

WINE BUSINESS MONTHLY

October 2015 • \$5.95

The Industry's Leading Publication for Wineries and Growers

www.winebusiness.com

The Future of Tank Cleaning

2015 \$ALARY \$URVEY REPORT

How the
WBM
30
Make Wine

Exclusive Look at Trinchero's
New Bottling Facility

What it Takes to Handle
Massive Lab Analyses

Plus:

Vineyard Appraiser Tony Correia
on the Booming Vineyard Market

Insight & Opinion:

How the Great Grape Shortage of 2012 is Driving the Vineyard Market

Tony Correia

Tony Correia is widely recognized as a leading authority on the valuation of agricultural and rural properties, with a special emphasis on vineyards and wineries. He holds the professional designation of Accredited Rural Appraiser (ARA), and is currently an owner of The Correia Company. He provides a wide array of valuation and consulting services on agricultural and rural properties, specializing in more challenging valuations involving wineries, vineyards, estate planning and settlement, undivided partial interests in real property, and water rights. He is also a frequent public speaker on agricultural property markets, appraisal, taxation, estate planning issues, water rights and the vineyard and wine industries. Correia has extensive experience in appraisal of vineyards and wineries, having been professionally engaged in such appraisals for more than 30 years.

SWAYING SLOWLY IN THE soft breeze of a balmy spring day, few things in agriculture are more seductive, and romanticized, than the premium varietal wine grapevine. Episodically, people become collectively seduced by the silent song of this siren, and a compulsive desire to own their very own piece of the wine world. Many actually embark on the journey destined to create the next cult Napa Cabernet or Sonoma Coast Pinot Noir, the current varieties du jour. Many years ago the varieties of choice were Chardonnay and Merlot, and some time before that we set out to do the same with Chablis.

If you were in the industry prior to the early 1980s you may remember Chablis, the generic blend of Chenin Blanc and Colombard. The American consumer was clamoring for more Chablis, and pundits assured us we could never produce sufficient volume to satisfy the impending demand.

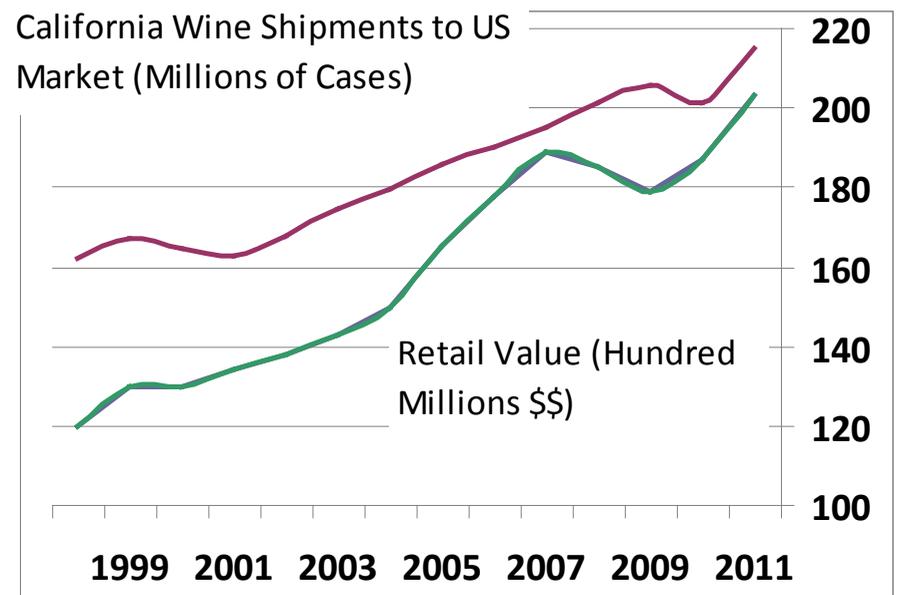
Today, we are watching over one of the strongest vineyard markets in modern history, with a fairly dramatic consolidation of the wine industry's grape supply, and heated pursuit of the very best uber-terroir sites. In order to grasp the magnitude of this market movement, we need to pause for a minute to look at the big picture. The bifurcation of the wine industry has essentially created two different worlds. Below \$10 per bottle, sales are slow and demand is soft. Here, we will concentrate on the market segment above the \$10 mark, where sales, prices and demand remain strong.

The Great Grape Shortage of 2012

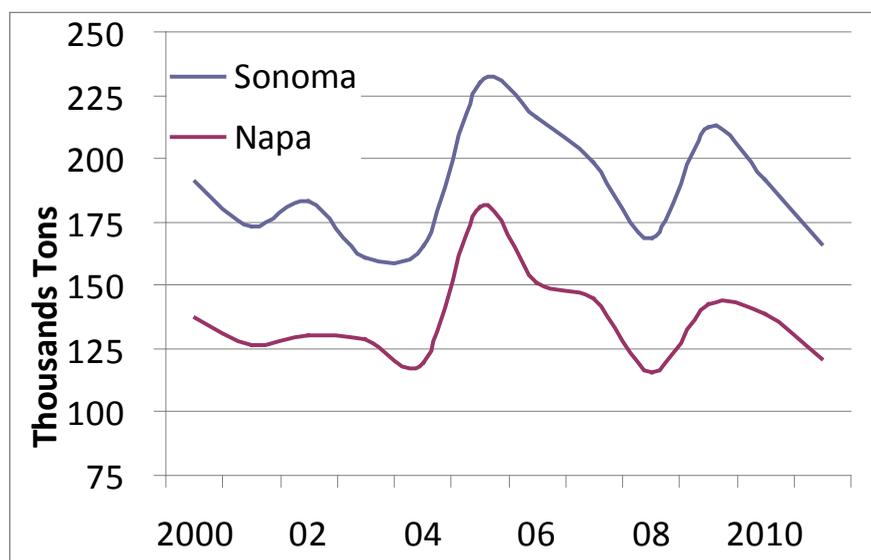
The California winegrape industry enjoys an interesting relationship with its sister industry, the California wine industry. While often traditionally viewed as an adversarial marriage of necessity, neither one can function without the other, and so they continue on, hand in hand, only pausing periodically to negotiate the annual dowry of the year's grape crop. In our short history, California's wine industry has experienced typical business cycles of expansion and contraction, following a recurring imbalance of supply of, and demand for, winegrapes. While some of these imbalances have proven fairly dramatic, the net result has been the continual perfection

of California's vineyard base. Growers, prodded by winery demands for ever higher quality have sought out the best sites and matched these to the best possible marriages of clones and rootstocks. These are typically planted at higher vine densities often with more refined trellis and canopy management systems and irrigation technology. However, in the premium coastal areas, planted vineyard acreage has shown little change since the turn of the millennium, and most market observers recognize we are now dealing with a fairly finite assemblage of premium vineyard properties. In the great Central Valley, however, things are a bit different, as sales of wine under \$10 per bottle are stagnant, at best, and demand for grapes in the big valley is soft, to say the least.

In the true premium arenas of Napa and Sonoma counties, this escalation of quality, coupled with the finite supply, has driven grape prices higher, albeit still buffeted by the occasional cyclical downturn, such as we saw in the wake of the global financial crisis in the Fall of 2008. While wine pricing



“Few blocks of land, which could be planted, are available today, as the better areas of the north coast are essentially all planted out.”



took significant hits in 2009 and even more in 2010, consumers continued to buy wine, albeit at reduced pricing, “trading down.” The rebound of the U.S. economy allowed consumers to open their wallets, and wine sales rebounded in tandem, with a sharp uptick in 2011, with total shipments shown by the red line, and retail value of those shipments in the green line. And as I have said for decades, “wine prices drive grape prices, and grape prices drive vineyard prices.”

While vintners rejoiced in renewed sales strength, they were also stunned by the downturn of grape production in Napa and Sonoma in 2010 and 2011. While premium wine sales had been steadily increasing since the turn of the millennium, save for the caesura of the recession, premium grape production had been declining since the huge 2005 crop, with only one uptick in 2009. But Mother Nature stepped in with some “interesting” weather in 2010-11, and these severely shortened crops were a sharp wake-up call to the wineries, who heard the message clearly. In the winter of 2011-12, wineries returned to real estate markets in search of vineyards, or land to plant vineyards, ending decades of ambivalence toward ownership of vineyard properties.

Wineries Aggressively Acquiring Vineyards

Jackson Family Wines led the charge with a nimble and aggressive acquisition program centered on Sonoma County, but rapidly extending as far north as Oregon’s Willamette Valley, where they quickly became one of the largest vineyard owners in the state. North Coast wineries were quick to sense this sea-change with a multitude joining the fray, including **E&J Gallo**, **Caymus**, **Silver Oak**, **Paul Hobbs**, **KB Wines**, **Frank Family Vineyards** and **Bill Foley**. Others, such as **Vintage Wine Estates**, focused on winery facility acquisitions, seeking out properties located to maximize Direct to Consumer sales.

Financial Buyers Compete with Wineries

Financial buyers, such as the **Silverado Group**, were challenged to compete with the wineries in the race for the better vineyards. The wineries enjoyed a different view, taking their profit from the finished product in the bottle, rather than from mere grapes. Lifestyle buyers also returned, with the premium vineyard estates attracting world-class prices, as uber-wealthy individuals and families bought into the adult Disneyland of Napa Valley and Sonoma County. And the large institutional investment funds are also immersed in the fray, with these funds actively pursuing vineyard acquisitions throughout the premium coastal wine growing regions. Vineyards look especially attractive after the huge returns generated over the past three years, with the unprecedented combination of three consecutive large crops, coupled with high grape prices. But Mother Nature has intervened once again, in the 2015 vintage, as the crop comes in. As they say “big crops get bigger, and small crops...”

Replanting and Red Blotch

Amidst all this market activity, extensive acreage in Napa and Sonoma Counties is being removed and replanted with new vineyards as growers struggle with increasing pressure from various viruses, including the newest pest, Red Blotch, which appears to be almost ubiquitous. Many larger growers are replanting on phased two to seven year programs, thus, the overall impact of Red Blotch on production may extend seven to 10 years. Given the burgeoning demand for grapes, this reduced production could translate to higher grape prices for several years to come. However, the recent surge of winery acquisitions could be even more of a damper on grape supply. As wineries gain full control over more of their grape sources, they will not need to look for additional supply on the open market. And at the same time, the market supply of uncommitted grapes is shrinking, due to that same expansion of winery vineyard ownership.

NIMBYs

The increased level of winery demand has fueled a renewed enthusiasm amongst local real estate markets, as this collection of potential buyers has raised the bar in coastal real estate markets, with heated competition for the better properties. Land markets have enjoyed similar demand, accelerated by the increasingly stringent regulatory hurdles for permitting land for vineyard development. The application process for new vineyard development has become increasingly burdensome in all premium coastal counties, with increased costs, time required, and significant risk as to how many

acres may actually be allowed. Fewer buyers are willing to face the challenge of running the gauntlet of these governmental processes, buttressed by neighborhood and environmental opposition, often tightly focused, organized, and well-funded. Most of the “good” land suitable for planting, some of which has been available for many years, has been acquired or developed. Few blocks of land, which could be planted, are available today, as the better areas of the north coast are essentially all planted out.

And as we have already noted, land in Napa Valley is being planted, replanted, or grafted, to Cabernet Sauvignon, more Cabernet Sauvignon, and even more Cabernet Sauvignon. Napa land traditionally not considered suitable for Cab is now being drained, and planted to Cab, with wineries eager and willing to absorb the grapes from these lands, and even from other areas. A similar phenomenon is seen in Sonoma County, where the land rush is to the super-sites for Pinot Noir. In this aspect, California is gradually adapting the Old World mentality of specific varieties for specific sites. Napa is Cab country, and the Sonoma Coast is Pinot country. We are not yet as sharply defined as Bordeaux or Burgundy, but we are certainly well on our way down that path. Similar differentiations are seen on the Central Coast, where the true premium areas have emerged.

The ancient forces of supply and demand are working their magic again, as the continuing demand by well-funded potential buyers chases a finite supply of the higher quality vineyards, or sites to create such vineyards. As **Will Rogers** said; “Buy land, they ain’t making any more.”

Uber-terroir Sites and Lifestyle Buyers

Vineyard prices are steadily creeping up in the premium wine regions, most especially in the best publicized AVAs of Napa and Sonoma Counties. Where we had seen top Napa vineyards selling for \$200,000 to \$300,000+ an acre, we now see prices as high as \$400,000, or even \$500,000 for the uber-terroir sites. These sites have become clearly identified over the years/decades for their ability to produce consistently great grapes, going into wines garnering 95+ point ratings, and consequent high bottle prices, in good years, and bad.

The North Coast enjoys a mélange of soils, from harsh, masculine volcanics, forged in the crucible of North America’s birth, to the slow, soft, feminine sedimentation of alluvial silts over ancient riverbeds, to the limestone uplifts of primordial sea beds. The juxtaposition of this mix of soil types, nestled in the multitude of microclimates molded by our coastal valleys creates a diversity of terroir seldom found in such propinquity. The very best sites are typically held in strong hands, and do not often see the daylight of the open market. When they do, you can rest assured competition for such sites will be intense. In the meantime, competition for all premium sites continues, forcing vineyard values higher, as the grape supply continues to be grasped by those same strong hands. **WBM**

Two barrels...



One round



One flat

Same oak Stunning results

Flexcube Inc,
433 Soscol Avenue
Suite A-100, Office 4
Napa, CA 94559

flexcube
THE NEW COOPERAGE

For further information contact 707 295 9552 or visit www.flexcubegroup.com