LAND AND BUILDINGS – WHICH LEVEL IN THE FAIR VALUE HIERARCHY?

FIRST TIME ADOPTION OF THE NEW FAIR VALUE STANDARD, AASB 13 *FAIR VALUE MEASUREMENT,* PRESENTS MANY CHALLENGES, INCLUDING DECIDING THE APPROPRIATE LEVEL IN THE FAIR VALUE HIERARCHY SO THAT ALL NECESSARY DISCLOSURES ARE INCLUDED IN THE FINANCIAL STATEMENTS.

This categorisation is particularly important for **non-financial assets** because we have never had to go through this exercise before, the Levels 1, 2 and 3 previously only applying to financial assets under AASB 7 *Financial Instruments: Disclosures*.

Example
XYZ Co measures land and buildings on the fair value basis.

Valuer determines fair value using the income approach (capitalisation of net income) as follows:
- Determine rentals for similar properties – range of $150 - $300 per square metre
- For this property, rentals would be in the range of $180 - 220 per square metre, based on characteristics of this property, e.g. locations etc
- Applies average rental rate to actual square meters of the land and buildings
- Deducts certain property costs
- Multiplies net amount by capitalisation rate to arrive at fair value
- Valuer also cross checks above capitalisation rate calculation to sales rates per square metre of similar properties in the area (varying from $900 – $2,500 per square metre before narrowing down the range).

These are Level 3 inputs
Level 2 inputs are those, other than quoted market prices within Level 1, that are observable for the asset or liability, either directly or indirectly. Observable inputs are developed using market data, e.g. yield curves used in determining fair value of interest rate swaps.

In this case, even though the valuer uses market observable data as a starting point (e.g. rental per square metre and sales rates per square metre), adjustments to a Level 2 input that are significant to the entire fair value measurement can result in a fair value being categorised within Level 3 if the adjustment uses **significant unobservable inputs**.

Conclusion
In this example, the valuer uses very broad ranges of market data and the adjustments would be too significant to remain as a Level 2 classification.

The adjustments are themselves significant unobservable inputs to the fair value calculation and it is therefore likely that Level 2 classifications of inputs for land and building and investment property valuations would be rare and limited to properties that are fairly homogenous and where adjustments are minimal.