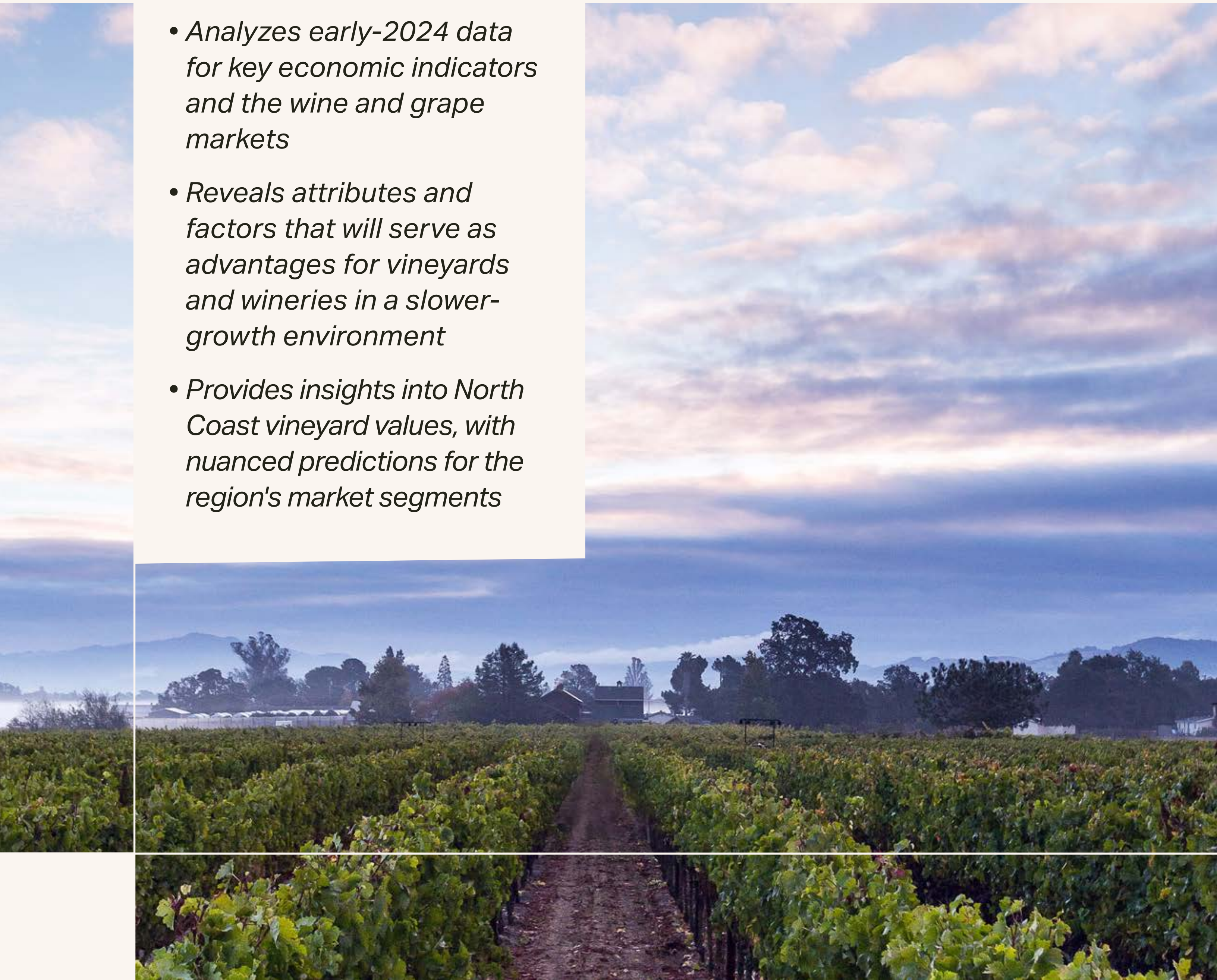
Winescape

A publication of American AgCredit

SUMMER 2024

This issue:

- *Analyzes early-2024 data for key economic indicators and the wine and grape markets*
- *Reveals attributes and factors that will serve as advantages for vineyards and wineries in a slower-growth environment*
- *Provides insights into North Coast vineyard values, with nuanced predictions for the region's market segments*



Down but Not Out

Despite broader market challenges, opportunities persist and the prospects for any one vineyard or winery hinge on its unique qualities and position within the market.

The trajectory of the U.S. wine market has changed little thus far in 2024. Sales volume continues to decline across channels and retail price tiers, though it continues to hold up better in dollar terms (**see Page 3**).

Despite still-high interest rates and stalled progress on inflation, I and my Terrain colleagues still expect the U.S. economy to achieve a soft landing. But this is likely to be accompanied by slowing growth, so the economy is not likely to provide a boost to wine sales in 2024.

Nonetheless, I expect some stabilization later this year as the post-pandemic hangover wears off. The direct-to-consumer (DtC) channel and higher price tiers of the three-tier market should benefit most (**see Page 5**).

Over the long term, secular headwinds will continue to weigh on global wine consumption. Thus, prospects for growth are more muted than in the past. Even so, the U.S. is the largest and most dynamic wine market in the world, and many wineries are still flourishing. Enterprising wineries that are prepared to adapt to the changing market environment will have plenty of opportunities going forward.

The grape market continues to be challenging. Activity has been slow, and a considerable amount of uncontracted fruit and bulk wine is available. Thus, 2024 is likely to be another challenging year for California growers unless they are in one of the few favored appellations where grape demand remains resilient (**see Page 7**).

Vineyard removals have accelerated, and grape demand should improve once elevated wine inventories fall back in line, though progress has been slow on both fronts. Nonetheless, the balance between grape supply and demand should improve over time, and grape prices will eventually firm up.

Demand for California vineyards has dipped, and the number of available properties has surged over the past six months. A disconnect in price expectations between buyers and sellers has led to a pause in sales activity.

The lack of transactions makes it difficult to get an accurate read on vineyard values. I see several compelling reasons to expect a downward adjustment in the near term, as I explain in the Trending Topic section on the North Coast vineyard market (**see Page 9**). However, the magnitude of the adjustment will vary widely. Vineyards in the most favored areas, including the premier sub-appellations in Napa, may see little or no reduction in value, while those in the North Coast's outlying areas such as Lake County are poised for a more substantial decline.

(Information about the data and sources behind the analysis in this report can be found in the Appendix on **Page 21**).

ABOUT THE AUTHOR

Chris Bitter, Ph.D., is Terrain's senior wine and grape analyst, focusing on generating research and insights in the areas that impact the business of vineyards and wineries. With more than 20 years of experience as an economist and market analyst, Chris is a former faculty member of the University of Washington's Runstad Center for Real Estate Studies. In 2016, he left his academic position to launch Vintage Economics, a market research and consulting firm focused on the wine industry.

Chris earned his Ph.D. in economic geography with a minor in agricultural and resource economics from the University of Arizona. His research has been published in a variety of national and international publications, including the Journal of Wine Economics, and he has delivered presentations at wine industry conferences around the globe.

New Market Realities

Enterprising wineries that know their customer and can articulate a compelling value proposition will be best positioned for opportunities in a slower-growth environment.

Wine Sales Dashboard: Change in Sales Volume by Channel and Price Segment

For more on the dashboard, see the Appendix on Page 21.

		Year-Over-Year Change	Trend
$$$	Retail: Value Segment	↓	—
$$$	Retail: Premium Segment	↘	—
$$$	Retail: Luxury Segment	↓	—
	Direct-to-Consumer	↓	—
	Export	↓	^

WINE SALES REMAIN SOFT IN EARLY 2024

The trajectory of wine sales has changed little thus far in 2024. Sales continue to decline in both the three-tier and DtC channels, with narrower losses in dollar terms than volume.

The same broad trends that have been in place in the three-tier channel over the last several years continue unabated.

My examination of NIQ data for the first four months of 2024 indicates that sales in NIQ retail outlets fell 3% by volume and 1% by value versus the same period in 2023. This compares with declines of 4% and 1%, respectively, on a year-over-year (YOY) basis.

Distributor depletions fell 9% YOY, the same as for the trailing 12-month period, according to SipSource data. The ongoing disconnect between depletions and retail sales suggests that retailers are still in destocking mode.

The same broad trends that have been in place in the three-tier channel over the last several years continue unabated. The middle price tier ($11 to $30) is still holding up better than the lower and upper tiers, and white and sparkling wines continue to perform better than reds and rosés. The U.S. and California are still ceding market share to imports, albeit at a gradual pace.

There are no signs yet of a turnaround in direct-to-consumer sales.

There are no signs yet of a turnaround in DtC sales. Shipments fell 8% by volume and 3% by value during the first four months of the year, according to data from Wines Vines Analytics/Sovos ShipCompliant. Shipment volume declined across all major DtC regions.

Shipments by large wineries, which surged during the pandemic, have fallen sharply over the past several years. When large wineries (those producing over 500,000 cases) are stripped out, the year-to-date (YTD) figures look slightly better and are more in line with other DtC datapoints that include tasting room carry-out sales.

Wine exports also remain weak, though there are signs of improvement.

Average bottle prices in the DtC channel also continue to trend upward. They were 6% higher in the first four months of 2024 versus the same period last year. Price increases have been particularly strong for small wineries (under 5,000 cases). Higher bottle prices have supported winery revenues but may also be contributing to the decline in shipment volume.

Wine exports also remain weak, though there are signs of improvement. Export volume fell 8% YOY in the first quarter. Nonetheless, the rate of decline has slowed over the past 12 months and export value rose 6% during the first quarter.

Because there is no comprehensive data source that captures all U.S. wine sales, it is impossible to get a precise read on the trajectory of the market. Nonetheless, the datasets considered in this section capture a large enough swath of the market to provide a reasonably accurate picture of the prevailing trend.

Consumer expenditure data from the Bureau of Economic Analysis paint a rosier picture of the wine market. However, I have concerns regarding their accuracy. Namely, the spending estimates for the spirts, beer and wine categories tend to move in lockstep over time, which does not seem plausible in light of other evidence.

THE ECONOMY CONTINUES TO CHUG ALONG

Economic growth has slowed in early 2024 in the face of high interest rates. However, most indicators continue to point to a reasonably strong economic backdrop, and there are no signs of a recession in sight.

Though GDP growth slowed in the first quarter compared with a strong Q4 2023 reading, employment growth remains solid and unemployment is still below 4%. Consumer spending remains resilient and is growing in real terms, though the pace of growth slowed a bit in the first quarter.

Key Economic Indicators

Indicator	Q1 2024	Q4 2023
Change in GDP (real)	1.3%	3.4%
Unemployment Rate	3.8%	3.7%
Change in Consumer Prices	3.8%	2.7%
Change in Consumer Spending (real)	2.0%	3.3%
Consumer Sentiment	78.4	64.9
Change in Employment	2.0%	1.6%
Change in Average Weekly Earnings	3.5%	3.6%
Credit Card Delinquency Rate	3.2%	3.1%

Sources: FRED, Terrain

The most troubling development in early 2024 is that progress on inflation has stalled, and interest rate cuts no longer look imminent.

The most troubling development in early 2024 is that progress on inflation has stalled, and interest rate cuts no longer look imminent. Consumer prices rose 3.8% during the first quarter, versus a 2.7% increase in Q4 2023. The Federal Reserve has signaled that it will need to see persistent improvement in key inflation measures before it begins to cut. At the same time, it has shown little inclination to raise rates.

I and my Terrain colleagues still believe the economy is on track for a soft landing. Inflation should abate, albeit at a gradual pace. And though far from a certainty, a rate cut or two is still possible by the end of the year. Nonetheless, economic growth is likely to soften in the near term, and the unemployment rate will likely continue to tick up slowly.

Consumers remain reasonably well positioned to continue to spend, though I expect some softening in consumer spending in the near term.

I expect some improvement in sentiment later this year, as long as inflation resumes its downward trend and interest rates begin to come down.

On the positive side, job growth remains solid, and wages have been tracking closely with inflation, leaving consumers neither better nor worse off in real terms. However, credit card and auto loan delinquency rates continue to rise gradually, an indication that there is some distress, particularly among lower-income consumers. This is not surprising given that credit card interest rates stand at an all-time high.

Consumer sentiment improved in the first quarter of 2024 but took a step back in May. I expect some improvement in sentiment later this year, as long as inflation resumes its downward trend and interest rates begin to come down.

Despite the lackluster outlook for the economy, I still expect some stabilization in wine sales volume as the post-pandemic hangover lifts.

Nonetheless, there are risks to the soft-landing scenario. For one, there is no guarantee that inflation will behave as expected. And the potential for an escalation in geopolitical conflicts or a particularly contentious presidential election are areas of concern. Rising asset values have also likely contributed to improving consumer sentiment. The S&P 500 has soared nearly 30% over the past seven months and house prices remain buoyant despite high interest rates. A correction in either could dampen confidence and spending.

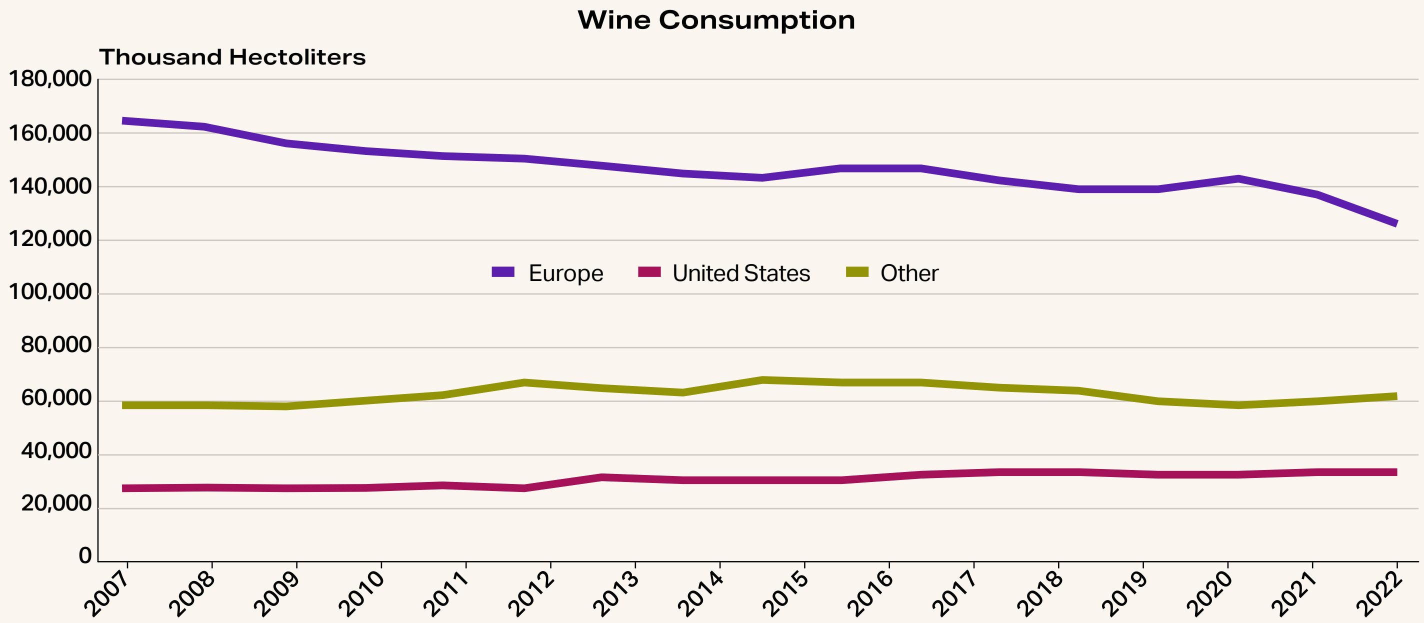
PREPARING FOR A SLOWER-GROWTH ENVIRONMENT

Despite the lackluster outlook for the economy, I still expect some stabilization in wine sales volume as the post-pandemic hangover lifts, particularly in the DtC channel and higher price tiers of the retail market. Even if retail sales do not return to outright growth, wine shipments should rebound from their depressed level in 2023 once inventories fall back in line. This may take time, though, as progress on the destocking front has been slow.

Over the longer term, prospects for sales volume growth still look muted given the wine market's secular headwinds that I've outlined in previous issues of "Winescape."

Global wine consumption has been falling for more than 15 years now. Preliminary estimates from the International Organisation of Vine and Wine (OIV) for 2023 suggest that wine consumption fell to its lowest level since 1996.

Chart 1: Europe Accounts for Most of the Decline in Wine Consumption



Sources: International Organisation of Vine and Wine, Terrain

Europe, which historically has had considerably higher levels of per capita wine consumption than the rest of the world, has accounted for most of the global decrease in consumption since the 2007 peak (see Chart 1). Consumption has been more resilient outside Europe, though it has also declined from its peak in 2017. Unfortunately, I do not see a compelling reason to expect a reversal in this trend.

Nonetheless, the sky is not falling for the U.S. wine industry. The U.S. remains the largest and most dynamic wine market in the world. Thus, there will continue to be plenty of opportunities for enterprising wineries. Also bear in mind that all wineries are not in the same boat, as some regions and market segments are better positioned than others in terms of market trends.

It is imperative to understand who your customer is, what they want, and the most effective way to reach them.

But clouds are building, and it is important to be realistic. U.S. wine consumption is likely to be flat or even decline gradually over the longer term, with the premium and luxury segments performing better than the value end of the market.

The new market realities will require new ways of thinking and doing. It is imperative to understand who your customer is, what they want, and the most effective way to reach them. To win them over, you will need to present a compelling value proposition, whether by providing a high quality-to-price ratio, engaging experiences in the tasting room, or a persuasive story behind your winery and wines.

THE GRAPE MARKET REMAINS QUIET

The grape market has been quiet so far in 2024. Newly initiated contracts have been few and far between, and spot market activity has been minimal. Some grape contracts have been renewed, but a sizable number have also been terminated.

In the face of declining wine sales, depressed shipments and high inventory levels, wineries are delaying grape purchases as they assess their future needs. There is little sense of urgency to act now because uncontracted fruit and bulk wine are abundant.

Consequently, grape prices in many California regions have seen some downward pressure, which has been most acute in the Central Valley. That said, prices are flat or even increasing modestly for certain varieties in prime appellations, such as high-end Cabernet Sauvignon from premier Napa Valley sub-AVAs.

Large U.S. wineries have been seeking to buttress margins by sourcing from lower-cost countries.

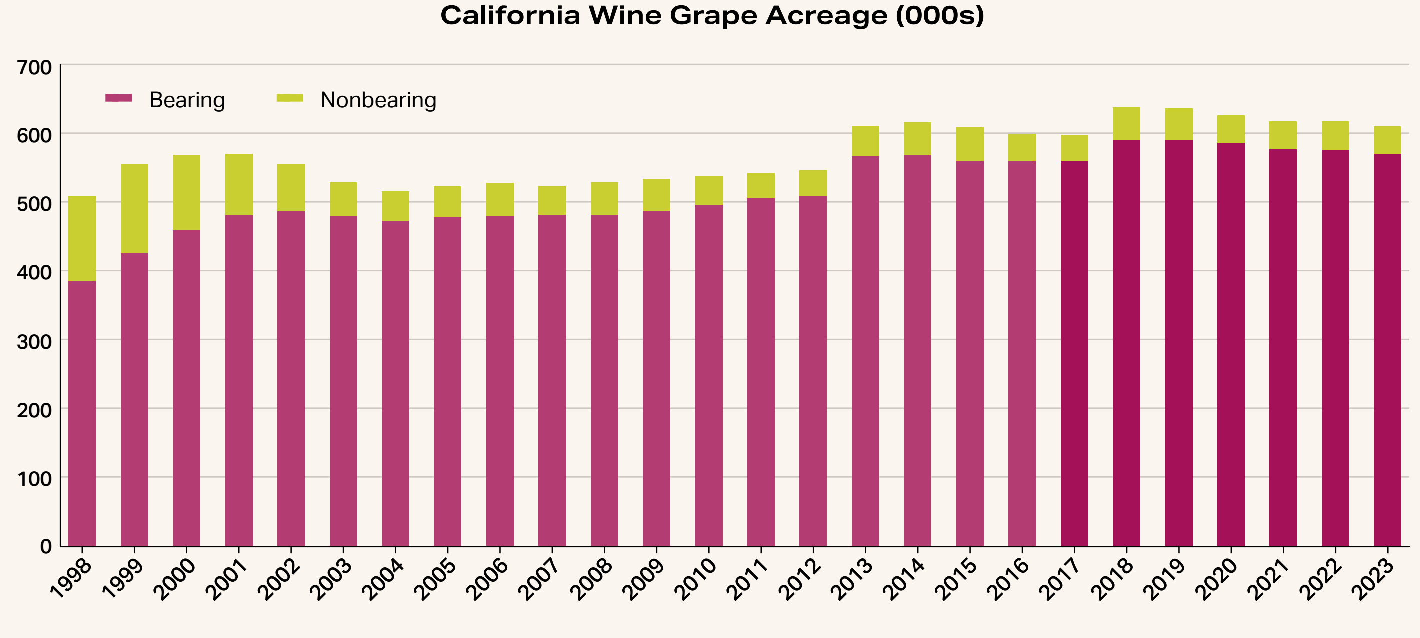
Bulk wine inventories continue to swell, and prices have softened. The global bulk market has firmed up a bit, mainly because of last year's short crop, which resulted in the lowest global wine output total since 1961. Nonetheless, bulk imports continue to pressure California growers because of their cost advantage relative to wines of similar quality made from California grapes.

Large U.S. wineries have been seeking to buttress margins by sourcing from lower-cost countries. This is a business decision necessitated by market conditions as consumers continue to push back on price increases. It will likely continue to be a headwind for the Central Valley for some time.

Much of the low-end imported bulk is winding up in bottles labeled with the U.S./American appellation, which allows up to 25% foreign grape content. Given that the cost differential is not likely to improve materially anytime soon, the solution to the problem involves convincing consumers of the superiority of the California appellation and that it is deserving of a price premium.

Given these factors, grape purchasing activity is likely to remain slow, and grape prices depressed, unless wine sales rebound or signs emerge that the 2024 crop will be short.

Chart 2: **Pace of Vineyard Acreage Decline Will Accelerate in 2024**



Sources: California Department of Food and Agriculture, Terrain

Absent a strong rebound in wine sales, the trajectory of grape prices will depend heavily on the pace of vineyard removals.

At this point, it is too early to say anything definitive about its potential size, but the grape crop has made it through the period of heightened frost risk unscathed and the water situation looks good again this year. A second consecutive year of heavy precipitation has refilled reservoirs, and groundwater levels have increased in some areas. The timing of the crop looks to be closer to normal this year, and it is likely to stay on track given forecasts for near-normal temperatures and precipitation for the remainder of the growing season in much of the state.

Absent a strong rebound in wine sales, the trajectory of grape prices will depend heavily on the pace of vineyard removals. According to figures from the recently released 2023 California Grape Acreage Report, bearing acreage has declined by 20,000 acres since its peak in 2019 (see Chart 2). This represents a reduction of just over 3%, and far more is needed to bring the market back into balance.

However, the acreage report figures do not include acreage that has been pulled since the 2023 harvest. Although removals are not systematically tracked, anecdotal evidence suggests there has been slow but steady progress on this front in recent months. The main impediment is a shortage of removal services.

The grape market should firm up over the next several years as vineyard removals begin to restrict supply. Moreover, once wholesale inventory destocking has been completed, grape demand should firm up, since wine shipments should recover some of the ground lost in 2023.

Neither of these is likely to happen fast enough to have a material impact on the balance between supply and demand by harvest time this year. Growers in oversupplied regions with uncontracted fruit should carefully consider any offer they receive, as there may not be a better one coming.

TRENDING TOPIC

Navigating the North Coast Transition

Though the region's vineyard values are poised for a downward adjustment, the magnitude and duration of the decline will vary widely across market segments.

Following a period of steady expansion in the mid-2010s, vineyard values have flattened throughout much of the North Coast in recent years.

Over the past year, market sentiment has become decidedly negative in light of declining wine sales, a surfeit of grapes, and concerns about the future course of wine consumption.

Consequently, buyers are both fewer and more cautious. At the same time, the number of available properties has soared. Activity has paused as buyers and sellers try to make sense of the current market environment and struggle to agree on price. The lack of transactions makes it difficult to discern where values stand today.

The objective of this section is to provide insights into the state of the North Coast vineyard market and the direction it is likely heading. The analysis relies heavily on the proprietary data and extensive market knowledge of American AgCredit's team of North Coast appraisal professionals.

I see compelling reasons that values are poised for a downward adjustment, though the magnitude and duration of the decline are less certain and will vary widely across the market segments of the region.

Additionally, values for top-tier vineyards in prime areas may not decline at all.

The market slump presents opportunities for wineries seeking to acquire vineyards. For those who need to sell, having realistic expectations on pricing is crucial. Both sides should keep in mind that each property has unique circumstances, and discounts will not always be warranted.

Vineyard values in the core areas should continue to appreciate over the long run, albeit at a more modest pace than in the past.

The North Coast is the premier wine-growing region in the U.S., and its future remains bright despite the murky outlook for overall wine consumption. Vineyard values in the core areas should continue to appreciate over the long run, albeit at a more modest pace than in the past.

While I explicitly focus on the North Coast vineyard market in this piece, many of the points made here are relevant to other regions of California as well.

STATE OF THE MARKET

North Coast Vineyard Market Dashboard

Market Segment	Demand	Supply	Activity	Values
Napa Prime	—	—	↓	—
Napa Secondary	↓	↑	↓	—
Napa Outlying	↓	↑	↓	—
Sonoma Prime	—	↑	↓	—
Sonoma Secondary	↓	↑	↓	—
Mendocino Anderson	—	—	↓	—
Mendocino Inland	↓	↑	↓	—
Lake	↓	↑	↓	—

Sources: American AgCredit, Terrain

The dashboard depicts our appraisal team's directional view of key market indicators as of the first quarter of 2024 for the eight distinct market segments that compose the North Coast region. The symbols represent change versus the same period in 2023. See the Trending Topic Appendix on **Page 22** for more details.

Demand: Fewer and More Discriminating Buyers

- The slumping North Coast grape market, heightened uncertainty about the trajectory of wine sales, and rising interest rates have depressed demand for North Coast vineyards.
- Demand has held up best for marquee vineyards in the prime areas of Napa, Sonoma and Mendocino counties. There is currently little interest in properties in Inland Mendocino and Lake County.

Winery buyers

- Given high winery inventory levels and abundant uncontracted fruit and bulk wine, securing grape supply is no longer a priority for most North Coast wineries. Many also no longer have the financial wherewithal to acquire vineyards.
- Some wineries are flourishing even in today's challenging market environment. Those that are in the market are taking a cautious approach, though they will move to purchase an adjacent parcel or one from which they are already sourcing fruit if the price makes sense.

Financial buyers

- Many have taken a step back. Those who are looking are being deliberate and are unwilling to compromise on their return requirements.
- They currently have little interest in vineyards that have uncontracted fruit, because of the difficulty in securing grape contracts, or are nearing the end of their economic life, because of escalating replanting costs.
- Vineyards in premier sub-AVAs like Pritchard Hill in Napa still command interest from financial buyers. Grape demand and prices in these places have remained more resilient, and investors continue to see the potential for income growth.

Lifestyle buyers

- High interest rates and economic uncertainty are deterrents in this market.

Supply: Up Across the Board

- The most momentous change over the past six months is a surge in available properties throughout much of the North Coast.
- Available properties include not only active listings but also quiet listings and exclusive offerings.
- The increase in inventory has been heaviest in the Lake and Inland Mendocino areas. At the other end of the spectrum, a handful of trophy vineyards have been listed and others are rumored to be quietly seeking buyers.
- Notably, several large California wineries are looking to divest themselves of some of their North Coast vineyard holdings.

Activity: On Hold

- The North Coast vineyard market has been quiet, and few transactions have closed over the past six months.
- A shrinking pool of buyers, heightened uncertainty, and a growing disconnect between buyers' and sellers' price expectations have contributed to the pause in activity.
- Buyers are holding firm to their targeted pricing, which typically reflects lower prices than have been paid in recent years. Most sellers haven't yet adjusted their expectations.
- We expect activity to pick up once the trajectory of wine sales becomes clearer and wineries have a better handle on their inventory situation and future grape needs.

Values: Steady for Now

- Table 1 shows our appraisal team's estimated value ranges for each of the North Coast market segments as of the first quarter of 2024.
- Given the lack of activity, it is difficult to get an accurate pulse on where North Coast vineyard values stand today.
- Buyers clearly have the upper hand now, but we have not yet changed our estimates because there is not enough transactional evidence to lower them.

LESSONS FROM THE PAST

Past vineyard market cycles can provide insights into where the market is heading from here. As Mark Twain so aptly put it, "History never repeats itself, but it does often rhyme."

Table 1: **North Coast Vineyard Value Ranges**

Estimated Value per Acre

	Vineyards		Plantable Land	
Market Segment	Low	High	Low	High
Napa Prime	$300,000	>$525,000	$200,000	>$300,000
Napa Secondary	$165,000	$375,000	$165,000	$245,000
Napa Outlying	$50,000	$165,000	$50,000	$110,000
Sonoma Prime	$90,000	$215,000	$65,000	$110,000
Sonoma Secondary	$70,000	$135,000	$25,000	$45,000
Mendocino Anderson	$65,000	$110,000	$25,000	$40,000
Mendocino Inland	$25,000	$55,000	$10,000	$20,000
Lake	$25,000	$50,000	$10,000	$20,000

Sources: American AgCredit, Terrain

A Vineyard Value Primer

The value of a vineyard ultimately depends on its ability to produce income. In the case of a stand-alone vineyard, this is the profit that can be achieved through grape sales. For a winery-owned vineyard, it is the profit that can be generated by selling the resultant wine. Thus, grape and wine prices, coupled with production costs, are key drivers of vineyard values.

Valuations also depend on the rate of return that buyers require, as it determines the present value of the projected income stream. Return requirements vary over time and depend on many factors, most important of which are the predictability of cash flows, perceived risks, and the returns available from alternative investments.

The vineyard market is somewhat unique in that buyers can have motivations other than, or in addition to, maximizing return on investment. For example, lifestyle buyers derive value from the satisfaction and prestige of owning or living on a vineyard property. Nonfinancial motivations are particularly important drivers of value for boutique properties in the North Coast.

In addition, shorter-term market forces such as the balance between supply (number of available properties) and demand (number of qualified buyers seeking to purchase vineyards) and market sentiment can play a decisive role in shaping transaction prices.

Vineyard values tend to be cyclical, with long periods of rising or flat values followed by briefer declines.

Changes in these fundamental factors drive changes in vineyard values over time.

Five Key Takeaways From the Historical Data

The charts in this section are based on the midpoint between American AgCredit's historical low- and high-end estimates of value for each county/market segment. The midpoint of a range is an imprecise measure of the central tendency of a distribution. Thus, the figures should be viewed only as a directionally relevant approximation of trends in North Coast vineyard values.

Five key takeaways are relevant to understanding the outlook for North Coast vineyard values.

1 Vineyard values are cyclical, and grape prices are key drivers

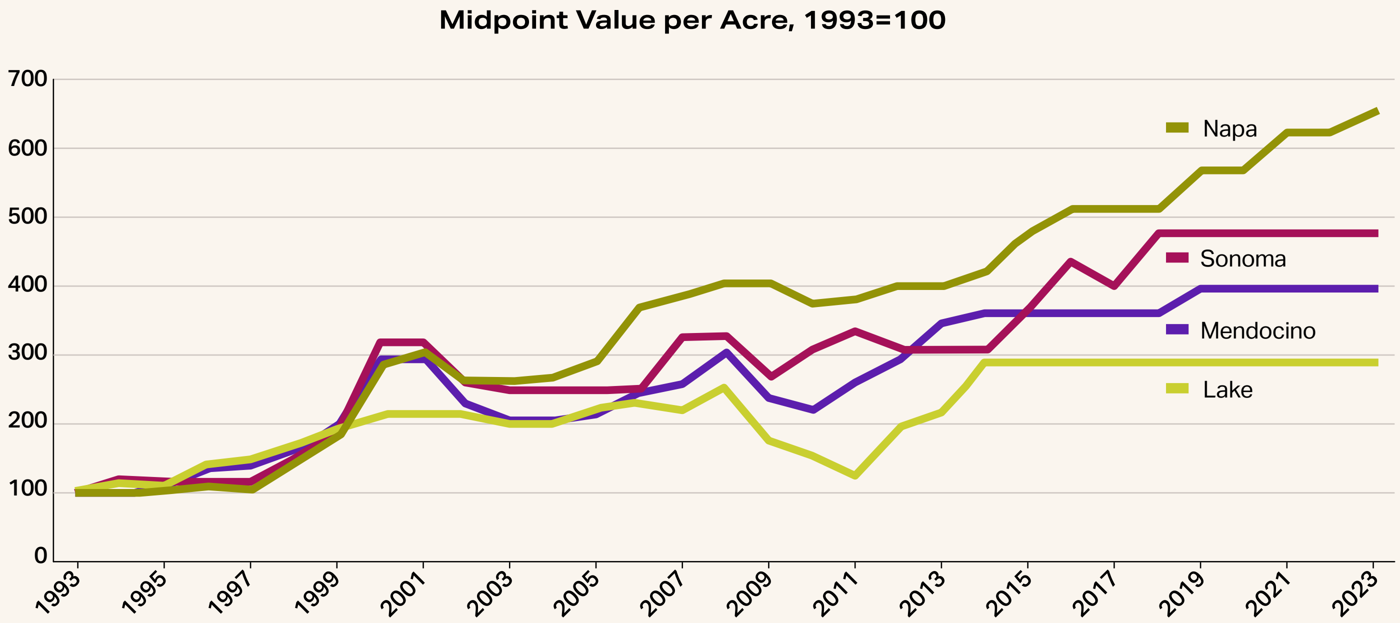
Vineyard values tend to be cyclical, with long periods of rising or flat values followed by briefer declines. However, the timing of peaks and valleys and magnitude of declines and increases vary across market areas.

Chart 1 shows the contours of the last several North Coast cycles. The values for each county are indexed to their starting point in 1993, which is assigned a value of 100.

Vineyard value cycles are driven by economic and grape market cycles. The past two downturns coincided with both recessions and grape market slumps.

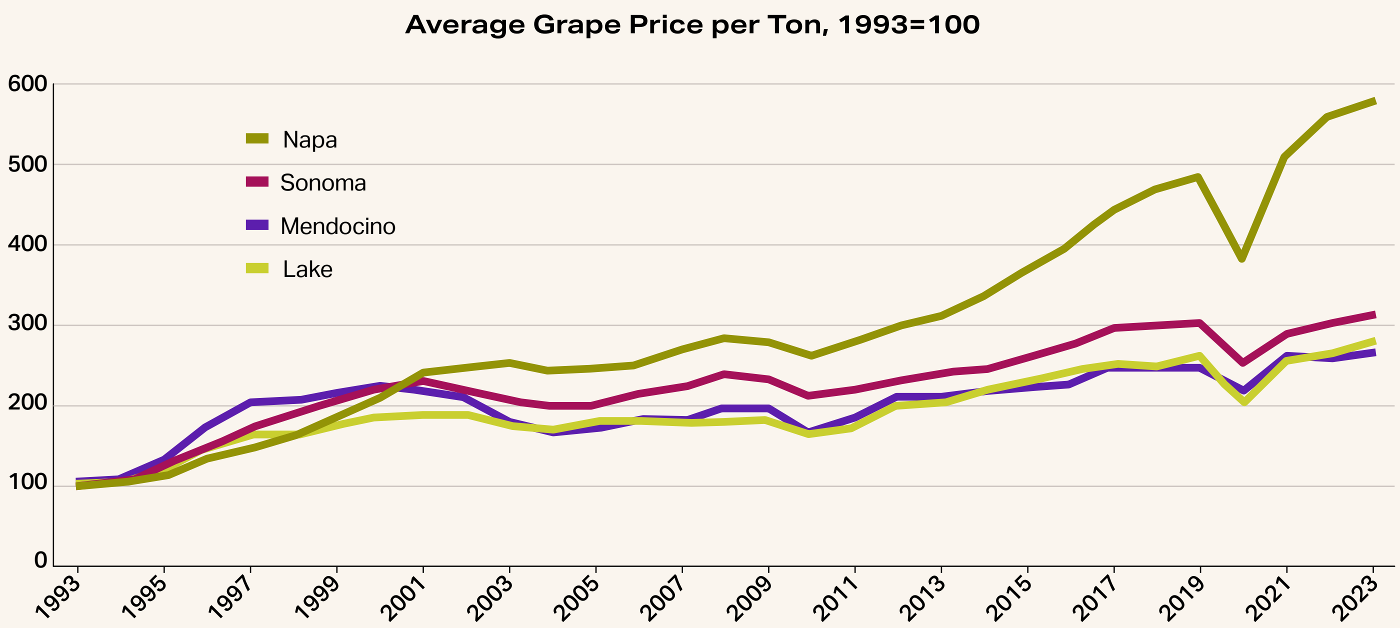
Chart 2 demonstrates the relationship between vineyard values and grape prices. The figures represent the average price per ton that grape growers received in each year, indexed to their starting point in 1993. Note that volatility in grape prices is smoothed by the prevalence of multiyear contracts in the North Coast.

Chart 1: **Vineyard Values Are Cyclical**



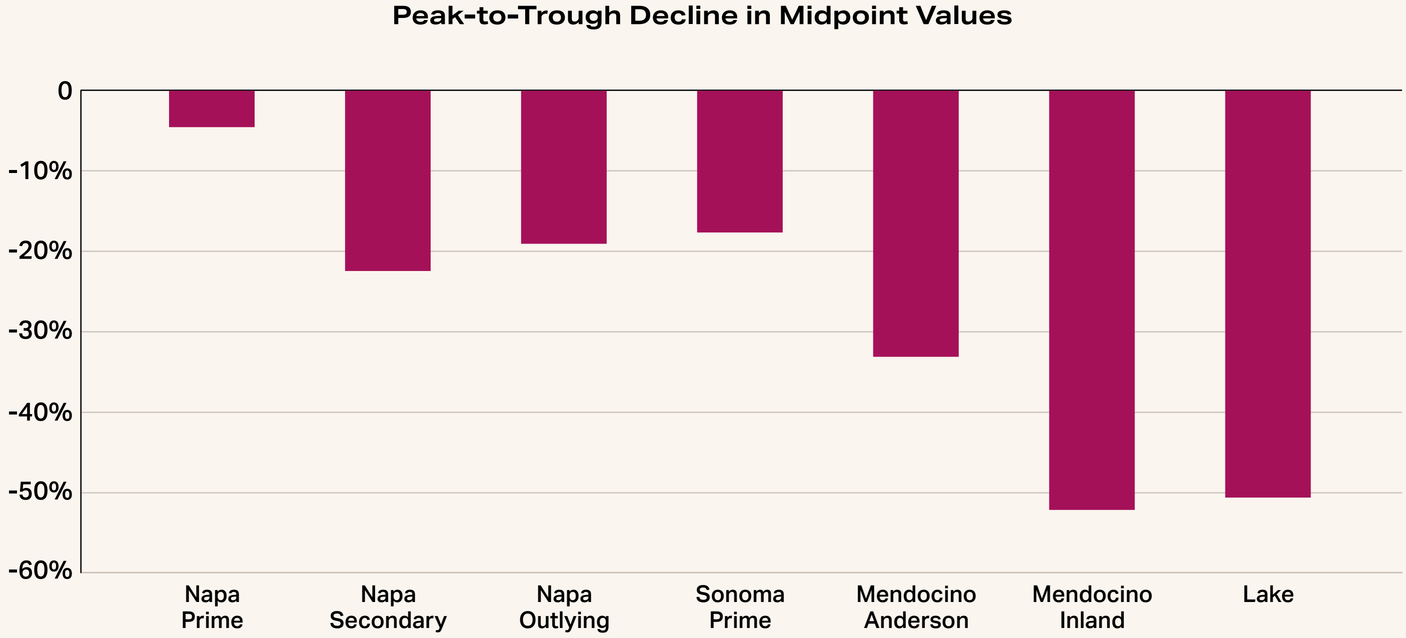
Sources: American AgCredit, Terrain

Chart 2: **Grape Prices Are Key Drivers of Vineyard Values**



Sources: California Department of Food and Agriculture, Terrain

Chart 3: Core Areas Held Their Value Better During the Last Downturn



Sources: American AgCredit, Terrain

2 In downturns, core areas tend to hold up better than peripheral areas

Chart 3 shows the change in value between the most recent peak (generally 2008) and subsequent trough. Drawdowns in vineyard values have generally been less severe in the most sought-after areas and more severe in the peripheral market segments. The "flight to quality" during corrections is evident in other asset markets as well.

Vineyards in the prime area of Napa, which includes the most desirable sub-appellations in the U.S., saw almost no drop in value. Grape supply in this area is constrained and there are often waiting lists for fruit, so grape prices tend to be more stable. Even in periods when grape prices have softened, demand for vineyards has remained resilient, with buyers eager to purchase property in this coveted area.

At the other end of the spectrum, vineyards in the peripheral Inland Mendocino and Lake County market segments lost around half of their value. Grape demand and prices tend to be more volatile in these areas, and it was difficult to find a home for grapes regardless of price during the last market downturn. Demand for vineyards also tends to be fickler, and a spate of distressed sales drove values lower.

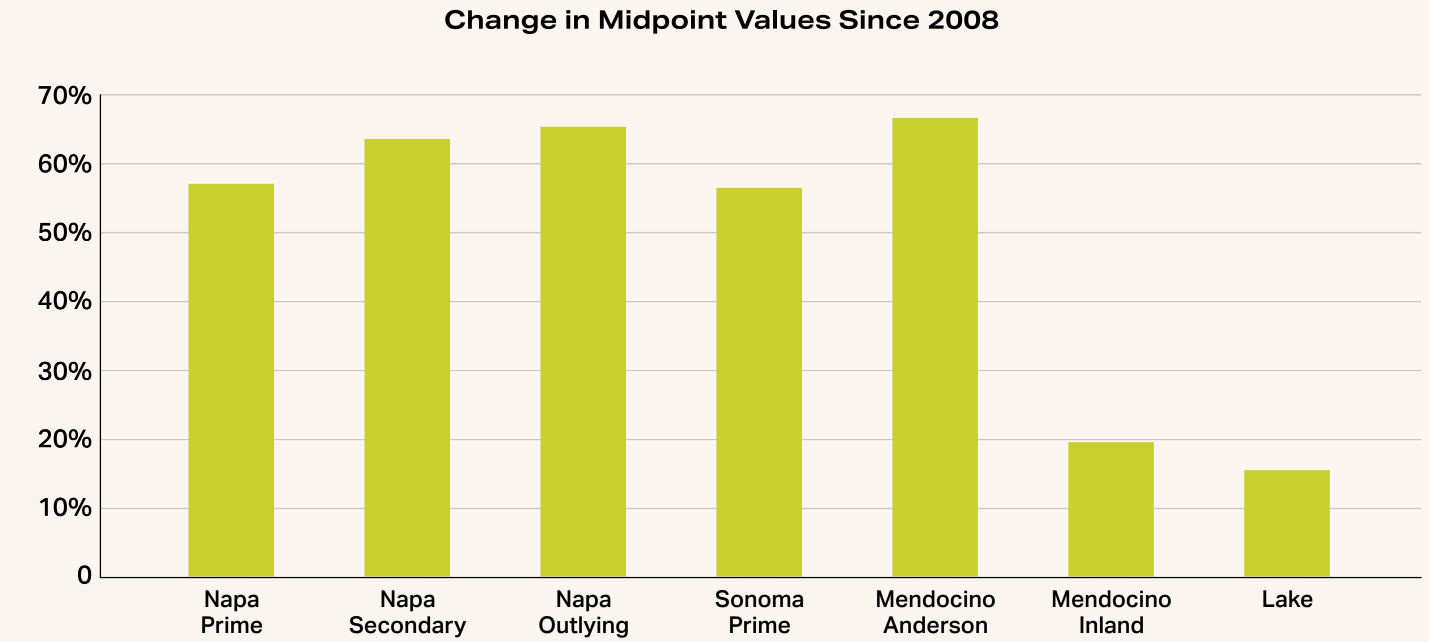
There has been a striking bifurcation in the trajectory of vineyard values in the North Coast.

3 Rates of appreciation have varied widely

Chart 4 shows the change in midpoint value estimates since the prior peak. Again, these figures are illustrative and directionally meaningful as opposed to precise measures of appreciation.

There has been a striking bifurcation in the trajectory of vineyard values in the North Coast. Values in the core areas including Napa, Sonoma and, to a lesser extent, Anderson Valley, have appreciated substantially since the prior peak, while those in Inland Mendocino and Lake County have been relatively stagnant.

Chart 4: **The Core Has Outperformed the Periphery**



Sources: American AgCredit, Terrain

This is partly attributable to greater constraints to new planting in the core areas, which inhibits growth in grape supply. Rapid growth in premium and luxury sales and surging DtC sales also stimulated demand for grapes from these areas. In turn, this has translated to stronger increases in grape prices, particularly in Napa, supporting higher vineyard values.

The peripheral areas have had more expansion in acreage, particularly in Lake County. Additionally, while these areas can produce high-quality fruit, their appellations have less cache with consumers, and their grapes are viewed as more of a commodity.

Consequently, their grapes compete with those growing in lower-cost regions such as the Central Coast and Lodi, which has held back grape prices and inhibited appreciation in vineyard values.

4 Top vineyards have commanded rising premiums

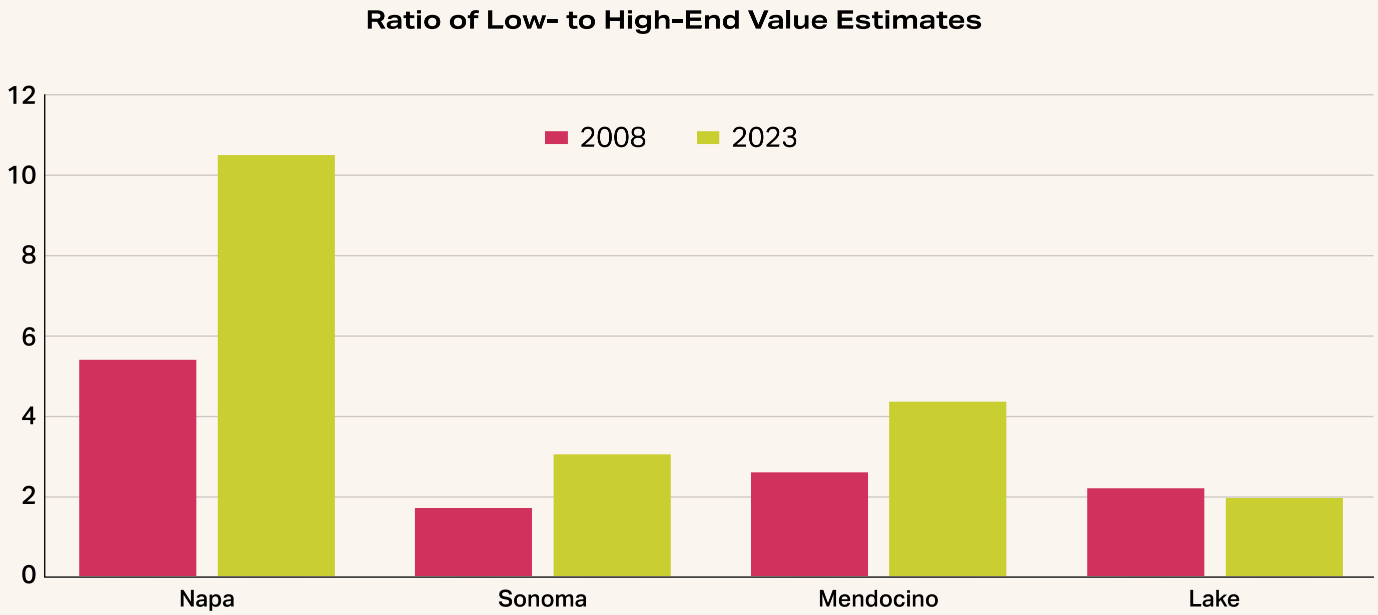
Chart 5 shows the ratio of American AgCredit's high- to low-value estimates for each county in 2008 and 2023. The ratio has increased in all areas except for Lake County. This indicates that the premium commanded by top-tier vineyards relative to bottom-tier properties has expanded in Napa, Sonoma and Mendocino counties during the current market cycle.

To capture these premiums and secure future fruit supply, wineries have been willing to pay ever-higher prices for trophy vineyards.

I attribute this primarily to rapidly rising prices for vineyard-designated wines from top-tier properties in the most prestigious North Coast areas.

To capture these premiums and secure future fruit supply, wineries have been willing to pay ever-higher prices for trophy vineyards. This conclusion is supported by a growing differential between low- and high-end grape prices for key varieties such as Cabernet Sauvignon in Napa and Pinot Noir in Sonoma and Mendocino counties.

Chart 5: The Premium for Top Vineyards Has Widened



Sources: American AgCredit, Terrain

The North Coast vineyard market is facing a number of headwinds that will likely depress values going forward.

5 Vineyard values have plateaued

A final point to note is that appreciation began to stall in the late 2010s as slowing growth in wine sales led to an excess supply of grapes and, thus, an overabundance of bulk wine. Vineyard values have been flat for the past four years across much of the North Coast, as shown in Chart 6. While they generally haven't fallen in nominal terms, values are down substantially in real terms, as general price inflation has exceeded 20% during this period.

OUTLOOK: VALUES POISED FOR A DOWNWARD ADJUSTMENT

While our appraisal team hasn't yet adjusted its value ranges down, the North Coast vineyard market is facing a number of headwinds that will likely depress values going forward.

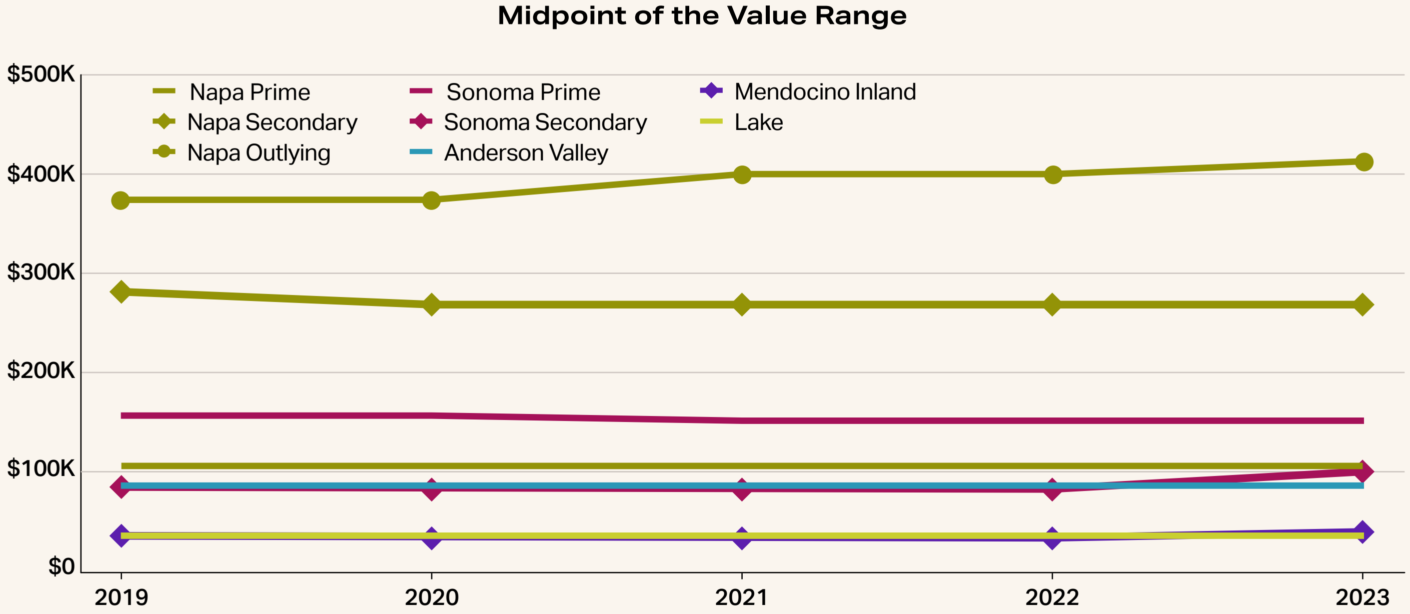
Five Key Headwinds for the North Coast Vineyard Market

1 Softening grape demand and prices

The North Coast grape market has softened considerably in the past six months because of a combination of declining wine sales and a large 2023 crop. The volume of uncontracted fruit has swelled, and many expiring contracts have not been renewed. Abundant supplies of inexpensive bulk wine are also reducing demand for grapes. Consequently, there is now widespread downward pressure on North Coast grape prices, and the possibility of losing contracts raises the risk of vineyard ownership.

That said, some areas are better positioned than others. For example, demand for grapes from premier vineyards and the most desirable sub-appellations (such as Oakville, St. Helena and Howell Mountain)

Chart 6: North Coast Vineyard Values Have Plateaued



Sources: American AgCredit, Terrain

has been more resilient and prices are stable or even increasing modestly.

2 A muted outlook for wine sales

Following a bump during the pandemic, premium and, particularly, luxury wine sales volume has fallen over the last several years. North Coast DtC sales have also declined substantially in volume terms.

Uncertainty regarding the trajectory of wine sales remains, and many North Coast wineries have tempered their expectations for growth going forward. This has contributed to weak demand for grapes and caused vineyard market sentiment to turn more negative.

The costs associated with planting vineyards and farming grapes in the North Coast have soared in recent years.

3 Rising production costs and growing risks

The costs associated with planting vineyards and farming grapes in the North Coast have soared in recent years. Planting costs now range from a low of around $35,000 per acre to as much as $200,000 on hillside Napa sites. The floor for annual farming costs now sits near $5,000 an acre and can run as high as $15,000 or more for cult Cabernet Sauvignon vineyards in Napa.

Anecdotal evidence suggests that these costs have risen by more than a third over the past four to five years, which surpasses both general inflation and grape price appreciation in the North Coast. This has reduced grower margins and the net income that vineyards can generate. Many of the properties currently on the market require replanting, and the exorbitant cost to do so has deterred buyers.

Moreover, fires and droughts in recent years have heightened perceptions of the risks associated with wine grape growing in the North Coast, which must be compensated for by higher returns.

4 High interest rates

Interest rates have risen sharply over the past two years and now stand near a 25-year high. High interest rates reduce the willingness and ability to pay for vineyard properties. Rising rates have also made less risky Treasury bonds look more attractive. Though some relief is possible later this year and more is likely in 2025, rates are likely to remain elevated for some time because of stubbornly high inflation. Long-term interest rates are unlikely to return to the ultra-low levels that juiced asset values during the 2010s.

5 A growing imbalance between the number of buyers and sellers

The inventory of available vineyard properties in the North Coast has swelled over the past year. At the same time, the pool of buyers has diminished. This imbalance, along with increasingly negative market sentiment, means that sellers will have to compete for buyers, which results in lower prices.

Near-Term Outlook: A Downward Adjustment Is Imminent

These headwinds are almost certain to depress North Coast vineyard values in the near term. While the direction is clear, the magnitude and duration of the decline will depend on the trajectory of wine sales and how quickly the imbalance between supply and demand in the grape market is resolved.

Some of these headwinds have been building for some time, and while values have yet to decline in nominal terms, they have fallen substantially in real terms in recent years because of inflation. Thus, some of the adjustment has already been accomplished by inflation.

The severity of the slump will vary widely across the North Coast. I believe the general pattern will be similar to that of the downturn that began in 2008.

Nonetheless, a further decline is almost certain. The full impact of the softening grape market, increasingly negative sentiment about the wine market, and the growing imbalance between buyers and sellers have yet to be fully incorporated into values.

The severity of the slump will vary widely across the North Coast. I believe the general pattern will be similar to that of the downturn that began in 2008. Vineyards in core areas are likely to hold their values better than those in outlying areas, and values for top-tier vineyards in the most desirable areas may not fall at all.

Within the outlying counties, vineyards in the Anderson Valley are best positioned to hold their value.

Properties in the prime segment of Napa are best positioned to hold their value, and any decline is likely to be minimal so long as luxury Cabernet Sauvignon sales continue to hold up. The secondary and, particularly, outlying areas of Napa are more exposed to the oversupplied grape market. Therefore, potential exists for a more sizable decrease in outlying areas such as the Pope Valley.

Values in the prime areas of Sonoma are also likely to hold up relatively well. However, grape price appreciation has been more modest in Sonoma than Napa, so a modest adjustment is likely. The secondary areas of Sonoma, which are less sought after, will likely see a more pronounced decline.

Grape contracts with a substantial remaining term will also have an advantage in the current market environment.

Within the outlying counties, vineyards in the Anderson Valley are best positioned to hold their value.

Like the past downturn, values in Lake County and Inland Mendocino are poised to take a bigger hit in the near term. The inventory of available properties stands near record levels, and the grape market will remain depressed for longer as these areas face stiff competition with other oversupplied regions.

On a positive note, valuations in Lake County and Inland Mendocino do not appear to be as stretched as they were heading into the last downturn. Nonetheless, some sellers have already cut asking prices — though this has stimulated little interest — and a decline of 20% or more is a realistic possibility.

Throughout the North Coast, vineyards in the early stages of their economic life should see stronger demand and pricing than their older counterparts given the high costs of replanting.

Grape contracts with a substantial remaining term will also have an advantage in the current market environment. In the outlying areas, vineyards with uncontracted fruit or those near the end of their productive life may be a tough sell at any price.

Longer-Term Outlook: Uncertain, but Reasons for Optimism

Longer term, North Coast vineyard values will continue to depend on the trajectory of premium and luxury wine sales and bottle prices, which will drive grape demand and prices. I expect to see premium and luxury wine sales stabilize over the next year or two, and DtC sales should also steady, but prospects for a return to pre-pandemic growth rates appear improbable at this point.

Given its status as the premier wine region in the U.S., the North Coast is well positioned to compete in a slower-growth market environment.

Given its status as the premier wine region in the U.S., the North Coast is well positioned to compete in a slower-growth market environment. Moreover, its wineries are favorably situated to take advantage of San Francisco's potential reemergence as a dominant hub for artificial intelligence.

Vineyards in the prime areas of Napa and Sonoma as well as the Anderson Valley should see values begin to appreciate once the grape market has turned the corner. They are best positioned vis-à-vis consumer demand and are nearly planted out. Thus, they have the best prospects for growth in grape prices. Nonetheless, appreciation is likely to be more modest in this cycle than it was in the past.

At the other end of the spectrum, vineyards in Lake County and Inland Mendocino are not likely to see appreciation for some time unless there is an upside surprise in wine sales. These areas will continue to face stiff competition with lower-cost areas until excess acreage is removed, which constrains the potential for increases in grape prices and vineyard values.

Holding out for an unrealistic price may result in a delayed transaction and ultimately a lower price than could be achieved today.

It's Important to Have Realistic Expectations

For those who need to sell vineyards, the key to getting a deal done in a timely manner will be to go in with realistic price expectations. A reputable appraiser can help you with this.

Holding out for an unrealistic price may result in a delayed transaction and ultimately a lower price than could be achieved today. Having a grape contract in hand before going to market is also crucial for those in secondary and outlying market segments unless there is an obvious winery buyer.

For those who do not need to sell, and are confident that demand for North Coast grapes will improve, it may pay to hold on until surplus vineyard inventory has been taken down and excess grapes and bulk wine have been absorbed. If you take this tack, prepare to be patient, as it may be some time before values begin to rise again, particularly in the outlying areas.

For wineries seeking to acquire vineyards, the current market environment should present opportunities to purchase at lower prices. But not all deals will make sense even at discounted pricing. It is essential to scrutinize the financials closely to ensure that anticipated bottle prices generate a sufficient margin above production costs to justify the purchase price.

Buyers should also keep in mind that every property will be valued based on its unique attributes and the most desirable properties may not trade at a discount at all. So, if you find a vineyard that fits your program and the numbers work, be careful to not overplay your hand or you may walk away with nothing.

Potential buyers can benefit from staying in close contact with a lender that understands the wine business. They can keep you abreast of changes in interest rates as well as explain the products and strategies available to finance acquisitions so that you can move quickly when you spot an opportunity.

Potential buyers can benefit from staying in close contact with a lender that understands the wine business.

Appendix

Data and Methods

INFORMATION SOURCES

There is no single, comprehensive source of information on the U.S. wine and grape markets. Rather, there are many different sources that capture specific slices of these markets. The analysis in this report represents a synthesis based on the review of multiple points of data and information.

These include statistical data from private data vendors, reports from industry service providers, U.S. government data, and internal data collected by American AgCredit's appraisal and underwriting teams. I assess the relevance and reliability of each source and weight it accordingly in the analysis.

The report also incorporates anecdotal information gleaned from conversations with market participants, including wineries, growers and various market intermediaries.

This approach enables "Winescape" to deliver a relevant and nuanced perspective on wine and grape market trends as well as an informed outlook.

THE WINE SALES DASHBOARD

The dashboard provides a directional view of trends in wine sales by volume, reflecting the fact that none of the market segments and sales channels are measured with precision.

The year-over-year change column is a directional indicator of the percentage change in wine sales for the most recent six-month period relative to the same period a year earlier. I focus on the six-month period because the quarterly data can be volatile.

Year-Over-Year Change	
	↑ Substantial increase
	↗ Modest increase
	→ Little to no change
	↘ Modest decline
	↓ Substantial decline

The trend column provides an indication of whether the rate of change in sales volume has improved or deteriorated over the past 12 months. For example, if sales in the value segment are falling on a year-over-year basis, but at a slower rate than in the past, the trend is improving and an up arrow is assigned.

Trend			
	▲ Improving	▬ Stable	▼ Deteriorating

The retail price segments are defined as follows:

Retail Price Segments			
	$$$	Value	Less than $11
	$$$	Premium	$11 to $29.99
	$$$	Luxury	$30 and up

TRENDING TOPIC APPENDIX

Dashboard Terms

- **Demand** – The number of qualified buyers actively seeking to purchase vineyards
- **Supply** – The number of vineyards available for sale, either actively listed or quietly offered
- **Activity** – The number of transactions that have been completed
- **Values** – See the following Value Estimates section

Value Estimates

Our value ranges represent estimates of the typical low and high values prevailing within each market segment and are based on transactional evidence. The vast majority of sales have fallen within these ranges, but outliers do occur. For example, sales in the Napa prime segment have occurred at much higher prices, but they are considered atypical. Homesites and homesite entitlements can also add substantially to values and are not incorporated in the estimates presented here.

Market Segments

The market segments are intended to distinguish subcounty areas that have the potential to command higher or lower than average transaction prices. They are generally associated with specific sub-AVAs in each county. However, it is important to note that high-value vineyards can exist within secondary areas based on their unique attributes and value drivers, and some vineyards in prime areas may fall short of the identified ranges.

Napa Prime: Includes meticulously maintained vineyards with desirable physical attributes and high historical grape or bottle pricing. Prime vineyards mainly produce luxury-quality Cabernet Sauvignon. They tend to be located within the heart of Napa Valley and the adjacent hillsides.

Napa Secondary: Comprises areas within the Napa core that produce less than luxury-quality Cabernet Sauvignon or lower-valued varieties such as Merlot or Sauvignon Blanc. Secondary properties are generally located in the areas immediately north and south of the prime areas.

Napa Outlying: Encompasses outlying areas that are not suitable for growing high-quality Cabernet Sauvignon, as well as areas that have the potential to be but are susceptible to extreme weather events such as heat or frost that can result in high variability in yields and quality from vintage to vintage.

Sonoma Prime: Includes vineyards within the most well-known and desirable growing areas of Sonoma County. They are typically suitable for producing high-quality Cabernet Sauvignon, Zinfandel, Pinot Noir or Chardonnay.

Sonoma Secondary: Includes vineyards in more recently established growing regions in Sonoma County that do not yet have well-established reputations. This includes the Petaluma Gap and areas within the Sonoma Coast AVA, as well as more remote locations with difficult access or terrain that is difficult and costly to develop.

Anderson Valley: Includes vineyards located in the Anderson Valley AVA in Mendocino County.

Inland Mendocino: Encompasses all properties within Mendocino County except for those located in the Anderson Valley AVA.

Lake: Includes all vineyards within Lake County.