

Solera National Bancorp, Inc.
Form 10-K
March 23, 2011
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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10 - K

**x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934**

For the fiscal year ended December 31, 2010

OR

**o TRANSITION REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF
1934**

Commission File Number 000-53181

SOLERA NATIONAL BANCORP, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of

02-0774841
(I.R.S. Employer

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incorporation or organization)

Identification No.)

319 South Sheridan Boulevard Lakewood, CO 80226

(Address of principal executive offices, including zip code)

(303) 209-8600

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: **None**

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value

\$.01 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant computed by reference to the price at which the common equity was last sold as of June 30, 2010 was \$8,999,777.

The number of shares of common stock, par value \$0.01 share, of the Registrant outstanding as of March 16, 2011, was 2,553,671.

DOCUMENTS INCORPORATED BY REFERENCE: Portions of the Company's definitive proxy statement for the 2011 Annual Meeting of Stockholders, expected to be held in June 2011, are incorporated by reference into Part III of this Form 10-K.

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ANNUAL REPORT ON FORM 10-K

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PART I

INTRODUCTORY NOTE. CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION AND RISK FACTORS

This Report on Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 about Solera National Bancorp, Inc. (the Company) and its subsidiary, Solera National Bank (the Bank, collectively with the Company, sometimes referred to as we, us and our) that are subject to risks and uncertainties. Forward-looking statements include information concerning future financial performance, business strategy, projected plans and objectives. Statements preceded by, followed by or that otherwise include the words anticipates, believes, estimates, expects, intends, plans, may increase, may fluctuate and similar expressions of future or conditional verbs such as will, should, would, and could are generally forward-looking in nature and not historical facts. Actual results may differ materially from those projected, implied, anticipated or expected in the forward-looking statements. Readers of this Annual Report should not rely solely on the forward-looking statements and should consider all uncertainties and risks throughout this Report. The statements are representative only as of the date they are made, and Solera National Bancorp, Inc. undertakes no obligation to update any forward-looking statement.

These forward-looking statements, implicitly and explicitly, include the assumptions underlying the statements and other information with respect to the Company's beliefs, plans, objectives, goals, expectations, anticipations, estimates, financial condition, results of operations, future performance and business, including management's expectations and estimates with respect to revenues, expenses, return on equity, return on assets, efficiency ratio, asset quality and other financial data and capital and performance ratios.

Although the Company believes that the expectations reflected in the forward-looking statements are reasonable, these statements involve risks and uncertainties that are subject to change based on various important factors, some of which are beyond the control of the Company. The following factors, among others, could cause the Company's results or financial performance to differ materially from its goals, plans, objectives, intentions, expectations and other forward-looking statements:

- the Company has a limited operating history upon which to base an estimate of its future financial performance;
- management of Solera National Bank may be unable to limit credit risk associated with Solera National Bank's loan portfolio, which would affect the Company's profitability;
- general economic conditions may be less favorable than expected, causing an adverse impact on our financial performance;
- the Company is subject to extensive regulatory oversight, which could restrain its growth and profitability;

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- our ability to comply with our Consent Order and potential regulatory actions if we fail to comply;
- interest rate volatility could significantly harm our business;
- the Company may not be able to raise additional capital on terms favorable to it;
- the effects of competition from a variety of competitors; and
- other factors including those disclosed under *Part I Item 1A Risk Factors* in this Annual Report on Form 10-K.

Any forward-looking statement made in this Annual Report on Form 10-K or elsewhere speaks only as of the date on which it is made. New risks and uncertainties arise from time to time, and it is impossible for management to predict these events or how they may affect the Company. The Company has no duty to, and does not intend to, update or revise the forward-looking statements in this Annual Report on Form 10-K after the date of

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this filing, except as may be required by law. In light of these risks and uncertainties, any forward-looking statement made in this Annual Report on Form 10-K or elsewhere might not occur.

Item 1. Business

Overview

Solera National Bancorp, Inc. - The Company, headquartered in Lakewood, Colorado, was organized as a Delaware corporation in 2006 to serve as a bank holding company for the Bank. The Company received approval from the Federal Reserve Bank of Kansas City to operate as a bank holding company for Solera National Bank on July 27, 2007. The Company raised a total of \$25.5 million in its initial public offering and used \$20.0 million of the proceeds to purchase shares of the Bank's common stock.

The Company chose a holding company structure because it believed it would provide flexibility in accommodating the Company's and Bank's business objectives. For example, with a holding company structure, the Company may assist the Bank in maintaining its required capital ratios by borrowing money and contributing the proceeds of that debt to the Bank as primary capital. Additionally, under provisions of the Gramm-Leach-Bliley Act, if the Company elected to be a financial holding company, it could engage in activities that are financial in nature or incidental or complementary to a financial activity, including merchant banking activities, in which the Bank would be prohibited from engaging.

At this time, the Company engages in no material business operations other than owning and managing the Bank. At December 31, 2010, Solera National Bancorp, Inc. had no employees, as all employees are employees of the Bank.

Solera National Bank. - On September 10, 2007, the Bank began banking operations as a federally-chartered national bank, having received all necessary regulatory approvals. The Federal Deposit Insurance Corporation, (FDIC), insures the Bank's deposit accounts up to the maximum amount currently allowable under federal law. The Bank is subject to examination and regulation by the Office of the Comptroller of the Currency, (OCC). The Bank is further subject to regulations by the Federal Reserve Board concerning reserves to be maintained against deposits and certain other matters and is a member of the Federal Reserve Bank (FRB).

Solera National Bank is a full-service commercial bank headquartered in Lakewood, Colorado with 25 full-time equivalent employees primarily dedicated to serving the six-county Denver metropolitan area. The Bank offers a broad range of commercial and consumer banking services to small- and medium-sized businesses, licensed professionals and individuals. While the Bank seeks to serve the entire community, it focuses on serving the local Hispanic and other minority populations which it believes are currently underserved. The Bank's website is www.solerabank.com.

Available Information

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The Company's Investor Relations information can be obtained through the Bank's internet address, www.solerabank.com. The Company makes available on or through its Investor Relations page without charge, its annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the SEC. The Company's reports filed with, or furnished to, the SEC are also available at the SEC's website at www.sec.gov. In addition, the Company makes available, free of charge, its press releases, and charters for the Audit Committee, Compensation Committee and Nomination and Corporate Governance Committee through the Company's Investor Relations page. Information on our website is not incorporated by reference into this document and should not be considered part of this Report.

Philosophy and Strategy

Solera National Bank operates as a full-service community bank, offering a wide array of financial products while emphasizing prompt, personalized customer service. The Bank believes that this philosophy, encompassing the service aspects of community banking, distinguishes the Bank from its competitors.

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To carry out its philosophy, the Bank's business strategy involves the following:

- capitalizing on the diverse community involvement, professional expertise and personal and business contacts of its Directors, executive officers and Community Advisory Council members;
- hiring and retaining experienced and qualified banking personnel, many of whom are bilingual;
- providing personalized customer service with consistent, local decision-making authority;
- utilizing technology and strategic outsourcing to provide a broad array of convenient products and services;
- operating from a highly visible and accessible banking office in close proximity to concentrations of targeted commercial businesses and professionals; and
- utilizing an effective business development calling program.

Market Opportunities

Primary Service Area. Solera National Bank's primary service area is the six-county Denver metropolitan area. The Bank's main office is located at 319 South Sheridan Boulevard in Lakewood, Colorado. According to information prepared by the Environmental Systems Research Institute, within a three mile radius of the Bank's main office, there are approximately 5,200 businesses, 52,000 employees and 165,000 residents. The Bank is targeting these small- to mid-sized businesses, as well as local residents. This location offers the ability to target Hispanic and other minority populations. For example, approximately 52% are Hispanic households within three miles of the Bank's main office. Solera National Bank draws most of its customer deposits and conducts most of its lending transactions from and within its primary service areas.

National Economy. On a national level, most economic indicators showed much-anticipated signs of improvement by the end of 2010. Preliminary data show the U.S. GDP increased at a real rate of 3.2% in the fourth quarter as exports increased and household spending rose at the fastest pace reported since early 2006. Consumer confidence readings ended 2010 at higher levels than they reached in late 2009, although households are still watching for signs of increased job prospects and higher income.

The U.S. Department of Labor, Bureau of Labor Statistics reported on March 4th, 2011, that the unemployment rate fell by 0.1% to 8.9% in February, while nonfarm payroll employment increased by 192,000. Job gains occurred in manufacturing, construction, professional and business services, health care, and transportation and warehousing.

Colorado Economy. Colorado's population has grown 15.84% since 2000. From 2009 to 2014, Colorado's population is projected to grow 10.11% compared to the projected national population growth of 4.64% through 2014. Colorado has been a high growth state since the 1950's with a population growth rate outpacing the national trend. Median household income should continue to grow faster than the rest of the nation as well.

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The Colorado economy continues to outperform the rest of the country. However, Colorado may lag the rest of the country in transitioning to an economic recovery because of the state's dependence on the natural gas industry; gas prices are not likely to return to 2007 levels until the national economy regains more solid footing. This means that bank performance in Colorado could take longer to turnaround than other areas.

According to statistics released by the Colorado Department of Labor and Employment on March 10, 2011, employers in Colorado added 2,200 non-farm payroll jobs from December to January for a total of 2,223,400 jobs. Private sector payroll jobs increased by 5,000 and government decreased by 2,800. The Colorado unemployment rate increased from 8.9% to 9.1% and the national unemployment rate dropped from 9.4% to 9.0% over the same period. At 9.1%, the January 2011 unemployment rate is up two-tenths of one percentage point from 8.9% in January 2010. The number of Coloradans participating in the labor force has declined 29,500 to 2,670,700, total employment has declined 30,900 to 2,427,400, and the number of unemployed has increased 3,300 to 243,300. The national unemployment rate declined from 9.7% to 9.0% from January 2010 to 2011.

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Colorado could potentially see additional bank failures and consolidation in the near future. Two significant failures have already been announced – United Western Bank and FirstTier Bank. These larger failures may have a negative impact on real estate values, particularly raw land and this could further stress other capital stressed banks. Many customers will be displaced or concerned about their bank and will continue to establish primary and secondary/backup banking relationships. The Dodd-Frank implementation will mean increased regulatory burden to all community banks increasing costs and decreasing profitability, and the image and reputation of banks will continue to suffer due to additional bank failures.

Denver Metropolitan Area Economy. The region's labor market has a long recovery ahead, but year-over-year gains suggest the rebuilding has begun, according to data compiled by the Metro Denver Economic Development Corporation (Metro Denver EDC Monthly Economic Summary February 2011). Metro Denver employers added a net total of 400 jobs between November and December. The small gain reflected seasonal data fluctuations, as layoffs in natural resources and construction that typically occur at this time of year offset seasonal hiring in wholesale and retail trade. The region began 2010 with an employment base dramatically smaller than it had been in previous years and incurred slight job gains during the year.

Metro Denver's unemployment rate remained unchanged at 8.5% in November and December. The region's unemployment rate for all of 2010 averaged 8.1%, or a rate three-tenths of a percentage point higher than the 2009 average and more than a full percentage point above the highest rate reported during the 2001 recession (7.0%). The average weekly number of new claims for unemployment insurance filed in Metro Denver declined between November and December. The weekly average calculated for the entire year (2,095) was roughly twice the average reported before the recession began but was almost 18% lower than the average from 2009.

Residential Real Estate. Data from Metrolist show Metro Denver existing home sales rose between November and December. December sales exceeded last year's sales total (+2.2%), although the gain was dwarfed by the broad pullback in sales that occurred earlier in the fall. Metro Denver existing home sales through all of 2010 fell 7.7% below the 2009 sales total as annual sales of detached homes fell 7.1% and sales of condominiums fell 10.2%. The number of new foreclosures filed in Metro Denver increased between November and December, but the total number of filings for the year was still almost 12% below the total reported in 2009. The 2010 data suggest the pace of foreclosures has clearly slowed, but the total filed in Metro Denver during the year (23,393) was still 24% higher than the total reported in 2006, when the foreclosure crisis started gaining momentum.

Commercial Real Estate. CB Richard Ellis' fourth quarter MarketView report for Denver's office market reflects several positive trends that emerged in 2010. Office market vacancy rates rose during the year, but rates did not reach the heights they did during the 2001 downturn. Toward the end of 2010, investors returned to the market to take advantage of affordable financing and a good selection of properties. Not all market fundamentals improved, though: lease rates have not recovered to a level that would support new development, and the CB Richard Ellis report suggests measurable rental rate growth could be a year or more away.

CB Richard Ellis' fourth quarter MarketView report suggests Denver's industrial market showed signs of improvement in 2010. Bulk warehouse leasing activity helped support the market throughout the year, as did activity by third-party logistics companies. Further, the industrial market has generally been less impacted by defaults and distressed assets than other property types. The market is still somewhat fragile, and landlords' focus on retaining tenants has kept lease rates low. Because construction in Metro Denver's market has been so limited, though, the market is poised to rebound with a good balance of supply and demand.

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CB Richard Ellis' fourth quarter MarketView report suggests Denver's retail market faces a slower recovery than the region's other property types. Average retail lease rates appear to have stabilized, but the report suggests rates may plateau for a while until stores grow more optimistic about expansion and vacancy falls more noticeably. For now, financing for retail projects remains tight, and the retailers that are optimistic seem more likely to expand their current space than they are to develop new buildings. Ultimately, sustained recoveries in consumer confidence and housing markets are indispensable for the recovery in retail real estate.

Competition. Solera National Bank faces substantial competition in both lending and deposit originations with other commercial banks, savings and loan associations, credit unions, consumer finance companies, pension trusts, mutual funds, insurance companies, mortgage bankers and brokers, brokerage and investment banking firms, asset-based non-bank lenders, government agencies and certain other non-financial institutions, including retail stores, that may offer more favorable financing alternatives than the Bank. The Bank generally competes based on customer service, the rates of interest charged on loans and the rates of interest paid for deposits.

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According to information disclosed on the FDIC's website (www.fdic.gov), as of June 30, 2010, most of the deposits held in traditional banking institutions in the Bank's primary banking market are attributable to super-regional banks (serving several states) and branch offices of out-of-state banks. The Company believes that banks headquartered outside of its primary service areas often lack the consistency of local leadership necessary to provide efficient service to individuals and small- to medium-sized business customers. Through its local ownership and management, the Company believes Solera National Bank is positioned to efficiently provide these customers with loan, deposit and other financial products tailored to fit their specific needs. The Company believes that the Bank competes effectively with larger and more established banks through an active business development program and by offering local access, competitive products and services, and more responsive customer service.

Business Strategy

Operating Strategy. In order to achieve the level of prompt, responsive service necessary to attract customers and to develop the Bank's image as a local bank with a community focus, Solera National Bank has employed the following operating strategies:

- *Experienced senior management.* The Bank's senior management possesses extensive experience in the banking industry, as well as substantial business and banking contacts in its primary service area.
- *Quality employees.* The Bank has hired, and will continue to hire, highly trained and seasoned staff. Ongoing training provides the staff with extensive knowledge of the Bank's products and services enabling its employees to answer questions and resolve customer issues quickly. The Bank has hired bilingual staff to serve diverse banking customers, including the Hispanic community.
- *Community-oriented Board of Directors.* The Bank's directors are either experienced bankers or local business and community leaders. All of its directors are currently or have been residents of the Bank's primary service areas, and most have significant business ties to the Bank's primary service areas, enabling them to be sensitive and responsive to the needs of the community. Additionally, the Board of Directors represents a wide variety of business experience and community involvement.
- *Well situated site.* The main office, located at 319 South Sheridan Boulevard in Lakewood, Colorado, occupies a highly visible location at a major traffic intersection. This site gives the Bank an extremely visible presence in a market that is dominated by branch offices of banks headquartered out of the area.
- *Individual customer focus.* The Bank is able to respond to credit requests quickly and be more flexible in approving loans based on collateral quality and personal knowledge of the customer. Clients enjoy the convenience of on-site visits by the Bank's business relationship managers and business consultation services.
- *Financial education and information resource center.* Solera National Bank serves as a financial and information center for the community, sponsoring professionals to conduct seminars and workshops on a variety of subjects of interest.

- *Officer, Director and Community Advisory Council call program.* The Company has implemented an active call program to promote its philosophy. The purpose of this call program is to visit prospective customers and to describe the Bank's products, services and philosophy and attending various business and community functions. All of the Bank's officers, Directors and Community Advisory Council members have extensive contacts in the Denver metropolitan market area alliance of local professionals.

- *Marketing and advertising.* The most significant marketing of the Bank are the calls on contacts provided by the officers, Directors, organizers, and stockholders of Solera National Bancorp, Inc. Additionally, the Bank expanded its outreach by forming a Community Advisory Council. The Council meets and communicates regularly to identify opportunities for the Bank.

Growth Strategies. Solera National Bank has implemented the following growth strategies:

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- *Capitalize on community orientation.* Management is capitalizing on the Bank's position as an independent, community bank to attract individuals, professionals and local business customers that may be underserved by larger banking institutions in its market area. As discussed previously, this includes tailoring services to the needs of the local community, particularly the Hispanic population.
- *Emphasize local decision-making.* The Bank is able to differentiate itself from the major regional banks operating in the Bank's market area by offering local decision-making by experienced bankers. This helps the Bank attract local businesses and service-minded customers.
- *Attract experienced lending officers.* Solera National Bank has hired experienced, well-trained lending officers. By hiring experienced lending officers, the Bank is able to grow more rapidly than it would if it hired inexperienced lending officers.
- *Offer fee-generating products and services.* The Bank's range of services, pricing strategies, interest rates paid and charged, and hours of operation are structured to attract its target customers and increase its market share. Solera National Bank strives to offer the small business person, professional, entrepreneur, and consumer, competitively priced products and services while utilizing technology and strategic outsourcing to increase fee revenue.
- *Small business lending.* The Bank provides services and capabilities for small- to medium-sized businesses utilizing long term financing for business acquisition, debt refinancing, working capital, real estate and equipment. The Bank has hired loan officers with extensive knowledge of small-business lending to provide adequate funding for the needs of these potential customers.

Lending Services

Lending Policy. The Bank offers a full range of lending products, including commercial loans to small- to medium-sized businesses, professionals, and consumer loans to individuals. The Bank understands that it is competing for these loans with competitors who are well established in its primary market area and have greater resources and lending limits. A quick response to credit requests has provided the Bank a competitive advantage.

The Bank's loan approval policy provides for two levels of lending authority. When the amount of total loans to a single borrower exceeds the Bank's President's or Chief Credit Officer's lending authority, the Board of Directors' Credit Committee determines whether to approve the loan request. The Bank will not make any loans to any of its Directors or executive officers unless the Board of Directors, excluding the interested party, first approves the loan, and the terms of the loan are no more favorable than would be available to any comparable borrower.

Lending Limits. The Bank's lending activities are subject to a variety of lending limits. Differing limits apply based on the type of loan or the nature of the borrower, including the borrower's relationship to the Bank. In general, however, the Bank may loan to any one borrower a maximum amount equal to 15% of the Bank's capital and surplus, or 25% if the amount that exceeds 15% is fully secured by financial instruments.. These lending limits will increase or decrease as the Bank's capital increases or decreases as a result of its earnings or losses,

among other reasons.

Credit Risks. The principal economic risk associated with each category of loans that the Bank expects to make is the creditworthiness of the borrower. Borrower creditworthiness is affected by general economic conditions and the strength of the relevant business market segment. General economic factors affecting a borrower's ability to repay include inflation and employment rates, as well as other factors affecting a borrower's customers, suppliers and employees. The larger, well-established financial institutions in the Bank's primary service areas are likely to make proportionately more loans to medium- to large-sized businesses than the Bank will make. Some of the Bank's commercial loans are made to small- to medium-sized businesses that may be less able to withstand competitive, economic and financial pressures than larger borrowers.

Real Estate Loans. Solera National Bank makes commercial real estate loans, construction and development loans and residential real estate loans. The following is a description of each of the major categories of real estate loans that the Bank makes and the risks associated with each class of loan.

- *Commercial real estate loans.* Commercial real estate loan terms generally are limited to ten years or less, although payments may be structured on a longer amortization basis. Interest rates may be fixed

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or adjustable, although rates typically will not be fixed for a period exceeding 60 months. Solera National Bank generally charges an origination fee for its services. The Bank generally requires personal guarantees from the principal owners of the property supported by a review by Bank management of the principal owners' personal financial statements. Risks associated with commercial real estate loans include fluctuations in the value of real estate, new job creation trends, tenant vacancy rates and the quality of the borrowers' management. The Bank limits its risk by analyzing borrowers' cash flow and collateral value on an ongoing basis.

- *Construction and development loans.* Solera National Bank generally makes owner-occupied construction loans with a pre-approved take-out loan and considers non-owner occupied construction loans on a case-by-case basis. Construction and development loans are generally made with a term of twelve to eighteen months and interest is paid monthly. The ratio of the loan principal to the value of the collateral as established by independent appraisal typically will not exceed industry standards. Loan proceeds are disbursed based on the percentage of completion and only after the project has been inspected by an experienced construction lender or third-party inspector. Risks associated with construction loans include fluctuations in the value of real estate and new job creation trends.

- *Residential real estate loans.* The Bank makes residential real estate loans consisting of residential second mortgage loans, home equity loans and lines of credit, and home improvement loans and lending for one-to-four family. The amortization of second mortgages generally does not exceed 15 years and the rates are generally not fixed for over 60 months. All loans are made in accordance with the Bank's appraisal policy with the ratio of the loan principal to the value of collateral as established by independent appraisal not exceeding 80%, unless the borrower has private mortgage insurance. The Bank expects that these loan-to-value ratios will be sufficient to compensate for fluctuations in real estate market value and to minimize losses that could result from a downturn in the residential real estate market.

Commercial and Industrial Loans. Solera National Bank targets small- to medium-sized commercial and industrial businesses. The terms of these loans vary by purpose and by type of underlying collateral, if any. The commercial loans are primarily underwritten on the basis of the borrower's ability to service the loan from cash flow. The Bank typically makes equipment loans for a term of seven years or less at fixed or variable rates, with the loan fully amortized over the term. Loans to support working capital typically have terms not exceeding one year and will usually be secured by accounts receivable, inventory or personal guarantees of the principals of the business. For loans secured by accounts receivable or inventory, principal is repaid as the assets securing the loan are converted into cash, and for loans secured with other types of collateral, principal is amortized during the term of the loan with remaining principal due at maturity. The quality of the commercial borrower's management and its ability both to properly evaluate changes in the supply and demand characteristics affecting its markets for products and services and to effectively respond to such changes are significant factors in a commercial borrower's creditworthiness. The Bank also offers a number of Small Business Administration (SBA) guaranteed loan programs to assist small businesses. The 504 program provides small businesses needing brick and mortar financing with long-term, fixed-rate financing to acquire major fixed assets for expansion or modernization. The 7(a) program helps start-up and existing small businesses obtain financing when they might not be eligible for business loans through normal lending channels.

Consumer Loans. Solera National Bank offers a variety of loans to individuals for personal, family and household purposes, including secured and unsecured installment and term loans. The loan officer reviews the borrower's past credit history, past income level, debt history and cash flow to determine the impact of all these factors on the ability of the borrower to make future payments as agreed. The principal competitors for consumer loans are the established banks and finance companies in the Bank's market.

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Composition of portfolio - The following table sets forth the composition of the Bank's loan portfolio.

(\$ in thousands)	December 31,	
	2010	2009
Real estate - commercial	\$ 38,504	\$ 26,063
Commercial and industrial	8,732	8,324
Real estate - residential	7,868	8,059
Construction and land development	1,894	7,067
Lease financing	1,359	
Consumer	540	991
GROSS LOANS	58,897	50,504
Net deferred (fees) / expenses	(75)	(114)
Allowance for loan losses	(1,175)	(830)
LOANS, NET	\$ 57,647	\$ 49,560

Average loan size of portfolio - The following table sets forth the number of loans, and the average size of each loan, within each class of the loan portfolio.

(\$ in thousands)	December 31, 2010		December 31, 2009	
	# of Loans	Average Loan Size	# of Loans	Average Loan Size
Real estate - commercial	67	\$ 575	39	\$ 668
Commercial and industrial	46	190	42	198
Real estate - residential	32	246	24	336
Construction and land development	4	473	8	883
Lease financing	1	1,359		
Consumer	28	19	33	30
GROSS LOANS	178	\$ 331	146	\$ 346

Repricing of portfolio - The following table summarizes the maturities for fixed rate loans and the repricing intervals for adjustable rate loans. A portion of the adjustable rate loans have floors which will keep those loans from repricing until interest rates move above those floors.

(\$ in thousands)	December 31, 2010			December 31, 2009		
	Fixed Rate	Principal Balance Adjustable Rate(1)	Total	Fixed Rate	Principal Balance Adjustable Rate(2)	Total
< 3 months	\$ 1,064	\$ 16,408	\$ 17,472	\$ 1,340	\$ 15,246	\$ 16,586
> 3 to 12 months	5,644		5,644	979		979
> 1 to 3 years	2,132	694	2,826	2,957		2,957
> 3 to 5 years	10,817	16,927	27,744	10,319	8,724	19,043
> over 5 years	4,831	380	5,211	10,939		10,939
Gross Loans Receivable	\$ 24,488	\$ 34,409	\$ 58,897	\$ 26,534	\$ 23,970	\$ 50,504

(1) Of the \$34.4 million adjustable rate loans, \$29.2 million mature after December 31, 2011.

(2) Of the \$24.0 million adjustable rate loans, \$10.8 million mature after December 31, 2010.

Contractual maturity of portfolio - The following tables set forth information at December 31, 2010 and 2009, regarding the dollar amount of loans maturing in the Bank's portfolio based on the contractual terms to maturity. The table does not give effect to potential prepayments. Loans that have no stated schedule of repayments or maturity are reported as due in one year or less.

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(\$ in thousands)	December 31, 2010					Total Loans
	<1 Year	1 - 5 Years	5 - 15 Years	Over 15 Years		
Real estate commercial	\$ 4,098	\$ 10,676	\$ 23,730	\$	\$	\$ 38,504
Commercial and industrial	3,843	3,124	1,765			8,732
Real estate residential		343			7,525	7,868
Construction and land development	1,894					1,894
Lease financing		1,359				1,359
Consumer	365	29		146		540
Gross Loans Receivable	\$ 10,200	\$ 15,531	\$ 25,495	\$ 7,671	\$	\$ 58,897

(\$ in thousands)	December 31, 2009					Total Loans
	<1 Year	1 - 5 Years	5 - 15 Years	Over 15 Years		
Real estate commercial	\$ 3,482	\$ 10,559	\$ 12,022	\$	\$	\$ 26,063
Commercial and industrial	5,129	2,348	845	2		8,324
Real estate residential		348		7,711		8,059
Construction and land development	6,861	206				7,067
Consumer	14	728		249		991
Gross Loans Receivable	\$ 15,486	\$ 14,189	\$ 12,867	\$ 7,962	\$	\$ 50,504

Asset Quality

General Management, along with the Bank's Directors' credit committee, consisting of the Bank's President & Chief Executive Officer, the Bank's Chief Credit Officer, and three independent board members, approve loans above established levels, monitor the credit quality of the Bank's assets, review classified and other identified loans and review management's recommendation for the proper level of allowances to allocate against the Bank's loan portfolio, in each case subject to guidelines approved by the Bank's Board of Directors.

Loan delinquencies If a borrower fails to make a required payment on a loan, the Bank will attempt to cure the deficiency by contacting the borrower and seeking payment. Contact is generally made following the fifth day after a payment is due, at which time a late payment fee is assessed. In most cases, delinquencies are cured promptly. While the Bank generally prefers to work with borrowers to resolve such problems, if a payment becomes 60 - 90 days delinquent, the Bank may institute foreclosure or other remedies, as necessary, to minimize any potential loss.

Non-performing assets At December 31, 2010 and 2009, respectively, the Bank had \$4.0 million and \$3,000 in non-performing assets. Non-performing assets are defined as non-performing loans and real estate acquired by foreclosure or deed-in-lieu thereof. Non-performing loans are defined as nonaccrual loans, loans 90 days or more past due but still accruing interest and loans that have been restructured resulting in a reduction or deferral of interest or principal. A loan is impaired when, based on current information and events, it is probable the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Troubled debt restructurings (TDRs) are defined as loans which the Bank has agreed to modify by accepting repayment terms substantially below current market terms such as, but not limited to, the rate of interest charged, amortization of principal longer than normal for the type of collateral or acceptance of a different type or lower amount of collateral than typically accepted. Loans are placed on nonaccrual status when, in the judgment of management, the probability of collection of interest is deemed to be insufficient to warrant further accrual. When any such loan is placed on nonaccrual status, previously accrued but unpaid interest will be deducted from interest income. There were \$1.8 million of nonaccrual loans at December 31, 2010 and no nonaccrual loans at December 31, 2009.

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The following table summarizes information regarding nonperforming assets:

(\$ in thousands)	December 31, 2010	December 31, 2009
Nonaccrual loans and leases	\$ 1,783	\$ 3
Other impaired loans	337	3
Total nonperforming loans	\$ 2,120	\$ 3
Other real estate owned	1,838	
Total nonperforming assets	3,958	3
Nonperforming loans	\$ 2,120	\$ 3
Allocated allowance for loan losses to nonperforming loans	(87)	
Net investment in nonperforming loans	\$ 2,033	3
Accruing loans past due 90 days or more	\$ 44	\$ 3
Loans past due 30-89 days	\$ 187	\$ 1,298
Loans charged-off, year-to-date	\$ 765	
Recoveries, year-to-date		
Net charge-offs, year-to-date	\$ 765	
Allowance for loan losses	\$ 1,175	\$ 830
Allowance for loan losses to loans, net of deferred fees/expenses	2.00%	1.64%
Allowance for loan losses to nonaccrual loans	65.90%	NA
Allowance for loan losses to nonperforming loans	55.42%	276.67%
Nonaccrual loans to loans, net of deferred fees/expenses	3.03%	NA
Loans 30-89 days past due to loans, net of deferred fees/expenses	0.31%	2.56%
Nonperforming assets to total assets	2.82%	0.00%

Classified assets - Federal regulations require that each insured financial institution classify its assets on a regular basis. In addition, in connection with examinations of insured institutions, federal examiners have authority to identify problem assets and, if appropriate, classify them. The Bank has established three classifications for potential problem assets: substandard, doubtful and loss. Loans classified as substandard are those loans with well-defined weaknesses, such that future capacity to repay the loan has been negatively impacted. Loans classified as doubtful are those loans that have characteristics similar to substandard loans, but the weaknesses have declined to the point where complete collection of the obligation from all sources is unlikely and a portion of the principal may be charged-off. Although loans classified as substandard do not duplicate loans classified as doubtful, both substandard and doubtful loans may include some loans that are past due at least 90 days, are on nonaccrual status or have been restructured. Loans classified as loss are those loans that are in the process of being charged-off. At December 31, 2010, Solera National Bank had \$5.2 million classified as substandard, one loan for \$161,000 classified as doubtful and no loans classified as loss. At December 31, 2009, the Bank had \$3.8 million classified as substandard and no loans classified as either doubtful or loss.

Allowance for loan losses - The Bank maintains an allowance for estimated loan losses based on a number of quantitative and qualitative factors. Factors used to assess the adequacy of the allowance for loan losses are established based upon management's assessment of the credit risk in the portfolio, historical loan loss, changes in the size, composition and concentrations of the loan portfolio, general economic conditions, and changes in the legal and regulatory environment, among others. In addition, because the Bank has limited history on which to base future loan losses, a comparison of peer group allowance ratios to gross loans is made with the intention of maintaining similar levels until the Bank has sufficient historical data to see trends in our own loss history. Provisions for loan losses may be provided both on a specific and general basis. Specific and general valuation allowances are increased by provisions charged to expense and decreased by charge-offs of loans, net of recoveries. Specific allowances are provided for impaired loans for which the expected loss is measurable. General valuation allowances are provided based on a formula that incorporates the factors discussed above. The Bank periodically reviews the assumptions and formula by which additions are made to the specific and general valuation allowances for losses in an effort to refine such allowances in light of the current status

of the aforementioned factors.

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The following table sets forth the allowance for loan losses activity for 2010 and 2009:

(\$ in thousands)	2010	2009
Balance at beginning of year	\$ 830	\$ 268
Provision charged to expense	1,110	562
Loans charged-off:		
Real estate commercial	(556)	
Commercial and industrial		
Real estate residential		
Construction and land development	(209)	
Lease financing		
Consumer		
Total loans charged-off	(765)	
Recoveries on loans previously charged-off		
Balance at end of year	\$ 1,175	\$ 830
Net charge-offs to average gross loans	1.31%	%

As a result of management's evaluation of all the aforementioned factors, the allowance for loan losses increased 36 basis points from 1.64% of gross loans at December 31, 2009 to 2.00% of gross loans at December 31, 2010.

The following tables allocate the allowance for loan losses based on management's judgment of inherent losses by loan category. It is based on management's assessment as of a given point in time of the risk characteristics for each of the component parts of the total loan portfolio and is subject to changes as and when the risk factors of each such component parts change. Such allocation is not indicative of either the specific amounts or the loan categories in which future charge-offs may be taken, nor should it be taken as an indicator of future loss trends. By presenting such allocation, management does not mean to imply that the allocation is exact or that the allowance for loan losses has been precisely determined from such allocation. For the years ended December 31, 2008 and 2007, a significant portion of the general valuation allowance was not allocated to each of the five categories specified in the tables below, but represented loans in all categories. It is represented by the term "Unallocated", and includes amounts representing risks associated with the decline in current economic conditions as well as factors associated with being a de novo bank. There was no unallocated component in 2009 and 2010 as the current economic conditions were evaluated by loan category and allocated as such. This resulted in a shift in the percentage of the allowance allocated to certain categories and is indicative of the relative weakness, both locally and nationally, of construction and development projects and general weaknesses in the business sector.

(\$ in thousands)	Amount	December 31, 2010	
		Percentage of loans in each category to total loans	Percentage of year-end allowance
Real estate commercial	\$ 470	65.4%	40.0%
Construction and land development	240	3.2	20.4
Real estate residential	90	13.4	7.7
Commercial and industrial	353	14.8	30.0
Consumer	8	0.9	0.7
Lease financing	14	2.3	1.2
Total Allowance for Loan Losses	\$ 1,175	100.0%	100%

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(\$ in thousands)	Amount	December 31, 2009		
		Percentage of loans in each category to total loans	Percentage of year-end allowance	Percentage of reserves to total loans by category
Real estate commercial	\$ 363	51.6%	43.7%	1.39%
Construction and land development	197	14.0	23.8	2.79
Real estate residential	6	15.9	0.7	0.07
Commercial and industrial	259	16.5	31.2	3.11
Consumer	5	2.0	0.6	0.50
Total Allowance for Loan Losses	\$ 830	100.0%	100.0%	1.64%

(\$ in thousands)	Amount	December 31, 2008		
		Percentage of loans in each category to total loans	Percentage of year-end allowance	Percentage of reserves to total loans by category
Real estate commercial	\$ 68	34.9%	25.4%	0.91%
Construction and land development	34	18.0	12.7	0.88
Real estate residential	23	23.5	8.6	0.46
Commercial and industrial	31	19.1	11.5	0.76
Consumer	8	4.5	3.0	0.83
Unallocated	104		38.8	
Total Allowance for Loan Losses	\$ 268	100.0%	100.0%	1.25%

(\$ in thousands)	Amount	December 31, 2007		
		Percentage of loans in each category to total loans	Percentage of year-end allowance	Percentage of reserves to total loans by category
Real estate commercial	\$ 28	78.8%	60.0%	0.95%
Construction and land development	4	10.5	8.0	0.95
Real estate residential	2	5.0	3.5	0.87
Commercial and industrial	1	5.0	3.0	0.75
Consumer		0.7	0.5	0.81
Unallocated	12		25.0	
Total Allowance for Loan Losses	\$ 47	100.0%	100.0%	1.24%

The allowance for loan losses reflects management's judgment of the level of allowance adequate to absorb estimated credit losses in the Bank's loan portfolio. The Board of Directors of the Bank approved a policy formulated by management for a systematic analysis of the adequacy of the allowance. The policy requires management to perform, on a quarterly basis, an in-depth analysis of the allowance which is presented to and approved by the Bank's Board of Directors.

The Bank's external asset review system and loss allowance methodology are designed to provide for timely identification of problem assets and recognition of losses. The current monitoring process includes segmenting the loan portfolio into pools of loans that share similar credit characteristics. The loan portfolio is further segmented into risk grades for criticized loans. These specific pools of loans are analyzed for purposes of calculating the contingent losses inherent within the portfolio.

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The portion of the allowance for loan losses related to contingent losses is derived by analyzing the historical loss experience of the Bank's peer groups and asset quality within each loan portfolio segment, along with assessing qualitative environmental factors, and correlating it with the delinquency and classification status for each portfolio segment. Loans that are categorized as substandard or doubtful are reviewed in more individual detail to determine if the loan is impaired. Those deemed not to be impaired are assigned a loss factor based on their risk grade.

Loss factors for each risk graded loan segment are based on experience of peer institutions and national and regional averages published by the OCC and FDIC. Given that the Bank has extremely limited historical trends, peer group statistics are used to validate the loss factors applied to the Bank's various loan segments. In addition, the following qualitative environmental elements are considered in determining the loss factors used in calculating the contingent losses: the levels of and trends in past due, the trend in volume and terms of loans, the effects of changes in credit concentrations, the effects of changes in risk selection and underwriting standards, and other changes in lending policies, procedures and practices, the experience, ability and depth of management and other relevant staff, national and local economic trends and conditions, and industry conditions.

Classified assets are reviewed on a monthly basis. This evaluation of individual loans is documented in the internal asset review report relating to the specific loan. As part of that review, potential impairment is also considered. Any deficiencies outlined by the impairment analysis are accounted for in the specific valuation allowance for the loan. A loan is determined to be impaired if management determines the recovery of the Bank's gross investment is not probable. A specific valuation allowance is applied if the amount of loss can be reasonably determined. To determine impairment, management assesses the fair value of the loan based on the present value of expected future cash flows discounted at the loan's effective interest rate or at the loan's observable market price or the fair value of the collateral, if the loan is collateral dependent.

The allowance requirements for any loan segment could be different in the future as the quantitative and qualitative factors change. Consequently, provision levels may also be influenced by changes in the quantitative and qualitative factors quarter over quarter. In addition, the OCC, as an integral part of their examination process, periodically reviews the Bank's valuation allowance. This governing agency may require increases to the allowance based on their judgments of the information available to them at the time of their examination.

Management believes that the Bank's overall asset quality is sound, as supported by the Bank's internal risk rating process.

Investments

In addition to loans, the Bank makes other investments primarily in obligations guaranteed as to principal and interest by the United States or by quasi-government agencies and other taxable securities. No investment in any of those instruments exceeds any applicable limitation imposed by law or regulation. The asset-liability management committee reviews the investment portfolio on an ongoing basis in order to ensure that the investments conform to the Bank's policy as set by its Board of Directors.

At the date of purchase, the Bank classifies debt and equity securities into one of two categories: held-to-maturity, or available-for-sale. Investment securities that management has the positive intent and ability to hold to maturity are classified as held-to-maturity and recorded at amortized cost. Since its inception, the Bank has not had any held-to-maturity investments. Investments to be held for an indefinite amount of time, but not necessarily to maturity, may be classified as available-for-sale and carried at fair value with unrealized gains or losses reported as a separate component of stockholders' equity in accumulated other comprehensive income (loss), net of applicable income taxes. Since the initial

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classification of its investment securities, the Bank has not transferred any investment securities between categories.

Declines in fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. Since inception, the Bank has not had any other than temporarily impaired investment securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method. Purchase premiums and discounts are recognized in interest income using the interest method over the estimated lives of the securities.

The following tables set forth the estimated market values and approximate weighted average yields of the debt securities in the investment portfolio by contractual maturity at December 31, 2010 and 2009. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations

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with or without call or prepayment penalties. Additionally, accelerated principal payments are often received on mortgage-backed securities (MBS) making it common for them to mature prior to their contractual maturity date.

(\$ in thousands)	At December 31, 2010										
	Within One Year		After One Year but within Five Years		After Five Years but within Ten Years		After Ten Years				
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield			
Securities available-for-sale											
U.S. government agencies	\$		% \$		% \$	868	3.52%	\$	4,984	2.48%	
Corporate				3,620	4.12		7,853	4.67			
State and municipal				819	1.87		21,498	4.48		508	5.23
Residential agency MBS							453	4.61		35,710	3.44
Total	\$		% \$	4,439	3.71%	\$	30,672	4.50%	\$	41,202	3.35%

(\$ in thousands)	At December 31, 2009											
	Within One Year		After One Year but within Five Years		After Five Years but within Ten Years		After Ten Years					
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield				
Securities available-for-sale												
U.S. government agencies	\$		% \$		% \$	2,954	3.81%	\$	2,215	5.43%		
Corporate		1,560	5.99		4,845	5.35		3,718	5.09			
State and municipal				978	5.66		12,563	5.23		8,660	5.59	
Residential agency MBS							500	3.05		35,448	4.52	
Total	\$	1,560	5.99%	\$	5,823	5.49%	\$	19,735	4.97%	\$	46,323	4.77%

The table below sets forth the amounts and distribution of the investment securities at December 31, 2010 and 2009.

(\$ in thousands)	2010		2009	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Securities available-for-sale				
Due within one year	\$	\$	\$	\$
Due after one year through five years		4,329		4,439
Due after five years through ten years		30,862		30,672
Due after ten years		40,921		41,202
Total securities available-for-sale	\$	76,112	\$	76,313
			\$	72,485
			\$	73,441

At December 31, 2010 and 2009, respectively, we held \$1.2 million and \$1.1 million of other equity securities consisting of Federal Home Loan Bank (FHLB) and Federal Reserve Bank stocks with no maturity date, which are not reflected in the above tables.

Deposit Services

The Bank offers a variety of deposit products and services at competitive interest rates. The Bank utilizes traditional marketing methods to attract new clients and deposits, including various forms of advertising and significant involvement in the local communities. The majority of depositors are residents of, and businesses and their employees located in, the Bank's primary service areas and the state of Colorado. The Bank attracts these deposits through personal solicitation by its officers and Directors, direct mail solicitations and advertisements published in the

local media. The Bank does not operate a money desk or otherwise solicit brokered deposits.

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The following table sets forth the composition of the Bank's deposits by type at December 31, 2010 and 2009:

(\$ in thousands)	December 31, 2010		December 31, 2009	
	Amount	% of Total	Amount	% of Total
Noninterest-bearing demand	\$ 1,891	2%	\$ 2,624	2%
Interest-bearing demand	11,605	10	6,830	7
Money market accounts	10,902	10	3,555	3
Savings accounts	46,230	42	51,763	50
Time deposits, less than \$100,000	9,462	8	16,624	16
Time deposits, \$100,000 or more	30,865	28	23,005	22
Total	\$ 110,955	100%	\$ 104,401	100%

The following table presents average deposits by type and the related average interest rate paid by deposit type for the years ended December 31, 2010 and 2009:

(\$ in thousands)	2010		2009	
	Average Balance	Average Rate	Average Balance	Average Rate
Noninterest-bearing demand	\$ 1,939	%\$	\$ 3,429	%
Interest-bearing demand	9,556	1.51	5,308	2.15
Money market accounts	6,586	1.51	4,086	2.02
Savings accounts	49,827	1.57	19,417	2.45
Time deposits	42,162	2.09	40,342	2.80
Total	\$ 110,070	1.73%	\$ 72,582	2.48%

Scheduled maturities of time deposits at December 31, 2010 are as follows:

(\$ in thousands)	Time Deposits greater than \$100,000		Time Deposits less than \$100,000		Total Time Deposits
	\$		\$		
Due in three months or less	\$	8,134	\$	3,039	\$ 11,173
Due in over three months through six months		3,391		1,260	4,651
Due in over six months through twelve months		5,623		1,878	7,501
Due in over twelve months		13,717		3,285	17,002
Total	\$	30,865	\$	9,462	\$ 40,327

Included in time deposits greater than \$100,000 at December 31, 2010 are approximately \$26.3 million of time deposits greater than \$100,000 but less than or equal to \$250,000. These time deposits are fully insured by the FDIC.

The following table sets forth the amount and maturities of the time deposits at December 31, 2009.

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(\$ in thousands)	Time Deposits greater than \$100,000	Time Deposits less than \$100,000	Total Time Deposits
Due in three months or less	\$ 4,747	\$ 3,536	\$ 8,283
Due in over three months through six months	4,947	2,330	7,277
Due in over six months through twelve months	8,868	4,970	13,838
Due in over twelve months	4,443	5,788	10,231
Total	\$ 23,005	\$ 16,624	\$ 39,629

Included in time deposits greater than \$100,000 at December 31, 2009 are approximately \$20.0 million of time deposits greater than \$100,000 but less than or equal to \$250,000.

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Supervision and Regulation

The following is not intended to be a complete discussion but is intended to be a summary of some of the more significant provisions of laws and regulations which are applicable to the Company and the Bank. This regulatory framework is intended to protect depositors, federal deposit insurance funds and the banking system as a whole, and not to protect security holders. To the extent that the information describes statutory and regulatory provisions, it is qualified in its entirety by reference to those provisions. Additionally, such statutes, regulations and policies are continually under review by Congress and state legislatures, and federal and state regulatory agencies. A change in statutes, regulations or regulatory policies applicable to the Company or the Bank, including changes in interpretations, could have a material effect on the Bank's business.

General. Banking is a complex, highly regulated industry. Consequently, the growth and earnings performance of the Company and the Bank can be affected, not only by management decisions and general and local economic conditions, but also by the statutes administered by, and the regulations and policies of, various governmental regulatory authorities. These authorities include, but are not limited to, the Federal Reserve, the FDIC, the OCC, the Internal Revenue Service and state taxing authorities. The effect of these statutes, regulations and policies and any changes to any of them can be significant and cannot be predicted.

The primary goals of the Bank regulators are to maintain a safe and sound banking system and to facilitate the conduct of sound monetary policy. In furtherance of these goals, Congress has created several largely autonomous regulatory agencies and enacted numerous laws that govern banks, bank holding companies and the banking industry. The system of supervision and regulation applicable to the Company and the Bank establishes a comprehensive framework for their respective operations and is intended primarily for the protection of the FDIC's deposit insurance funds, the Bank's depositors and the public, rather than the stockholders and creditors. The following is an attempt to summarize some of the relevant laws, rules and regulations governing banks and bank holding companies, but does not purport to be a complete summary of all applicable laws, rules and regulations governing banks and bank holding companies. The descriptions are qualified in their entirety by reference to the specific statutes and regulations discussed.

Regulatory Reform. On July 21, 2010, the President signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), which comprehensively reforms the regulation of financial institutions, products and services. Many of the provisions of the Dodd-Frank Act noted in this section are also discussed in other sections below. Furthermore, many of the provisions of the Dodd-Frank Act require study or rulemaking by other agencies, a process which will take months and years to fully implement.

Among other things, the Dodd-Frank Act provides for new capital standards that eliminate the treatment of trust preferred securities as Tier 1 capital. Existing trust preferred securities are grandfathered for banking entities with less than \$15 billion of assets, such as the Company. The Dodd-Frank Act permanently raises deposit insurance levels to \$250,000, retroactive to January 1, 2008, and provides unlimited deposit insurance coverage for transaction accounts through December 31, 2012, which is mandatory for all insured depository institutions. Pursuant to modifications under the Dodd-Frank Act, deposit insurance assessments will be calculated as of April 1, 2011, based on an insured depository institution's assets rather than its insured deposits and the minimum reserve ratio of the FDIC's Deposit Insurance Fund will be raised to 1.35%. The payment of interest on business demand deposit accounts is permitted by the Dodd-Frank Act. The Dodd-Frank Act authorizes the Federal Reserve Board to regulate interchange fees for debit card transactions and establishes new minimum mortgage underwriting standards for residential mortgages. Further, the Dodd-Frank Act bars banking organizations, such as the Company, from engaging in proprietary trading and from sponsoring and investing in hedge funds and private equity funds, except as permitted under certain limited circumstances. The Dodd-Frank Act empowers the newly established Financial Stability Oversight Council to designate certain activities as posing a risk to the U.S. financial system and to recommend new or heightened standards and safeguards for financial institutions engaging in such activities.

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Under the Dodd-Frank Act, the Federal Reserve Board may directly examine the subsidiaries of the Company, including the Bank. Further, the Dodd-Frank Act establishes the Office of Financial Research which has the power to require reports from financial services companies such as the Company. The Dodd-Frank Act also establishes the Bureau of Consumer Financial Protection (CFPB) as an independent bureau of the Federal Reserve Board. The CFPB has the exclusive authority to prescribe rules governing the provision of consumer financial products and services, which in the case of the Bank will be enforced by the OCC. Further, the Dodd-Frank Act establishes a new standard for preemption of state consumer financial laws, which will affect national banking associations such as the Bank. Pursuant to the Dodd-Frank Act, federal banking agencies have proposed new

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regulations which prohibit incentive-based compensation arrangements that encourage executives and certain other employees to take inappropriate risks.

Solera National Bancorp, Inc.

General. As a result of holding all of the capital stock of Solera National Bank, the Company is a bank holding company registered with, and subject to regulation by, the Federal Reserve under the Bank Holding Company Act of 1956, as amended. The Bank Holding Company Act and other federal laws subject bank holding companies to particular restrictions on the types of activities in which they may engage, and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations.

In accordance with Federal Reserve policy, the Company is expected to act as a source of financial strength to the Bank and commit resources to support the Bank. This support may be required under circumstances when the Company might not be inclined to do so absent this Federal Reserve policy. As discussed below, the Company could be required to guarantee the capital plan of the Bank if it becomes undercapitalized for purposes of banking regulations.

Certain Acquisitions. The Bank Holding Company Act requires every bank holding company to obtain the prior approval of the Federal Reserve before (i) acquiring more than five percent of the voting stock of any bank or other bank holding company, (ii) acquiring all or substantially all of the assets of any bank or bank holding company, or (iii) merging or consolidating with any other bank holding company.

Additionally, the Bank Holding Company Act provides that the Federal Reserve may not approve any of these transactions if it would result in or tend to create a monopoly or substantially lessen competition or otherwise function as a restraint of trade, unless the anti-competitive effects of the proposed transaction are clearly outweighed by the public interest in meeting the convenience and needs of the community to be served. The Federal Reserve is also required to consider the financial and managerial resources and future prospects of bank holding companies and banks concerned and the convenience and needs of the community to be served. The Federal Reserve's consideration of financial resources generally focuses on capital adequacy, which is discussed below. As a result of the Patriot Act, which is discussed below, the Federal Reserve is also required to consider the record of a bank holding company and its subsidiary bank(s) in combating money laundering activities in its evaluation of bank holding company merger or acquisition transactions.

Under the Bank Holding Company Act, if adequately capitalized and adequately managed, any bank holding company incorporated in Delaware may purchase a bank located outside of Delaware. Conversely, an adequately capitalized and adequately managed bank holding company incorporated outside of Delaware may purchase a bank located inside Delaware. In each case, however, restrictions currently exist on the acquisition of a bank that has only been in existence for a limited amount of time or will result in specified concentrations of deposits.

Change in Bank Control. Subject to various exceptions, the Bank Holding Company Act and the Change in Bank Control Act of 1978, together with related regulations, require Federal Reserve approval prior to any person or company acquiring control of a bank holding company. Control is conclusively presumed to exist if an individual or company acquires 25% or more of any class of voting securities of the bank holding company. With respect to Solera National Bancorp, Inc., control is rebuttably presumed to exist if a person or company acquires 10% or more, but less than 25%, of any class of voting securities.

Permitted Activities. Generally, bank holding companies are prohibited under the Bank Holding Company Act, from engaging in or acquiring direct or indirect control of more than 5% of the voting shares of any company engaged in any activity other than (i) banking or managing or controlling banks or (ii) an activity that the Federal Reserve determines to be so closely related to banking as to be a proper incident to the business of banking.

Activities that the Federal Reserve has found to be so closely related to banking as to be a proper incident to the business of banking include:

- factoring accounts receivable;
- making, acquiring, brokering or servicing loans and usual related activities;

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- leasing personal or real property;
- operating a non-bank depository institution, such as a savings association;
- trust company functions;
- financial and investment advisory activities;
- conducting discount securities brokerage activities;
- underwriting and dealing in government obligations and money market instruments;
- providing specified management consulting and counseling activities;
- performing selected data processing services and support services;
- acting as agent or broker in selling credit life insurance and other types of insurance in connection with credit transactions; and
- performing selected insurance underwriting activities.

Despite prior approval, the Federal Reserve has the authority to require a bank holding company to terminate an activity or terminate control of or liquidate or divest certain subsidiaries or affiliates when the Federal Reserve believes the activity or the control of the subsidiary or affiliate constitutes a significant risk to the financial safety, soundness or stability of any of its banking subsidiaries. A bank holding company that qualifies and elects to become a financial holding company is permitted to engage in additional activities that are financial in nature or incidental or complementary to financial activity. The Bank Holding Company Act expressly lists the following activities as financial in nature:

- lending, exchanging, transferring, investing for others, or safeguarding money or securities;

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- insuring, guaranteeing or indemnifying against loss or harm, or providing and issuing annuities, and acting as principal, agent or broker for these purposes, in any state;
- providing financial, investment or advisory services;
- issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly;
- underwriting, dealing in or making a market in securities;
- other activities that the Federal Reserve may determine to be so closely related to banking or managing or controlling banks as to be a proper incident to managing or controlling banks;
- foreign activities permitted outside of the United States if the Federal Reserve has determined them to be usual in connection with banking operations abroad;
- merchant banking through securities or insurance affiliates; and
- insurance company portfolio investments.

To qualify to become a financial holding company, Solera National Bank and any other depository institution subsidiary that the Company may own at the time must be well capitalized and well managed and must have a Community Reinvestment Act rating of at least satisfactory. Additionally, the Company would be required to file an election with the Federal Reserve to become a financial holding company and to provide the Federal Reserve with 30 days written notice prior to engaging in a permitted financial activity. A bank holding company that falls out of compliance with these requirements may be required to cease engaging in some of its activities. The Federal

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Reserve serves as the primary umbrella regulator of financial holding companies, with supervisory authority over each parent company and limited authority over its subsidiaries. Expanded financial activities of financial holding companies generally will be regulated according to the type of such financial activity: banking activities by banking regulators, securities activities by securities regulators and insurance activities by insurance regulators. The Company currently has no plans to make a financial holding company election.

Sound Banking Practice. Bank holding companies are not permitted to engage in unsound banking practices. For example, the Federal Reserve's Regulation Y requires a holding company to give the Federal Reserve prior notice of any redemption or repurchase of its own equity securities, if the consideration to be paid, together with the consideration paid for any repurchases in the preceding year, is equal to 10% or more of the company's consolidated net worth. The Federal Reserve may oppose the transaction if it believes that the transaction would constitute an unsafe or unsound practice or would violate any law or regulation. As another example, a holding company could not impair its subsidiary bank's soundness by causing it to make funds available to non-banking subsidiaries or their customers if the Federal Reserve believed it not prudent to do so.

The Financial Institutions Reform, Recovery and Enforcement Act of 1989, or FIRREA, expanded the Federal Reserve's authority to prohibit activities of bank holding companies and their non-banking subsidiaries which represent unsafe and unsound banking practices or which constitute violations of laws or regulations. FIRREA increased the amount of civil money penalties which the Federal Reserve can assess for activities conducted on a knowing and reckless basis, if those activities caused a substantial loss to a depository institution. The penalties can be as high as \$1,000,000 for each day the activity continues. FIRREA also expanded the scope of individuals and entities against which such penalties may be assessed.

Anti-tying Restrictions. Bank holding companies and affiliates are prohibited from tying the provision of services, such as extensions of credit, to other services offered by a holding company or its affiliates.

Dividends. Consistent with its policy that bank holding companies should serve as a source of financial strength for their subsidiary banks, the Federal Reserve has stated that, as a matter of prudence, a bank holding company, generally should not maintain a rate of distributions to stockholders unless its available net income has been sufficient to fully fund the distributions, and the prospective rate of earnings retention appears consistent with the bank holding company's capital needs, asset quality and overall financial condition. In addition, the Company is subject to certain restrictions on the making of distributions as a result of the requirement that the Bank maintain an adequate level of capital as described below. As a Delaware corporation, the Company is restricted under the Delaware General Corporation Law from paying dividends under certain conditions.

Solera National Bank

Solera National Bank is subject to the supervision, examination and reporting requirements of the National Bank Act and the regulations of the OCC. The OCC regularly examines the Bank's operations and has the authority to approve or disapprove mergers, the establishment of branches and similar corporate actions. The OCC also has the power to prevent the continuance or development of unsafe or unsound banking practices or other violations of law. Solera National Bank is also subject to numerous state and federal statutes and regulations that affect its business, activities and operations. The Bank's deposits are insured by the FDIC to the maximum extent provided by law.

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Branching and Interstate Banking. National banks are required by the National Bank Act to adhere to branching laws applicable to state banks in the states in which they are located. Under current Colorado law, banks are permitted to establish branch offices throughout Colorado with prior regulatory approval. In addition, with prior regulatory approval, banks are permitted to acquire branches of existing banks located in Colorado. Finally, banks generally may branch across state lines by merging with banks or by purchasing a branch of another bank in other states if allowed by the applicable states' laws. If the resulting bank is a Colorado state bank, the merger is subject to Colorado state law. If the resulting bank is an out-of-state bank, the merger will be subject to the laws of that state. Colorado law, with limited exceptions, currently permits branching across state lines through interstate mergers if the bank located in Colorado has been in existence for at least five years. Under the Federal Deposit Insurance Act, states may opt-in and allow out-of-state banks to branch into their state by establishing a new start-up branch in the state. Colorado law currently does not permit *de novo* branching into the state of Colorado.

Deposit Insurance Assessments. Banks must pay assessments to the FDIC for federal deposit insurance protection. The FDIC has adopted a risk-based assessment system as required by the Federal Deposit Insurance

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Corporation Improvement Act, or FDICIA. Under this system, FDIC-insured depository institutions pay insurance premiums at rates based on their risk classification. Institutions assigned to higher risk classifications (that is, institutions that pose a higher risk of loss to their respective deposit insurance funds) pay assessments at higher rates than institutions that pose a lower risk. An institution's risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to the regulators. Pursuant to the Dodd-Frank Act, the FDIC has amended the deposit insurance assessment by changing the calculation of deposit assessments. Under the new calculation, deposit premiums will be based on assets rather than insurable deposits. To determine its actual deposit insurance premiums, the Bank will compute the base amount on its average consolidated assets less its average tangible equity (which the FDIC proposes to be defined as the amount of Tier 1 capital) and its applicable assessment rate. The new assessment formula will become effective on April 1, 2011, and will be used to calculate the June 30, 2011 assessment. Future expenses will be based on asset levels, Tier 1 capital levels, assessment rates, CAMELS ratings, and whether there are any future special assessments by the FDIC. We expect that the new rates and assessment base will reduce our current FDIC insurance assessments. However, if the risk category of the Bank changes adversely, our FDIC insurance premiums could increase.

In November 2009, the FDIC issued a final rule that mandated that insured depository institutions prepay their quarterly risk-based assessments to the FDIC for the fourth quarter of 2009 and for all of 2010, 2011, and 2012 on December 30, 2009. The amount of the Bank's prepaid deposit premium was \$471,000 as of December 31, 2010. Each institution, including the Bank, recorded the entire amount of its prepayment as an asset (a prepaid expense). The prepaid assessments bear a 0% risk weight for risk-based capital purposes. Starting with the quarter ending December 31, 2009, and each quarter thereafter, the Bank has recorded and will record an expense for its regular quarterly assessment for the quarter and a corresponding credit to the prepaid assessment until the asset is exhausted. The FDIC will not refund or collect additional prepaid assessments because of a decrease or growth in deposits over the remaining two years. However, should the prepaid assessment not be exhausted after collection of the amount due on June 30, 2013, the remaining amount of the prepayment will be returned to the Bank. The timing of any refund of the prepaid assessment will not be affected by the change in the deposit insurance assessment calculation discussed above. In June 2009, the FDIC also implemented a five basis point special assessment of each insured depository institution's assets minus Tier 1 capital. The Company incurred approximately \$41,000 during 2009 for this special assessment. The FDIC may take further actions in the future that result in higher assessment rates that could have a material adverse effect on earnings. In 2008, the level of FDIC deposit insurance was temporarily increased from \$100,000 to \$250,000 per depositor and this level of insurance was made permanent under the Dodd-Frank Act. Additionally, the Dodd-Frank Act provides temporary unlimited deposit insurance coverage for noninterest-bearing transactions accounts beginning December 31, 2010, and ending December 31, 2012. This replaced the FDIC's Transaction Account Guarantee Program, which expired on December 31, 2010.

The FDIC has the power to adjust deposit insurance assessment rates at any time. The FDIC may terminate its insurance of deposits if it finds that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order, or condition imposed by the FDIC. The Bank's deposit insurance assessments may increase or decrease depending on the risk assessment classification to which the Bank is assigned by the FDIC. We cannot predict whether the FDIC will increase deposit insurance assessment levels in the future. Any increase in insurance assessments could have an adverse effect on the Bank's earnings.

Expanded Financial Activities. The Gramm-Leach-Bliley Financial Services Modernization Act of 1999 expands the types of activities in which a holding company or national bank may engage. Subject to various limitations, the act generally permits holding companies to elect to become financial holding companies and, along with national banks, conduct certain expanded financial activities related to insurance and securities, including securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency activities; merchant banking activities; and activities that the Board of Governors of the Federal Reserve has determined to be closely related to banking. Banks with financial subsidiaries must establish certain firewalls and safety and soundness controls, and must deduct their equity investment in such subsidiaries from their equity capital calculations. Expanded financial activities of financial holding companies and banks will generally be regulated according to the type of such financial activity: banking activities by banking regulators, securities activities by securities regulators, and insurance activities by insurance regulators.

Community Reinvestment Act. The Community Reinvestment Act requires that, in connection with examinations of financial institutions within its jurisdiction, the FDIC shall evaluate the record of each financial institution in meeting the credit needs of its assessment area, including low-

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and moderate-income neighborhoods. These facts are also considered in evaluating mergers, acquisitions, and applications to open a branch or facility. Failure to adequately meet these criteria could impose additional requirements and limitations on the Bank. Because

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the Bank's aggregate assets are currently less than \$250 million, under the Gramm-Leach-Bliley Act, it is subject to a Community Reinvestment Act examination only once every 48 months. We received a satisfactory rating on our first examination, which is the only examination we have been subject to to-date. Additionally, the Bank must publicly disclose the terms of various Community Reinvestment Act-related agreements.

Other Regulations. Interest and other charges collected or contracted for by the Bank will be subject to state usury laws and federal laws concerning interest rates. The Bank's loan operations are also subject to federal laws applicable to credit transactions, such as:

- the federal Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;

- the Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;

- the Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;

- the Fair Credit Reporting Act of 1978, governing the use and provision of information to credit reporting agencies;

- the Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies; and

- the rules and regulations of the various federal and state agencies charged with the responsibility of implementing these federal and state laws.

The loan and deposit operations of Solera National Bank are subject to:

- the Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;

- the Electronic Funds Transfer Act, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services; and

- other rules and regulations of the various federal and state agencies charged with the responsibility of implementing these federal and state laws.

Dividends. Solera National Bank is required by federal law to obtain prior approval of the OCC for payments of dividends if the total of all dividends declared by its Board of Directors in any year will exceed its net profits earned during the current year combined with its retained net profits of the immediately preceding two years, less any required transfers to surplus. In addition, Solera National Bank is unable to pay dividends unless and until it has positive retained earnings and the Amended Consent Order, signed on December 16, 2010, has been lifted.

In addition, under the FDICIA, Solera National Bank may not pay any dividend if the payment of the dividend would cause the Bank to become undercapitalized or in the event the Bank is undercapitalized. The OCC may further restrict the payment of dividends by requiring that a financial institution maintain a higher level of capital than would otherwise be required to be adequately capitalized for regulatory purposes. Moreover, if, in the opinion of the OCC, Solera National Bank is engaged in an unsound practice (which could include the payment of dividends), the OCC may require, generally after notice and hearing, that Solera National Bank cease such practice. The OCC has indicated that paying dividends that deplete a depository institution's capital base to an inadequate level would be an unsafe banking practice. Moreover, the OCC has also issued policy statements providing that insured depository institutions generally should pay dividends only out of current operating earnings.

Check Clearing for the 21st Century Act. The Check Clearing for the 21st Century Act, also known as Check 21, gives substitute checks, such as a digital image of a check and copies made from that image, the same legal standing as the original paper check. Some of the major provisions include:

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- allowing check truncation without making it mandatory;
- demanding that every financial institution communicate to accountholders in writing a description of its substitute check processing program and their rights under the law;
- legalizing substitutions for and replacements of paper checks without agreement from consumers;
- retaining in place the previously mandated electronic collection and return of checks between financial institutions only when individual agreements are in place;
- requiring that when accountholders request verification, financial institutions produce the original check (or a copy that accurately represents the original) and demonstrate that the account debit was accurate and valid; and
- requiring recrediting of funds to an individual's account on the next business day after a consumer proves that the financial institution has erred.

Capital Adequacy. The Federal Reserve monitors the capital adequacy of bank holding companies, such as Solera National Bancorp, and the OCC monitors the capital adequacy of Solera National Bank. The federal bank regulators use a combination of risk-based guidelines and leverage ratios to evaluate capital adequacy and consider these capital levels when taking action on various types of applications and when conducting supervisory activities related to safety and soundness. The risk-based guidelines apply on a consolidated basis to bank holding companies with consolidated assets of \$500 million or more and, generally, on a bank-only basis for bank holding companies with less than \$500 million in consolidated assets. Each insured depository subsidiary of a bank holding company with less than \$500 million in consolidated assets is expected to be well-capitalized.

The risk-based capital standards are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and their holding companies, to account for off-balance-sheet exposure, and to minimize disincentives for holding liquid assets. Assets and off-balance-sheet items, such as letter of credit and unfunded loan commitments, are assigned to broad risk categories, each with appropriate risk weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance-sheet items. The minimum guideline for the ratio of total capital to risk-weighted assets is 8%. Total capital consists of two components, Tier 1 Capital and Tier 2 Capital. Tier 1 Capital generally consists of common stock, minority interests in the equity accounts of consolidated subsidiaries, noncumulative perpetual preferred stock, and a limited amount of qualifying cumulative perpetual preferred stock, less goodwill and other specified intangible assets. Tier 1 Capital must equal at least 4% of risk-weighted assets. Tier 2 Capital generally consists of subordinated debt, preferred stock (other than that which is included in Tier 1 Capital), and a limited amount of loan loss reserves. The total amount of Tier 2 Capital is limited to 100% of Tier 1 Capital.

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In addition, the Federal Reserve has established minimum leverage ratio guidelines for bank holding companies with assets of \$500 million or more. These guidelines provide for a minimum ratio of Tier 1 Capital to average assets, less goodwill and other specified intangible assets, of 3% for bank holding companies that meet specified criteria, including having the highest regulatory rating and implementing the Federal Reserve's risk-based capital measure for market risk. All other bank holding companies with assets of \$500 million or more generally are required to maintain a leverage ratio of at least 4%. The guidelines also provide that bank holding companies of such size experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels without reliance on intangible assets. The Federal Reserve considers the leverage ratio and other indicators of capital strength in evaluating proposals for expansion or new activities. The Federal Reserve and the FDIC recently adopted amendments to their risk-based capital regulations to provide for the consideration of interest rate risk in the agencies' determination of a banking institution's capital adequacy.

Bank holding companies with assets under \$500 million are exempt from the capital adequacy guidelines if they meet certain qualitative requirements. However, a bank holding company does not qualify for the exemption if it, or its nonbanking subsidiary, as applicable, (i) is engaged in significant nonbanking activities, (ii) conducts significant off-balance-sheet activities, or (iii) has a material amount of registered debt or equity securities (other than trust preferred securities). Certain transition rules apply to trust preferred securities, but these transition rules do not apply to Solera National Bancorp because the Company did not issue trust preferred securities before

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September 28, 2005. To continue to qualify for the exemption from the capital adequacy guidelines, small bank holding companies (i) must be well-capitalized, (ii) are subject to debt retirement requirements, and (iii) are subject to certain debt-to-equity ratios, generally including a restriction on paying dividends if the bank holding company's debt to equity ratio is not one-to-one or less.

Failure to meet capital guidelines could subject a bank or bank holding company to a variety of enforcement remedies, including issuance of a capital directive, the termination of deposit insurance by the FDIC, a prohibition on accepting brokered deposits, and other restrictions on its business.

Concentrated Commercial Real Estate Lending Regulations. The OCC, along with the Federal Reserve and the FDIC, has promulgated guidance governing financial institutions with concentrations in commercial real estate lending. The guidance provides that a bank has a concentration in commercial real estate lending if (i) total reported loans for construction, land development, and other land represent 100% or more of total capital or (ii) total reported loans secured by multifamily and non-farm non-residential properties and loans for construction, land development, and other land represent 300% or more of total capital and the outstanding balance of such loans has increased 50% or more during the prior 36 months. At December 31, 2010, Solera National Bank's ratios were 14% and 97%, respectively, well below the regulatory guideline for highly concentrated. If a concentration is present, management must employ heightened risk management practices including board and management oversight and strategic planning, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing, and increasing capital requirements.

Prompt Corrective Action Regulations. Under the prompt corrective action regulations, the FDIC is required and authorized to take supervisory actions against undercapitalized banks. For this purpose, a bank is placed in one of the following five categories based on the Bank's capital:

- well-capitalized (at least 5% leverage capital, 6% Tier 1 risk-based capital and 10% total risk-based capital);
- adequately capitalized (at least 4% leverage capital, 4% Tier 1 risk-based capital and 8% total risk-based capital);
- undercapitalized (less than 8% total risk-based capital, 4% Tier 1 risk-based capital or 3% leverage capital);
- significantly undercapitalized (less than 6% total risk-based capital, 3% Tier 1 risk-based capital or 3% leverage capital); and
- critically undercapitalized (less than 2% tangible capital).

Federal banking regulators are required to take various mandatory supervisory actions and are authorized to take other discretionary actions with respect to institutions in the three undercapitalized categories. The severity of the action depends upon the capital category in which the

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institution is placed. Generally, subject to a narrow exception, banking regulators must appoint a receiver or conservator for an institution that is critically undercapitalized. The federal banking agencies have specified by regulation the relevant capital level for each category. An institution that is categorized as undercapitalized, significantly undercapitalized, or critically undercapitalized is required to submit an acceptable capital restoration plan to its appropriate federal banking agency. A bank holding company must guarantee that a subsidiary depository institution meets its capital restoration plan, subject to various limitations. The controlling holding company's obligation to fund a capital restoration plan is limited to the lesser of 5% of an undercapitalized subsidiary's assets at the time it became undercapitalized or the amount required to meet regulatory capital requirements. An undercapitalized institution is also generally prohibited from increasing its average total assets, making acquisitions, establishing any branches or engaging in any new line of business, except under an accepted capital restoration plan or with FDIC approval. The regulations also establish procedures for downgrading an institution to a lower capital category based on supervisory factors other than capital.

Restrictions on Transactions with Affiliates and Loans to Insiders. Solera National Bancorp and Solera National Bank are subject to the provisions of Section 23A of the Federal Reserve Act. These provisions place limits on the amount of:

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- the Bank's loans or extensions of credit to affiliates;
- the Bank's investment in affiliates;
- assets that the Bank may purchase from affiliates, except for real and personal property exempted by the Federal Reserve;
- the amount of loans or extensions of credit to third parties collateralized by the securities or obligations of affiliates; and
- the Bank's guarantee, acceptance or letter of credit issued on behalf of an affiliate.

The total amount of the above transactions is limited in amount, as to any one affiliate, to 10% of the Bank's capital and surplus and, as to all affiliates combined, to 20% of its capital and surplus. In addition to the limitation on the amount of these transactions, each of the above transactions must also meet specified collateral requirements. The Bank must also comply with other provisions designed to avoid the taking of low-quality assets.

Solera National Bancorp and Solera National Bank are also subject to the provisions of Section 23B of the Federal Reserve Act which, among other things, prohibit the Bank from engaging in any transaction with an affiliate unless the transaction is on terms substantially the same, or at least as favorable to the Bank or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies.

The Bank is also subject to restrictions on extensions of credit to its executive officers, directors, principal stockholders and their related interests. These types of extensions of credit (1) must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties and (2) must not involve more than the normal risk of repayment or present other unfavorable features.

Privacy. Financial institutions are required to disclose their policies for collecting and protecting confidential information. Customers generally may prevent financial institutions from sharing personal financial information with nonaffiliated third parties except for third parties that market the institutions' own products and services. Additionally, financial institutions generally may not disclose consumer account numbers and other customer information to any nonaffiliated third party for use in telemarketing, direct mail marketing or other marketing through electronic mail to consumers.

Bank Secrecy Act. Congress enacted the Bank Secrecy Act (BSA) as a tool for the U.S. government to use to fight drug trafficking, money laundering, terrorist financing, tax evasion and other crimes. Congress enacted the BSA to prevent banks and other financial services providers from being used as intermediaries for, or to hide the transfer or deposit of money derived from, criminal activity or used for the purpose of

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financing criminal activity. On March 1, 2011, the Financial Crimes Enforcement Network, or FinCEN, made a technical adjustment to transfer its regulations implementing BSA from 31 CFR Part 103 to 31 CFR Chapter X as part of an ongoing effort to increase the efficiency and effectiveness of its regulatory oversight. Title 31 establishes, among other things: (a) anti-money laundering program requirements, (b) reporting requirements including reports of transactions in currency, filing obligations, required identification, aggregations, structured reports and suspicious activity reports (SAR), (c) records required to be maintained and retained by the bank, (d) special information sharing procedures to deter money laundering and terrorist activity, (e) special standards of diligence, prohibitions, and special measures for correspondent accounts, foreign financial institutions and private banking accounts. The FinCEN s SARs confidentiality final rule released on November 23, 2010, promotes the protection of SAR information while seeking to ensure that the appropriate parties, but only those parties, have access to SARs. The regulation clarifies the scope of the statutory prohibition against the disclosure by a financial institution of a SAR or any information that would reveal the existence of a SAR. Solera National Bank has a Bank Secrecy Act compliance policy and program.

Anti-terrorism Legislation. In the wake of the tragic events of September 11th, on October 26, 2001, the President signed into law the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001. Also known as the USA Patriot Act, the law enhances the powers of the federal government and law enforcement organizations to combat terrorism, organized crime and money laundering. The USA Patriot Act significantly amended and expanded the application of the Bank Secrecy Act,

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including enhanced measures regarding customer identity, suspicious activity reporting rules and enhanced anti-money laundering programs.

Under the USA Patriot Act, financial institutions are subject to prohibitions against specified financial transactions and account relationships as well as enhanced due diligence and know your customer standards in their dealings with foreign financial institutions and foreign customers. For example, the enhanced due diligence policies, procedures and controls generally require financial institutions to take reasonable steps:

- to conduct enhanced scrutiny of account relationships to guard against money laundering and report any suspicious transaction; and
- to ascertain the identity of the nominal and beneficial owners of, and the source of funds deposited into, each account as needed to guard against money laundering and report any suspicious transactions.

Under the USA Patriot Act, financial institutions must also establish anti-money laundering programs. The USA Patriot Act sets forth minimum standards for these programs, including: (i) the development of internal policies, procedures and controls; (ii) the designation of a compliance officer; (iii) an ongoing employee training program; and (iv) an independent audit function to test the programs.

In addition, the USA Patriot Act requires the bank regulatory agencies to consider the record of a bank in combating money laundering activities in their evaluation of bank merger or acquisition transactions. Regulations proposed by the U.S. Department of the Treasury to effectuate certain provisions of the USA Patriot Act provide that all transaction or other correspondent accounts held by a U.S. financial institution on behalf of any foreign bank must be closed within 90 days after the final regulations are issued, unless the foreign bank has provided the U.S. financial institution with a means of verification that the institution is not a shell bank. Proposed regulations interpreting other provisions of the USA Patriot Act are continuing to be issued.

Under the authority of the USA Patriot Act, the Secretary of the Treasury adopted rules on September 26, 2002 increasing the cooperation and information sharing among financial institutions, regulators and law enforcement authorities regarding individuals, entities and organizations engaged in, or reasonably suspected based on credible evidence of engaging in, terrorist acts or money laundering activities. Under these rules, a financial institution is required to:

- expeditiously search its records to determine whether it maintains or has maintained accounts, or engaged in transactions with individuals or entities, listed in a request submitted by the Financial Crimes Enforcement Network, or FinCEN;
- notify FinCEN if an account or transaction is identified;
- designate a contact person to receive information requests;

- limit use of information provided by FinCEN to: (1) reporting to FinCEN, (2) determining whether to establish or maintain an account or engage in a transaction and (3) assisting the financial institution in complying with the Bank Secrecy Act; and
- maintain adequate procedures to protect the security and confidentiality of FinCEN requests.

Under the information sharing between the government agencies and financial institution rule, a financial institution may also share information regarding individuals, entities, organizations and countries for purposes of identifying and, where appropriate, reporting activities that it suspects may involve possible terrorist activity or money laundering.

The Secretary of the Treasury also adopted a rule on September 26, 2002 intended to prevent money laundering and terrorist financing through correspondent accounts maintained by U.S. financial institutions on behalf of foreign banks. Under the rule, financial institutions: (i) are prohibited from providing correspondent accounts to foreign shell banks; (ii) are required to obtain a certification from foreign banks for which they maintain a correspondent account stating the foreign bank is not a shell bank and that it will not permit a foreign shell bank to have access to the U.S. account; (iii) must maintain records identifying the owner of the foreign bank for which they

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may maintain a correspondent account and its agent in the United States designated to accept services of legal process; and (iv) must terminate correspondent accounts of foreign banks that fail to comply with or fail to contest a lawful request of the Secretary of the Treasury or the Attorney General of the United States, after being notified by the Secretary or Attorney General.

Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act of 2002 was enacted in response to public concerns regarding corporate accountability in connection with certain accounting scandals. The stated goals of the Sarbanes-Oxley Act are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies, and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws.

The Sarbanes-Oxley Act includes specific additional disclosure requirements, requires the Securities and Exchange Commission and national securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules, and mandates further studies of certain issues by the Securities and Exchange Commission. The Sarbanes-Oxley Act represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to state corporate law, such as the relationship between a Board of Directors and management and between a Board of Directors and its committees.

The Company has incurred additional expense in complying with the provisions of the Sarbanes-Oxley Act and the regulations that have been promulgated to implement the Sarbanes-Oxley Act, particularly those regulations relating to the establishment of internal controls over financial reporting.

Proposed Legislation and Regulatory Action. New regulations and statutes are regularly proposed that contain wide-ranging proposals for altering the structures, regulations and competitive relationships of financial institutions operating in the United States. The Company cannot predict whether or in what form any proposed regulation or statute will be adopted or the extent to which its business may be affected by any new regulation or statute.

Effect of Governmental Monetary Policies. The commercial banking business is affected not only by general economic conditions but also by the fiscal and monetary policies of the Federal Reserve. Some of the instruments of fiscal and monetary policy available to the Federal Reserve include changes in the discount rate on member bank borrowings, the fluctuating availability of borrowings at the discount window, open market operations, the imposition of and changes in reserve requirements against banks' deposits and assets of foreign branches, the imposition of and changes in reserve requirements against certain borrowings by banks and their affiliates, and the placing of limits on interest rates that banks may pay on time and savings deposits. Such policies influence to a significant extent the overall growth of bank loans, investments, and deposits and the interest rates charged on loans or paid on time and savings deposits. The Company cannot predict the nature of future fiscal and monetary policies and the effect of such policies on the future business and its earnings.

All of the above laws and regulations add to the cost of operating the Company and the Bank. The Company also notes that there has been an expansion in recent years by certain financial service providers that are not subject to the same rules and regulations as the Company and the Bank. These institutions, because they are not so highly regulated, may have a competitive advantage over the Company and the Bank and may continue to draw funds away from traditional banking institutions.

Item 1A. Risk Factors

The reader should carefully consider the following risk factors and all other information contained in this report in connection with his, her or its ownership of or investment in the Company's securities. These risks and uncertainties are not the only ones faced by the Company or the Bank. Additional risks and uncertainties not presently known to the Company or that the Company currently believes are immaterial also may impair the business of the Company or the Bank. If any of the events described in the following risk factors occur, the Company's and the Bank's business, results of operations and financial condition could be materially adversely affected. In addition, the trading price of the Company's stock could decline due to any of the events described in these risks.

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The Company's business may be adversely affected by conditions in the financial markets and economic conditions generally.

The Company's financial performance generally, and in particular the ability of borrowers to pay interest on and repay principal of outstanding loans and leases and the value of collateral securing those loans and leases, is highly dependent upon the business environment primarily in the Front Range of Colorado, which includes the Denver metropolitan area. A favorable business environment is generally characterized by, among other factors, economic growth, efficient capital markets, low inflation, high business and investor confidence, and strong business earnings. Unfavorable or uncertain economic and market conditions can be caused by: declines in economic growth, declines in housing and real estate valuations, business activity or investor or business confidence; limitations on the availability or increases in the cost of credit and capital; increases in inflation or interest rates; natural disasters; or a combination of these or other factors.

The United States entered into a recession in December 2007. In 2008 and 2009, the financial services industry and the securities markets generally were materially and adversely affected by significant declines in the values of nearly all asset classes and by a serious lack of liquidity. This was initially triggered by declines in home prices and the values of subprime mortgages, but spread to all mortgage and real estate asset classes, to leveraged bank loans and to nearly all asset classes, including equities. While the economy officially emerged from the recession in June 2009, the recovery has been tepid. Economic weakness has continued into 2010 and 2011 with unemployment remaining stubbornly high. The official U.S. unemployment rate is 8.9%, as of February 2011, according to figures released by the U.S. Department of Labor Bureau of Labor Statistics on March 4, 2011.

As a result of the challenging economic environment and declining collateral values, many lending institutions, including us, have experienced stress in their loan portfolio. Bank and bank holding company stock prices have been negatively affected, and the ability of banks and bank holding companies to raise capital or borrow in the debt markets has become more difficult. Further, the bank regulatory agencies have been and are expected to continue to remain aggressive in responding to concerns and trends identified in examinations, including the issuance of formal or informal enforcement actions or orders.

Each of these developments may negatively impact our operations by restricting our business operations, including our ability to originate loans, and adversely impact our financial performance or our stock price. In addition, further negative market developments may cause adverse changes in payment patterns, causing increases in delinquencies and default rates, which may impact our charge-offs and provision for credit losses. There can be no assurance that these conditions will improve in the near term. Such conditions could materially and adversely affect the credit quality of the Company's loans, and therefore, the Company's results of operations and financial condition.

Continuation of the weakened economic environment could reduce our customer base and demand for financial products such as loans.

Our success significantly depends upon the growth in population, income levels, and housing starts in our market. The weakened economic environment has negatively affected the market in which we operate. If the communities in which we operate do not grow or if prevailing economic conditions remain unfavorable, our business may be adversely impacted. Borrowers will be less likely to repay their loans as scheduled. Moreover, the value of real estate or other collateral that secures our loans has been adversely affected by the economic conditions and could continue to be negatively affected. Unlike many larger institutions, we are not able to spread the risks of unfavorable local economic conditions across a large number of diversified economies. Continued economic weakness could, therefore, result in losses that materially and adversely affect our business.

Management of Solera National Bank may be unable to adequately measure and limit credit risk associated with the Bank's loan portfolio, which would affect our profitability.

As a material part of the Bank's business plan, it makes commercial and industrial, consumer, construction, and commercial and residential real estate loans. The principal economic risk associated with each class of loans is the creditworthiness of the borrower, which is affected by the strength of the relevant business market segment, local market conditions and general economic conditions.

Additional factors related to the credit quality of commercial and industrial loans include the quality of the management of the business and the borrower's ability both to properly evaluate changes in the supply and demand characteristics affecting its market for products and services and to effectively respond to those changes. Additional

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factors related to the credit quality of commercial real estate loans include tenant vacancy rates and the quality of management of the property. Additional factors related to the credit quality of construction loans include fluctuations in the value of real estate and new job creation trends.

The majority of the Bank's loans are made to small- and medium-sized businesses, and professionals that are less able to withstand competitive, economic and financial pressures than larger borrowers. If the Bank is unable to effectively measure and limit the risk of default associated with its loan portfolio, our profitability will be adversely impacted.

We are exposed to higher credit risk by commercial real estate, commercial business, and construction lending.

Commercial real estate, commercial business, and construction lending usually involves higher credit risks than that of single-family residential lending. These types of loans involve larger loan balances to a single borrower or groups of related borrowers. Commercial real estate loans may be affected to a greater extent than residential loans by adverse conditions in real estate markets or the economy because commercial real estate borrowers' ability to repay their loans depends on successful development of their properties, as well as the factors affecting residential real estate borrowers. These loans also involve greater risk because they generally are not fully amortizing over the loan period, but have a balloon payment due at maturity. A borrower's ability to make a balloon payment typically will depend on being able to either refinance the loan or sell the underlying property in a timely manner.

Commercial business loans are typically based on the borrowers' ability to repay the loans from the cash flow of their businesses. These loans may involve greater risk because the availability of funds to repay each loan depends substantially on the success of the business itself.

Commercial real estate, commercial business, and construction loans are more susceptible to a risk of loss during a downturn in the business cycle. Our underwriting, review, and monitoring cannot eliminate all of the risks related to these loans.

Our allowance for probable loan losses may be insufficient.

We maintain an allowance for loan losses, which is a reserve established through a provision for probable loan losses charged to expense. This allowance represents management's best estimate of probable losses that may exist within the existing portfolio of loans. The determination of the appropriate level of the allowance for probable loan losses inherently involves a high degree of subjectivity and requires us to make significant estimates and assumptions regarding current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting the value of properties used as collateral for loans, problems affecting the credit of borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside our control, may require an increase in the allowance for probable loan losses. In addition, bank regulatory agencies periodically review our allowance for loan losses and may require an increase in the provision for probable loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. If charge-offs in future periods exceed the allowance for probable loan losses, we will need additional provisions to increase the allowance for probable loan losses. Any increases in the allowance for probable loan losses will result in a decrease in net income and have a material adverse effect on our financial condition and results of operations.

Interest rate volatility could significantly harm our business.

Our results of operations are affected by the monetary and fiscal policies of the federal government and the regulatory policies of governmental authorities. A significant component of our earnings is our net interest income. Net interest income is the difference between income from interest-earning assets, such as loans and investments, and the expense of interest-bearing liabilities, such as deposits and borrowed funds. In particular, changes in relative interest rates may reduce our net interest income as the difference between interest income and interest expense decreases. As a result, we have adopted asset and liability management policies and utilize interest rate risk measurement tools to minimize the potential adverse effects of changes in interest rates on net interest income. However, there can be no assurance that a change in interest rates will not negatively impact our results from operations or financial position. Since market interest rates may change by differing magnitudes and at different times, significant changes in interest rates over an extended period of time could reduce overall net interest income. An increase in interest rates could also have a negative impact on our results of operations by reducing the ability of borrowers to repay their current loan obligations, which could lead to increased loan defaults, foreclosures and write-offs, and necessitate further increases to our allowance for loan losses.

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Funding to provide liquidity may not be available to us on favorable terms or at all.

Liquidity is the ability to meet cash flow needs on a timely basis at a reasonable cost. The liquidity of Solera National Bank is used to make loans and to repay deposit liabilities as they become due or are demanded by customers. Liquidity policies and limits are established by the Board of Directors. Management regularly monitors the overall liquidity position of the Bank to ensure that various alternative strategies exist to cover unanticipated events that could affect liquidity. Management monitors guidelines to diversify the Bank's funding sources to avoid concentrations in excess of board approved policies in any one market source. Funding sources include federal funds purchased, securities sold under repurchase agreements, and non-core deposits. The Bank is also a member of the Federal Home Loan Bank System, which provides funding through collateral advances to members.

We maintain a portfolio of securities that can be used as a secondary source of liquidity. There are other sources of liquidity available to us should they be needed. These sources include sales of loans, our ability to acquire additional national market, non-core deposits, and additional collateralized borrowings such as Federal Home Loan Bank advances. Solera National Bank also can borrow from the Federal Reserve's discount window.

There is no assurance that we will be able to obtain such liquidity on terms that are favorable to us, or at all. If we were unable to access any of these funding sources when needed, we might be unable to meet customers' needs, which could adversely impact our financial condition, results of operations, cash flows and liquidity, and level of regulatory-qualifying capital.

We may not be able to raise additional capital on terms favorable to us.

We are required by regulatory authorities to maintain adequate levels of capital to support our operations. To support our continued growth, or replenish capital as a result of losses, we may need to raise additional capital. Our ability to raise additional capital, if needed, will depend in part on conditions in the capital markets at that time, which are outside our control. Accordingly, we cannot assure you of our ability to raise additional capital, if needed, on terms acceptable to us. If we cannot raise additional capital when needed, our ability to further expand our operations through internal growth and acquisitions could be materially impaired. In addition, if we decide to raise additional equity capital, your interest could be diluted.

The liquidity of our common stock is affected by its limited trading market.

Our shares do not, at this time, qualify for listing on any national securities exchange, and we cannot assure that our shares will ever be listed on a national securities exchange. However, our shares are traded on the OTC Bulletin Board and at least one company makes a market in our common stock. Because our shares are not listed on a national securities exchange, we cannot assure you that a broadly followed, established trading market for our common stock will ever develop or be maintained. Furthermore, we cannot assure you that at least one company will make a market in our shares for as long as we will be quoted on the OTC Bulletin Board. Active trading markets generally result in lower price volatility and more efficient execution of buy and sell orders. In addition, active trading markets tend to reduce the bid-ask spreads for sales transactions. On the other hand, the absence of an active trading market reduces the liquidity, and is likely to have an adverse effect on the market value of our shares. In addition, if we cease to be quoted on the OTC Bulletin Board, stockholders will find it more difficult to dispose of, or to obtain accurate quotations as to the market value of, our common stock, and the market value of our common may decline.

Departures of key personnel or directors may impair the Bank's operations.

The Company's success depends, in large part, on its ability to attract and retain key personnel. Competition for qualified personnel can be intense and the Company may not be able to hire or retain the key personnel that it depends upon for success. The unexpected loss of services of one or more of the Company's key personnel could have a material adverse impact on its business because of their skills, knowledge of the markets in which the Company operates, years of industry experience and the difficulty of finding qualified replacement personnel in a timely manner.

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Solera National Bank faces intense competition from a variety of competitors.

Competition in the banking and financial services industry is strong. In our market, we compete for loans, deposits and other financial products and services with local independent banks, national and super-regional banks, savings institutions, and credit unions, among others. Many of our competitors have competitive advantages, including greater financial resources and higher lending limits, a wider geographic presence, more accessible branch office locations, the ability to offer a wider array of services or more favorable pricing alternatives, as well as lower origination and operating costs. Because we maintain a smaller staff and have fewer financial and other resources than larger institutions with which we compete, we may be limited in our ability to attract customers.

We believe that Solera National Bank has emerged as a successful competitor in the market area we operate in. However, if we are unable to attract and retain customers, we may be unable to achieve growth in the loan and core deposit portfolios, and our results of operations and financial condition may be negatively impacted.

The potential for business interruption exists throughout the Company's organization.

We rely on third-party service providers for much of our communication, information, operating and financial control systems technology, including our internet banking services and data processing systems. Any failure or interruption of these services or systems or breaches in security of these systems could result in failures or interruptions in our customer relationship management, general ledger, deposit and/or loan systems. The occurrence of any failures or interruptions may require us to identify alternative sources for such services, and we cannot be sure that we can negotiate terms that are as favorable, or can obtain services with functionality similar to our existing systems without expending substantial resources, if at all.

Natural disasters, acts of war or terrorism and other external events could significantly impact our business.

Natural disasters, acts of war or terrorism and other adverse external events could have a significant impact on our ability to conduct business. Such events could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, and result in loss of revenue and/or cause us to incur additional expenses. Although management has established disaster recovery policies and procedures, the occurrence of any such event could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition, results of operations and cash flows.

Managing reputational risk is important to attracting and maintaining customers, investors and employees.

Threats to the Company's reputation can come from many sources, including but not limited to unethical practices, employee misconduct, failure to deliver minimum standards of service or quality, compliance deficiencies, and questionable or fraudulent activities of our customers. We have policies and procedures in place to protect our reputation and promote ethical conduct, but these policies and procedures may not be fully effective. Negative publicity regarding our business, employees, or customers, with or without merit, may result in the loss of customers, investors and employees, costly litigation, a decline in revenues and increased governmental regulation.

Government regulation may have an adverse effect on the Company's profitability and growth.

Bank holding companies and national banking associations operate in a highly regulated environment and are subject to supervision, regulation and examination by various federal regulatory agencies, as well as other governmental agencies in the states in which they operate. Federal and state laws and regulations govern numerous matters including changes in the ownership or control of banks and BHCs, maintenance of adequate capital, the financial condition of the Company, permissible types, amounts and terms of extensions of credit and investments, permissible non-banking activities, the level of reserves against deposits and restrictions on dividend payments. The OCC possesses cease and desist powers to prevent or remedy unsafe or unsound practices or violations of law by banks subject to their regulation, and the FRB possesses similar powers with respect to BHCs. These and other restrictions limit the manner in which we may conduct business and obtain financing.

On July 21, 2010, the Dodd-Frank Act, which comprehensively reforms the regulation of financial institutions, products and services, was signed into law. Because many aspects of the Dodd-Frank Act are subject to rulemaking and will take effect over several years, it is difficult to forecast the impact that such rulemaking will have on us, our customers or the financial industry. Certain provisions of the Dodd-Frank Act that affect deposit insurance assessments, the payment of interest on demand deposits and interchange fees could increase the costs associated with the Bank's deposit-generating activities, as well as place limitations on the revenues that those

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deposits may generate. For example, the FRB has proposed rules governing debit card interchange fees that apply to institutions with greater than \$10 billion in assets. Market forces may effectively require all banks to adopt debit card interchange fee structures which comply with these rules, which will significantly reduce the fee income earned from debit card transactions.

We are subject to a Regulatory Consent Order.

On December 16, 2010, pursuant to a Stipulation and Consent to the Issuance of a Consent Order the Bank consented and agreed to the issuance of an Amended Consent Order (Order), by the OCC, the Bank's primary banking regulator. The Order replaced and superseded the Consent Order entered into on March 18, 2010. The Order was based on the findings of the OCC during an examination that began on September 6, 2010. Since the completion of the examination, the Bank and its Board of Directors have taken steps to address the findings of the examination, have addressed many of the matters in the Order, and expect to complete all of the actions required to be taken by the deadline dates stated in the Order. The Bank is committed to establishing stronger banking practices with respect to credit risk management and administration, and strategic planning. However, there can be no assurance that the terms and conditions of the Order will be met or that the impact or effect of such terms and conditions will not have a material adverse effect with respect to our financial condition, results of operations and future prospects.

Our deposit insurance premiums could increase in the future, which could have an adverse impact to future earnings.

The FDIC insures deposits at FDIC-insured financial institutions, including the Bank. The FDIC charges insured financial institutions premiums to maintain the Deposit Insurance Fund (DIF) at a certain level. On February 7, 2011, the FDIC adopted final rules to implement changes required by the Dodd-Frank Act with respect to the FDIC assessment rules. In particular, the definition of an institution's deposit insurance assessment base is being changed from total deposits to total assets less tangible equity. In addition, the FDIC is revising the deposit insurance assessment rates down. The changes will become effective April 1, 2011. The new initial base assessment rates range from 5 to 35 basis points depending on risk category. We expect that the new rates and assessment base will reduce our current FDIC insurance assessments. However, if the risk category of the Bank changes adversely, our FDIC insurance premiums could increase.

The FDIC may further increase or decrease the assessment rate schedule in order to manage the DIF to prescribed statutory target levels. An increase in the Risk Category for the Bank or in the assessment rates could have an adverse effect on the Bank's earnings. The FDIC may terminate deposit insurance if it determines the institution involved has engaged in or is engaging in unsafe or unsound banking practices, is in an unsafe or unsound condition, or has violated applicable laws, regulations or orders.

Due to the nature of our business, we may be subject to litigation from time to time, some of which may not be covered by insurance.

As a holding company and through our bank subsidiary, we operate in a highly regulated industry, and as a result, are subject to various regulations related to disclosures to our customers, our lending practices, and other fiduciary responsibilities, including those to our shareholders. From time to time, we may become subject to legal actions relating to our operations that could involve claims for substantial monetary damages. Although we maintain insurance, the scope of this coverage may not provide us with full, or even partial, coverage in any particular case. As a result, a judgment against us in any such litigation could have a material adverse effect on our financial condition and results of operation.

Our financial statements are based in part on assumptions and estimates, which, if wrong, could cause unexpected losses in the future.

Pursuant to U.S. generally accepted accounting principles, we are required to use certain assumptions and estimates in preparing our financial statements, including in determining credit loss reserves and the fair value of certain assets and liabilities, among other items. If assumptions or estimates underlying our financial statements are incorrect, we may experience material losses. For additional information, see Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies.

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We do not intend to pay dividends in the foreseeable future.

We currently have no material source of income other than dividends that we receive from Solera National Bank. Therefore, our ability to pay dividends to our stockholders depends on the Bank's ability to pay dividends to us. The Board of Directors of the Bank intends to retain earnings to promote growth and build capital and recover any losses incurred in prior periods. Accordingly, we do not expect to receive dividends from the Bank, or pay dividends to our stockholders, in the foreseeable future. In addition, banks and bank holding companies are subject to certain regulatory restrictions on the payment of cash dividends.

Our certificate of incorporation and bylaws, and the employment agreements of our executive officers, contain provisions that could make a takeover more difficult.

Our certificate of incorporation and bylaws include provisions designed to provide our Board of Directors with time to consider whether a hostile takeover offer is in our and our stockholders' best interests, but could be utilized by our Board of Directors to deter a transaction that would provide stockholders with a premium over the market price of our shares. These provisions include the availability of authorized, but unissued shares, for issuance from time to time at the discretion of our Board of Directors; bylaw provisions enabling our Board of Directors to increase the size of the board and to fill the vacancies created by the increase; and bylaw provisions establishing advance notice procedures with regard to business to be presented at a shareholder meeting or director nominations.

In addition, there are change in control provisions in the employment agreements of our executive officers providing for lump-sum cash payments based on the officer's base compensation.

While we are not aware of any current takeover threats or changes in control, these provisions may discourage potential acquisition proposals and could delay or prevent a change in control, including under circumstances in which our stockholders might otherwise receive a premium over the market price of our shares. These provisions may also have the effect of making it more difficult for third parties to cause the replacement of our current management and may limit the ability of our stockholders to approve transactions that they may deem to be in their best interests.

Our directors and executive officers could have the ability to influence stockholder actions in a manner that may be adverse to your personal investment objectives.

As of March 1, 2011, our directors and executive officers owned 220,913 shares of our common stock, which represents 8.7% of the number of shares outstanding. Additionally, we issued warrants to our initial organizers and stock options to our directors and executive officers. If our executive officers and directors exercised all of their warrants, our directors and executive officers would own shares upon exercise representing as much as 15.3% of our then existing outstanding common stock. Moreover, although all of the stock options are not immediately exercisable by their terms, upon exercise of the stock options granted to our directors and executive officers, our directors and executive officers would own shares upon exercise representing as much as 19.6% of our then existing outstanding common stock based on number of shares outstanding.

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Due to their significant ownership interests, our directors and executive officers will be able to exercise significant control over the management and affairs of Solera National Bancorp and Solera National Bank. For example, our directors and executive officers may be able to influence the outcome of director elections or block significant transactions, such as a merger or acquisition, or any other matter that might otherwise be approved by the non-affiliate stockholders.

Item 1B. Unresolved Staff Comments

None.

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Item 2. Properties

The Bank's main office, which is also the principal executive office of the Company, is located at 319 South Sheridan Boulevard, Lakewood, Colorado 80226. The Bank occupies a 6,218 square foot one-story freestanding building. The Bank also leases 3,518 square feet in Lakewood, Colorado that serves as administrative offices for our executive management, accounting and credit administration functions. The Bank has entered into lease agreements with respect to each of the banking locations. The aggregate commitments under the leases are set forth in the notes to the audited financial statements included in this Form 10-K. Management believes that these facilities are adequate to meet the present needs of the Company and the Bank.

Item 3. Legal Proceedings

On December 16, 2010, pursuant to a Stipulation and Consent to the Issuance of a Consent Order, Solera National Bank consented and agreed to the issuance of an Amended Consent Order (the "Order") by the Office of the Comptroller of Currency. The Order replaces and supersedes the Consent Order entered into on March 18, 2010 by the Bank, a copy of which is included as Exhibit 10.13 to this Annual Report. The provisions of the Order shall remain effective and enforceable, except to the extent that, and until such time as, any provisions of the Order have been amended, suspended, waived, or terminated in writing by the OCC. The Order is based on the findings of the OCC during an examination that began on September 6, 2010. Since the completion of the examination, the Bank and its Board of Directors have taken steps to address the findings of the examination, have addressed many of the matters in the Order, and expect to complete all of the actions required to be taken by the deadline dates stated in the Order. The Bank did not admit any wrongdoing in entering into the Order, and in connection with the actions outlined in the Order, is committed to establishing stronger banking practices with respect to credit risk management and administration, and strategic planning.

The Order requires the Bank or its Board of Directors, among other things:

- to establish a compliance committee of at least five members to monitor and coordinate compliance with the Order within five (5) days;
- to develop a written strategic plan for the Bank covering at least two years within ninety (90) days of the Order;
- to refrain from declaring dividends unless in compliance with the two-year plan described above and only upon prior written approval of the OCC;
- to provide for compliance with the Bank Secrecy Act, by performing a comprehensive BSA risk assessment periodically (no less than every two years);
- to ensure adherence to a written program of policies and procedures to provide for compliance with the BSA, effective as of the date of the Order;
- to ensure the Bank manages and controls the risk in the loan portfolio, effective as of the date of the Order;

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- to prepare, adopt and thereafter adhere to, revisions to the Bank's loan policy, as well as any necessary procedures, to address weaknesses in the Bank's credit risk management and underwriting, within one-hundred and twenty (120) days of the Order;
- to develop, implement and thereafter ensure Bank adherence to a written program designed to assess and manage the credit risk associated with the Bank's Home Equity Line of Credit portfolio, within sixty (60) days of the Order.

The foregoing description of the Order does not purport to be complete and is qualified in its entirety by reference to the Stipulation and the Order, copies of which are attached to this Annual Report as Exhibits 10.16 and 10.17, respectively, and incorporated herein by reference.

Item 4. [Removed and Reserved]

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Price of Common Stock

The Company's common stock is traded over the counter on the OTC Bulletin Board under the symbol

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SLRK.OB . Corporate Stock Transfer is the Company's transfer agent and registrar, and is able to respond to inquiries from stockholders on its website: www.corporatestock.com or at its mailing address: 3200 Cherry Creek Drive South, Suite #430, Denver, CO 80209. The following table sets forth the high and low sales prices for the periods indicated below. The table reflects inter-dealer prices, without retail mark-up, mark-down or commission, and may not represent actual transactions.

	High		Low
Year Ended December 31, 2010:			
First Quarter	\$ 5.45	\$	4.70
Second Quarter	4.95		4.35
Third Quarter	4.50		4.05
Fourth Quarter	4.50		3.50

	High		Low
Year Ended December 31, 2009:			
First Quarter	\$ 8.00	\$	5.50
Second Quarter	6.50		5.00
Third Quarter	6.50		5.75
Fourth Quarter	5.90		5.25

The last price at which the Company's common stock was sold was \$3.29 on March 22, 2011.

 Holders

As of March 12, 2011 there were approximately 700 holders of record.

 Dividends

The Company has never declared or paid dividends on its common stock. In addition, the Company expects to retain future earnings, if any, for use in the operation and expansion of the Bank's business and does not anticipate paying any cash dividends in the foreseeable future. Any determination to pay dividends in the future will be at the discretion of the Board of Directors and will, among other factors, depend upon regulatory requirements and restrictions, the Company's results of operations, its financial condition and capital requirements. Because, as a holding company, the Company conducts no material activities at this time other than holding the common stock of the Bank, its ability to pay dividends depends on the receipt of dividends from the Bank. The Board of Directors of the Bank intends to retain earnings to promote growth and build capital and to recover any losses incurred in prior periods. Accordingly, the Company does not expect to receive dividends from the Bank in the foreseeable future. In addition, banks and bank holding companies are both subject to certain regulatory restrictions on the payment of cash dividends. In the case of the Company, for example, the existence of any cash at the Company in order to be able to pay dividends to stockholders of the Company is substantially dependent on the earnings of the Bank and the payment of dividends by the Bank to the Company, as the Bank's sole stockholder. The Bank is currently prohibited by the regulators from paying dividends without regulatory approval until the accumulated deficit has been eliminated. For additional discussion of legal and regulatory restrictions on the payment of dividends, see *Part I - Item 1. Business - Supervision and Regulation*.

Recent Sales of Unregistered Securities

None.

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Issuer Purchases of Equity Securities

None.

Item 6. Selected Financial Data

As a smaller reporting company, this item is not required.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The purpose of the following discussion is to address information relating to the financial condition and results of operations of the Company that may not be readily apparent from the financial statements and notes included in this Report. This discussion should be read in conjunction with the information provided in the Company's financial statements and the notes thereto. The financial information provided below has been rounded in order to simplify its presentation. However, the ratios and percentages provided below are calculated using the detailed financial information contained in the financial statements, the notes thereto and the other financial data included elsewhere in this Annual Report.

General

The Company is a Delaware corporation that was incorporated on January 12, 2006 to organize and serve as the holding company for Solera National Bank, a national bank that opened for business on September 10, 2007. Solera National Bank is a full-service commercial bank headquartered in Lakewood, Colorado serving the Denver metropolitan area. The Company's main banking office is located at 319 South Sheridan Boulevard, Lakewood, Colorado 80226. The Bank's telephone number is (303) 209-8600.

The Bank offers a broad range of commercial and consumer banking services to small- and medium-sized businesses, licensed professionals and individuals who management believes are particularly responsive to the personalized service that Solera National Bank provides to its customers. Management believes that local ownership and control allows the Bank to serve customers more efficiently and effectively and aids in the Company's growth and success. Solera National Bank competes on the basis of providing a personalized banking experience combined with a full range of services, customized and tailored to fit the individual needs of its clients. Solera National Bank serves the entire market area, with a particular emphasis on the local Hispanic population, along with other minority and disadvantaged communities due to the significant growth in these markets.

During the year ended December 31, 2007, the Company received approval from the Federal Reserve Bank of Kansas City to operate as a bank holding company for Solera National Bank. Additionally, the Company closed on its initial public offering, in which the Company raised \$25.5 million, and Solera National Bank received final regulatory approvals and began operations on September 10, 2007.

The following discussion focuses on the Company's financial condition and results of operations during the years ended December 31, 2010 and 2009, presented on a consolidated basis.

As of December 31, 2010, on a consolidated basis, the Company had total assets of \$140.1 million, net loans of \$57.6 million, total deposits of \$111.0 million and stockholders' equity of \$18.3 million.

Critical accounting policies

This discussion and analysis of the Company's financial condition and results of operations is based upon the Company's financial statements, which have been prepared in accordance with United States generally accepted accounting principles. The preparation of these consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities at the date of the financial statements. Actual results may differ from these estimates under different assumptions or conditions. The following is a description of the Company's significant accounting policies used in the preparation of the accompanying consolidated financial statements.

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Allowance for loan losses

Implicit in the Company's lending activities is the fact that loan losses will be experienced and that the risk of loss will vary with the type of loan being made and the creditworthiness of the borrower over the term of the loan. The allowance for loan losses represents the Company's recognition of the risks of extending credit and its evaluation of the loan portfolio. The allowance for loan losses is maintained at a level considered adequate to provide for probable loan losses based on management's assessment of various factors affecting the loan portfolio, including a review of problem loans, business conditions, historical loss experience, evaluation of the quality of the underlying collateral, and holding and disposal costs. In addition, because the Bank has limited history on which to base future loan losses, a comparison of peer group allowance ratios to gross loans is made with the intention of maintaining similar levels until the Bank has sufficient historical data to see trends in our own loss history. The allowance for loan losses is increased by provisions charged to expense and reduced by loans charged-off, net of recoveries. Loan losses are charged against the allowance for loan losses when management believes the loan balance is uncollectible.

The Company has established a formal process for determining an adequate allowance for loan losses. The allowance for loan losses calculation has two components. The first component represents the allowance for loan losses for impaired loans; that is loans where the Company believes collection of the contractual principal and interest payments is not probable. To determine this component of the calculation, collateral-dependent impaired loans are evaluated using internal analyses as well as third-party information, such as appraisals. Impaired loans that are not collateral-dependent (i.e. loans where repayment may be received by means other than foreclosure and sale of the underlying collateral) are evaluated using a discounted cash flow of the payments expected over the life of the loan using the loan's effective interest rate and giving consideration to currently existing factors that would impact the amount or timing of the cash flows.

The second component of the allowance for loan losses represents contingent losses—the estimated probable losses inherent within the portfolio due to uncertainties. Factors considered by management to estimate inherent losses include, but are not limited to, 1) historical and current trends in downgraded loans; 2) the level of the allowance in relation to total loans; 3) the level of the allowance in relation to the Bank's peer group; 4) the levels and trends in non-performing and past due loans; and 5) management's assessment of economic conditions and certain qualitative factors as defined by bank regulatory guidance, including but not limited to, changes in the size, composition and concentrations of the loan portfolio, changes in the legal and regulatory environment, and changes in lending management. The recorded allowance for loan losses is the aggregate of the impaired loans component and the contingent loss component.

At December 31, 2010, the Company had an allowance for loan losses of \$1.2 million. Management believes that this allowance for loan losses is adequate to cover probable losses based on all currently available evidence. Future additions to the allowance for loan losses may be required based on management's continuing evaluation of the inherent risks in the portfolio. Additional provisions for loan losses may need to be recorded if the economy declines, asset quality deteriorates, or the loss experience changes. Also, federal regulators, when reviewing the Bank's loan portfolio in the future, may require the Bank to increase the allowance for loan losses. Any increase in the allowance for loan losses would adversely affect earnings. An analysis of the allowance for loan losses as well as its allocation among certain categories of the loan portfolio can be found in Item 1 Asset Quality, above.

Share-based compensation

The Company grants stock options as incentive compensation to employees and directors. The cost of employee/director services received in exchange for an award of equity instruments is based on the grant-date fair value of the award, which is determined using a Black-Scholes-Merton model. This cost, net of estimated forfeitures, is expensed to salaries and employee benefits over the period which the recipient is required to provide services in exchange for the award, generally the vesting period.

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Estimation of fair value

The estimation of fair value is significant to a number of the Company's assets, including available-for-sale investment securities and other real estate owned. These are all recorded at either fair value or at the lower of cost or fair value. Furthermore, accounting principles generally accepted in the United States require disclosure of the fair value of financial instruments as a part of the notes to the consolidated financial statements. Fair values are volatile and may be influenced by a number of factors, including market interest rates, prepayment speeds, discount rates and the shape of yield curves.

Impairment of investment securities

Investment securities are evaluated for impairment on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value below amortized cost is other-than-temporary. Securities are evaluated for impairment utilizing criteria such as the magnitude and duration of the decline, current market conditions, payment history, the credit worthiness of the obligor, the intent of the Company to retain the security or whether it is more likely than not that the Company will be required to sell the security before recovery of the value, as well as other qualitative factors. If a decline in value below amortized cost is determined to be other-than-temporary, which does not necessarily indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not favorable, the security is reviewed in more detail in order to determine the portion of the impairment that relates to credit (resulting in a charge to earnings) versus the portion of the impairment that is noncredit related (resulting in a charge to accumulated other comprehensive income). A credit loss is determined by comparing the amortized cost basis to the present value of cash flows expected to be collected, computed using the original yield as the discount rate.

New accounting pronouncements

See Note 1 of the Notes to Consolidated Financial Statements contained in Item 8. Financial Statements and Supplementary Data for information on recent accounting pronouncements and their impact, if any, on our consolidated financial statements.

Results of operations for the years ended December 31, 2010 and 2009

During the year ended December 31, 2010, the Company had net income of approximately \$134,000, an improvement of approximately \$1.4 million from net losses of approximately \$1.3 million during the year ended December 31, 2009. The improvement in earnings during the 2010 year is primarily attributable to the increase in net interest income of \$1.3 million due to higher average earning assets and an increase in net interest margin. This coupled with an increase in gain on sales of securities of \$961,000 partially offset by increases in the provision for loan losses of \$548,000 account for the improvement in net income year over year.

During 2010, the Company's overhead costs, or noninterest expenses, totaled approximately \$4.4 million compared to \$4.2 million for the prior year. This increase was primarily the result of increased banking activity and therefore higher processing fees, increased FDIC premiums and additional professional fees.

The 2010 year resulted in a return on average assets of 0.09% which was an improvement over the 2009 loss on average assets of 1.2%. Fiscal 2010 ended with a return on average equity of 0.67% in comparison to a loss on average equity of 6.7% during 2009.

Net interest income and net interest margin

Net interest income is the difference between interest and fee income, principally from loan and investment security portfolios, and interest expense, principally on customer deposits and borrowings. Net interest income is our principal source of earnings. Changes in net interest income result from changes in volume, spread and margin. Volume refers to the average dollar level of interest-earning assets and interest-bearing liabilities. Spread refers to the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities. Margin refers to net interest income divided by average interest-earning assets, and is influenced by the level and relative mix of interest-earning assets and interest-bearing liabilities.

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The following table sets forth, for the periods indicated, information related to the Company's average balance sheet and its average yields on assets and average costs of liabilities. These yields are derived by dividing the annualized income or expense by the average balance of the corresponding asset or liability.

(\$ in thousands)	Average Balance	2010 Interest/ Dividend	Average Yield/Rate	Average Balance	2009 Interest/ Dividend	Average Yield/Rate
ASSETS						
Federal funds sold and other short-term investments	\$ 2,153	\$ 10	0.48%	\$ 3,082	\$ 14	0.45%
Investment securities	72,534	2,959	4.08	56,943	2,896	5.09
Gross loans, net of unearned fees	58,038	3,381	5.82	38,133	2,093	5.49
FHLB and Federal Reserve Bank stock	1,140	41	3.61	1,080	42	3.89
TOTAL EARNING ASSETS	133,865	\$ 6,391	4.77%	99,238	\$ 5,045	5.08%
Non-earning assets	3,918			3,053		
TOTAL ASSETS	\$ 137,783			\$ 102,291		
LIABILITIES						
Interest-bearing deposits						
Interest-bearing demand	\$ 9,556	\$ 144	1.51%	\$ 5,308	\$ 114	2.15%
Savings and money market	56,413	879	1.56	23,503	557	2.37
Time deposits	42,162	882	2.09	40,342	1,131	2.80
TOTAL INTEREST-BEARING DEPOSITS	\$ 108,131	\$ 1,905	1.76%	\$ 69,153	\$ 1,802	2.61%
Securities sold under agreements to repurchase and federal funds purchased						
	598	8	1.31	995	12	1.21
Federal Home Loan Bank borrowings						
	6,807	261	3.82	9,040	334	3.69
Other borrowings	98	9	9.41	139	13	9.35
TOTAL INTEREST-BEARING LIABILITIES	\$ 115,634	\$ 2,183	1.89%	\$ 79,327	\$ 2,161	2.72%
LIABILITIES						
Noninterest-bearing demand deposits	1,939			3,429		
Other liabilities	444			515		
TOTAL LIABILITIES	2,383			83,271		
STOCKHOLDERS' EQUITY	19,766			19,020		
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 137,783			\$ 102,291		
NET INTEREST INCOME / MARGIN						
		\$ 4,208	3.14%		\$ 2,884	2.91%
NET INTEREST SPREAD						
			2.89%			2.36%

The following table presents the dollar amount of changes in interest income and interest expense for the major categories of interest-earning assets and interest-bearing liabilities. The information details the changes attributable to a change in volume (i.e. change in average balance multiplied by the prior-period average rate) and changes attributable to a change in rate (i.e. change in average rate multiplied by the prior-period average balance). There is a component that is attributable to both a change in volume and a change in rate. This component has been allocated proportionately to the rate and volume columns.

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(\$ in thousands)	Twelve Months Ended December 31, 2010 Compared to Twelve Months Ended December 31, 2009		
	Net Change	Rate	Volume
Interest income:			
Gross loans, net of unearned fees	\$ 1,288	\$ 135	\$ 1,153
Investment securities	63	(165)	228
FHLB and Federal Reserve Bank stocks	(1)	(4)	3
Federal funds sold and other short-term investments	(4)	(2)	(2)
Total interest income	\$ 1,346	\$ (36)	\$ 1,382
Interest expense:			
Interest-bearing checking	\$ 30	\$ (18)	\$ 48
Savings and money market	322	(104)	426
Time deposits	(249)	(302)	53
Federal funds purchased and securities sold under agreements to repurchase	(4)	2	(6)
Federal Home Loan Bank borrowings	(73)	12	(85)
Other borrowings	(4)		(4)
Total interest expense	\$ 22	\$ (410)	\$ 432
Net interest income	\$ 1,324	\$ 374	\$ 950

For the year ended December 31, 2010, the Company's net interest income increased \$1.3 million to \$4.2 million as compared to \$2.9 million for 2009. This increase is a combination of a favorable rate increase of \$374,000 and a favorable volume increase of \$950,000 as reflected in the table above.

The \$374,000 favorable rate increase was primarily a result of reduced interest expense on interest-bearing deposits as rates decreased 85 basis points. The Bank lowered the promotional rates paid on certain interest-bearing checking accounts, savings accounts and money market accounts without a net loss of balances. The Federal Reserve Board influences the general market rates of short-term interest, including the deposit and loan rates offered by the Bank. The Bank's loan portfolio is significantly affected by changes in the prime interest rate. The prime interest rate, which is the rate offered on loans to borrowers with strong credit, remained unchanged throughout 2009 and 2010 at 3.25%. Rates on our loan portfolio have increased 33 basis points over 2009 primarily due to a shift in the loan mix to more fixed-rate loans at higher interest rates. This was partially offset by an unfavorable rate decrease on the investment portfolio as proceeds from principal repayments were reinvested at lower market rates during 2010.

The \$950,000 favorable volume variance contributed to the overall 23 basis point increase in net interest margin during 2010. Most notably, volume increases on the Company's loan portfolio accounted for \$1.2 million of the overall increase in net interest income. Since the loan portfolio is the Company's highest yielding asset, this had the largest impact on the increase in net interest margin which rose from 2.91% for fiscal year 2009 to 3.14% during fiscal year 2010.

On an annualized basis, the Company's net interest spread, (the yield earned on interest-earning assets less the cost of interest-bearing liabilities) increased 53 basis points from 2.36% for 2009 to 2.89% for 2010.

Provision for loan losses and allowance for loan losses

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The provision for loan losses is the annual cost of providing an allowance or reserve for estimated probable losses on loans. The provision for loan losses increased \$548,000 to \$1.1 million in 2010 partially due to charge-offs of approximately \$520,000 taken during the third quarter related to two real estate development participations from the Bank's early stages of operation. The Bank has no other purchased loan participations on its balance sheet and minimal remaining exposure to real estate construction or development. The allowance for loan losses reflects

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management's judgment of the level of allowance adequate to absorb estimated credit losses in the Bank's loan portfolio.

Information regarding the calculation of the loan loss provision, the factors considered by the Company in establishing the reserves and the quality of the Bank's loan portfolio are included in the section of this Report titled *Part I - Item 1. Business - Asset Quality*.

Noninterest income

Noninterest income for the year ended December 31, 2010 of \$1.4 million, an increase of \$809,000 over 2009, consisted of: (1) realized gains, net of losses, on the sale of investment securities of approximately \$1.3 million, an increase of \$961,000 from 2009 due to favorable market conditions during 2010; (2) service charges on deposit accounts of approximately \$74,000, a decrease of \$173,000 over 2009 primarily due to the loss of a money-services-business deposit customer; (3) a \$10,000 gain on the sale of an OREO property and (4) \$16,000 in other income, an increase of \$11,000 over 2009, primarily due to the Bank's new residential mortgage lending partnership.

Noninterest expense

Noninterest expenses totaled \$4.4 million for the year ended December 31, 2010 an increase of \$175,000, or 4%, from the prior year which totaled \$4.2 million. This consisted of an increase in professional fees of \$108,000, or 34%, due primarily to increased compliance and Bank Secrecy Act consulting costs related to rectifying weaknesses identified in the Consent Order executed on March 18, 2010 and amended on December 16, 2010, and increased legal and consulting costs incurred in anticipation of a transaction to acquire deposits and loans from Liberty Savings Bank FSB, which was terminated on November 19, 2010. This increase was offset by a decrease of \$111,000, or 5%, in salaries and employee benefits related to reduced incentive compensation expense during 2010 and a reduction in average salaries and benefits per full-time employee. Occupancy expense remained unchanged and other general and administrative expenses increased \$178,000, or 19%, year-over-year, as detailed in the following table and discussed in the ensuing narrative:

(\$ in thousands)	12 Months Ended			Increase/ (Decrease)		
	2010	December 31,	2009			
Other general and administrative expenses:						
Data processing	\$	321	\$	275	\$	46
FDIC assessments		192		162		30
Other regulatory and reporting fees		114		98		16
Marketing and promotions		100		109		(9)
Directors fees		49				49
Travel and entertainment		46		49		(3)
Other loan expense		45		10		35
Telephone		41		38		3
Printing, stationery and supplies		36		43		(7)
Dues and memberships		35		34		1
Insurance		23		19		4
Franchise taxes		17		9		8
Postage, shipping and courier		17		24		(7)
Training and education		9		12		(3)

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OREO expense	8		8
Miscellaneous	40	33	7
Total	\$ 1,093		