

How residential rent levels are decided in Sweden, new rules

Daniel Goldman, 2011-03-21

Introduction

The Swedish Parliament has decided that new rules on rent setting will apply from January 1st, 2011. The decision was made on June 22nd, 2010. The difference for the tenant is not that great. The rent will be negotiated as before and the utility value (Swe: bruksvärde) will remain the basis for the negotiation. One change is in the review of which utility value to consider, that is, when you find out if the rent is reasonable you, according to the previous rules, should only consider the rent of the municipality property companies. Now, you should not only take into account the rents of comparable apartments in municipality property companies (Swe: Allmännyttan), but also, to an equivalent part, the apartments in private property companies. Another change in the municipal property companies' role. They will still be operated in a non-profit way but also operated by normal commercial principles. One difficult principle to combine, one could say.

Utility value determines the rent

The rent should reflect the tenants' "general values" of different grades of accommodation. It may be the apartment's size, number of rooms, floor plan, standard, order, outdoor environment, the buildings location with its nearby service and attractiveness.

The rent is determined by the apartment's condition. The utility value system lets the tenant know why he or she pays a certain level of rent and the rent should reflect the apartment's quality and standard. Not so much consideration is given to the apartment's location in the municipality. More consideration in the new rules is given to the attractiveness of the location. This is an attempt to lower the illegal sub-letting, reflecting the fact the people actually pay more attention to the location of the apartment than previously reflected in the difference in the rent levels. Most of us surely want to pay extra for an apartment in A-location Stockholm compared to a C-location, in the same city. This extra amount of SEK, has historically been too low; therefore, the problem with a black market for rental contracts in for example Stockholm is rather common. This of course

reflects the fact that the rent levels based on the utility value in A-located apartments do not, to a sufficient degree, consider the attractiveness of the location. This is different in the new legislation.

New rules for an improved property market

The Parliament's overall objective is a long-term well-functioning property market where the consumer demands will encounter a variety of supply of apartments that meet their needs. There are clear signs that today's property rental market does not meet this goal. The growing property crisis, in particular metropolitan areas, has led to increased tensions in the rental market, including the form of so-called black trade in leases and a growing sector of illegal second- and third hand apartments. Meanwhile, apartments in other parts of the country where the population is decreasing are standing empty.

The public property companies account for almost half of the supply of rental apartments in Sweden. The conditions governing these companies have a very large impact on the function of the market. Regulations concerning the public and private companies have changed over the years. The structure of the property companies was done with preferential financing terms. For long, however, all types of for example financing conditions are the same for all property companies together with the legislation concerning tax. What now remains of these specific regulations is the ban on running municipality property companies for the purpose of making profits and the limitation of dividends to their owners. Prior to the new law, these companies use to be the standard setters for rent for the entire rental market. This has led to criticism from private property owners who have based the criticism on the current EU law and lack of healthy competition.

It has been argued that the current regulatory framework for public and municipal property companies is incompatible with the current EU law on state aid in cases for municipality property companies. The rule of dividend restrictions in the Allbo Act acts as an indirect self-cost principle. The rule results in a lower required yield on municipality property companies than on private property companies. Such allocation of market return means that the municipality property companies receive an economic advantage over private property companies. Since the vast majority of public property companies are owned by the municipality, it could mean that a form of state financed support is issued. The rents that the public property companies negotiate

use to be the standard rent for the entire rental market. This is not a fair system for the private property companies who do not have the same required yield or state supported aid and needs to operate successfully to be sustainable.

It is the parliament's view of particular importance to protect the Swedish model of public property companies that meets the demand for all needs of apartment standard and location in the property market, not only to people with low incomes or who otherwise need assistance in getting an apartment. The government therefore believes that the creation of a new regulation for the public property companies is needed, which are clearly compatible with the current EU law. As a consequence, a new rent-setting reform was created.

As of January 1, 2011 new rules for public property companies and new rules on rent setting were therefore introduced. The conditions for the municipal property companies and private landlords should be equivalent and will result in a better functioning property rental market, a greater interest in investing in and managing rental properties and eventually an improved supply of rental apartments.

The changes will in time provide a better functioning property market were it is more attractive to own and invest in rental properties, but still provide sufficient protection for the tenants.

The new law on public municipal property companies

A new law on public municipal property companies will replace the previous Law on municipality property companies, the so-called Allbo Act of 2002. The law covers only property companies who are run as corporations by one or more municipalities. The new law for municipal property companies clarifies the definition of companies and new requirements for the conduct of business:

- (i) A municipality property company's main task will be to manage properties with rental apartments to the public interest, provide public property to the community and provide tenants with influence to affect their living situation.
- (ii) The municipality property company will operate under commercial principles with normal yields.

Changes in rental law

Collectively negotiated rents should be normative

Rents in public property companies will no longer be the norm for all rental negotiations. Instead, collectively negotiated rents, regardless of contractors, should be the norm for a review if a potential rent is reasonable or not. The private property owners and the municipal property companies are equal partners in the rent negotiation system and the tenant association will negotiate rents at the same time with both the private property owners and the municipality property companies. This contributes to stability in the negotiation and further transparency in the rent setting.

The utility value system is sustained in the new law. In order to create conditions for a well-functioning rental property market it is now accepted that the relationship between supply and demand is to be taken into account in rent setting in the utility value system. If demand for rental apartments in a specific geographic location significantly exceeds supply, such as when requiring a waiting period of several years to receive an apartment, the rents should be allowed to be risen by about five percent per year. Similarly, the rents should be allowed to be decreased by around five percent per year, if demand in a specific geographic location is significantly lower than supply, such as when there are many long term vacancies. The adjustment should continue until the demand is not significantly higher or lower than the supply.

New security rule against excessive rent increases

A security rule is introduced to mitigate the impact of the sharp rental increases in cases where the rent was previously too low in relation to the utility value. It means that if the new rent is much higher than the previous rent, the Swedish rent tribunal should determine that a lower rent should be paid over a certain time to mitigate the sharp increase in rent. The protection rule is applicable to large rent increases as a result of an adaptation to what is a reasonable rent in comparison to the apartment's utility value, when switching apartments and when dividing an apartment so not to result in lock-in effects.

The security rule applies to, with the current inflation rate, when the rent increases by more than about five percent annually. The protection rule strikes in cases where a review under the utility value system could lead to higher rents due to for example long queues in a residential area.

For the protection of tenants, a tenant's rent can only be increased once a year. Today the law allows for an increase twice a year, although this is not common in practice.

Long term implications

It is likely that rents will rise in residential areas where there is substantial excess demand, for example the attractive parts of the municipalities, where the rents are not proportional to the attractiveness of the location. Increase in the supply of rental apartments will lead to a slower rise in rent. In areas with high vacancies, the rent level will be status quo or, when having high vacancies, reduced. If the supply of rental apartments is reduced, the rents will be reduced less.

A better adjustment of the rent level to the tenants' values can contribute to a better functioning property market with shorter queues, less illegal trade in rented accommodation, fewer sales to tenant associations and also some new construction of rental apartments.

With higher rents, the Swedish state's costs for property and municipal expenditures for financial assistance under the Social Services Law, to some extent can be increased.

Higher rents will also lead to increased profits for property companies, which in turn will lead to increased state tax revenue. The municipal property companies will be able to distribute their profits to the owner municipalities. A better functioning property market is also beneficial for the economy in general.

References

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Questions

1. From which date are the new rules applicable?
2. Describe what is meant by utility value?
3. What is the factor in the utility value that has become more important?
4. See question 3 above. Why?
5. Why have private property companies criticized the former rules?
6. What is the Allbo Act?
7. The new law for municipal property companies clarifies the definition of companies and new requirements for the conduct of business. Mention the two major changes more thoroughly?
8. Mention the change in how the rent level is negotiated compared with before, according to the new rules?
9. What is the security rule?
10. Mention a few long term implications the new rules will result in?