

Napa Valley Appellation Value Up to \$228,000 per Acre

We first examined the value of the Napa Valley American Viticultural Area (AVA) in 2012, using an innovative method - wine price differentials - as the basis for our analysis. We published updates for the 2016, 2017 and 2018 AVA values, and now we've updated our analysis for 2019. Our current analysis revealed a Napa Valley AVA value for prime Cabernet Sauvignon vineyards of \$228,000 per acre, up 5.6% from \$216,000 in 2018. Wine prices for Napa Cab have softened in 2018 and 2019, however the cost of capital has been favorably impacted by low interest rates in 2019, continuing the strong market for vineyard and AVA values. As part of our analysis requires a close examination of Napa Valley wines and their wine critic ratings, we also select a couple "best value" Napa Cabs in this report.

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The Importance of the AVA Value

The contribution of the appellation to a vineyard's value became much more important in 2010 when the IRS issued a Chief Counsel Memorandum (CCM) concluding that the right to use an appellation or American Viticultural Area designation is an intangible asset, and is amortizable to offset income over a period of 15 years under § 197 of the Internal Revenue Code. Simply put, every dollar of AVA value shields a dollar of vineyard income from tax over 15 years. With purchases of vineyards routinely in the millions and tens of millions, the value of the AVA has become a material issue for buyers.

Our Method

As discussed in our 2012 newsletter on the same topic, we believe, along with most wine industry consultants, that grape prices are closely tied to wine prices. As Napa Valley Cabernet Sauvignon wine prices have increased over the past 25 years, Cabernet Sauvignon grape prices have increased almost in lock-step. Our analysis shows that changes in Cabernet Sauvignon wine prices explain, in statistical terms, about 94% of the change in Cabernet Sauvignon grape prices. We also postulated in 2012 that if a Napa Valley AVA value exists, it must reveal itself in the prices consumers are willing to pay for wine with "Napa Valley" on the label. If consumers weren't willing to pay more for Napa Valley wine, then it seems unlikely Napa Valley grapes could sell for more given the very strong relationship between wine and grape prices. Finally, we needed a method to adjust out of the wine price, the quality difference between Napa Valley wines and those from lesser-known appellations. Otherwise, we would be unsure if the higher wine price was due to having "Napa Valley" on the label, or due to the higher quality of the wine. We are fortunate in that drinking wine is a favorite pastime of a lot of us and there are a host of services that provide

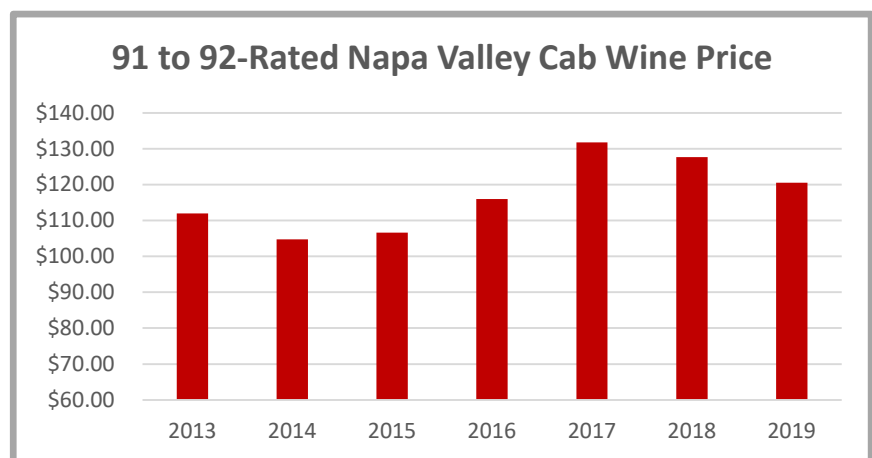


wine ratings for 1000's of wines across the country. Comparing the prices of wines of the *same critic rating* allows us to adjust for quality differences. Making this adjustment is very important as the IRS in the CCM was concerned about methodologies that did not eliminate value attributable to the quality of the property, and by extension the grapes and wine, itself.

The Wine Market

Our experience providing AVA valuations over the past few years has revealed that the market for wine is quite efficient, i.e., wine prices react to over and under-supply conditions. This can be seen in the chart below for Napa Cabs with a rating between 91-92 points (the average critic rating of the wines we analyzed between 2013 and 2019).

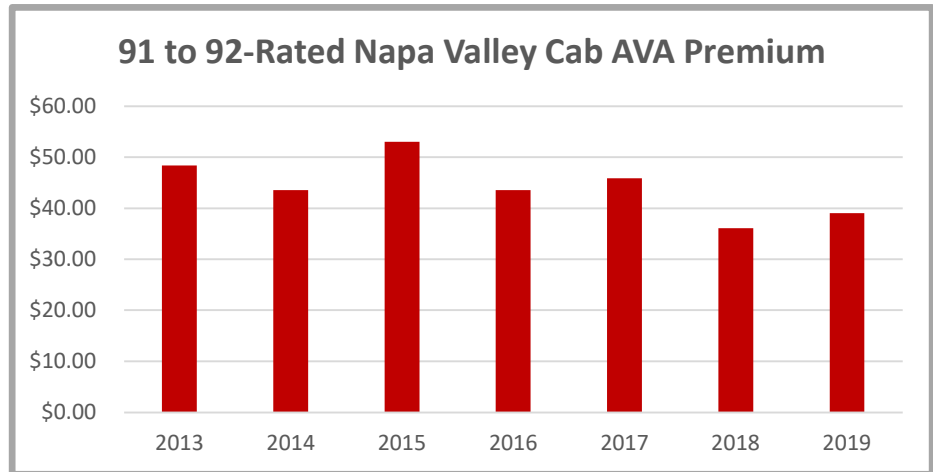
Wine prices react to over and under-supply conditions.



The supply of Napa Cab was reasonably balanced in 2013 through 2017 leading to a good wine pricing environment. After a couple years of increased Napa wine supply in 2016 and 2017 however, wine prices started to show some weakness. In 2019, prices continued to be challenged by an over-supply environment. Large increases of Cab available for sale from Washington also seems to have contributed to the poor pricing environment in 2018 and 2019. And with good yields/supply from Napa in the last couple years, wineries can expect a challenging environment on pricing to continue.

This is relevant to our AVA valuation method because fluctuations in wine prices can make certain years less meaningful for observation. Using annual data that represents an over or under-supply environment will tend to under or over-state the wine price premium attributable to the Napa Valley AVA. And the same market forces that impact the Napa Cab wine market also impact the lesser-known AVA market. Care must be taken in selecting the period over which to observe the wine market and price premium.

The second graph on the following page shows the Napa Valley per bottle retail price premium calculated from 2013 to 2019. As expected, the premium also reacts to over and under-supply forces. The general trend, however, is flat to down, suggesting consumers are not willing to pay *any* price for a great Napa Cab, and will seek alternatives.



Selection of the wines that make up the sample of Napa and lesser-known AVA Cabs for our analysis is very important. It goes without saying that the sample needs to be randomly selected. But beyond that, it is important to select wines that are reviewed by several wine critics. We have found wine prices are much more highly correlated with average critic reviews than the review of a single critic.

Beyond these data inputs there are many other factors that influence the value of the Napa Valley AVA. The suitability of the ground to grow Cabernet Sauvignon grapes is perhaps the most important. The AVA value for a vineyard that is best suited to grow Chardonnay will be lower than the \$228,000 AVA for a prime Cabernet Sauvignon vineyard. In addition, all the factors that affect the value of a vineyard, can impact the value of the AVA - vine condition and age, productivity, operating costs, and grape contracts, for example.

Napa “Best Value” Cabs

As part of our analysis of the Napa AVA premium we calculate what a wine *should* sell for based upon its critic rating. Some wines sell for more than the forecast price, and some wines sell for less. This can happen when a vintage is rated significantly higher or lower than the previous same-label vintages, and the winery continues to sell the wine for a comparable price. The Napa Cabs rated as best values in 2019 were the 2016 Chappellet Signature Cabernet Sauvignon (rated 94) and the 2014 Snowden Brothers Vineyard Cabernet Sauvignon (rated 94).



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