RENTED DWELLINGS MARKET

Costs for rented dwellings are the largest single item in Sweden's consumer price index (over 11 per cent). Insights into pricing in this market are therefore of importance for monetary policy. Over the past two decades, dwelling rents have risen more strongly than the total CPI. One reason is that rented dwellings are a regulated market and this has resulted in weak competition.

In that CPI calculations assume that charges for cooperative dwellings follow rented dwellings, rent costs actually affect 15 per cent of the CPI (1997). A rent increase of, say, 3 per cent accordingly adds almost 0.5 percentage points to the level of the CPI. For domestic inflation as calculated by the Riksbank, this rent increase contributes as much as 0.7 percentage points.[4]

Sweden has approximately one and a half million rented dwellings, of which almost 60 per cent are managed by municipal housing utilities. Rents are set in negotiations whereby tenant associations and housing utilities agree on the total rent increase for a stock of properties with rented dwellings. The negotiations start from the utilities' cost position. In other words rent setting is based on costs.

The agreed increase is then distributed over the dwellings in the stock, a procedure that is regulated by the principle of utility value, which holds that the rent for a dwelling is to be set in relation to the dwelling's size, degree of modernity, layout, sound insulation, etc. Allowance is also made for the dwelling's general environmental location and distance from communications. No allowance is to be made at this stage for such factors as the year of construction and costs for construction and operation. The utility value principle also regulates the rent increases that private landlords are entitled to. Dwelling rents are accordingly driven by the public housing utilities. In the Swedish system for rent setting, the aggregated rent increase, which is registered in the CPI, is determined exclusively by the cost position of these utilities.

Why is it, then, that the costs of public housing utilities have risen faster than inflation in both the 1980s and the '90s? Almost 10 per cent of the rent is spent on municipal charges for water, sewerage services, refuse collection, etc. The price rise for such goods and services has regularly exceeded overall inflation in the 1990s. About 20 per cent of the rent covers property tax and depreciation. In recent years, property tax has risen at an average annual rate of about 13 per cent, while depreciation costs have tended to follow inflation. Heating costs take almost 15 per cent of the rent and are another item that has regularly risen faster than the CPI. Interest costs, which represent about 30 per cent of the rent, are an item that, in view of the lower interest rates, might be expected to lead to a slower future increase in rents. As the housing utilities borrow mainly on a long-term basis, the full effect of a general fall in interest rates takes time to materialise. Moreover, the effect of lower interest rates has been partly countered by the gradual reduction of interest subsidies. Besides the items mentioned above, rent has to cover costs for rent default, insurance, vacant dwellings, administration, operation and maintenance.

To sum up, rents have risen faster than inflation for various reasons. In the first place there is the system whereby rents are negotiated and the outcome is largely determined by landlords' costs. Moreover, substantial components of the operating costs are determined in "markets" where pricing has the characteristics of a monopoly. This weakens the incentive to be cost-efficient. The tax burden has grown appreciably and the reduction of subsidies in recent years has also added to costs, though this has been countered by lower interest rates. In the longer run the main problem is that the negotiating system does not provide the desired incentive to be efficient in resource utilisation and cost management. The system can therefore result in inflation being higher than otherwise.

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4 This follows from the Riksbank's assessment that goods and services produced in Sweden make up 64 per cent of the content of the CPI: $15/64 = 0.23$ and $0.23 \cdot 3 = 0.69$.