The Fed - Debt Overhang and the Retail Apocalypse

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Debt overhang is central for theories of capital structure, yet credible empirical estimates of its effects remain elusive. We study the consequences and mechanisms of debt overhang using exogenous changes in the leverage of commercial retail properties. Identification comes from changes in property values occurring after pre-determined debt rollover dates. We show that debt reduces profitability by impairing property owners' response to negative shocks, reducing the business activity of their remaining retail tenants. For the median property, a 10 percentage point leverage increase causes 22% lower employment, mostly in large retail stores, and overall 15% lower operating income.