



DIMINISHED VALUE: The Meeting of Junk Science and Reality

— PART ONE

TECHNICAL FEATURE

“Diminished Value” is a term used to define the reduction in a vehicle’s worth or dollar value due to its involvement in an event for which it was repaired. Most of the Diminished Value (DV) issues are associated with collision events of some sort. The basic theory is that a consumer purchasing a previously owned (used) vehicle will find a vehicle that has been damaged during a prior ownership worth less money than a comparable, undamaged one. At first glance, this concept seems logical and, under some conditions, probably true for the general public. The problem is not if the vehicle is worth less, but *when* the vehicle is worth less – and by how much? Further, is a repaired vehicle actually worth less than an undamaged, unrepaired vehicle regardless of other factors such as mechanical condition and maintenance? This two-part article is an attempt to address the issue of Diminished Value and differentiate the reality from the junk science used to re-value collision-damaged vehicles.

TYPES OF DIMINISHED VALUE

There are two primary causes for DV (and a third that is less accepted, but possibly just as significant). A vehicle may be subject to one or more of the following:

- Inherent DV
- Repair-Related DV
- Component-Related DV

Inherent DV is the reduced value due to the mere fact that the vehicle was involved in a collision event. This allegation has blossomed due to the proliferation of CARFAX* vehicle history reporting services, which advise potential car buyers of a vehicle’s repair history. The existence of some collision or comprehensive (comp)-related listing is fodder for negotiations based on Inherent DV. We call this “the CARFAX effect.”

Repair-Related DV is the most significant DV issue. It is a decreased vehicle value due to improper and/or incomplete collision or comp repairs. Such has been the basis for a decrease in a vehicle’s value since the first used vehicle was sold. Although there is still an inherent problem (no pun intended) with putting a price on the DV, improper or incomplete repairs are considered a very real basis for paying less for a car. Improper repairs may

also pose a significant safety issue for the purchaser, passenger or surrounding drivers. That’s another topic for another day.

Component-Related DV, which was introduced and is supported by many vehicle manufacturers, is based on the use of non-factory components in vehicle repair. The concept is that non-factory (a.k.a. aftermarket) parts are inferior to factory OEM parts. Although we support the use of factory parts for most aspects of a repair, aftermarket and other non-factory parts have their place in the repair industry. Since we have not seen calculations based solely on Component-Related DV, we will not spend much time and effort on this area, especially when Component-Related DV is often a part of Repair-Related DV.

VEHICLE CONDITION

Of the DV appraisals we have seen, many include a subjective assessment of vehicle condition. However, this assessment is outside the scope of what DV is directed at - presumably, the customer comparing a vehicle that he or she is interested in purchasing with other vehicles of the same character. As a consumer, is a vehicle’s visible condition as critical as its mechanical condition? We suggest that the potential for future maintenance costs during ownership of a used vehicle are associated with mechanical failure, not cosmetic failure. More on that to come.

THE CARFAX EFFECT

Many proponents of DV use CARFAX as a basis of establishing Inherent Diminished value. However, CARFAX reports (as valuable as they are as a purchasing tool) are not full and complete representations of a vehicle’s condition, nor do they opine on a vehicle’s value.

Under the CARFAX concept, a customer has the choice of purchasing one of two vehicles that are identical in every way (color, mileage, options, condition, etc.) with one exception: One of the vehicles was involved in some type of collision event based on a CARFAX report. Both vehicles are cosmetically equal in every way (or we would have a Repair-Related DV issue). It is natural to assume that the purchaser will not choose the collision-involved vehicle and purchase the non-collision involved vehicle unless the collision-involved vehicle is sold at a lower price. Therefore, the previously damaged (and repaired) vehicle is worth

less money. Translation: Its value is diminished. Simple, right? Not really.

Statistically, it is nearly impossible for two vehicles to be so identical that they are equal in every way but prior repairs. I have seen hundreds of silver Toyota Camrys identical on paper, but very different in person. In addition, a purchaser knows (or should know) that the future cost of ownership is not the sustainability of properly completed repairs, but the mechanical condition. So let's expand our scenario by assuming that the vehicle with prior (properly repaired) collision damage has a well-documented service history, while the other vehicle does not. Now, cosmetically, these vehicles are identical. Posed with cosmetically identical vehicles – one undamaged, and one repaired but with a “better” service history record – which one will be worth more? Will they now be worth the same?

The future costs of vehicle ownership are the maintenance of mechanical components, not the cosmetics. Therefore, the vehicle with the well-documented maintenance may be the car of choice. This means that the prior collision did not diminish the value of the maintained vehicle.

The concept of Inherent DV is weakened by the mysterious calculations used by DV appraisers to establish the diminished value amount. Many DV appraisers do not disclose the calculations and only express a net opinion on the money owed to the injured party (vehicle owner). Who, some ask, is the vehicle owner? If your vehicle is leased, the “owner” may be a branch of the manufacturer. Or maybe the vehicle is financed. In this case, is the bank (in part or whole) the owner? If a lessee is awarded a DV settlement, is he or she required to share that settlement with the lessor? If the vehicle is bank-owned, does the registered owner pay the bank? Does the registered owner split the DV settlement with the lienholder? Probably not.

Many vehicle manufacturers have recommended or certified repair shops. Many of these same manufacturers suggest (if not outright state) that the value of the vehicle will not be affected by the event if repairs are performed by a certified repair facility.

REPAIR-RELATED DV

Unlike Inherent DV, Repair-Related DV is very real. However, like Inherent DV, Repair-Related DV calculations are mystical and unscientific.

An improper or incomplete repair process on a collision-damaged vehicle is dangerous in many ways, most importantly to the safety of the occupants in subsequent collisions. If a vehicle sustains structural damage during a collision, both Repair-Related DV and Inherent DV become more substantial. Some areas that support issues of DV include:

- Lack of compliance with manufacturers' repair procedures;
- Use of non-factory replacement parts; and
- Adherence to repair procedures dictated by the damage appraisal.

It can be argued that a poorly repaired vehicle can be of no value to the driver. We have examined many vehicles for alleged improper repair and found many unfit for return to service. This, however, is the exception, not the rule.

The DV assessment of the vehicle repairs is far from consistent from appraiser to appraiser. Yes, some consistency can be found in the formulas, but the basis of the repair assessment and the gradations of the repairs (used in the calculation process) are completely subjective. Thus, the consistency necessary for a scientifically based assessment is not present. This may work at the claims level, but the rules change when the court system is involved.

Look for Part Two of this story in next month's *Hammer & Dolly*, and please feel free to contact us if you have any questions. **H&D**

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Executive Director's Thoughts

I know many of you are already aware of the effect that information availability has on your business. Customers' awareness of their vehicle information makes them more likely to ask about the potential ramifications of repair to their vehicle's future value. Understanding their perspective and being able to explain it well offers them a service level that will give them comfort in the process.

- Jordan Hendler