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What is Proposition 33: Justice For Renters Act??

For the third time in the past decade, California voters will vote during the general election on a repeal of Costa-Hawkins, triggering vacancy control on all apartments in select cities such as Los Angeles.

"The Justice for Renters Act is just 23 words: "The state may not limit the right of any city, county, or city and county to maintain, enact or expand residential rent control. It would remove California's statewide rent control ban and give local communities the right to stabilize rents and make apartments more affordable for low-income and middle-income renters."

This very vague language put together by the AIDS foundation which owns very poorly run apartments with countless housing violations in Los Angeles.

The inaptly named "Justice for Renters Act" is proposed on the November ballot to overturn the Costa-Hawkins Rental Housing Act in California, and has sparked significant concern among owners of rental housing throughout the state. Originally enacted in 1995, Costa-Hawkins is currently the standard across California's rental housing policy. It exempts single-family and newer construction apartments from rent control and allows landlords to attain market rate for units upon tenant turnover. Achieving market rate is essential to encourage investment in housing and to maintain a balance in the housing market. "Justice for Renters" threatens to introduce vacancy control, capping rents after a tenant vacates. This would lead to a decrease in property values and would disincentivize future investment in property improvements and maintenance.

New York City works well as a case study. Vacancy control was passed in 2019, capping allowable rental rates upon tenant turnover to 20% of the previous tenant's rent.

This is now widely acknowledged as the main cause for current reduction in availability and quality of the city's housing supply.

Five years later New York City has a vacancy rate of 1.4%, and estimated 40,000 units deliberately vacant as the landlord is unable to earn a fair return on their investment to renovate those vacant units.

One notable Multihousing News article from 2020 discussed more about the consequences of vacancy control, demonstrating that it alters the investment landscape by shifting investor sentiment from property appreciation to in-place cash flow, causing a significant drop in property prices as the value-add component diminishes. This shift would have a profound impact on California's housing market, mirroring the consequences faced in New York.

The difference from the last time the vacancy control vote has been on the ballot in 2018 and 2020 has been a significant voter shift in California to the far left focusing on social justice issues.

Liberal cities in California such as Los Angeles, Santa Monica, and West Hollywood have already decided they will institute vacancy control should proposition 33 pass this November.

Los Angeles apartments historically have sold at cap rates less than the rest of the country as investors priced in rental upside potential and willingness to take a lower initial return. If proposition 33 passes, cap rates will go up significantly and a deterioration in value in the 15% - 35% range depending on how close the individual property rents are to market rents. Lenders will also pull back lending throughout the state as bank owned foreclosures will increase.

The sad part of a Costa-Hawkins repeal is no one really benefits. For example, a tenant moves out of an apartment rented for \$800. The new allowable rent may be \$875, however that unit needs to be fully renovated and will cost at a minimum \$30,000. Obviously, no landlord will fork over \$30,000 to earn a miniscule \$900 increase in annual rent. The landlord, like many in New York City, will keep that unit vacant as they cannot afford to renovate the very dated unit. This will mean the housing stock will actually decrease, causing market rents for units that don't fall under rent control to skyrocket hurting not only tenants that need affordable housing but also the smaller landlord that cannot afford to keep the apartment building since they are not earning a return on their investment and may even be operating at a loss.

The long term effects on Proposition 33 are quite obvious for anyone who has studied economics. Institutional owners will "redline" Los Angeles and other liberal cities in California that enact vacancy control which will create less new units. Units will deliberately be held vacant after long term renters vacate creating an even smaller housing stock when we desperately need many more units throughout Los Angeles and the state.

EXAMPLE:

10-Unit Apartment Building in Los Angeles

Rents are \$1,000 on average, net operating income of \$72,000, based on a 5.25% cap rate today the value is \$1,371,000.

Should Proposition 33 pass, rental upside would be meaningless so the cap rate would need to be above the cost of debt and well above treasury yields to justify risk, so let's call it a 6.75% cap rate. The value overnight would change to \$1,066,667. *The building value just dropped 22%.*

The main issue is with flat top-level revenue of rents, increased expenses through higher utilities costs, plus doubling or tripling of insurance that continues to lower net operating income and force some owners to sell at a large loss.

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