Diminution of Value (DOV) due to Increased Flooding Vulnerability (IFV) land damage – Unit Title Developments

Fact sheet August 2016

What is Diminution of Value?

When EQC cash settles Increased Flooding Vulnerability land damage, it assesses the customer's loss in one of two ways – either:

- the amount it would cost the customer to repair the land damage (the repair cost); or
- Diminution of Value.

Where the property is a unit title development, Diminution of Value is assessed for each principal unit and its accessory unit(s) (together in this fact sheet referred to as a "unit"). The Diminution of Value for the unit title development is the total of the Diminution of Value assessed across all units.

Diminution of Value measures the reduction in a unit's market value which has been caused by Increased Flooding Vulnerability land damage.

Diminution of Value does not measure the impact of an increase in flooding vulnerability caused by off-site effects, such as narrowing of river banks, shallower river beds and damage to storm water drains.

Why is EQC using Diminution of Value to settle some Increased Flooding Vulnerability land damage claims?

In many cases it is not possible to identify an appropriate repair for Increased Flooding Vulnerability land damage. For example, this may be because:

- it is not feasible to carry out a repair of the Increased Flooding Vulnerability land damage. This may be the case if the residential building has to be removed in order to do land repairs to address Increased Flooding Vulnerability damage under the building; or
- it is not possible to carry out the repair legally. For example, it may not be possible to get a resource consent required under the Resource Management Act for the land repairs to the Increased Flooding Vulnerability damage.

In these cases, for unit title developments, EQC is not able to base the settlement on repair cost. Instead, EQC is basing the settlement of Increased Flooding Vulnerability land damage on the reduction in value of the units due to this land damage. This is called Diminution of Value.

The High Court has confirmed in its Declaratory Judgment in December 2014 that EQC can settle Increased Flooding Vulnerability land damage by paying the amount of the Diminution of Value in appropriate cases.

What approach do EQC's valuers take to assessing Diminution of Value?

EQC's valuers have developed a standardised approach to assessing whether increased vulnerability to flooding impacts on a unit's market value. This approach is designed to ensure that Diminution of Value is assessed in a consistent way for all Increased Flooding Vulnerability customers.

The methodology for determining Diminution of Value has been approved by a peer review panel of valuers. The panel members were nominated by the major New Zealand professional valuation associations.

How is Diminution of Value assessed?

Once EQC's engineers identify a unit title development as being more vulnerable to flooding under the engineering assessment, a registered valuer undertakes an initial assessment of the units.

If the initial assessment identifies no reduction in any units' market value (and the Diminution of Value is therefore nil), then the unit title development will not qualify for Increased Flooding Vulnerability land damage. In this case, the valuer will not carry out further assessments.

However, if the registered valuer's initial assessment identifies a reduction in one or more unit's market value, the valuer will take the following three steps to assess the amount of Diminution of Value for the unit:

1. Establish the pre-earthquake value of the unit

The valuers use recognised techniques to establish the value of the unit as at 3 September 2010. To help determine this value, verifiable evidence has been gathered from a variety of sources. This evidence includes:

- information on the most relevant sales for the area; and
- unit age and size.

The valuation is made as at 3 September 2010, the day before the first earthquake in the Canterbury earthquake sequence. This is to ensure that the valuation is a fair market valuation and is not distorted by the effects of the earthquakes on the property market.

2. Determine the amount of the reduction in the unit's market value because it has Increased Flooding Vulnerability land damage

To assess the amount of the long-term market reduction of value, EQC's valuers take into account factors, such as:

- depth of the increased future flooding;
- location of that flooding (including in relation to the unit), and its likely frequency; and
- features of a unit that make it more or less likely to lose value due to a risk of flooding. For example, the location of the unit and its views are often major drivers of valuation. The location and views may be such that the market could reasonably be expected to attach less weight to Increased Flooding Vulnerability damage to the unit.

3. Exercise valuation judgement as to the resulting Diminution of Value

The valuer makes a final check to ensure the reduction in value determined for the unit is appropriate as a matter of valuation judgement.

Every valuer's assessment of a unit is reviewed by a senior valuer.

Can a unit title development be identified by EQC's engineers as being more vulnerable to flooding, but EQC's valuers determine that the increased vulnerability has had no impact on the unit title development's market value?

Yes. This may occur for example, where the likely location of the increased future flooding is only on a part of the insured land that is away from any of the units. Although that part of the insured land is more vulnerable to flooding, the valuer may determine that the increased vulnerability has not reduced the value of any of the units.

What if a Body Corporate whose land settlement for Increased Flooding Vulnerability was based on Diminution of Value, believes the land can be repaired?

If a Body Corporate can show that it can in fact obtain a resource consent for the land repair and that it will in fact do the land repair, then the settlement amount may be changed to be based on repair cost. This is unless the repair cost is disproportionate to the amount of the Diminution of Value. This comparison will be determined on a case by case basis.

Settlement amounts are also subject to the land cover cap amount which is set out in section 19 of the Earthquake Commission Act. The EQC land cover cap is generally the value of the area of damaged land or the value of a parcel of land that is the minimum lot size under the relevant District Plan, whichever is the smaller.

Why is there no indexing of the Diminution of Value assessment to reflect the increase in property market valuations in general in the Christchurch market in the last five years?

When doing the Diminution of Value assessment, EQC starts by assessing the market value of the unit immediately before the earthquakes (3 September 2010).

EQC then uses this value as the base for calculating the reduction in value (DOV) of the unit that has occurred since that date as the direct result of the Increased Flooding Vulnerability damage caused by the earthquakes.

In accordance with the EQC Act, EQC assesses the base value from the date immediately before the damage occurred. There is no scope under the Act to choose a base value as at a future date (i.e. after the date of the damage), or somehow apply an index to increase the amount of the base value.

EQC has assessed the base valuation as at 3 September 2010 for all the earthquakes that have caused the Increased Flooding Vulnerability damage. This is to ensure that the base valuation is a fair market valuation and is not distorted by the effects of the earthquakes on the property market since 3 September 2010.

What does a Body Corporate have to do with the settlement amount assessed on the basis of Diminution of Value?

A Diminution of Value settlement amount is paid where there is no feasible repair available for the Increased Flooding Vulnerability land damage, or because the repair is not able to be done legally. While a Body Corporate may wish to use the settlement amount to mitigate the effects of any future flooding, there is no requirement to do so.

The Body Corporate must determine how it wishes to use and allocate the settlement. All unit owners are members of the Body Corporate and are generally entitled to a say in how the settlement money is applied. It is most likely that the Body Corporate chairperson would call a general meeting at which a special resolution is made as to how the money will be applied. EQC has no say in how this money is allocated by the Body Corporate.

A breakdown of the IFV settlement amount on a unit by unit basis prior to any excess deduction is enclosed with the settlement letter. This breakdown may assist in deciding how to distribute the payment to the unit owners, if the Body Corporate resolves to do so.

If the Diminution of Value settlement amount is not used to repair the Increased Flooding Vulnerability damage, it will not affect future EQC cover for the unit title development.

If the Body Corporate is unsure of what it should do with land damage payments, then it may wish to seek legal advice.

For more detail on Diminution of Value for Increased Flooding Vulnerability damage, see www.eqc.govt.nz/IFV