

French Hotel Industry - Rates up only moderately despite business recovery

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As forecasted by MKG Consulting, 2006 confirms the strengthening of the recovery with an increase in the RevPAR by 5.4% on the first three quarters of the year.

œ Improved results on the 4* segment meant strong growth of occupancy rate (+3.7 points) with an increase in average daily rates that continues to be weak (+2.1%).

œ Growth in the RevPAR for other categories is the result of increases in average daily rates within the context of a stable occupancy rate.

œ Nonetheless, changes in rates are no surprise during a period when business is recovering. In the mid-term, rates practised by French hotels even prove to be mostly moderate.

Results of corporate chains in France by category

Cumulated results from January to September 2006

	Occupancy rate 09/06	Var. OR (pts)	ADR in € 09/06	Var. ADR %	RevPAR in € 09/06	Var. RevPAR %
0*/1*	72,7%	-0,7	35,7	5,3%	26,0	4,3%
2*	69,1%	0,3	60,2	3,1%	41,6	3,6%
3*	63,9%	0,3	86,6	2,5%	55,3	3,0%
4*	69,1%	3,7	187,9	2,1%	129,9	7,9%
GLOBAL	68,9%	0,5	77,0	4,7%	53,1	5,4%

Source: MKG Consulting Database - official supplier to hotel chains - October 2006

Average daily rates and RevPAR are expressed in euros all taxes included

As MKG Consulting forecasted, growth of the RevPAR has been stronger in 2006

The RevPAR for hotel chains in France on the first 3 quarters of 2006 is up by 5.4%. This result is perfectly in line with MKG Consulting's forecast for growth between 5% and 7%, confirming an acceleration of the business recovery for the sector with respect to growth in the RevPAR in France by 3.0% in 2005.

All categories are on an uptrend, and the prize goes to the 4* segment where the RevPAR rose by 7.9%. The French luxury hotel industry was greatly affected in recent years by the bad economic situation and the slump in international travel. But 2006 clearly marks the end of the tunnel. Occupancy rates rose by 3.7 points over 2005. The proportion of rooms sold by the 4* segment rose significantly from one year to the next with respect to other categories, reinforcing the increase of the global average daily rate (+4.7%).

Within this favourable climate, the other categories are no exception. On the 0* to 3* segments growth in average daily rates ensures growth for the RevPAR: between 3.0% for 3* and 4.3% for budgetproperties. But occupancy rates show very mild variations with a downtrend.

Can we thus conclude that hotel operators are experiencing the effects of the rate increase that took place in recent months, in an industry that has become too expensive?

Rate increases are fairly moderate in the end

Remembering a few arguments helps put recent changes into perspective.

- 1) The drop in occupancy rate for 0*/1* hotels since 2000 may be explained first by the strong growth in supply, rather than by the increase in rates. Between 2000 and 2005, the hotel supply for these categories grew by nearly 12,500 rooms, or 19.4%. At the same time, the number of rooms sold by hotels in 0*/1* chains, was far from being down: it grew by 9.4%. Demand rose in fact by 1.8% on average per year during this period, despite higher rates.
- 2) This growth in supply is mostly for the 1* segment rather than 0*: 9,500 additional rooms in 1* versus 3,000 rooms in 0*. This change appears to be in phase with a demand for improved quality in terms of equipment and attractiveness of rooms, even on these 'entry-level' segments. The increase in rates was a natural accompaniment to this desired improvement of products.
- 3) In the mid-term, the importance of rate hikes for the hotel sector deserves discussion. Since 1988, the change in average daily rates across all categories reached 1.2% on a yearly average. At the same time, the overall level of rates rose by 2.0% yearly.

The limited increase in global average daily rate may be explained first by the structural change of the chain hotel supply: the advent of the most economic categories limits rate hikes because of an increased supply of hotels offering inexpensive services.

But, even by segment, growth in hotel rates proves to be fairly moderate in the mid term.

Of course, the evolution of rates in budget categories might be stronger than on other segments: +3.5% annual growth on average since 1988. But contrary to an often widespread belief, 0* and 1* categories remain quite affordable. Comparison with the evolution of the minimum wage puts the increase of prices into perspective for the 0*/1* segment: whereas a 0*/1* room was the equivalent of 4.35 hours at minimum wage in 1988, this ratio falls to 4.30 hours in 2006.

On the other categories, mid-term changes are even less significant. For example, the average daily rate for the 4* segment where business is very sensitive to economic growth and the international situation, is very cyclical with periods of significant growth that are sometimes strong and periods of great stability and decline. But on average since 1988, growth has been 1.9% per year. On this period, the rate hike followed closely behind inflation. And yet we may observe a qualitative improvement in the 4* supply with property openings at the upper end of the segment.

4) Since the bottom of the cycle in 2003, average daily rates have returned to a growth track. Their progress tends to accelerate for all segments (+2.2% growth in 2005 and +4.7% at the end of September 2006 overall).

But the explanation of this performance is based on the success of optimisation strategies of the clientele mix. In fact, in 2006, hoteliers show an increase in volumes of nights of the most profitable clientele (business and international clientele).

The distribution of rooms via less profitable channels, which hotels tend to develop in periods when the economy is slow, becomes less indispensable. Growth of average daily rates thus comes, at least in the early stages of recovery, as much from the change in the clientele mix as from the changes in rates.

One concluding observation must be made with regard to the outlook for the French hotel market. In recent years, the biggest real estate investment groups or hoteliers are seeking entry into France's market, particularly on the economy segments.

This is what recent transactions involving Eurazeo with B&B, or Foncière des Murs with Accor reveal. Very recently B&B has been preparing to buy Villages Hôtel, and the operation ought to become effective beginning 2007. In this period of improved performance, 4* hotels are no exception since Paris will soon add a new palace to its inventory with the opening of Fouquet's, on November 3.

These operations reflect the confidence of operators within a sector that practices rates that are far from exorbitant and whose recent changes are in no way exceptional in the end.

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