

Financial Mail

Can Vukile work its Spanish magic in Italy?

The market will keep a close watch to see whether the prolific dealmaker's next European chapter proves as lucrative as its Iberian foray

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La Centurie in Padua, Italy. (Supplied/Vukile Property Fund)

It's no secret that the JSE is littered with companies whose offshore expansion strategies have flopped. Mall owner Vukile Property Fund is a notable exception. When many of its peers ventured into the UK and Eastern Europe a decade ago (with varying degrees of success), Vukile CEO Laurence Rapp didn't want to follow the crowd into overtraded markets. Instead, he placed his bets on the largely uncharted territory of Spain and neighbouring Portugal.

Vukile first expanded its South African retail footprint into that region in mid-2017 by buying a portfolio of 11 retail parks for €193m through its Madrid-listed subsidiary Castellana Properties.

Since then, the value of Vukile's Iberian portfolio has ballooned to €2.2bn, cementing its position as one of the biggest retail landlords in Iberia.



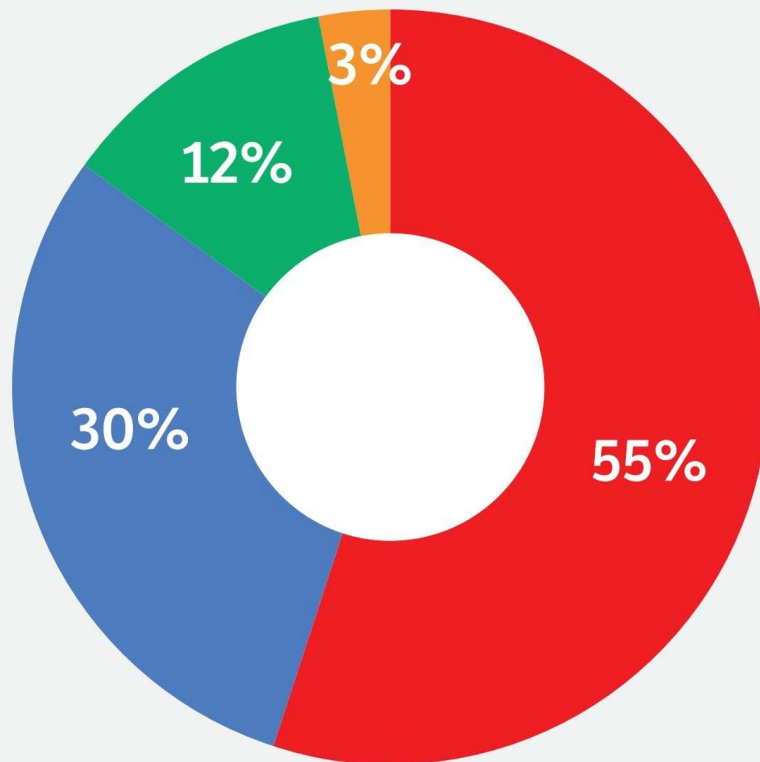
Most of the Iberian growth happened post-pandemic. In the past 18 months alone, five major deals have been concluded to the value of more than €900m. These involve Forum Madeira, a 21,472m² centre on the Portuguese island; Bonaire Shopping Centre in Valencia, which at nearly 56,000m² is the largest mall in the region; Berceo Centro Comercial, a 49,416m² shopping centre in La Rioja, Spain; Islazul, an upscale 90,000m² shopping and leisure destination in Madrid; and a 50% stake in Splau Shopping Centre, a prime 55,000m² centre in Barcelona.

Though Vukile remains a major player in South Africa — its R19.5bn portfolio of 38 township, rural, urban and commuter malls includes East Rand Mall, Gugulethu Square (Cape Town), Dobsonville Mall (Soweto) and Mall of Mthatha (Eastern Cape) — its Iberian assets have grown to 67% of its R63.7bn portfolio.

Vukile's contrarian investment strategy has paid off handsomely for shareholders. Over the past decade, it has consistently been one of the JSE's best-performing real estate investment trusts (Reits), in terms of both dividend and share price growth. In the 10 years to end-May, Vukile notched up a total annualised return of just shy of 13%, placing it among the top three best-performing South African Reits alongside Fairvest A and Stor-Age, according to data from the SA Reit Association.

VUKILE PORTFOLIO SPLIT*

Total assets: R63.7bn



*Incl recent Italian acquisitions

Source: Vukile Property Fund

Notwithstanding lingering pandemic-induced woes, load-shedding and higher-for-longer interest rates, in the five years to June 19 Vukile's share price surged 123% — more than double the 56% delivered by the JSE's all property index over the same period.

At the results briefing for the year to March last week, Rapp revealed details of Vukile's plan to replicate its Iberian success story in Italy. The Reit has already established a new Italian holding company, Esperia Properties, and bought three hypermarket-anchored convenience centres for €115m: Le Due Valli (8,152m²) in Turin in northwestern Italy, Le Centurie (11,996m²) in Padua in the east near Venice, and Quarto Nuovo (20,872m²) near Naples in the south. Rapp is eyeing

another two Italian deals worth about €200m and says the Italian portfolio value could reach €1bn within the next 12 months.

But why Italy?

Referring to Vukile's strategy of entering undertraded and undervalued Western European markets as it did in Spain and Portugal nine years ago, Rapp said Vukile is buying retail assets in Italy "ahead of the curve". Retail centres in Italy can still be bought at yields of 8%-10%, which is attractively priced compared with Spain, where yields are sitting at 6.25%-7.5% (annual net rental as a percentage of purchase price). "Italy is a very accretive market at the moment," Rapp said.

He added that retail property ownership in the country is highly fragmented among smaller investors and family-owned offices, which creates opportunities for consolidation. And planning approvals to build new centres are very restrictive, "so if you buy well in Italy, you can have long-term dominance in that region".

Rapp noted that Italy has a more prosperous population than Spain in terms of income per capita and net household wealth, which creates a solid underpinning for retail spending. "Italy also has a deep-rooted consumer culture with one of the lowest online shopping penetration levels in Europe, which means physical retail stores remain indispensable" he said. Importantly, Rapp stressed that Vukile is not entering Italy as a "newbie" but through its partnership with Pradera, the pan-European retail asset manager in which it bought a 35% stake earlier this year.

If you buy well in Italy, you can have long-term dominance in that region

— *Laurence Rapp*

"Pradera was a phenomenally important strategic deal for us, as it has well-established operations in nine European countries, Italy included, with €5bn of retail assets under management." Rapp said Pradera allows Vukile to derisk its entry into new markets with local "boots on the ground instead of being mere briefcase bankers".

Rapp plans to stick to the strategy of buying retail assets that offer value-unlock potential through expansion, reconfiguration, refurbishment and retenanting opportunities. The idea is to build a portfolio of scale in Italy in a similar way to what Vukile did in Iberia — by first acquiring smaller, value-orientated retail centres and, over time, moving towards bigger and higher-quality malls with asset management potential.

"We wanted a neat, small entry into Italy, to understand the market and create a solid platform from which to grow, which we believe is the most prudent way to go," Rapp said.



Vukile will fund its Italian expansion through last month's heavily oversubscribed bookbuild, which raised a hefty R2.8bn in fresh capital. That comes shortly after R2.65bn was raised in October, most of which was deployed in Iberian deals. While some question the extent to which Vukile has in recent years tapped the market for capital to pursue its offshore growth ambitions, Rapp's retort is that when you are primed for growth and windows of opportunity open, you need to move quickly.

Besides, he said, the overwhelming support for Vukile's bookbuilds — from local and international investors — is a clear signal that the market likes the way Vukile allocates capital. "Our track record of doing accretive deals offshore has been proved over and over," said Rapp. "Look how well we've used the money and how much value we've unlocked for shareholders."

Analysts agree that Vukile's capital allocation capabilities are best in class, with a management team that is highly regarded for its dealmaking prowess.

"We are generally cautious when companies enter new markets without an established operating platform, as execution risk can be elevated," says Curwin Rittles, senior investment analyst at Metope Group. "However, Vukile has a strong track record of disciplined capital allocation in Europe and has mitigated some of this risk through its investment in a pan-European asset manager with local market expertise and deal-sourcing capabilities."

Rittles adds: "Strong on-the-ground platforms and capital support are often what differentiate successful offshore expansions from those that struggle through market cycles."



Still, some believe Italy may be a more difficult market to conquer than Spain.

Golden Section Capital MD Garreth Elston says while Vukile's Italian foray may well turn out to be an "Iberia 2.0", the success achieved in Spain was underpinned by stronger GDP growth, lower structural unemployment and a more liquid institutional investment market than Italy offers.

Elston believes Vukile's entry into Italy via small, grocery-anchored convenience centres makes sense, as it is the most defensive retail format in any market, "especially in Italy, where e-commerce penetration is low". The downside, he says, is that it may be more difficult to exit secondary, provincial assets in Italy than in Spain.

That Vukile's largest Italian asset — Quarto Nuovo — is in the relatively poor region of Naples, with a 15.6% unemployment rate, is also of some concern, says Elston. "We hope Vukile focuses more on the northern areas of Italy for future expansion, as we believe this will lower the risk, albeit at a higher price for quality assets." He adds: "Whether Italy rerates on the Iberian timeline is the unresolved question on which the long-term capital return depends."

Evan Robbins, portfolio manager at Old Mutual Investment Group, shares the sentiment. He says while Rapp has made a spirited case for Italy and retail property in that country looks attractively priced, it remains to be seen whether Vukile's Italian foray is the right move. "Vukile's demonstrable competence in Spain and Portugal may not be as easy to replicate in Italy. It is a real player in Iberia, with proven capability. Why move to a different geography with its own competitive dynamics?"