



Economic Growth in the Washington Wine Industry FOR THE PORT OF KENNEWICK

An HDR Engineering White Paper – September 27, 2013

Introduction

The Port of Kennewick is the owner of 16-acres in a 28-acre area that has been identified for potential redevelopment within historic downtown Kennewick near the Columbia River. The property, initially platted as Columbia Gardens, is located on Kennewick's original Columbia River waterfront and is adjacent to what is now known as Duffy's Pond. The pond itself was created in the 1950s when the U.S. Army Corps of Engineers constructed shoreline levees as part of their flood control efforts in building McNary Dam. Slackwater behind the dam flooded Clover Island, reducing it from its original 162 acres down to the current 16 acre island. Creation of the levees effectively divided the city from the river and for years development was focused away from the river. Over the



Property currently owned by the Port of Kennewick adjacent to Duffy's Pond. **Source: Port of Kennewick**

past decade the City and Port of Kennewick have begun to refocus development and redevelopment efforts on and near the Columbia River as part of the *Bridge to Bridge, River to Railroad* plan developed for downtown Kennewick. As a partner in the effort the Port has been able to acquire much of the property surrounding Duffy's Pond and is now looking at the development of an Urban Wine Village as one of the potential uses in the area. The Village would be a "working" wine village in that tenants would be able to produce wine in the village, sending their effluent to the City of Kennewick sewer treatment system for processing rather than having to develop their own holding and treatment systems on their vineyards. One of the benefits of such a location for the wineries would be access to the approximately 40,000 vehicles that pass along the road each day, while the concentration of several wineries in the area would be a boon for downtown revitalization as more people visit to taste wine, have dinner or shop. The purpose of this white paper is to look at the growth of the Washington (and regional) wine industry to determine if this type of development would make sense from the perspective of growth in the industry (i.e., is there enough growth in the wine industry to support such a development long-term).

I. Wine Industry Growth

As part of this study HDR was tasked with looking at growth in the Washington (and regional) wine industries over the past decade. In order to determine the feasibility of development of an urban wine village or something similar, the wine industry would have to be strong and growing in order to support such activity. HDR looked at a number of different factors to determine the levels of growth in the industry and determined that by any standard the industry is growing.

By Year	Washington Wineries
2003	240
2004	300
2005	360
2006	460
2007	540
2008	562
2009	620
2010	709
2011	748
2012	773
2013	796

Source: Washington State Liquor Control Board, Washington Wine Commission

Note: 2010 data based on Oct. 2010 licenses, 2013 data based on Sept. 13 licenses.

Table 1 shows wineries licensed by the State over time and there is definitely a growth trend as you look at the number of licenses.

Over the past decade the number of wineries in the State of Washington has grown by 330%, averaging about 56 new winery licenses per year over that time.

Table 1

In addition, grape production over that time has also risen significantly, not only in Washington, but in the other major wine producing states as well. A review of statistics from the United States Department of Agriculture revealed the extent of that growth over the past five years, which shows not only have the quantity of grapes harvested grown, but they have also held their overall value in the market, making the production of wine a more profitable endeavor (Table 2)

In addition, grape production over that time has also risen

U.S. Grape Production 2008-2012										
Year	Tons Produced					Average Price				
	2008	2009	2010	2011	2012	2008	2009	2010	2011	2012
California	3,015,000	3,703,000	3,589,000	3,347,000	3,700,000	\$610	\$612	\$574	\$578	\$666
Washington	145,000	156,000	160,000	142,000	188,000	\$1,030	\$989	\$1,040	\$987	\$1,040
Oregon	34,700	40,200	31,200	41,500	46,000	\$2,050	\$1,910	\$2,030	\$1,950	\$2,050
Other States	89,520	81,600	87,800	92,610	79,070	\$900	\$924	\$959	\$956	\$995
United States	3,284,220	3,980,800	4,269,530	4,153,660	4,413,120	\$574	\$599	\$746	\$675	\$895

Source: USDA NASS Annual Noncitrus Fruits and Nuts Report

Table 2

In reviewing production by gallons of wine, there is also dramatic growth in the Washington wine industry over the past decade. Table 3 shows that between 2002 and 2010 (latest data available) the Washington wine industry increased its total output by 4.6 million gallons. That translates into an increase of over 1.9 million cases of wine in an eight year period. (one case of wine is approximately 2.4 gallons)

WA Wine Production	2002	2003	2004	2005	2006	2007	2008	2009	2010
Gallons Produced (millions)	15.5	17.7	17.3	16.5	19	20	21.4	25	20.1

Source: Washington Wine Commission Report on Economic Impacts of the Washington Wine Industry by Stonebridge Research LLC

Table 3

In addition, over the past four years wineries in the Benton/Franklin County area have grown by 27%, outpacing the growth in Walla Walla (table 4) in both percentages and in real numbers. Though the number of wineries between 2012 and 2013 is unchanged, significant growth in the industry occurred in both 2011 and 2012 which lends credence to the idea of supporting the industry in its growth efforts.

If you take a look at wine sales in a broader sense growth in the industry is also quite clearly defined.

Over the past 20 years the value of sales in U.S. manufactured wine has tripled from \$11 billion in 1993 to nearly \$35 billion in 2012, and since 2002 sales have jumped from \$21.8 billion to nearly \$35 billion. In 2008 and 2009 the Great Recession did impact the wine industry as it saw reductions in sales volume two years straight.

Benton/Franklin Wineries	2010	2011	2012	2013
By Year	48	53	61	61
Includes licenses in Pasco, Kennewick, Richland, West Richland, Benton City and Paterson				
Source: Washington State Liquor Control Board, Washington Wine Commission				
Note: 2010 data based on Oct. 2010 WSLCB licenses, 2013 based on Sept. 2013 licenses.				
Walla Walla Wineries	2010	2011	2012	2013
By Year	132	138	139	139
Source: Washington State Liquor Control Board, Washington Wine Commission				
Note: 2010 data based on Oct. 2010 WSLCB licenses, 2013 based on Sept. 2013 licenses.				

Table 4

Those two years were the only two years in the past 20 when either the quantities of cases sold (in the millions) or the sales value did not increase (Table 5). As this table clearly shows, the sale of wine in the United States is not only profitable, but it continues to grow at a fairly rapid pace, increasing by over 100 million cases between 2002 and 2012.

WINE SALES IN THE U.S.—2002 to 2012 in millions of 9-liter cases

*(Wine shipments from California, other states and foreign
producers entering U.S. distribution)*

Year	Table Wine ¹	Dessert Wine ²	Sparkling Wine/ Champagne	Total Wine	Total Retail Value ³
2012	314.9	27.5	17.7	360.1	\$34.6 billion
2011	304.4	29.8	17.4	351.5	\$32.9 billion
2010	286.4	27.9	15.4	329.7	\$30.0 billion
2009	280.1	26.9	14	321.1	\$28.7 billion
2008	273.2	27.2	13.4	313.8	\$30.0 billion
2007	272	26.3	13.8	312.1	\$30.4 billion
2006	264	24.1	13.6	301.6	\$27.8 billion
2005	256.2	21.9	13	291.1	\$25.8 billion
2004	247.7	18.9	13	279.7	\$24.0 billion
2003	239.7	16.8	12.1	268.8	\$22.3 billion
2002	232.2	15.6	11.8	259.5	\$21.8 billion

WINE SALES IN THE U.S.—2002 to 2012 in millions of 9-liter cases
(Wine shipments from California, other states and foreign producers entering
U.S. distribution) - Source: www.wineinstitute.org at
<http://www.wineinstitute.org/resources/pressroom/04082013>

Sources: Volume—Wine Institute, Department of Commerce, Estimates by Gomberg, Fredrikson & Associates. Preliminary. History revised.

Totals may not add up exactly due to rounding. Excludes exports. To convert cases to gallons, multiply cases by 2.3775

¹ Includes all still wines not over 14 percent alcohol; excludes Canadian malt coolers.

² Includes all still wines over 14 percent alcohol and sake. History revised based on TTB reports.

³ Estimated retail value includes markups by wholesalers, retailers and restaurateurs.

Table 5

While this bodes well for the industry as a whole, one has to wonder where the growth in the wine market is coming from. The answer to that is fairly simple; growth in population in the United States is driving some of that, with a drinking age population of nearly 257 million Americans. But a change in the tastes of Americans is the bigger factor.

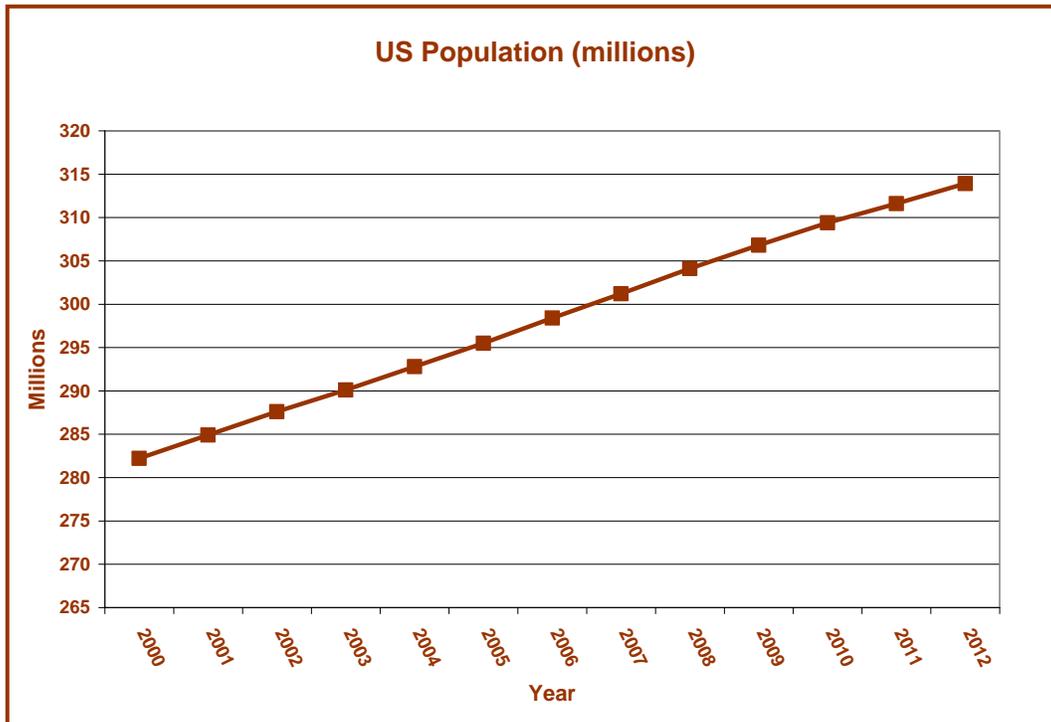


Chart 1

As Chart 1 shows, the U.S. population is growing, albeit at a relatively slow pace. Since 2000 the U.S. has seen a growth of 31 million residents, none of which are old enough to legally drink alcohol. However if you go back to 1990 and look at similar trends, the nation is adding approximately between 3 and 4 million new members every year and each year another cohort of that population reaches drinking age. More importantly, approximately 60% of those who are 21 or older drink alcohol at least occasionally according to a Gallup poll conducted in July of 2013. More importantly than the growth in population, is what those who do drink choose to drink. Gallup, as part of its annual Consumption Habits poll, has found that much of the growth driving the wine industry is a change in the consumption habits of the drinking public (Chart 2).

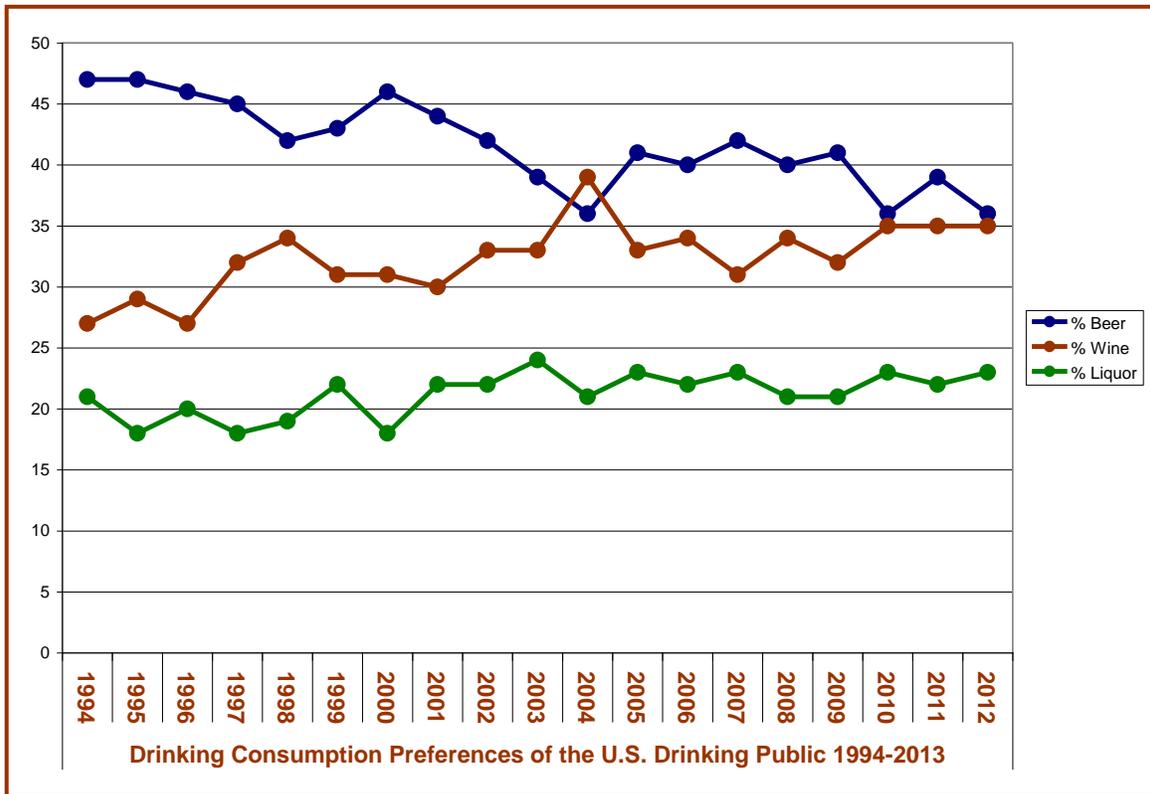


Chart 2

As the chart shows, wine has become the alcoholic drink of choice for many Americans compared to just 20 years ago. In the early 1990s beer was the beverage of choice for over 45% of Americans while wine lagged well back at 27%. Today the two are almost identical which has added significant growth to the bottom line of the wine industry. More importantly, young drinkers are turning to wine more than ever before. In the early 1990s fully 71% of adults under 30 said they drank beer most often, today that number has fallen to 41%

<i>Preferred Drink, by Age</i>			
Based on those who drink alcohol			
	% Beer	% Wine	% Liquor
18- to 29-year-olds			
1992-1994	71	14	13
2012-2013	41	24	28
Change	-30	+10	+15
30- to 49-year-olds			
1992-1994	48	31	17
2012-2013	43	29	24
Change	-5	-2	+7
50+			
1992-1994	28	37	30
2012-2013	29	46	19
Change	+1	+9	-11

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Table 6

In addition to gaining ground among younger drinkers, Gallup also discovered that wine has gained significant ground among older Americans, with those who prefer wine with their dinner rising from 37% in the 1992-94 time frame, up to 46 percent in 2012-13, a nine percentage point increase. With gains at both the top and bottom end of the scale, wine is well positioned for growth now and well into the future as the drink of choice for a significant number of Americans.

That growth is also reflected in the consumption numbers, as well. Not only are more Americans drinking wine that in the past, they are consuming it in greater quantities.

When taken together these numbers would appear to show that growth in the wine industry is inevitable and that the Port, given its economic

Year	Total Wine per Resident 1	Total Wine Gallons	Total Table Wine Gallons 2
2012	2.73 gals	856 million	749 million
2011	2.68 gals	836 million	724 million
2010	2.53 gals	784 million	681 million
2009	2.49 gals	763 million	666 million
2008	2.45 gals	746 million	650 million
2007	2.46 gals	742 million	647 million
2006	2.40 gals	717 million	628 million
2005	2.34 gals	691 million	609 million
2004	2.26 gals	665 million	589 million
2003	2.20 gals	639 million	570 million
2002	2.14 gals	617 million	552 million
2001	2.01 gals	574 million	512 million
2000	2.01 gals	568 million	507 million
1999	2.02 gals	543 million	475 million
1998	1.95 gals	526 million	466 million
1997	1.94 gals	519 million	461 million
1996	1.89 gals	500 million	439 million
1995	1.77 gals	464 million	404 million
1994	1.77 gals	459 million	395 million
1993	1.74 gals	449 million	381 million
1992	1.87 gals	476 million	405 million
1991	1.85 gals	466 million	394 million
1990	2.05 gals	509 million	423 million

¹All wine types including sparkling wine, dessert wine, vermouth, other special natural and table wine. Based upon Bureau of the Census estimated resident population. Per capita consumption will be higher if based on legal drinking age population.

²Because of changes in reporting, these numbers include all still wines not over 14 percent alcohol. History revised.

Source: <http://www.wineinstitute.org/resources/statistics/article86>

Table 7

development mission should do as much as it can to assist the industry in its growth. One particularly intriguing statistic is that surrounding wineries and production throughout the United States. This data (table 8), as much as any other, shows the tremendous potential for growth in the Washington wine industry going forward. In 2010 the northwest (Oregon and Washington) accounted for 16 percent of all the wineries in the country, but only 3.7 percent of the total production of wine. That would indicate that the wineries in the northwest are underrepresented in the marketplace, a situation which is beginning to right itself as word spreads about the quality of Washington and Oregon wines compare to those of California. As the table shows, California (as should be expected, is king with over 44% of the wineries in the country, which account for nearly 90% of all production. As in most cases the California wine industry dwarfs the rest of the country in its size and capacity for production.

However, water, land and overall costs are starting to drive many of the established California wineries into looking outside of the state for both land and production facilities.

Gary Black, President of Integrated Structures Inc., a Berkeley California Architecture and Engineering firm that specializes in winery-related development said that he is seeing more interest in expansion from established California wineries, but that land costs and water issues in his state are forcing them to look into other areas. A prime example of this broadening of their search for land outside of California occurred in March of 2013 when Jackson Family Wines (makers of Kendall Jackson and LaCrema brands) purchased nearly 400 acres of vineyards in Oregon. The company purchased the properties in order to produce Pinot Noir wines.

Percentage of Wineries and Wine Production by Geographic Region – 2010		
Region	Wineries	Production*
Northeast	10.2	4.1
South	13.3	1.2
Midwest	12.6	0.8
Mountain	3.8	0.2
California	44.1	89.5
Northwest	16	3.7
Total	100	99.5

Source: Based on data obtained from the U.S. Treasury Alcohol and Tobacco Tax Trade Division via <http://ita.doc.gov/td/ocg/wine2011.pdf>

*Production may also included non grade wine production. Data doesn't total 100% due to incomplete state data

Table 8

II. Are Washington Wineries Growing

While growth in the overall wine industry is pretty obvious, one of the more difficult questions to answer is whether Washington wineries, particularly smaller wineries, are growing along with the industry. This question is of a more qualitative nature insofar as some wineries, particularly boutique wineries, may choose to not grow as they are able to demand a premium price for their product, thus maximizing their profits while minimizing risk and cost.

According to the “Economic Impact of Washington State Wine and Grapes” study performed by Stonebridge Research Group for the Washington Wine Commission in 2012, fully 90 percent of Washington wineries produce less than 30% of Washington wine. This data would seem to hold up in light of an article in the Puget Sound Business Journal which showed that Ste. Michelle Wine Estates sold over 14 million gallons of wine in 2012 while the next largest producer, Walla Walla Wine Works sold just 1.5 million. In fact, the rest of the top 10 wineries in Washington, when combined, sold just 38% of Ste. Michelle sold in 2012.

However, in interviews with both John Bookwalter of Bookwalter Winery and ReNae Pilgrim of Terra Blanca wines it would seem that the smaller wineries are indeed growing, but their growth is somewhat tempered by the high capital cost of expansion and a strong aversion in the industry to risk.

Bookwalter said that many wineries want to grow their business, as does he. However, scaling up in the wine business is risky due to the capital-intensive nature of growth in the business. Bookwalter, who produced about 30,000 cases of wine in 2012, is looking to grow slowly, adding between 2,000 and 5,000 cases per year.

He also indicated that now is a good time to grow because Washington wines hold under 5% of the market nationally. That small percentage of market share makes it possible, but as he indicated, expansion is capital intensive and how you get that capital makes a difference in how you grow. Adding investors adds pressure and removes control, while staying internal can slow or even stall growth.

Pilgrim indicated that Terra Blanca is in much the same position as Bookwalter, in both production size and in its mindset that growth should come in a risk-averse manner. Terra Blanca made a significant investment a few years ago, adding capacity to its production and storage facilities so that it can scale up to between 50,000 and 75,000 cases annually. Right now the firm is at 30,000 and growing between 2,000 and 5,000 cases per year. Like Bookwalter, the growth at Terra Blanca is measured and largely focused on slowly scaling up production without overextending the firm.

While these two wineries may not be a fully representative sample, history can also be a guide as wineries such as Hedges, Badger Mountain, and Maryhill have all scaled up slowly but are now among the top 10 wine producers in the State.

So growth, as Bookwalter indicated, is relative. Companies such as Leonetti Vineyards, and Cayuse Winery remain small boutique wineries producing between 5,000 and 10,000 cases annually and selling them exclusively to club members based on their reputation as top-shelf wines. However, many wineries have eschewed the premium only approach and are poised for growth, as the capital becomes available.

Bookwalter indicated that the Port's approach to assisting the industry is a good step toward assisting in expansion by reducing some of the capital costs associated with scaling up in size.

Black also indicated that the Port's approach would provide some relief for winemakers looking to grow, indicating that he thinks the Port is sitting in an "if you build it" situation, saying that solving some of the capital cost issues with expansion such as waste treatment and fire suppression will help to drive winemakers looking to expand into the facilities for no other reason than it minimizes the up-front capital costs of expansion.

SOURCES

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- <http://www.nass.usda.gov/>

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R. Gary Black, President Integrated Structures – Telephone interview on Sept. 26, 2013

John Bookwalter, President and Winemaker, Bookwalter Wines – Telephone Interview on Sept. 24, 2013

ReNae Pilgrim, President of Terra Blanca Wines – Telephone Interview on Sept. 25, 2013.