



## ***Bergman Euro-National*** Wine Country Professionals: Vineyards, Estates & Wineries

### **Mixed Signals, Vineyard & Wine Economics 2007**

Summer 2007

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Here we are more than half way through 2007 with what appears to be a healthy crop in Napa and Sonoma Counties. Moving towards harvest we should hope for a more normal year than the previous two harvests. With increased demand for wine we can hope to alleviate the flood of fruit that has swamped the bulk wine market for the last few years. However not all demand for grapes is created equally. This is clearly apparent today where some grapes / wines are flying off the shelf and others are still trying to stay afloat. It wouldn't take a brain surgeon to figure out which varietals those are.

So where are we in the over all scope of things, you ask? As far as vineyard sales and values go, things are improving rapidly. Sales have surged with an impressive amount of large buyers lurking about with checkbooks in hand. We have sold more than half of our inventory since the beginning of the year. Due to all the action vineyard values are on the rise. On the winery side of things we have heard that as a group many wineries have had their best years ever recently.

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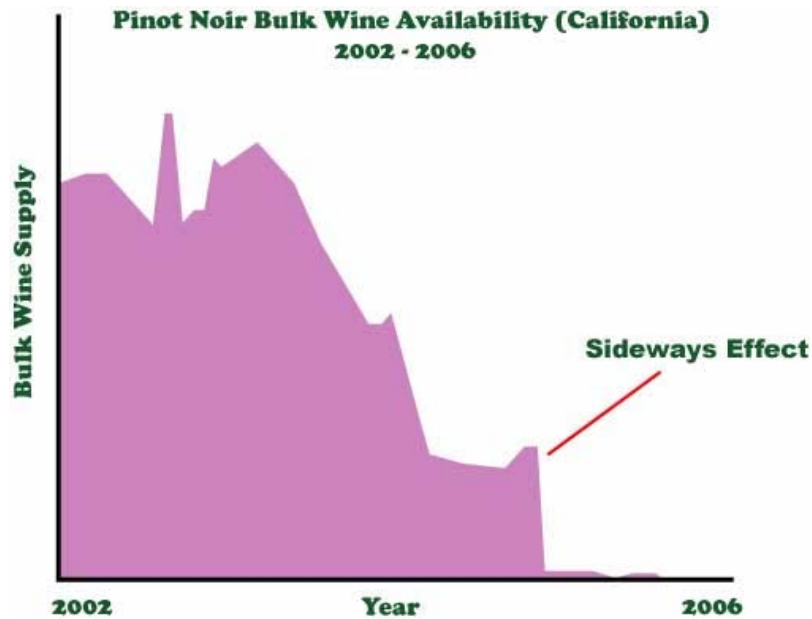
### **“Hey, You Work Out?”**

One way to view the overall market conditions is to take a look at the bulk wine market. We can comfortably say there are at least a couple varietals that are a bit overweight or in a glut including Cabernet Sauvignon and especially Merlot. Even so we are seeing improvement in the Cabernet market while Merlot looks to be backed up for at least a couple more years despite some increase in demand. On the flip side the varietals such as Zinfandel being in “balance”, Chardonnay looks to be in good shape especially from the areas like the Russian River Appellation, and of course the darling of the moment Pinot Noir is especially favored and in great demand. Hey, we were big fans before Sideways came out!

### **Flex Your Muscle**

It's no big surprise that the hot vineyard demand is Pinot Noir in the Russian River, Sonoma Coast and the Green Valley Appellations. It's funny how a movie called “Sideways” could start “The Pinot Revolution”, but it did.

Looking back we can see that thousands of gallons of bulk Pinot Noir wine was available in 2004 when “Sideways” made its debut. In a matter of days, sales of Pinot Noir jumped 30% and every gallon of bulk Pinot Noir juice was gone. Just like that, in an instant the Pinot Revolution began. Here is a chart showing the last 5 years of Pinot Bulk Wine Availability:

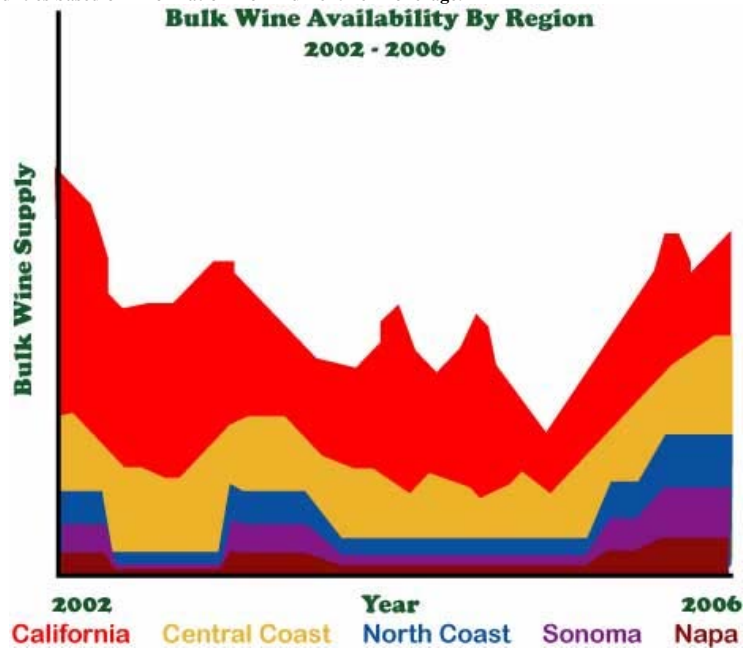


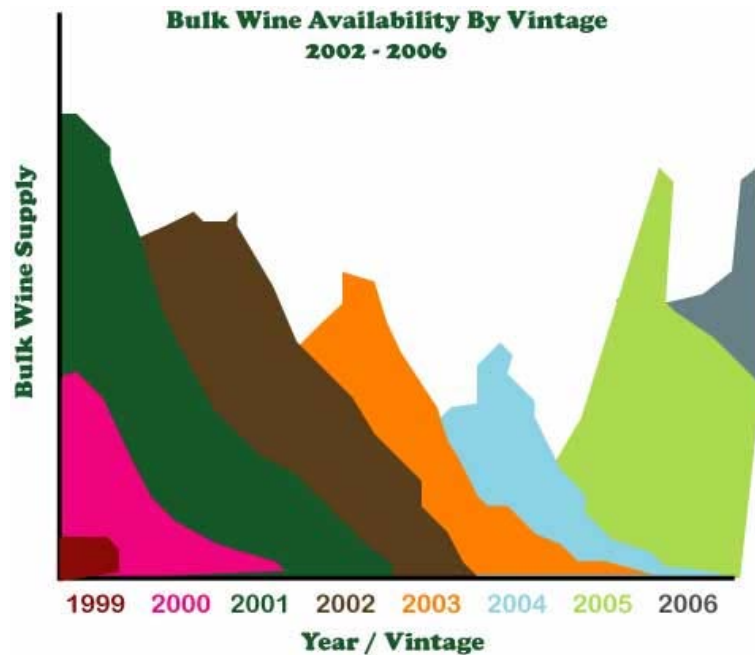
This phenomena has caused seemingly everyone in the cooler areas of Santa Barbara to Oregon and beyond to plant Pinot Noir. Pinot vineyards are in very high demand and are selling in the cooler regions of Sonoma County for \$85,000 an acre to as high as \$125,000 an acre. The higher price points are for highly rated "Cult Quality" vineyard most of which is being purchased by the highly acclaimed Pinot Noir wine makers in the area. Yes Pinot Noir is the darling of the moment.

#### We're Only As Strong As Our Weakest Link

The rest of the grape and wine market is also picking up, with the exception of one particular varietal, known as Merlot. For some reason Merlot has recently fallen out of favor. Could it have been from a single comment made in a certain movie? No one will know for sure, but be assured it will be back in favor soon. In actuality the demand for Merlot has gone up, not much but it's certainly headed in the right direction. It is important to recognize that the rising demand for Merlot is taking place off of a huge base. Unfortunately at the same time the supply has gone up too, WAY UP.

Bulk wine over all has had its cycles of ups and down trends. Here is an over view of the bulk wine situation as it compares the state of California, Central Coast, North Coast, Sonoma and Napa Counties based on information from Turrentine Brokerage.





You can see where Pinot Noir is in the scheme of things by looking at the amount of bulk wine in graphs 2 and 3 verses the amount of bulk Pinot Noir in graph 1. Talk about dropping off a cliff. Overall it would appear that we have enough wine to last for generations. Wrong!!! On the contrary, by all observations, it appears that we are headed for a shortage of grapes across the board in the next few years. This forecast of a looming shortage is based on stronger demand for wine and the nearly non-existence of new plantings (Pinot excluded) along with the removal of thousands of acres of vineyard from the central valley.

To get a better idea of how we can even imagine that there may be a shortage looming and what the future could hold for Pinot look at these numbers. In 1995 approximately 55% of the Merlot that was planted was not yet producing fruit, in 2006 only 3.3% of the vineyards planted to Merlot were yet to come into production. You can see how the amount of new plantings of Merlot has decreased substantially for obvious reasons. A few other examples include Zinfandel, in 1995 23% of Zinfandel vineyards were not yet producing. In 2006 that number has declined to 5%. In 1997 26 % of Chardonnay vineyards were yet to bear fruit, in 2006 that number decreased to just 3%. Even more substantial, in 1998 of all the Syrah planted 72% had not yet provided a crop, in 2006 only 4% of all Syrah vineyards in California were not yet bearing fruit. One of the more recent victims of over planting was Cabernet that in 1999 had 36% of all Cabernet vineyards still yet to produce a crop. Today only 1.7% of all Cabernet vineyards are yet to provide us with some fruit.

There are at least a couple quick takeaways from this information. One is that when there's a shortage people plant. The other is when there's too much fruit or a glut people stop planting. As you can see from the information above people have basically stopped planting and if history provides any glimpse into the future, we're headed towards a shortage.

As the overwhelming demand for higher quality wines grow, keep in mind that we are seeing less and less land available to grow these high quality grapes. It is apparent that two things will happen and happen soon: one will be that the demand for higher quality plantable vineyard land will have a much higher value, and the other is that we will see other AVA areas become more popular.

It's pretty easy to see where we are headed and you will notice that Pinot Noir is not mentioed in the statistics above. However, Pinot Noir has had its gluts and high demand as well. At this point we are seeing many of the Pinot vineyards that were planted earlier in the decade come on line and may alleviate the current shortage in this much sought after varietal. At least for a little while.

### The Sky Is Not Falling

The most important thing to remember is that our wonderful wine and vineyard industry has been around for over more than a century. You know the old saying, the more things change the more they stay the same. This is certainly true with regards to the ups and downs in the wine industry. The technology is constantly changing for the better but there has always been a supply and demand problem. We haven't noticed any reason for this to change in the near future.

It is important for growers to remember that the "The Sky Is Not Falling" every time we enter a glut. For wineries it is important to remember the same when there is a short supply of grapes. Right now thousands of acres of Merlot are being ripped out, or budded over to some other varietal. You can bet that sooner than later, say 3 years, Merlot will be in short supply. Remember Chardonnay took a hit in the early part of the millennium. Only a couple years later Chardonnay was back in strong demand again after thousands upon thousands of acres in the central valley were ripped out and planted to other crops. Similarly, Cabernet was in over supply a couple of years ago and now Cab is back.

Just like Pinot Noir is the hot item today, its moment in the sun also will pass when way too much Pinot is planted. What comes around goes around.



### What's Ahead?

Let's talk about vineyard values. Over the past several years we have seen positive movement in the vineyard value department. Vineyard sales in both Napa and Sonoma Counties have increases in the amount paid for vineyards after several years of stagnant growth in Napa and an actual decrease of values in Sonoma. In Napa we have seen Napa vineyard sales go as high as \$280,000 an acre and Sonoma vineyard sales as high as \$125,000 an acre. These are obviously for the crème de la crème vineyards but the trend is encouraging.

Additionally it seems that participants in the wine and vineyard business are feeling more optimistic as well. In a survey performed by Silicon Valley Bank respondents (winery and vineyard owners) provided feedback on what they expected to pay for vineyards in 2007. This analysis focused on what the respondents would expect to pay for an average vineyard acre. For Napa the response was \$167,941 for newly planted vines, \$168,889 for older vines, and \$118,529 for developable land. In Sonoma County respondents said that the price for a newly planted vineyard acre would be \$91,667, \$83,333 for older vines, and \$57,667 for developable land. Keep in mind these are survey responses and not based on actual sales but the numbers are not too far from the mark.

Reflecting further upon the data above combined with numbers going back to 1998 we can see the obvious direction of the perceived vineyard values. In 1998 respondents felt that they would expect to pay \$41,123 per acre for vineyard in Sonoma County while in Napa the expectation was \$50,542 per acre. Gee Martha, things sure have changed! It is important to note these perceptions have moved in tandem with actual market conditions.

Vineyard values will continue to climb in the long term as they have done over the last 50 years. This trend shows the average vineyard value has increased from 100% to almost 300% every decade. However as we have seen in the past, we will experience highs and lows on a yearly basis called "Economic Cycles".

### How About Supply & Demand?

During the most recent downturn in the wine and vineyard industry that started in 2001 we have seen thousands upon thousands of acres of vines ripped out. Since then we have seen very few new vineyards planted. Guess what, it's time to start planting again. Demand is coming fast and I predict that by 2010 we will have a shortage of high quality grapes in certain varieties. This translates to a higher demand for quality grape growing land, thus vineyard values will begin to climb even faster than they are now.

It's the old saying that "They ain't taken any more VineyardLand", especially in Napa and Sonoma Counties. The limited supply of quality vineyard land along with all the restrictions and red tape to even plant a small vineyard today could certainly lead one to believe that it's only a matter of time before our dirt will turn to gold. In some cases it already has. This does offer other AVA's and growing areas the opportunity of stepping up just behind Napa and Sonoma Counties to begin to fill the gap. Grape prices will begin to climb again, vineyard values are already on the rise and it appears that we are headed for another 5 to 10 years of good times. So, don't fret if you see a hiccup in the market, it will pass and the beat will go on and on.

We would like to give a hearty thanks for a tremendous amount of wonderful information provided by the 2007 Wine Industry Symposium in May of this year. The Symposium provides a great monitor of past, present and future expectations. There are some very special professionals that care enough to share their knowledge with all of us to help our wine and vineyard industry stay on the straight and narrow path of success.

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