Real Estate Economics / Volume 49, Issue S2 / pp. 526-556

Original Article

A Backup Quarterback View of Mezzanine Finance

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First published: 03 September 2019 https://doi.org/10.1111/1540-6229.12299

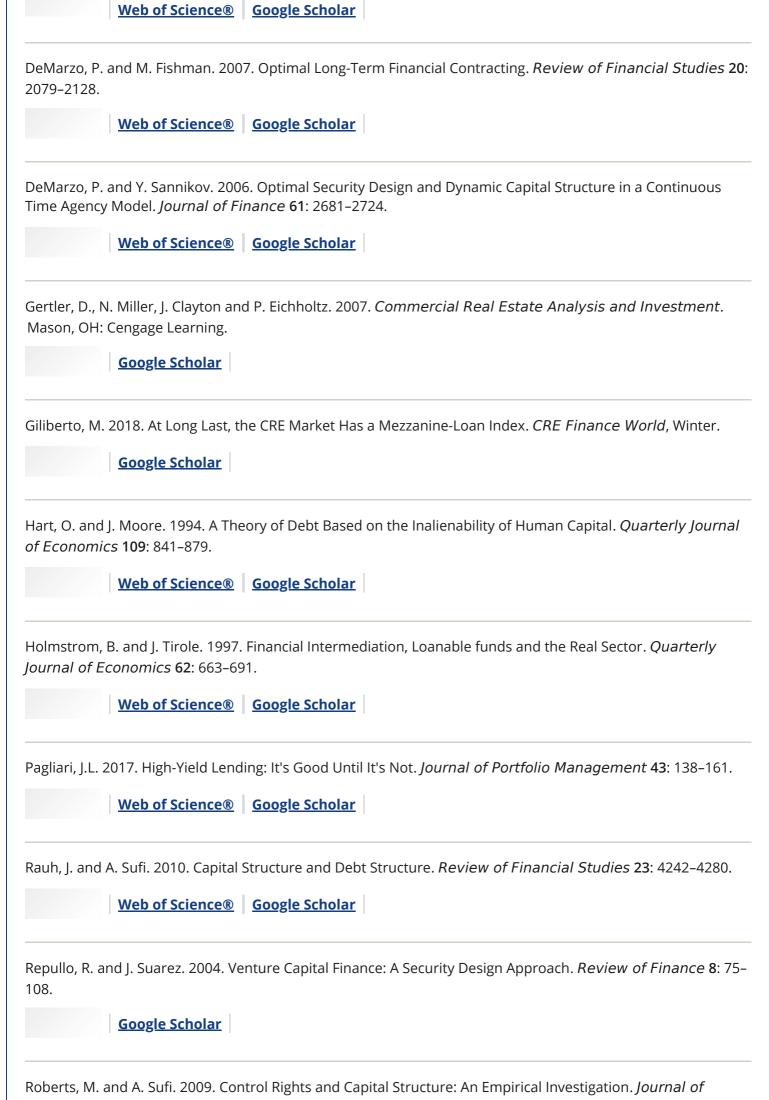
Abstract

A significant number of real estate transactions involve the use of mezzanine finance. One obvious purpose of mezzanine debt is to plug financing gaps left by other forms of financing. In this article, we formalize a complementary role of mezzanine finance in a simple model with moral hazard on the part of operators. According to our theory, mezzanine financiers serve as substitute operating agents—backup quarterbacks of sorts—ready to replace the original operator when the project underperforms. The presence of skilled mezzanine investors in the capital structure makes it cheaper to provide incentives to incumbent operators.

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