

Sweden's progress to a free social rental housing market.

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Background

Before the Second World War, Sweden's rental market was a traditional unregulated profit-market totally dominated by private landlords. Minister of Housing, Gunnar Myrdal, was a key actor in facilitating the idea of opening the market to competition from not-for-profit housing organisations, following his major commission of enquiry into housing. The decisive factor behind Myrdal's initiative was the inability of the profit rental sector to provide sufficient cheap housing for ordinary people, and the need for alternative providers. The immediate trigger was the flight of capital from housing to the munitions industries that took place with the outbreak of war. But the malaise was, as in most societies, chronic.

The path chosen by most English-speaking countries - that of creating a publicly-owned "poor-housing" sector, thereby keeping the rental market as a reserve for profit-landlords, sheltered from not-for-profit competitors, was eschewed in favour of nurturing not-for-profit providers to eventually be in a position to compete on the open rental market on equal terms with profit-providers. The hope was that shortfalls in housing construction on the part of profit-providers would be made up by not-for-profit providers which, in turn, would expand their share of the market until they could comprise an effective competitor to profit-renting, providing not-for-profit housing to a wide range of households.

Rent-regulation and interest subsidies, 1942-1967

It was necessary to support not-for-profit providers until they could become established on the market, while minimising discrimination against profit landlords. This was done by making available housing loans at subsidised rates of interest to both profit and not-for-profit providers. But while those for profit providers only covered 70 percent of construction costs those of not-for-profit providers were 100 percent loans. The thinking here was that the established profit landlords would normally have capital reserves to draw on or potentially mortgageable property to raise loans with. By contrast, the new not-for-profit providers did not have either the capital reserves or the loan-potential in the form of an established stock with a re-mortgageable value. In addition, rent regulation was designed in such a way as to ensure that costs were covered as well as allowing a margin for profit. As each annual cohort of newbuild aged its rents were raised to cost-covering levels plus a margin for profit. This meant that the rents of profit and not-for-profit housing were kept in line with each other. However, as construction prices rose and as the housing stock grew, a rent-gap emerged between the rents of old and new buildings.

Historical cost rent regulation (called in Sweden "rent-splitting") was introduced in 1942. As the years passed the rent-gap between old and new properties grew. As it grew, demand became increasingly skewed towards older and lower-rent properties. It is well known that old properties are not intrinsically less attractive than new ones - quite the opposite in many cases. They are usually more centrally-located and are often thought of as having "charm" (*the bijou factor*)- constructed in old styles, with high or sloping ceilings, tiled stoves, *etc.* Therefore, a black market quickly emerged in which tenants paid illegal key-money either to the outgoing tenant or to unscrupulous private landlords to gain access to centrally-located charming old rental property with low rents.

De-regulation: (1) from rent-splitting to negotiated rent-setting: after 1967

The move to the social market was accelerated when rent-splitting was replaced in 1967 with a new system of negotiated rents based on the principle of use-values. Each year rent levels are negotiated between the tenants union and SABO, the not-for-profit national umbrella organisation. Once these are determined, profit-providers then have to set comparable rents, thereby giving not-for-profit a "market-leading" role. Comparison is, of course, made with similar not-for-profit housing, which presupposes a good representation of not-for-profit rental housing in all segments of the market. It should be noted, however, that "market-leading" in this context is achieved through the system of indirect regulation (negotiated rent-setting) not through the exercise of market strength.

The idea of having the tenants union negotiate rents with the not-for-profit companies was to build into the rent-setting process a system of checks and balances against unreasonable rent increases. The tenants union was to act as a sort of watchdog, to ensure that in the absence of the profit-motive the not-for-profit housing companies remain cost-conscious. Perhaps uniquely, in the Swedish case, the tenants union was therefore given a key policy corporatist role in rent-setting.

However, one of the problems with such a negotiated rent-setting system is that the tenants union are not only concerned to keep rents low. They argue that their existing members should not have to cross-subsidise newbuild for future tenants, that newbuild should be subsidised by society as a whole. Built into the rent-negotiation, therefore is an interest-bias in favour of retaining rent-splitting, so that existing tenants do not cross-subsidise newbuild.

While research findings do indeed show that the demand gap between older attractive apartments and newer less attractive apartments did decrease, negotiated rents did not significantly reduce the distorting effects of rent-splitting. Old properties continued to have lower rents than newbuild, despite being generally more attractive. Since 1967 there has been further market-reform of this system, to take into account locational factors more, which the

tenants union have been resisting. But the system still favours the tenants of old properties. So the black market in the purchase of rental contracts of older properties remains.

De-regulation: (2) the maturation of the social rental market since 1967

Progress towards an integrated social rental market has been painfully slow but nevertheless discernable. Much of the tardiness has reflected the enormous expansion in housing demand that took place in Sweden in the early decades of the postwar period, Sweden's era of urbanisation. Not-for-profit housing organisations provided the great bulk of this output. This in turn kept their front-end loading very high throughout the stock-expansion years of the 1940s and 1950s, culminating in the "million programme" from 1965-1974 when one million new units were constructed. Because of this huge 30-year expansion by the late 1970s the ratio of outstanding debt to market value was still not much less than 1:1.

By the end of the million programme not-for-profit rental housing had reached numerical parity with profit renting. But due to the sustained heroic levels of newbuild its ability to cross-pool rents remained significantly below that of the profit sector. It is only the decline of overall levels of newbuild sustained over the last quarter of a century that has enabled the outstanding debt-to-market value ratio of the not-for-profit stock to gradually fall to significantly below 1:1.

In Sweden this ratio is an important measure of competitive efficiency, and is usually termed *solidity*. A solidity of 30 percent indicates a debt burden amounting to 70 percent of the market valuation of the housing stock. This is commonly taken as an optimum level of solidity and one that is often found in the older and more slowly-expanding profit rental sector. Once the not-for-profit rental sector reaches these levels of solidity it will reach parity with the profit rental sector in terms of its financial competitiveness.

An analysis of the solidity of the not-for-profit housing organisations carried out by SABO, in the early 1990s indicated that in the major urban local authorities solidity had risen to around 15 percent. In the twenty years since then low rates of newbuild in combination with rapidly rising property prices have undoubtedly increased their solidity even further.

Increasing solidity has been reflected in further de-regulation. Since the early 1990s, not-for-profit has been exposed to the same taxation and subsidy regime as profit rental providers. Even more important, all interest subsidies were phased out, and by the turn of the century net housing support was more than outweighed by net housing taxation. Not-for-profit providers are now to all intents and purposes treated no differently from profit-providers.

There are some exceptions, the most important being that - in contrast to profit-providers - not-for-profit providers are still expected to meet the housing

needs of the disadvantaged. They are also still essentially local operators, that is, owned by the local authorities and their market activities are restricted to within the boundaries of one local authority, while profit operators may operate wherever they like. On the other hand, most local authorities only have one not-for-profit company operating in its area and so can still be propped up by capital injections if needed. Yet this is double-edged, as local authorities hostile to the whole idea of not-for-profit competing with profit providers are also free to asset-strip, something that, as we shall see below, has become a serious problem in recent years.

Recent retrograde developments

Recent events have undone some of the progress made in the previous half-century. The first is that a bourgeois coalition local government (Stockholm City) implemented a sort of right-to-buy in the period between coming to office in 1998 and losing it in 2002. The attractive inner-city not-for-profit rental stock disappeared as large-scale conversions of not-for-profit to co-operative tenant-ownership were made. As a result of this, the not-for-profit share fell between the two local elections from around 20 percent to 5 percent. The Stockholm government also transferred to other uses than housing a large amount of capital - some 4 billion kronor - from the not-for-profit housing company, *Stockholmshem*, to the local government holding company of which the not-for-profit housing company is a subsidiary.

The new social democratic Stockholm City government has stopped the sales but much damage has already been done. There have also been other sell-offs. In one Greater Stockholm local government (Nacka) where a bourgeois government took control the entire not-for-profit stock was sold to a profit-landlord company. In Malmö the not-for-profit company lost its not-for-profit status when the local government took out too high profits. As a result of all this and similar cases elsewhere, not-for-profit rents as the basis to compare to profit-rents are getting hard to find in some areas.

These, of course, are local changes that are usually associated with the election of a bourgeois local government. As such, the effect remains patchy and varied. Cities like Gävle and Uppsala have not had a change of government and so have not experienced this sort of asset-stripping. Stockholm is, of course, a major market and, moreover, one that is attracting in-migration from rural northern areas. Yet, as the Stockholm experience testifies, it only takes the election of a local government that is hostile to not-for-profit renting for much damage to be done to the move towards an integrated rental market, thereby seriously compromising the strategy in just one mandate period.

Central Government attempts to prevent asset-stripping

The social democratic central government is trying to protect the not-for-profit companies from this sort of erosion, but its not clear if they will succeed. For example, they want the locally-owned not-for-profit rental companies to be

made into private not-for-profit housing organisations with protected status instead of as at present being companies majority-owned by the local government. This would prevent one-off elected local governments from asset-stripping them either by selling them or exposing them to political decisions like right-to-buy.

Another damage-limitation measure is to require that all proposed sell-offs of not-for-profit stocks be subjected to review by the County in which the housing stocks are located and that the sell-offs only be approved if they do not so decimate the not-for-profit stock as to seriously compromise the setting of profit rents by the absence of not-for-profit alternatives to facilitate comparison. It remains to be seen how effective this will be.

A more serious and chronic problem is that because pressure from the tenants union negotiated rents continue to skew demand towards older properties there is now little new-build investment. This has become an increasingly acute problem, and should probably have been dealt with earlier by further relaxing of rent-setting procedures.

This has not happened. Instead, the main interest groups on the rental market, the "iron triangle" of the Tenants Union, SABO and the Private Landlords Association have recently come to their own agreement that newbuild should have free-rent setting, and the government has agreed (a particularly clear case of housing policy corporatism). The trouble with this change is it is going to have a continuing, and even reinforced, rent-splitting effect. What is needed is market-sensitive rent-pooling so the cost profile of the not-for-profit stock imitates the market while remaining within cost-covering limits.

One problem here is that the tenants union always looks to its members interests first, which means protecting existing tenants at the expense of future tenants. So it has been fighting a rearguard action against market-simulating the not-for-profit rent structure, and trying to maintain as much historic cost rents as possible. They argue that existing tenants should not have to subsidise newbuild through rent-pooling (rent-averaging) - this should be the government's responsibility in subsidies paid for by everyone. The latest iron triangle agreement is in line with that aspiration.

Conclusions

The Swedish experience is that progress towards a fully functioning and free social rental market is at best crab-like (or perhaps more like two steps forward one step back). One solution would be to phase out negotiated rent-setting in selected local markets where not-for-profit providers are robust and well-established. But Sweden's housing system has strong centralist traditions, and such a localist solution has quite simply not been considered.

A more localist approach would have the advantage of giving two important signals to counter the critique that is often made of it being a sclerotic system that refuses to marketise sufficiently to generate rent-differentials that genuinely reflect demand. First, local progress towards a genuine social rental market would clearly signal the fact that there is a continuing process of deregulation and freeing up of the rental market. Equally important, it would provide a strong argument against asset-stripping and mass sales/conversions of not-for-profit housing, as it would make explicit its disadvantages to tenants.

The Swedish social rental market is gradually emerging, but its achilles heel is its national uniformity, and the fact that the not-for-profit housing organisations are in the form of limited liability companies majority-owned by its local authority and constituted as a subsidiary of the local authority holding company. They are therefore vulnerable to decimation as a result of short-term and often temporary changes in the political complexion of local government.

The government is aware of this problem and is introducing legislation to create a new organisational form - the not-for-profit organisation, that, unlike a Trust is allowed to make profits as long as these are ploughed back into housing, and cannot be held as a subsidiary of a holding company. The idea is that all local authority housing companies will take this form.

This still, however, leaves the not-for-profit housing organisation in local authority control, and as such exposed to hostile political measures.

The system in some other countries which have opted to create a mixed social rental market is instructive here. Germany and Switzerland have social rental markets but these are not only more decentralised but the not-for-profit sector is more diverse and fragmented than in Sweden, with many different kinds of ownership forms - rental co-operatives, trusts, limited-profit companies, charitable organisations and local government. This combination of decentralisation and ownership diversity makes it practically impossible for hostile local or national administrations to subject not-for-profit housing organisations to asset-stripping, and thereby to "unscramble the egg" of the social rental market.

It is worth noting that Denmark has a not-for-profit stock with about the same share of the rental market as in Sweden but one that it is instead privately-owned and with a large degree of tenant influence. The minority conservative Rasmussen Government has set up a commission of enquiry to explore how the private not-for-profit housing trusts - despite being in private ownership - might be subjected to a compulsory right to buy. Given the sensitivity of what is hoped to be achieved, the enquiry has been shrouded in secrecy, and at time of writing a report is awaited.

It is clearly possible for a hostile and determined government to undermine the progress to a free social rental market. It is even possible to sabotage it entirely by selling off the attractive part of the not-for-profit stock, thereby residualising whatever is left so that it becomes a public poor housing sector. The main benefit of this for profit landlords is that by removing the not-for-profit competition from the market what remains is a purely for-profit rental market. In Sweden the challenge has been local and more fragmented, but the jury is still out on whether the bold and visionary project to create a free and competitive social rental market will succeed.

Relevant publications by the author

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