

■ Liquid Assets

You don't have to own a vineyard to invest in the fruit of the vine.

12/1/2006

By Joseph Finora Jr.

Your client has everything. The homes are paid for. The children have been put through school. Estate plans and long-term care are in place. While a comfortable retirement is all but a matter of time, don't pop any corks yet since he's about to hit you with one of the strangest requests you've ever fielded. "I want to invest in wine; more specifically, wine futures." Maybe he doesn't have everything after all? Or maybe he knows something you don't. While investing in names such as Rothschild, Petrus and Haut-Brion sounds intriguing and exclusive, wine futures can be as risky as they are rewarding. The world of wine futures is an international business complete with agents (called negociants and courtiers) and a host of ancillary experts covering everything from agricultural forecasts to proper shipping and storage to insurance and taxes. And then there's the challenge of helping your client decide whether to make a profit by selling the wine on a secondary, ultra high-end market—or just enjoy a bottle with family, friends and perhaps the advisor who helped guide him.

"I became involved in wine futures because I saw them as a chance to get in front of the large price increases that usually follow a good vintage and producer," says Shaun Golden, an advisor with AG Edwards in Riverhead, N.Y. with a nose for value. "You could also hit a home run if the market for a given wine or vintage takes off, or enjoy it with friends. In some cases both may be possible."

Talk about your liquid assets. Purchasers of wine futures (also called "En Primeur") commit to buying wine after it is made, but before bottling. "Cask" or barrel samples are made available for tasting to wine journalists (critics) and large wholesale buyers in the spring following the vintage. The brokers and merchants report their opinions on the wine's potential to customers who decide whether or not to place orders. If they do, they'll get the wine at what they speculate will be a very reasonable price, but they must pay in full at the time of purchase. The wine is generally bottled and shipped around two years later. Among the wine writers whose notes can make or break a vintage's future are Robert Parker, Stephen Tanzer and Allen Meadows.

"Investing in wine futures can have huge payoffs," says Dan McCarty, an advisor in Albany, N.Y. "The wine may increase in value at a huge rate of return and may be unavailable to the public at a later date. Like any collectible, if it's scarce, the price only goes up, and the futures price will then look like a bargain.

Largely because weather conditions were considered very good, the 2005 futures broke out of the gate nearly 60 percent higher than their 2004 predecessors. How they will fare as a long-term investment is uncertain. While futures release prices are frequently the lowest at which these wines will ever be sold, due to a number of factors, there is always the chance that the vintage will not live up to expectations and fail to command a high price in subsequent markets.

"There's no way for sure to know what the market is going to bear in the future for a specific wine or more importantly, how the wine is ultimately going to evolve once it is put in the bottle," notes Golden. "There are other economic factors at play. This is a luxury market, and turns in the economy and stock market could impact what people are willing to pay for fine wine."

"I avoid wine futures," says Steve Mazda, an investment advisor in Doylestown, Pa. with some 1,000 bottles in his cellar. "Buying wine futures is the equivalent of derivatives. People take them to the extreme. They're too illiquid, too speculative, and if you're wrong you lose too much and have nothing to drink."

The Future Is Now

Think your client is spending too much time in his temperature-controlled wine cellar? Consider that a case of 2000 Le Pin sold as a future for \$8,000. A case can now command \$20,000 to \$30,000. Chateau Latour 2000 futures were first available in June 2001 for \$250. By 2003 they were selling for nearly \$400. By June 2005, that same Chateau Latour sold for about \$550 and one year later about \$650—an increase in value of 25 to 36 percent in the first two years and a further 40 percent to 75 percent between 2003 and 2006 (an overall increase of 100 percent and 150 percent), according to wine-searcher.com—a search engine of wine stores and wine auction price lists. The site will also answer such questions as: "Where can I buy 1990 Cheval Blanc and at what price?"

Investing in wine is in some ways similar to investing in rare stamps or coins. In many other ways, it's remarkably different. You wouldn't put a rare stamp on an envelope and mail it off to pay your utility bill. While some wine lovers are strictly in it for investment potential, there are many who regularly open exquisite vintages to share with those

who appreciate them as much as they do. Consider that a bottle of 1996 Lafite Rothschild was purchased as a future in 1997 at \$250. Ten years later, it averaged between \$454 and \$659—expensive, but not so outrageous that some wine lovers wouldn't serve it at a dinner party with like-minded aficionados.

But for a client who wants to buy wine futures, a lot can go wrong: bad cellaring, oxidation, poor temperature control, irresponsible shipping and handling. One of the first ways an advisor can help is to ensure they deal only with established and reputable retailers and importers who, in turn, negotiate with proven producers known for making wines that improve over time.

"The risks come from the multiple layers of supply and the huge number of firms offering the same products at very similar pricing," advises James Gunter, vice president of Domaines & Estates Wines, a national distributor based in Dallas, who adds that any agent should have at least 10 years of experience. "Many of these courtiers and negociants have been in business for centuries. The connections and allocations of the wines are passed from generation to generation."

Bordeaux, France's largest wine-producing appellation, is home to more than 90 percent of the world's futures market. Bordeaux futures are offered each year in an annual campaign that begins in March following the vintage. It has been estimated that more than 3,000 individual chateau names exist in Bordeaux with some properties producing very small amounts of wine. But the futures phenomenon is now increasingly used in California, the Rhone Valley, Italy and with vintage port. In Burgundy, buying futures can often be the only way to secure wines that are available in very limited quantities.

On the other end of the equation, futures help wineries offset production costs. Marco Borghese, a former commodities broker and proprietor of Castello di Borghese Vineyards in Cutchogue on Long Island's North Fork, sells futures directly to customers. The wines are presented in barrels at private tastings where they're offered at a 30 to 40 percent discount to those willing to pay on the spot. "We get paid in advance and the customer gets a discount," notes Borghese.

"You can approach a winery directly about futures," advises Kevin Brown, proprietor and winemaker at R&B Cellars in Alameda, Calif. "Not all do it, but many like the idea of getting paid early. If the wine you bought gets a high rating from a respected writer, it's like finding gold. You can easily triple your investment, especially if production is in short supply."

"Not all wine is investment grade," warns Stephen Bachman, a former investment banker and founder and chief executive officer of Vinfolio (www.vinfolio.com), a wine purchasing, advisory and storage firm in San Francisco which also publishes the *Wine Price File*, a compilation of wine auction prices. According to the 22nd annual edition (released July 2006), the three most popular vintages were 2000, 1996 and 1990. A 750ml bottle of an 1811 Yquem fetched \$42,504—the highest price for that bottle size—while a three liter 1947 Cheval Blanc sold for \$135,125, the highest price for a large bottle. Auction sites such as Christie's, which has been marketing wine since 1766, can help determine value. According to company figures, in 2005 Christie's saw total sales volume of nearly \$42 million in its global fine wine auction market.

"The first thing to do is get educated about what's happening in Bordeaux," says Chris Adams, executive vice president at Sherry-Lehmann Wines & Spirits in New York City. In business since 1934, Sherry-Lehmann (www.sherry-lehmann.com) has had lots of time to cultivate relationships in nearly every aspect of wine futures. "Match up with a retailer," Adams advises. "Stay in touch along the way to learn how a vintage is faring." Adams regularly communicates with contacts and makes visits to France to monitor anything that can impact a vintage, such as weather. "When buying futures you can also request that they be bottled to your specifications," says Adams. While wine will usually come in the 750 ml size, if you want a half-bottle, magnum or double-magnum, buying futures is the only way to do this, but there may be an extra charge for the service.

Unlike many American wineries which sell futures directly to consumers, after a French wine is produced, it goes through a series of handlers. "The allocation system is the heart of the Bordeaux wine business and is a totally unique method," notes Gunter. Once a winery has determined its market price, it contacts a small group of agents, called courtiers and divides the cases of production among this group. "Each courtier has negociants as customers and the quantity of wine is sub-divided and allocated to them."

"When buying more expensive wine from mature vintages, the risk of buying fakes increases as does the risk of buying wine which has been damaged through improper handling and storage at some point between release and purchase," says Bachman. "What may appear to be the same wine on the label may be very different inside the bottle. Even one day of heat exposure can ruin a wine forever. As a result, assurances of provenance may drive large differences in pricing for what is ostensibly the same wine."

"Treat wine futures as you would any investment," says Glazer. "Be sure that whoever is offering the wine actually

has it available in a confirmed allocation and has the experience and financial strength to take all appropriate measures necessary to ensure delivery at the offering price.”

Protecting Your Investment

Most homeowner insurance policies do not sufficiently cover wine collections, making a good argument for specialty coverage should a bottle or an entire collection be damaged, destroyed or stolen.

“Serious collectors should purchase specialized insurance to provide coverage on an ‘all-risk’ basis,” says Theresa Lawless, property product manager of Fireman’s Fund Insurance Company. “This is the most comprehensive insurance for a wine collection.”

Standard homeowner policies rarely cover fire, lightning, explosion and theft. Critical coverage includes loss due to breakage, mechanical breakdown of a wine-cooling unit or temperature fluctuation due to power outage or flood. Specialized coverage can usually be added to a homeowner policy, and usually there’s no deductible. A \$100,000 collection would cost around \$450 to insure—possibly less if a home is equipped with fire and burglar alarms and/or sprinklers.

With blanket coverage, the most common way to insure wine, one lump sum of coverage is provided for the entire collection with a maximum or “per item” limit for a single bottle usually maxing out at \$50,000. This type of coverage does not require an appraisal or receipt.

Wines may also be covered on an itemized or scheduled basis utilizing an agreed upon value, so there is no guesswork in the case of a claim. Wines valued at \$10,000 or more should be scheduled, according to Lawless, and a risk-management advisor will appraise the collection and examine the cellar or storage area.

Keeping a tight inventory is widely recommended, including receipts and appraisals. Organizations like Vinfolio offer collection management software to automatically value a collection, provide “recommended drink dates” and a bar-coding system to keep track of what you use.

And Then There Are Taxes

No matter how much your client may be in love with his wine, if he purchased it as an investment, it is subject to Section 1221 (Capital Assets) of the Internal Revenue Code. Wine bought for investment is subject to the same capital gains/losses rules as any other item: When held for over a year, it’s a long-term gain; under a year, it’s a short-term gain.

“Serious collectors should detail with their accountant the nature of their commitment to this type of investment. Many factors will go into determining deductions,” says Kurt Keiss, CPA, a partner at Marks, Paneth & Shron LLP in N.Y.

“If you always intended to drink the wine and something happens to it, you cannot claim a deduction. If you intended to use it as an investment only and something happens to it, that may be claimed, but it can be difficult to prove that you were using it as an investment—not just a beverage to be sipped.” If a loss can be justified as “ordinary and necessary”—not excessive—you may be able to claim a deduction. A serious collector who travels the globe negotiating with wine distributors may be able to justify a trip, but there are no blanket rules on this.

Many collectors benefit by donating wine to a charity auction. At “Wine on Air,” produced by Connecticut Public Television, donated wine is independently appraised. Bidding starts at 50 percent of the wine’s appraised value and the money raised goes to support Connecticut’s public television, CPTV. The donor receives a letter for tax purposes stating the price for which the wine was sold.

“Often the wines are overbid at these auctions,” says Liz Johnston-Linehan, CPTV events manager. “And those donating something really special sometimes appear on the show.” How’s that for a bonus?

If you’re still not sure about getting into wine futures, consider Robert Parker’s simple advice, “The best reason to buy futures is because you really want the wine.”

We’ll drink to that.

Joseph Finora Jr., is a writer and amateur wine maker. He last wrote about franchising.