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Affordable Housing Resource Center

Lend Lease Real Estate Investments' report, America's Prosperity: A Chicken in Every Pot

Page 1 | Page 2 | Page 3 | Page 4 | Page 5 | Page 6 | Page 7 | Page 8
Page 9 | Page 10 | Page 11 | Page 12 | Page 13 | Page 14 | Page 15

Page 1

Lend Lease REAL ESTATE INVESTMENTS

SUMMER 2000

Commentary

By M. Leanne Lachman and Deborah L. Brett

America's Prosperity: A Chicken in Every Pot

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Visible evidence of America's affluence confronts us everyday: in advertising for vacation travel and cell phones, in discussions about Roth IRAs and 401(k)s, in articles about dysfunctionally low unemployment, and in children's expectations of continuous costly entertainment. Top executives, entrepreneurs, well-educated professionals, and lottery winners aren't the only beneficiaries of the largesse. Middle-class and moderate-income Americans are sharing in the fruits of prosperity. Admittedly, many workers haven't seen big wage increases. But in a tight labor market, employees enjoy greater job security, and more options are available when they decide to switch jobs. Most households – and individuals – have materially benefited from the recent economic surge. And the new information age offers a sense of limitless potential.

Needless to say, people at the bottom of the economic spectrum have not experienced the same growth in income and assets as those at the top. Nearly one in four American households still earns less than $20,000. Workers with little education and/or limited English fluency can certainly find work when the unemployment rate hovers around 4%, but their jobs don't pay much. Furthermore, low-wage earners are disproportionately affected by health problems, family troubles, and mobility restrictions.

The country's economic prosperity has been a mixed blessing for these people – especially those who are renters. (Nearly two-thirds of all renters have low or very low incomes.) As shelter costs rise and the stock of subsidized units shrinks, rental housing affordability worsens. Demand for low-cost rental units is steadily growing; but the supply is contracting. As discussed toward the end of this paper, expansion of the Low-Income Housing Tax Credit program would be one way to fill the void.

spectrum have not experienced the same growth in in-

Did you miss Lend Lease's Autumn 1999 **Commentary**, titled **Evolving America: Real Estate's Demand Profile**? It focuses on demographic changes in the early part of this new century. To request a copy, e-mail *commentary@lendleaserei.com* or call 212.554.1600.

Top

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Dimensions of Our Affluence

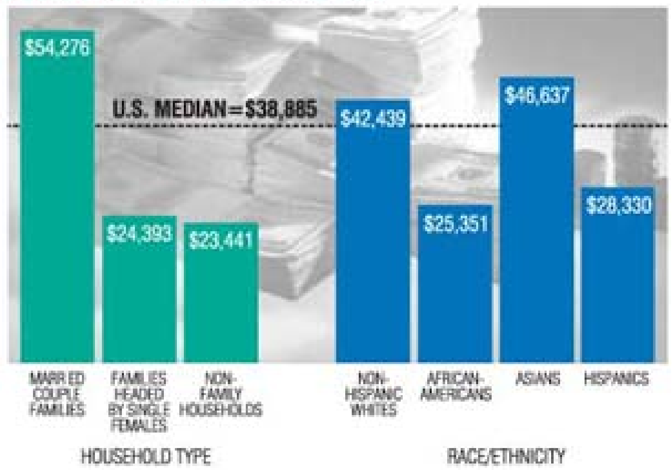
- Americans have experienced real growth in both income and purchasing power since 1994.
- Off-the-books earnings add a minimum of 10% to average household income. In many locations, closer to 20% of purchasing power is attributable to the underground economy.
- Census income statistics don't include non-cash subsidies and in-kind assistance (housing subsidies, school lunches, Medicaid) that improve living standards for the poor.
- Stricter welfare eligibility rules, combined with the current labor shortage, are bringing many marginally-skilled people into the work force. Welfare caseloads are at record lows; this will not be sustainable when the inevitable slowdown occurs.
- The economic boom has enlarged and broadened the ranks of the rich. Dot-com millionaires are the darlings of feature writers.
- Our wealthiest households are capturing an increasing share of total income and assets.
- Although the typical American family certainly isn't rich, its members are living comfortably. One in 10 households earns over $100,000 per year; 20% make over $75,000.
- Incomes are fluid over each American's life span, increasing as people gain education and experience, move to new jobs, or alter their lifestyles, and then declining in their retirement years. The general trend is toward greater affluence.
- Mature adults – age 45 to 54 – are at their peak earning potential. The Babyboom cohort is now reaching this stage, and its large numbers will heighten America's sense of economic well-being.
- More households are involved with the stock market than ever before – either as direct investors in corporate equities and mutual funds or through retirement plans.
- Not only are incomes and net worths on the rise, but future wealth transfers to Babyboomers and Generation Xers could total $7-10 trillion or more by 2017.

Top

Real Income Growth

Households of all sizes, types, ages, and races are enjoying increased purchasing power. Just between 1997 and 1998, median income rose 3.5%. Although 1998 was the fourth consecutive year with real income gains, it was the first year that household income surpassed 1989's pre-recession peak.[1] There is every reason to believe that the 1999 numbers were even more cheery. Single parents, women employed full time, and Hispanics all registered above-average gains – though they have a long way to go before catching up with stereotypical households. Young people also did well, benefiting enormously from technology's growth. Empty nesters cashed in capital gains from equity investments, and seniors were protected from asset erosion by Social Security indexing and low inflation.

Figure 1
MEDIAN HOUSEHOLD INCOME: 1998



Source: Census Bureau, Current Population Survey

A Half-Empty Pot?

- Single female parents earn less than half the median income of married couple families.
- Median household income for African-Americans and Hispanics still falls well below that of white non-Hispanics.
- The housing stock affordable to financially struggling families is shrinking, as rents rise faster than inflation, subsidized projects "opt out" of the Section 8 program, and public housing units are demolished.
- The Low-Income Housing Tax Credit (LIHTC) program is the primary federal funding source for affordable new units. Yet the annual LIHTC allocation formula has not been increased since the program began in 1986.
- Many states administering LIHTC allocations favor projects serving the poorest households, shutting out low- and moderate-income working families.
- Moderate-income senior citizens cannot find affordable rentals with the supportive services they need to remain independent.
- The need for low-cost rental housing will increase over the next decade as the Babyboom Echo reaches adulthood.

[1] After registering real dollar declines between 1989 and 1993, median household income grew by 9.6% from 1994 to 1998.

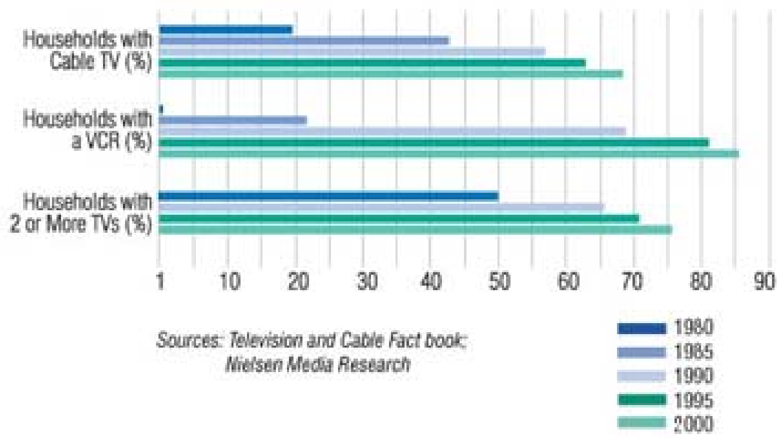
Top

Page 4

Why We Feel Prosperous

We Americans are generally comfortable about our financial circumstances. Over 70% of respondents in a January 2000 Gallup Poll rated economic conditions as "excellent" or "good," an enormous increase over January 1992, when only 12% were so positive. The media are filled with stories about how well we're doing (or how lucky we are). Consumer confidence is strong, and families are willing to spend on large houses, road warrior SUVs, home theater systems, and newly remodeled kitchens and baths. We readily buy items once considered luxuries, and splurging on Christmas gifts or getaway weekends seems perfectly acceptable.

Figure 2
A NATION OF COUCH POTATOES



Sources: Television and Cable Fact book; Nielsen Media Research

These visible signs of prosperity aren't limited to the rich. The average American family enjoys at least the outward trappings of prosperity: vacations, upscale clothing brands, home computers, dishwashers, air conditioning, and cable TV. Some households shelter more vehicles than people!

Over the last five years, home ownership rates climbed as families took advantage of reasonable interest rates and attractive financing terms. Furthermore, homes keep getting both bigger and grander, as seen in Figure 3.

Today's renters also occupy newer and more spacious apartments. Between 1990 and 1997, the median new multifamily unit increased by nearly 100 square feet. Over two-thirds of apartments are now built with two or more bedrooms. Fewer older units are overcrowded or dilapidated than a decade ago – in part because the average household is smaller but also because much of the nation's worst housing has either been renovated, abandoned, or demolished.

The continued existence of poverty troubles us more than disproportionate wealth.

Top

Page 5

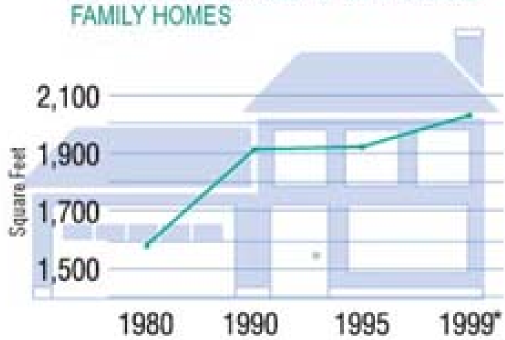
Winners and Losers

Although all categories of households have benefited from the economic boom, some have certainly done better than others. The rich have gotten richer. (So what else is new?) Larger numbers of households are in the top income brackets, but not because the poor are getting poorer. People move up the income/wealth ladder as they get older, acquire work skills and experience, save and invest. Earnings are greatest for households between ages 45 and 54. What appears to be a growing gap between rich and poor is partially a result of the huge number of Babyboomers now in the their prime earning years. Their incomes will taper off as they age.

Contrary to widely held perceptions, low- and moderate-income households have participated in the boom and have seen real growth in earning power. The proportion of households earning less than $25,000 (in constant dollars) is the same today as it was 10 years ago, and lower than during the recession years of the early 1990s. These households did not fall further behind.

The average family is smaller today than twenty years ago, but the typical new single-family home is 25% larger.

Figure 3
MEDIAN FLOOR AREA OF NEW SINGLE FAMILY HOMES



CHANGING CHARACTERISTICS OF NEW HOMES: 1980-99

	Percent with 4 Or More Bedrooms	Percent with 2 Or More Baths	Percent with Central Air Conditioning
1980	20%	73%	63%
1990	29%	87%	76%
1995	30%	89%	80%
1999*	34%	93%	84%

**Preliminary*

Source: Census Bureau

Top

Page 6

Figure 4
HOUSEHOLD INCOME DISTRIBUTION DURING THE '90s BOOM
Percent of Total Households by Income Bracket, 1995-1998

Note: The Census Bureau's Current Population Survey does not break down household incomes over $100,000

Source: Census Bureau; Lend Lease Real Estate Investments

Income levels are higher – and growth even stronger – than Census Bureau figures suggest. A lot of American families are earning more than they report.

The Have-Nots

Those who haven't fully enjoyed the fruits of prosperity share certain demographic characteristics. Left behind are:

- Recent immigrants and others with limited English fluency
- Single parents
- Adults who didn't graduate or failed to continue their education past high school
- Low-wage workers unable to save and invest
- Locationally-disadvantaged workers who can't get to where the jobs are
- Those who borrow too much and are saddled with interest payments
- People who would like to work steadily but are hampered by illness, permanent disability, or family instability
- Renters who are not accumulating equity in a home

More Income Than Meets the Eye

There is strong evidence that income levels are higher – and growth even stronger – than Census Bureau figures suggest. The Census measures money income; it doesn't count the value of food stamps, Medicaid, housing subsidies, school lunches, or other transfers that boost the purchasing power of many poor families. Similarly, income data do not include employer-provided health insurance and Medicare coverage. Also, Census statistics are pre-tax; they don't consider either the equalizing effects of a progressive tax system or the additional resources available to moderate-income working families from the earned income tax credit.

Equally important in a tight labor market, skilled tradespeople can easily moonlight, professionals can do consulting, and low-wage workers readily find second jobs. Oftentimes, such work is not part of the formal economy and isn't counted when people report their income to the IRS or to the Census. The underground economy benefits the affluent as well as the poor, but low- and moderate-income households (including welfare recipients) are especially active participants. The Bureau of Labor Statistics' 1998 Consumer Expenditure Survey indicated that, on average, households with incomes below $30,000 spent more than they earned. How do you explain that? Many retired people are drawing down their savings to pay expenses, and some younger households are undoubtedly using debt to finance a lifestyle they can't afford, but a lot of American families are simply earning more than they report.

Larger numbers of households are in the top income brackets, but not because the poor are getting poorer. What appears to be a growing gap between rich and poor is partially a result of the huge number of Babyboomers now in their prime earning years.

Figure 5
WHO WANTS TO BE A MILLIONAIRE?
Number of Tax Returns Filed with Adjusted Gross Income Of One Million Dollars or More[2]

Source: Internal Revenue Service

[2] *Tax return data are not directly comparable with Census household income estimates.*

Top

Page8

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Perceiving Prosperity

Most Americans believe they are participating in prosperity. And the growing wealth of other people doesn't bother them. The Gallup Organization's 1998 Social Audit yielded the following opinions:

- 27% of Americans consider themselves to be either "lower income" or "poor," a decrease from 30% in 1990. In contrast, 12% described themselves as "rich" or "upper income," compared with 7% in 1990.
- About one in four American adults identify themselves as "have nots."[3] Those who define themselves this way tend to be low income, less educated, single, renters rather than owners, African-American or Hispanic, and they have little in the way of personal wealth.
- More Americans thought that the poor population was *decreasing* (and the rich population *increasing*) in 1998 than 10 years earlier.
- Americans do not perceive a widening gap between haves and have-nots.
- The continued existence of poverty troubles us more than disproportionate wealth.
- Most Americans believe that our economic system is basically fair, offering plenty of opportunity to succeed for those willing to work hard.[4]

Perhaps Americans recognize that, despite the existence of poverty, our standard of living is higher than that of other mature economies in Western Europe and the Far East, as shown in Figure 6.

"I heard he came into money and moved to a portabella."

Figure 6
PER CAPITA GROSS DOMESTIC PRODUCT (GDP)
U.S. and Other Nations, 1997

United States	$29,326
Norway	$26,771
Switzerland	$25,902
Japan	$24,574
Germany	$22,049
Australia	$21,949
France	$21,293
European Union	$20,546
United Kingdom	$20,483
Korea	$14,477

Note: Calculated on a "purchasing power parity" basis.

Source: Organization for Economic Cooperation and Development

[3] *This includes people who worry about household finances most of the time, don't have enough money for basic necessities at some time during the year, perceive their situation as worse than that of their parents, and label themselves as "poor" or "lower income."*
[4] *The poll was conducted in the spring of 1998 and covered 5,001 adult respondents. Results were reported by the Gallup News Service.*

Building Assets for the Long Term

Middle-income families – not just the rich – have experienced net worth increases during this economic cycle. More households are active stock market participants, either directly (as owners of corporate securities and mutual funds) or indirectly (through individual retirement accounts and pension funds). As a result, families in the $50,000 to $75,000 income bracket are no longer exclusively dependent on home value appreciation to build wealth. Investment opportunities once restricted to executives in corporate America's top echelons are now available to middle managers, teachers, and construction workers.

Yet wealth is still heavily concentrated in the holdings of our most affluent families, who are enjoying above-average growth in both income and assets. Stories of "stock market millionaires" and young high-tech retirees abound. Substantial investment gains, both realized and anticipated (capital gains, stock options), are just part of the story. Skyrocketing executive compensation also plays a role.

Families at the lowest end of the income spectrum are unable to save and build wealth. According to the Federal Reserve Board's Survey of Consumer Finances, median net worth[5] declined for the lowest income groups between 1995 and 1998. Although more low-income households are participating in the stock market in some way, their investments are growing less rapidly than those of middle- and upper-income families.

Housing equity continues to be the most important asset for low- and moderate-income homeowners. Real estate values rose between 1995 and 1998, but stock market gains were more dramatic. Families that didn't own stock were unable to fully participate in the economic boom.

Although owning stocks and real estate is important, education is the demographic factor that correlates most highly with earning power and wealth. The median net worth of households with one or more college degrees went way up between 1995 and 1998. For those without a high school diploma, family wealth dropped 13% in just three years — and 32% (in real dollars) in the nine years between 1989 and 1998.

Figure 7
MEDIAN AND MEAN NET WORTH BY INCOME LEVEL, 1998

Family Income Range[6]	Median Net Worth (000s)	Mean Net Worth (000s)
Under $10,000	$ 3.6	$ 40.0
$10,000-$24,999	$ 24.8	$ 85.6
$25,000-$49,999	$ 60.3	$ 135.4
$50,000-$99,999	$152.0	$ 275.5
$100,000 and up	$510.8	$1,727.8
All Families	$ 71.6	$ 282.5

Source: Federal Reserve Board

[5] *Value of assets minus liabilities.*
[6] *The Federal Reserve uses the term "families" in much the same way that the Census Bureau uses "households."*

Top

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Debt Levels Rise

Household indebtedness is on the rise, both in absolute dollar terms and as a share of income. In 1998, a typical household's outstanding loans totaled over $33,000, an increase of 42% over three years earlier. In and of itself, this isn't necessarily cause for alarm. Houses cost more, so mortgages are larger.[7] Also, until recently, low mortgage interest rates encouraged homebuyers to borrow more and enticed owners to take out home equity loans. The same was true for auto loans, where attractive financing terms caused consumers to say "why not?"

Roughly three-fourths of households have some type of indebtedness, a share that has not changed of late. However, the proportion of households with outstanding credit card balances dropped between 1995 and 1998; and median card debt was only $1,700. Most importantly, outstanding debt levels grew more slowly than the value of assets during the recent boom. So we've come out ahead . . . thus far. With household balance sheets increasingly dependent on stock market performance, however, economists worry about the precarious nature of our newfound confidence.

Looking Toward the Future

Too little attention is paid to the probable size of future wealth transfers, and even less research is focused on the characteristics of beneficiaries. Many American households will see their net worths escalate as sizable inheritances are passed from today's frugal seniors to their children and grandchildren. The Social Welfare Research Institute at Boston College calculates that nearly 26 million estates with an aggregate value of $12 to $18 trillion will be probated by 2017, and that $7 to $10 trillion will go to personal heirs (as opposed to charities, taxes, or other expenses). The range of these estimates reflects different assumptions regarding wealth growth, savings, and spending as the population ages, as well as Americans' propensity to make donations while still living. More detail is shown in Figures 8 and 9.

Although owning stocks and real estate is important, education is the demographic factor that correlates most highly with earning power and wealth.

[7] *About two-thirds of all homeowners have mortgage debt or home equity lines of credit. Housing-related debt accounts for 72% of total household indebtedness.*

Top

Figure 8
PROJECTED VALUE OF PERSONAL ESTATES: 1998 TO 2017
Middle Series Projection

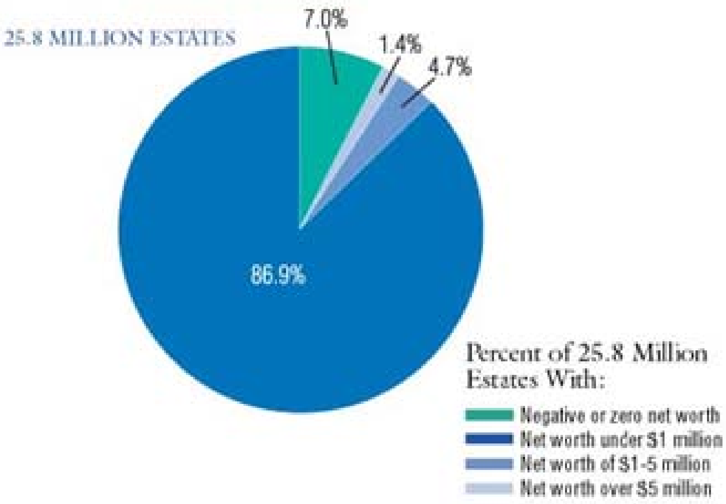


Figure 9
PROJECTED TOTAL VALUE OF ESTATES AND BEQUESTS: 1998-2017

	Low	Middle ($ Trillions)	High
Gross Value of Estates	$ 11.6	$ 14.2	$ 17.6
Less Estate Fees & Taxes	-2.9	-3.6	-4.6
Less Charitable Bequests	-1.7	-2.2	-2.7
Bequests to Heirs	$ 7.1	$ 8.5	$ 10.3

Note: Each scenario has different assumptions regarding saving/dissaving as a percent of wealth by age of household head and by degree of wealth. In each successive scenario, assets grow at 2%, 3%, and 4%.

Source: John J. Havens and Paul G. Schervich, "Millionaires and the Millennium: New Estimates of the Forthcoming Wealth Transfer and the Prospects for a Golden Age of Philanthropy," Boston College Social Welfare Research Institute, October 19, 1999.

Clearly, we can look toward substantial growth in aggregate assets, even with the conservative assumptions used by the researchers. As Babyboomers age and eventually pass their expanded estates on to the Echo Boomers, the total value of inheritances for the next 50 years could reach $136 trillion. (Compare this to 1998's total personal net worth of about $32 trillion.) For those in the real estate business, this source of wealth will unlock additional funds for leisure time activities, second homes, and retail purchases. What is less clear is which types of households will benefit and how inheritances will affect the distribution of wealth among America's haves and have-nots.

Top

Page 12

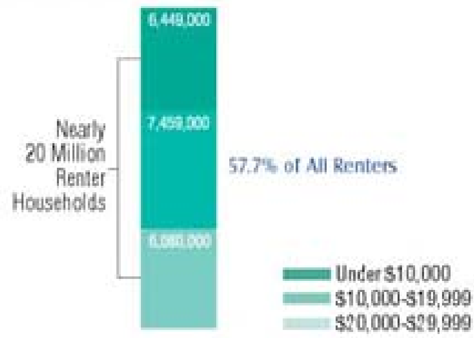
Lend Lease

Affordable Rental Housing: The Persistent Need

One in four American households earned less than $20,000 in 1998. Half are renters. Most of these households would qualify as "very low income" for purposes of determining eligibility for federal housing assistance.[8] Another 14.3 million households earned between $20,000 and $30,000, and could be deemed "low income." Of these, 42% are tenants.[9] Median income for renter households was $25,395 in 1998, or slightly over half of the owner median ($47,920).

Very low-income renters pose a special challenge when the overall economy is strong and shelter costs are rising. Rent increases are outpacing inflation in all 23 metropolitan areas tracked by the Consumer Price Index. Consequently, rent growth is eclipsing income gains for the working poor. The number of low-income households spending too much for shelter is rising, while the supply of affordable units is static at best – and more probably declining.

Figure 10
RENTER HOUSEHOLDS WITH INCOMES UNDER $30,000:1998



Source: Census Bureau, Current Population Survey

The supply of low-cost unsubsidized rental units continues to dwindle as rent increases outpace growth in renter median incomes. The stock of subsidized units is also shrinking as property owners increasingly opt out of federal subsidy programs in search of higher returns.

Source: The State of the Nation's Housing: 1999, p. 25

[8] *The Census Bureau estimated median household income in 1998 at $38,885. According to HUD standards, household income below 80% of the median in a given locale is considered "low." "Very low-income" households earn less than 50% of median. Today, virtually all rental subsidies are targeted at the "very low-income" group.*
[9] *About half of all households earning under $30,000 are homeowners, compared with 66% overall. A large number of older Americans own their homes free and clear but have few resources to pay for maintenance, utilities, and taxes.*

Top

Now and for the foreseeable future, the federal Low-Income Housing Tax Credit (LIHTC) is "the only game in town" for producing large numbers of new, affordable units. Since 1986, this program has produced more than one million apartments for very low-income households. Yet new allocations have not kept pace with growing needs. Congress limited each state's available tax credits to $1.25 per capita back in 1986 — an amount that hasn't been adjusted upward as construction costs rise.[10] Over 40% of units built using LIHTCs need additional subsidies from state or local governments to keep rents below the required maximums.

The LIHTC program technically permits occupancy by households earning as much as 60% of area median income, but the criteria for awarding credits favor those projects that set aside units for the very poorest families (incomes below 50% of area median). A single parent with a minimum-wage job or an elderly couple on Social Security can usually qualify.

LIHTC projects can be especially effective in providing affordable shelter for working families with low incomes because tenants pay fixed but modest rents, plus utilities. Expanding both the allocation and income targeting criteria could go a long way toward easing the housing cost burdens of America's less affluent working families.

HUD stopped supporting new project-based Section 8 buildings years ago, and no new voucher commitments were authorized by Congress for the four years from 1995 to 1998 — just as the housing market was heating up. Although 50,000 vouchers were allocated for FY 1999 and 100,000 for FY 2000, these subsidies are almost exclusively targeted to two groups: tenants in Section 8 buildings with expiring subsidy contracts and participants in welfare-to-work initiatives. Thus, the new vouchers are not adding much to the supply of affordable rentals.

In 1998, America's housing stock included 4.9 million federally-subsidized units,[11] 2.7 million of which were in public housing or project-based Section 8 buildings. The remaining 2.2 million units were subsidized using Section 8 vouchers or certificates, other HUD programs, or Rural Housing Service assistance.

Between 1996 and 1998, owners of 30,000 Section 8 units left the program because their contracts expired. Contracts for another one million units terminate between 1999 and 2004. Many of these buildings will remain in the Section 8 program for the time being, but their owners can no longer rely on long-term subsidy commitments. (Funds must be appropriated annually.) When Section 8 projects "opt out" and rents are raised to market levels, tenants may not be able to find affordable options in their current buildings or elsewhere in the marketplace. In contrast, rent limits and income eligibility guidelines for the LIHTC program remain in effect for 30 years.

Source: National Low Income Housing Coalition

[10] *The National Low-Income Housing Coalition supports legislation (now awaiting Congressional action) to increase the states' tax credit allocations to $1.75 per capita and index them to inflation.*
[11] *Not including units whose rents are kept affordable through use of the LIHTC program.*

Top

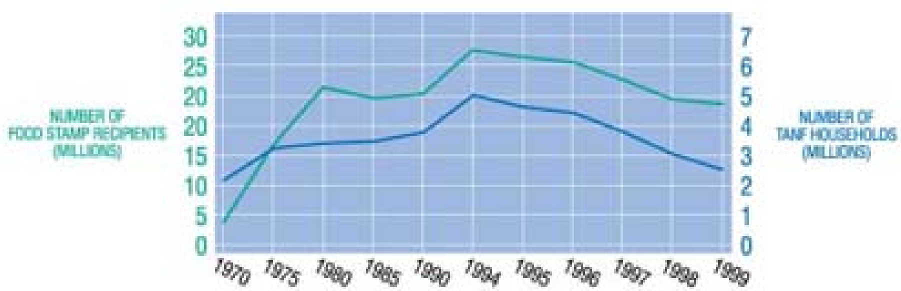
Furthermore, three-fourths of Section 8 vouchers must go to households earning less than 30% of median income.[12] As a result, working couples in minimum-wage jobs have a tough time finding housing subsidies, either through Section 8 or the LIHTC program.

Some may question the need to build more affordable rental units at a time when more Americans than ever are becoming homeowners. However, the evidence clearly shows that most renters are no better off than they were in the first half of the 1990s.

- Very low-income households (especially immigrants and minorities) accounted for the bulk of rental demand growth.
- Renter households' median income rose only 0.3% in real dollars between 1996 and 1998, according to the Census Bureau. And the Federal Reserve reports that their median net worth was a paltry $4,200 in 1998, having declined from $5,200 in 1995.
- The Consumer Price Index for Residential Rent rose 6.2% between 1996 and 1998, compared with overall inflation of 3.9%. In 1998 alone, rent increases were double the rate of inflation.

With eroding assets and no real income growth, poor tenants are especially vulnerable to the rent increases that seem to go hand-in-hand with a booming economy. Owners of better-quality unsubsidized units find they can raise rents because moderate-income families have few choices. In addition, a portion of the inventory of low-cost units is lost every year through abandonment, demolition, or conversion to non-residential use. A precise tally is difficult, and the loss of units tends to be concentrated in less desirable central-city neighborhoods. However, we know that the number of households on waiting lists for public housing or Section 8 certificates is growing, and wait times are longer.

Figure 11
FOOD STAMPS AND TEMPORARY ASSISTANCE FOR NEEDY FAMILIES (TANF)



Note: TANF is the program formerly known as Aid to Families with Dependent Children (AFDC).
Sources: U.S. Departments of Agriculture and Health and Human Services

[12] *The remaining 25% of available vouchers can be given to households earning up to 80% of the area's median income.*

Top

Page 15

The need for low-cost rental housing will continue to grow, even in an era of prosperity. We have made huge strides in correcting the physical problems associated with low-cost housing, but the U.S. has yet to fully confront affordability issues. Demand for moderately-priced rentals will grow even faster in this decade. During the 1990s, relatively few young adults entered the rental market for the first time, but this will change as the Babyboom Echo joins the work force in large numbers.

Moderate- and even middle-income senior citizens who can no longer live alone find it difficult to locate affordable apartments with the supportive services they need. And while today's welfare caseloads are at record lows (because of more stringent eligibility criteria and an extraordinarily tight job market), the inevitable economic slowdown will put many under-educated workers back on the waiting lists for subsidized apartments.

The U. S. Department of Housing and Urban Development estimates that 5.3 million American households have "worst case" housing needs, meaning that they have very low incomes, pay more than half their income for housing or live in severely substandard units, and receive no housing assistance from government agencies. (These are in addition to the occupants of the 4.9 million federally-subsidized units.)

"Sure, we need affordable housing—just so long as it doesn't come at the expense of unaffordable housing."

Poor tenants are especially vulnerable to the rent increases that go hand-in-hand with a booming economy. The need for low cost rental housing will continue to grow, even in an era of prosperity.

Top

Back