

# *A rental market in crisis*

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## English Summary

This report concerns *rent control*, this type of legislation results in systematically lower rent levels than would prevail in a market equilibrium. During the past 100 years, Sweden has for the most part had such legislation.

More specifically, this report concerns some of the symptoms of rent control; housing shortage, long waiting times to secure a rental contract, conversions of rental apartments into tenant owned apartments, and not least, the existence of a black market for rental contracts. During periods of rent control, we have seen legislation aimed at reducing all these symptoms. However, little focus has been given to rent control itself. In the report I give an overview of rental market in Sweden today and how it has developed over time. I then address each symptom in more detail. I conclude with a discussion about what need we wish the rental market to fulfill and then give a suggestion on how this could be achieved.

### ***Housing shortage and long waiting times***

Housing shortage and long waiting times in order to secure a rental apartment have been a constant problem on the regulated market in Sweden<sup>1</sup>. The answer to this problem has historically, without exceptions, been to increase production with the help of subsidies. The problem has, however, lasted. Regardless of the level of construction, the waiting times have increased.

Parallel to the problem with allocation of apartments through waiting times, which is unlikely to mirror the efficient allocation of the pricing mechanism, the housing problem has become particularly severe for household with low incomes. These households cannot turn to the owner occupied market because of capital constraints. In order to accept the inefficient allocation of a waiting list, there must be an upside. The analysis in this book shows, on the

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<sup>1</sup> In Sweden there is a queuing system for rental apartments. Normally, the apartments are allocated on the basis of time spent in the housing queue. To apply for an apartment, one must first register in the housing queue. There is no national platform for this, each city or region basically has its own queue.

contrary, that the larger subsidies made possible by controlling rent, are allocated to households with relatively higher incomes.

### ***Conversions of rental apartments***

Conversions of rental apartments to condominiums can be given several explanations. One is that there are tax incentives for either tenure form. A stronger incentive is however that the realizable value of one specific apartment larger in one tenure form than another. With rent control, a conversion to condominium allows both the tenant and the landlord to split the market value. Consequently, during periods of rent control in Sweden, when the price of condominiums has not been subject to price control, we have seen a movement from the rental market, *en masse*. This has been met by policies from two perspectives. One that aims at reducing the conversions, through stricter demands, and one that aims at facilitating, through lesser demands.

### ***The black market for rental contracts***

The black market is difficult to study because of its nature. Few people involved in these transactions are willing to speak about them. It is however a known fact that when the price of a good or an asset is subject to control, and the price is set lower than individuals are willing to pay, incentives appear for a black market. Solutions have focused on threats of imprisonment, and mandatory allocation of all apartments through waiting lists.

For this book I have talked to a woman, Maria, who recently tried buying an apartment on the black market. Her story gives an insight into the desperation created by a dysfunctional housing market. Without possibilities of buying her home, and with no accrued time on the waiting list, her only option was the black market.

I have also talked to a representative of the other side, the black market realtor, Lars. Under false pretext of wanting to buy an apartment he agreed to a meeting. The most interesting take away from this meeting, aside from price information, was his view of suggested legislation. From his perspective, the legislation that suggest that buyers of illegal rental will also risk imprisonment, is welcomed. This type of legislation, of course, shifts the power balance in his favor.

### ***Possible solutions***

The solution largely depends on what purpose we want the rental market to fulfill. My view is that the rental market is especially important for two groups: those who live temporarily somewhere and those who cannot (or do not want to) own their housing. The rental market must therefore cater to people with different planning horizons. Those who have a short housing perspective, for example, individuals who will stay only for a brief time in a particular city and then move. But also, households with a longer housing perspective who, for economical or other reasons, do not want to own their home.

In order for the rental market to be a viable option we need to have some degree of tenant security. Yet, tenant security necessitates some sort of foreseeable rent levels during the tenancy. My suggestion is that rents can be set freely in all new contracts. Contracts have to be offered with a minimum duration of ten years during which rent increases should be transparent. At contract renegotiation the rent should be capped at the level of similar apartments, with rents set freely.

This solution takes care of the inefficiencies caused by allocation. It also takes care of any inefficiencies caused on the supply side by rent control. However, the increased rent levels that will occur in certain parts, might lead to an unwanted allocation and segregation. However, in the policymaker's toolbox there are several policies that could solve such problems. One would be to increase housing allowances aimed at certain households. Another solution could be to provide public subsidized housing to certain households.