

Diminution of Value (DOV) due to Increased Flooding Vulnerability (IFV) land damage (for where the house has been or will be rebuilt)

FACT SHEET - November 2016

What is Diminution of Value (DOV)?

When EQC cash settles Increased Flooding Vulnerability (IFV) 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
- DOV.

DOV measures the reduction in a property's market value which has been caused by IFV land damage.

This fact sheet deals with the situation where the house that was on the property before the 2010-2011 Canterbury earthquakes has been or will be rebuilt.

Where the house that was on the property before the 2010-2011 earthquakes has been or will be rebuilt, the DOV only applies to the insured land on the property. The DOV does not apply to the associated residential buildings, such as the house, garage and garden shed.

DOV 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 DOV to settle some IFV land damage claims?

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

- it is not feasible to carry out a repair of the IFV land damage (for example, raising the level of the ground); 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 repairs to the IFV land damage.

In these cases, EQC is not able to base the settlement on repair cost. Instead, EQC bases the settlement of IFV land damage on the reduction in value of the insured land on the property due to this land damage.

This is called DOV.

The High Court confirmed in its Declaratory Judgment in December 2014 that EQC can settle IFV land damage by paying the amount of the DOV in appropriate cases.

What approach do EQC's valuers take when assessing DOV for IFV land damage where the house on the property has been or will be rebuilt?

For this situation, EQC's valuers have developed a standardised approach to assessing whether increased vulnerability to flooding impacts on the market value of the insured land on a property. The approach is designed to ensure that DOV is assessed in a consistent way for IFV customers in this situation.

The methodology for determining DOV 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 DOV assessed where the house on the property has been or will be rebuilt?

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

If the initial assessment identifies no reduction in the market value of the insured land on the property due to the increased flooding vulnerability (and the DOV is therefore nil), the property will not qualify for IFV land damage. In this case, the valuer will not carry out a further assessment of DOV.

However, if the registered valuer's initial assessment does identify a reduction in the market value of the insured land on the property due to the increased flooding vulnerability, the valuer will take the following three steps to assess the amount of DOV of the insured land with IFV land damage:

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1) Establish the pre-earthquake value of the insured land on the property

The valuers use recognised techniques to establish the value of the insured land on the property 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 land sales for the area.

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 market value of the insured land on the property because it has IFV land damage

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

- the depth of the increased future flooding;
- the location of that flooding (including in relation to the likely location of a house that may be built on the land). Where a new house is yet to be rebuilt, EQC's valuers generally assume that it would be built on substantially the same footprint as the house that was on the land before the earthquakes. However, they also have regard to how the location and size of a house on the land may change when it is rebuilt (taking into account the relevant characteristics of the land and area);
- the likely frequency of the flooding;
- the relationship between increased flood levels and likely floor levels required by the relevant local authority for any house on the land; and
- features of a property that make it more or less likely to lose value due to a risk of flooding. For example, the location of the property 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 IFV land damage to the property.

3) Exercise valuation judgement as to the resulting DOV

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

Every valuer's assessment of the insured land on a property is reviewed by a senior valuer.

Can a property 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 market value of the insured land on the property?

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 the building platform. Although that part of the insured land is more vulnerable to flooding, the valuer may determine that the increased vulnerability has not reduced the market value of the insured land.

What if a customer whose settlement for IFV land damage was based on DOV, believes their land can be repaired?

If a customer can show that they can in fact obtain a resource consent for the land repair and that they will 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 DOV. This comparison will be determined on a case by case basis.

Where a property with IFV land damage has been sold since the earthquakes, the settlement will also be based on the DOV. This settlement approach for IFV land damage is consistent with the Declaratory Judgment which was delivered in December 2014.

Settlement amounts are also subject to the land cover cap amount which is set out in section 19 of the Earthquake Commission Act (EQC 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 DOV assessment to reflect the increase in property market valuations in general in the Christchurch market in the last six years?

When doing the DOV assessment where the house on a property has been or will be rebuilt, EQC starts by assessing the market value of the insured land on the property immediately before the earthquakes (3 September 2010).

EQC then uses this value as the base for calculating the reduction in value (DOV) of the insured land on the property that has occurred since that date as the direct result of the IFV land damage caused by the earthquakes.

In accordance with the EQC Act, EQC assesses the base land value from the date immediately before the land damage occurred. There is no scope under the EQC 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 IFV land 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 do I have to do with the settlement amount assessed on the basis of DOV?

A DOV settlement amount is paid where there is no feasible repair available for the IFV land damage, or because the repair is not able to be done legally. While you may wish to use the settlement amount to mitigate the effects of any future flooding, there is no requirement to do so.

If you do not use the DOV settlement amount to repair the IFV land damage, it will not affect future EQC cover for the property.

Depending on how much the settlement amount is, it may be paid to the property's mortgage provider.

What does "has been or will be rebuilt" mean?

For IFV land damage assessment purposes, EQC considers that the house on a property "has been or will be rebuilt" where either:

- the insured land on the property is currently a vacant site; or
- the house that was on the property before the 2010-2011 Canterbury earthquakes:
 - currently remains on the property but is intended to be rebuilt on the property; or
 - is currently being rebuilt on the property; or
 - has already been rebuilt on the property.

How would the DOV assessment as a result of IFV land damage be different if the house that was on the property before the 2010-2011 earthquakes remained in place and was not to be rebuilt?

In that case, the DOV assessment would be based on a different valuation methodology, which is used where the house that was on the property before the 2010-2011 earthquakes remains in place. The DOV would apply to the insured land and the associated residential buildings, such as the house, garage and garden shed.

By contrast, where the house has been or will be rebuilt, EQC's valuers use a valuation methodology developed for that situation. The DOV reflects the loss of value of the insured land only. The assessment of the DOV takes into account the impact of IFV land damage on the future use of the insured land, including as a building platform for a house.

Why is DOV assessed differently for properties where the house that was on the property before the 2010-2011 earthquakes has been or will be rebuilt (as compared to where the house remains in place and is not to be rebuilt)?

The different DOV assessments have been developed to take into account these two different scenarios:

- where the house remains in place and is not to be rebuilt, the claimant has a damaged asset (insured land) that is associated with a house that will stay on the land. The reduction in market value (DOV) will apply to the insured land as well as the house as a result of the IFV land damage;
- where the house has been or will be rebuilt, DOV cannot be assessed by reference to the pre-earthquake house. The pre-earthquake house is gone or will be gone. It will be replaced by a house that may have different characteristics and value. The potential characteristics and value of a new house will be reflected in the value of the insured land. The DOV will therefore be assessed for the insured land value only. This DOV assessment will take into account the likely impact of the IFV land damage once a new house is rebuilt.