



CIATTI
GLOBAL WINE & GRAPE BROKERS



California Report

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**Ciatti Global Wine
& Grape Brokers**

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The bulk wine market across California registered a small uptick in activity in the past four weeks. With prices softening to their lowest level in five years, the Coast saw some opportunistic buyers move onto the market in search of small volumes of 2017 reds such as Napa Valley Cabernet, as well as Sauvignon Blanc, with which to start new Coastal brands. Lodi and the Central Valley, meanwhile, has seen activity on 2018 Pinot Grigio, Chardonnay and Sauvignon Blanc from longstanding buyers who have come onto the market a few weeks later than normal, suggesting the 2017 whites took a little extra time to work through.

We have seen buyers looking to renegotiate grape contracts to reflect the price softening on the market. In addition, the potential has opened up for 'California' appellation program owners to – temporarily at least – up the proportion of Coastal appellation wine going into their blends without the need to change their cost structure, or at least slow the reduction in their use of Coastal wine. We are also seeing a 'just-in-time' business model on bulk wine purchases, with buyers seeking quick turnaround times between sealing the deal, taking possession of the wine and bottling it – indicative of an inventory build-up making storage space difficult. In general, wineries still have inventory and many are putting the excess back onto the market.

That said, the big inventory is mainly comprised of the four big varieties – Cabernet, Pinot Noir, Chardonnay and Pinot Grigio – and volume and choice on some of the other varieties is not as plentiful as the overall market pace suggests. As we pointed out last month, inventory of Merlot, for example, is lower now than it was in apparently less plentiful years back in 2015 and 2016. As such., buyers seeking varieties outside the big four should not wait to seek out what they need.

The make-up of the inventory – Cabernet, Pinot Noir, Chardonnay and Pinot Grigio – reflects where the great majority of new plantings have been going in over the past few years: the Coast. It feels like the Lodi/Central Valley market has less inventory than the Coast and its market seems more normal with – as mentioned above – activity a little delayed rather than paused. Buyers here are not changing their focus or sourcing plan.

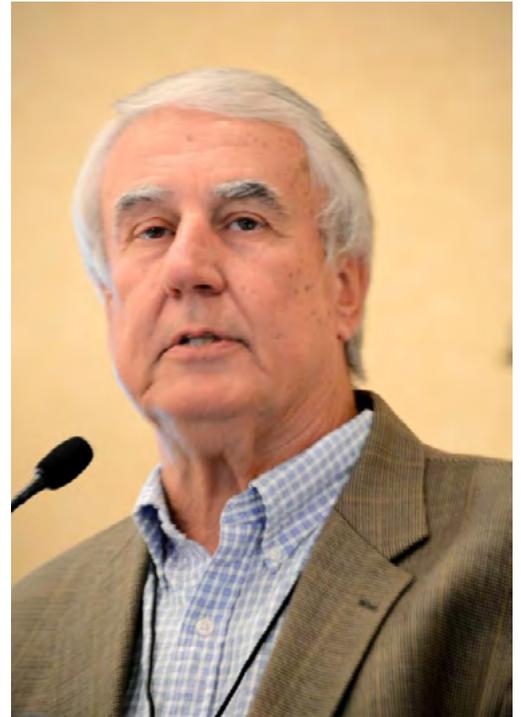
Read on for a report on California's vineyards and land, as well as more on the latest wine and grape opportunities.

Robert Selby

California Vineyards & Land

We spoke to Tony Correia, for over forty years widely recognized as a leading authority on the valuation of agricultural and rural properties, including wineries and vineyards in California. He is currently owner of The Correia Company.

The market for vineyards, and undeveloped land for vineyards, which had been in the doldrums in the years following the 2008/09 Great Recession, was kickstarted from 2012 onward by wineries who – following the short 2010 and 2011 crops – sought to consolidate their grape supply sources. They were then joined on the market by investment groups attracted by vineyards’ appealing investment characteristics. In the years since, the vineyard land market has been brisk. In Napa Valley, for example, there has been a surge in sales of undeveloped land for vineyards in the last 12-18 months: land that might have sold for \$150,000 per acre in 2016/17 is now selling close to \$250,000/acre and – in really hot areas like Oakville or Rutherford – can sell for up to \$300,000/acre.



It should be noted that this is the price per net acre of undeveloped land, and not for a planted vineyard, and excluding values of other assets such as homesite, home, winery permit etc. The price of actual, prime planted vineyards in Napa Valley is at around \$300-400,000/acre, and for super premium Napa vineyards – producing grapes for \$250+ bottles of wine – vineyards can command as high as \$500,000+/acre. Winery-owned vineyards can justify this price if their premium product is selling healthily off the shelf, but a grower-owned vineyard might not be able to justify those kinds of numbers off the back of grape sales, especially now as we see a softening of grape prices. It is understandable if growers become worried when they see wineries who usually buy grapes looking instead to sell them, as well as renegotiate supply contracts downward.

With total winegrape growing area in California estimated by the California Wine Institute at 602,000 acres in 2016, up from 507,000 in 1998, slowing retail sales and – in turn – softening grape and wine prices – could put some downward pressure on the overall land and vineyard market. That said, the past hundred years or more has shown that land and vineyard prices tend to be what Tony calls “sticky” – “in that they are more stabilized. Grape prices move up and down, but especially in the premium areas like Napa land values tend to hold up even in the downturns in the cycle”. This is because they have traditionally been perceived as good solid investments. In addition, while some growers may be worried, there are others who have robust grape contracts with wineries seeing positive sales and they look to the future with confidence.

Generally speaking, the value of vineyards in the most prime locations producing grapes for wines high up the quality ladder are traditionally most insulated against a grape and wine price downturn, while vineyards in the outlying areas feel the market’s ups and downs more. An outlying area may not be far from a premium area – for example, it may be situated in the Napa Valley appellation, but outside the Napa Valley watershed, such as Los Carneros or Pope Valley.

Tony is still seeing plenty of competitive buying activity both on premium vineyards in the North Coast – in Napa Valley (such as Rutherford) and Sonoma County for example – and the Central Coast, with wineries the primary buyers, either to tie-up long-term supply or avoid losing the supply to another winery: “Every time a winery buys a vineyard, there is a supply of grapes that is off the open market.” In the long term the open market will only get smaller as the baby boomer generation of growers gradually retires and sells-up to wineries and investment groups: in general, families can’t or won’t continue the business on when they

see the value of the property versus the relatively small returns from farming, plus the hassles of the regulatory environment.

Potential vineyard buyers themselves are increasingly attentive to projected operating costs. The rise in water, labor and other regulatory pressures has caused those that need financing to pause.

Of increasing importance is the enormously-politicized issue of water supply, particularly California's new long-term Sustainable Groundwater Management Act which will regulate groundwater use across the state in general and in some areas more so. (Surface water has already been regulated to a great degree.) This will affect vineyards well beyond the Central Valley, where ground subsidence has put cracks in the California Aqueduct. "On the Coast this is something most folks never anticipated," said Tony. "They thought: 'I own the ground, I

own the water'. But that's no longer the case." Many investment groups will now only consider vineyards with at least two sources of water.

Another growing concern for investors is new labor regulations: in 2016 California legislated for agricultural workers to receive overtime. This came into force in January this year for businesses employing at least 26 people, and will apply to all businesses from 2022. The wine industry also faces stiff competition for labor from construction and hospitality. The resulting higher labor costs have seen a big push towards mechanization.

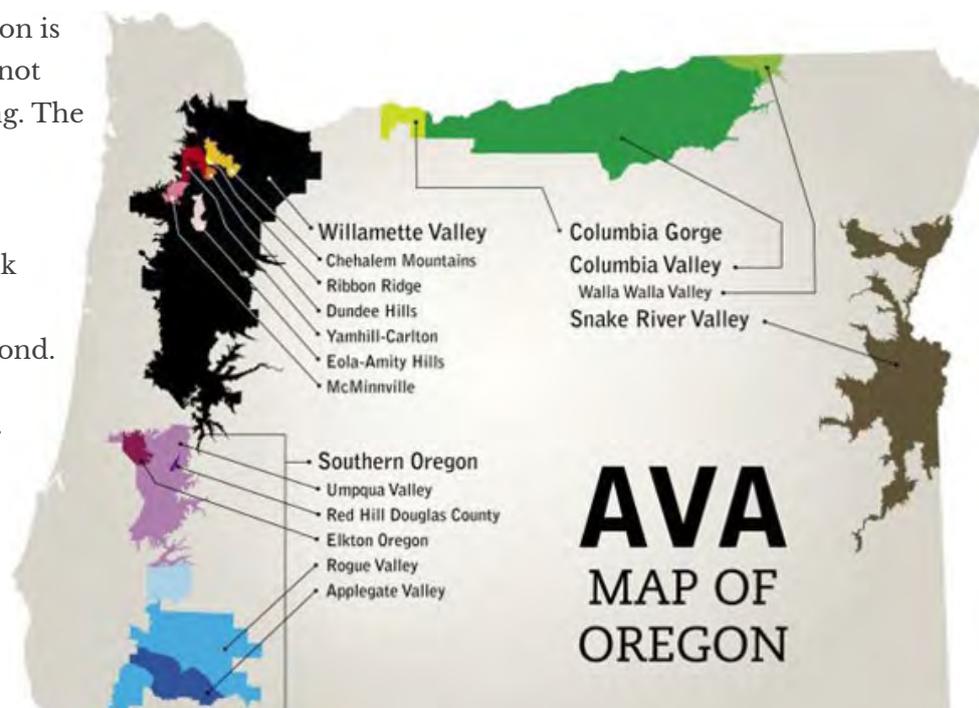
Moving forward, opportunistic buyers may start eyeing vineyards, waiting for motivated sellers to sell up at what they – the buyers – see as a good price. But it should be noted that, as ever, all it could take is one hard freeze, one short crop, to change how the market is perceived by buyers and for vineyard prices to firm-up.

Oregon Update

Currently the bulk wine market in Oregon is fairly well supplied with 2018 vintage Pinot Noir and there is some aggressive pricing. The 2017 Pinot Noir is almost sold out.

There is also discussion in the Oregon industry about getting aggressive on bulk wine production contracts which might interest buyers from California and beyond. (Canada is currently the leading export market for Oregon wine, accounting for almost 50% of the state's export sales in 2017.) With new plantings and some healthy crops in the past few years, supply in Oregon looks plentiful and – just as in California – some wineries are giving notice on contracts and moving to the spot market.

According to University of Oregon statistics, Oregon's harvested winegrape area amounted to 31,008 acres in 2017, producing some 91,342 tons of grapes, up from 27,658 acres producing 79,282 tons the year before. Of that 91,342 tons, some 59% - 53,457 tons – was Pinot Noir.



California Weather

February was a rainy month in California's growing areas – mainly in the Coast – with several “atmospheric rivers” bringing colder than average temperatures and significant precipitation that has saturated the ground, as well as boosting the Sierra Nevada snowpack to 153% of average by the start of March. This has probably removed water reserves

as a topic of concern as the growing season gets underway: according to meteorologist Gregory Jones of Oregon's Linfield College, the “drought footprint in California is now the lowest it has been in nearly ten years”. March is forecast to bring average to above-average rainfall to California. The cold and wet conditions have kept premature budbreak at bay.

Hot Opps Box

With **bulk wine** pricing having fallen back to where it was five years ago, now is a good time for wine buyers to step onto the market and secure what they need, either via spot or contract. More wines are being listed and coming onto the market each day and we have large amounts of high-quality bulk wines available. There are particular opportunities on 2016, 2017 and 2018 Cabernet and other reds – including Pinot Noir – from premium markets in the North and Central Coasts, and Oregon.

Now is a good time for buyers seeking to secure **2019 grapes** as there are opportunities out there (most of the dialogue on grapes is one-year deals). If you're thinking about buying grapes, or if you have grapes available for sale this year, contact **Molly on +1 415 630 2416 or molly@ciatti.com** to get listed.



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