



SUBMISSION
TO THE REVIEW OF NON-FORESTRY
MANAGED INVESTMENT SCHEMES

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Wine Grape Growers Australia

Wine Grape Growers' Australia (WGGA) is the peak industry body representing Australia's 7500 wine grape growers. The WGGA Executive Committee includes representatives of 8 Electoral Zones covering all wine grape producing regions. Part of the role of the organization is to advocate policies and programs that will impact positively on the profitability and sustainability of the wine grape sector – including the impact of vineyard investment.

Wine Grape Sector Environment

The Australian wine grape sector is now suffering significant adjustment pressures as a result of an overheating of vineyard plantings; wine grape and wine production, stemming from more than a decade of rapid growth in vineyard plantings that has seen Australia's vineyard area more than double since 1995 to over 160,000 hectares. This rapid expansion of the national vineyard estate has also been marked by the entrance of a large scale investor funded vineyards into the wine grape sector – many of these as Managed Investment Schemes (MIS); developed by wine companies, new and existing vineyard operators, investment promoters and others.

The surge in vineyard investment reached its peak between 1998 and 2000 – prompted by shortages of grapes available to wineries to grow export markets which had shown strong and growing demand for Australian wines since the early 1990's. Consequently, the sector experienced unprecedented high prices for grapes through the mid to late 1990s and the signing of long-term supply contracts between wineries and growers. This buoyant industry climate sent a strong investment signal for new investment in vineyards, and generated a new trend of investors from outside the traditional sphere of the Australian wine industry investing in vineyards via Vineyard MIS.

The unprecedented growth in wine grape plantings from the mid-1990s to 2002 has seen a rapid reversal of the supply shortages of the 1990s that prompted this rapid growth in the industry's vineyard base. By 2004 the Australian wine industry was beginning to move into oversupply, with an associated rapid decline in grape prices, culminating in a significant volume of grapes left on the vine or dumped following vintage 2006. The 2004, 2005 and 2006 vintages produced three consecutive record or near record harvests – with the a new record production of over 2 million tonnes in 2006 comprising 1.9 million tonnes crushed by wineries and a further 135,000 tonnes (ABS) either not harvested or dropped to the ground.

Beside this record production and a oversupply of wine grapes, WGGA estimated that up to 300,000 tonnes of the 1.9 million tonnes taken by wineries was sold at prices below the cost of wine grape production. Despite a drought affected low 2007 vintage of 1.45 million tonnes, the much higher than expected 1.83 million tonne vintage produced in 2008; linked with the high \$A and declining export volumes (for the first time in over 15 years) is once again driving the industry towards higher inventories of wine than wineries require. Wine grape oversupply is now considered by the industry's peak bodies as chronic.

As a result, the major wineries – having re-contracted large numbers of growers in the face of the anticipated low volume drought affected 2007 and 2008 vintages are now cutting back on their contract wine grape purchases and shedding grower contracts. At the release in June 2008 of the *Australian Wine Grape Outlook 2008-2012* WGGA advised growers of a return of downward pressure on grape prices (notably for Chardonnay, which is Australia's most widely planted white grape variety) and lower required volumes likely for vintage 2009 from all the major wine producers.

The industry now faces a sharp structural adjustment with profound economic ramifications for a large proportion of the grower sector, the future shape of the Australian wine industry's production base, and for regional economies. It is now widely acknowledged by both WGGA and the Winemakers Federation of Australia (WFA) that the industry's vineyard 'footprint' is too large for the industry's medium and longer term wine grape requirements and wine sales profile with estimates of between 25,000 and 30,000 hectares over-planted against the longer term demand projected.

Impact of MIS Vineyards

Despite the rapid emergence of wine grape oversupply, a significant spike in wine inventories, and a sharp trend downwards in wine grape prices, and in direct contradiction of repeated statements from WGGA, WFA and the Australian Wine & Brandy Corporation (AWBC) that there was no market signal for new large-scale planting, the planting of significant new MIS vineyards by selected investment promoters and MIS operators continued unabated up until June 30 2008, when the

taxation arrangements for Non-Forestry MIS changed. However, it should be noted that other MIS Vineyard operators have ceased investment in additional plantings due to the difficulties in securing new supply contracts with major wine producers, the uncertain outlook for future wine grape demand, and the movement of prices to less viable levels. A number of these MIS operators have been openly critical of the continuing planting of MIS vineyards by others.

In 2006 ABARE estimated MIS vineyards represented 9.8% of the total area of vineyards or 15,000 hectares. WGGA now estimates MIS vineyard plantings at not less than 16,000 hectares or 10% of plantings – representing more than 200,000 tonnes of existing or potential wine grape production.

Not surprisingly, growers (particularly long-time growers experiencing market dislocation) are highly critical of MIS vineyard developments and their perceived role in overheating vineyard plantings. The impact on the future viability of long term wine grape growers is an issue of very serious concern amongst many wine grape grower communities, which perceive a pattern of large wineries actively encouraging large scale Vineyard MIS plantings by providing supply contracts, while reducing the levels of contracted fruit or eliminating contracts with smaller family-run vineyards. At the heart of these industry concerns is that preferential taxation arrangements available to Vineyard MIS investors are encouraging growth in wine grape supply at odds with demand signals. In other words, investors are being encouraged to invest in Vineyard MIS to utilize available tax deductions – not through a realistic assessment of the medium and long term demand for and profitability of the wine grapes their Vineyard MIS investment will produce.

Of primary concern to the industry is the capacity of Vineyard MIS to skew the market for wine grapes and for wine. WGGA is concerned over the impact of the grapes generated by MIS plantings that may not have an identified end-market secured via long term supply contracts with established wine producers, or are purely speculative, with grapes sold at unviable returns on the spot market to generate some cash flows (as the investors capital has already been sunk in the vineyard, the promoters and operators fees are assured, and profitable income from wine grape sales is therefore not the primary driver). WGGA contends that the production of wine grapes by some Vineyard MIS on a speculative basis or for sale at marginal returns is contributing to the oversupply of low priced wine grapes that has perpetuated the imbalance in supply and demand in the wine grape sector over recent years.

WGGA's Position On Vineyard Investments and Vineyard MIS

PREVIOUS DIALOGUE WITH GOVERNMENT

WGGA has raised concerns with the Australian Government over some time regarding a number of negative aspects of Vineyard MIS plantings:

- WGGA presented a Submission to the Dutton Inquiry Into Forestry MIS in 2006 – using that Inquiry to call on the Howard Government to take action to circumvent the upfront taxation benefits available to investors in Non-Forestry Agricultural MIS and to change the ASIC rules governing statements in prospectuses to require sources of independent industry outlook analysis to be prominently published in MIS prospectuses.
- WGGA applauded the 2007 decision of the Howard Government to remove the upfront taxation benefits to Non-Forestry Agricultural MIS from June 30, 2007 and expressed its disappointment that a 12 month extension was granted by the Government; predicting a rash of last minute Vineyard MIS plantings – which has subsequently occurred.
- WGGA wrote to Prime Minister Rudd in February 2008 – asking him to stick with the timetable of removing preferential taxation treatment of Non Forestry Agricultural MIS investments at June 30, 2008; despite pending legal action by some MIS proponents.
- WGGA has supported the ATO ruling that Non-Forestry Agricultural MIS investments are capital in nature and supports its decision to cease issuing Product Rulings on new schemes.

CURRENT VIEWS ON VINEYARD MIS

WGGA is not anti-investment, nor anti-MIS per se. WGGA recognizes that the financial model presented by MIS could potentially be used by growers to harness new external investment in their vineyards or to allow vineyard syndication that could leverage the financial advantages of additional scale.

However WGGA remains deeply concerned about two key aspects of Vineyard MIS:

- The taxation benefits available to MIS investors prior to June 30 2008 have been the predominant driver of investment in many Vineyard MIS, and as such have added to the overheating of wine grape plantings; distorted the wine grape market through oversupply of wine grapes; and in some cases the sale of wine grapes at significantly below economically sustainable levels.
- That the looseness of the ASIC provisions regarding information currently provided on some Vineyard MIS prospectuses and the lack of reference to official sources of industry information has in some cases allowed investors to be misled on the future outlook for the industry and the outlook for profitable revenues from their vineyard investment.

Taxation Driven Investments

WGGA maintains that the previously existing preferential taxation treatment of Vineyard MIS investment has had a negative impact on the wine grape sector because their key driver is tax benefit for investors – not the generation of profits from the sale of wine grapes from the vineyards over the longer term. In support of this proposition WGGA makes the following points:

- MIS vineyard plantings have continued – despite the current downturn in vineyard revenues, chronic oversupply of wine grapes, and despite the widespread publicity regarding the sector's current and longer term economic difficulties.
- Many MIS vineyard plantings are speculative – without a secure supply contract or viable market for the grapes produced. This supports the proposition that the prime motivation for continued Vineyard MIS plantings is revenue for the scheme promoters, financial advisers and the vineyard managers through fee revenues, rather than profitable income generated by future wine grape sales.
- The structuring of the schemes has allowed unreasonably high levels of taxation deductions in the early years of the investment – through the grossing up of vineyard land purchase, establishment costs and management fees to levels that still allow significant short term tax benefits, despite the elimination of accelerated depreciation of vineyards. WGGA is aware of a number of Vineyard MIS that have charged investors more than double the reasonable establishment costs for vineyards in that production zone, even taking into account the legal and advisory costs of establishing and marketing the MIS. It is apparent that investors have been more attracted to the tax deductions available through payment of such large sums in the initial years of the investment than pursuing alternative direct investments in vineyard developments not structured as MIS at significantly lower establishment costs. WGGA maintains that this not only confirms the tax-driven nature of Vineyard MIS but promotes investment decisions that are less, or at best, not particularly concerned with future levels of vineyard income per se.

Investment Based On Mis-Information

WGGA maintains that despite the ASIC rules regarding statements on future earnings in prospectuses, some Vineyard MIS have used misinformation to convey a positive basis for an investment in the wine industry.

- Many Vineyard MIS plantings are promoted in more general or generic terms by using selected and overly optimistic media articles regarding the buoyancy and rapid growth of the wine industry, implying strong future wine grape prices and investor revenues – completely at odds with the market realities.

- While Vineyard MIS require the statement of an independent expert on the viticultural aspects of the plantings, there is no requirement to publish independent sources of information on the sector such as the outlook statements by ABARE, AWBC or the annual Australian Wine Grape Outlook Paper.

Recommendations for Government Action

The WGGA submits that:

- Vineyard MIS have contributed to the overheating of vineyard plantings, and the consequent distortion of the wine grape and wine markets. On that basis there is no public benefit in restoring the preferential taxation treatment of Vineyard MIS investments. The industry's current efforts to move supply and demand back into balance as rapidly as possible will be frustrated by the restoration of the preferential tax treatment of Vineyard MIS plantings(many of which are speculative in nature) undertaken against the prevailing market conditions and investment sentiment and economic outlook of the wine industry. There is a need for the Government to align the nature and level of tax deductions available to investors in Vineyard MIS with the common, reasonable establishment and management cost levels prevailing within the industry.

1: WGGA RECOMMENDS THAT THE GOVERNMENT CONFIRM ITS WITHDRAWAL OF PREFERENTIAL TAXATION ARRANGEMENTS FOR VINEYARD MIS, AND PUTS FUTURE TAXATION DEDUCTION ARRANGEMENTS FOR VINEYARDS ON THE SAME BASIS FOR ALL PRODUCERS.

- The current provisions governing Vineyard MIS prospectuses are not sufficient to protect against misinformation being provided to investors. Independent information provided by industry peak bodies or the Government economic and industry agencies on the industry economic outlook and prospects for profitable investment in the wine industry is required in future prospectuses.

2: WGGA RECOMMENDS THAT THE GOVERNMENT REQUIRE ALL FUTURE VINEYARD MIS PROSPECTUSES TO INCLUDE A PROMINENT RECOMMENDATION TO INVESTORS TO SEEK INDEPENDENT INFORMATION ON THE FUTURE INDUSTRY PROSPECTS FROM ACCREDITED PEAK INDUSTRY BODIES AND GOVERNMENT AGENCIES.

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