claim mentioned above.

On January 5, 2012, both parties submitted their Statements of Defense mutually denying all of the other party's claims.

Following submission of the party's pleadings, it was decided that Vitec would submit an expert opinion to prove its accusation and that the Company would be entitled to submit a counter opinion on its behalf. On March 17, 2012, Vitec submitted their expert opinion by Dr. Adi Ayal. The Company submitted an expert opinion on its behalf by Prof. Yossi Spiegel.

During the end of March 2012, evidentiary hearings were held before the Arbitrator. In these hearings Vitec's witnesses provided their primary testimony and were cross-examined by the Company's attorneys. Additional evidentiary hearings for Vitec's witnesses were held on the beginning of May 2012, and on June 25, 2012.

The Company's witnesses gave their primary testimony and were cross-examined by Vitec's attorneys between June 26 and June 28, 2012. Additional evidentiary hearing for the Company's witnesses was held on July 16, 2012.

Vitec submitted their written summations on September 23, 2012, the Company submitted its written summations on November 25, 2012 and Vitec responded to the Company's summations on December 19, 2012.

On January 20, 2013, the Arbitrator informed the parties that his final decision regarding the arbitration with Vitec will be given along with the final decision regarding the personal claim against Adv. Doron Afik and the latter Adv. Afik's counter-claim (for further information, see below).

In addition, in connection with the sale of our Video Solutions Business to Vitec, both parties agreed on mutual indemnification for a period of two years until July 2012 for damages arising or resulting from, *inter alia*, breach or material inaccuracy relating to the representations, warranties and covenants and the liabilities that Vitec may incur which are part of the excluded liabilities arising or resulting therefrom such as the breach or material inaccuracy of any representation or warranty, and for that purpose \$1 million out of the aggregate consideration in the Vitec Transaction was put in escrow as security for such understanding. In light of the existing arbitration proceedings between Vitec and us, and following the refusal of Vitec to the release of such indemnification escrow funds, the decision regarding the release of the escrow funds was brought in front of the arbitrator, who decided, on July 15, 2012, to restrain us from releasing the indemnification escrow funds until a final award in the arbitration process.

As of the date of this annual report, the Company is expecting the final decision of the arbitrator regarding the arbitration proceedings against Vitec.

It is difficult to assess the likelihood of success of the arbitration proceedings against Vitec in each and every cause of action due to the diversity of the claims raised against us, the complexity and ambiguity of such proceedings and Vitec's pleading and the fact that the final decision is subject to the arbitrator discretion. Nevertheless, we believe that the Company's financial statements include an adequate provision to cover the probable outcome of the Vitec arbitration.

#### *Vitec Consortiums*

As part of the above agreement, on June 30, 2010 the Company, Vitec and Adv. Doron Afik, acting as trustee, or the Trustee, entered into the Consortium Escrow Agreement, or the Consortium Agreement. Under the Consortium Agreement, \$100,000 were to be held in escrow per each EU Consortium Agreement to be transferred from the Company to Vitec under the agreement. Once such Consortium Agreement was transferred to Vitec, the Trustee was to transfer \$100,000 per Consortium Agreement to the Company.

On December 7, 2010, Vitec gave notice to the Company that one such agreement was transferred to the Company and on December 16, 2010, \$100,000 were transferred by the Trustee to the Company.

On February 9, 2011, an employee of Vitec notified the Company that according to the EU website the final two Consortium Agreements had been transferred to Vitec. Despite such notice the Trustee has refrained from transferring the remaining funds to the Company.

The Trustee submitted a motion with the Tel-Aviv District Court requesting instructions from the court as to what to do with the abovementioned escrow funds following the Company's request. This motion was dismissed by the court due to lack of authority, in accordance with the Company's request. The Company also filed a claim with the Tel-Aviv District Court requesting that it order the Trustee to transfer the escrow funds to the Company. Vitec and the Trustee have filed a motion to dismiss this claim with the court. This proceeding was later transferred to arbitration proceedings with the consent of the parties. Additionally, the amount of \$200,000 which has been held by the Trustee was deposited with the court's fund office.

In the following months, the Company received official confirmations as to the transfer of the second and third consortium agreement to Vitec.

This proceeding is currently pending the final decision of the arbitrator regarding the arbitration proceedings against Vitec.

*Personal Claim against Adv. Doron Afik*

Due to the Trustee's refusal to transfer the escrow funds relating to the two remaining Consortium Agreements to the Company, the Company believes the Trustee breached his duties as Trustee and caused damage to the Company. Therefore, on June 9, 2011, the Company filed a statement of claim for damages of NIS 1,000,000 against the Trustee, along with an *ex-parte* motion for a lien on all of the Trustee's bank accounts.

On June 16, 2011, the court rendered its decision granting the lien subject to the Company depositing certain securities. The Trustee then filed a motion to cancel the lien and the court decided to transfer the proceedings to the District Court, but that the lien would remain in effect until a decision by the District Court. The District Court for Tel Aviv-Yaffo ordered the removal of the lien, and later on at the parties' mutual request, the court ordered to transfer these proceedings to arbitration.

On November 10, 2011 the Company submitted its statement of claim against Adv. Afik to the Arbitrator, in the same form as previously submitted to the court.

On January 15, 2012, Adv. Afik submitted his Statement of Defense to the claim against him, denying all of the Company's claims against him. Also on January 15, 2012, Adv. Afik submitted a counterclaim against Optibase, or the Afik Counter-Claim. In the Afik Counter Claim Adv. Afik demands to receive an aggregate sum of NIS 2,474,693.18 from the Company. Adv. Afik's claim is based on three main claims: (i) The Company's response to an article published in the website [www.sponsor.co.il](http://www.sponsor.co.il) constitutes libel against Adv. Afik for which he is owed damages of NIS 500,000; (ii) By obtaining liens on Adv. Afik's assets, the Company caused Adv. Afik damages of NIS 1,465,494.46; and (iii) That a publication about the liens obtained on Adv. Afik's assets also constitutes libel against Adv. Afik for which he is owed NIS 509,198.72. The Statement of Defense on behalf of the Company was submitted on March 4, 2012.

Evidentiary hearings on the Vitec Arbitration were scheduled for April 10, 2013. On January 11, 2013, Adv. Afik submitted his affidavit along with an expert opinion on his behalf. The company is required to submit a counter opinion on its behalf until March 14, 2013.

On January 20, 2013, the Arbitrator informed the parties that his decision regarding the arbitration with Vitec will be given along with the decision regarding the personal claim against Adv. Doron Afik and the Afik Counter-Claim.

We believe that the Company has strong legal and factual arguments to defend itself from the claims in the Afik Counter Claim.

#### **Dividend Policy**

We have not declared or paid any cash dividends on our ordinary shares in the past. We do not expect to pay cash dividends on our ordinary shares in the foreseeable future and intend to retain our future earnings, if any, to finance the development of our business.

A dividend policy, if adopted, will be determined by our board of directors and will depend, among other factors, upon our earnings, financial condition, capital requirements, the impact of the distribution of dividends on our financial condition and tax liabilities, and such other conditions as our board of directors may deem relevant. Under Israeli law, an Israeli company may pay dividends only out of its retained earnings as determined for statutory purposes. Under our articles of association the distribution of dividends will be made by a resolution of our board of directors. See "Description of Share Capital" and "Israeli Taxation and Investment Programs".

Cash dividends paid by an Israeli company are normally subject to a withholding tax, except for dividends paid to an Israeli company in which case no tax is withheld unless the dividend is in respect of earnings from an Approved Enterprise. In addition, because we have received certain benefits under Israeli laws relating to Approved Enterprises, the payment of dividends by us may be subject to certain Israeli taxes to which we would not otherwise be subject. The tax-exempt income attributable to the Approved Enterprise can be distributed to shareholders without subjecting us to taxes only upon our complete liquidation. If we decide to distribute cash dividends out of income that has been exempted from tax, the income out of which the dividend is distributed will be subject to corporate tax at a rate between 10% and 25%. See "Israeli Taxation and Investment Programs". In the event that cash dividends are declared in the future, such dividends will be paid in NIS or in foreign currency subject to any statutory limitations. Under current Israeli regulations, any dividends or other distributions paid in respect of ordinary shares will be freely repatriable in such non-Israeli currencies at the rate of exchange prevailing at the time of conversion, provided that Israeli income tax has been paid on, or withheld from, such payments. Because exchange rates between the NIS and the dollar fluctuate continuously, a U.S. shareholder will bear the risks of currency fluctuations during the period between the date such dividend is declared and paid by us in NIS and the date conversion is made by such shareholder into U.S. dollars.

#### **ITEM 8.B. SIGNIFICANT CHANGES**

Since the date of our financial statements for the year ended December 31, 2012, there has been a further progress in the arbitration between us and Vitec, as more fully described in Item 8. "Financial Information - Legal Proceedings".

#### **ITEM 9. THE OFFER AND LISTING**

##### **9.A. OFFER AND LISTING DETAILS**

Our ordinary shares are traded on The NASDAQ Global Market under the symbol OBAS since our initial public offering on April 7, 1999.

The following table sets forth, for the periods indicated, the high and low closing sale prices per share of our ordinary shares as reported by The NASDAQ Global Market.

All prices per share of our ordinary shares below was adjusted to reflect a one-for-five reverse share split of our ordinary shares that we effected on September 27, 2012. See "Item 4.A. History and Development of the Company - Reverse Share Split".

Year	Nasdaq	
	High	Low
2008	\$ 13.65	\$ 3.7
2009	\$ 7.5	\$ 4.65
2010	\$ 8	\$ 6
2011	\$ 8.75	\$ 4.95
2012	\$ 6.45	\$ 4.51
<b>2011</b>		
First Quarter	\$ 8.75	\$ 7.1
Second Quarter	\$ 8.75	\$ 6.8
Third Quarter	\$ 7.55	\$ 6.6
Fourth Quarter	\$ 7.6	\$ 4.95
<b>2012</b>		
First Quarter	\$ 6.45	\$ 5.25
Second Quarter	\$ 6.4	\$ 5.4
Third Quarter	\$ 6.35	\$ 5.4
Fourth Quarter	\$ 6.45	\$ 4.51
<b>2013</b>		
First Quarter (until March 1, 2013)	\$ 6.25	\$ 5.6
<b>Most Recent Six Months</b>		
September 2012	\$ 5.75	\$ 5.2
October 2012	\$ 6.45	\$ 4.51
November 2012	\$ 5.74	\$ 5.43
December 2012	\$ 5.88	\$ 5
January 2013	\$ 6.25	\$ 5.6
February 2013	\$ 5.7	\$ 5.7

On March 12, 2013, the reported closing sale price of our ordinary shares on The NASDAQ Global Market, was \$5.65 per share.

#### 9.B. PLAN OF DISTRIBUTION

Not applicable.

#### 9.C. MARKETS

Our ordinary shares have been listed on The NASDAQ Global Market since April 7, 1999, under the symbol "OBAS".

#### 9.D. SELLING SHAREHOLDERS

Not applicable.



#### **9.E. DILUTION**

Not applicable.

#### **9.F. EXPENSES OF THE ISSUE**

Not applicable.

#### **ITEM 10. ADDITIONAL INFORMATION**

##### **10.A. SHARE CAPITAL**

Not applicable.

##### **10.B. MEMORANDUM AND ARTICLES OF ASSOCIATION**

###### **Purposes and Objects of the Company**

We are a public company registered under the Companies Law as Optibase Ltd., registration number 52-003707-8.

Pursuant to our articles of association, our objectives are to engage in any lawful business and our purpose is to act pursuant to business considerations to make profits. A consideration to the Company's purpose and objectives can be found in Chapter 1 to the Company's articles of association.

Our articles of association also state that we may contribute a reasonable amount for an appropriate cause, even if the contribution is not within the framework of our business considerations.

###### **The Powers of the Directors**

The power of our directors to vote on a proposal, arrangement or contract in which the director is interested is limited by the relevant provisions of the Companies Law. In addition, the power of our directors to vote on compensation to themselves or any members of their body is limited in that such decision requires the approval of the audit committee, the board of directors and the shareholders at a general meeting, see "Approval of Certain Transaction" below.

Under Israeli law each director must act with an independent and sole discretion. Director who does not act this way is in breach of his fiduciary duties.

The powers of our directors to borrow are not limited, except in the same manner as any other transaction by the Company.

###### **Rights Attached to Shares**

Our registered share capital is NIS 3,900,000 divided into a single class of 6,000,000 ordinary shares, par value NIS 0.65 per share, of which 3,819,051 ordinary shares were outstanding as of March 1, 2013 (all numbers hereto was adjusted to reflect a one-for-five reverse share split of our ordinary shares that we effected on September 27, 2012. See "Item 4.A. History and Development of the Company - Reverse Share Split"). All outstanding ordinary shares are validly issued, fully paid and non-assessable. The rights attached to the Ordinary Shares are as follows:

###### *Dividend rights*

Holders of Ordinary Shares are entitled to the full amount of any cash or share dividend subsequently declared. The board of directors may propose a dividend only out of profits, in accordance with the provisions of the Companies Law. Declaration of a dividend requires the approval of our board of directors. Please see Item 10.E. "Taxation" below.

One year after a dividend has been declared and is still unclaimed, the board of directors is entitled to invest or utilize the unclaimed amount of dividend in any manner to our benefit until it is claimed. We are not obligated to pay interest or linkage differentials on an unclaimed dividend.

*Voting rights*

Holders of ordinary shares have one vote for each ordinary share held on all matters submitted to a vote of shareholders. Such voting rights may be affected by the grant of any special voting rights to the holders of a class of shares with preferential rights that may be authorized in the future. Currently there are no shares of capital stock outstanding with special voting rights. The quorum required for an ordinary meeting of shareholders consists of at least two shareholders present in person or by proxy who hold or represent, in the aggregate, at least thirty three and one third percent (33.3%) of our voting rights. In the event that a quorum is not present within half an hour of the scheduled time, the shareholders' meeting will be adjourned to the same day of the following week, at the same time and place, or such time and place as the board of directors may determine by a notice to the shareholders. If at such adjourned meeting a quorum is not present at the time of opening of such meeting, two shareholders, at least, present in person or by proxy, shall constitute a quorum.

An ordinary resolution, such as a resolution for the election of directors, or the appointment of auditors, requires the approval by the holders of a majority of the voting rights represented at the meeting, in person, by proxy or through a voting instrument and voting thereon. Under our articles of association, if a resolution to amend the articles of association is recommended by our board of directors, such recommended resolution's adoption in a general meeting of the shareholders requires an ordinary majority. In any other case, such a resolution requires approval of a special majority of more than three quarters of the votes of the shareholders entitled to vote themselves, by proxy or through a voting instrument.

The directors (who are not external directors) are appointed by decision of an ordinary majority at a general meeting. The directors have the right at any time, in a resolution approved by at least a majority of our directors, to appoint any person as a director, subject to the maximum number of directors specified in our articles of association, to fill in a place which has randomly been vacated, or as an addition to the board of directors. Any such director so appointed shall hold office until the next annual general meeting and may be reelected.

Under our articles of association our directors (who are not external directors) are elected by an ordinary majority of the shareholders at each duly convened annual meeting, and they serve until the next annual meeting, provided that external directors shall be elected in accordance with the Companies Law. In each annual meeting the directors that were elected at the previous annual meeting are deemed to have resigned from their office. A resigning director may be reelected.

Under the NASDAQ corporate governance rules, foreign private issuers are exempt from many of the requirements if they instead elect to be exempted from such requirements, provided they are not prohibited by home country practices and disclose where they have elected to do so.

*Rights in the Company's profits*

All of our ordinary shares have the rights to share in our profits distributed as a dividend and any other permitted distribution.

*Rights in the event of liquidation*

All of our ordinary shares confer equal rights among them with respect to amounts distributed to shareholders in the event of liquidation.

### **Changing Rights Attached to Shares**

According to our articles of association, our share capital may be divided into different classes of shares or the rights of such shares may be altered by an ordinary majority resolution passed by the general meetings of the holders of each class of shares separately, or after obtaining the written consent of the holders of all of the classes of shares. As of the date hereof, we only have one class of shares.

### **Annual and Extraordinary Meetings**

Our board of directors must convene an annual meeting of shareholders every year by no later than the end of fifteen months from the last annual meeting. Notice of at least twenty-one days prior to the date of the meeting is required. An extraordinary meeting may be convened by the board of directors, as it decides or upon a demand of any two directors or 25% of the directors, whichever is lower, or by one or more shareholders holding in the aggregate at least 5% of the voting rights in the Company. Where the board of directors is requisitioned to call a special meeting, it shall do so within twenty-one days, for a date that shall not be later than thirty-five days from the date on which the notice of the special meeting is published. Notice of a general meeting shall be given to all shareholders entitled to attend and vote at such meeting. No separate notice is to be given to registered shareholders of the Company. Notices may be provided by the Company in person, in mail, transmission by fax or in electronic form. A notice to a shareholder may alternatively be served, as general notice to all shareholders, in accordance with the rules and regulations of any applicable securities authority with jurisdiction over the Company or in accordance with the rules of any stock market upon which the Company's shares are traded.

### **Limitations on the Rights to Own Securities in the U.S.**

Our memorandum and articles of association do not restrict in any way the ownership of our shares by non-residents of Israel, and neither the memorandum and articles of association nor Israeli law restricts the voting rights of non-residents of Israel, except that under Israeli law, any transfer or issue of shares of a company to a resident of an enemy state of Israel is prohibited and shall have no effect, unless authorized by the Israeli Minister of Finance.

### **Limitations on Change in Control and Disclosure Duties**

Our memorandum and articles of association do not restrict the change of control nor do they impose any disclosure duties beyond the requirements set out in Israeli law. For restriction of change of control provision under Israeli law, see Item 3.D. "Risk Factors", under the heading "Risks Relating to Operations in Israel – Anti-takeover Provisions" above.

### **Changes in Our Capital**

Changes in our capital are subject to the approval of the shareholders at a general meeting by an ordinary majority of shareholders participating and voting in the general meeting.

### **Fiduciary Duty and Duty of Care of Directors and Officers**

The Companies Law codifies the duties directors and officers owe to a company. An "Officer" includes a company's general manager, general business manager, executive vice president, vice president, any other person assuming the responsibilities of any of the foregoing positions without regard to such person's title and other directors or managers directly subordinate to the general manager. The directors' and officers' principal duties to the company are a duty of care and a fiduciary duty to act in good faith for the company's benefit which include:

- ❖ the avoidance of any conflict of interest between the director's or officer's position with the company and any other position he or she fulfills or with his or her personal affairs;
- ❖ the avoidance of any act in competition with the company's business;

- ❖ the avoidance of exploiting any of the company's business opportunities in order to gain a personal advantage for himself or for others; and
- ❖ the disclosure to the company of any information and documentation relating to the company's affairs obtained by the director or officer due to his or her position with the company.

The Companies Law requires that directors, officers or a controlling shareholder of a public company disclose to the company any personal interest that he or she may have, including all related material facts or documents in connection with any existing or proposed transaction by the company. The disclosure must be made without delay and no later than the first board of directors meeting at which the transaction is first discussed.

#### **Approval of Certain Transactions**

Generally, under the Companies Law, engagement terms of directors, including the grant of an exemption from liability, purchase of directors' and officers' insurance, or grant of indemnification (whether prospective or retroactive) and engagement terms of such director with a company in other positions require the approval of the audit committee, the board of directors and the shareholders of the company. In addition, transactions between a public company and its director or officer, or a transaction between such company and other person in which such director or officer has a personal interest must be approved by such company's board of directors, and if such transaction is considered an extraordinary transaction (as defined below) it must receive the approval of such company's audit committee as well. The determination whether such transaction is considered extraordinary or not is required to be made by audit committee.

The Companies Law also requires that any extraordinary transaction between a public company and its controlling shareholder or an extraordinary transaction between such company and other person in which such company's controlling shareholder has a personal interest must be approved by the audit committee, the board of directors and the shareholders of the company by an ordinary majority, provided that (i) such majority vote at the shareholders meeting shall include a majority of the total votes of shareholders having no personal interest in the transaction, participating at the voting (excluding abstaining votes); or (ii) the total number of votes of shareholders mentioned in clause (i) above who voted against such transaction does not exceed two percent (2%) of the total voting rights in the company. An "extraordinary transaction" is defined in the Companies Law as any of the following: (i) a transaction not in the ordinary course of business; (ii) a transaction that is not on market terms; or (iii) a transaction that is likely to have a material impact on the company's profitability, assets or liability. Such an extraordinary transaction which shall last for a period exceeding three years shall be approved again by such company's audit committee, board of directors and general meeting of shareholders by the special majority described above once in every three years.

The Companies Law further provides that the engagement terms of a controlling shareholder or its relative (including by an entity controlled by such controlling shareholder or its relative) with the company, either as an officer or an employee, must also be approved by such company's audit committee, board of directors and general meeting by the special majority described above. Such an engagement which shall last for a period exceeding three years shall be approved again by such company's audit committee, board of directors and general meeting by the special majority described above once in every three years. However, an engagement described in the beginning of this paragraph only which may be approved for a period exceeding three years, provided that the audit committee approved the engagement term to be reasonable under the circumstances.

The Companies Law prohibits any person who has a personal interest in a matter to participate in the discussion and voting pertaining to such matter in the company's board of directors or audit committee except for in circumstances when the majority of the board of directors' (or the audit committee – as the case may be) has a personal interest in the matter. In case the majority has a personal interest in such matter then such matter must also be approved by the company's shareholders. An officer who has a personal interest may be present for the presentation of the transaction if the chairman of the audit committee or the chairman of the board of directors as the case may be, determined that such officers presence is required for the presentation of the said transaction.

## Compensation of Officers and Directors

Amendment No. 20 to the Companies Law, or Amendment No. 20, which recently came into effect, adopted new procedures relating to the approval of executive compensation and the formulation of compensation policies in Israeli public companies (including companies that issued only debentures to the public). Pursuant to Amendment No. 20, Israeli public companies are required to establish a compensation committee and adopt a policy regarding the compensation and terms of employment of their directors and officers. For information on the composition, roles and objectives of the compensation committee pursuant to the Companies Law and our compensation committee charter, see Item 6.C. "Board Practices – Committees of the Board of Directors – The Compensation Committee".

Pursuant to the Companies Law following Amendment No. 20, the compensation policy must be approved by the company's board of directors after reviewing the recommendations of the compensation committee. The compensation policy also requires the approval of the general meeting of the shareholders, which approval must satisfy one of the following (which we refer to hereinafter as the Majority Requirement): (i) the majority should include at least a majority of the shares of the voting shareholders who are non controlling shareholders or do not have a personal interest in the approval of the compensation policy (in counting the total votes of such shareholders, abstentions shall not be taken into account) or (ii) the total number of votes against the proposal among the shareholders mentioned in paragraph (i) does not exceed two percent of the aggregate voting power in the company. Under certain circumstances and subject to certain exceptions, the board of directors may approve the compensation policy despite the objection of the shareholders, provided that the compensation committee and the board of directors determines that it is for the benefit of the company, following an additional discussion and based on detailed arguments.

The Companies Law provides that the compensation policy must be re-approved every three years, in the manner described above. Moreover, the board of directors is responsible for reviewing from time to time the compensation policy and deciding whether or not there are any circumstances that require an adjustment to the company's compensation policy. When approving the compensation policy, the relevant organs must take into consideration the goals and objectives listed in the Companies Law, and include reference to specific issues listed in the Companies Law. Such issues include, among others: (i) the relevant person's education, qualifications, professional experience and achievements; (ii) such person's position within the company, the scope of his responsibilities and previous compensation arrangements with the company; (iii) the proportionality of such person's compensation in relation to the average and median pay of other employees in the company, including contract workers, and the impact of the differences between such person's compensation and the other employees' compensation on the labor relations in the company; (iv) the authority, at the board of director's sole discretion, to lower any variable compensation components or set a maximum limit (cap) on the actual value of the non-cash variable components, when paid; and (v) in the event that the terms of engagement include any termination payments - the term of employment of the departing person, the company's performance during that term, and the departing person's contribution to the performance of the company. The abovementioned issues will be referred to hereinafter as Compensation Policy Mandatory Criteria.

In addition, the Companies Law provides that the following matters shall be included in the compensation policy: (i) the award of variable components must be based on long term and measurable performance criteria (other than non-material variable components, which may be based on non measurable criteria taking into account the relevant person's contribution to the performance of the company); (ii) the company must set a ratio between fixed and variable pay, set a cap on the payment of any cash variable compensation components as of the payment of such components, and set a cap on the maximum cash value all non-cash variable components as of their grant date; (iii) the compensation policy must include a provision requiring the relevant person to return to the company any compensation that was awarded on the basis of financial figures that were subsequently restated; (iv) equity based variable compensation components should have an appropriate minimum vesting periods, which should be linked to long term performance objectives; and (v) the company must set a clear limit on termination payments. The abovementioned matters will be referred to hereinafter as Compensation Policy Mandatory Provisions.

Amendment No. 20 also introduced new procedures for the approval of compensation arrangements with officers and directors of Israeli public companies (including companies that issued only debentures to the public). Pursuant to the Companies Law following Amendment No. 20, any transaction with an office holder (except directors and the CEO of the company) with respect to such office holder's compensation arrangements and terms of engagement, requires the approval of the compensation committee and the board of directors. Such transaction must be consistent with the provisions of the company's compensation policy, provided that the compensation committee and the board of directors may, under special circumstances, approve such transaction that is not in accordance with the company's compensation policy, if both of the following conditions are met: (i) the compensation committee and the board of directors discussed the transaction in light of the roles and objectives of the compensation committee (see Item 6.C. "Board Practices – Committees of the Board of Directors – the Compensation Committee") and after taking into consideration the Compensation Policy Mandatory Criteria and including in such transaction the Compensation Policy Mandatory Provisions; and (ii) the company's shareholders approved the transaction, provided that in public companies the approval must satisfy the Majority Requirement. Notwithstanding the above, the compensation committee and the board of directors may, under special circumstances, approve such transaction even if the shareholders' meeting objected to its approval, provided that (i) both the compensation committee and the board of directors re-discussed the transactions and decided to approve it despite the shareholder's objection, based on detailed arguments, and (ii) the company is not a 'Public Pyramid Held Company'. For the purpose hereof, a "Public Pyramid Held Company" is a public company that is controlled by another public company (including companies that issued only debentures to the public), which is also controlled by another public company (including companies that issued only debentures to the public) that has a controlling shareholder.

Transactions between public companies (including companies that have issued only debentures to the public) and their chief executive officer, with respect to his or her compensation arrangement and terms of engagement, require the approval of the compensation committee, the board of directors and the shareholder's meeting, provided that the approval of the shareholders' meeting must satisfy the Majority Requirement. Notwithstanding the above, the compensation committee and the board of directors may, under special circumstances, approve such transaction with the CEO even if the shareholders' meeting objected to its approval, provided that (i) both the compensation committee and the board of directors re-discussed the transactions and decided to approve it despite the shareholder's objection, based on detailed arguments, and (ii) the company is not a Public Pyramid Held Company. Such transaction with the CEO must be consistent with the provisions of the company's compensation policy, provided that the compensation committee and the board of directors may, under special circumstances, approve such transaction that is not in accordance with the company's compensation policy, if both of the following conditions are met: (i) the compensation committee and the board of directors discussed the transaction in light of the roles and objectives of the compensation committee (see Item 6.C. "Board Practices – Committees of the Board of Directors – the Compensation Committee") and after taking into consideration the Compensation Policy Mandatory Criteria and including in such transaction the Compensation Policy Mandatory Provisions; and (ii) the company's shareholders approved the transaction, provided that in public companies the approval must satisfy the Majority Requirement. In addition, the compensation committee may determine that such transaction with the CEO does not have to be approved by the shareholders of the company, provided that: (i) the CEO is independent based on criteria set forth in the Companies Law; (ii) the compensation committee determined, based on detailed arguments, that bringing the transaction to the approval of the shareholders may compromise the chances of entering into the transaction; and (iii) the terms of the transaction is consistent with the provisions of the company's compensation policy. Under the Companies Law, non material amendments of transactions relating to the compensation arrangement or terms of engagement of office holders (including the CEO), require only the approval of the compensation committee.

With respect to transactions relating to the compensation arrangement and terms of engagements of directors in public companies (including companies that have issued only debentures to the public), the Companies Law following Amendment No. 20 provides that such transaction shall be subject to the approval of the compensation committee, the board of directors and the shareholders' meeting. Such transaction must be consistent with the provisions of the company's compensation policy, provided that the compensation committee and the board of directors may, under special circumstances, approve such transaction that is not in accordance with the company's compensation policy, if both of the following conditions are met: (i) the compensation committee and the board of directors discussed the transaction in light of the roles and objectives of the compensation committee (see Item 6.C. "Board Practices – Committees of the Board of Directors – the Compensation Committee") and after taking into consideration the Compensation Policy Mandatory Criteria and including in such transaction the Compensation Policy Mandatory Provisions; and (ii) the company's shareholders approved the transaction, provided that in public companies the approval must satisfy the Majority Requirement.

Amendment No. 20 became effective on December 12, 2012. Under Amendment No. 20, Israeli public companies must adopt a compensation policy within nine months from the date on which the amendment became effective, *i.e.* September 12, 2013. During this period, extensions of existing terms of engagement with directors and officers of Israeli public companies are not subject to the provisions of Amendment No. 20, provided that they are extended as-is without any modification. As of the date of this annual report, we have not yet adopted a compensation policy in accordance with the provisions of Amendment No. 20.

On January 11, 2013, the SEC approved the amended NASDAQ listing standards on compensation committees and advisers. Among others, the amended NASDAQ listing standards include provisions relating to the establishment of a compensation committee, the compensation committee charter, compensation committee members' independence requirements, and arrangements relating to advisers retained by the compensation committee. Under the amended rules, the compensation committee adviser and compensation committee authority requirements become effective on July 1, 2013. However, NASDAQ listed companies will have until their first annual meeting after January 15, 2014, or, if earlier, October 31, 2014, to comply with other standards, including the compensation committee member independence standards and the requirement to have a compensation committee and charter (including any charter amendment to reflect the compensation committee authority requirements). NASDAQ listed companies must certify compliance with the listing standards within 30 days after the applicable implementation deadline. In addition, under the amended rules, foreign private issuers are exempt from compliance with the amended listing standards if home country practice is followed and the listed company discloses with the SEC the reasons why it does not have an independent compensation committee. As of the date of this annual report, we have not yet amended our compensation committee charter to reflect the requirements of the amended rules, but we plan to do so in the future.

#### **Anti-Takeover Provisions; Mergers and Acquisitions**

*Special Tender Offer.* The Companies Law provides that an acquisition of shares of an Israeli public company must be made by means of a special tender offer if, as a result of the acquisition, the purchaser would become a holder of at least 25% of the voting rights in the company. This rule does not apply if there is already another holder of at least 25% of the voting rights in the company. Similarly, the Companies Law provides that an acquisition of shares in a public company must be made by means of a tender offer if, as a result of the acquisition, the purchaser would become a holder of more than 45% of the voting rights in the company and no other shareholder of the company holds more than 45% of the voting rights in the company. These requirements do not apply if the acquisition (i) occurs in the context of a private placement by the company that received shareholder approval, (ii) was from a shareholder holding at least 25% of the voting rights in the company and resulted in the acquirer becoming a holder of at least 25% of the voting rights in the company, or (iii) was from a holder of more than 45% of the voting rights in the company and resulted in the acquirer becoming a holder of more than 45% of the voting rights in the company. The special tender offer may be consummated only if (a) at least 5% of the voting power attached to the company's outstanding shares will be acquired by the offeror and (b) the number of shares tendered in the offer exceeds the number of shares whose holders objected to the offer.

In the event that a special tender offer is made, a company's board of directors is required to express its opinion on the advisability of the offer or shall abstain from expressing any opinion if it is unable to do so, provided that it gives the reasons for its abstention. An office holder in a target company who, in his or her capacity as an office holder, performs an action the purpose of which is to cause the failure of an existing or foreseeable special tender offer or is to impair the chances of its acceptance, is liable to the potential purchaser and shareholders for damages, unless such office holder acted in good faith and had reasonable grounds to believe he or she was acting for the benefit of the company. However, office holders of the target company may negotiate with the potential purchaser in order to improve the terms of the special tender offer, and may further negotiate with third parties in order to obtain a competing offer.

A special tender offer may not be consummated unless a majority of the shareholders who announced their stand on such offer have accepted it (in counting the total votes of such shareholders, shares held by the controlling shareholder, shareholders who have personal interest in the offer, or shareholder who own 25% or more of the voting rights in the company, shall not be taken into account). If a special tender offer was accepted by a majority of the shareholders who announced their stand on such offer, then shareholders who did not announce their stand or who had objected to the offer may accept the offer within four days of the last day set for the acceptance of the offer.

In the event that a special tender offer is accepted, the purchaser or any person or entity controlling it at the time of the offer or under common control with the purchaser or such controlling person or entity shall refrain from making a subsequent tender offer for the purchase of shares of the target company and cannot execute a merger with the target company for a period of one year from the date of the offer, unless the purchaser or such person or entity undertook to effect such an offer or merger in the initial special tender offer.

*Full Tender Offer.* A person wishing to acquire shares or a class of shares of an Israeli public company and who would, as a result, hold over 90% of the target company's issued and outstanding share capital or that certain class of shares is required by the Companies Law to make a tender offer to all of the company's shareholders for the purchase of all of the issued and outstanding shares of the company or class of shares. If either (i) the shareholders who do not accept the offer hold less than 5% of the issued and outstanding share capital of the company or of the applicable class, and more than half of the shareholders who do not have a personal interest in the offer accept the offer, or (ii) the shareholder who do not accept the offer hold less than 2% of the issued and outstanding share capital of the company or of the applicable class, then all of the shares that the acquirer offered to purchase will be transferred to the acquirer by operation of law. However, a shareholder that had its shares so transferred, whether it accepted the tender offer or not, may, within six months from the date of acceptance of the tender offer, petition the court to determine that tender offer was for less than fair value and that the fair value should be paid as determined by the court. If the shareholders who did not accept the tender offer hold at least 5% of the issued and outstanding share capital of the company or of the applicable class of shares, the acquirer may not acquire shares of the company that will increase its holdings to more than 90% of the company's issued and outstanding share capital or of the applicable class from shareholders who accepted the tender offer.

*Merger.* The Companies Law permits merger transactions if approved by each party's board of directors and, unless certain requirements described under the Companies Law are met, a majority of each party's shares voted on the proposed merger at a shareholders' meeting called with at least 35 days' prior notice.

For purposes of the shareholder vote, unless a court rules otherwise, the merger will not be deemed approved if a majority of the shares represented at the shareholders meeting that are held by parties other than the other party to the merger, or by any person who holds 25% or more of the outstanding shares or the right to appoint 25% or more of the directors of the other party, vote against the merger. If the transaction would have been approved but for the separate approval of each class or the exclusion of the votes of certain shareholders as provided above, a court may still approve the merger upon the request of holders of at least 25% of the voting rights of a company if the court holds that the merger is fair and reasonable, taking into account the value of the parties to the merger and the consideration offered to the shareholders.

Upon the request of a creditor of either party to the proposed merger, the court may delay or prevent the merger if it concludes that there exists a reasonable concern that, as a result of the merger, the surviving company will be unable to satisfy the obligations of any of the parties to the merger, and may further give instructions to secure the rights of creditors.

In addition, a merger may not be completed unless at least 50 days have passed from the date that a proposal for approval of the merger was filed by each party with the Israeli Registrar of Companies and 30 days have passed from the date the merger was approved by the shareholders of each of the merging companies.

*Anti-Takeover Measures Under Israeli Law.* The Companies Law allows us to create and issue shares having rights different from those attached to our ordinary shares, including shares providing certain preferred rights, distributions or other matters and shares having preemptive rights. As of the date of this annual report, we do not have any authorized or issued shares other than our ordinary shares. In the future, if we do create and issue a class of shares other than ordinary shares, such class of shares, depending on the specific rights that may be attached to them, may delay or prevent a takeover or otherwise prevent our shareholders from realizing a potential premium over the market value of their ordinary shares. The authorization of a new class of shares will require an amendment to our articles of association which requires the prior approval of the holders of a majority of our ordinary shares at a general meeting.



*Tax Law.* Israeli tax law treats some acquisitions, such as a stock-for-stock swap between an Israeli company and a foreign company, less favorably than U.S. tax law. For example, Israeli tax law may subject a shareholder who exchanges his ordinary shares for shares in a foreign corporation to immediate taxation. Please see Item 10E. "Taxation".

#### **10.C. MATERIAL CONTRACTS**

##### *Swiss Pro Capital Limited*

On March 1, 2010, the Company's subsidiary in Luxembourg Optibase RE 1 SARL or Optibase RE 1 entered into an Option Agreement, or the Option Agreement, with a Cypriot company, Swiss Pro, with respect to a commercial building acquired by the Company in October, 2009 in Rümlang, Switzerland. Through its beneficial owner, Swiss Pro introduced Optibase to the Rümlang property and facilitated Optibase's acquisition and financing of the property. Under the Option Agreement, Optibase RE 1 granted Swiss Pro an option to purchase twenty percent (20%) of the share capital of Optibase RE 1. Swiss Pro undertook to pay a purchase price for the option of CHF 315,000 for the option. The exercise price under the Option Agreement is calculated based on twenty percent (20%) Optibase's acquisition costs for the Rümlang Property plus interest and an adjustment for proceeds that are distributed to the shareholders of Optibase RE 1. The shares that would be issued to Swiss Pro upon exercise of the option will not have voting rights and would be subject to transfer restrictions in favor of Optibase.

##### *Sale of our Video Solutions Business*

On March 16, 2010 we and our subsidiary, Optibase Inc., entered into an APA with Optibase Technologies Ltd. and Stradis Inc., wholly owned subsidiaries of S.A. Vitec (also known as Vitec Multimedia), pursuant to which Optibase Technologies Ltd. and Stradis Inc. will purchase all of the assets and liabilities related to our Video Solutions Business. Closing of the transaction occurred on July 1, 2010. The following is a short summary of the principal provisions of the APA:

##### *Acquired Assets and Liabilities*

Pursuant to the APA, Vitec has acquired all rights, title and interest in and to all of our assets and assumed certain liabilities, related to our Video Solutions Business only or the Acquired Assets. Our Video Solutions Business included the design, development, manufacture, production, supply, sale, marketing and distribution of video devices and related services or the Video Solutions Business.

The Acquired Assets included all inventories, tangible assets, intellectual property rights and right under certain assumed agreements, all in relation to the Video Solutions Business only. In addition, Vitec also acquired all rights to the name "Optibase" and derivatives thereof provided, however, that we are entitled to use the Optibase name in connection with our business so long as such use is not related to the field of video solutions.

The following was not purchased by Vitec pursuant to the APA: the legal entities of Optibase Ltd. and Optibase Inc.; any securities of Optibase Inc. and any of our other subsidiaries or affiliates; our rights to any grants from the Israeli Office of the Chief Scientist or from other EU/EC sponsored programs or other grants, received or receivable as to the period ending upon closing of the Transaction; cash, cash equivalents and other investments; leases on our offices, and other properties; rights and claims under current insurance policies and all other assets not related to the and our Video Solutions Business, or Excluded Assets. In addition, the Excluded Assets include, inter alia, our real estate assets as well as other investments, held directly or indirectly by us.

#### *Consideration*

As consideration for the Acquired Assets and the assumption of our liabilities, Vitec paid us a sum of \$8 million (plus adjustments relating to receivables and payables as of the closing of the Transaction), of which a sum of \$7 million was paid in cash upon closing and \$1 million was deposited in an escrow for a period of two years as a security for damages arising or resulting from, *inter alia*, breach or material inaccuracy relating to our representations and warranties and covenants and liabilities that Vitec may incur which are part of the Excluded Liabilities.

In addition, under to the APA, the consideration will be further adjusted according to an earn-out mechanism pursuant to which 45% of Vitec's revenues deriving from the Video Solutions Business and exceeding \$14 million in the year following the closing of the Transaction, will be paid to us. According to information recently received from Vitec, we will not receive any proceeds from the "earn-out" mechanism.

#### *Signing Deposit*

Upon signing of the APA, Vitec deposited US \$500,000 in escrow to be paid to us if closing does not take place within a specific period of time from signing, subject to certain limited circumstances, principally relating to the non-fulfillment of certain closing conditions by Optibase, including, *inter alia*, the receipt of necessary governmental and third party approvals and the transfer of a certain number of employees to Vitec, in which case, such funds will be returned to Vitec. Following the closing of the Transaction, such sums were repaid to Vitec.

#### *Representations and Warranties*

The APA includes certain representations and warranties which are customary for transactions of this type. Such representations and warranties include, among others, representations and warranties by the Company that relate to the Acquired Assets and Liabilities, to our financial results, intellectual property, employment matters, legal proceedings etc. and representations and warranties of Vitec relating to, among others, its ability to continue and operate the Video Solutions Business and the financial condition of Vitec. Such representations and Warranties will survive closing for a period of twenty four months, except for certain exceptions relating to, *inter alia*, provisions providing for non-competition and confidentiality undertakings and fraud or willful misconduct.

#### *Closing Conditions*

Consummation of the Transaction is subject to the fulfillment of certain conditions precedent standard for transactions of this nature, including, *inter alia*, receipt of all necessary approvals and permits, the approval of our shareholders and the transfer of a certain number of employees to Vitec.

With respect to the consortium agreements to which we are a party, if necessary approvals for the assumption of such agreements are not obtained until closing, we may choose to either terminate the APA or pay to Vitec a certain amount unsubstantial to the Company for each consortium agreement which cannot be assigned to Vitec.

#### *Additional Undertakings*

Both parties have undertaken several covenants for the period beginning on the signing of the APA and for the period beginning on date of the closing of the Transaction. In this respect, during the period beginning on the signing of the APA and ending on closing of the Transaction, we have undertaken, *inter alia*, to continue and operate the business in the ordinary course of business and not to make any action relating to the acquisition, sale, or transfer of any of the Acquired Assets or change of control over Seller other than in the ordinary course of business and Vitec has undertaken, among others, to offer employment to a certain number of our employees on terms no less favorable than their current terms of employment or service with the Seller. In addition, for the period following the closing of the Transaction, we have undertaken to comply with non-competition and confidentiality provisions and Vitec has undertaken to provide us with access to information and records, and to endeavor to continue operating the Video Solutions Business for a period of at least twelve months from the closing of the Transaction.

#### *Indemnification*

The APA includes mutual indemnification for a period of two years for damages arising or resulting from, inter alia, breach or material inaccuracy relating to the representations, warranties and covenants and the liabilities that Vitec may incur which are part of the Excluded Liabilities arising or resulting therefrom such as the breach or material inaccuracy of any representation or warranty. In addition, indemnification provisions will apply for longer periods in the case of damages resulting from fraud or willful misconduct, a period of three years from closing for non-competition provisions and an indefinite confidentiality undertaking). The mutual indemnification will be limited to a maximum amount of \$6 million.

From and after the closing, the rights of the parties to indemnification shall be the exclusive remedy of the Parties with respect to claims resulting from this Agreement.

The amount of \$1 million which will be deposited in the indemnity escrow account as aforementioned, will be used for such indemnification, and any outstanding sums will be paid by the indemnifying party.

#### *Termination*

Both parties shall have the right to terminate the APA, if the other side has breached any material representation, warranty, or covenant contained in the APA, or if closing did not take place within 120 days from the signing of the APA. Vitec may also terminate the APA if any material portion of the Acquired Assets is no longer in our possession immediately prior to closing or is damaged and we have not cured such situation within a period of 30 days. In addition, as aforesaid, we may terminate the agreement if the necessary approvals for the assumption of the consortium agreements are not obtained until closing.

#### *Guaranty of S.A. Vitec*

S.A. Vitec has undertaken to fully guarantee all undertakings, representations, warranties and obligations of Optibase Technologies Ltd. under the APA.

#### *Assignment Notice and Joinder Agreement*

In connection with the closing of the Vitec Transaction, on June 30, 2010 the parties to the APA and Stradis Inc. signed an Assignment Notice and Joinder Agreement pursuant to which Optibase Technologies assigned Stradis Inc, the right to purchase all of the Acquired Assets (as defined in the APA) owned by Optibase Inc. and the Assumed Liabilities (as defined in the APA) related to such Acquired Assets and Stradis Inc. was deemed a signatory and party to the APA considered the "Purchaser" together with Optibase Technologies Ltd. under the APA and all representations, warranties, covenants, rights and obligations of the Purchaser under the APA shall apply jointly and severally to both Optibase Technologies Ltd. and Stradis, mutatis mutandis.

#### *Side Letter*

In connection with the closing of the Vitec Transaction, on June 30, 2010 the parties to the APA signed a Side Letter pursuant to which the parties agreed upon certain arrangements including, *inter alia*, the following: (i) closing of the transaction will occur on July 1, 2010; (ii) funds relating to three European Union consortium agreements which will be placed in a consortium escrow account to be released to the Company upon the transfer of each such agreement; and (iii) since the Company and Vitec could not reach an understanding with respect to the adjustment sums payable upon closing and in order to prevent postponement of the closing date, the Side Letter stipulated that the Company would provide a calculation of the adjustment amount within five days of the closing and Vitec would deposit in escrow an amount equal to the adjustment amount, to be released over a period of 12 months as Vitec collects amounts owed to the Company from customers.

To date, we and Vitec commenced an arbitration proceedings, see Item 8. "Financial Information - Legal Proceedings".

#### ***Office Complex in Geneva, Switzerland***

On March 3, 2011 we acquired, through our subsidiary, an office building complex in Geneva, Switzerland known as Centre des Technologies Nouvelles (CTN), or the Property. The acquisition was undertaken by OPCTN S.A., or OPCTN, a Luxembourg company owned 51% by Optibase and 49% by The Phoenix Insurance Company Ltd and The Phoenix Comprehensive Pension, collectively The Phoenix. OPCTN undertook the transaction by acquiring all of the ownership interest in the Property owner Eldista. The seller, Apollo CTN. S.a.r.l, or Apollo is an entity majority owned by area property partners.

Centre des Technologies Nouvelles (CTN) is a six-building complex located in the Plan-Les-Ouates business park in the outskirts of Geneva. The complex includes approximately 35,000 square meter (approximately 377,000 square feet) of primarily space and is a center for advanced industries including biotech electronic and information technology industries.

The transaction was based on a value of CHF 126.5 million (approximately \$136.5 million as of the purchase date) and included the assumption of an existing nonrecourse mortgage financing in the principal amount of CHF 85.3 million (approximately \$92.4 million as of the purchase date) provided by Credit Suisse. The purchase price for the Eldista shares was CHF 37.7 million (approximately \$40.6 million as of the purchase date) subject to a post-closing price adjustment to reflect Eldista's assets and liabilities as of the closing date.

On the date of the agreement, we paid to the seller Apollo CTN S.a.r.l CHF 37.4 million and additional CHF 300,000 as post-closing price adjustment (approximately \$40.2 million and \$ 319,000 respectively as of the purchase date).

OPCTN and Apollo entered into a Share Purchase Agreement which included customary representations, and warranties as well as limited indemnities from Apollo regarding Eldista and the Property. The Seller's obligations under the SPA are guaranteed by Apollo Real Estate Fund II LP and Apollo European Real Estate Fund II (Euro) LP.

#### ***Shareholders Agreement with the Phoenix***

In connection with the purchase of the office complex in Geneva, Switzerland, we and The Phoenix entered on February 8, 2011 into a Shareholders Agreement regarding our joint shareholdings in OPCTN. The Shareholders Agreement provides that Optibase will manage the day-to-day operations of OPCTN and Eldista but that certain actions of OPCTN and Eldista are subject to the joint approval of and the Phoenix. These actions include amendments to organizational documents, changes to business activity, financing arrangements, related party agreements, lease agreements exceeding twenty five percent of the leasable area of the Property, and requesting investments from shareholders in excess of CHF one million in a given year and CHF 2.5 million in aggregate.

The Shareholders Agreement also provides that Optibase and Phoenix will fund operating expenses and necessary capital expenditures for the Property that are not adequately funded by operating income, up to an amount of CHF two million per event or CHF five million per event if the capital expenditures are recommended by a third-party building engineering company. If we or The Phoenix do not provide our respective share of these expenses, the Shareholders Agreement provides that the OPCTN shareholdings (and shareholders loans) of the non-funding shareholder ownership will be diluted.

The Shareholders Agreement prohibited us and the The Phoenix from transferring shares in OPCTN until March 2012 and provides that any transfer of shares thereafter (other than to a related party) is subject to the reasonable approval of Optibase and The Phoenix. In addition, the Shareholders Agreement includes right of first offer, tag along and drag along rights in favor of both Optibase and Phoenix. The agreement provides that Optibase will make day-to-day decisions and provides The Phoenix with customary protective rights.

#### ***Private Placement to Shlomo (Tom) Wyler***

Following the approval of our audit committee and board of directors, and the approval of our shareholders during a special general meeting of our shareholders held on May 5, 2011, the Company issued to Mr. Wyler, the president of the Company and a member of our board of directors, 500,000 ordinary shares of the Company, then representing 13.11% of the Company's voting rights in consideration for \$5 million. The Company further undertook to make best efforts to register for resale all the shares issued to Mr. Wyler in the private placement, and the existing shares then held by Mr. Wyler under the Securities Act within six months as of their issue date.

#### ***Office Complex in Geneva, Switzerland (CTN) refinancing agreement***

On October 28, 2011 we entered into a CHF 15 million mezzanine bank loan and a CHF 85 million refinancing mortgage loan with Credit Suisse for the Company's Centre de Technologies Nouvelles (CTN) office building complex in Geneva, Switzerland. The refinancing was undertaken by OPCTN and by OPCTN's subsidiary, Eldista which is the owner of the Property.

Under the new financing agreements, Credit Suisse provided the mezzanine loan to OPCTN and refinanced the existing mortgage loan that Credit Suisse had provided to Eldista in 2010 that had an outstanding balance of CHF 83 million with a new CHF 85 million mortgage loan. The combined interest rate of the two new loans represents a 97 basis-point discount compared with the interest rate that Credit Suisse charged in the 2010 mortgage loan. The loans are amortized at a rate of CHF two million per year. The loans are secured by a first mortgage over the Property and by a pledge of Eldista's shares.

The refinancing allowed us and our partners (51% and 49% respectively) to retrieve approximately CHF 15 million of the equity initially invested in the acquisition. As of the refinancing date the refinancing increased our overall liquidity and reduced principal payments by a total of CHF 3.75 million over the next four years period. Based on current interest rates and net of loan expenses, we also expect a reduction of interest expenses by approximately CHF 2.1 million, resulting in an overall expected improvement to cash flows due to the refinancing of approximately CHF 5.8 million for the four years period.

On October 2, 2011, the Company's board of directors approved the refinancing agreement. Following the approval of the Company's board of directors of the Refinancing Loan and the Mezzanine Loan, the loan documents were completed and the loan was executed on October 28, 2011.

#### **10.D. EXCHANGE CONTROLS**

Israeli law and regulations do not impose any material foreign exchange restrictions on non-Israeli holders of our ordinary shares. In May 1998, a new "general permit" was issued under the Israeli Currency Control Law, 1978, which removed most of the restrictions that previously existed under the law and enabled Israeli citizens to freely invest outside of Israel and freely convert Israeli currency into non-Israeli currencies.

Dividends, if any, paid to holders of our ordinary shares, and any amounts payable upon our dissolution, liquidation or winding up, as well as the proceeds of any sale in Israel of our ordinary shares to an Israeli resident, may be paid in non-Israeli currency or, if paid in Israeli currency, may be converted into freely repatriable dollars at the rate of exchange prevailing at the time of conversion.

Under Israeli law (and our memorandum and articles of association), persons who are neither residents nor nationals of Israel may freely hold, vote and transfer ordinary shares in the same manner as Israeli residents or nationals. Subject to anti-terror legislations, there are no limitations on the rights of non-resident or foreign owners to hold or vote ordinary shares imposed under Israeli law or under our articles of association.

## 10.E. TAXATION

The following is a discussion of tax consequences material to us and our Israeli and U.S. shareholders. To the extent the discussion is based on new tax legislation, which has not been subject to judicial or administrative interpretation, we cannot assure you that the tax authorities or the courts will accept the views expressed in this section. The discussion is not intended, and should not be construed, as legal or professional tax advice and does not exhaust all possible tax considerations. Holders of our ordinary shares should consult their own tax advisors as to the United States, Israeli or other tax consequences of the purchase, ownership and disposition of ordinary shares, including, in particular, the effect of any non-U.S., state or local taxes.

### Israeli taxation

#### *General Corporate Tax Structure in Israel*

Generally, Israeli companies are subject to "Corporate Tax" on their taxable income. On July 25, 2005, the Knesset (Israeli Parliament) approved an amendment to the Income Tax Ordinance, which prescribes, among others, a gradual decrease in the corporate tax rate in Israel to the following tax rates: in 2006 - 31%, in 2007 - 29%, in 2008 - 27%, in 2009 - 26% and in 2010 and thereafter - 25%. In July 2009, the Israeli Parliament (the Knesset) passed the Economic Efficiency Law (Amended Legislation for Implementing the Economic Plan for 2009 and 2010), 2009, which prescribes, among other things, an additional gradual reduction in Israeli corporate tax rate starting from 2011 to the following tax rates: 2011 - 24%, 2012 - 23%, 2013 - 22%, 2014 - 21%, 2015 - 20%, 2016 and thereafter - 18%.

In December 2011, the Israeli Parliament passed the Law for Socioeconomic Change (Legislative Amendments) (Taxes), 2011 (the "Tax Burden Law") which prescribes, among others, to cancel, effective from 2012, the scheduled progressive reduction in the corporate tax rate and to raise the statutory corporate tax rate to 25% in 2012. In view of the increase in the corporate tax rate to 25% in 2012, the real capital gains tax rate and the real betterment tax rate will also be increased. The Amendment was enacted effective as of January 1, 2012. The adoption of the amendment had no effect on the financial statements.

Beginning as of 2010, Israeli companies are subject to regular corporate tax rate for their capital gains. In 2009, Israeli companies were generally subject to capital gains tax at a rate of 25% for such gains (other than capital gains from the sale of listed securities derived by companies with respect to which the provisions of Section 6 of the Israeli Income Tax Law (Inflationary Adjustments) 5745-1985 (the "Inflationary Adjustments Law"), or the provisions of Section 130A of the Income Tax Ordinance, 1961 (the "Ordinance"), applied immediately before the 2006 tax reform came into force, which were instead subject to the regular corporate tax rate).

#### *Special Provisions Relating to Measurement of Taxable Income*

According to the law, until 2007, the results for tax purposes were measured based on the changes in the Israeli CPI. In February 2008, the "Knesset" (Israeli parliament) passed an amendment to the Income Tax (Inflationary Adjustments) Law, 1985, which limits the scope of the law starting 2008 and thereafter. Starting 2008, the results for tax purposes are measured in nominal values, excluding certain adjustments for changes in the Israeli CPI carried out in the period up to December 31, 2007. The amendment to the law includes, inter alia, the elimination of the inflationary additions and deductions and the additional deduction for depreciation starting 2008.

### *Israeli Transfer Pricing Regulations*

On November 29, 2006, Income Tax Regulations (Determination of Market Terms), 2006, promulgated under Section 85A of the Tax Ordinance, came into effect or the TP Regs. Section 85A of the Tax Ordinance and the TP Regs generally require that all cross-border transactions carried out between related parties be conducted on an arm's length principle basis and will be taxed accordingly. The TP Regs are not expected to have a material affect on us.

### *Capital Gains Tax on Sales of Our Ordinary Shares*

The following is a short summary of the material provisions of the tax environment to which shareholders may be subject. This summary is based on the current provisions of tax law. To the extent that the discussion is based on new tax legislation that has not been subject to judicial or administrative interpretation, we cannot assure you that the views expressed in the discussion will be accepted by the appropriate tax authorities or the courts.

The summary does not address all of the tax consequences that may be relevant to all purchasers of our common shares in light of each purchaser's particular circumstances and specific tax treatment. For example, the summary below does not address the tax treatment of residents of Israel and traders in securities who are subject to specific tax regimes. As individual circumstances may differ, holders of our common shares should consult their own tax adviser as to the United States, Israeli or other tax consequences of the purchase, ownership and disposition of common shares. The following is not intended, and should not be construed, as legal or professional tax advice and is not exhaustive of all possible tax considerations. Each individual should consult his or her own tax or legal adviser.

Israeli law generally imposes a capital gains tax on the sale of any capital assets by residents of Israel, as defined for Israeli tax purposes, and on the sale of assets located in Israel, including shares in Israeli companies, by both residents and non-residents of Israel, unless a specific exemption is available or unless a tax treaty between Israel and the shareholder's country of residence provides otherwise. The law distinguishes between real gain and inflationary surplus. The inflationary surplus is a portion of the total capital gain which is equivalent to the increase of the relevant asset's purchase price which is attributable to the increase in the Israeli consumer price index (CPI) or, in certain circumstances, a foreign currency exchange rate, between the date of purchase and the date of sale. The real gain is the excess of the total capital gain over the inflationary surplus.

Generally, the tax rate applicable to capital gains derived from the sale of shares, whether listed on a stock market or not, is 20% for Israeli individuals, unless such shareholder claims a deduction for financing expenses in connection with such shares, in which case the gain will generally be taxed at a rate of 25%. Additionally, if such shareholder is considered a "material shareholder" (generally a shareholder who holds directly or indirectly 10% or more of the rights to profits, right to nominate a director or voting rights) of the company issuing the shares, the tax rate shall be 25%. Israeli companies are subject to the Corporate Tax rate on capital gains derived from the sale of shares, unless such companies were not subject to the Adjustments Law (or certain regulations) at the time of publication of the aforementioned amendment to the Tax Ordinance that came into effect on January 1, 2006, in which case the applicable tax rate is 25%. However, the foregoing tax rates do not apply to: (i) dealers in securities; and (ii) shareholders who acquired their shares prior to an initial public offering (that may be subject to a different tax arrangement).

Notwithstanding the foregoing, pursuant to the Tax Burden Law, the capital gain tax rate applicable to individuals is 25% from 2012 and onwards (or from 25% to 30% if the selling individual shareholder is a Substantial Shareholder at any time during the 12-month period preceding the sale). With respect to assets (not shares that are listed on a stock exchange) purchased on or after January 1, 2003, the portion of the gain generated from the date of acquisition until December 31, 2011 will be subject to the previous capital gains tax rates (20% or 25%) and the portion of the gain generated from January 1, 2012 until the date of sale will be subject to the new tax rates (25% or 30%).

Pursuant to amendments to the Tax Ordinance, effective as of January 1, 2012, the capital gains tax rate applicable to individuals upon the sale of such securities is such individual's marginal tax rate but not more than 25% (or 30% with respect to a Substantial Shareholder). A 30% tax rate will apply to an individual who meets the definition of a 'Substantial Shareholder' on the date of the sale of the securities or at any time during the 12 months preceding such date. A 'Substantial Shareholder' is defined as a person who, either alone or together with any other person, holds, directly or indirectly, at least 10% of any of the means of control of a company (including, among other things, the right to receive profits of the company, voting rights, the right to receive the company's liquidation proceeds and the right to appoint a director). Different tax rates apply to capital gains accrued from the sale by individuals of securities that are not publicly traded as aforesaid.

With respect to corporate investors, effective January 1, 2012, capital gain tax equal to the corporate tax rate (as of January 1, 2012 - 25%) will be imposed on the sale of traded shares.

The determination of whether the individual is a substantial shareholder will be made on the date that the securities are sold. In addition, the individual will be deemed to be a substantial shareholder if at any time during the 12 months preceding this date he had been a substantial shareholder.

The tax basis of shares acquired prior to January 1, 2003 will be determined in accordance with the average closing share price in the three trading days preceding January 1, 2003. However, a request may be made to the tax authorities to consider the actual adjusted cost of the shares as the tax basis if it is higher than such average price.

Non-Israeli residents (including corporations) are exempt from Israeli capital gains tax on any gains derived from the sale of shares of Israeli companies publicly traded on a recognized stock exchange or regulated market outside of Israel, provided however that such capital gains are not derived from a permanent establishment in Israel, such shareholders are not subject to the Adjustments Law, and such shareholders did not acquire their shares prior to an initial public offering. However, non-Israeli corporations will not be entitled to such exemption if an Israeli resident (i) has a controlling interest of 25% or more in such non-Israeli corporation, or (ii) is the beneficiary or is entitled to 25% or more of the revenues or profits of such non-Israeli corporation, whether directly or indirectly.

In some instances where our shareholders may be liable to Israeli tax on the sale of their ordinary shares, the payment of the consideration may be subject to the withholding of Israeli tax at the source.

Pursuant to the Convention Between the government of the United States of America and the government of Israel with Respect to Taxes on Income, as amended, or the U.S.-Israel Tax Treaty, the sale, exchange or disposition of ordinary shares by a person who (i) holds the ordinary shares as a capital asset, (ii) qualifies as a resident of the United States within the meaning of the U.S.-Israel Tax Treaty and (iii) is entitled to claim the benefits afforded to such person by the U.S.-Israel Tax Treaty, generally, will not be subject to the Israeli capital gains tax. Such exemption will not apply if (i) such Treaty U.S. Resident holds, directly or indirectly, shares representing 10% or more of our voting power during any part of the 12-month period preceding such sale, exchange or disposition, subject to certain conditions, or (ii) the capital gains from such sale, exchange or disposition can be allocated to a permanent establishment in Israel. In such case, the sale, exchange or disposition of ordinary shares would be subject to Israeli tax, to the extent applicable; however, under the U.S.-Israel Tax Treaty, such Treaty U.S. Resident would be permitted to claim a credit for such taxes against the U.S. federal income tax imposed with respect to such sale, exchange or disposition, subject to the limitations in U.S. laws applicable to foreign tax credits. The U.S.-Israel Tax Treaty does not relate to U.S. state or local taxes.

#### ***Taxation of Israeli Shareholders on Receipt of Dividends***

Israeli Resident Individuals. Israeli residents who are individuals are generally subject to Israeli income tax for dividends paid on our common shares (other than bonus shares or share dividends) at 25% from 2012 if the recipient of such dividend is a Substantial Shareholder at the time of distribution or at any time during the preceding 12-month period. Pursuant to the Tax Burden Law, as of 2012 such tax rate is 25%, or 30% if the dividend recipient is a Substantial Shareholder at the time of distribution or at any time during the preceding 12-month period. However, dividends distributed from taxable income accrued during the period of benefit of an Approved Enterprise, Benefited Enterprise or Preferred Enterprise are subject to withholding tax at the rate of 15%, if the dividend is distributed during the tax benefit period under the Investment Law or within 12 years after that period. An average rate will be set in case the dividend is distributed from mixed types of income (regular and Approved/ Benefited/ Preferred income).



Israeli Resident Corporations. Israeli resident corporations are generally exempt from Israeli corporate tax for dividends paid on our common shares.

#### ***Taxation of Non-Resident Holders of Shares***

Non-residents of Israel are subject to income tax on income accrued or derived from sources in Israel. Such sources of income include passive income such as dividends, royalties and interest, as well as non-passive income from services rendered in Israel. As of 2006, distributions of dividends other than bonus shares, or stock dividends, income tax is withheld at the source at the rate of 20% or 25% if considered a "material shareholder" (25% and 30% if considered a "material shareholder", as of 2012 – The Burden Law), 15% for dividends generated by an Approved Enterprise (if the dividend is distributed during the tax exemption period or within 12 years thereafter. In the event, however, that the company is qualified as a Foreign Investors' Company, there is no such time limitation), unless a different rate is provided in a treaty between Israel and the shareholder's country of residence.

Under the U.S.-Israel Tax Treaty, the maximum tax on dividends paid to a holder of ordinary shares who is a Treaty U.S. Resident is 25%. However, under the Investments Law, dividends generated by an Approved Enterprise (or Benefited Enterprise) are taxed at the rate of 15%. Furthermore, dividends not generated by an Approved Enterprise (or Benefited Enterprise) paid to a U.S. corporation holding at least 10% of our issued voting power during the part of the tax year which precedes the date of payment of the dividend and during the whole of its prior tax year, are generally taxed at a rate of 12.5%.

A non-resident of Israel who receives dividends from which tax was withheld is generally exempt from the duty to file returns in Israel in respect of such income, provided such income was not derived from a business conducted in Israel by the taxpayer, and the taxpayer has no other taxable sources of income in Israel.

#### **United States Federal Income Tax Consequences**

The following is a summary of certain material U.S. federal income tax consequences that apply to U.S. Holders who hold ordinary shares as capital assets. This summary is based on the United States Internal Revenue Code of 1986 or the Code, as amended, Treasury regulations promulgated thereunder, judicial and administrative interpretations thereof, and the U.S.-Israel Tax Treaty, all as in effect on the date hereof and all of which are subject to change either prospectively or retroactively. This summary does not address all tax considerations that may be relevant with respect to an investment in ordinary shares. This summary does not account for the specific circumstances of any particular investor, such as:

- ❖ broker-dealers,
- ❖ financial institutions,
- ❖ certain insurance companies,
- ❖ investors liable for alternative minimum tax,
- ❖ tax-exempt organizations,
- ❖ non-resident aliens of the U.S. or taxpayers whose functional currency is not the U.S. dollar,
- ❖ persons who hold the ordinary shares through partnerships or other pass-through entities,
- ❖ investors that actually or constructively own 10 percent or more of our voting shares, and
- ❖ investors holding ordinary shares as part of a straddle or a hedging or conversion transaction.

This summary does not address the effect of any U.S. Federal taxation other than U.S. Federal income taxation. In addition, this summary does not include any discussion of state, local or foreign taxation. You are urged to consult your tax advisors regarding the non-U. S. and United States federal, state and local tax considerations of an investment in ordinary shares.

For purposes of this summary, a U.S. Holder is:

- ❖ an individual who is a citizen or, a resident of the United States for U.S. federal income tax purposes;
- ❖ a partnership, corporation or other entity created or organized in or under the laws of the United States or any political subdivision thereof;
- ❖ an estate whose income is subject to U.S. federal income tax regardless of its source;
- ❖ a trust if: (a) a court within the United States is able to exercise primary supervision over administration of the trust, and (b) one or more United States persons have the authority to control all substantial decisions of the trust; or
- ❖ a trust, if the trust were in existence and qualified as a "United States person," within the meaning of the Code, on August 20, 1996 under the law as then in effect and elected to continue to be so treated.

#### *Additional Tax on Investment Income*

In addition to the income taxes described above, U.S. holders that are individuals, estates or trusts and whose income exceeds certain thresholds will be subject to a 3.8% Medicare contribution tax on net investment income, which includes dividends and capital gains.

#### *Taxation of Dividends*

The gross amount of any distributions received with respect to ordinary shares, including the amount of any Israeli taxes withheld therefrom, will constitute dividends for U.S. Federal income tax purposes, to the extent of our current and accumulated earnings and profits as determined for U.S. federal income tax principles. You will be required to include this amount of dividends in gross income as ordinary income. Distributions in excess of our earnings and profits will be treated as a non-taxable return of capital to the extent of your tax basis in the ordinary shares and any amount in excess of your tax basis, will be treated as gain from the sale of ordinary shares. See Item 10.D. "Exchange Controls" under the heading "Disposition of Ordinary Shares" below for the discussion on the taxation of capital gains. Dividends will not qualify for the dividends-received deduction generally available to U.S. corporations under Section 243 of the Code.

Certain dividend income received by individual U.S. Holders, in taxable years beginning after December 31, 2012 may be eligible for a reduced rate of taxation. Such dividend income will be taxed at the applicable long-term capital gains rate (currently, a maximum rate of 20%) if the dividend is received from a "qualified foreign corporation," and the shareholder of such foreign corporation holds such stock for at least 61 days during the 121-day period that begins on the date that is 60 days before the ex-dividend date for the stock. The holding period is tolled for any days on which the shareholder has reduced his risk of loss. A "qualified foreign corporation" is one that is eligible for the benefits of a comprehensive income tax treaty with the United States. A foreign corporation will be treated as qualified with respect to any dividend paid, if its stock is readily tradable on an established securities market in the United States. Dividend income will not qualify for the reduced rate of taxation if the corporation is a passive foreign investment company, or PFIC (*see* below), for the year in which the dividend is distributed or for the previous year.

Dividends that we pay in NIS, including the amount of any Israeli taxes withheld therefrom, will be included in your income in a U.S. dollar amount calculated by reference to the exchange rate in effect on the day such dividends are received. A U.S. Holder who receives payment in NIS and converts NIS into U.S. dollars at an exchange rate other than the rate in effect on such day may have a foreign currency exchange gain or loss that would be treated as U.S. source ordinary income or loss. U.S. Holders should consult their own tax advisors concerning the U.S. tax consequences of acquiring, holding and disposing of NIS.

Any Israeli withholding tax imposed on such dividends will be a foreign income tax eligible for credit against a U.S. Holder's U.S. federal income tax liability, subject to certain limitations set out in the Code (or, alternatively, for deduction against income in determining such tax liability). The limitations set out in the Code include computational rules under which non-U.S. tax credits allowable with respect to specific classes of income cannot exceed the U.S. federal income taxes otherwise payable with respect to each such class of income. Dividends generally will be treated as foreign-source passive income for United States foreign tax credit purposes. Foreign income taxes exceeding the credit limitation for the year of payment or accrual may be carried back for the first preceding taxable years and forward for the first ten taxable years in order to reduce U.S. federal income taxes, subject to the credit limitation applicable in each of such years. A U.S. Holder will be denied a foreign tax credit with respect to Israeli income tax withheld from dividends received on the ordinary shares to the extent such U.S. Holder has not held the ordinary shares for at least 16 days of the 31-day period beginning on the date which is 15 days before the ex-dividend date or to the extent such U.S. Holder is under an obligation to make related payments with respect to substantially similar or related property. Any days during which a U.S. Holder has substantially diminished its risk of loss on the ordinary shares are not counted toward meeting the 16-day holding period required by the statute. The rules relating to the determination of the foreign tax credit are complex, and you should consult with your personal tax advisors to determine whether and to what extent you would be entitled to this credit.

#### *Dispositions of Ordinary Shares*

If you sell or otherwise dispose of ordinary shares, you will recognize gain or loss for U.S. Federal income tax purposes in an amount equal to the difference between the amount realized on the sale or other disposition and the adjusted tax basis in ordinary shares. Subject to the discussion below under the heading "Passive Foreign Investment Companies," such gain or loss generally will be capital gain or loss and will be long-term capital gain or loss if you have held the ordinary shares for more than one year at the time of the sale or other disposition. In general, any gain that you recognize on the sale or other disposition of ordinary shares will be U.S.-source for purposes of the foreign tax credit limitation; losses will generally be allocated against U.S. source income. Deduction of capital losses is subject to certain limitations under the Code.

In the case of a cash basis U.S. Holder who receives NIS in connection with the sale or disposition of ordinary shares, the amount realized will be based on the U.S. dollar value of the NIS received with respect to the ordinary shares as determined on the settlement date of such exchange. A U.S. Holder who receives payment in NIS and converts NIS into United States dollars at a conversion rate other than the rate in effect on the settlement date may have a foreign currency exchange gain or loss that would be treated as U.S. source ordinary income or loss.

#### *Passive Foreign Investment Companies, or PFIC*

There is a substantial risk that we are a passive foreign investment company, or PFIC, for U.S. federal income tax purposes. Our treatment as a PFIC could result in a reduction in the after-tax return to the U.S. Holders of our ordinary shares and may cause a reduction in the value of such shares.

For U.S. federal income tax purposes, we will be classified as a PFIC for any taxable year in which either (i) 75% or more of our gross income is passive income, or (ii) the average percentage of the value of all of our assets for the taxable year which produce or are held for the production of passive income is at least 50%. For this purpose, cash is considered to be an asset which produces passive income. Passive income includes, among others, dividends, interest, certain types of royalties and rents, annuities, net foreign exchange gains and losses and the excess of gains over losses from the disposition of assets which produce passive income. As a result of our substantial cash position and the decline in the value of our stock, we may be a PFIC under a literal application of the asset test that looks solely to market value. If we are a PFIC for U.S. federal income tax purposes, U.S. Holders of our ordinary shares would be required, in certain circumstances, to pay an interest charge together with tax calculated at maximum rates on certain "excess distributions," including any gain on the sale of ordinary shares.

The consequences described above can be mitigated if the U.S. Holder makes an election to treat us as a qualified electing fund, or QEF. A shareholder making the QEF election is required for each taxable year to include in income a pro rata share of the ordinary earnings and net capital gain of the QEF, subject to a separate election to defer payment of taxes, which deferral is subject to an interest charge. We have agreed to supply U.S. Holders with the information needed to report income and gain pursuant to a QEF election. The QEF election is made on a shareholder-by-shareholder basis and can be revoked only with the consent of the Internal Revenue Service, or IRS.

As an alternative to making the QEF election, the U.S. Holder of PFIC stock which is publicly traded could mitigate the consequences of the PFIC rules by electing to mark the stock to market annually, recognizing as ordinary income or loss each year an amount equal to the difference as of the close of the taxable year between the fair market value of the PFIC stock and the U.S. Holder's adjusted tax basis in the PFIC stock. Losses would be allowed only to the extent of net mark-to-market gain previously included by the U.S. Holder under the election for prior taxable years. All U.S. Holders are advised to consult their own tax advisers about the PFIC rules generally and about the advisability, procedures and timing of their making any of the available tax elections, including the QEF or mark-to-market elections.

#### *Backup Withholding and Information Reporting*

Payments in respect of ordinary shares may be subject to information reporting to the U.S. Internal Revenue Service and to a 28 percent U.S. backup withholding tax. Backup withholding will not apply, however, if you (i) are a corporation or come within certain exempt categories, and demonstrate the fact when so required, or (ii) furnish a correct taxpayer identification number and make any other required certification. Backup withholding is not an additional tax. Amounts withheld under the backup withholding rules may be credited against a U.S. Holder's U.S. tax liability, and a U.S. Holder may obtain a refund of any excess amounts withheld under the backup withholding rules by filing the appropriate claim for refund with the IRS. Any U.S. holder who holds 10% or more in vote or value of our ordinary shares may be subject to certain additional United States information reporting requirements.

#### *U.S. Gift and Estate Tax*

An individual U.S. Holder of ordinary shares will be subject to U.S. gift and estate taxes with respect to ordinary shares in the same manner and to the same extent as with respect to other types of personal property.

#### **Other Income Tax**

Taxable income of the Company's subsidiary in Luxemburg, Switzerland and the United States is subject to tax at the rate of approximately 29%, 24% and 35% respectively in 2012.

#### **10.F. DIVIDEND AND PAYING AGENTS**

Not applicable.

#### **10.G. STATEMENT BY EXPERTS**

Not applicable.

#### **10.H. DOCUMENTS ON DISPLAY**

Reports and other information of Optibase filed electronically with the SEC may be found at [www.sec.gov](http://www.sec.gov). They can also be inspected without charge and copied at prescribed rates at the public reference facilities maintained by the SEC Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Copies of this material are also available by mail from the Public Reference Room at 100 F Street, NE, Washington, D.C. 20549, at prescribed rates.

#### **10.I. SUBSIDIARY INFORMATION**

Not applicable.

## ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Most of our revenues are generated in CHF but a portion of our expenses is incurred in NIS and in U.S. dollars. Therefore, our results of operations may be seriously harmed by inflation in Israel and currency fluctuations.

The inflation rate in Israel was approximately 2.7% in 2010, approximately 2.2% in 2011, and approximately 1.6% in 2012. The appreciation of the NIS against the dollar was approximately 6% in 2010, a devaluation of 7.2% in 2011, and an appreciation of 1.4% in 2012 and the devaluation of the NIS against the CHF was approximately 3.3% in 2010, 7.5% in 2011, and 0.4% in 2012. The appreciation of the CHF against the dollar was approximately 9.4% in 2010, 0.1% in 2011, and 2.7% in 2012.

Our operations could be adversely affected if we are unable to guard against currency fluctuations in the future. Accordingly, we may enter into currency hedging transactions to decrease the risk of financial exposure from fluctuations in the exchange rate of NIS against the U.S. dollar and against the CHF. These measures, however, may not adequately protect us from material adverse effects due to the impact of inflation in Israel.

Our functional currency is the U.S. Dollar.

The functional currencies of our subsidiaries are CHF and U.S. dollar. The Company has elected to use U.S. dollar as its reporting currency for all years presented.

While the functional currency of our subsidiaries in the United States is the U.S. dollars, the functional currency of our subsidiaries in Switzerland is their lead currency, *i.e.* CHF. Since our functional and reporting currency is the U.S. dollars, the financial statements of Optibase Real Estate SARL and OPCTN S.A whose functional currency has been determined to be CHF have been translated into U.S. dollars. Assets and liabilities of this subsidiary are translated at the year-end exchange rates and their statement of operations items are translated using the actual exchange rates at the dates on which those items are recognized. Such translation adjustments are recorded as a separate component of accumulated other comprehensive income in shareholders' equity.

### Interest Rate and Rating Risks

Our exposure to market risk for changes in interest rates in Switzerland relates primarily to our long term loan taken for the purchase of our real-estate property in Switzerland and denominated in Swiss Franks (CHF). Changes in Swiss interest rates, could affect our financial results.

### Investments Risks

In the second quarter of 2003, we transferred approximately \$39.3 million of our monies and investments to Optibase, Inc. to achieve better net profit from the investment. As of December 31, 2012, our available net cash was \$19.3 million. As of December 31, 2012, our available cash was invested in short term interest bearing bank deposits and money market funds with several banks. Our available cash (including the money market funds) is generally classified as cash and cash equivalents and, consequently, is recorded on the consolidated balance sheets as such.

## ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

Not applicable.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

Not applicable.

ITEM 15. CONTROLS AND PROCEDURES

(a) Our management, including our chief executive officer and chief financial officer, has evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2012. Based on such review, our chief executive officer and chief financial officer have concluded that we have in place effective controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure, and is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms.

(b) Our management, under the supervision of our chief executive officer and chief financial officer, is responsible for establishing and maintaining adequate internal control over our financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) of the Securities Exchange Act of 1934, as amended. The Company's internal control over financial reporting is defined as a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect our transactions and asset dispositions;
- provide reasonable assurance that transactions are recorded as necessary to permit the preparation of our financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and
- provide reasonable assurance regarding the prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on our financial statements.

Due to its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, 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.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we evaluated the effectiveness of our internal control over financial reporting as of December 31, 2012 based on the framework for Internal Control-Integrated Framework set forth by The Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, our management concluded that the Company's internal controls over financial reporting were effective as of December 31, 2012.

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting, because we are neither a "large accelerated filer" nor an "accelerated filer" as those terms are defined in the Securities Exchange Act.

(c) There were no changes in our internal controls over financial reporting identified with the evaluation thereof that occurred during the period covered by this annual report that have materially affected, or are reasonable likely to materially affect our internal control over financial reporting.

**ITEM 16. [RESERVED]**

**ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT**

The board of directors has determined that Ms. Orli Garti-Seroussi is an "audit committee financial expert" and that she is independent under the applicable Securities and Exchange Commission and NASDAQ listing rules.

**ITEM 16B. CODE OF ETHICS**

We have adopted a Code of Business Conduct and Ethics for our employees, including our chief executive officer and senior financial officers. The Code of Business Conduct and Ethics is attached as Exhibit 11.1 to this annual report, and published on our website in the address: <http://www.optibase-holdings.com/homesites/PageGen.asp?page=18523>.

**ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

Kost, Forer Gabbay & Kasierer, a member of Ernst & Young Global, or Ernst & Young has served as our independent public accountants for each of the fiscal years in the three-year period ended December 31, 2012, for which audited financial statements appear in this annual report on Form 20-F.

The following table presents the aggregate fees for professional services and other services rendered by Kost, Forer Gabbay & Kasierer to Optibase in 2011 and 2012 (in thousands):

	<u>2011</u>	<u>2012</u>
Audit fees <sup>(1)</sup>	115	112
Audit-related fees <sup>(2)</sup>	20	14
Tax fees <sup>(3)</sup>	--	--
All other fees <sup>(4)</sup>	--	--
<b>Total</b>	<b>135</b>	<b>126</b>

(1) Audit fees consist of fees billed for the annual audit services engagement and other audit services, which are those services that only the external auditor can reasonably provide, and include the group audit; statutory audits; comfort letters and consents; attest services; and assistance with and review of documents filed with the SEC.

(2) Audit-related fees consist of fees billed for assurance and related services that are reasonably related to the performance of the audit or review of our financial statements or that are traditionally performed by the external auditor, and include consultations concerning financial accounting and reporting standards; internal control reviews of new systems, programs and projects; review of security controls and operational effectiveness of systems; review of plans and control for shared service centers, due diligence related to acquisitions; accounting assistance and audits in connection with proposed or completed acquisitions; and employee benefit plan audits.

(3) Tax fees include fees billed for tax compliance services, including the preparation of original and amended tax returns and claims for refund; tax consultations, such as assistance and representation in connection with tax audits and appeals, tax advice related to mergers and acquisitions, transfer pricing, and requests for rulings or technical advice from taxing authority; tax planning services; and expatriate tax planning and services.

(4) All other fees include fees billed for training; forensic accounting; data security reviews; treasury control reviews and process improvement and advice; and environmental, sustainability and corporate social responsibility advisory services.

**Audit Committee Pre-approval Policies and Procedures**

Our audit committee's main role is to assist the board of directors in fulfilling its responsibility for oversight of the quality and integrity of the accounting, auditing and reporting practices of the Company. Our audit committee oversees the appointment, compensation, and oversight of the public accounting firm engaged to prepare or issue an audit report on the financial statements of the Company. Our audit committee's specific responsibilities in carrying out its oversight role include the approval of all audit and non-audit services to be provided by the external auditor and quarterly review the firm's non-audit services and related fees. These services may include audit services, audit-related services, tax services and other services, as described above. It is the policy of our audit committee to approve in advance the particular services or categories of services to be provided to the Company periodically. Additional services may be pre-approved by our audit committee on an individual basis during the year.

During 2011 and 2012, our audit committee approved all the audit-related fees, tax fees or other fees provided to us by Kost, Forer Gabbay & Kasierer in Israel or by Ernst & Young in the United States.

**ITEM 16D. EXEMPTION FROM THE LISTING STANDARDS FOR AUDIT COMMITTEE**

We have not and do not expect to apply for any exemptions from the NASDAQ listing standards for audit committees.

**ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS**

Not applicable.

**ITEM 16F. CHANGES IN REGISTRANT'S CERTIFYING ACCOUNTANT**

None.

**ITEM 16G. CORPORATE GOVERNANCE**

There are no significant ways in which the Company's corporate governance practices differ from those followed by domestic companies listed on the Nasdaq Global Market.

**ITEM 16H. MINE SAFETY DISCLOSURE**

Not Applicable.



**PART III**

**ITEM 17. FINANCIAL STATEMENTS**

Not Applicable.

**ITEM 18. FINANCIAL STATEMENTS**

The following are our financial statements audited by Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, together with the reports of Kost Forer Gabbay & Kasierer, a member of Ernst & Young Global, for the fiscal year ended December 31, 2012, are filed as part of this annual report:

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**ITEM 19. EXHIBITS**

See Exhibit Index.

OPTIBASE LTD. AND ITS SUBSIDIARIES  
CONSOLIDATED FINANCIAL STATEMENTS  
AS OF DECEMBER 31, 2012  
U.S. DOLLARS IN THOUSANDS

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**To the Shareholders and Board of Directors of**

**OPTIBASE LTD.**

We have audited the accompanying consolidated balance sheets of Optibase Ltd. ("the Company") and its subsidiaries as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2012. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company and its subsidiaries as of December 31, 2012 and 2011, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accounting principles.

Tel-Aviv, Israel  
March 13, 2013

**KOST FORER GABBAY & KASIERER**  
A Member of Ernst & Young Global

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands

	December 31,	
	2012	2011
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 19,142	\$ 22,945
Restricted cash	134	131
Trade receivables	148	732
Other accounts receivable and prepaid expenses (Note 5)	217	1,267
Total assets attributed to discontinued operations (Note 1c)	980	980
<b>Total</b> current assets	<b>20,621</b>	<b>26,055</b>
<b>LONG-TERM INVESTMENTS:</b>		
Long-term deposits	50	45
Investments in companies and associates (Note 6)	7,993	100
<b>Total</b> long-term investments	<b>8,043</b>	<b>145</b>
<b>PROPERTY AND OTHER ASSETS, NET</b>		
Real Estate Property, net (Note 3)	194,826	192,173
Other assets, net (Note 4)	1,392	1,512
<b>Total</b> property, equipment and other assets	<b>196,218</b>	<b>193,685</b>
<b>Total</b> assets	<b>\$ 224,882</b>	<b>\$ 219,885</b>

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED BALANCE SHEETS

U.S. dollars in thousands (except share and per share data)

	December 31,	
	2012	2011
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Current maturities of long term loans (Note 8)	\$ 2,597	\$ 2,529
Accounts payable and accrued expenses (Note 7)	3,476	4,060
Total liabilities attributed to discontinued operations (Note 1c)	2,563	2,990
<b>Total current liabilities</b>	<b>8,636</b>	<b>9,579</b>
<b>LONG-TERM LIABILITIES:</b>		
Deferred tax liabilities (Note 10)	15,262	14,705
Land lease liability, net	7,290	7,175
Other Long-Term Liabilities	2,844	3,559
Long term loans, net of current maturities (Note 8)	124,298	123,606
<b>Total long-term liabilities</b>	<b>149,694</b>	<b>149,045</b>
<b>COMMITMENTS AND CONTINGENT LIABILITIES (Note 9)</b>		
<b>SHAREHOLDERS' EQUITY (Note 11):</b>		
Share capital -		
Ordinary Shares of NIS 0.65 par value -		
Authorized: 6,000,000 shares at December 31, 2011 and 2012; Issued:		
3,882,945 shares at December 31, 2011 and 2012;		
Outstanding: 3,814,162 and 3,819,051 shares at December 31,		
2011 and 2012, respectively		
	744	744
Additional paid-in capital	130,824	130,734
Treasury shares (68,695 and 63,895 shares at December 31, 2011 and 2012, respectively)	(821)	(954)
Accumulated other comprehensive income	986	305
Accumulated deficit	(84,259)	(85,730)
<b>Total shareholders' equity of Optibase Ltd.</b>	<b>47,474</b>	<b>45,099</b>
Non-controlling interests	19,078	16,162
<b>Total shareholders' equity</b>	<b>66,552</b>	<b>61,261</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 224,882</b>	<b>\$ 219,885</b>

The accompanying notes are an integral part of the consolidated financial statements.

March 13, 2013  
Date of approval of the  
financial statements

Amir Philips  
Chief Executive Officer.

Alex Hilman  
Executive Chairman of the board of directors

CONSOLIDATED STATEMENTS OF OPERATIONS

U.S. dollars in thousands (except share and per share data)

	Year ended December 31,		
	2012	2011	2010
Fixed income from real estate rent	\$ 13,676	\$ 12,479	\$ 1,650
Costs and expenses:			
Cost of real estate operations	1,966	1,869	59
Real estate depreciation and amortization	2,569	2,153	695
General and administrative	2,068	3,057	1,502
<b>Total costs and expenses</b>	<b>6,603</b>	<b>7,079</b>	<b>2,256</b>
Operating income (loss)	7,073	5,400	(606)
Gain on bargain purchase (Note 1(b)3)	-	4,412	-
Equity share in earnings (losses) of associates, net	(32)	-	-
Other loss (Note 6)	(100)	-	(600)
Financial income (expenses), net (Note 12)	(1,243)	(7,481)	304
Income (loss) before taxes on income	5,698	2,331	(902)
Taxes on income (Note 10)	1,643	481	43
Net income (loss) from continuing operations	4,055	1,850	(945)
Net income (loss) from discontinued operations (Note 1(c))	-	(51)	5,399
Net income	4,055	1,799	4,454
Net income attributable to non-controlling interest	2,478	2,038	-
Net income (loss) attributable to Optibase LTD.	<b>\$ 1,577</b>	<b>\$ (239)</b>	<b>\$ 4,454</b>
Net earnings (loss) per share:			
Basic and diluted net earnings (loss) per share from continuing operations	\$ 0.41	\$ (0.07)	\$ (0.3)
Basic and diluted net earnings (loss) per share from discontinued operations	\$ 0.00	\$ (0.00)	\$ 1.65
Basic and diluted net earnings (loss) per share	\$ 0.41	\$ (0.07)	\$ 1.35
Weighted average number of shares used in computing basic net earnings (loss) per share:	3,818,198	3,641,935	3,310,974
Weighted average number of shares used in computing diluted net earnings (loss) per share:	3,820,233	3,641,935	3,311,358

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

U.S. dollars in thousands (except per share data)

	Year ended December 31,		
	2012	2011	2010
Net Income	\$ 4,055	\$ 1,799	\$ 4,454
Less: net earnings (loss) attributable to non-controlling interests	2,478	2,038	-
Net earnings attributable to Optibase LTD.	<u>\$ 1,577</u>	<u>\$ (239)</u>	<u>\$ 4,454</u>
Other comprehensive income:			
Change in foreign currency translation adjustment	\$ 1,172	\$ (305)	\$ 533
Less: other comprehensive income (loss) attributable to non-controlling interests	491	(131)	-
Other comprehensive income (loss) attributable to Optibase LTD.	<u>\$ 681</u>	<u>\$ (174)</u>	<u>\$ 533</u>
Comprehensive income	\$ 5,227	\$ 1,494	\$ 4,987
Less: comprehensive income attributable to non-controlling interest	2,969	1,907	-
Comprehensive income attributable to Optibase LTD.	<u>\$ 2,258</u>	<u>\$ (413)</u>	<u>\$ 4,987</u>

The accompanying notes are an integral part of the consolidated financial statements.

STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

U.S. dollars in thousands

	Ordinary shares	Additional paid-in capital	Treasury Shares	Accumulated other comprehensive income (loss) *)	Accumulated Deficit	Total shareholders' equity of Optibase Ltd.	Non- controlling interests	Total shareholders' equity
Balance as of January 1, 2010	650	\$ 125,649	\$ (1,208)	\$ (54)	\$ (89,799)	\$ 35,238	\$ -	\$ 35,238
Stock-based compensation related to options and unvested shares granted to employees	-	167	-	-	-	167	-	167
Issuance of treasury shares upon vesting of shares	-	(88)	134	-	(46)	-	-	-
Other comprehensive income	-	-	-	533	-	533	-	533
Net income	-	-	-	-	4,454	4,454	-	4,454
Balance as of December 31, 2010	650	125,728	(1,074)	479	(85,391)	40,392	-	40,392
Issuance of ordinary shares	94	4,906	-	-	-	5,000	-	5,000
Stock-based compensation related to options and unvested shares granted to employees	-	120	-	-	-	120	-	120
Issuance of treasury shares upon vesting of shares	-	(20)	120	-	(100)	-	-	-
Other comprehensive income	-	-	-	(174)	-	(174)	(131)	(305)
Non-controlling interests	-	-	-	-	-	-	14,255	14,255
Net income (loss)	-	-	-	-	(239)	(239)	2,038	1,799
Balance as of December 31, 2011	744	130,734	(954)	305	(85,730)	45,099	16,162	61,261
Stock-based compensation related to options and unvested shares granted to employees	-	117	-	-	-	117	-	117
Issuance of treasury shares upon vesting of shares	-	(27)	133	-	(106)	-	-	-
Other comprehensive income	-	-	-	681	-	681	491	1,172
Non-controlling interests	-	-	-	-	-	-	(53)	(53)
Net income (loss)	-	-	-	-	1,577	1,577	2,478	4,055
Balance as of December 31, 2012	744	\$ 130,824	\$ (821)	\$ 986	\$ (84,259)	\$ 47,474	\$ 19,078	\$ 66,552

The accompanying notes are an integral part of the consolidated financial statements.

\*) As of December 31, 2012, 2011 and 2010 includes only foreign currency translation adjustments.



CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2012	2011	2010
<b>Cash flows from operating activities:</b>			
Net income	\$ 4,055	\$ 1,799	\$ 4,454
Loss (income) from discontinued operations	-	51	(5,399)
Income (loss) from continued operation	\$ 4,055	1,850	(945)
Adjustments required to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	2,569	2,220	696
Impairment of an investment in company	100	-	600
Stock-based compensation related to options and unvested shares granted to employees	117	120	167
Gain from a bargain purchase	-	(4,412)	-
Decrease in trade receivables	577	1,216	-
Equity share in losses (earnings) of associates, net	32	-	-
Increase (decrease) in deferred tax liabilities	159	(579)	-
Increase (decrease) in other long-term liabilities	(792)	3,319	-
Increase (decrease) in land lease liabilities	(81)	-	-
Decrease (increase) in other accounts receivable and prepaid expenses	1,073	1,371	29
Increase (decrease) in accrued expenses and other accounts payable	(597)	(3,200)	(162)
Net cash provided by continuing operations	7,212	1,905	385
Net cash used in discontinued operations	(427)	(70)	(202)
Net cash provided by operating activities	6,785	1,835	183
<b>Cash flows from investing activities:</b>			
Purchase of equipment	-	(5)	(5)
Proceeds from (investment in) short-term deposit	-	(1,065)	3,750
Proceeds from (investment in) long-term lease deposits	(5)	101	(57)
Investment in real estate property	(210)	(1,187)	(8,786)
Increase in restricted cash	(3)	(131)	-
Acquisition of Eldista, net (b)	-	(20,684)	-
Investments in associates	(8,025)	-	-
Proceeds from sale of the Video activity	-	-	6,800
Net cash provided by (used in) investing activities	(8,243)	(22,971)	1,702

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

U.S. dollars in thousands

	Year ended December 31,		
	2012	2011	2010
<b>Cash flows from financing activities:</b>			
Issuance of ordinary shares in a private placement	-	5,000	-
Proceeds from long term bank loans	-	106,441	-
Repayment of long term bank loans	(2,553)	(91,847)	(406)
Repayment of loan to non-controlling interests	(53)	(5,618)	-
Net cash provided by (used in) financing activities from continuing operations	(2,606)	13,976	(406)
Exchange differences on balances of cash and cash equivalents	261	(155)	130
Increase (decrease) in cash and cash equivalents	(3,803)	(7,315)	1,609
Cash and cash equivalents at the beginning of the year	22,945	30,260	28,651
Cash and cash equivalents at the end of the year	\$ 19,142	\$ 22,945	\$ 30,260
<b>(a) Supplemental cash flow activities:</b>			
Cash paid during the year for:			
Taxes	\$ 1,902	\$ 1,903	\$ -
Interest	\$ 2,237	\$ 3,081	\$ 207
<b>(b) Acquisition of Eldista, net:</b>			
Working capital deficiency, net		\$ (155)	
Building (including land)		161,451	
In place leases, net		1,124	
Deferred tax liabilities		(15,282)	
Mortgage loan		(92,705)	
Swap instrument		(392)	
Land lease liability		(7,311)	
Rent settlements with tenants		(1,759)	
Gain from a bargain purchase		(4,412)	
Non controlling interests		(19,875)	
Net cash paid by the Company		\$ 20,684	

The accompanying notes are an integral part of the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 1:- GENERAL

- a. Optibase Ltd. ("the Company") was incorporated and commenced operations in 1990.

During 2009 the Company had entered into the fixed-income real estate sector after an acquisition of a commercial building in Switzerland.

Until the sale of its video solutions business to VITEC Multimedia ("Vitec") in July 2010 (See 1c below), the Company and its U.S subsidiary, Optibase Inc, provided equipment for a wide range of professional video applications in the Broadband IPTV, Broadcast, Government, Enterprise and Post-production markets. (collectively: the Video Activity). Following the sale of the Video Activity, the Company's only operation is the fixed-income real-estate.

As of December 31, 2012, the Company manages its activity through three active subsidiaries: Optibase Real Estate Europe SARL ("Optibase SARL") in Luxembourg which was incorporated in October 2009, Optibase Inc. in the United States which was incorporated in 1991 ("Optibase Inc") and OPCTN SA in Geneva a Luxembourg company owned 51% by the Company which was incorporated in February 2011 ("Subsidiaries"), (collectively: "the Group").

In addition, during 2012, the Company has acquired beneficial interests in a commercial office building and in a shopping centers portfolio in the U.S.

- b. Acquisitions and investments in associates:

1. Marquis Residence in Miami, Florida

On December 30, 2010, the Company's wholly-owned subsidiary, Optibase Inc, acquired 21 condominium units in the Marquis Residence in Miami, Florida for consideration of approximately \$ 8,632 in cash. The acquisition of the units was accounted for as acquisition of an asset. The Company is renting part of the units and in principle holds the units for investment purposes and will consider selling the units in accordance with its business considerations and market conditions. As of December 31, 2012, out of the 21 units 19 units have been rented.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 1:- GENERAL (Cont.)

2. Centre des Technologies Nouvelles in Geneva, Switzerland

On March 2, 2011 the Company acquired through a newly established subsidiary an office building complex in Geneva, Switzerland known as Centre des Technologies Nouvelles (CTN) (the "Property"). The acquisition was undertaken by OPCTN S.A., a Luxembourg company owned 51% by Optibase and 49% by The Phoenix Insurance Company Ltd and The Phoenix Comprehensive Pension (collectively, "The Phoenix"). OPCTN S.A. undertook the transaction by acquiring all of the ownership interest in the Property owner Eldista GmbH, a Swiss Company ("Eldista").

CTN is a six-building complex located in the Plan-Les-Ouates business park in the outskirts of Geneva. The complex includes approximately 35,000 square meters (approximately 377,000 square feet) of primarily space and is a center for advanced industries including biotech electronic and information technology industries.

The total purchase price for the Eldista shares was CHF 37,720 (representing \$ 40,559 - as of the purchase date), subject to a post-closing price adjustment to reflect Eldista's assets and liabilities as of the closing date.

On the date of the agreement, the Company paid to Apollo CTN S.A.R.L (the "Seller"), CHF 37,420 and additional CHF 300 as post-closing price adjustment (approximately \$ 40,234 and \$ 319, respectively as of the purchase date).

The acquisition of the property through the acquisition of Eldista was accounted for by the Company as a business combination in accordance with ASC 805 "Business Combination". The acquired activities and assets of Eldista constitute a business as they consist of inputs and processes applied to those inputs that have the ability to create outputs.

The results of operations of the acquired property are included in the Company's financial statements from the date the acquisition has been completed.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 1- GENERAL (Cont.)

The total purchase price was allocated as follows:

	USD
Cash paid for Eldista shares	\$ 40,559
Assets and liabilities acquired:	
Land	23,654
Building	137,797
Swap instrument	(392)
Mortgage loan	(92,705)
Rent settlements with tenants	(1,759)
Lease provision	(7,311)
In-place leases, net	1,124
Deferred tax liabilities	(15,282)
Other current net assets	(155)
Gain from a bargain purchase	(4,412)
Total purchase price	40,559
Less:	
Purchase price paid by non-controlling interests	(19,875)
Net purchase price	\$ 20,684

The bargain purchase gain was recorded since the total acquisition date fair value of the identifiable net assets acquired exceeded the total purchase price.

Accordingly, the Company recorded the bargain purchase gain as other income in the amount of \$ 4,412 in the consolidated statement of operations for the year ended December 31, 2011.

3. Two Penn Center Plaza in Philadelphia, Pennsylvania:

On August 16, 2012, and following the approval by the Company's audit committee and board of directors, the Company's shareholders approved its entrance into a limited partnership that will be formed to acquire beneficial interests in the owner of a commercial office building in Philadelphia known as Two Penn Center Plaza where the general partner and certain limited partners of the limited partnership are affiliated with Mr. Shlomo (Tom) Wyler, the Company's president and member of board of directors, who then considered the controlling shareholder of the Company.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 1- GENERAL (Cont.)

On October 12, 2012, the Company through its subsidiary Optibase Inc., became a limited partner of 2 Penn Philadelphia LP, a Pennsylvania limited partnership (the "Partnership"), which acquired a beneficial interest in the owner of a Class A twenty story commercial office building in Philadelphia known as Two Penn Center Plaza. At the closing of the acquisition of Two Penn Center Plaza, Optibase Inc., made a capital contribution of \$4,025 (to the Partnership in consideration for 19.66% beneficial interest in Two Penn Center Plaza. Two Penn Center Plaza has approximately 500,000 rentable square feet and is located in the Center City neighborhood of Philadelphia opposite City Hall and Love Park.

The Company accounted for the investment using the equity method of accounting and accordingly recorded during 2012 an equity loss in an associate in the amount of \$ 32.

4. Texas Shopping Centers Portfolio:

On December 31, 2012, the Company through its subsidiary Optibase Inc. acquired approximately 4% beneficial interest in a portfolio of shopping centers located in Texas.

The shopping centers portfolio includes more than two million square feet of leasable area and is located in Houston, Dallas, and San Antonio areas of Texas. The purchase price for the transaction was approximately \$ 4,000. The transaction was based on a portfolio valuation of approximately \$ 342,000 including existing nonrecourse mortgage financing in the principal amount of approximately \$ 252,000. The primary mortgage loan has a fixed interest rate of 5.73% and matures in April 2016.

Optibase Inc., undertook this investment by making a \$1,000 capital contribution as an approximately 16.5% limited partner in Global Texas, LP a Florida limited partnership that is a limited partner in Global Texas Portfolio, LP, a Delaware limited partnership. Global Texas Portfolio, LP acquired 49% of the beneficial interests in the shopping center portfolio.

In connection with the transaction, Optibase Inc., became an owner of approximately 16.5% of the partnership interests in Global Texas Lender, LP a Florida limited partnership and made a \$3,000 capital contribution to Global Texas Lender, LP. Global Texas Lender, LP provided a loan to Global Texas Portfolio, LP, bearing interest at 11% per annum, to finance a portion of the purchase price paid by Global Texas Portfolio, LP to acquire its 49% beneficial interest in the shopping center portfolio.

c. Sale of the Video Activity (Discontinued operations):

On March 16, 2010, the Company and its subsidiary, Optibase Inc., entered into an asset purchase agreement (the "Agreement") with Optibase Technologies Ltd. and Stradis Inc., wholly owned subsidiaries of S.A. Vitec (also known as Vitec Multimedia) (S.A. Vitec, Optibase Technologies Ltd. and Stradis Inc., collectively "Vitec") pursuant to which the Company sold to Vitec all of the assets and liabilities related to the Company's Video Solutions Business (the "Video Activity") for an aggregate consideration of \$ 8,000, subject to certain price adjustments and an earn-out mechanism pursuant to which 45% of Vitec's revenues deriving from the Video Activity exceeding \$ 14,000 in the year following the closing of the transaction, will be paid to the Company. Closing of the transaction occurred on July 1, 2010. In the year following the closing, the Company did not achieve the earn-out target and no additional consideration was received by the Company.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 1:- GENERAL (Cont.)

Under the Agreement, the Company and Vitec agreed on a price adjustment mechanism to the initial consideration, upon which, Vitec shall add or subtract to the consideration an amount equal to accounts receivable, net plus other receivables and prepaid expenses minus accounts payable and other payables, all as of the Closing date (the "Adjustment Amount"), whereby the Adjustment Amount as calculated by the Company would be deposited by Vitec in escrow within five days from the closing date, to be released over a period of 12 months as Vitec collects amounts owed to the Company from customers.

Vitec has refrained from depositing any amount in escrow. This led to a dispute between the parties. For further details see Note 9e.1.

The Company recorded in 2010 a capital gain of approximately \$ 6,300 resulting from this Sale of the Video Activity.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 1:- GENERAL (Cont.)

The results of operations of the Video Activity for the years ended December 31, 2010, 2011 and 2012, which were reported separately and retroactively as discontinued operations in the consolidated statements of operations are summarized as follows:

	Year ended December 31,		
	2012	2011	2010
Revenues	\$ -	\$ -	\$ 4,457
Operating income	\$ -	\$ -	\$ 2,874
Costs and expenses	\$ -	\$ 51	\$ 3,779
Other Income	\$ -	\$ -	\$ 6,304
Net income (loss) from discontinued operations	\$ -	\$ (51)	\$ 5,399
Basic and Diluted net earnings per share from discontinued operations	\$ -	\$ (0.00)	\$ 0.33

The assets and liabilities of the Video Activity for the years ended December 31, 2011 and 2012, which relates to the discontinued operations and presented in the consolidated balance sheets, are summarized as follows:

	December 31,	
	2012	2011
<b>Assets:</b>		
Other accounts receivable	\$ 980	\$ 980
Total assets	\$ 980	\$ 980
<b>Liabilities:</b>		
Other accounts payable and accrued expenses	\$ 2,563	\$ 2,990
Total liabilities	\$ 2,563	\$ 2,990



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES

a. Basis of presentation of the financial statements:

The preparation of financial statements in conformity with U.S generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. The Company's management believes that the estimates, judgments and assumptions used are reasonable based upon information available at the time they are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

b. Functional currency, presentation currency and foreign currency:

The functional currency of the Company is the U.S Dollar.

The functional currencies of Optibase's subsidiaries are CHF and U.S dollar. The Company has elected to use U.S dollar as its reporting currency for all years presented.

While the functional currency of the Company's subsidiaries in the United States is the U.S dollars, the functional currency of the subsidiaries in Switzerland is their lead currency, i.e. CHF. Since the Company's functional and reporting currency is the USD, the financial statements of Optibase Real Estate SARL and OPCTN S.A. whose functional currency has been determined to be CHF have been translated into U.S. dollars. Assets and liabilities of these subsidiaries are translated at the year-end exchange rates and their statement of operations items are translated using the actual exchange rates at the dates on which those items are recognized. Such translation adjustments are recorded as a separate component of accumulated other comprehensive income in shareholders' equity.

c. Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiaries. Intercompany transactions and balances, including profits from intercompany sales not yet realized outside of the Group, have been eliminated upon consolidation.

d. Non-controlling Interests:

Non-controlling interests generally represent the portion of equity that the Company does not own in those entities that it consolidates. The Company accounts for and reports its non-controlling interests in accordance with the provisions required under the Consolidation Topic of the FASB ASC 160. Non-controlling interests are separately presented within the equity section of the consolidated balance sheets. The amounts of consolidated net earnings attributable to the Company and to the non-controlling interests are presented on the consolidated statement of income.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

e. Cash equivalents:

Cash equivalents include short-term, highly liquid investments that are readily convertible to cash, with original maturities of three months or less at the date acquired.

f. Property and equipment:

Real estate and equipment are stated at cost net of accumulated depreciation. Costs include those related to acquisition, including building improvements.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, as follows:

	<u>Years</u>
Building and buildings' improvements	30-100
Computers and equipment	3

g. Long-lived assets including intangible assets:

The Company and its subsidiaries long-lived assets are reviewed for impairment in accordance with ASC 360, "Property, Plant and Equipment", whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

The Company reviewed assets on a component-level basis, which is the lowest level of assets for which there are identifiable cash flows that can be distinguished operationally and for financial reporting purposes. The carrying amount of the asset group was compared with the related expected undiscounted future cash flows to be generated by those assets over the estimated remaining useful life of the primary asset. In cases where the expected future cash flows were less than the carrying amounts of the assets, those assets were considered impaired and written down to their fair values. Fair value was established based on discounted cash flows. As of December 31, 2011 and 2012, no impairment losses have been identified.

h. Investments in companies:

Investments in non-marketable equity securities of companies in which the Company does not have control or the ability to exercise significant influence over their operation and financial policies are recorded at cost.

Management evaluates investments in non marketable equity securities for evidence of other-than temporary declines in value. When relevant factors indicate a decline in value that is other-than temporary the Company recognizes an impairment loss for the decline in value. As for impairment charges recorded during 2010 and 2012 see Note 6(a).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

i. Investments in associates:

Associates in which the Group has significant influence over the financial and operating policies without having control are accounted for using the equity method of accounting. Under the equity method, the investment in associates is accounted for in the financial statements at cost plus changes in the Group's share of net assets, including other comprehensive income (loss), of the associates. The equity method is applied until the loss of significant influence. The investment is classified as non-current asset held-for-sale and includes the difference between the acquisition cost and the Group's share in the net fair value of the associates' net identifiable assets. After initial recognition, the excess value is measured at cost and is amortized according to the nature of each identifiable asset (mostly to the real estate property).

Associates in which the Group has no significant influence over the financial and operating are recorded at cost.

j. Goodwill and bargain purchase gain:

Goodwill reflects the excess of the fair value of the acquired business over the fair value of net identifiable assets acquired in various business acquisitions. The Company accounts for goodwill in accordance with the Intangibles - Goodwill and Other Topic of the FASB ASC 350.

A bargain purchase gain in the Eldista acquisition, represents the excess of 100% of the recognized bases of identifiable assets acquired, net of assumed liabilities, over the aggregate of the acquisition-date fair values of (1) the acquirer's interest in the acquiree, (2) noncontrolling interests in the acquiree and (3) any equity interest held in the acquiree by the acquirer immediately before the acquisition date.

With respect to bargain purchase, the Company recognized a gain in the amount of \$ 4,412 a corresponding deduction from net income attributable to non-controlling interest in the amount of \$ 2,162 in the consolidated statement of operations for the year ended December 31, 2011 (See note 1(b)2).

k. Intangibles assets:

Intangible assets consist of in-place lease values, tenant origination costs and above-market rents that were recorded in connection with the acquisition of the properties. Intangible assets are amortized and accreted using the straight-line method over the term of the related leases. When a lease is terminated early, any remaining unamortized balances under lease intangible assets or liabilities are charged to earnings.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

l. Derivative Instruments:

The Company accounts for derivatives and hedging based on ASC No. 815, "Derivatives and Hedging". ASC No. 815 requires the Company to recognize all derivatives on the balance sheet at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, the Company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge, or a hedge of a net investment in a foreign operation. If the derivatives meet the definition of a hedge and are so designated, depending on the nature of the hedge, changes in the fair value of such derivatives will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings, or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value is recognized in earnings. As of December 31, 2012, the Company had no outstanding hedging instruments. At times, it may use derivative instruments to manage exposure to variable interest rate risk. From time to time, the Company enters into interest rate swaps to manage its exposure to variable interest rate risk and treasury locks to manage the risk of interest rates rising prior to the issuance of debt. The Company generally enters into derivative instruments that qualify as cash flow hedges and it do not enter into derivative instruments for speculative purposes.

m. Business Combinations:

The Company allocated the purchase price of acquired properties to land, building, intangible assets and other liabilities in accordance with the Business Combinations Topic of the FASB ASC 805-10. The Company allocated the initial purchase price of assets acquired (net tangible and identifiable intangible assets) and liabilities assumed based on their relative fair values at the date of acquisition. There are two categories of intangible assets to be considered:

(1) in-place leases; (2) above and below-market value of in-place leases. The aggregate value of other acquired intangible assets, consisting of in-place leases, is measured by the excess of (i) the purchase price paid for a property after adjusting existing in-place leases to market rental rates over (ii) the estimated fair value of the property as-if-vacant, determined as set forth above. The value of in-place leases exclusive of the value of above-market and below-market in-place leases is amortized to depreciation expense over the estimated remaining term of the respective leases. The value of above-market and below-market in-place leases is amortized to rental revenue over the estimated remaining term of the leases. If a lease were to be terminated prior to its stated expiration, all unamortized amounts relating to that lease would be written off. Other than as discussed above, the Company has determined that our real estate properties do not have any other significant identifiable intangibles. The results of operations of acquired properties are included in our financial statements as of the dates they are acquired. The intangible assets and liabilities associated with property acquisitions are included in other assets and other liabilities in our consolidated balance sheets.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

n. Revenue recognition:

The Company generates revenues from fixed income real-estate derived from its buildings held through its subsidiaries in Switzerland (Rümlang and Geneva) and Miami FL.

Rental income includes minimum rents and expenses recoveries. Minimum rents are recognized on an accrual basis over the terms of the related leases on a straight-line basis. Lease revenue recognition commences when the lessee is given possession of the leased space and there are no contingencies offsetting the lessee's obligation to pay rent.

o. Contingencies:

The Company periodically estimates the impact of various conditions, situations and/or circumstances involving uncertain outcomes to its financial condition and operating results. The Company accounts for contingent events as required by ASC 450 "Contingencies". ASC 450 defines a contingency as "an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur". Legal proceedings are a form of such contingencies.

In accordance with ASC 450, accruals for exposures or contingencies are being provided when the expected outcome is probable. It is possible, however, that future results of operations for any particular quarter or annual period could be materially affected by changes in the Company's assumptions, the actual outcome of such proceedings or as a result of the effectiveness of the Company strategies related to these proceedings.

p. Income taxes:

The Company and its subsidiaries account for income taxes in accordance with ASC Topic 740, "Income Taxes" ("ASC 740"), which prescribes the use of the liability method, whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company and its subsidiaries provide a valuation allowance, if necessary, to reduce deferred tax assets to amounts more likely than not to be realized.

ASC 740 clarifies the accounting for uncertainties in income taxes by establishing minimum standards for the recognition and measurement of tax positions taken or expected to be taken in a tax return. Under the requirements of ASC 740, the Company must review all of its tax positions and make a determination as to whether its position is more-likely-than-not to be sustained upon examination by regulatory authorities. If a tax position meets the more-likely-than-not standard, then the related tax benefit is measured based on a cumulative probability analysis of the amount that is more-likely-than-not to be realized upon ultimate settlement or disposition of the underlying issue. The Company policy is to accrue interest and penalties related to unrecognized tax benefits in its financial expenses.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

q. Concentrations of credit risk:

Financial instruments that potentially subject the Company and its subsidiaries to concentrations of credit risk consist principally of cash and cash equivalents, accounts receivables and long-term lease deposits.

Cash and cash equivalents are invested in U.S. dollar deposits with major banks in Israel, the United States and Switzerland. Cash and cash equivalents in the United States may be in excess of insured limits and are not insured in other jurisdictions. The Company maintains cash and cash equivalents with diverse financial institutions and monitors the amount of credit exposure to each financial institution.

Accounts receivable includes amounts billed to tenants and accrued expense recoveries due from tenants. The Company makes estimates of the uncollectability of its accounts receivable using the specific identification method related to base rents, straight-line rent balances, expense reimbursements and other revenues. It also analyzes accounts receivable and historical bad debt levels, tenant credit-worthiness, payment history and current economic trends when evaluating the adequacy of the allowance for doubtful accounts. Accounts receivable are written-off when they are deemed to be uncollectible and the Company is no longer actively pursuing collection. The Company's reported net income is directly affected by management's estimate of the collectability of accounts receivable.

r. Earnings (loss) per share:

Basic net earnings (losses) per share are computed based on the weighted average number of Ordinary shares outstanding during each year. Diluted net earnings (losses) per share is computed based on the weighted average number of Ordinary shares outstanding during each year, plus dilutive potential Ordinary shares considered outstanding during the year, in accordance with ASC 260, "Earning Per Share". All outstanding stock options and unvested shares have been excluded from the calculation of the diluted net earnings (losses) per Ordinary share because the securities are anti-dilutive for all periods presented.

s. Accounting for stock-based compensation:

ASC Topic 718 "Compensation - Stock Compensation" ("ASC 718"), requires companies to estimate the fair value of share-based awards on the date of grant using an option-pricing model.

The Company recognizes these compensation costs net of a forfeiture rate and recognizes the compensation costs for only those shares expected to vest on a straight-line basis over the requisite service period of the award, which is generally the option vesting term of four years. ASC 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

The Company estimates the fair value of stock options granted using the Black-Scholes- Merton option pricing model. The option-pricing model requires a number of assumptions, of which the most significant are the expected stock price volatility and the expected option term. Expected volatility is calculated based upon actual historical stock price movements. The expected term of options granted is based upon historical experience and represents the period of time that options granted are expected to be out standing. The risk free interest rate is based on the yield from U.S. treasury bonds with an equivalent term. The Company has historically not paid dividends and has no foreseeable plans to pay dividends.

The fair value was estimated at the date of grant using the following weighted average assumptions for the Black-Scholes model for the year ended December 31, 2011, During 2012 there were no grants:

	<u>December 31,</u> <u>2011</u>
Dividend yield	0%
Volatility	67%
Risk free interest	0.9% -1.7%
Expected term (years)	4.75%

t. Treasury Shares:

During the past years, the Company repurchased certain of its Ordinary shares on the open market and holds such shares as treasury shares. The Company presents the cost to repurchase treasury shares as a reduction from shareholders' equity. From time to time the Company reissues treasury shares under the stock purchase plan, upon exercise of option and upon vesting of restricted stock units. When treasury stock is reissued, the Company accounts for the re-issuance in accordance with ASC No. 505-30, "Treasury Stock" and charges the excess of the purchase cost, including related stock-based compensation expenses, over the re-issuance price to retained earnings. The purchase cost is calculated based on the specific identification method. In case the purchase cost is lower than the re-issuance price, the Company credits the difference to additional paid-in capital.

u. Fair value of financial instruments:

The carrying amounts of the Company's financial instruments, including cash and cash equivalents, other accounts receivable, trade payables, other accounts payable, and accrued liabilities, approximate fair value because of their generally short-term maturities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 2:- SIGNIFICANT ACCOUNTING POLICIES (Cont.)

Effective January 1, 2008, the Company adopted ASC 820 "Fair Value Measurements and Disclosures". ASC 820 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, ASC 820 establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1- Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2- Include other inputs that are directly or indirectly observable in the marketplace.

Level 3- Unobservable inputs which are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

Warrants are measured at fair value under ASC 820 on a recurring basis as of December 31, 2011 and 2012.

Swap instrument (see note 1(b)2) is measured at fair value under ASC 820 on a recurring basis as of December 31, 2011 and 2012 using significant unobservable inputs (Level 2).

v. Comprehensive income:

In June 2011, the FASB issued ASU 2011-05 Presentation of Comprehensive Income, codified in ASC 220 "Comprehensive Income". The guidance requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The guidance also eliminates the option to present the components of other comprehensive income as part of the statement of equity. The Company adopted the new guidance commencing January 1, 2012. The Company chose to present the Comprehensive Income in two separate but consecutive statements.

w. Reclassification:

Certain comparative figures may have been reclassified to conform to the current year presentation.

x. Impact of newly issued Accounting Standards:

There were no impacts of new accounting standards during 2012.



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 3:- REAL ESTATE PROPERTY, NET

	Land	Building	Condominium units	Currency translation adjustment	Total
<b>Cost:</b>					
At January 1, 2011	\$ 2,832	\$ 19,604	\$ 8,632	\$ 1,992	\$ 33,060
Additions	23,654	138,983	781	(1,583)	161,835
At December 31, 2011	26,486	158,587	9,413	409	194,895
Additions	-	168	42	4,938	5,148
At December 31, 2012	26,486	158,755	9,455	5,347	200,043
<b>Accumulated depreciation:</b>					
At January 1, 2011	-	655	-	52	707
Depreciation charge for the year	-	2,011	45	(41)	2,015
At December 31, 2011	-	2,666	45	11	2,722
Depreciation charge for the year	-	2,149	262	84	2,495
At December 31, 2012	-	4,815	307	95	5,217
<b>Real estate property, net:</b>					
At December 31, 2012	\$ 26,486	\$ 153,940	\$ 9,148	\$ 5,252	\$ 194,826
At December 31, 2011	\$ 26,486	\$ 155,921	\$ 9,368	\$ 398	\$ 192,173

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 4:- OTHER ASSETS, NET

	Above market value of in-place leases *)	Currency translation adjustment	Total
<b>Cost:</b>			
At January 1, 2011	\$ 659	\$ 59	\$ 718
Additions	1,125	(11)	1,114
At December 31, 2011	1,784	48	1,832
Additions	-	50	50
At December 31, 2012	1,784	98	1,882
<b>Accumulated depreciation:</b>			
At January 1, 2011	154	12	166
Depreciation charge for the year	162	(8)	154
At December 31, 2011	316	4	320
Depreciation charge for the year	158	12	170
At December 31, 2012	474	16	490
<b>Other assets, net:</b>			
At December 31, 2012	<u>\$ 1,310</u>	<u>\$ 82</u>	<u>\$ 1,392</u>
At December 31, 2011	<u>\$ 1,468</u>	<u>\$ 44</u>	<u>\$ 1,512</u>

Intangible assets consist of lease contracts with tenants deriving from the acquisition of a commercial building located in Switzerland in 2009 in the amount of \$ 410 and from the acquisition of a building complex in Geneva in 2011 in the amount of \$ 1,102 (see details in Note 1(b)2).

\*) Amortization expenses amounted to \$ 132, \$ 162 and \$ 158 for the years ended December 31, 2010, 2011 and 2012, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

**NOTE 4:- OTHER ASSETS, NET (Cont.)**

Estimated amortization expenses by years are as follows:

Year	Estimated amortization expenses
2013	\$ 282
2014	439
2015	235
2016	224
2017 and thereafter	212
	<u>\$ 1,392</u>

**NOTE 5:- OTHER ACCOUNTS RECEIVABLE AND PREPAID EXPENSES**

	December 31,	
	2012	2011
Short-term deposit (1)	\$ -	\$ 1,065
Prepaid expenses	160	147
Income receivable	17	20
Others	40	35
	<u>\$ 217</u>	<u>\$ 1,267</u>

- (1) As part of the CTN transaction, OPCTN S.A. deposited CHF 1,000 (\$ 1,065) into an escrow account following to the purchase of Eldista. The release of the adjustment escrow was depended on the consequence of the net assets adjustment. Finally the escrow was released in March, 2012 (see note 1b(2)).

**NOTE 6:- INVESTMENTS IN COMPANIES AND ASSOCIATES**

- a. The Company invested several amounts in Mobixell Networks Inc. (Mobixell), a privately held Company which is engaged in the design, development and marketing solutions for mobile rich media adaptation, optimization and delivery. As of December 31, 2012, the Company holds 2.04% of Mobixell's shares on a fully diluted basis. During 2012 the Company's has impaired its entire investment in Mobixell following several financing rounds in which the Company did not participate. As a result the Company has recorded impairments of \$ 600 and \$ 100 recorded during 2010 and 2012, respectively.
- b. During 2012, the Company acquired through its subsidiary beneficial interests in Two Penn Center Plaza in Philadelphia, Pennsylvania and in Texas Shopping Center Portfolio for further details please see note 1(b)3 and 1(b)4, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 7:- OTHER ACCOUNTS PAYABLE AND ACCRUED EXPENSES

	December 31,	
	2012	2011
Employees and payroll accruals	\$ 176	\$ 163
Accrued expenses	1,350	1,681
Institution (mainly tax provision)	1,710	1,881
Advance rent payments	45	191
Tenant security deposits	138	96
Other	57	48
	\$ 3,476	\$ 4,060

NOTE 8:- LONG TERM LOANS

- a. On October 29, 2009, Optibase SARL received a mortgage loan ("the Loan") from a financial institution in Switzerland, in the amount of CHF 18,800 for the purpose of purchasing the real estate property located in Rümlang, Switzerland ("the Property"). As of December 31, 2011 and 2012 total mortgage loan amounted to \$ 18,810 and \$ 18,903 with current maturities of \$ 400 and \$411 respectively. The loan bears a variable interest rate based on current money and capital markets in Switzerland plus the bank's customary margins (0.8%). The financial institution may increase margin at any time if creditworthiness of the borrower or quality of the property is impaired. Principal and interest of the loan are payable quarterly. The mortgage loan may be repaid at any time with a three months prior written notice by the Company. The mortgage loan is governed by the laws of Switzerland and bears other terms and conditions customary for that type of mortgage loans. The Company pledged to the bank the property and all accounts and assets of the Company's subsidiary which are deposited with the bank against the loan received. The Company is required to meet certain covenants under this mortgage loan. As of December 31, 2012, the Company met these covenants.

Maturities of the loan by years are as follows:

**Year ended December 31,**

2013 (current maturity)	\$ 411
<b>Long-term portion:</b>	
2014	411
2015	411
2016	411
2017	411
2018 and thereafter	17,259
	\$ 18,903

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 8:- LONG TERM LOANS (Cont.)

- b. On September, 2010, Eldista was granted a mortgage loan from a financial institution in Switzerland, in the amount of CHF 85,250 for the purpose of purchasing its real estate property located in Geneva, Switzerland. The Company pledged to the bank the property and all accounts and assets of the Company's subsidiary which are deposited with the bank against the loan received.

On October 2011, OPCTN and Eldista entered into a CHF 100,000 bank loan refinancing with Credit Suisse for the above mentioned loan. Under the new financing agreement, Credit Suisse provided a new loan to OPCTN and Eldista which replaced the mortgage loan that Credit Suisse provided to Eldista. The combined interest rate of the new loans is 0.83% compared with 1.8% that Credit Suisse charged on the previous mortgage loan. The loans are repaid at a rate of CHF 2,000 per year and are secured by a first mortgage over the property and by a pledge of Eldista's shares.

The modification of the loan was accounted for by the Company in accordance with ASC 470-50 "Debtor's Accounting for a Modification or Exchange of Debt Instruments". The new debt instrument was initially recorded at fair value and that amount was used to determine the debt extinguishment gain or loss to be recognized and the effective rate of the new instrument.

As a result of the refinancing of the loan, the Company recorded during 2011 financial expense in the amount of \$ 400 (representing CHF 375).

Maturities of the loan by years are as follows:

**Year ended December 31,**

2013 (current maturity)	\$ 2,186
<b>Long-term portion:</b>	
2014	2,186
2015	2,186
2016	2,186
2017	2,186
2018 and thereafter	96,651
	<u>\$ 105,395</u>

The Company is required to meet certain covenants under this mortgage loan. As of December 31, 2012, the Company met these covenants.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**U.S. dollars in thousands (except share and per share data)**

**NOTE 9:- COMMITMENTS AND CONTINGENT LIABILITIES**

a. Lease commitments:

The Company and its subsidiaries facilities and motor vehicles are leased under several operating lease agreements for periods ending in 2014.

Future minimum lease commitments under non-cancelable operating leases are as follows:

<b>Year ended December 31</b>		
2013	\$	57
2014		10
	\$	67

b. Consultancy agreement with Swiss Pro Capital Limited:

Following the CTN transaction (as further described in Note 1b(2)), Eldista entered into a consultancy services agreement ("Consultancy Agreement") with Swiss Pro Capital Limited, ("Swiss Pro"), a Cypriot company. According to the agreement, Swiss Pro will receive a monthly fee for its services and will also be entitled to a bonus based on future performance above a certain return on the investment. The term of the Consultancy Agreement is for two years, and ends on May 19, 2013. At the conclusion of the term, Swiss Pro may cease performing the consultancy services and Eldista may cease paying Swiss Pro an ongoing monthly fee. In addition, beginning on May 19, 2013, Eldista will have the right to prepay any bonus that may be due to Swiss Pro according to the mechanism set forth in the Consultancy Agreement.

c. Guarantees:

As of December 31, 2012, the Company has obtained bank guarantees in the amount of \$ 134.

d. Assets pledged as collateral:

As collateral for the Company's bank guarantees, a fixed charge has been placed on the Company's property and equipment, shareholders' equity, a floating charge (security interest in assets of the Company as they exist from time to time) has been placed on all the other assets of the Company and a specific charge of \$60 has been placed on the Company's bank deposit.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 9:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

e. Office of the Chief Scientist and European Commission commitments:

Until the sale of the Video Activity the Company participated in programs sponsored by the Israeli Government and by the European Commission for the support of research and development activities.

The Company was obligated to pay royalties to the Office of the Chief Scientist ("OCS"), amounting to 3%-3.5% of the sales of the products and other related revenues generated from such projects, up to 100% of the grants received, linked to the U.S. dollar and for grants received after January 1, 1999 also bearing interest at the rate of LIBOR. The obligation to pay these royalties is contingent on actual sales of the products and in the absence of such sales, no payment is required. The Company is currently undergoing an audit by the OCS for royalties paid before the sale of our Video business. As of December 31, 2012, the Company believes it has sufficient provisions to cover the outcome of such review process. The provision for the above commitments was recorded under liabilities attributed to discontinued operations as the Company has no further obligation to pay royalties on revenues generated by the Video Activity subsequent to its sale.

Through the sale of the Video Activity, the Company has paid or accrued royalties to the OCS in the amount of \$ 4,308, and had an outstanding contingent obligation to pay royalties in the amount of approximately \$ 4,248 plus interest.

In addition, during 2010 and 2011 the Company was audited by the European Commission for grants received under 3 FP6 contracts. As results of the audit findings implementation the company paid during 2012 an amount of \$ 430 which settled and closed the financial audit.

f. Legal claim and contingent liabilities:

1. Under the Agreement related to the sale of Video Activity (as further described in Note 1c) the parties agreed on a price adjustment mechanism, upon which, Vitec shall add or subtract to the consideration the adjustment amount whereby the adjustment amount would be deposited in escrow within five days from the closing date.

However, Vitec has refrained from depositing any amount in escrow.

In that respect, since October, 2010 through April 2011, both parties have filed several and separate motions with the Tel-Aviv District Court, seeking, inter alia, fixed and temporary injunctions. Since then the motions filed by both parties have been dismissed by the court and were transferred to arbitration proceedings.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 9:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

In November 2011, Vitec and the Company submitted their Statement of Claim to the Arbitrator.

The Company submitted its Statement of Claim against Vitec demanding that Vitec pay an aggregate sum of \$ 1,506 for the Adjustment Amount owed to the Company while Vitec submitted its Statement of Claim against the Company, demanding that the Company pay Vitec a total amount of approximately \$ 22,878.

The Statement of Claim brought by Vitec is based, inter alia, on the following main causes of action: (i) loss of business opportunities (mainly M&A transactions) for lack of available cash; (ii) mail fraud; (iii) defamation; (iv) expenditures related to the legal proceedings between the parties; and (v) several additional causes of action, among others, based on Vitec's claim mentioned above.

In January, 2012, both parties submitted their Statements of Defense mutually denying all of the other party's claims.

Following submission of the party's pleadings, it was decided that Vitec would submit an expert opinion to prove its accusation and that the Company would be entitled to submit a counter opinion on its behalf. On March 17, 2012, both parties submitted their expert opinion.

In March, May and June 2012, evidentiary hearings were held before the Arbitrator. During these hearings Vitec's witnesses gave their primary testimony and were cross-examined by the Company's attorneys.

In June 2012, the Company witnesses gave their primary testimony and were cross-examined by Vitec's attorneys.

Vitec has submitted their written summations in September 2012, the Company has submitted its written summations by November 2012 and Vitec's response to the Company's summations by December 2012.

In January 2013, the Arbitrator informed the parties that his final decision regarding the arbitration with Vitec will be given along with the final decision regarding the personal claim against Adv. Doron Afik and the latter Adv. Afik's counter-claim (for further information, see below).

In addition, both parties agreed on mutual indemnification for a period of two years until July 2012 for damages arising or resulting from, inter alia, breach or material inaccuracy relating to the representations, warranties and covenants and the liabilities that Vitec may incur which are part of the excluded liabilities arising or resulting therefrom and for that purpose \$1,000 out of the aggregate consideration in the Vitec Transaction was put in escrow as security.



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 9:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

In light of the existing arbitration proceedings, and following the refusal of Vitec to the release of such indemnification escrow funds, the decision regarding the release of the escrow funds was brought in front of the arbitrator, who decided to restrain the Company from releasing the indemnification escrow funds until a final award in the arbitration process.

To date, the Company is expecting the final decision of the arbitrator regarding the arbitration proceedings against Vitec.

It is difficult to assess the likelihood of success of the arbitration proceedings against Vitec in each and every cause of action due to the diversity of the claims raised against the Company, the complexity and ambiguity of such proceedings and Vitec's pleading and the fact that the final decision is subject to the arbitrator discretion. Nevertheless, the Company believes that its financial statements include an adequate provision to cover the probable outcome of the Vitec arbitration.

2. Personal Claim against Adv. Doron Afik:

As part of the Agreement the Company, Vitec and Adv. Afik as trustee (the "Trustee") entered into the Consortium Escrow Agreement of March 16, 2010 (the "Consortium Agreement"). Under the Consortium Agreement, \$ 300 of the consideration were held in escrow \$ 100 per each EC Consortium Agreement to be transferred from the Company to Vitec under the Agreement.

Due to the Trustee's refusal to transfer the escrow funds to the Company, the Company believes the Trustee is in breach of his duties as Trustee and is causing damage to the Company. Therefore, in June 2011, the Company filed a statement of claim for damages of approximately \$ 268 against the Trustee along with an ex-parte motion for a lien on all of the Trustee's bank accounts.

In June 2011, the court rendered its decision granting the lien subject to the Company depositing certain securities. The Trustee then filed a motion to cancel the lien and the court decided to transfer the proceedings to the District Court, but that the lien would remain in effect until a decision by the District Court. The District Court for Tel Aviv-Yaffo ordered the removal of the lien, and later on at the parties' mutual request, the court ordered to transfer these proceedings to arbitration.

In November 2011 the Company submitted its statement of claim against Adv. Afik to the Arbitrator.

In January 2012, Adv. Afik submitted his Statement of Defense to the claim against him, denying all of the Company's claims against him. Also in January 2012, Adv. Afik submitted a counterclaim against Optibase, ( the "Counter-Claim"). In the Counter Claim Adv. Afik demands to receive a total amount of approximately \$ 663 from the Company. Adv. Afik's claim is based on three main claims: (i) The Company's response to an article published in a certain website constitutes libel against Adv. Afik; (ii) Damages caused by obtaining liens on Adv. Afik's assets; and (iii) That a publication about the liens obtained on Adv. Afik's assets also constitutes libel against Adv. Afik.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 9:- COMMITMENTS AND CONTINGENT LIABILITIES (Cont.)

In March 2012 the Company submitted its Statement of Defense.

In January 2013, Adv. Afik submitted his affidavit along with an expert opinion on his behalf. The company is required to submit a counter opinion on its behalf until March 14, 2013.

The evidentiary hearings for this proceeding were scheduled for April 2013.

In January 2013, the Arbitrator informed the parties that his decision regarding the arbitration with Vitec will be given along with the decision regarding the personal claim against Adv. Doron Afik and the Afik Counter-Claim.

The Company believes that it has strong legal and factual arguments to defend itself from the claims in the Afik Counter Claim.

NOTE 10:- TAXES ON INCOME

a. Corporate tax rates:

The Israeli corporate tax rate was 25% in 2010, 24% in 2011 and 25% in 2012.

A company is taxable on its real (non-inflationary) capital gains at the corporate tax rate of 25% in the year of sale.

On December 5, 2011, the Israeli Parliament (the Knesset) passed the Law for Tax Burden Reform (Legislative Amendments), 2011 ("the Law") which, among others, cancels effective from 2012, the scheduled progressive reduction in the corporate tax rate. The Law also increases the corporate tax rate to 25% in 2012. In view of this increase in the corporate tax rate to 25% in 2012, the real capital gains tax rate and the real betterment tax rate were also increased accordingly.

Taxable income of the Company's subsidiary in Luxemburg, Switzerland and the United States is subject to the following tax rates:

	Year ended December 31,		
	2012	2011	2010
Luxemburg	29%	29%	29%
Switzerland	24%	24%	25%
United States	35%	34%	35%

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 10:- TAXES ON INCOME (Cont.)

b. Tax assessments:

The Company has final tax assessments through the tax year 2008.

c. Deferred tax assets and liabilities:

Deferred tax assets and liabilities deriving from the acquisition of a building complex in Geneva in 2011 (see details in Note 1(b)2). The deferred taxes are computed at the average tax rate of 24%, based on the corporate income tax in Switzerland, which is the tax rate that will be in effect when the differences are expected to reverse.

	December 31,	
	2012	2011
Deferred tax assets:		
Lease provision	\$ 1,749	\$ 1,722
Swap instrument	682	854
Mortgage loan	245	243
Deferred tax assets	<u>2,676</u>	<u>2,819</u>
Deferred tax liabilities:		
Land	\$ (5,770)	\$ (5,620)
Building	(11,834)	(11,640)
Other assets, net	(334)	(264)
Deferred tax liabilities	<u>(17,938)</u>	<u>(17,524)</u>
Deferred tax liabilities, net	<u>\$ (15,262)</u>	<u>\$ (14,705)</u>

d. Net operating losses carry-forward:

Through December 31, 2012, Optibase Ltd. had net operating losses carry-forward for tax purposes in Israel of approximately \$ 67.5 millions which may be carried forward and offset against taxable income in the future, for an indefinite period.

As of December 31, 2012, Optibase Inc. had U.S. federal net operating loss carry-forward of approximately \$ 28.5 millions that can be carried forward and offset against taxable income for 20 years, no later than 2013 to 2033. Utilization of U.S. net operating losses may be subject to the substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code of 1986, and similar state provisions. The annual limitation may result in the expiration of net operating losses before utilization. Based upon the weight of available evidence, which includes the Company's historical operating performance and the recorded cumulative net losses in all prior fiscal periods, the Company has provided a full valuation allowance against its Israeli and U.S. deferred tax assets.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 10:- TAXES ON INCOME (Cont.)

- e. Reconciliation of the theoretical tax expenses to the actual tax expenses:

A reconciliation between the theoretical tax expense, assuming all income is taxed at the statutory tax rate applicable to the income of the Company and the actual tax expense as reported in the statements of operations is as follows:

	Year ended December 31,		
	2012	2011	2010
Income (loss) before taxes as reported	\$ 5,698	\$ 2,331	\$ (902)
Theoretical tax benefit computed at the statutory rate (25%, 24% and 25% for the years 2010, 2011 and 2012, respectively)	\$ 1,424	\$ 560	\$ (226)
Differences in tax rates on income deriving from foreign subsidiaries	(54)	42	(89)
Gain derived from bargain purchase	-	(1,059)	-
Tax adjustments in respect of currency translation	(305)	154	643
Deferred taxes on losses and other temporary differences for which valuation allowance was provided	324	626	(339)
Settlement of prior years tax assessments	-	41	-
Other non-deductible expenses	254	117	54
Income tax expense	\$ 1,643	\$ 481	\$ 43

- f. Income (loss) before taxes on income consists of the following:

	Year ended December 31,		
	2012	2011	2010
Domestic	\$ (810)	\$ (3,138)	\$ (1,343)
Foreign	6,508	5,469	441
	\$ 5,698	\$ 2,331	\$ (902)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 10:- TAXES ON INCOME (Cont.)

g. Income tax expenses are comprised as follows:

	Year ended December 31,		
	2012	2011	2010
Current	\$ 1,537	\$ 863	\$ 7
Deferred	106	(382)	36
	<u>\$ 1,643</u>	<u>\$ 481</u>	<u>\$ 43</u>
Domestic	\$ -	\$ -	\$ -
Foreign	1,643	481	43
	<u>\$ 1,643</u>	<u>\$ 481</u>	<u>\$ 43</u>

h. As of December 31, 2011 and 2012 the Company has no liability for unrecognized income tax benefits, and there was no change in its liability for unrecognized income tax benefits during all years presented.

NOTE 11:- SHAREHOLDERS' EQUITY

a. General:

1. The Ordinary shares of the Company are traded on the NASDAQ Global Market since April 1999.

Ordinary shares confer on their holders the right to receive notice to participate and vote in general meetings of the Company, the right to a share in excess assets upon liquidation of the Company, and the right to receive dividends, if declared.

2. On August 16, 2012, and following the approval of the Company's board of directors, the company shareholders approved a one-for-five reverse share split of the company's ordinary shares, (" Reverse Share Split"). The Reverse Share Split was effective on September 27, 2012 and reduced the Company's ordinary shares to a 6,000,000 and 3,882,945 shares authorized and issued respectively. The exercise price and the number of shares issuable pursuant to our outstanding options have been adjusted pursuant to the terms of such instruments in connection with the Reverse Share Split. No fractional ordinary shares were issued in connection with the Reverse Share Split, and all such fractional shares were rounded to the nearest whole number of ordinary shares.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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U.S. dollars in thousands (except share and per share data)

NOTE 11:- SHAREHOLDERS' EQUITY (Cont.)

All share and purchase amounts were adjusted to reflect the one-for-five reverse share split.

3. On May 5, 2011, following the receipt of the approval of the Company's shareholders on March 30, 2011, the Company completed a private placement of 2,500,000 ordinary shares of the Company to the Company's President and the controlling shareholder of the Company, in consideration for \$ 5,000.

b. Stock options:

In 1999, the Company adopted an Israeli Option Plan ("1999 Israeli option plan"), and a U.S. Option Plan ("1999 U.S. option plan") (collectively "the 1999 plans"). Under the terms of the above option plans, options may be granted to employees, officers, directors and consultants. Also, the options generally become exercisable monthly over a four-year period, commencing one year after date of the grant, subject to the continued employment of the employee. The options generally expire no later than seven years from the date of the grant.

In May 2003 the Company amended its 1999 Plan to provide for the grant of options to Israeli optionees under Section 102 of the Israeli Tax Ordinance.

The exercise price of the options granted under the abovementioned plans may not be less than the nominal value of the shares into which such options are exercised. Any options which are forfeited or cancelled before expiration, become available for future grants.

The total number of options available for future grants as of December 31, 2012 was 467,722.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 11:- SHAREHOLDERS' EQUITY (Cont.)

A summary of the Company's stock option activity, and related information, is as follows:

	Year ended December 31, 2012		Weighted average Remaining contractual term (years)
	Amount	Weighted average exercise price	
Outstanding at the beginning of the year	129,100	\$ 9.75	
Granted	-		
Forfeited	2,100	\$ 27	
<b>Outstanding at the end of the year</b>	<b>127,000</b>	<b>\$ 9.76</b>	<b>4.59</b>
Exercisable options at the end of the year	66,589	\$ 10	3.87
Options vested and expected to vest at end of year	125,767	\$ 9.83	3.77

The weighted average fair value of options granted during the years ended December 31, 2010, 2011 was \$ 0.82, \$ 0.66, respectively.

The aggregate intrinsic value represents the total intrinsic value (the difference between the Company's closing stock value as of December 31, 2012 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2012. This amount changes based on the fair market value of the Company's stock. As of December 31, 2011 and 2012, the total intrinsic value of outstanding options was \$ 0.

As of December 31, 2012, there was \$ 184 of total unrecognized compensation cost related to options compensation arrangements granted under the Company's stock option plans. That cost is expected to be recognized over a period of up to four years.

c. Non-vested shares:

In May 2006, the Board of Directors approved the adoption of the 2006 Israeli Incentive Compensation Plan (the "2006 Plan"). The 2006 Plan provides for the grant of options, restricted shares and restricted share units in accordance with various Israeli tax tracks.

The Company currently uses the 2006 Plan for the grant of restricted shares only. The restricted shares are granted at no consideration and with a vesting schedule of two years (50% each year). The restricted shares are granted in accordance with the Israeli capital gains tax track. As of December 31, 2012 the pool consists of 60,000 Shares, where an aggregate of 11,690 ordinary shares has been reserved for issuance under the 2006 Plan.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 11:- SHAREHOLDERS' EQUITY (Cont.)

A summary of the status of the entity's non-vested shares as of December 31, 2012, and changes during the year ended December 31, 2012, is presented below:

Non-vested shares	Shares	Weighted average grant date fair value
Non-vested at January 1, 2012	6,000	\$ 7.15
Granted	4,000	\$ 5.39
Exercised	(4,000)	\$ 7.28
Forfeited and cancelled	-	
Non-vested at December 31, 2012	<u>6,000</u>	<u>\$ 6.05</u>

As of December 31, 2012, there was \$ 15 of total unrecognized compensation cost related to unvested share-based compensation arrangements granted to employees under the Plan. That cost is expected to be recognized over a period of up to two years.

- d. The total equity-based compensation expense related to all of the Company's equity-based awards, recognized for the years ended December 31, 2010, 2011 and 2012, was comprised as follows:

	Year ended December 31,		
	2012	2011	2010
General and administrative from continued operations	\$ 117	\$ 120	\$ 112
Expenses recorded as discontinued operations	-	-	55
Total equity-based compensation expense	<u>\$ 117</u>	<u>\$ 120</u>	<u>\$ 167</u>



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

U.S. dollars in thousands (except share and per share data)

NOTE 12:- SELECTED STATEMENT OF OPERATIONS DATA

Financial income (expenses):

	Year ended December 31,		
	2012	2011	2010
Financial income:			
Interest	\$ 44	\$ 35	\$ 612
Foreign currency translation adjustments	130	-	-
Remeasurement of derivatives	811	-	-
	<u>985</u>	<u>35</u>	<u>612</u>
Financial expenses:			
Interest	(2,228)	(3,081)	(207)
Foreign currency translation adjustments	-	(334)	(101)
Remeasurement of derivatives	-	(4,101)	-
	<u>(2,228)</u>	<u>(7,516)</u>	<u>(308)</u>
	<u>\$ (1,243)</u>	<u>\$ (7,481)</u>	<u>\$ 304</u>

NOTE 13:- TRANSACTION AND BALANCES WITH RELATED PARTY

On October 12, 2012, the Company entered into a limited partnership where the general partner and certain limited partners are affiliated with Mr. Shlomo (Tom) Wyler, the Company's president and member of board of directors, who then considered the controlling shareholder of the Company, for further information regarding this investment see Note 1(b)3.

**SIGNATURES**

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

Date: March 13, 2013

OPTIBASE LTD.

By: /s/ Amir Philips

Name: Amir Philips

Title: Chief Executive Officer

## EXHIBIT INDEX

<b>Exhibit Number</b>	<b>Description of Document</b>
1.1	Amended and Restated Memorandum of Association of Optibase Ltd. (incorporated by reference to Exhibit 3.1 to the Registrant's Report on Form 6-K dated February 15, 2002).
1.2	Amended and Restated Articles of Association of Optibase Ltd. (incorporated by reference to Exhibit 1.2 to the Registrant's Annual Report on Form 20-F for the fiscal year ended December 31, 2011).
4.1	Framework Agreement between Eldista GmbH and CREDIT SUISSE AG dated October 6, 2011. (incorporated by reference to Exhibit 4.7 to the Registrant's Annual Report on Form 20-F for the fiscal year ended December 31, 2011).
4.2	Security Agreement between Eldista GmbH and CREDIT SUISSE AG dated October 6, 2011. (incorporated by reference to Exhibit 4.8 to the Registrant's Annual Report on Form 20-F for the fiscal year ended December 31, 2011).
4.3	Framework Agreement between OPCTN S.A. and CREDIT SUISSE AG dated October 6, 2011. (incorporated by reference to Exhibit 4.9 to the Registrant's Annual Report on Form 20-F for the fiscal year ended December 31, 2011).
4.4	Deed of Pledge Agreement between OPCTN S.A. and CREDIT SUISSE AG dated October 6, 2011. (incorporated by reference to Exhibit 4.10 to the Registrant's Annual Report on Form 20-F for the fiscal year ended December 31, 2011).
4.5	Form of Letter of Indemnification between Optibase Ltd. and its directors and officers. (incorporated by reference to Exhibit 4.11 to the Registrant's Annual Report on Form 20-F for the fiscal year ended December 31, 2011).
4.6	Form of Letter of Indemnification between Optibase, Inc. and its directors and officers (incorporated by reference to Exhibit 4.9 to the Registrant's Annual Report on Form 20-F for the fiscal year ended December 31, 2002).
4.7	1999 Israel Share Option Plan, as amended (incorporated by reference to exhibits filed with the Registrant's Annual Report on Form 20-F for the fiscal year ended December 31, 1999).
4.8	1999 U.S. Share Option Plan, as amended (incorporated by reference to exhibits filed with the Registrant's Annual Report on Form 20-F for the fiscal year ended December 31, 1999).
4.9	102 Plan (incorporated by reference to exhibits filed with the Registrant's Annual Report on Form 20-F for the fiscal year ended December 31, 1999).
4.10	Employee Stock Purchase Plan (incorporated by reference to exhibits filed with the Registrant's Annual Report on Form 20-F for the fiscal year ended December 31, 1999).
4.11	2003 Amendment to the 1999 Israel Share Option Plan (incorporated by reference to Exhibit 4.(c).9 to the Registrant's Annual Report on Form 20-F for the fiscal year ended December 31, 2003).
4.12	2006 Israeli Incentive Compensation Plan (incorporated by reference to Exhibit 4.1 to the Registrant's Registration Statement on Form S-8 (File no. 333-137644)).
8.1*	List of the subsidiaries of the Company.
11.1	Code of Business Conduct and Ethics (incorporated by reference to Exhibit 11.1 to the Registrant's Annual Report on Form 20-F for the fiscal year ended December 31, 2010).
12.1*	Certification by Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
12.2*	Certification by Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
13.1*	Certification by Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
13.2*	Certification by Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
15.1*	Consent of Kost, Forer Gabbay & Kasierer, a member of Ernst & Young Global.

\* Filed herewith

List of Subsidiaries

Optibase Inc., a California corporation  
Optibase Real Estate Miami LLC, a Delaware limited liability company  
Optibase 2Penn LLC, a Delaware limited liability company  
OPTX Equity LLC, a Delaware limited liability company  
OPTX Lender LLC, a Delaware limited liability company  
Optibase Real Estate Europe Sarl, a Luxemburg company  
Optibase RE1 Sarl, a Luxemburg company  
OPCTN SA, a Luxemburg company  
Eldista GmbH, a Swiss company

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CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Amir Philips, certify that:

1. I have reviewed this annual report on Form 20-F of Optibase Ltd.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: March 13, 2013

/s/ Amir Philips  
Amir Philips  
Chief Executive Officer

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CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Yakir Ben-Naim, certify that:

1. I have reviewed this annual report on Form 20-F of Optibase Ltd.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: March 13, 2013

/s/ Yakir Ben-Naim  
Yakir Ben-Naim  
Chief Financial Officer

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CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Optibase Ltd. (the "Company") on Form 20-F for the period ending December 31, 2012, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned hereby certify that to the best of our knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 13, 2013

/s/ Amir Philips  
Name: Amir Philips  
Title: Chief Executive Officer

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CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Optibase Ltd. (the "Company") on Form 20-F for the period ending December 31, 2012, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned hereby certify that to the best of our knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 13, 2013

/s/ Yakir Ben-Naim  
Name: Yakir Ben-Naim  
Title: Chief Financial Officer

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**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the Registration Statements (Form S-8 File No. 333-10840; Form S-8 File No. 333-12814; Form S-8 File No. 333-13186; Form S-8 File No. 333-91650; Form S-8 File No. 333-122128; S-8 File No. 333-137644; Form S-8 File No. 333-139688; Form S-8 File No. 333-148774;) pertaining to Optibase Ltd. of our report, dated March 13, 2013, with respect to the consolidated financial statements of Optibase Ltd., included in the Annual Report (Form 20-F) for the year ended December 31, 2012.

Tel-Aviv, Israel  
March 13, 2013

*/s/ Kost Forer Gabbay & Kasierer*  
KOST FORER GABBAY & KASIERER  
A Member of Ernst & Young Global

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