

On the economics of slum dwellings: a developed country approach

*Project description*¹

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Slum dwellings in Sweden

Sweden seemed to for a long time enjoy a reputation of high living standards; both in terms of average figures such as size of housing, but also in terms of a high lowest level of housing standard. This was influenced by post-war housing policies including the so called ‘million housing program’, a period between 1964-1975 during which a million new homes were to be created in a country of only around 8 million people. Despite the volumes of construction, the new housing provided a significant increase in housing quality for a large number of people, offering modern amenities. However, after three or four decades the mass produced housing units of the 1960s and 1970s are now reaching a level of decay that calls for significant renovation. Given that such a large number of housing were constructed in a short period of time, the need for large-scale refurbishment will appear about the same time. This coincides with a period of access to easy capital during the financial boom in the early 2000’s. This could be taken as a sign that financing of refurbishment should be more easily achievable., but this seems not to have been the case. On the contrary, it

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seems that the easy access to capital have resulted in quickly rising property prices. Coincidentally – or maybe not – this was also a period when several cases of slum dwellings came to the common notion of Swedes.

The origin of this paper comes from a growing notion that Sweden, often used as an example of a welfare state, has demonstrated examples of housing of such low standard that they could be referred to as slums. The major newspapers have all had articles on the existence of ‘slum lords’² in several Swedish cities. The concept of slum is emotional, often subjective, and calls for a clarification. In a segmented market, it is perfectly possible for a landlord to address a market segment with a low willingness to pay and thereby offer lower quality, e.g. by less frequent renovation, using less expensive material and so on. This is not necessarily a problem, since also consumers may prefer a lower price and spend their money on other goods. The cases referred to here are however cases where the living standard is below an acceptable level from a public health and safety perspective. When substandard housing is referred to in this text, the focus is housing with problems grave enough to cause severe health problems. The examples include housing with e.g. inner walls covered with mould causing severe respiratory problems for the inhabitants, balconies so poorly maintained they fall down, and cockroach-infested apartments. At the risk of inflating the concept, the study will use the word slum for the phenomenon. Certainly, there are many similarities to slum dwellings in developing countries, but the existence of low quality housing is more puzzling in countries where the living standard generally is high and the institutional framework stronger. Furthermore, studies from developing countries often focus on the legal aspects as key characteristics of slums, since many slums consist of squatters and there is a lack of formalized possession. The cases referred to in this study in general do not demonstrate problems associated with property rights. Nevertheless, there are general features of slum dwellings that may make experiences from developing countries useful.

The aim of this project description is to provide a review of the research on the slum dwelling phenomenon in developed countries and to contribute to an understanding of the existence of slums in relatively wealthy societies. The study will be used as a starting point for further research, including research-funding applications.

Slum is of course not a new phenomenon, but for a welfare society such as the Swedish one, it seems to have come as a surprise to many. The study starts with a general discussion of the slum concept using what is called the housing condition diamond. This is a framework that allows for a general discussion of the different dimensions of what we mean by the concept of slum. This is important because there are several aspects of a slum, and slum areas may differ. From this, the focus will shift somewhat and focus on the slumlords; who are they, and what are the driving forces behind? The discussion has a market approach, focusing on supply side explanations as well as demand side explanations. Subsequently, there will be a classification of slumlords as experienced from the Swedish market. Given the difficulty of finding empirical data, this classification should be

² Examples include Svenska dagbladet, January 19 2011 on the Stockholm area, Corren, February 23 2013 on the Linköping area, and Sydsvenskan September 25 2013 on Malmo.

interpreted as a start for further studies. Finally, the discussion will turn to looking at compliance of the regulations targeting property maintenance. Unlike many developing countries, the Swedish cases of slumlords exist in a context of a fairly regulated system and there should be several legal means to address the issue from a legal perspective. This part should primarily be considered as an explorative discussion and suggesting future research.

The explorative approach to the study also implies that a mix of methods has been used. Deriving from media representation and primarily newspaper articles, the article classifies slumlords into two different types that have seemed to be prevalent on the Swedish market. Interviews with the Tenant association and area representatives were also performed.

The different dimensions of slums

Encyclopaedia Britannica defines slum as a ‘densely populated area of substandard housing, usually in a city, characterized by unsanitary conditions and social disorganization’. *Oxford Encyclopaedic Dictionary* (OED) has a similar definition: ‘an overcrowded and squalid back street, district, etc. usually in a city and inhabited by very poor people’ adds a second definition: ‘a house or building unfit for human habitation’ (Hawkins and Allen, 1991: 1369). The first definitions are thus focused on the neighbourhood, whereas the second one focuses on separate buildings. The definition used here is the second one, and thus slum landlords are providers of housing unfit for human habitation. The usage of the concept slum has received criticism and was for some period almost not used in scientific and policy documents (source). One problem, as asserted by e.g. Gilbert (2007), is the risk of labeling inhabitants of a certain area. Undoubtedly, slum is a concept that stirs emotions and it is not always clear what is meant by the concept.

One reason for this is simply that slums are not homogeneous and may have different characteristics. Gulyani and Talukdar (2008) suggest that a one-dimensional view of the concept is not very useful and instead suggest using a multi criteria framework. Gulyani and Talukdar (2008) suggest using a four-dimension framework of slum areas rather than one single definition or threshold, using a so-called living conditions diamond. The living conditions diamond contains the characteristics of infrastructure, Housing unit, Tenure, and neighbourhood and location. The point of using different characteristics is to allow for an analysis when in fact slums may have very different characteristics, but there are also certain characteristics that are in common.

The living conditions diamond have bearings also for this case, although the focus is on separate dwellings rather than whole neighbourhoods, and on a developed country setting rather than a developing country setting. Nevertheless, it provides a framework that allows for an analysis of the concept also when context differs.

Tenure

Tenure is one of the characteristics that demark a general difference between developed and developing countries. Most slum studies, in fact many definitions, being explicit or more implicit, refer to informal settlements as one of the things defining a slum. In many slum areas, residents do not have the formal right to the land. Early works of de Soto (1989) claim this lack of property rights has contributed to poverty traps, since it is not possible to invest in your home or use it as collateral. In the Swedish cases we are looking at here, there is no such informality of land rights. There are a few cases reported in which immigrants not being part of the welfare system have built what can be considered informal settlements, but these are very brief and are in general quickly evicted by the local authorities. For most cases, the landlord is the formal owner of the real estate property. The informality instead often concerns the landlord-tenant relation.

Infrastructure

Developing country slums generally lack in providing basic services such as water and sanitation to the inhabitants. The provision of these services are made both through the municipality, providing the physical networks, private sector providers who may be providing the services associated with the utilities, and the landlord who provides in the dwelling provisions. For the Swedish cases, the public investments seem not to differ greatly from more advantageous neighbourhoods. The focus may therefore rather be on the part of utility networks that are put in place and maintained by the landlord and the focus may therefore be more on dwelling characteristics rather than general infrastructure.

Neighbourhood

The neighbourhood matters in several potential ways. For a single landlord, the investment activities of surrounding landlords may affect the returns on investment in your own dwellings. This type of spatial externalities may make it difficult for single landlords to upgrade their dwellings if their portfolio constitutes a small share of the total neighbourhood properties. In order to create a positive development, landlords need to be coordinated. The incentives for one landlord to invest may be a function of the total investment in the area.

There may also be a risk of lock-in effects if landlords for speculative reasons refrain from investing, thus waiting out other landlords or public actors to invest and subsequently be able to reap the benefits of this by selling at a higher price. Investing in public goods can most certainly suffer from a free rider problem, so that each property owner may be deterred from investing. These positive externalities may result in underinvestment in areas where property ownership is dispersed, as compared to areas where one owner dominates the market or even has full control.

Housing unit

The focus of this study is the dwelling rather than the neighbourhood. Although the degree generally differs from developing countries, the basic notion of lack of basic necessities are still observable;

lack of heating, health hazard coming from poor ventilation but also lack of basic maintenance of e.g. balconies and elevators.

Supply side explanations to slum lord strategies

Putting it simply, the market value of real estate is generally defined as the present value of future profits. This is similar to valuing other types of assets, such as stocks. For real estate, this implies that the asset market, where properties are sold, depend highly on the space market, which is a rental market (DiPasquale and Wheaton, 1992). Poor maintenance should thus, all else equal, result in lower price of the property. A very low level of maintenance should by this way of reasoning not be a sound financial strategy, since below a certain level of maintenance you would risk deteriorating the capital stock. However, one aspect that differ real estate from stocks is the existence of transaction costs, stemming from the notion that real estate are highly heterogeneous and the owner in general has an information advantage when it come so the maintenance of the property.

From a micro perspective, the real estate market is characterized by, among other factors, high transaction costs. A useful taxonomy divides transaction costs into three different types of costs according to the different phases of the transaction (Dahlman, 1979). First, there are search costs associated with buyers and sellers finding each other, and this type of costs tend to decrease with the level of heterogeneity associated with the product. Given the geographical characteristics of real estate assets, real estate tends to be pretty much unique products. This goes for land but also for the buildings constructed on the piece of land as well; a phenomenon which is closely related to the fact that buildings have long life cycles. For the transaction, this implies that the seller in general has an information advantage over the potential buyer. This incurs costs on the buyer; for transactions of commercial real estate assets, different forms of due diligence is undertaken in order to estimate the quality of the asset. However, poor maintenance does not necessarily reveal itself until after a few years. Although there is information on the overall maintenance costs from the annual reports, the buyer may still run a risk of not having complete information of the state of the building. In the line of reasoning of Akerlof, buyers would however in the lack of information expect all housing units in this case be of poor quality, hence running a risk of a market only containing poor quality housing. In other words, there are no incentives for the seller to invest in the housing. The second type of transactions costs has to do with the bargaining costs. Finally, there are bargaining costs and policing or enforcement costs. This final post is related to the first one in the sense that, if information is poor before the contract is written, the ex post costs may be considerably increased.

Poor maintenance of housing can stem from speculative behaviour in a boom market. Although there are still many questions to be raised about economics booms and busts, there is a well-documented pattern that seems to prevail in many different types of so called bubbles, even though the underlying asset may differ. The boom period is often characterized by easy access to capital. Agnello and Schuknecht (2011) suggest that both domestic and international credit influence the probability of busts and booms. Access to capital can be affected by regulations or deregulations of the capital market, but there also seems to be psychological effects influencing boom periods. In general, booms are characterized by less risk aversion, and warning signs are often written off

basically stating ‘this time is different’ (Reinhart & Rogoff, 2009). The period before the financial crash in 2007-2008 was a period characterized with intense innovations in the financial sector with new financial instruments. The bust period is often characterized as a mirror image of the boom period; the supply of capital is reduced partly due to investors getting cold feet. Capital thus becomes less easily available.

There may also exist other types of disincentives for the landlord to invest in a dwelling. Of the known cases, landlords are to large extent absentee landlords, meaning that they may lack some of the incentives to invest that a local landlord would have Gulyani and Talukdar (2008). A local investor may have a more long-term perspective of the investments, and also risk more in terms of brand-name and goodwill if hit by a bad reputation.

The market mechanism – demand side explanations

Many markets are segmented and that is not necessarily a problem. The fact that some production caters for a group with low willingness to pay by offering low quality goods is not necessarily a problem. Using the concept of Hirshman (1970), a consumer facing poor quality may have two choices; *exit* and *voice*. *Exit* means that the consumer may choose not to use the same product again or, in the case of tenant buildings, to move. In order for this to work, the market cannot exhibit any significant thresholds. For the rental market this is often not the case. In addition to direct moving costs, finding a new place to live involves search costs that may be considerable. Indirect costs may stem from having to change schools for families with children, only to mention an example. For low income household, the possibility of finding new housing may be close to non-existing, since a new rental contract can be hard to come by without a solid financial track record or current status.

The second option for the consumer is to use the voice mechanism; complaining to the producer or provider of the good. In the tenant situation, there is the possibility to raise concerns directly with the landlord, but there may also be organized ways of filing complaints.

Lind and Blomé (2012) state three reasons for why tenants choose not to leave substandard housing; i) a lack of viable options, ii) rent was not paid by the tenant and therefore the tenant allegedly should be less concerned with the quality of the product and iii) the preference of some tenants to have a no questions-asked policy.

Based on a census in Nairobi, Gulyani and Talukdar (2008) find that although residents in slums generally have low incomes, the rent levels in slum areas tend to be high. This is supported by anecdotal evidence from a real estate appraiser giving slum dwellings in Malmö and Lund as examples where rent per square meter would surpass high-end apartments in new constructions. In the Swedish cases, the large number of tenants sharing a flat or some of the apartments explained this.

Towards a typology of slum lords

The difficulty of finding reliable and representative data is a challenge when discussing a phenomenon with a negative ring, which furthermore is a fuzzy concept, and therefore any attempt to classify slumlords is a risky business. Nevertheless, patterns from qualitative data indicate the presence of two quite different types of slumlords that can be explained from two somewhat different theoretical perspectives. The first type of landlords, that perhaps is the most documented by media, are large institutional owners, often with a deliberate absentee strategy. The second type that has been found perhaps received less media but are still documented e.g. through tribunal cases. These are small, private owners present in cities but also in more rural settings. Given that these two types of owners differ in the underlying strategies and incentives, it can be useful to use a typology.

Type I: a large, absent owner

Swedish media have reported on several cases of dilapidated tenant houses, often but not always in poorer neighbourhoods of the larger Swedish cities. The so-called million program housing units that were constructed in the 1960s and 1970s have, after a few decades, entered a phase of large-scale renovation needs. When constructed, these areas implied attractive housing for large groups of people coming from very poor housing conditions, since the new dwellings provided modern sanitary facilities, kitchens and other housing amenities, but also the areas were thought to offer attractive. This social engineering soon however turned into something very different and became symbols of social problems. The stigma implied that the purchasing power remained low, and can be said to have contributed to a downward spiral of the neighbourhoods.

The entrance of large-scale real estate companies with a low maintenance profile coincided with a prolonged boom period of not just the Swedish economy, but also the global economy. Two of the most referred-to owners (newspapers explicitly used slumlords as an expression to describe these particular landlords) in the Swedish cases were two internationally owned investment companies, funded by large pension funds. The ownership strategy may therefore be described as portfolio investments, where dwelling-specific and local risks could be diversified through a balanced portfolio. Property prices were also rapidly increasing, making overall risks smaller as long as prices would continue to rise. The boom years of 2005-2007 seem to have attracted several short-term investors to the Swedish tenant market. The phenomenon seems to demonstrate the characteristics of economic booms; access to cheap capital, steadily rising property prices and increasing risk propensity. Property transactions contain considerable transaction costs and the risk of information asymmetry in the transaction can therefore make it a viable strategy for short-term performance. Anecdotal evidence suggests that many of the transactions were undertaken without previous due diligence and little local knowledge.

The property assets of the two large international owners seem to follow the business cycle. Although assets are not public information, larger transactions are generally reported in the media. After 2008, when the financial markets went into severe trouble, the companies started selling off.

Today the total assets are very small. The continuation of the project will include a descriptive study of real estate transactions of one or two highly cited landlords.

Type II: small, private owners

One source of identifying slumlords is to look into tribunal cases from the Regional Rent and Tenancies Tribunals. The tribunals deal with tenant dissatisfaction with the housing standards, and from cases lost by landlords are presented in a landlord blacklisting by the Swedish Union of Tenants. A quick look at the blacklist reveals the somewhat surprising notion that the companies mentioned above are not present. Instead the striking finding is the over-representation of small private owners. In most cases, tenant houses are packaged into companies, and transferred as companies rather than real estate property. However, many of the landlords in the list of resolved tribunal cases are private individuals.

From an economic perspective, the existence of scale economies in property management could suggest that smaller units are less efficient than larger units. This could serve as one explanation of the over-representation of small landlords. The scale economies refer to the actual property maintenance functions, such as janitors and electricians, as well as administrative services of handling customer relations and conflicts. Anecdotal evidence from local landlords confirm the difficulty of smaller property managers to exploit scale economies, but international evidence (Kemp and Ferrari, 2012) points to an increasing role of small private landlords, implying this is not necessarily the case. The Scottish findings do however highlight the role of local knowledge as a deliberate strategy amongst smaller landlords.

Another possible explanation to the over-representation of smaller owners may come from the type of spatial externalities discussed above. For a smaller owner, the possibilities of affecting the neighbourhood should be smaller than that of large owners who may control a large share of the building stock. When a neighbourhood facing a downward spiral of development, an ownership structure of dispersed ownership may complicate the picture and make it more difficult to turn the negative trend around. The continuation of this project is thought to focus on a case study showing the characteristics of a dispersed neighbourhood. Given the difficulty of finding representative data, a case study may be a more appropriate manner to approach the question.

The voice mechanism – a tribunal case perspective

A related but somewhat different aspect of the issue of slumlords refers to who gets represented through the institutional framework. Regional Rent and Tenancies Tribunals discussed above are thought to provide a consumer protection to tenants primarily by working as mediators in civil law suits between tenants and landlords. However, when mediation is not possible the tribunal can also

make decisions in certain cases. Each year 25 000 – 30 000 cases are received by the tribunals, but only dozens get as far as reaching a verdict by the tribunal.



Map 1. Geographic distribution of tribunal cases in the Regional rent and tenancies tribunal. Source: The Swedish Union of Tenants

One of the tools at hand of the tribunals is imposition of maintenance (förvaltningsåläggande). The landlord is then forced to contract another real estate manager to correct the found errors. The landlord is to stay away from the property in question.

A more severe penalty is receivership (tvångsförvaltning) and implies that the owner loses the right to maintain the property and that public authorities decide on another property manager. This penalty is imposed when the landlord e.g. fails to pay for electricity or hot water so that the tenants run the risk of not having access to basic necessities. According to the local tenant union representatives, receivership has become more difficult lately given that it is difficult to find property managers willing to take over the property management. One reason for this, they claim, is the slimmed-down organizations in the business. Previously, the municipal housing companies would often assume the

task whereas today there seems to be more reluctance. The municipal companies would previously have social goals as part of their business goals, but are today required to act as private businesses and make market based decisions (free translation)³.

Using the court cases to highlight the problem of slumlords raises the issue of who is eventually represented in the process. Although the list provides an indication of the problems, it only reveals cases that have gone through a lengthy legal processing. In that sense, it could be seen as the tip of an iceberg. However, there is also a risk of an adverse selection problem, in that it may underrepresent tenants with limited legal capacity, e.g. for lack of language, lack of knowledge of society. Furthermore the scale economies discussed may also exist in the legal capacities, making larger companies more skilled in avoiding negative publicity. Figure 1 shows a map of the geographic distribution of cases on the tenant black list. Although future work is needed for understanding the dynamics at place, the quick look suggests there is little correlation of the known cases from Swedish media.

In 1976, an *ex ante* control of purchaser of tenant buildings was installed, with the purpose of preventing speculative behaviour (SOU, 2008:75). The legislation implied that anyone who wanted to buy a tenant building needed to go through a control process before the transaction. In the present legislation, this system was replaced by the strengthened *ex post* possibility to run a civil law suit in which the tenant, either individually or through The Swedish Union of Tenants, can address the rent tribunal and, in some cases, appeal tribunals and the Supreme tribunal. The reason for abolishing the *ex ante* control, was allegedly (SOU 2008:75) that the regulation was considered inefficient.

To use the language of Becker (1968): The risk of a landlord breaking the law getting caught and receive a penalty today is relatively slim. The legislation is relatively strict, but enforcement is weak. In other words, the implementation of the regulation calls for some attention in itself.

Summary remarks and future work

The focus of this study is to provide a framework for further research, and as such the approach is explorative.

One suggestion from this brief study is that there are several studies from developing countries that may be used in order to understand the existence of slum dwellings also in a developed country. This does not imply that context is irrelevant, but rather the message is that many of the incentives structures may be similar. In any country, we need to provide housing also for groups who may not have a very competitive position on the market. For those groups, there is a real risk that housing has such low standard that it may call for special attention and solutions. On the supply side, the economic cycles may interact with the real estate markets in different ways, and globalization of

³ The exact Swedish formulation is 'affärsmässig'.

finances may trigger some of these problems. In other words, context may differ but economic fundamentals have an impact on developing and developed countries. Learning from other countries is therefore essential.

The study furthermore suggests that there seems to have been two main types of slumlords represented on the Swedish housing market. To some extent, these are driven by different rationales and call for further studies.

Finally, the handling of poor quality in housing raises issues related to what is referred to as voice and exit of tenants. Understanding who gets represented in the legal processes is fundamental for understanding the outcomes of the system. In the end, if we are to understand the phenomenon of slumlords, this is a vital part of the puzzle.

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DN, Herrgården - värst utsatta området i Rosengård, Publicerad 2008-12-20 16:43

DT, Akta dig för Acta Publicerad 10 dec 2008 06:45 Uppdaterad 9 jun 2011 12:43

SvD, Husen förfaller när slumvärdar tar över , 19 januari 2011 kl 04:00 , uppdaterad: 23 januari 2011 kl 21:36 (del i artikelserie)

SvD, Mögel i Sveriges största privata hyresvärd, 3 maj 2010 kl 15:08 , uppdaterad: 17 maj 2012 kl 03:20

SvD, SvD granskar: Slumvärdarna, del 2, ”Vi bor sämre än djur här”, 20 januari 2011 kl 02:00 , uppdaterad: 23 januari 2011 kl 21:49

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