

Napa Valley Appellation Value Holding Steady at \$216,000 per Acre

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Our current analysis reveals a 2022 Napa Valley AVA value for prime Cabernet Sauvignon vineyards of \$216,000 per acre, holding steady despite borrowing cost challenges. Wine prices for Napa Cab softened in 2022 as the market digested the large crops from 2018 and 2019. We expect wine pricing to improve with the short crops of 2020 and 2021 entering the market. With rising interest rates, pure grape growers found it hard to purchase vineyards as the economic returns wouldn't allow them to pay market prices. Wineries are accepting lower returns on farming in exchange for access to grape supply to grow their labels. 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.

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

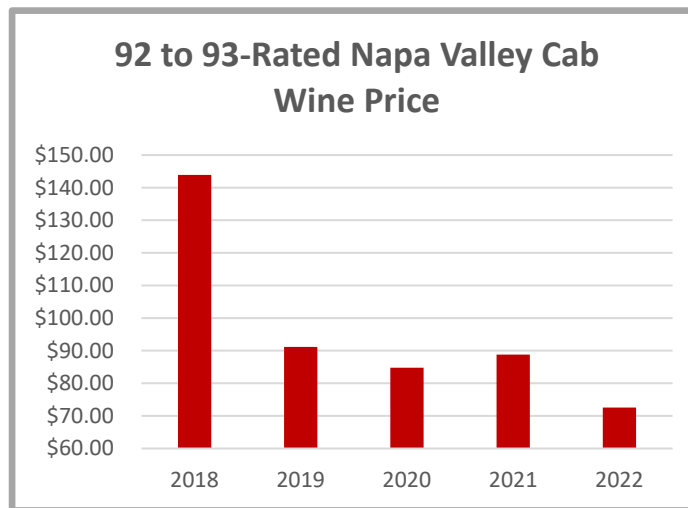


wine ratings for 1000's of wines across the country. Comparing the prices of wines of the *same critic rating* allows us to adjust for quality differences. Making this adjustment is very important as the IRS in the CCM was concerned about methodologies that did not eliminate value attributable to the 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 92-93 points (the average critic rating of the wines we analyzed between 2018 and 2022).

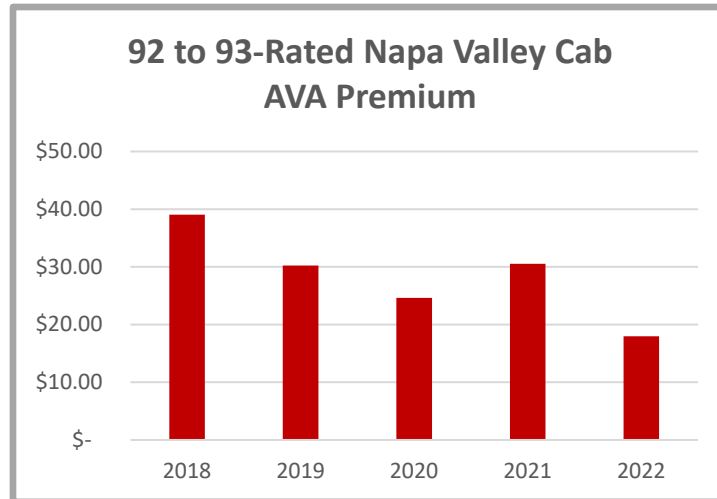
Wine prices react to over and under-supply conditions.



The supply of Napa Cab was reasonably balanced in 2013 through 2016 leading to a stable wine pricing environment. But in 2017 and 2018 prices reacted to reduced supply due to the short 2015 crop. After a couple years of increased Napa wine supply in 2018 and 2019, however, wine prices started to show some weakness. In 2022, prices continued to be challenged by an over-supply environment, as well as challenges with the pandemic.

The second graph on the following page shows the Napa Valley per bottle retail price premium calculated from 2018 to 2022. 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. We expect the Napa Valley bottle premium will increase as supplies tighten and bottle prices increase.

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 \$216,000 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 2022 were the 2018 Turnbull Estate Cabernet Sauvignon Napa Valley (\$54, rated 93.5) and the 2018 Clos du Val Cabernet Sauvignon Napa Valley (\$50, rated 93.3).



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