HOTEL CALIFORNIA©

In 1982, Rebecca Warren obtained her bachelors degree in Business Administration from California State University, Chino, specializing in the hospitality industry. After working for fifteen years as a manager at the Marriott Hotel in Newport Beach, California, Ms. Warren decided to go on her own and acquire an existing hotel located in Palm Desert in the state of Green and convert it to a bed and breakfast inn.

After locating a suitable hotel, known as Hotel California, Ms. Warren conducted an in-depth study of the market and decided that the hotel possessed an immense potential if it were to become a bed and breakfast inn. She contacted the listing agent of the hotel, Babak Gordon, and obtained preliminary data on the property, including financial statements of the hotel for the past three years. The hotel was listed for sale for $4.5 million.

After conducting her own due diligence, Ms. Warren, Shirley Ramirez, the hotel owner, and Mr. Gordon met on January 5, 2005 and had a preliminary discussion on the purchase and sale of the hotel. Following the meeting, Ms. Ramirez called Ms. Warren and offered her the property for $4.3 million, excluding the furniture. The sale was to conclude following a 45-day escrow. On January 6, 2005, Ms. Warren faxed Ms. Ramirez a letter stating the following:

> "Thank you for offering to sell me the hotel you own, Hotel California, located at 20567 Avenue of the Stars, Palm Desert, Green. I am excited to accept your offer to sell the hotel for $4.3 million, excluding the furniture. However, since it would take me some time to arrange financing, I would like to close escrow within 60 days. I look forward to working with you on this deal.
>
> Sincerely,
>
> Signed
> /S/ Rebecca Warren"

The same day, Ms. Warren contacted a number of lenders to secure financing for the deal. Most lenders that she contacted turned her down due to her poor credit record and lack of business ownership experience. However, on January 30, 2005, she managed to obtain a financing commitment from one lender. It was a sixty-day firm commercial loan commitment from Bank of the West. The loan commitment required that Bank of the West would obtain a first priority lien on the hotel property, as well as on an unrelated undeveloped parcel of land that Ms. Warren owned in Lagoon Beach, Green. Ms. Warren had acquired the land in Lagoon Beach in 1984 and had managed to pay off the mortgage on that property on November 1,

2004. However, the lender on the Lagoon Beach property, Mechanics National Bank, had failed to remove the lien it had on that property despite the language in the deed of trust requiring it to promptly record a reconveyance of its lien on the property upon payment in full of the underlying loan.[1]

For the next sixty days following her faxed response, Ms. Warren vigorously attempted to get Mechanics National Bank to remove its lien on the Lagoon Beach property, but to no avail. She specifically mentioned to a number of officers at the bank that she would need Mechanics National Bank to reconvey the lien on her Lagoon Beach property as soon as possible so that she could pledge the property as collateral for a new loan she was in the process of obtaining to finance a hotel acquisition. Despite repeated assurances from various officers at Mechanics National Bank, no one at Mechanics National Bank initiated and followed up on the processing of the reconveyance request. The failure resulted due to the various internal turnovers in Mechanics National Bank. The estimated market price for the undeveloped Lagoon Beach property is approximately $800,000.

To further her chances of obtaining a loan from the Bank of the West (and to try and persuade them to lend the money without a lien on the vacant land,) Ms. Warren contracted for an appraisal report from an independent company. Ms. Warren hired Desert Mirage Accounting to prepare an appraisal using techniques that banks generally employ to determine the loan value of small hotels. Unfortunately, that valuation did not result in enough loan value to justify the hotel property as the sole collateral on the loan. Hence, to obtain the loan from Bank of the West, she still needed clear title to the vacant land.

On March 28, 2005, following the sixtieth day, Bank of the West informed Ms. Warren that its previous loan commitment of sixty days had expired. Ms. Warren desperately attempted to obtain alternative financing, but was unable to locate another loan.

Hoping to get extra time, Ms. Warren contacted Ms. Ramirez and Mr. Gordon and asked for a thirty days extension for the consummation of the deal. Mr. Gordon then informed Ms. Warren that Ms. Ramirez had already entered into a sale agreement with another buyer and hence the property was no longer available for sale.

Not giving up on her dream of owning a bed and breakfast Inn, Ms. Warren located another hotel, similarly situated, that was virtually identical to the one she pursued

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[1] In most states, lenders typically use the deed of trust as the mechanism for holding a security interest in real property. In a deed of trust transaction, the borrower deeds to the trustee the property that is to be put up as security for the mortgage obtained from the lender. The trust agreement usually gives the trustee the right to foreclose or sell the property if the debtor fails to make a required payment on the debt. However, under the typical “reconveyance clause” in a deed of trust, upon full repayment of the debt, the lender must request the trustee to promptly reconvey the property and release any liens on it too.

previously. Later in 2005, Ms. Warren acquired it for $4.7 million, excluding the furniture.

Ms. Warren is now seeking a recovery for her damages of lost opportunity to acquire the first Palm Desert hotel. She is suing her former mortgage lender, Mechanics National Bank, for negligent failure to promptly remove the lien on her Lagoon Beach property.

The Hotel CA Income Statement is provided as a separate Excel file.

Required

Your company is handling Ms. Warren's lawsuit. Your team has been charged with writing a report for your company.

In answering this case, please review financial accounting LDC concepts 6 (valuation), 5 (cash flow analysis) and 7 (time value of money); statistics concept 5; and business law concepts 1, 2, and 10.