

# Summary

## **The fundamental structure of the Swedish housing market**

The basic structure of the Swedish housing market dates back to the rent regulation introduced in 1942 and the two reform periods carried out in 1967–70 and 1990–94. Taken together, these reforms created the conditions that today define the modern markets for single-family homes, tenant-owned apartments, and the rent-regulated sector. Ever since these reforms were implemented, the three markets have influenced one another in ways that have triggered new waves of political intervention. Because the understanding of the interaction between these three markets has been weak, such interventions have often exacerbated the very problems they were intended to solve.

During the period 1942–68, the housing market was fully regulated. Rental apartments, tenant-owned apartments, and state-financed single-family homes were all subject to price controls. A complicating factor was the so-called “rent split,” meaning the widening gap created because new production costs were reflected each year in higher rents while regulated rents for older units remained low. This continually increased the distance between the two, creating a lack of incentives for households to move out of older, cheaper rental units. The regulations and the rent split led to very low mobility within the existing housing stock. As a result, extremely high levels of new construction were required – production that could only be maintained through credit market regulation and subsidies.

## Liberalized markets and new imbalances

The reforms of the late 1960s aimed both to eliminate subsidies for new construction and to increase mobility within the housing stock. As a result, the markets for single-family homes and tenant-owned apartments were liberalized, while rent regulation was replaced by the utility-value system (*bruksvärdesregleringen*). The reforms made the housing market more dynamic and transformative. Above all, the market for single-family homes expanded, leading to a sharp decline in the construction of multi-family housing. The pressure on actors in the multi-family housing sector resulted, from 1975 onward, in extensive subsidization of the entire housing sector. This was accompanied by the use of the utility-value principle to compress rents across the stock. The importance of location factors was subsequently reduced by both the subsidies – which made it attractive to build under the same conditions throughout the country – and the utility-value system. This rent compression can be seen in both Figure 1.1 and the appendix. The first signs of increasing heterogeneity in the market appeared immediately after the liberalization of the credit market in 1985. With freer capital flows, location factors were more strongly asserted than before, which is clearly visible in both the single-family home and tenant-owned markets.

## The slow rise of the tenant-owned market and the revitalization of inner cities

The market for tenant-owned apartments was liberalized at the same time as the single-family home market in 1969, but a striking feature of the 1970s was the far slower development of that market. Initially, prices were strongly depressed, primarily due to the declining condition of the inner cities after the long period of rent regulation. Maintenance had been systematically neglected for more than three decades, and the low mobility had led both to an aging population and a population decline of roughly fifty percent in the central districts of the major cities. In the mid-1970s, housing prices in inner-city locations were also affected by several legislative measures

aimed at curbing demand, while both the subsidies and the application of the utility-value system had similar effects.

Because the central locations still held a certain level of attractiveness, a slow but steady conversion to tenant-owned units began during the 1970s. This development was concentrated entirely in the most desirable areas of Stockholm and Gothenburg, and from the latter half of the 1970s, prices began to rise broadly across the metropolitan regions. At this point, the younger share of the population in the inner cities also started to grow. As seen in Figure 1.2 and the appendix, this was a revitalization from a very weak starting point, during which it had long been comparatively cheaper to purchase a co op apartment. Measured in price per square meter, tenant-owned apartments remained significantly cheaper than single-family homes for an extended period.

### **Credit deregulation, price increases, and crisis**

The deregulation of the credit market in 1985 greatly amplified the rise in tenant-owned housing prices (Figure 1.2). As had previously occurred in the single-family home market, location factors were now able to exert a clearer influence. It was also significant that new industries, concentrated in the larger cities, began to expand, which contributed to growing numbers of young households forming in those areas. Increasing population, higher service levels, and accelerating renovations meant that the attractiveness of the previously neglected inner-city areas recovered very quickly at this stage. When the upswing of the 1980s peaked, tenant-owned prices in the country's larger cities were generally approaching parity with single-family home prices. The development was also notable in that the rise in tenant-owned prices in the 15–20 largest cities in the late 1980s for the first time clearly marked the divide – later to deepen – between urban areas and sparsely populated regions (Figure 1.2 and the appendix).

The real estate crisis of the early 1990s then triggered a sharp decline in both single-family home prices and tenant-owned prices. However, the fall was proportionally greater in the tenant-owned market, caused by the uncertainty surrounding newly formed associations with high exposure to subsidized state loans. When

these loans matured following the removal of subsidies, the high interest rates of 1993–95 took effect, leading to increased monthly charges and, in some cases, bankruptcies. The situation stabilized quickly, though, and from 1995 a long trend of rising tenant-owned prices began, continuing until they again reached approximate parity with single-family homes during the first decade of the 2000s. Because tenant-owned prices had risen from levels far below those of single-family homes, the increase was perceived as a speculative bubble. This interpretation was likely reinforced by the sharp decline in tenant-owned prices during the real estate crisis, which had created the impression that tenant-owned markets were more speculative than other markets.

### **Desubsidization and growing regional differences**

The available price data clearly shows that the development of tenant-owned housing prices from the second half of the 1990s onward was not the result of a speculative bubble. The strong increase was instead the effect of a long period of price suppression under rent regulation, which had left the inner cities deteriorated, sparsely populated, and unattractive. Yet the inherent locational attractiveness remained, and the recovery of both the deteriorated urban fabric and relative price levels had already begun in the latter half of the 1970s. Desubsidization reinforced this recovery as transparency in the market increased significantly.

The subsidies and the legislation introduced in the mid-1970s had evened out price formation across the country and limited investment activity in the inner cities. The reforms of the early 1990s removed many of these barriers. Without subsidies, location factors became fully reflected in the market, meaning that new construction immediately after desubsidization became feasible only in a limited number of places in the country. The special position of the inner cities relative to outer areas thus became evident.

Market heterogeneity therefore became fully apparent after 1995. For both single-family homes and tenant-owned housing, the differences between metropolitan and sparsely populated markets increased sharply (Figure 1.2), a pattern that generally applied across all major Swedish regions (see appendix). Property values in regional

centers rose relative to smaller towns, and population growth concentrated in these central localities. This trend was especially pronounced among younger households in the family-forming years.

Changes in rent setting after the reforms were a crucial part of this growing heterogeneity. Between 1975 and 1990, the utility-value system had primarily been used to compress rents across the country and across the housing stock. This began to change with the 1990 tax reform, when rising construction costs started to be reflected in rent levels. After desubsidization, this development intensified. With rising tenant-owned prices, land prices also increased. When political considerations prevented rent increases, the competitive position of rental-housing producers weakened during the decade around the turn of the millennium. Tenant-owned housing therefore came to dominate new construction, while rising apartment prices accelerated the conversion of rental units into tenant-owned units. The overwhelming majority of these conversions involved privately owned properties.

During the first decade of the 2000s, this created a paradoxical development: desubsidization led the owned housing stock toward price parity between single-family homes and tenant-owned apartments in all major cities, while at the same time the differences between large urban regions and sparsely populated areas widened significantly. For rental housing, the exact opposite development occurred. After initial political hesitation, construction costs were allowed to be reflected in rents, creating greater rent differentials even within the same urban areas.

The problem of rent splitting then re-emerged, reducing mobility within the housing stock and creating increasing excess demand/queues for the older, cheaper rental units – a situation that was subsequently interpreted in public debate as a general “housing shortage.”

Desubsidization created a new construction sector in which each project had to cover its own costs. This meant that the development of individual projects became the center of attention, shifting the focus toward detailed development plans rather than holistic planning. Problems on the supply side caused by the planning system did not become fully visible until around 2010. A major issue in the rapidly growing urban regions of recent decades is that the

supply side has responded weakly to rising prices. One significant explanation lies in the planning system established during the subsidized era. Despite longstanding criticism, the problems persisted, making planning processes – particularly for single-family homes – more difficult. As a result, high price levels have become entrenched, complicating market entry for younger households.

The growth in private debt generated by rising prices in metropolitan areas led, after 2010, to limitations on new lending to the owned housing market through loan-to-value caps and amortization requirements. These measures reduced risks to the financial system but also restricted younger households' ability to enter the housing market. The resulting increase in demand for rental housing – viewed as a low-risk asset class in the late 2010s – combined with low interest rates led to a new peak in rental-housing construction. The parallels with the mistakes of the late 1980s are substantial, and many Swedish municipalities are now confronted with large numbers of vacant rental units.

These surpluses also highlight the very different situation in sparsely populated regions. From the introduction of rent regulation onward, the system had been governed by allocation quotas managed by county administrative boards and housing committees. Because quotas were based on historical conditions, they became path-dependent and failed to reflect the ongoing structural transformation during the postwar decades. In municipalities with weak economic development, the resulting situation is therefore entirely different. The large stock built during the regulated period has led to a slow recovery in prices.

The municipalities illustrated in Figure 1.3 highlight this effect. In the weakest category, the population aged 20–44 – entering the labor market and forming new households – has fallen by a quarter since 1990. At the same time, the population over 65 continues to grow. As this group is soon expected to leave their single-family homes or rental apartments, the housing markets in sparsely populated regions will remain weak and in considerable need of restructuring. The combination of inexpensive single-family homes, population decline, and relatively high rents has produced vacancies and the need for demolitions. For a period, the surplus housing stock became a tool for generous migration policies, but this created severe integration challenges, leading to much more restrictive rules.

Consequently, the problems of declining demand and rising vacancies have reappeared during the 2020s.

## **A divided housing market**

Taken together, two waves of reforms have reshaped the structural demand for housing in Sweden. The general structure that characterized the housing sector for a very long time no longer exists. Recognizing the increasing heterogeneity of the markets is therefore essential for implementing measures that can improve conditions in those parts of the housing sector that have experienced the greatest problems during the market-dominated period after 1995. Above all, this concerns the socioeconomically segregated areas of the larger cities, as well as sparsely populated regions more generally.