Contributions of the Entrepreneur, Developer, and Contractor

The measure of anticipated profit used in the cost approach is entrepreneurial incentive, the amount required to entice an entrepreneur to take on the project. In analyzing the components of reward and compensation anticipated (or actually received) by an entrepreneur, appraisers should understand the concepts of entrepreneurial incentive, entrepreneurial profit, developer's fee, and contractor's profit:

- *Entrepreneurial incentive* is the total anticipated profit that is expected to be received by the entrepreneur for the managerial coordination, acceptance of risk, and time and effort related to the development. In projects in which the entrepreneur also acts as the developer, the entrepreneurial incentive comprises cost items for the different roles served by the individual, with the sum of those items equivalent to the total entrepreneurial incentive.
- *Entrepreneurial profit* (sometimes called *developer's profit*) is a historic fact looking back. It is the actual profit earned after a project is completed and sold.
- *Developer's fee* represents compensation for the time, energy, and expertise of an individual other than the original entrepreneur—usually, in large projects, the person responsible for managing the overall development process.
- *Contractor's profit* (including subcontractors' fees) is part of the direct costs and is therefore not included in the entrepreneurial incentive.

be the first cost lost in value if those properties are not constructed similar to the ideal improvement. An owner-occupant may consider additional operating profit, long-term control, or ownership pride or prestige to be an adequate incentive to develop and occupy that property.

The way in which comparable properties have been developed affects the availability of data. Appraisers are sometimes able to calculate entrepreneurial profit from actual comparable costs for speculatively built properties such as condominiums and multifamily developments. In the value estimate of a speculatively built property, entrepreneurial profit represents a return to the entrepreneur for the skills employed and the risks incurred, although the actual return may differ from the anticipated return. In large-scale developments, however, the issue is complicated because the entrepreneurial profit may not reflect the proportionate contributions of the improved site and the improvement to the overall property value. Developers of tract subdivisions, for example, often realize most of their profit on the value of the houses built on the finished lots, not necessarily on the value of the lots, which could be analyzed as a separate investment opportunity with its own separate measure of entrepreneurial profit.

Data on entrepreneurial profit for custom-built properties may not be available if the property owner who contracted the actual builders was acting as the developer. The prices of upscale, custom-built properties often reflect the attractiveness of these amenity-laden properties as well as the high costs of the materials used. Thus, the breakdown of costs for custom-built properties may not be comparable to the breakdown for speculatively built properties, which further complicates the task of estimating a rate of entrepreneurial profit. Theoretically, however, the value of custom-built properties should also reflect an entrepreneurial profit, although functional obsolescence may offset that profit when the custom-built improvements do not serve the market.

Appraisers should also scrutinize the cost data on which the value estimate is based to determine whether or not an allowance for entrepreneurial incentive or