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Income effects of the utility value system

Summary

One of the Riksdag's housing policy objectives is a housing market that works well in the long term and in which consumers are supplied with a range of housing that meets their needs.¹ Several works in the legislative history have put forward that a policy favouring work and growth depends on an efficient housing market and an efficient rental market.²

One of the housing policy instruments used by the State is the much-debated system for rent-setting, called the utility value system. The idea is to prevent drastic rent hikes at times of housing shortages that force tenants with limited financial resources to move. The purpose is to provide existing tenants with security of tenure that is effective even in times of housing shortages, thus preventing segregation.

The security of tenure is created in that the rent is not only determined by the number of people prepared to pay, and thus does not soar when there is a housing shortage. In economic terms this is sometimes described as the individuals' values not being fully

¹ Govt. Bill 2008/09:1, Committee Report 2008/09:CU1, Riksdag Communication 2008/09:116 and 117.

² Govt. Bill 2011/12:1, Expenditure Area 18, Committee Report 2011/12:CU1.

capitalised in the rent level, and that the utility value rent may thus be lower than a potential market rent in a shortage market.

The fact that we do not have market rents on housing is, however, often criticised, for example because it can inhibit housing construction and create poor mobility in the housing market.

Several authorities are of the opinion that the housing shortage in Sweden is not general, but applies mainly to certain groups: above all young people and new arrivals, but also people who have recently moved to urban areas and households with low or average incomes.³ One explanation offered for this selective housing shortage is that the stock of rental housing is not fully utilised since the utility value system to some extent means that people can afford to remain in an apartment that is perhaps unnecessarily large, even if their income were to fall. Expressed in economic terms, the need for individuals to adapt their housing situation to any changes in income is reduced, since their valuation is not fully capitalised in the utility value rent.⁴

In that situation, the utility value system can be said to create an economic benefit for the person living in rented property. The economic benefit, if recognised by the tenant, may be utilised to occupy more space than he or she could have afforded if the rent had been adapted to the market. Another alternative is that the economic margin is used to reduce the labour supply; that is that people living in rented properties perceive the economic benefit created by the utility value system as a raised income, and that they thus do not need to work as much.⁵

This has been examined by the National Board of Housing, Building and Planning (2013) in a theoretical analysis, which showed that the utility value system generates welfare losses estimated by the Board to be almost SEK 10 billion per year. According to the Board of Housing, Building and Planning most of this welfare loss (about 90 per cent) is due to ineffective use of the housing stock.

Even if it is possible to predict these effects of the Swedish rent setting system based on theoretical assumptions, it is not a real problem until tenants really react to this transfer of value by reducing their labour supply, for example.

³ Ministry Publications Series 2015:35, *Investeringsstöd för anordnande av hyresbostäder och bostäder för studerande*, p. 40.

⁴ Compare for example Lindbeck (2016).

⁵ Compare for example National Board of Housing, Building and Planning (2013).

The purpose of this audit is to study the effect access to rented accommodation with lower rent than market rent as a result of the utility value system has on income increases and ultimately the labour supply.

In order to answer the question an experiment was used in which just over 600 rented housing units were allocated by lot to people seeking housing over a ten-year period. The purpose of the audit is not, however, to analyse the housing lottery itself, but to use the random distribution of rented accommodation among applicants that the lottery entailed to investigate how access to rented accommodation in a shortage market where utility value rent falls short of market rent affects individuals in various ways.

Audit findings

The audit supports the hypothesis that the utility value system means that access to rented accommodation in a shortage market has an effect on both income from work and education. The analysis shows that income from work decreases on average by about SEK 50 000 per individual and year in years 3, 4 and 5 after the individuals had moved into their rented housing and been allocated their own tenancy contract. At the same time the access to rental housing has a positive effect on education; the individuals who were allocated a tenancy contract raised their education level in years 3, 4, and 5 after moving into their rented housing, which is a ten percent improvement compared with those who did not get a tenancy contract. The negative effect on income from work remained, however, even taking into account the fact that the individuals started studying and reduced their income as a consequence. The income effect measured indicated that access to rented accommodation at a rent that is lower than market rent has a negative effect on income from work and thus does not benefit the labour supply, which is not in line with the intentions that housing policy should favour work and growth.

The effect on income may seem great, but the size can be compared with results from studies of lottery wins, for example. A study of lottery participants who win large and small prizes respectively shows that about eleven per cent of an income increase from a lottery or similar is used to reduce income from work (Imbens et al. 2001). If this is applied to the results of this audit, the average value of a tenancy contract in Solna for one year would be about SEK 450 000 kronor⁶. This is relatively well in line with the estimated value of a tenancy contract previously calculated by property owners and managers (Swedish Property Federation 2006). At that time the value was estimated to

⁶ Note that this represents an average value for the tenancy contracts distributed by lot in the experiment. The average unit size was about 3.5 rooms.

be about SEK 100 000–150 000 per room in the outskirts of Stockholm. However, housing prices, which are crucial for estimating the value of a tenancy contract, have increased by about 80 per cent in the county of Stockholm since 2006 when the survey was carried out.⁷ According to the magazine *Hem & Hyra* (2011)⁸ there are also cases where property owners buy out tenants (give evacuation grants) and then transform rented housing units into tenant-owner rights and sell them on. Compensation may then be anything from the cost of the move to several hundred thousand kronor, but there are extreme cases where tenants have received millions.

The audit refers to an aspect of the utility value system that is often drawn attention to but that has not been possible to analyse empirically. It is limited to a geographical area where there was a housing shortage during the period in question. The findings should therefore be possible to generalise for other housing markets and periods when there is a corresponding shortage.

The Swedish National Audit Office's observations

The audit findings give support to the hypothesis that the design of the rent-setting system, the utility value system, has a negative impact on individuals' labour supply. Earlier studies have not taken this effect of the utility value system into account. The report therefore contributes to new knowledge that should be used when proposals are formed about how the present system of rent-setting can be developed.

The audit also shows the link between households' income and segregation. The fact that the average income is lower in rented accommodation than in tenant-owner accommodation is often used to argue that the utility value system reduces income segregation (see for example Bergenstråhle 2016; Enström Öst et al. 2014). The audit findings show, however, that an explanation for these income differences may be the negative income effect that the utility value system in itself generates. Hence income is not an optimum indicator of whether the utility value system reduces segregation or not.

⁷ Source: Estate Agent Statistics.

⁸ Hem & Hyra, downloaded on 24 October 2017, <https://www.hemhyra.se/nyheter/salj-din-hyresratt-vitt/>.