

Fine and Rare Wine

As investors increasingly come to view art as an asset class, they are now looking to wine as an investment as well. Sotheby's 2018 Wine Market Report says that its auction sales surged over 50% in 2018 to \$98 million, up from \$64 million in 2017. More than half of that was in Hong Kong, where sales doubled from the previous year.¹ Overall auction numbers worldwide reached \$479 Million in 2018, a record for wine at auction. Whiskey is gaining strength in the marketplace as well, with a 63% increase at auction in 2018 to over \$50 million, and is an asset class to be carefully watched along with wine².

The wine market as a whole (new introductions to the market plus vintage collectibles) totals approximately \$300 billion dollars, and this number is projected to reach \$423.59 billion by 2023. About \$70 billion worth of new wine is released annually.³

I. History of the wine as an investment

While wine collecting has been a popular hobby for many over the years, the consideration of wine as an asset is a somewhat newer phenomenon, with an uptick in the market starting in the 2000s driven to a great extent by the Chinese. The wine market has been closely tied to the global economy as a whole, but largely the Chinese economy as well. When the 2008 recession hit, the wine market fell, but the 2009 Chinese economic stimulus package kick-started the Asian economy and helped rejuvenate the wine market. The Asian market continues to buy majority of wine (63 percent).⁴ Once the Chinese government imposed austerity measures upon government officials in 2011, purchasing diminished quickly, causing a large drop in prices seemingly overnight. This opened new opportunities for collectors to take advantage of wine as an investment. The market began to see a turnaround in 2017 and has quickly escalated and continued to grow at fair rates through the first quarter of 2019, signaling a strong market for both buying and selling. A series of strong vintages have helped demand.

Historically the wine market was focused most prominently

on Bordeaux, but recent years have seen it broadening. "Collectors realized after the 2011 correction in the wine market that investing in a single region is too narrow an approach. This led to an increase in collecting in other regions such as Burgundy, Rhone, California and most recently Italy, resulting in more diverse portfolios." said Brian Ward, Director of Wine and Whiskey for Winston Art Group. Burgundy is becoming the sought-after choice, with Sotheby's 2018 report detailing that the region represented 42% of all sales and that average bottle prices of Burgundy wines were up 65% at auction – with North American and Asian buyers chiefly responsible for the price increases. Asian collectors tend to favor Burgundy, as the pinot noir grape that dominates in the region pairs well with Asian cuisines and is ready to be drunk at a younger age than a Bordeaux. Wines from Italy

Sotheby Wine Auction Sales Totals (in \$Millions) & Number of Sales



Source: Sotheby's 2018 Wine Market Report

¹<https://www.sothebyswine.com/ny/press-releases/2018-wine-market-report>

²<https://www.sothebyswine.com/ny/press-releases/2018-wine-market-report>

³<https://www.globenewswire.com/news-release/2018/04/09/1467083/0/en/Global-Wine-Market-Will-Reach-USD-423-59-Billion-by-2023-Zion-Market-Research.html>

⁴<https://www.sothebyswine.com/ny/press-releases/2018-wine-market-report>

and California have increasingly become staples of collector portfolios as well.

Collectors here, refers to more than just wine enthusiasts, but encompasses those that buy wine as an investment as well.

II. What makes a wine valuable?

In evaluating a wine's prospect for appreciation, experts look at a variety of factors:

Producer

> According to Brian Ward, while wine producers have grown in number (every year, the number of wineries in the United States alone increases by just over 4%), some elite craft wines can potentially increase in value over time and many of these are in France: Château Margaux, Château Lafite Rothschild, Domaine de la Romanée-Conti.

Rarity

> There are two factors that determine rarity. Production, which is subject to the unpredictability of weather as well as the whims of the producers, can affect value by leading to a limited supply. For example, Burgundy is produced in much smaller amounts than Bordeaux, creating an immediate scarcity that's likely attributed to the region's meteoric rise in popularity among collectors. The other factor is consumption. As more of a certain wine is consumed, the increasing rarity raises its value. Burgundy is typically produced and subsequently purchased for more immediate consumption compared to a Bordeaux, which may need a longer period of time to hit its peak drinking window.

Vintage

> To produce a good vintage wine, growing and production conditions must be optimal. Climate for grape crops is especially important, determining the ideal balance of sugar, acidity and (in red grapes) tannins, so much so that even slight deviations from optimal weather can lead to less valuable wine. For example, the 1982 Bordeaux is considered a classic vintage with another 20-30 years to maturity, while the 1983 Bordeaux (just one year later) is already considered past its peak. A string of recent very good vintages (2009, 2010, 2015, 2016) in the last decade will strengthen demand and increase the appetite of collectors looking for returns over time.

Drinking Range (Longevity)

> Closely related to the vintage factor, longevity increases the value of wine. The best vintages tend to have longer lifespans, but every wine reaches a peak at some point and thereafter begins deteriorating. This is obviously an

Rare Whiskey

Rare whiskey—or "whisky," as the Scots spell it, and they make some of the best—topped the Knight Frank Luxury Investment Index (KFLII)* in 2019, having achieved 40% value growth in the past year and a 582% increase since 2009 – the highest of any investment.

A 1926 Macallan with the Sir Peter Blake label sold in New York in fall 2018 for \$843,200, setting the record for a spirit sold at auction in North America.

Whiskey glimmers with the charm of rarity even more so than wine, which eventually breaks down in the bottle. Whiskey, which ages in a barrel and not in the bottle, has become enticingly collectible, with prices hinging on supply and demand.

Ghost distilleries, which are no longer active in whiskey production, still shelter whisky going through the aging process, which they later bottle and release before shuttering. Whiskey from such distilleries is often highly sought after.

important consideration if wine is purchased as a long-term investment, as nobody wants to acquire an investment that is already depreciating. The challenge is that predicting lifespan is as much an art as a science, and even the top experts sometimes disagree about when a particular bottle will reach its optimal age.

Critic Scores

> Critics who taste and write about new wine releases are hugely influential and none more than Robert Parker, an acclaimed wine critic, who recently retired from the scene. Mr. Parker developed and maintains a scoring system that is relied on heavily by wine drinkers and collectors alike. A wine boasting a 100 from Mr. Parker, will instantly be more valuable than one scored at 95. He also developed a reputation for accurately predicting longevity. The rise of new critics that specialize in a specific region, such as Antonio Galloni for Italy or Allen Meadows for Burgundy, has added to the consideration of what makes a wine valuable and garnered followers who reference their notes and scores before a final purchase.

III. How to invest in wine

As alternative investments rise in popularity, introducing fine wines or rare whiskey into a portfolio may be a smart diversification move. According to Cult Wines, a leading wine investment consultancy and collection management service, for the last 50 years the fine wine market has remained stable, despite the world's economic crisis⁵ A collection can be further diversified by including wines varying in region, type, and age.

It's always a good idea to work with a professional broker or wine expert to ensure that any wine purchased is authentic and correctly valued. For example, a broker can help obtain the chain of provenance to prove good storage and a high likelihood of authentication. As wine grows in popularity, fake wines have snaked their way into the market as well. An inspection of a wine collection may include the tasting of lower value wine bottles within the collection, analysis of the corks (Are they raised? Depressed?), and other visual signs that may indicate poor storage conditions for a collection.

Once the wine is purchased, it's recommended to store it in bond if purchased and stored overseas, which helps with authentication and adds value (think of the value of a pristinely packaged toy collectible versus an opened figurine). Storing wines "in bond" means they're stored in a designated bonded warehouse and have not yet passed through customs and had Duty and VAT paid on them. Wine that's likely to be resold should be kept in bond to avoid having to pay VAT and Duty at all. If wine is purchased and stored in the US market, it is recommended to be stored at a professional facility that specializes exclusively in wine storage.

Investing in wine is not without additional cost – as a physical asset, wine must be properly stored to maintain – and potentially grow – value. Keeping wine in bond ensures optimal storage conditions are met, but many collectors prefer to harbor collections in their own cellars. The climate must be diligently regulated in any such home cellar at 55 degrees F and 60 – 65% humidity, with backup generators to ensure that weather events or other unexpected power outages do not compromise the integrity of the wine. It is recommended a drinking or investment cellar be tiered into three levels. Tier 1 are wines meant to be served to guests or for regular drinking. Tier 2 are wines that have value with the potential to age and increase in value, but still are ready to drink and the owner does not feel 'guilty' serving. Tier 3 are wines that are meant for investment and should be stored properly in original wood cases. It is a good idea to buy an extra or two to enjoy and monitor how the wine is aging over



Source: Sotheby's 2018 Wine Market Report

time. According to Ward, "It is important to remember that unlike many traditional securities, wine is a relatively illiquid asset with an inefficient market, requiring patience and up to 5-7 years to ensure optimum chances for profitable sales. Wines like Burgundy have seen a steady increase due to rarity and the onset of the whisky market is offering broader opportunities to invest."

Like any other valuable collectible, it is important to insure wine for potential loss. Wine can be insured for an annual premium of around 50 cents to a dollar per 100 dollars in value, which typically covers full replacement value. However, insurance will likely require climate-controlled storage, and may not protect against certain events such as generator failure or other situations that compromise storage conditions aside from natural events.

IV. Financial and Estate planning with wine

How to divest or liquidate?

As an illiquid asset in liquid form, wine is subject to unique complexities when divesting or liquidating.

Auction markets typically come with the caveats of uncertainty, steep fees, and fluctuating prices that may not meet expectations. Auction houses also prefer wine that come in quantity, are more desirable wines in the marketplace, have documented storage and strong provenance. This may exclude many smaller collections that have focuses on one or two bottles for a specific producer over time. The rise of online auctions and marketplaces has made selling wine more convenient, and therefore accessible to many types of buyers. It is highly recommended to work with a broker to determine the best method of selling a collection. Often it is more profitable to work directly with a broker to sell to a private collector, consign the collection or sell directly to a fine and rare wine retailer. This ensures an agreed upon price that is often equivalent to the net

⁵<https://www.wineinvestment.com/wine-investment/alternative-investments/>

at auction, but without the long wait for payment and uncertainty of what may or may not sell.

It is illegal to sell wine directly from a private collection without a wine license, so it is important to work with a consultant to identify the best method for the disposition of a wine collection to maximize a return.

As with buying wine, the best move for selling may be working with a broker or other wine expert in conjunction with a financial planning expert to ensure that the collection is fairly valued, yields the highest return and is handled in the most tax-efficient way possible.

Estate planning concerns

Estate planning involving wine collections can bring unique challenges. As wine has a "shelf" life, it likely needs to be handled differently than other inheritable assets. While some vintages may have longevity, others don't and heirs who may not share the original collector's knowledge and passion could end up with an expensive collection of vinegar if they don't store the bequest properly or hold on to wine past its peak.

Therefore, collectors should think carefully about what their desires for the collection are. Should it be passed down, sold or donated to a worthy cause. "There are many tax and structuring issues related to the disposition of collectibles, and wine in particular," said Frazer Rice, a Senior Wealth Strategist at Calamos Wealth Management. "Actions taken to safeguard the collection and endow its maintenance will help prevent nasty surprises many years from now."

No matter the decision, careful and deliberate steps must be taken and resources earmarked to ensure the collection's long-term value. According to Mr. Rice, "This includes having a coordinated ownership structure and an estate plan in place that recognizes its value and the owner's wishes. Wine collections may stand the test of time when owners treat them like businesses. There are certain formalities, including proper valuations and titling documentation, and other best practices that are important to follow."

An executor or heir might not be knowledgeable about the best means of acquiring the highest sale price for the wine. Storage and transportation are also unique concerns, with considerations including proper packaging, climate control, insurance, and regulations for shipping alcohol. To ensure all necessary considerations are accounted for, work with a professional to outline desires in proper legal documentation.

Wine collections can be the source of great pleasure and may provide an interesting store of value for an owner. Surrounding the collection with sound advice, proper structuring and a well-considered plan could ensure a collection's enjoyment for generations to come.

*Knight Frank's Luxury Investment Index (KFLII) tracks the performance of a theoretical basket of selected collectible asset classes - such as art, classic cars and wine - using existing third-party indices. Each asset class is weighted to reflect its relative importance and value within the basket.

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