The Mezzanine Gap

Filling the Space Between Senior Debt and Equity in GCC Real Assets

Authored by CK Adya

Independent Researcher, London Business School

May 2026

Abstract

Between the senior debt that a lender will provide and the equity that a sponsor can raise lies a gap, the space in the capital structure that is too risky for senior debt but too valuable to fund with expensive common equity. Mezzanine capital fills this gap, providing subordinated debt or hybrid capital that increases leverage and reduces the equity required without diluting common ownership. This paper examines the mezzanine gap in Gulf Cooperation Council (GCC) real assets, where it is frequently underserved, and the role of mezzanine capital in filling it. Using an indicative dataset calibrated to 2026 conditions, it sets out the position of mezzanine in the capital stack, the forms it takes, its effect on leverage and equity returns, and a framework for when a sponsor should use it. It examines the structuring of mezzanine, including the intercreditor relationship with senior lenders, the perspective of the mezzanine provider, and the risks the instrument carries. The analysis finds that mezzanine creates value for a sponsor whenever the return on the equity it releases exceeds its cost, that it is most valuable in the mid-sized transactions where the equity gap is material but common equity is dilutive, and that the GCC mezzanine market, though underdeveloped relative to the senior and equity markets, is growing as private credit deepens. Three indicative case studies, a sensitivity analysis, an international comparison and an implementation roadmap support the analysis, which is intended for sponsors weighing whether to fill their capital gap with mezzanine.

Keywords: Capital structure, GCC, intercreditor, leverage, mezzanine finance, real assets, subordinated debt

1. Introduction

Every leveraged real asset transaction has a gap. The senior lender will fund a portion of the cost, typically half to sixty percent, and no more, because beyond that its security thins and its risk rises. The sponsor can raise a portion as equity, but equity is expensive and dilutive. Between the senior debt and the equity lies a gap, a slice of the capital structure that the senior lender will not reach and that the sponsor would prefer not to fill with costly common equity. This is the mezzanine gap, and how a sponsor fills it materially affects its returns.

Mezzanine capital exists to fill this gap. Sitting between senior debt and equity in priority, it is subordinated to the senior lender but ranks ahead of equity, and it provides capital that increases the total leverage and reduces the common equity required, at a cost between that of senior debt and equity. For a sponsor, mezzanine is the instrument that bridges the gap between what the senior lender will provide and what the sponsor can raise as equity, and using it well is a genuine source of return.

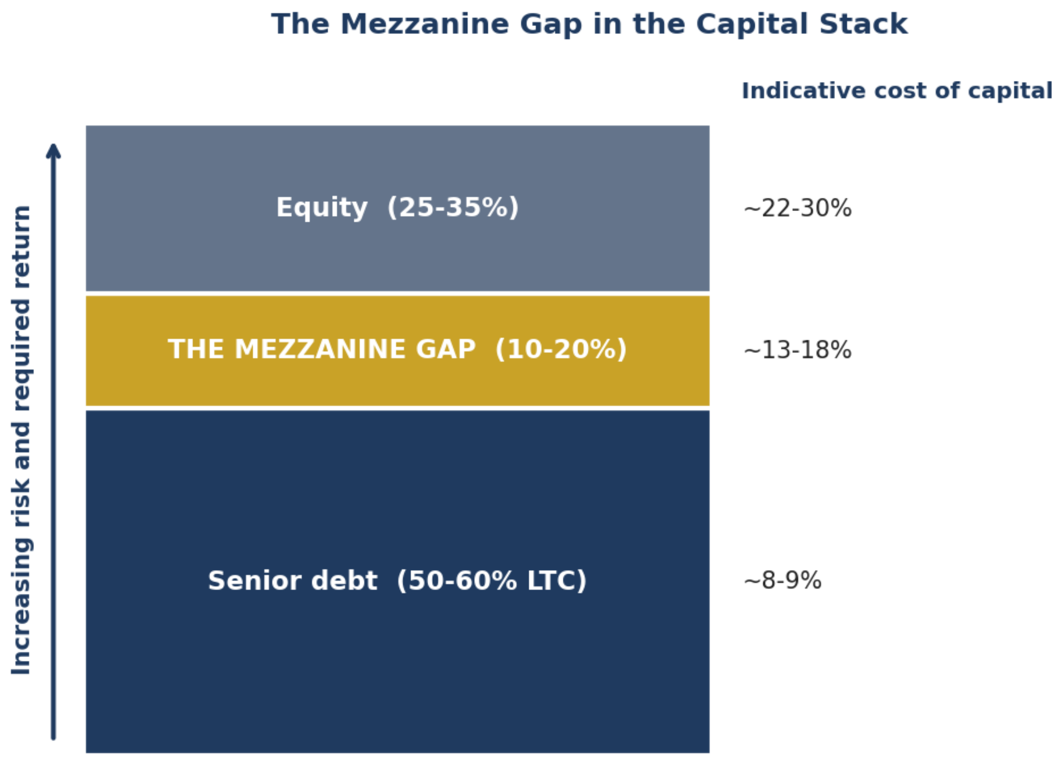
The central argument of this paper is that mezzanine creates value for a sponsor whenever the return on the equity it releases exceeds its cost, and that it is most valuable in the mid-sized transactions where the equity gap is material but common equity is too dilutive. A sponsor that understands when and how to use mezzanine can increase its leverage, reduce its equity, and improve its returns, while one that defaults to filling the gap with common equity leaves value on the table. The paper develops the framework for this decision and examines the GCC mezzanine market, which, though underdeveloped relative to the senior and equity markets, is growing as private credit deepens.

The figures used throughout are indicative, calibrated to observable GCC conditions in early 2026 but not drawn from any specific transaction. The paper proceeds from the position of mezzanine in the capital stack (Section 2), through its forms (Section 3), its effect on returns (Section 4), the decision framework (Section 5), structuring and the intercreditor relationship (Section 6), the mezzanine provider perspective (Section 7), risk (Section 8), the GCC market (Section 9), three case studies (Section 10), sensitivity analysis (Section 11), an international comparison (Section 12), common errors (Section 13), an implementation roadmap (Section 14), a strategic perspective (Section 15), a conclusion (Section 16) and limitations (Section 17).

2. The Mezzanine Gap in the Capital Stack

The mezzanine gap is best understood visually, and Figure 1 illustrates it. The senior debt funds the base of the capital structure, the equity funds the top, and between them lies the gap, the space that the senior lender will not reach and that the sponsor must fill somehow. Without mezzanine, the sponsor fills this gap with common equity, which is expensive and dilutive; with mezzanine, the sponsor fills part of it with subordinated capital that is cheaper than equity and that does not dilute common ownership.

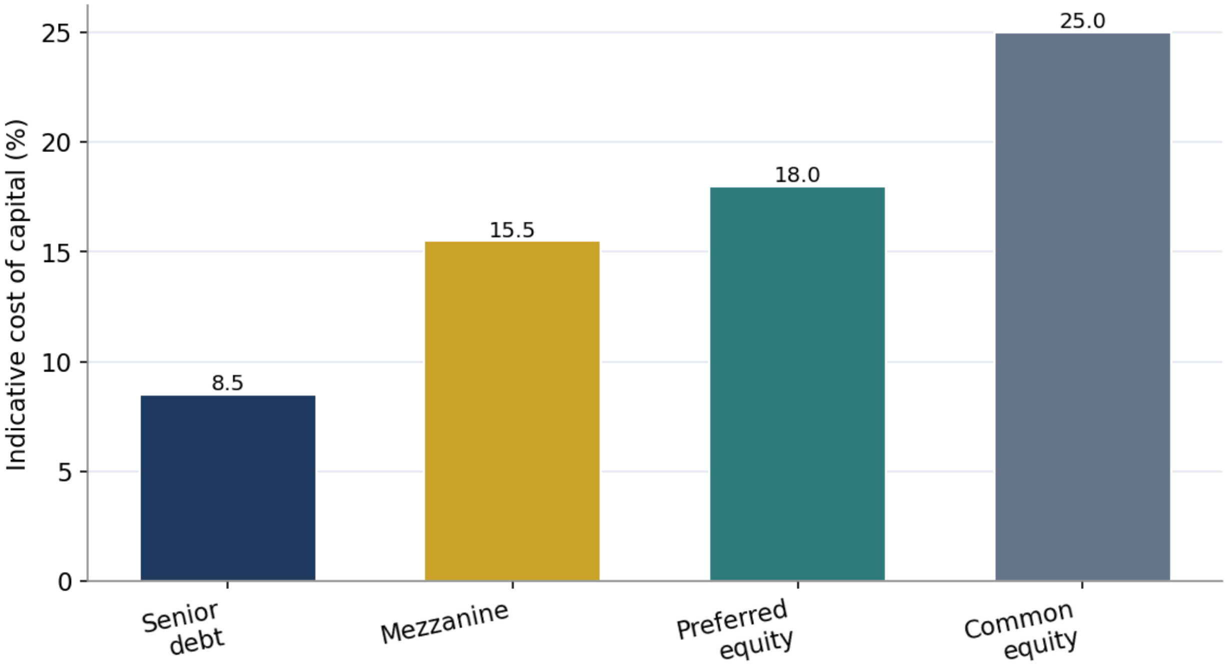
Figure 1. The Mezzanine Gap in the Capital Stack



The gap arises because of the different risk appetites of the capital providers. The senior lender, protected by its first-ranking security, accepts a low return and lends only up to the point where its security remains comfortable. The equity, bearing the first loss, demands a high return. The gap between them is a risk space that neither the conservative senior lender nor the return-hungry equity is ideally suited to fund, and mezzanine, with its intermediate risk and return, is the natural filler. The existence of the gap is structural, a feature of how the capital providers divide the risk, and it is present in every leveraged transaction.

The cost of capital across the stack, illustrated in Figure 2, shows why filling the gap with mezzanine rather than equity creates value. Mezzanine, at a cost between senior debt and equity, is cheaper than the common equity that would otherwise fill the gap, so substituting mezzanine for equity in the gap reduces the blended cost of capital and increases the return to the remaining equity. This substitution is the source of the value that mezzanine creates, and it is available to any sponsor willing to use the instrument.

Figure 2. Cost of Capital Across the Stack

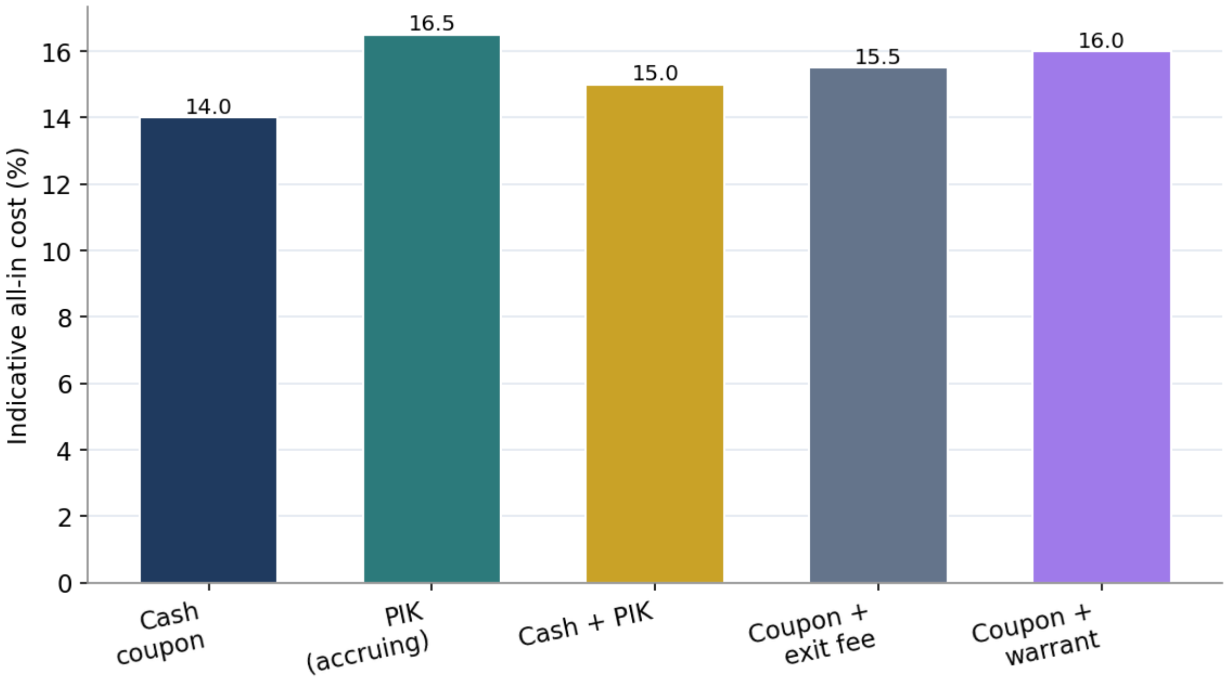


In the GCC, the mezzanine gap is frequently underserved, because the mezzanine market is less developed than the senior debt market, dominated by banks, and the equity market, served by family offices and institutions. A sponsor in the region often finds it easier to raise senior debt and equity than to raise mezzanine, which means the gap is frequently filled with equity by default, leaving value on the table. The growth of private credit, which increasingly provides mezzanine, is beginning to address this, but the GCC mezzanine market remains a developing one, and a sponsor that can access it has an advantage over one that fills the gap with equity for want of an alternative.

3. The Forms of Mezzanine

Mezzanine takes several forms, which differ in how the return is paid and in the features attached, and Figure 3 illustrates their indicative cost. The simplest form is a cash coupon, a periodic interest payment like senior debt but at a higher rate reflecting the subordination. A payment-in-kind, or PIK, structure accrues the return rather than paying it in cash, adding it to the principal, which suits a transaction that cannot service a cash coupon during construction or before stabilisation but which can repay the accrued amount on exit.

Figure 3. Forms of Mezzanine and Indicative Cost



Many mezzanine structures blend a cash coupon with a PIK element, paying part of the return in cash and accruing part, which balances the provider desire for current income against the borrower limited cash during the project. Some mezzanine carries an exit fee, a payment due on repayment that boosts the provider return, or a warrant or equity kicker that gives the provider a share of the upside, aligning it partly with the equity. These features allow the mezzanine return to be structured to suit the transaction cash flows and the parties preferences, and the choice among them is part of structuring the instrument.

Table 1 summarises the forms and their suitability. The choice depends on the transaction cash flow profile and the parties objectives: a transaction with cash flow during the project can service a cash coupon, while one without, such as a development before completion, suits a PIK or accruing structure that defers the payment to exit. The provider preference for current income versus a larger exit payment, and its appetite for equity upside through a warrant, also shape the choice. The flexibility of mezzanine in how its return is structured is one of its attractions, allowing it to fit transactions that a rigid instrument could not.

Table 1. Forms of Mezzanine

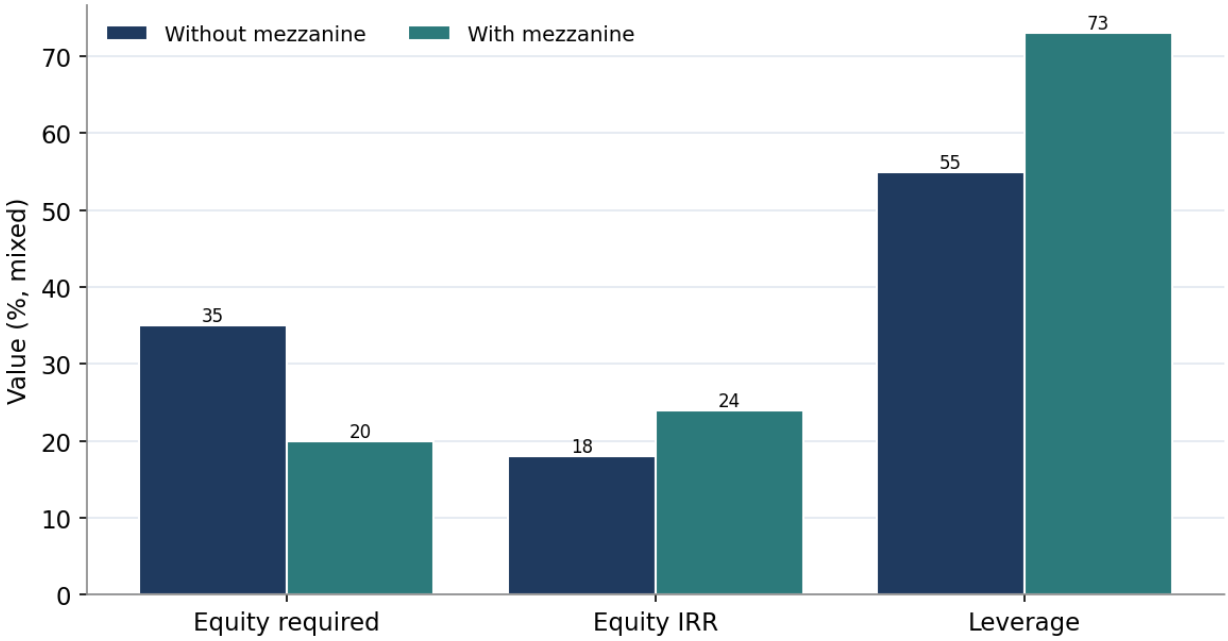
Form	Return paid	Suits	Note
Cash coupon	Periodically in cash	Cash-generating asset	Like dearer senior
PIK / accruing	Accrued to principal	Development, pre-stabilisation	Deferred to exit
Cash + PIK	Part cash, part accrued	Mixed cash profile	Balanced
Coupon + exit fee	Cash + payment on exit	Boost provider return	Common
Coupon + warrant	Cash + equity upside	Align with equity	Higher provider return

The form is chosen to fit the cash flow and the parties objectives. Not transaction-specific.

4. The Effect of Mezzanine on Returns

The value of mezzanine to a sponsor is in its effect on the equity return, illustrated in Figure 4. By filling part of the gap with mezzanine rather than equity, the sponsor reduces the equity it must invest, and because the project return is then spread over a smaller equity base, the equity return rises. The mezzanine, in effect, leverages the equity, amplifying its return, at the cost of the mezzanine coupon and the increased risk that leverage brings.

Figure 4. The Effect of Mezzanine on Equity Required, IRR and Leverage



Mezzanine reduces equity required and raises equity IRR and leverage. Not a forecast.

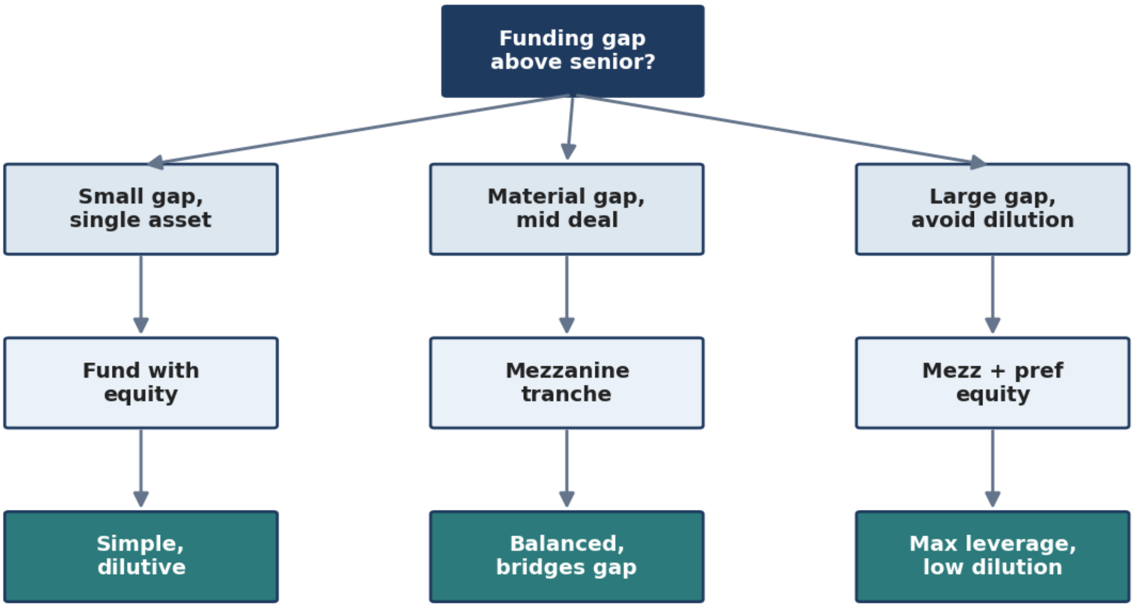
The condition for mezzanine to create value is simple: the return the sponsor earns on the equity that mezzanine releases must exceed the cost of the mezzanine. If the project earns more on the released equity than the mezzanine costs, the substitution is value-creating; if it earns less, the mezzanine destroys value. Because the project equity return typically exceeds the mezzanine cost in a healthy transaction, mezzanine usually creates value, but the margin narrows as the mezzanine cost rises or the project return falls, and in a marginal or stressed transaction mezzanine can destroy value.

The effect of mezzanine on returns is therefore a leverage effect, with the benefits and risks that leverage brings. Figure 7, presented later, shows that the equity IRR rises with leverage in a base case but falls sharply in a stressed case as the fixed mezzanine obligations overwhelm the diminished cash flow. Mezzanine, like all leverage, amplifies both the upside and the downside, and a sponsor using it must be comfortable that the transaction can service the mezzanine through a reasonable downside, not merely in the base case. The decision to use mezzanine is thus a decision about leverage and risk appetite as much as about cost.

5. The Decision Framework

The framework for deciding whether to use mezzanine matches the instrument to the size of the funding gap and the sponsor objectives, illustrated in Figure 5. A small gap on a single asset may be best filled with equity, because the cost and complexity of arranging mezzanine, including the intercreditor negotiation, may not be justified by the small quantum. A material gap on a mid-sized transaction is the natural home of mezzanine, where the gap is large enough to justify the instrument and common equity would be materially dilutive. A large gap where the sponsor wishes to maximise leverage and minimise dilution may justify both mezzanine and preferred equity.

Figure 5. Mezzanine Decision Framework by Funding Gap



Indicative framework. The size of the gap and the sponsor objectives determine the approach.

The mid-sized transaction is where mezzanine earns its place, as in the capital stack framework of a companion paper. At this size, the equity gap above senior debt is large enough that filling it entirely with common equity is both expensive and dilutive, but the transaction is large enough to justify the cost and complexity of a mezzanine tranche. The sponsor that fills the gap with mezzanine at this size reaches a higher leverage, limits its equity and its dilution, and improves its return, while accepting the intercreditor negotiation and the mezzanine cost. This is the core use case for the instrument.

The framework also depends on the availability of mezzanine, which in the GCC cannot be taken for granted. A sponsor that can access mezzanine, increasingly through private credit, has the option the framework describes; a sponsor that cannot must fill the gap with equity regardless of the framework. The growth of the GCC mezzanine market is therefore expanding the set of sponsors that can use the instrument, and a sponsor that builds relationships with mezzanine providers gains access to a tool that improves its returns and that less-connected sponsors cannot use. Access to mezzanine is itself a competitive advantage in the region.

6. Structuring and the Intercreditor Relationship

The defining structural feature of mezzanine is its subordination to the senior lender, and the relationship between the senior and mezzanine lenders is governed by an intercreditor agreement that is central to the structure. The intercreditor agreement defines the ranking of the claims, the circumstances in which the mezzanine lender may take enforcement action, the standstill the mezzanine accepts while the senior is being repaid, and the allocation of recoveries in a default. It is the document that makes the two layers of debt coexist, and negotiating it is frequently the critical-path item in arranging a mezzanine-inclusive structure.

The intercreditor negotiation reflects the tension between the senior and mezzanine lenders. The senior lender wants the mezzanine deeply subordinated, prevented from enforcing or interfering while the senior is at risk, and clearly behind the senior in recoveries. The mezzanine lender wants enough rights to protect its position, including the ability to cure a senior default, to receive its coupon while the senior is performing, and to have a voice in a restructuring. The agreement balances these, and the balance struck reflects the relative bargaining power of the two lenders and the norms of the market. A sponsor must allow time for this negotiation, because a structure that is sound on a spreadsheet can stall while the lenders negotiate their relative rights.

Beyond the intercreditor, the mezzanine structure includes its security, often a second-ranking charge or a share pledge rather than a first mortgage, its covenants, which are typically lighter than the senior covenants but still present, and its return structure, chosen from the forms discussed earlier to fit the transaction cash flow. The structuring must ensure that the mezzanine can be serviced or accrued through the project, that its security and rights are clear, and that its relationship with the senior is well-defined. A well-structured mezzanine coexists smoothly with the senior debt and the equity; a poorly structured one creates conflict that can impair the transaction.

7. The Mezzanine Provider Perspective

A mezzanine tranche is placed only if a provider finds it attractive, and understanding the provider perspective is essential to structuring and pricing it. The mezzanine provider underwrites a middle risk: it expects to be repaid in the base case and most moderate downsides, but it absorbs loss before the senior lender in a severe downside, and it is compensated with a return between senior debt and equity. It scrutinises the equity cushion beneath it, the headroom between the projected value and the combined senior and mezzanine claim, and the sponsor incentive and ability to complete, because these determine its risk.

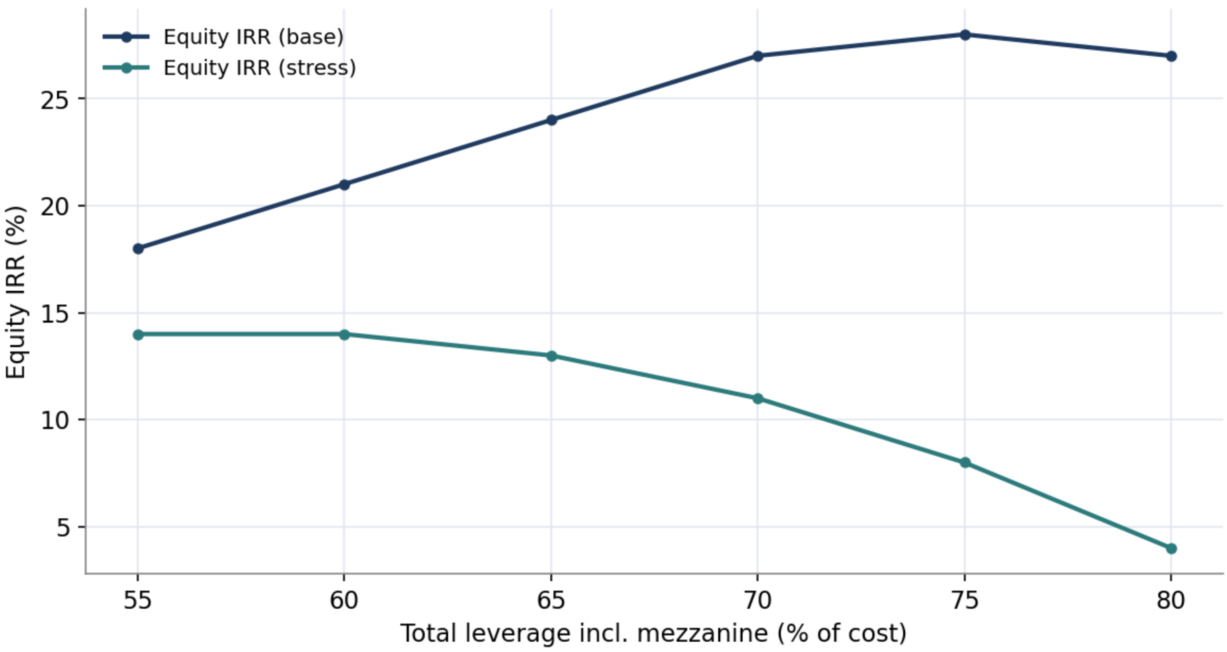
The mezzanine provider is, in the GCC, frequently a private credit fund, a family office, or a specialist mezzanine investor, and the growth of these providers is what is developing the regional mezzanine market. Each assesses the transaction risk and return, seeking a return that compensates for the subordination, and each requires the intercreditor protections and the security appropriate to its position. The provider appetite for the equity upside, through a warrant or kicker, varies, and a provider seeking upside may accept a lower coupon in exchange, while one seeking current income demands a higher coupon. Matching the structure to the provider preferences is part of placing the tranche.

Understanding the provider perspective tells the sponsor how to structure an attractive mezzanine tranche. It should demonstrate a solid equity cushion beneath the mezzanine, a credible project with a clear path to the return that repays the mezzanine, and a sponsor aligned through its own equity, and it should offer the intercreditor protections and the return structure the provider requires. A sponsor that presents these gives the provider a position it can underwrite, and places the mezzanine on good terms; a sponsor that presents a thin equity cushion or a weak project struggles to place the mezzanine or places it on punitive terms. The provider perspective disciplines the structure toward a sound transaction with an adequate equity cushion.

8. Risk Considerations

Mezzanine carries risks for the sponsor that flow from its nature as leverage and subordinated debt. The principal risk is that the additional leverage that mezzanine provides amplifies the downside as well as the upside, so that a transaction that uses mezzanine is more exposed to a downturn than one that does not. The fixed mezzanine obligations, whether cash or accruing, continue regardless of the project performance, and a project that underperforms may struggle to service or repay the mezzanine, which can precipitate a default that the equity cushion alone would have absorbed.

Figure 6. Equity IRR Against Leverage Including Mezzanine, Base and Stress



Mezzanine raises the IRR in the base case but the stress case falls sharply at high leverage. Not a forecast.

Figure 6 illustrates this risk. In the base case, the equity IRR rises with the leverage that mezzanine provides, up to a point; in the stress case, the IRR rises briefly and then falls sharply as the fixed mezzanine obligations overwhelm the diminished cash flow. The gap between the two curves at high leverage is the risk that mezzanine introduces, and it widens as the leverage rises. A sponsor must size its mezzanine against the stress case, not the base case, ensuring that the transaction can service the mezzanine through a reasonable downturn, because a mezzanine sized to the base case can turn a manageable downturn into a default.

A second risk is the intercreditor risk: in a default, the relationship between the senior and mezzanine lenders, governed by the intercreditor agreement, determines the outcome, and a poorly negotiated agreement can leave the sponsor or the mezzanine in a weak position. A third risk is the refinancing risk for accruing mezzanine, where the accrued amount must be repaid on exit or refinancing, and a delay in the exit allows the accrued amount to grow, increasing the burden. These risks are manageable through prudent sizing, careful structuring and a conservative view of the exit, but they are real, and a sponsor using mezzanine must understand and manage them.

9. The GCC Mezzanine Market

The GCC mezzanine market is less developed than the senior debt and equity markets, which is the underserved gap this paper identifies. Historically, a sponsor seeking to fill the gap above senior debt had few mezzanine providers to turn to, and frequently filled the gap with equity by default. This underdevelopment of the mezzanine market is a feature of the regional financing system, and it has meant that the value mezzanine could create has frequently been left uncaptured.

The growth of private credit, examined in a companion paper, is developing the mezzanine market, as private credit funds increasingly provide mezzanine alongside senior direct lending. This growth is expanding the set of sponsors that can access mezzanine and capturing the value that the underserved gap left uncaptured. A sponsor that builds relationships with the growing pool of mezzanine providers can increasingly use the instrument, and the development of the market is, on balance, improving the efficiency of regional capital structures by allowing the gap to be filled with appropriately priced mezzanine rather than expensive equity.

The compliant dimension is relevant here too. Mezzanine can be structured in Shariah-compliant form, and a portion of the regional capital and borrower demand is for compliant structures, so a provider able to offer compliant mezzanine accesses a wider market. The development of compliant mezzanine alongside conventional mezzanine is part of the broadening of the regional mezzanine market, and it serves the compliant sponsors and capital that conventional structures cannot. As the market develops, the availability of both conventional and compliant mezzanine is increasing, which benefits the sponsors that can use the instrument.

10. Indicative Case Studies

Three indicative cases show mezzanine in action. The figures are synthetic and constructed for analytical clarity, not drawn from any specific transaction.

10.1 Case A: real estate development mezzanine

Case A is a mid-sized real estate development where the sponsor fills the gap above senior debt with a mezzanine tranche structured as a cash coupon plus PIK, deferring part of the cost to exit when the units are sold. The mezzanine allows the sponsor to reach a higher leverage and limit its equity, improving its return, and the deferred PIK element suits the development cash flow, which generates little cash before the units are sold. The sponsor accepts the intercreditor negotiation and the mezzanine cost in exchange for the reduced equity and the improved return.

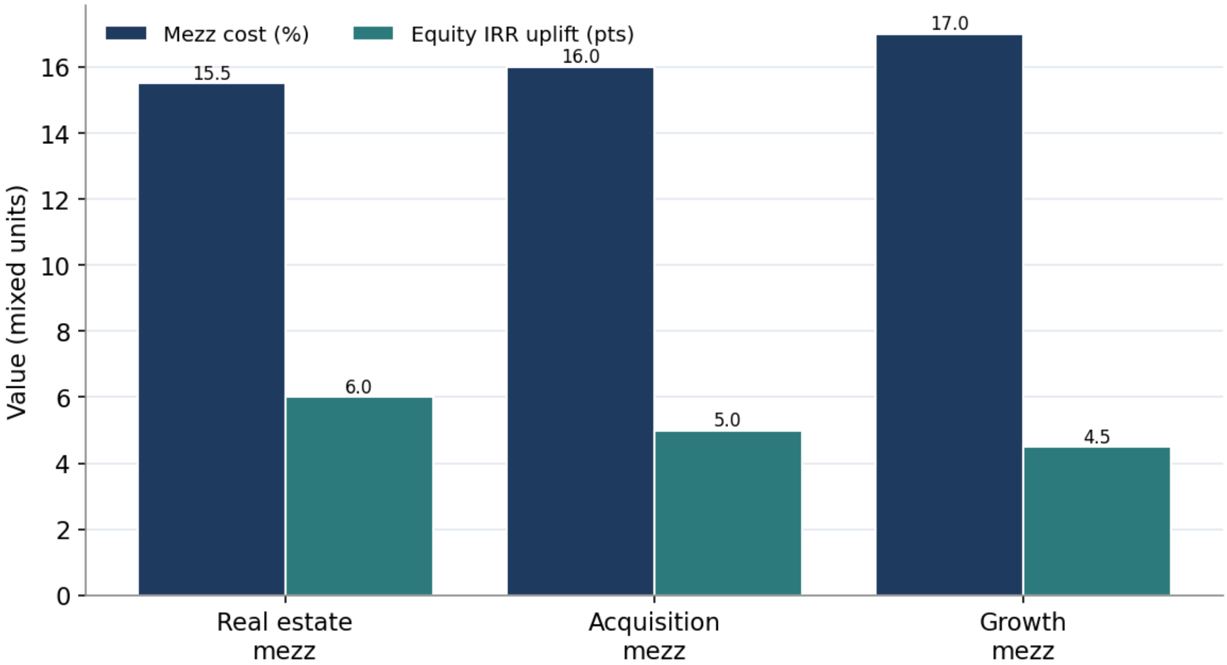
10.2 Case B: acquisition mezzanine

Case B is an acquisition where the sponsor uses mezzanine to bridge the gap between the senior acquisition debt and its equity, allowing it to complete the acquisition with less equity than an all-equity gap would require. The mezzanine, structured as a cash coupon plus an exit fee, leverages the acquisition and improves the sponsor return, and it allows the sponsor to pursue an acquisition that its equity alone could not have funded. The case illustrates mezzanine enabling a transaction by bridging the gap, not merely improving the return on one the sponsor could have funded anyway.

10.3 Case C: growth mezzanine

Case C is a growth company that uses mezzanine to fund its expansion without diluting its equity, structured as a cash coupon plus a warrant that gives the provider a share of the upside. The mezzanine funds the growth, the warrant aligns the provider with the company success, and the company avoids the dilution that an equity raise would have caused. The case illustrates mezzanine as a tool to fund growth while preserving ownership, with the warrant aligning the provider, which is a common structure for growth mezzanine.

Figure 7. Mezzanine Cost and Equity IRR Uplift by Case



Synthetic figures for analytical comparison. Not a forecast.

Figure 7 compares the three cases on the mezzanine cost and the equity IRR uplift it provides. In each case, the mezzanine costs more than senior debt but less than equity, and it provides an uplift to the equity IRR by reducing the equity required and leveraging the return. The cases illustrate the range of uses, development, acquisition and growth, and the consistent value mezzanine provides when the project return exceeds its cost, while reminding that the uplift comes with the increased leverage and risk that the instrument introduces.

11. Sensitivity and Scenario Analysis

A tornado analysis identifies the variables that most influence the equity IRR in a mezzanine-inclusive structure. Figure 8 presents the result.

Figure 8. Sensitivity of Equity IRR to Key Variables

Each bar shows the equity IRR when the labelled variable moves to its low or high case. Dashed line is the base case. Indicative.

The analysis shows that the project margin dominates the equity IRR, with the mezzanine cost, the senior leverage and the mezzanine quantum also significant. The prominence of the project margin reflects the leverage effect: because the equity is leveraged by the mezzanine, the equity return is highly geared to the project performance, so a strong margin produces a high equity return and a weak margin a low one. The mezzanine cost matters because it is the cost of the leverage, and the mezzanine quantum matters because it determines how much leverage is applied. The sensitivity confirms that mezzanine amplifies the project performance into the equity return, for better and worse.

Table 2. Scenario Matrix for Equity IRR

Scenario	Project margin	Exit timing	Equity IRR
Upside	Strong	Early	30%
Base	Moderate	On plan	22%
Mild stress	Weak	Late	14%
Severe stress	Poor	Very late	5%

Indicative scenarios with mezzanine in the structure. Not a forecast.

The scenario matrix shows the amplification clearly. In the upside, the mezzanine leverage lifts the equity IRR well above what an unleveraged structure would produce; in the severe stress, the fixed mezzanine obligations compress the equity IRR far below it, as the accruing cost grows with the delayed exit and the weak margin leaves little for the equity. The matrix underlines the central risk message: mezzanine amplifies the outcome, and a sponsor using it must be comfortable with the downside it introduces, sizing the mezzanine so that the severe-stress scenario remains survivable rather than catastrophic.

12. International Comparison

Mezzanine is a mature, well-established instrument in the United States and Europe, where a deep market of mezzanine and subordinated-debt providers serves the gap above senior debt across real estate and corporate transactions. The structures, the intercreditor norms and the pricing are well developed, and mezzanine is a routine part of the capital structure for mid-sized leveraged transactions. The GCC market is following this trajectory, with a lag, as private credit develops the regional mezzanine market toward the depth of the mature markets.

The international experience offers lessons for the developing GCC market. It shows that mezzanine is a durable, valuable instrument that fills a genuine structural gap, that its intercreditor norms can be standardised to reduce the negotiation burden, and that a deep mezzanine market improves the efficiency of capital structures by allowing the gap to be filled appropriately. As the GCC market develops and standardises, the cost and complexity of arranging mezzanine should fall, making the instrument more accessible and capturing more of the value that the underserved gap has left uncaptured. The regional market can draw on the mature-market structures and norms while adapting them to the regional context and the compliant dimension.

13. Common Errors and How to Avoid Them

A recognisable set of errors recurs in the use of mezzanine.

- **Defaulting to equity.** Filling the gap with equity by default, for want of a mezzanine provider, leaves value uncaptured. The remedy is to build relationships with mezzanine providers and use the instrument where it creates value.
- **Over-sizing the leverage.** Sizing the mezzanine to the base case rather than the stress case can turn a manageable downturn into a default. The remedy is to size mezzanine against a reasonable downside.
- **Underestimating intercreditor time.** Underestimating the intercreditor negotiation can stall a structure that is sound on a spreadsheet. The remedy is to begin the intercreditor negotiation early.
- **Ignoring accrual risk.** Using accruing mezzanine without a conservative view of the exit allows the accrued cost to grow if the exit is delayed. The remedy is to underwrite the exit conservatively.

Each of these errors is avoidable through the disciplined approach the framework encourages: access mezzanine and use it where it creates value, size it against the downside, allow time for the intercreditor, and underwrite the exit conservatively. The sponsor that does so captures the value mezzanine offers while managing its risks, while the one that does not either leaves value uncaptured or takes on risk it cannot manage.

14. Implementation Roadmap

1. Determine the size of the funding gap above senior debt and assess whether it is large enough, and the transaction big enough, to justify mezzanine over equity.
2. Confirm that the project return on the equity that mezzanine would release exceeds the mezzanine cost, the condition for mezzanine to create value.
3. Choose the form of mezzanine, cash, PIK, exit fee, warrant, to fit the transaction cash flow and the parties objectives.

4. Size the mezzanine against a reasonable downside, ensuring the transaction can service it through a stress scenario.
5. Begin the intercreditor negotiation early, allowing time for the senior and mezzanine lenders to agree their relative rights.
6. Demonstrate a solid equity cushion and a credible project to the mezzanine provider, to place the tranche on good terms.
7. Underwrite the exit conservatively, particularly for accruing mezzanine where a delayed exit grows the accrued cost.

15. Strategic Perspective: Access as Advantage

In the underdeveloped GCC mezzanine market, access to mezzanine is itself a strategic advantage, because a sponsor that can fill the gap with mezzanine rather than equity earns higher returns and can pursue transactions that an equity-only sponsor cannot. A sponsor that builds relationships with the growing pool of mezzanine providers, and that understands how to structure and use the instrument, can capture this advantage, while a sponsor that fills the gap with equity for want of access leaves the advantage to others. As the market develops, the advantage will diminish as access broadens, but for now, in a developing market, it is real and worth pursuing.

The strategic value of mezzanine access compounds over a programme of transactions. A sponsor that uses mezzanine across its transactions earns higher returns on each, pursues more transactions with the same equity, and builds a track record with mezzanine providers that improves its access and terms over time. This compounding makes the investment in mezzanine relationships and capability worthwhile, and it distinguishes the sophisticated sponsor that manages its full capital structure from the one that relies on senior debt and equity alone. The sponsor that masters the mezzanine gap captures a source of return that the regional market has frequently left on the table.

The broader strategic point is that the capital structure is a source of return in its own right, as a companion paper on the capital stack argues, and mezzanine is one of the principal instruments for optimising it. A sponsor that thinks of the capital structure as something to be optimised, filling each layer with the most appropriate and cheapest capital, rather than as a default of senior debt and equity, extracts more value from the same underlying asset. Mezzanine, by filling the gap that would otherwise be filled with expensive equity, is a key tool for this optimisation, and mastering it is part of the broader discipline of treating the capital structure as a lever of value.

16. Conclusion

The mezzanine gap, the space in the capital structure between the senior debt a lender will provide and the equity a sponsor can raise, is a structural feature of every leveraged transaction, and how a sponsor fills it materially affects its returns. This paper has argued that mezzanine, by filling the gap with capital cheaper than equity and without diluting common ownership, creates value whenever the return on the equity it releases exceeds its cost, and that it is most valuable in the mid-sized transactions where the gap is material but common equity is dilutive.

In the GCC, the mezzanine gap is frequently underserved, and sponsors have often filled it with equity by default, leaving value uncaptured, but the growth of private credit is developing the market and expanding access. A sponsor that can access mezzanine, that understands when and how to use it, and that sizes and structures it prudently, can increase its leverage, reduce its equity, and improve its returns, while managing the risks that the instrument introduces. In a developing market, access to mezzanine is itself an advantage, and mastering the mezzanine gap is part of the broader discipline of treating the capital structure as a source of return. The frameworks in this paper are intended to help sponsors capture the value the gap offers.

17. Limitations and Directions for Further Research

This paper is framework-oriented and relies on indicative data, and its conclusions are directional rather than precise. The costs, returns and leverage figures are calibrated to observable conditions but are not empirical estimates, and they vary with the transaction and the market. The GCC mezzanine market is developing, and its depth and pricing are evolving.

Several extensions would strengthen the analysis. An empirical study of mezzanine pricing and availability in the GCC would replace the indicative figures with data. An analysis of intercreditor norms in the regional market would sharpen the structuring discussion. And a study of how mezzanine-inclusive structures perform through a downturn, when the leverage risk is tested, would illuminate the risk that the framework emphasises. Each is a natural subject for a later paper in this series.

Appendix A. Base Case Assumptions

Table 3. Base Case Assumptions

Parameter	Value	Parameter	Value
Senior cost	~8.5%	Mezzanine cost	~15.5%
Preferred equity	~18%	Common equity	~25%
Senior LTC	50-60%	Mezzanine LTC	10-20%
Mezzanine forms	Cash, PIK, exit fee, warrant	Total leverage	70-80%
Intercreditor	Critical-path item	Currency	AED (USD peg)
Market	Developing	Compliant option	Available

Indicative parameters used to generate the figures and case studies. Not transaction-specific.

Appendix B. Glossary of Terms

Table 4. Glossary of Key Terms

Term	Definition
Mezzanine	Subordinated debt or hybrid capital between senior and equity.
Mezzanine gap	The space in the stack between senior debt and equity.
PIK	Payment-in-kind, where the return accrues to principal.
Exit fee	A payment due to the provider on repayment.

Warrant / kicker	An equity upside given to the mezzanine provider.
Intercreditor agreement	The contract governing senior and mezzanine ranking.
Subordination	The ranking of mezzanine behind senior debt.
Standstill	A period in which mezzanine may not enforce.
Loan-to-cost	A facility as a percentage of total project cost.
Equity cushion	The equity beneath the mezzanine that absorbs first loss.

Definitions provided for reference.

References

[1] Brealey R., Myers S., Allen F., Principles of Corporate Finance, 13th Edition, McGraw-Hill Education, 2020.

[2] Geltner D., Miller N., Clayton J., Eichholtz P., Commercial Real Estate Analysis and Investments, 3rd Edition, OnCourse Learning, 2014.

[3] Brueggeman W., Fisher J., Real Estate Finance and Investments, 16th Edition, McGraw-Hill Education, 2018.

[4] Preqin, Private Debt and Mezzanine Finance, Market Overview, 2024.

[5] Damodaran A., The Cost of Capital, Stern School of Business, New York University, 2016.

[6] Accounting and Auditing Organization for Islamic Financial Institutions, Shariah Standards, AAOIFI, 2017.

[7] Bank for International Settlements, Leveraged Finance and Financial Stability, BIS Papers, 2020.

[8] Rosenbaum J., Pearl J., Investment Banking, 3rd Edition, Wiley, 2020.

[9] Moody Analytics, Mezzanine and Subordinated Debt Overview, 2024.

[10] Public materials on private credit and mezzanine frameworks, relevant GCC authorities, accessed 2026.

About the Author

Chennakeshav Adya is an independent researcher and corporate finance practitioner with more than twenty years of international experience across business strategy, transformation, and strategic finance. He has originated and led transactions across real estate, technology, and clean energy in the UAE, the United Kingdom, India, Europe, and the Americas, and has advised developers, corporates, family offices, and fund managers on capital raising and structuring. He is a guest speaker at London Business School and writes on startups, capital markets, and the application of technology in finance. The views expressed in this paper are his own and do not constitute investment advice.