Solera National Bancorp, Inc.
Form 10-K
March 21, 2013

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2012

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 | 02-0774841 |
| --- | --- |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer 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
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
o Yes þ 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. o Yes þ 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. þ Yes o 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). þ Yes o 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. þ

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 | o | Accelerated filer | o |
| Non-accelerated filer | o | Smaller reporting company | þ |
| (Do not check if a smaller reporting company) | | | |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). o Yes þ 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 29, 2012 was $8,684,944.

The number of shares of common stock, par value $0.01 share, of the Registrant outstanding as of March 14, 2013, was 2,653,671.

DOCUMENTS INCORPORATED BY REFERENCE: Portions of the Company's definitive proxy statement for its 2013 Annual Meeting of Stockholders, expected to be held in May 2013, are incorporated by reference into Part III of this Form 10-K.

SOLERA NATIONAL BANCORP, INC.

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 c 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 the Company 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 its 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;
- we are subject to extensive regulatory oversight, which could restrain our growth and profitability;
- our new residential mortgage lending division may expose us to increased operating and compliance risks;
- 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 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.

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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 in July 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.

At this time, the Company engages in no material business operations other than owning and managing the Bank. At December 31, 2012, Solera National Bancorp, Inc. had no employees, as all staff 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").

On June 29, 2012, the OCC terminated the Amended Consent Order (the "Consent Order") by and between the OCC and Solera National Bank which was entered into on December 16, 2010. The Consent Order replaced and superseded the consent order entered into on March 18, 2010 by the Bank. As such, the Bank is no longer subject to any formal or informal regulatory agreement.

Solera National Bank is a full-service commercial bank headquartered in Lakewood, Colorado that offers a broad range of commercial and consumer banking services to small- and medium-sized businesses, licensed professionals and individuals primarily located in the six-county Denver metropolitan area. While the Bank serves the entire community, it has a specialized focus serving the local Hispanic and other minority populations which it believes are currently underserved.

In December 2012, the Company launched a residential mortgage division with five loan production offices in Colorado including Boulder, two locations in Colorado Springs, the Denver Tech Center and Durango. With the addition of more than 50 mortgage professionals, the Bank now offers residential mortgage loans, the vast majority of which will be sold on the secondary market. In the aftermath of the recent economic recession and the changing regulatory environment, we concluded that a combination of disruption in the residential mortgage lending market, the stringent underwriting standards which followed, and the historically low interest rate environment, presented a significant opportunity to expand our residential mortgage lending capabilities. As a result, we spent considerable effort exploring options, and in 2012, we identified a group of mortgage professionals seeking to align with a bank. After an extended due diligence period, we determined that this group brought the skills and experience required to enter this line of business thereby increasing franchise value. As of December 31, 2012, the Bank had 63 full-time equivalent employees. That number reached 82 employees during the first quarter 2013 after the new residential mortgage division became fully operational.

Available Information

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 Securities and Exchange Commission ("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.

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Philosophy and Strategy

Solera National Bank operates as a full-service community bank and mortgage banking operation offering a wide array of financial products and services 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.

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, several of whom are fluent in Spanish;
- 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, professionals and individuals; and
- utilizing an effective business development calling program.

Market Opportunities

Primary Service Area. Solera National Bank's primary service area for its community banking operation 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 gathered from SNL Analytics, within a three mile radius of the Bank's main office, there are approximately 7,250 businesses, 97,000 employees and 198,000 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 as approximately 52% are Hispanic households within three miles of the Bank's main office. Most of the Bank's customers are from our primary service area. With the addition of the residential mortgage division, the Bank now has a presence in Boulder, Colorado Springs, the Denver Tech Center and Durango.

National Economy. On a national level, the economic recovery stalled in the fourth quarter of 2012. However, most economic indicators showed positive growth for the year, with momentum heading into 2013. The second estimate release by the Bureau of Economic Analysis on February 28, 2013 showed that the U.S. GDP increased at an annual rate of only 0.1 percent in the fourth quarter. The increase in real GDP in the fourth quarter primarily reflected positive contributions from personal consumption expenditures (PCE), nonresidential fixed investment, and residential fixed investment that were partly offset by negative contributions from private inventory investment, federal government spending, exports, and state and local government spending. Imports, which are a subtraction in the calculation of GDP, decreased. Job and income gains are expected to continue, along with further strengthening in the housing market. Consumer confidence readings declined in January, with the majority of respondents indicating concerns over their financial situation driven largely by federal tax increases and spending cuts.

The U.S. economy added 236,000 jobs in February while hiring in December was revised upward by 23,000 and January was revised downward by 38,000, according to figures released by the U.S. Labor Department on March 8, 2013. The unemployment rate edged down to 7.7%, but has shown little net movement since September 2012.

Although the job market is improving, the pace of improvement still remains too slow to absorb the approximately 22.6 million people who are either out of work or underemployed.

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Colorado Economy. According to statistics released on March 18, 2013 by the Colorado Department of Labor and Employment, nonfarm payroll jobs in Colorado increased by 7,100 from December to January for a total of 2,342,900 jobs, according to the survey of business establishments. According to the survey of households, the unemployment rate decreased two-tenths of a percentage point to 7.3%. The number of people actively participating in the labor force increased 6,000 to 2,753,500 and total employment increased 11,800 to 2,552,800 causing the number of unemployed to decline 5,800.

Over the year, the unemployment rate is down 1% from 8.3% in January 2012. The number of Coloradans participating in the labor force increased 12,000, total employment increased 38,100 and the number of unemployed decreased 26,100.

Denver Metropolitan Area Economy. Economic indicators released for 2012 show positive signs of growth, with the year proving to be stronger than expected. The unemployment average for 2012 was lower than in 2011, home sales and median home prices are slowly increasing, and stock market returns are encouraging considering recent turmoil in fiscal policies, according to data compiled by the Metro Denver Economic Development Corporation (Metro Denver EDC) in its Monthly Economic Summary for February 2013. However, consumer confidence remains uneasy. The Denver metro area's unemployment rate remained stable at 7.2 percent in December. The year-to-date average shows Metro Denver’s rate for 2012 was 7.7 percent. For 2012, employment increased by 34,500 jobs over 2011, an increase of 2.5 percent.

Management believes that our primary market has begun to stabilize compared to the significant negative trends experienced at the height of the recession. However, there can be no guarantee that continued concerns about the global economy will not have an adverse impact on the local economy in which we operate.

Competition. Solera National Bank faces substantial competition in both lending and deposit originations from 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, 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.

According to information disclosed on the FDIC’s website (www.fdic.gov), as of June 30, 2012, most of the deposits held in traditional banking institutions in the Bank’s primary banking market were 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. We believe that we can compete 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, we have employed the following operating strategies:

Experienced senior management. Our senior management possesses extensive experience in the banking industry, as well as substantial business and banking contacts in our primary service area. Additionally, our newly hired

President of the residential mortgage division has extensive experience managing mortgage banking activities.

Quality employees. We have 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 our employees to answer questions and resolve customer issues quickly. We have hired staff fluent in Spanish 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 our Directors are currently or have been residents of the Bank's primary service area, and most have significant business ties to the Bank's primary service area, enabling them to be sensitive and responsive to the needs of the community. Additionally, the Board of Directors encompasses a wide variety of business experience and community involvement.

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Well situated sites. The main banking 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 highly visible presence in a market that is dominated by branch offices of banks headquartered out of the area. Each of the mortgage offices is located in active mortgage markets with excellent access to a broad customer base.

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. The 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. We have implemented an active call program to promote our philosophy. The purpose of this call program is to visit prospective customers and to describe the Bank's products, services and philosophy and attend 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.

Marketing and advertising. The most significant marketing efforts include sponsorships of community events, support of local non-profits and the calls on contacts provided primarily by Bank officers.

Growth Strategies. We have implemented the following growth strategies:

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.

Capitalize on newly launched residential mortgage lending division. Management will be implementing cross-selling strategies targeting our banking and residential mortgage customers. Additionally, management is evaluating the opportunity to convert one or more of the recently acquired residential mortgage loan production offices into deposit-taking locations which should increase the number of customer relationships and core deposits.

Emphasize local decision-making. We are able to differentiate ourselves from the major regional banks operating in our 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, home buyer and consumer, competitively priced products and services while utilizing technology and strategic outsourcing to increase fee revenue. Our mortgage operation is expected to significantly enhance our noninterest income.

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.

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Lending Services

Lending Policy. The Bank offers a full range of lending products including mortgage loans for both purchase and refinance customers, 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 timely 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. In addition, all mortgage loans are carefully underwritten to ensure compliance with residential mortgage rules and regulations and with our secondary market investors' policies.

Lending Limits. The Bank's lending activities are subject to a variety of lending limits. In general, 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. The amount of these lending limits 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 which impacts a borrower's ability to repay. The larger, well-established financial institutions in the Bank's primary service area are likely to make proportionately more loans to medium- and large-sized businesses than the Bank will make. The majority of the Bank's commercial loans are made to small- and medium-sized businesses that may be less able to withstand competitive, economic and financial pressures than larger borrowers.

Real Estate Loans. The Bank makes residential mortgage loans to be sold, 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 category 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 or adjustable, although rates typically will not be fixed for a period exceeding 60 months. The Bank generally charges an origination fee for its services. The Bank also generally requires personal guarantees from the principal owners of the business or property supported by a review by Bank management of the principal owners' personal financial statements. For analytical purposes, we categorize our commercial real estate loans into those that are owner occupied and those that are non-owner occupied. Generally, non-owner occupied loans have more inherent risk as the borrower's ability to repay is dependent upon the tenant's ability to pay. 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. The 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 (portfolio). 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 the purchase or refinance of one-to-four family properties. The amortization of second mortgages generally does not exceed 15 years and the rates are generally not fixed for over 60 months. The amortization of first mortgages will not exceed 30 years and the rates are generally adjustable. 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.

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Residential real estate loans (held for sale). Beginning in December 2012, the Bank began offering traditional residential mortgage loans. These loans are generally conventional, conforming loans for the purchase or refinance of a one-to-four family property. These loans are recorded as loans held for sale on the Bank's Consolidated Balance Sheets as they will be sold to an investor on the secondary market which significantly reduces our credit risk. The Bank enters into an interest rate lock commitment with the customer and simultaneously enters into a forward sales commitment with the secondary market investor which locks the pricing on the subsequent sale of the loan thereby eliminating the Bank's exposure to interest rate risk.

Commercial and Industrial Loans. We target 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 traditional lending channels.

Consumer Loans. The 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, credit unions and finance companies in the Bank's market.

Composition of portfolio - The following table sets forth the composition of the Bank's loan portfolio according to the loan's purpose:

| ($ in thousands) | December 31, 2012 | December 31, 2011 |
|---|---|---|
| Commercial real estate ("CRE") | $ 38,230 | $ 37,862 |
| Commercial and industrial | 9,383 | 5,971 |
| Residential real estate | 10,608 | 10,460 |
| Construction and development | 791 | 1,307 |
| Consumer | 620 | 45 |
| GROSS LOANS | 59,632 | 55,645 |
| Net deferred expenses / (fees) | 175 | (77) |
| Allowance for loan and lease losses | (1,063) | (1,067) |
| LOANS, NET | $ 58,744 | $ 54,501 |

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

| ($ in thousands) | December 31, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| | # of Loans | Average Loan Size | # of Loans | Average Loan Size |
| Commercial real estate | 75 | $ 510 | 63 | $ 601 |
| Commercial and industrial | 59 | 159 | 43 | 139 |
| Residential real estate | 48 | 221 | 36 | 291 |
| Construction and development | 2 | 396 | 4 | 327 |
| Consumer | 32 | 19 | 25 | 2 |
| GROSS LOANS | 216 | $ 276 | 171 | $ 325 |

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

| ($ in thousands) | December 31, 2012 Principal Balance | | | December 31, 2011 Principal Balance | | |
|---|---|---|---|---|---|---|
| Interval | Fixed Rate | Adjustable Rate(1) | Total | Fixed Rate | Adjustable Rate(2) | Total |
| < 3 months | $1,855 | $13,520 | $15,375 | $93 | $13,798 | $13,891 |
| > 3 to 12 months | 1,539 | 802 | 2,341 | 2,655 | — | 2,655 |
| > 1 to 3 years | 7,607 | 14,970 | 22,577 | 10,760 | 10,382 | 21,142 |
| > 3 to 5 years | 4,866 | 3,765 | 8,631 | 3,903 | 8,438 | 12,341 |
| over 5 years | 10,708 | — | 10,708 | 5,616 | — | 5,616 |
| Gross Loans Receivable | $26,575 | $33,057 | $59,632 | $23,027 | $32,618 | $55,645 |

(1) Of the $33.1 million adjustable rate loans, $31.0 million mature after December 31, 2013.

(2) Of the $32.6 million adjustable rate loans, $31.0 million mature after December 31, 2012.

Contractual maturity of portfolio - The following tables set forth information at December 31, 2012 and 2011, 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.

| ($ in thousands) | December 31, 2012 | | | | |
|---|---|---|---|---|---|
| | <1 Year | 1 - 5 Years | 5 - 15 Years | Over 15 Years | Total Loans |
| Commercial real estate | $2,383 | $8,618 | $27,079 | $150 | $38,230 |
| Commercial and industrial | 1,529 | 3,999 | 3,362 | 493 | 9,383 |
| Residential real estate | 900 | 470 | 1,173 | 8,065 | 10,608 |
| Construction and development | 628 | 163 | — | — | 791 |
| Consumer | 10 | 499 | 3 | 108 | 620 |
| Gross Loans Receivable | $5,450 | $13,749 | $31,617 | $8,816 | $59,632 |

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| ($ in thousands) | December 31, 2011 | | | | |
|---|---|---|---|---|---|
| | <1 Year | 1 - 5 Years | 5 - 15 Years | Over 15 Years | Total Loans |
| Commercial real estate | $805 | $13,064 | $23,993 | $— | $37,862 |
| Commercial and industrial | 2,422 | 2,787 | 762 | — | 5,971 |
| Residential real estate | — | 2,461 | 1,200 | 6,799 | 10,460 |
| Construction and development | 1,150 | 157 | — | — | 1,307 |
| Consumer | 11 | 24 | — | 10 | 45 |
| Gross Loans Receivable | $4,388 | $18,493 | $25,955 | $6,809 | $55,645 |

Asset Quality

General – Management, along with the Bank’s Directors’ credit committee, currently 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, 2012 and 2011, the Bank had $1.8 million and $2.4 million, respectively, 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 where the borrower is experiencing financial difficulties and for which the Bank has agreed to modify by accepting repayment terms 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 current period interest income. There were $13,000 and $610,000 of nonaccrual loans at December 31, 2012 and 2011, respectively.

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The following table summarizes information regarding non-performing assets:

| ($ in thousands) | December 31, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| Nonaccrual loans and leases | $ 13 | | $ 610 | |
| Other impaired loans | — | | — | |
| Total non-performing loans | 13 | | 610 | |
| Other real estate owned | 1,776 | | 1,776 | |
| Total non-performing assets | $ 1,789 | | $ 2,386 | |
| | | | | |
| Non-performing loans | $ 13 | | $ 610 | |
| Allocated allowance for loan and lease losses to non-performing loans | — | | — | |
| Net investment in non-performing loans | $ 13 | | 610 | |
| | | | | |
| Accruing loans past due 90 days or more | $ — | | $ — | |
| Loans past due 30-89 days (1) | $ 147 | | $ 1,349 | |
| | | | | |
| Loans charged-off, year-to-date | $ 88 | | $ 276 | |
| Recoveries, year-to-date | (84 | ) | (13 | ) |
| Net charge-offs, year-to-date | $ 4 | | $ 263 | |
| Allowance for loan and lease losses | $ 1,063 | | $ 1,067 | |
| | | | | |
| Allowance for loan and lease losses to loans, net of deferred fees/expenses | 1.78 | % | 1.92 | % |
| Allowance for loan and lease losses to nonaccrual loans | | NM% | 174.92 | % |
| Allowance for loan and lease losses to non-performing loans | | NM% | 174.92 | % |
| Nonaccrual loans to loans, net of deferred fees/expenses | 0.02 | % | 1.10 | % |
| Loans 30-89 days past due to loans, net of deferred fees/expenses | 0.25 | % | 2.43 | % |
| Non-performing assets to total assets | 1.16 | % | 1.64 | % |

(1) The $1.3 million of past due loans at December 31, 2011 were brought current as of January 10, 2012.

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, 2012 and 2011, the Bank had $4.6 million classified as substandard and no loans classified as doubtful or loss.

Allowance for Loan and Lease 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 and lease 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 and lease losses activity for 2012 and 2011:

| ($ in thousands) | 2012 | 2011 |
|---|---|---|
| Balance at beginning of year | $ 1,067 | $ 1,175 |
| Provision charged to expense | — | 155 |
| Loans charged-off: | | |
| Commercial real estate | — | (149) |
| Commercial and industrial | (85) | (116) |
| Residential real estate | — | — |
| Construction and development | — | (11) |
| Consumer | (3) | — |
| Total loans charged-off | (88) | (276) |
| Recoveries on loans previously charged-off: | | |
| Commercial real estate | — | 13 |
| Commercial and industrial | 14 | — |
| Residential real estate | 70 | — |
| Construction and development | — | — |
| Consumer | — | — |
| Total recoveries | 84 | 13 |
| Balance at end of year | $ 1,063 | $ 1,067 |
| | | |
| Net charge-offs to average gross loans | 0.01 % | 0.46 % |

As a result of management's evaluation of all the aforementioned factors, the allowance for loan and lease losses decreased 14 basis points from 1.92% of gross loans at December 31, 2011 to 1.78% of gross loans at December 31, 2012.

The following tables allocate the allowance for loan and lease 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 components of the total loan portfolio and is subject to change as and when the risk factors of each such component changes. 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 and lease losses has been precisely determined from such allocation.

| ($ in thousands) | December 31, 2012 | | | |
|---|---|---|---|---|
| | Amount | Percentage of loans in each category to total loans | Percentage of year-end allowance | Percentage of reserves to total loans by category |
| Commercial real estate | $ 836 | 64.1 % | 78.7 % | 2.19 % |
| Commercial and industrial | 59 | 15.7 | 5.5 | 0.63 |
| Residential real estate | 41 | 17.8 | 3.8 | 0.39 |
| Construction and development | 124 | 1.4 | 11.7 | 15.68 |
| Consumer | 3 | 1.0 | 0.3 | 0.48 |
| Total allowance for loan and lease losses | $ 1,063 | 100.0 % | 100.0 % | 1.78 % |

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| ($ in thousands) | December 31, 2011 | | | |
|---|---|---|---|---|
| | Amount | Percentage of loans in each category to total loans | Percentage of year-end allowance | Percentage of reserves to total loans by category |
| Commercial real estate | $708 | 68.0 % | 66.4 % | 1.87 % |
| Commercial and industrial | 125 | 10.7 | 11.7 | 2.09 |
| Residential real estate | 60 | 18.8 | 5.6 | 0.57 |
| Construction and development | 174 | 2.4 | 16.3 | 13.31 |
| Consumer | — | 0.1 | — | — |
| Total allowance for loan and lease losses | $1,067 | 100.0 % | 100 % | 1.92 % |

The allowance for loan and lease 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 reviewed by the Directors' credit committee and then 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.

The portion of the allowance for loan and lease 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 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 loans, 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 or are immediately charged-off to bring the loan to its net realizable value. 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.

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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 must classify debt and equity securities into one of two categories: held-to-maturity, or available-for-sale. Since its inception, the Bank has not had any held-to-maturity investments; however, investments that management has the positive intent and ability to hold to maturity would be classified as held-to-maturity and recorded at amortized cost. Investments to be held for an indefinite amount of time, but not necessarily to maturity, are 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, net of applicable income taxes. Since the initial 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. During the first quarter 2011, the Company recognized $67,000 of loss on available-for-sale securities related to other than temporary impairment on five securities that management had the intent to sell before recovery of value. Those five securities were sold during the second quarter for a net loss of $48,000, a $19,000 improvement from their March 31, 2011 estimated fair values. The Bank has not recognized any other than temporary impairment in 2012.

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, 2012 and 2011. The timing of principal payments received differs from the contractual maturity because borrowers may be required to make contractual principals payments and often have the right prepay obligations without a prepayment penalty. As a result, the timing with which principal payments are received on mortgage-backed securities ("MBS") is not represented in the tables below. For instance, we received $15.8 million in proceeds from the maturity/call/prepayment of securities during 2012 (see our Consolidated Statements of Cash Flows on page F-6) versus no dollars contractually maturing within one year as set forth in the tables below.

| ($ in thousands) | At December 31, 2012 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Within One Year | | After One Year but within Five Years | | After Five Years but within Ten Years | | After Ten Years | |
| Securities available-for-sale | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield |
| Corporate | $1,023 | 5.63 % | $4,532 | 2.69 % | $8,895 | 3.08 % | $— | — % |
| State and municipal | — | — | 1,923 | 5.06 | 13,636 | 3.30 | 6,558 | 3.20 |
| | — | — | — | — | 711 | 2.67 | 47,432 | 1.79 |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Residential agency MBS and Collateralized Mortgage Obligations (CMO) | | | | | | | | | | | |
| Total | $1,023 | 5.63 | % | $6,455 | 3.40 | % | $23,242 | 3.19 | % | $53,990 | 1.96 | % |

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| ($ in thousands) | At December 31, 2011 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Within One Year | | After One Year but within Five Years | | After Five Years but within Ten Years | | After Ten Years | |
| Securities available-for-sale | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield |
| Corporate | $— | — % | $6,794 | 3.39 % | $8,024 | 4.14 % | $— | — % |
| State and municipal | — | — | 1,789 | 4.33 | 2,096 | 4.39 | — | — |
| Residential agency MBS and CMO | — | — | — | — | 3,600 | 2.86 | 60,892 | 2.00 |
| Total | $— | — % | $8,583 | 3.59 % | $13,720 | 3.84 % | $60,892 | 2.00 % |

The table below sets forth the amounts and distribution of the investment securities at December 31, 2012 and 2011.

| ($ in thousands) | 2012 | | 2011 | |
|---|---|---|---|---|
| Securities available-for-sale | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value |
| Due within one year | $ 1,003 | $ 1,023 | $ — | $ — |
| Due after one year through five years | 6,180 | 6,455 | 8,540 | 8,583 |
| Due after five years through ten years | 22,869 | 23,242 | 13,799 | 13,720 |
| Due after ten years | 53,590 | 53,990 | 60,349 | 60,892 |
| Total securities available-for-sale | $ 83,642 | $ 84,710 | $ 82,688 | $ 83,195 |

At December 31, 2012 and 2011, we held $1.2 million and $1.1 million, respectively, 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 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.

The following table sets forth the composition of the Bank’s deposits by type at December 31, 2012 and 2011:

| ($ in thousands) | 2012 | | 2011 | |
|---|---|---|---|---|
| | Amount | % of Total | Amount | % of Total |
| Noninterest-bearing demand | $ 3,387 | 3 % | $ 3,550 | 3 % |
| Interest-bearing demand | 8,218 | 7 | 9,355 | 8 |
| Money market accounts | 10,511 | 8 | 9,781 | 8 |
| Savings accounts | 44,847 | 36 | 49,073 | 41 |
| Time deposits, less than $100,000 | 4,559 | 3 | 5,193 | 4 |
| Time deposits, $100,000 or more | 53,210 | 43 | 42,032 | 36 |
| Total | $ 124,732 | 100 % | $ 118,984 | 100 % |

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The following table presents average deposits by type and the related average interest rate paid by deposit type for the years ended December 31, 2012 and 2011:

| ($ in thousands) | 2012 | | 2011 | |
|---|---|---|---|---|
| | Average Balance | Average Rate | Average Balance | Average Rate |
| Noninterest-bearing demand | $ 3,187 | — % | $ 2,489 | — % |
| Interest-bearing demand | 8,621 | 0.84 | 10,948 | 1.08 |
| Money market accounts | 10,459 | 0.60 | 10,304 | 1.04 |
| Savings accounts | 46,593 | 0.62 | 50,935 | 1.05 |
| Time deposits | 53,999 | 1.33 | 39,011 | 1.60 |
| Total | $ 122,859 | 0.93 % | $ 113,687 | 1.22 % |

The following table sets forth the amount and maturities of the time deposits at December 31, 2012:

| ($ in thousands) | Time Deposits $100,000 or greater | Time Deposits less than $100,000 | Total Time Deposits |
|---|---|---|---|
| Due in three months or less | $5,129 | $360 | $5,489 |
| Due in over three months through six months | 5,114 | 466 | 5,580 |
| Due in over six months through twelve months | 6,935 | 1,112 | 8,047 |
| Due in over twelve months | 36,032 | 2,621 | 38,653 |
| Total | $53,210 | $4,559 | $57,769 |

Included in time deposits $100,000 or greater at December 31, 2012 are approximately $40.0 million of time deposits between $100,000 and $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, 2011.

| ($ in thousands) | Time Deposits $100,000 or greater | Time Deposits less than $100,000 | Total Time Deposits |
|---|---|---|---|
| Due in three months or less | $5,468 | $980 | $6,448 |
| Due in over three months through six months | 9,869 | 530 | 10,399 |
| Due in over six months through twelve months | 4,863 | 958 | 5,821 |
| Due in over twelve months | 21,832 | 2,725 | 24,557 |
| Total | $42,032 | $5,193 | $47,225 |

Included in time deposits $100,000 or greater at December 31, 2011 are approximately $34.4 million of time deposits between $100,000 and $250,000. These time deposits are fully insured by the FDIC.

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.

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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 required study or rulemaking by other agencies, a process which is taking several years to fully implement.

Among other things, the Dodd-Frank Act permanently raised deposit insurance levels to $250,000, retroactive to January 1, 2008, and provided unlimited deposit insurance coverage for noninterest-bearing transaction accounts through December 31, 2012.  The definition of noninterest-bearing accounts also includes the interest on lawyer trust accounts.  Pursuant to modifications under the Dodd-Frank Act, deposit insurance assessments effective April 1, 2011, are 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 was raised to 1.35%. The payment of interest on business demand deposit accounts is permitted by the Dodd-Frank Act. The Dodd-Frank Act authorized the Federal Reserve Board to regulate interchange fees for debit card transactions and established 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 empowered 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.

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 established 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 established 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 regulations which prohibit incentive-based compensation arrangements that may 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.

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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;
- 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.

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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;
- 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 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.

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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.

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 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 amended the deposit insurance assessment during 2011 by changing the calculation of deposit assessments. Effective April 1, 2011, the deposit insurance premiums are based on assets rather than insurable deposits and the assessment rate is influenced by Tier 1 capital levels, and the Bank's CAMELS ratings. Assessments may change if there are any future special assessments by the FDIC. Additionally, if the risk category of the Bank changes adversely, our FDIC insurance premiums could increase.

In late 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. The amount of the Bank's prepaid deposit premium was $0 as of December 31, 2012.

The FDIC has the power to adjust deposit insurance assessment rates at any time or to make special assessments that could result in higher assessment rates that could have a material adverse effect on earnings. 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.

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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- 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 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 in 2010, 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 are 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.

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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.

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 letters 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.

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 have 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 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.

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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, development, and other land represent 100% or more of total risk-based capital or (ii) total reported loans secured by multifamily and non-owner occupied, non-farm non-residential properties and loans for construction, development, and other land represent 300% or more of total risk-based capital and the outstanding balance of such loans has increased 50% or more during the prior 36 months. At December 31, 2012, Solera National Bank's ratios were 6% and 88%, respectively, well below the regulatory guideline for highly concentrated loans in commercial real estate. 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 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:

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.

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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 help identify the source, volume, and movement of currency and other monetary instruments transported or transmitted into and out of the United States or deposited in financial institutions. These records enable law enforcement and regulatory agencies to pursue investigation of criminal, tax, and regulatory violations, if warranted, and provide evidence useful in prosecuting money laundering and other financial crimes. The Money Laundering Control Act augmented the BSA's effectiveness by directing banks to establish and maintain procedures reasonably designed to ensure and monitor compliance with the reporting and recordkeeping requirements of the BSA. The Annunzio-Wylie Anti-Money Laundering Act ("AML") further strengthened the sanctions for BSA violation and the role of the U.S. Treasury. In addition, the Suspicious Activity Report ("SAR") was developed in 1996. All banking organizations are required to file a SAR whenever a known or suspected criminal violation of federal law or a suspicious transaction related to money laundering activity or a violation of the BSA is detected. Office of the Foreign Currency ("OFAC") requirements are separate and distinct from the BSA, but both OFAC and the BSA share a common national security goal. Solera National Bank has BSA, AML, and OFAC compliant policies, procedures and programs.

Anti-terrorism Legislation. In the wake of the tragic events of September 11, 2001, President Bush 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, 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.

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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 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.

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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.

ITEM 1A. RISK FACTORS

The reader should carefully consider the following risk factors and all other information contained in this Report in connection with 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.

Our financial performance 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, housing and real estate values, business activity, or lowered 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 continued during 2010 through 2011, with modest recovery in 2012. Elevated unemployment, under-employment and household debt, along with continued stress in the consumer real estate market and certain commercial real estate markets, pose challenges to domestic economic performance and the financial services industry. As we enter 2013, many of these challenges still exist, with sustained high unemployment rates and the lengthy duration of unemployment directly impairing consumer finances and confidence. The official U.S. unemployment rate is 7.7%, as of February 2013, according to figures released by the U.S. Department of Labor Bureau of Labor Statistics on March 8, 2013.

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As a result of the challenging economic environment and lower collateral values, many lending institutions, including us, experienced stress in their loan portfolio. Bank and bank holding company stock prices were negatively affected, and the ability of banks and bank holding companies to raise capital or borrow in the debt markets became more difficult. However, the banking industry continues to improve following the deep recession resulting from the financial crisis of 2008.

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 loan and lease losses. There can be no assurance that these conditions will improve materially in the near term. Such conditions could materially and adversely affect the credit quality of our loans, and therefore, our 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 strength in the housing 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 do not continue to improve, 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 could be further 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 the Bank may be unable to adequately measure and limit credit risk associated with our loan portfolio, which would affect our profitability.

As a material part of the Bank’s business plan, we make various types of commercial and consumer loans. The principal economic risk associated with each loan 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 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 many larger borrowers. If the Bank is unable to effectively measure and limit the risk of default associated with its loan portfolio, our profitability will likely be adversely impacted.

Our new mortgage lending division may expose us to increased operating and compliance risk.

On November 30, 2012, the Bank entered into an agreement to acquire the business assets of five loan production offices of an established residential mortgage loan origination company in Colorado. Under the agreement, the Bank has employed former employees of this company and utilizes its business name and operating procedures to originate

residential mortgage loans in Colorado.  The anticipated volume of mortgage originations is expected to significantly exceed the Bank's existing mortgage originations volume, and involves lending in new market areas with new staff and new processes.  It is expected that almost all residential mortgage loan originations will be sold to secondary market investors.  The Bank has implemented an oversight/review process to assimilate this activity into the Bank's risk management program; however, these new activities may initially expose the Bank to new and additional risks inherent in mortgage banking operations.

We may be required to repurchase residential mortgage loans which may result in losses or reduction in capital.

The Bank, through its residential mortgage division, routinely sells residential mortgage loans to various third party investors.  The Bank may be required under repurchase obligations, to repurchase a loan in the event of failure to timely cure a material breach, which includes, among other things, early payment default with respect to the loan.  If an investor executes its repurchase obligation provision, the Bank would have the option to either include the loan in its loan portfolio and to service the loan during the period held, or to sell the loan.  There can be no guarantee that the sale of such a loan would be at or above the carrying value of the loan, which would require immediate loss recognition and reduction of capital.

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We are exposed to higher credit risk from commercial real estate, commercial business, and construction lending that is highly dependent on market conditions in the Colorado Front Range.

Commercial real estate, commercial business, and construction lending usually involve 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. Unlike larger banks that are more geographically diversified, we provide services primarily to the Front Range of Colorado. Due to our concentration of operations in the Front Range, we are dependent on the local economic conditions in our market area that could result in higher credit risks to us if conditions further deteriorate. Our underwriting, review, and monitoring cannot eliminate all of the risks related to commercial real estate, commercial business, and construction lending loans.

Our allowance for loan and lease losses may be insufficient.

We maintain an allowance for loan and lease losses, which is a reserve established through a provision for probable loan and lease 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 and lease 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 creditworthiness 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 and lease losses. In addition, bank regulatory agencies periodically review our allowance for loan and lease losses and may require an increase in the provision for probable loan and lease 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.

We continue to hold and acquire other real estate owned ("OREO") properties which has led to increased operating costs and vulnerability to declines in real estate values.

In the ordinary course of our business, we foreclose and take title to the real estate that serves as collateral on defaulted loans. During 2011 and 2012, we experienced an increase in OREO activity and incurred expenses of approximately $21,000 and $55,000, respectively, to operate these properties. We expect that our 2013 operating results will be negatively impacted by the two OREO properties we currently hold as we continue to incur costs associated with owning and operating these properties. Further, we are subject to potential declines in market values associated with these properties which could lead to write-downs of the property's value and a corresponding expense

to our income statement. We cannot predict, with certainty, how long it will take to dispose of these properties.

Interest rate volatility could adversely impact 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 and lease losses.

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The value of our available-for-sale investment securities may be negatively affected by disruptions in securities markets.

The market for some of the investment securities held in our portfolio has been somewhat volatile over the past several years. Volatile market conditions may detrimentally affect the value of these securities due to the perception of heightened credit and liquidity risks. If interest rates were to increase, the value of our investments would likely decline. There can be no assurance that declines in market value will not result in other than temporary impairments of these assets, which would lead to accounting charges that could have a material adverse effect on our net income and capital levels. Our mortgage-backed security portfolio may be subject to prepayment risk as borrowers may be able to refinance their current mortgages into lower rate mortgages. Our mortgage-backed portfolio may also be subject to extension risk as interest rates rise and borrowers are unable to refinance their current mortgages into lower rate mortgages, extending the average life of the bonds.

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. 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 collateralized advances to members.

We maintain a portfolio of investment 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, and our ability to acquire additional national market, non-core. The Bank can also 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 cannot assure that attractive acquisition or expansion opportunities will be made available to us in the future.

Our business strategy includes the continuance of internally-generated growth, as well as opportunistic acquisitions of competitors' loans and deposits, or branches. We face competition from many types of financial institutions, which could increase prices for potential acquisitions that we believe are attractive. Expansion may also be hindered as a result of regulatory oversight. Regulators will consider among other things, our liquidity, capital, profitability and regulatory compliance in determining whether to approve a proposed acquisition or expansion. Failure to effectively manage our growth could have a material adverse effect on our business, future prospects, financial condition and results of operations and could affect our ability to successfully implement our business strategy.

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, the share ownership of our existing stockholders would likely be diluted.

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

The Company's shares do not, at this time, qualify for listing on any national securities exchange and trading volume is very limited. We cannot assure that our shares will ever be listed on a national securities exchange. However, our shares are traded over-the-counter (OTCQB) and at least two broker/dealers make 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 broker/dealer will make a market in our shares for as long as we will be quoted on the OTCQB. 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. The absence of an active trading market reduces liquidity, and we believe our low trading volume has had an adverse effect on the market prices of our shares. The trading price of our common stock may also be affected by numerous other factors, including, but not limited to our press releases, trends in our industry, and expectations of future financial performance regardless of our actual operating performance. In addition, if we cease to be quoted on the OTCQB, stockholders will likely 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 stock may decline.

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

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

Solera National Bank faces significant 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 viable competitor in the market area in which we operate. However, if we are unable to attract and retain customers, we may be unable to achieve further growth in the loan and core deposit portfolios, and our results of operations and financial condition may be negatively impacted.

Offerings of new products and services may subject us to additional risks.

Customer demands may lead us to offer new products and services which create new risks and uncertainties. We may invest significant time and resources in deploying these offerings, and we may not meet our established timelines or profitability goals associated with the products or services. Furthermore, we may encounter difficulties from competitive alternatives, shifting market preferences or compliance with regulations that impact our offerings. Managing these risks is critical to the development and implementation of new products and services and failure to do so may significantly impact our business, results of operations and financial condition.

The potential for business interruption exists throughout our 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 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.

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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.

Existing and proposed government regulations that, when adopted, may have an adverse effect on our profitability and growth.

Bank holding companies (BHCs) 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.

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. If the risk category of the Bank changes adversely, our FDIC insurance premiums could increase. Additionally, 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.

We face risks associated with acquisitions or mergers.

As our Bank continues to grow, we may pursue, or be a party to, an acquisition or merger opportunity. Mergers and acquisitions bring risks, which may include, among other things:

- difficulty of integrating the personnel, operations and systems of an acquired entity;
- possible loss of key employees and customers of the acquired or merged entity;
- potential disruption of our ongoing business;
- difficulty in estimating the value of the acquired or merged entity;
- inability of management to successfully execute the strategy associated with the acquisition or merger; and
- potential changes in banking or tax laws or regulations that may affect the combined entity.

There can be no assurance that we will successfully overcome all risks associated with an acquisition or merger. We may devote a significant amount of time and effort to addressing these risks which could have a material adverse effect on our business.

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 stockholders. From time to time, we may become subject to legal actions relating to our operations that could involve claims for substantial monetary damages. During 2012, we were party to two legal matters, which were incidental to the operation of our business. These matters were settled prior to trial and resulted in $135,000 of legal settlement costs incurred by the Bank. Although the Company was confident it could successfully defend against the claims, we agreed to settle to avoid costly litigation and business distraction. Although we maintain insurance, the scope of this coverage may not provide us with full, or even partial, coverage against future legal claims. As a result, a judgment against us in any such litigation could have a material adverse effect on our financial condition and results of operations.

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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 the allowance for loan and lease losses 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."

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

The Company currently has no material source of cash flow since we receive no dividends 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.

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 stockholder 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 which may be a financial disincentive to any party desiring to obtain control of the Company.

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, 2013, our directors and executive officers owned, or had voting rights on 289,650 shares of our common stock, which represents 10.9% 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 16.7% 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 27.4% of our then existing outstanding common stock based on number of shares outstanding.

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 of space in Lakewood, Colorado that serves as administrative offices for our executive management, accounting and marketing functions. Additionally, the Bank has five residential mortgage loan production offices located in Colorado including, Boulder, two in Colorado Springs, the Denver Tech Center and Durango. The Bank has entered into lease agreements with respect to each of these locations. The aggregate commitments under the leases are set forth in Note 8 to the Consolidated 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

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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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 under the symbol “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 of our stock 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.

| Year Ended December 31, 2012: | High | Low |
|---|---|---|
| First Quarter | $ 4.00 | $ 3.30 |
| Second Quarter | 4.95 | 4.00 |
| Third Quarter | 4.75 | 4.35 |
| Fourth Quarter | 5.00 | 4.75 |

| Year Ended December 31, 2011: | High | Low |
|---|---|---|
| First Quarter | $ 3.60 | $ 3.00 |
| Second Quarter | 3.50 | 2.75 |
| Third Quarter | 3.15 | 2.75 |
| Fourth Quarter | 3.35 | 2.85 |

Holders

As of February 28, 2013, there were approximately 680 holders of record of our common stock.

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, it is a holding company, the Company conducts no material activities at this time other than holding the common stock of the Bank and 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 holding company, for example, cash to pay dividends to stockholders of the holding company, is substantially dependent on the earnings of the Bank and the payment of dividends by the Bank to the holding 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.”

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Recent Sales of Unregistered Securities

None.

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 Report.

General

The Company is a Delaware corporation that was incorporated in 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. While Solera National Bank serves the entire community, it has a specialized focus serving the local Hispanic population, along with other minority and disadvantaged communities due to the significant growth in these markets and its belief that these populations are currently underserved. In December 2012, the Company launched a residential mortgage division with five loan production offices in Colorado including Boulder, two locations in Colorado Springs, the Denver Tech Center and Durango. With the addition of more than 50 mortgage professionals, the Bank now offers residential mortgage loans, the vast majority of which will be sold on the secondary market. We expect that the residential mortgage lending division will generate the majority of our noninterest income and noninterest expenses over the near term, and employ the majority of our employees.

The following discussion focuses on the Company's financial condition and results of operations during the years ended December 31, 2012 and 2011, presented on a consolidated basis.

As of December 31, 2012, on a consolidated basis, the Company had total assets of $153.9 million, net loans of $58.7 million, total deposits of $124.7 million and stockholders’ equity of $19.9 million.

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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 summarized description of the Company's significant accounting policies used in the preparation of the accompanying consolidated financial statements. Please see Note 1 of the Notes to Consolidated Financial Statements contained in "Item 8. Financial Statements and Supplementary Data" beginning on page F-7 of this Annual Report on Form 10-K for a more complete description of our significant accounting policies.

Allowance for loan and lease 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 and lease losses represents the Company's recognition of the risks of extending credit and its evaluation of the loan portfolio. The allowance for loan and lease 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.

The Company has established a formal process for determining an adequate allowance for loan and lease losses. The allowance for loan and lease losses calculation has two components. The first component represents the allowance for loan and lease losses for impaired loans; that is loans where the Company believes collection of the contractual principal and interest payments is not probable. The second component 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 and lease losses is the aggregate of the impaired loans component and the contingent loss component.

At December 31, 2012, the Company had an allowance for loan and lease losses of $1.1 million. Management believes that this allowance for loan and lease losses is adequate to cover probable losses based on all currently available evidence. Future additions to the allowance for loan and lease 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 and lease losses. Any increase in the allowance for loan and lease losses would likely have an adverse effect on earnings. An analysis of the allowance for loan and lease losses as well as its allocation among certain categories of the loan portfolio can be found in Part I – Item 1. Business – Asset Quality, above.

Stock-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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Additionally, the Company may grant restricted stock awards. These stock awards may vest based on a performance or service condition. For awards that vest based on a service condition, the compensation expense is recognized over the service period based on the grant-date fair value of the award (as determined by the quoted market price on the date of grant). For awards that vest based on a performance condition, the expense is recognized based on the number of awards that are expected to vest based on then-current projections. Should these expectations change in future periods, additional expense could be recorded or expense previously recorded could be reversed. Prior to the vesting of stock awards, each grantee shall have the rights of a stockholder with respect to voting and dividend rights of the granted stock.

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, 2012 and 2011

During the year ended December 31, 2012, the Company recorded net income of $281,000 an improvement of $39,000, or 16%, from net income of $242,000 for the year ended December 31, 2011. The improvement in earnings was primarily attributable to the $128,000 increase in noninterest income and the $155,000 decrease in provision for loan and lease losses due to stabilizing loan quality, partially offset by a $151,000 net increase in total noninterest expense. See "Non interest expense" below for further details. Additionally, the Company experienced a 24 basis point decrease in net interest margin from 3.03% in 2011 to 2.79% in 2012, which contributed to a $93,000 decrease in net interest income.

The Company recorded return on average assets of 0.19% in 2012, compared with 0.17% in 2011 and return on average equity of 1.43% in 2012, compared with 1.29% in 2011.

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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 primary source of revenues. 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.

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 annual income or expense by the average balance of the corresponding asset or liability.

| ($ in thousands) | 2012 | | | | 2011 | | | |
|---|---|---|---|---|---|---|---|---|
| | Average Balance | Interest/ Dividend | Average Yield/Rate | | Average Balance | Interest/ Dividend | Average Yield/Rate | |
| ASSETS | | | | | | | | |
| Federal funds sold and other short-term investments | $1,129 | $10 | 0.84 | % | $1,619 | $7 | 0.45 | % |
| Investment securities | 84,920 | 2,013 | 2.37 | | 77,302 | 2,407 | 3.11 | |
| Gross loans, net of unearned fees | 58,309 | 3,272 | 5.61 | | 57,208 | 3,300 | 5.77 | |
| FHLB and Federal Reserve Bank stock | 1,162 | 40 | 3.43 | | 1,139 | 35 | 3.06 | |
| TOTAL EARNING ASSETS | 145,520 | $5,335 | 3.67 | % | 137,268 | $5,749 | 4.19 | % |
| Non-earning assets | 5,941 | | | | 2,484 | | | |
| TOTAL ASSETS | $151,461 | | | | $139,752 | | | |
| | | | | | | | | |
| LIABILITIES | | | | | | | | |
| Interest-bearing deposits | | | | | | | | |
| Interest-bearing demand | $8,621 | $73 | 0.84 | % | $10,948 | $119 | 1.08 | % |
| Savings and money market | 57,052 | 350 | 0.61 | | 61,239 | 645 | 1.05 | |
| Time deposits | 53,999 | 717 | 1.33 | | 39,011 | 625 | 1.60 | |
| TOTAL INTEREST-BEARING DEPOSITS | $119,672 | $1,140 | 0.95 | % | $111,198 | $1,389 | 1.25 | % |
| Securities sold under agreements to repurchase | 515 | 3 | 0.67 | | 573 | 6 | 1.03 | |
| FHLB borrowings | 8,025 | 131 | 1.63 | | 6,320 | 197 | 3.12 | |
| Other borrowings | 9 | 2 | 16.20 | | 54 | 5 | 9.42 | |
| TOTAL INTEREST-BEARING LIABILITIES | $128,221 | $1,276 | 1.00 | % | $118,145 | $1,597 | 1.35 | % |
| Noninterest-bearing demand deposits | 3,187 | | | | 2,489 | | | |
| Other liabilities | 439 | | | | 399 | | | |
| TOTAL LIABILITIES | 131,847 | | | | 121,033 | | | |
| STOCKHOLDERS' EQUITY | 19,614 | | | | 18,719 | | | |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $151,461 | | | | $139,752 | | | |
| NET INTEREST INCOME / MARGIN | | $4,059 | 2.79 | % | | $4,152 | 3.03 | % |

| | | | | |
|---|---|---|---|---|
| NET INTEREST SPREAD | 2.67 | % | 2.84 | % |

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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.

| ($ in thousands) | Year-ended December 31, 2012 compared to the Year-ended December 31, 2011 | | |
|---|---|---|---|
| | Net Change | Rate | Volume |
| Interest income: | | | |
| Gross loans, net of unearned fees | $ (28) | $ (96) | $ 68 |
| Investment securities | (394) | (671) | 277 |
| FHLB and Federal Reserve Bank stocks | 5 | 4 | 1 |
| Federal funds sold and other short-term investments | 3 | 3 | — |
| Total interest income | $ (414) | $ (760) | $ 346 |
| | | | |
| Interest expense: | | | |
| Interest-bearing demand | $ (46) | $ (24) | $ (22) |
| Savings and money market | (295) | (253) | (42) |
| Time deposits | 92 | (74) | 166 |
| Securities sold under agreements to repurchase | (3) | (3) | — |
| FHLB borrowings | (66) | (152) | 86 |
| Other borrowings | (3) | 26 | (29) |
| Total interest expense | $ (321) | $ (480) | $ 159 |
| | | | |
| Net interest income | $ (93) | $ (280) | $ 187 |

The Company's net interest margin declined 24 basis points from 3.03% in 2011 to 2.79% in 2012. The decrease was primarily due to the rate on interest-bearing assets declining by more than the rate on interest-bearing liabilities, combined with unfavorable shifts in volume including an increase in higher-costing time deposits and the increase in the average balance of lower-yielding investment securities outpacing the increase in higher-yielding loans.

The $760,000 unfavorable rate decrease on interest-earning assets was primarily attributable to the reinvestment of principal payments received on mortgage-backed securities and from sale of investment securities at near historically low rates. The impact of this decline was mitigated by the decrease in interest expense on interest-bearing liabilities. The cost of money market, savings and time deposits decreased year-over-year due to a lower interest rate environment as well as the implementation of a tiered rate structure on savings accounts during the second quarter of 2012. This, in conjunction with the restructuring of $3.5 million in fixed-rate FHLB advances during the fourth quarter 2011, enabled the Bank to save 35 basis points on the cost of interest-bearing liabilities during 2012 as compared 2011.

The Federal Reserve Board influences the level and direction of interest rates. 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, has remained at 3.25% since December 2008 and, thus, has had no impact on the change in loan yields during this time period. The federal funds rate, which is the cost of immediately available, overnight funds, has behaved in a similar manner, changing insignificantly since the end of 2008. However, other treasury rates have hit historic lows in recent months. Our Bank's loan portfolio has been impacted some by these low

rates, as reflected in the 16 basis point decrease in loan yield from 2011 to 2012 but our investment portfolio has seen sharp declines, as mentioned above, given this interest rate environment.

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Total interest and dividend income was $5.3 million for 2012, consisting primarily of interest and fees on loans of $3.3 million and interest on investment securities of $2.0 million. Average gross loans, net of unearned fees, increased $1.1 million to $58.3 million from 2011. Average investment securities increased $7.6 million to $84.9 million during 2012.

Total interest expense was $1.3 million, a decrease of $321,000 from $1.6 million in 2011. Net interest income was $4.1 million in 2012, a decrease of $93,000, or 2%, from 2011. On an annual basis, the Company's net interest spread, (the yield earned on interest-earning assets less the cost of interest-bearing liabilities) declined17 basis points from 2.84% in2011 to 2.67% in2012.

Net interest income is expected to be enhanced in 2013 due to interest earned on residential mortgage loans held for sale.

Provision and allowance for loan and lease losses

The provision for loan and lease losses is the annual cost of providing an allowance or reserve for estimated probable losses on loans and leases. The provision decreased $155,000 in 2012to $0 due to improved loan quality. Impaired loans totaled $13,000 at December 31, 2012 versus $610,000 at December 31, 2011. The allowance for loan and lease losses reflects 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 and lease 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 was $1.0 million for the year ended December 31, 2012, an increase of $128,000, or 14%from $920,000 for the year ended December 31, 2011 consisting of:

A) $730,000 in realized gains, net of losses, from the sales of investment securities, which was a decrease of $141,000 from 2011 primarily due to the Company capitalizing on favorable market conditions during 2011. Gains on the sale of securities are not part of the Bank's expected ongoing operations and should not be considered recurring. Additionally, if interest rates rise, the value of our investment portfolio will likely decrease which would impair our ability to recognize gains from the sale of investment securities in future periods.

B) $149,000 of gains related to the sale of the guaranteed portion of SBA 7(a) loans, which is a new product line the Bank started offering in the second quarter of 2012.

C) $96,000 in other income which consisted of $67,000 in increases in the cash surrender value of bank-owned life insurance, which the Company purchased during the first quarter 2012, and $26,000 of operating income on one of the Bank's OREO properties. Income for OREO properties is not part of the Bank's expected ongoing operations and should not be considered recurring.

D) $73,000 in service charges on deposit accounts, which was a 7%, or $5,000 increase from 2011 primarily due to an increase in the number of accounts.

E) Additionally, the Company experienced a $25,000 loss on the sale of OREO during the third quarter of 2011, which negatively impacted total noninterest income for the year ended December 31, 2011.

We expect noninterest income to increase significantly in 2013 due to gains from the sale of residential mortgage loans to secondary market investors.

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Noninterest expense

Noninterest expense totaled $4.8 million for the year ended December 31, 2012 an increase of $151,000, or 3%, from the prior year which totaled $4.7 million. This was primarily due to a$154,000, or13% year-over-year increase in other general and administrative expenses, as detailed in the following table and discussed below:

| ($ in thousands) | Year Ended December 31, | | Increase/ |
|---|---|---|---|
| Other general and administrative expenses: | 2012 | 2011 | (Decrease) |
| Data processing | $ 319 | $ 304 | $ 15 |
| FDIC assessments | 152 | 212 | (60) |
| Other regulatory and reporting fees | 131 | 150 | (19) |
| Marketing and promotions | 107 | 84 | 23 |
| Directors fees | 101 | 88 | 13 |
| Loan and collection expense | 90 | 104 | (14) |
| OREO expense | 55 | 21 | 34 |
| Telephone | 48 | 48 | — |
| Travel and entertainment | 47 | 33 | 14 |
| Insurance | 47 | 32 | 15 |
| Dues and memberships | 35 | 29 | 6 |
| Printing, stationery and supplies | 34 | 32 | 2 |
| ATM and debit card fees | 16 | 14 | 2 |
| Franchise taxes | 15 | 14 | 1 |
| Postage, shipping and courier | 13 | 13 | — |
| Customer checks and other customer expenses | 11 | 15 | (4) |
| Training and education | 9 | 15 | (6) |
| Operating losses / legal settlements | 138 | 11 | 127 |
| Miscellaneous | 11 | 6 | 5 |
| Total | $ 1,379 | $ 1,225 | $ 154 |

The most significant changes included increases of:

A) $127,000 in operating losses / legal settlements primarily related to legal settlements;

B) $34,000 related to expenses incurred on the Bank's two OREO properties;

C) $23,000 in marketing and promotion expenses partially due to increased business development efforts and partially due to costs incurred to improve our website and on-line banking platform;

D) $15,000 in insurance expenses from enhanced coverage obtained during the third quarter of 2011;

E) $15,000 in data processing due to increased customer volumes;

F) $14,000 in travel and entertainment correlated to an increase in loan demand;

G) $13,000 in directors fees due primarily to an increase in directors credit committee meetings and an increase in the number of board members in 2012.

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We expect OREO expense to continue to impact our 2013 operating results as we incur costs such as taxes, insurance, repairs and maintenance, among others, on these properties. Additionally, management realizes there is some exposure to additional impairment on these properties if there are declines in real estate values.

These increases were partially offset by decreases of:

A) $60,000 in FDIC fees due to lower assessment rates;

B) $19,000 in regulatory and reporting fees due to lower SEC reporting costs and lower OCC assessment fees; and

C) $14,000 in loan and collection expenses reflecting improving asset quality.

All other general and administrative costs remained relatively stable from year to year.

Salaries and Employee Benefits
Salaries and employee benefits expense was relatively unchanged compared to the prior year, increasing only 1%, or $27,000. The Company experienced an increase in salaries of approximately $200,000 associated with the start-up of the residential mortgage division. However, this increase was partially offset by $106,000 in lower stock option expense and a $54,000 increase in deferred salary expense due to an increase in loans originated during 2012. The deferred salary expense will be amortized to interest income on loans utilizing the level-yield method thereby adjusting the loan yield below the stated note rate. Management expects compensation expense to be higher in 2013 due to the addition of approximately 55 employees associated with the residential mortgage division. It should be noted that 17 employees are commission-based loan officers who are compensated based upon the sale of residential mortgage loans.

Occupancy
Occupancy expense decreased $45,000 or 9% from 2011 due to lower common area maintenance charges, execution of a lease extension at a reduced rate, and lower depreciation expense on fixed assets. It should be noted that management anticipates occupancy expense to be higher in 2013 due to the addition of five locations associated with the residential mortgage division.

Professional Fees
Professional fees increased $15,000, or 3% year-over-year primarily due to increased information technology consulting costs.

Key ratios

| Ratio | December 31, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| Return on Average Assets | 0.19 | % | 0.17 | % |
| Return on Average Equity | 1.43 | % | 1.29 | % |
| Average Equity to Average Assets | 12.95 | % | 13.39 | % |

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Financial Condition as of December 31, 2012 and 2011

Loans

The Bank's loan portfolio represents the highest yielding component of the Company's interest-earning assets. Therefore, it is essential for the Bank to increase loan volumes in order to positively impact earnings. The size of the Bank's loan portfolio remained largely unchanged in 2012, ending the year at $58.7 million, primarily due to intense competition for high-quality loans. Management believes that our primary market has stabilized compared to the significant negative trends experienced following the financial crisis of 2008. We remain cautiously optimistic that we can generate meaningful loan growth as the economy continues to recover; however, there is no guarantee that this will occur. In addition, the Company expects to have increased loan volume due to our new residential mortgage division. These loans will be classified as loans held for sale and carried at the lower of cost or market on our Consolidated Balance Sheet. Information regarding the Company's loan portfolio as of December 31, 2012 and 2011 is included in the section of this Report titled "Part I - Item 1. Business - Lending Services" and "Part I - Item 1.Business - Asset Quality."

Securities and other earning assets

The securities portfolio is used to make various term investments, to provide a source of liquidity and to serve as collateral for certain types of deposits and borrowings. Information regarding the Company's securities portfolio as of December 31, 2012 and 2011 is included in the section of this Report titled "Part I - Item 1. Business - Investments."

Nonearning assets

Premises and equipment, which includes furniture, fixtures, equipment and leasehold improvements, totaled $998,000 and $599,000 at December 31, 2012 and 2011, respectively, net of accumulated depreciation of $736,000 and $637,000, respectively. The $399,000 increase was primarily due to the asset purchase agreement executed by the Company on November 30, 2012 to purchase the assets and assume the leases for five residential mortgage loan production offices located in Colorado including Boulder, two locations in Colorado Springs, the Denver Tech Center and Durango. With the addition of these assets and leases, the Company's occupancy expenses will increase.

As of December 31, 2012 and 2011, other real estate owned consisted of two properties carried at $1.8 million which approximates the properties' fair values less estimated costs to sell.

Deposits

Deposits are the Company's primary source of funds to support its earning assets. The Company has been able to effectively compete for deposits in its primary market areas by offering attractive interest rates and personalized service. Additionally, on February 15, 2013, the Company entered into a Purchase and Assumption Agreement with Liberty Savings Bank, FSB, (Liberty) whereby the Bank will assume approximately $12 million of customer deposits, excluding certificates of deposit, and a nominal amount of overdraft lines of credit balances associated with deposit accounts from Liberty's Lakewood, Colorado branch. This increase in deposits will increase the Bank's liquidity. The transaction is expected to close during the second quarter of 2013. Information regarding the Company's deposit mix as of December 31, 2012 and 2011 is included in the section above titled "Part I - Item 1. Business –Deposit Services."

Federal Home Loan Bank borrowings

The Bank is a member of the FHLB of Topeka and, as a regular part of its business, obtains advances from the FHLB. Overnight advances bear interest at a variable rate while all other advances bear interest at a fixed rate. All advances are collateralized by certain securities pledged by the Bank and some of the Bank's qualifying loans. As of December 31, 2012, the Bank's authorized borrowing line with the FHLB totaled $61.6 million, subject to the availability of sufficient collateral to pledge against such borrowings. Of the $61.6 million available, $8.5 million was outstanding at December 31, 2012. Interest rates on these outstanding FHLB borrowings ranged from 0.43% to 3.01%, with a weighted-average interest rate of 1.57% at December 31, 2012. The Bank has pledged certain

qualifying loans and certain bonds from its investment portfolio as collateral.

During the fourth quarter 2011, the Bank restructured $3.5 million of its fixed-rate FHLB advances which reduced our effective interest from 4.37% to 2.14% and extended the average maturity.  This restructuring qualified as a debt modification, as opposed to a debt extinguishment, per U.S. GAAP.  As such, the prepayment penalty, of approximately $133,000, is being amortized over the life of the new borrowings through the effective-interest method and is included in the 2.14% new effective interest rate.

As of December 31, 2011, the Bank had $6.5 million in advances from the FHLB with a weighted-average interest of 1.90%.  The Bank had pledged certain qualifying loans and certain bonds from its investment portfolio as collateral.

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Liquidity and capital resources

Our 2007 stock offering closed with $25.5 million in total gross proceeds. Of this sum, $20.0 million was used to purchase common stock of Solera National Bank and approximately $3.6 million was used for pre-opening costs incurred by both the Company and the Bank. During 2009, the Company invested an additional $1.0 million in common stock of Solera National Bank. At December 31, 2012, the Company (excluding Solera National Bank) had approximately $2.2 million in remaining cash. These funds can be used for Company operations, investment, for additional purchase of Solera National Bank stock and other corporate activities. The primary source of liquidity for the Company will be dividends paid by Solera National Bank. Solera National Bank is currently restricted from paying dividends until we have received a prior written determination of no supervisory objection from the OCC and until it has positive retained earnings.

Solera National Bank's liquidity is monitored by its staff, the asset liability committee and the Bank's Board of Directors, who review historical funding requirements, current liquidity positions, sources and stability of funding, marketability of assets, options for attracting additional funds, and anticipated future funding needs, including the level of unfunded commitments.

Solera National Bank's primary sources of funds are retail and commercial deposits, loan and securities repayments, other short-term borrowings, and other funds provided by operations. While scheduled loan repayments and maturing investments are relatively predictable, deposit flows and early loan prepayments are influenced by interest rates, general economic conditions, and competition. Fluctuations in the balances of depositors may cause temporary increases and decreases in liquidity from time to time. The Bank handles such fluctuations by utilizing existing liquidity sources. Concerns over deposit fluctuations with respect to the overall banking industry were addressed by the FDIC and the Dodd-Frank Act which permanently increased the FDIC insurance coverage to $250,000 per depositor. Additionally, the Dodd-Frank Act extended unlimited FDIC insurance to noninterest-bearing transaction deposit accounts until December 31, 2012.

Solera National Bank maintains investments in liquid assets based upon management's assessment of (1) the need for funds, (2) expected deposit flows, (3) yields available on short-term liquid assets, and (4) objectives of the asset/liability management program.

Additionally, in January 2009, the Bank became a member of the Certificate of Deposit Account Registry Service ("CDARS®") program, offered by Promontory Interfinancial Network, LLC ("Promontory"). Through CDARS®, the Bank's customers can increase their FDIC insurance by up to $50 million through reciprocal certificate of deposit accounts. This is accomplished by the Bank entering into reciprocal depository relationships with other member banks. The individual customer's large deposit is broken into amounts below the $250,000 amount and placed with other banks that are members of the network. The reciprocal member bank issues certificate of deposits in amounts that ensure that the entire deposit is eligible for FDIC insurance. These sources provide secondary liquidity to the Company to service its depositors' needs. In August 2011, the Bank became a participating member in Insured Cash Sweep, a service offered by Promontory. As of December 31, 2012 and 2011, the Bank had $6.2 million and $11.3 million, respectively, in CDARS® deposits.

As loan demand increases, greater pressure will be exerted on Solera National Bank's liquidity. However, it is management's intention to maintain a conservative loan to deposit ratio in the range of 80 to 90% over time. Given this goal, Solera National Bank will not aggressively pursue lending opportunities if sufficient funding sources (e.g., deposits, Fed Funds, etc.) are not available, nor will Solera National Bank seek to attract volatile, non-local deposits with above market interest rates. As of December 31, 2012, the loan to deposit ratio was 48% compared to 47% as of December 31, 2011.

The Bank is a member of the FHLB of Topeka, which gives the Bank access to a secured line of credit with approximately $61.6 million of available funding as of December 31, 2012, subject to the availability of sufficient collateral to pledge against such borrowings. Additionally, the Bank has approved, unsecured federal funds purchase lines totaling $9.1 million with its correspondent banks. Each of these lines expires during 2013, however, it is anticipated the Company will be approved for new lines once the existing lines expire. The Bank also has the ability to borrow at the Federal Reserve Bank Discount Window on a secured basis.

Solera National Bank had cash and cash equivalents of $2.7 million, or 2% of total Bank assets, at December 31, 2012. Management believes that with the ability to raise deposits, access to unsecured federal funds established with correspondent banks, and access to funding from the FHLB, Solera National Bank should have more than adequate liquidity to meet anticipated future funding needs.



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Interest rate sensitivity

Net interest income, the Bank's expected primary source of earnings, can fluctuate with significant interest rate movements. The Company's profitability depends substantially on the Bank's net interest income, which is the difference between the interest income earned on its loans and other assets and the interest expense paid on its deposits and other liabilities. A large change in interest rates may decrease the Bank's net interest income. Most of the factors that cause changes in market interest rates, including economic conditions, are beyond the Company's control. To lessen the impact of interest rate fluctuations, the Bank attempts to structure the balance sheet so that re-pricing opportunities exist for both assets and liabilities in roughly equal amounts at approximately the same time intervals. Imbalances in these re-pricing opportunities at any point in time constitute interest rate sensitivity.

Interest rate sensitivity refers to the responsiveness of interest-bearing assets and liabilities to changes in market interest rates. The rate sensitive position, or "gap," is the difference in the volume of rate sensitive assets and liabilities at a given time interval. The general objective of gap management is to actively manage rate sensitive assets and liabilities in order to reduce the impact of interest rate fluctuations on the net interest margin. The Bank attempts to maintain a balance between rate sensitive assets and liabilities as the exposure period is lengthened to minimize the Bank's overall interest rate risk. The Bank regularly evaluates the balance sheet's asset mix in terms of several variables: yield, credit quality, appropriate funding sources and liquidity. The Bank's Asset Liability Committee meets regularly to develop a strategy for future periods in order to effectively manage the Bank's interest rate risk.

Off-balance-sheet arrangements

In the ordinary course of business, the Company enters into various off-balance-sheet commitments and other arrangements to extend credit that are not reflected in the consolidated balance sheets of the Company. The business purpose of these off-balance-sheet commitments is the routine extension of credit. As of December 31, 2012, commitments to extend credit included approximately $11.8 million for revolving line of credit arrangements, and unused commitments for loans. As of December 31, 2011, commitments to extend credit included approximately $6.3 million for revolving line of credit arrangements, unused commitments for loans and commitment letters outstanding for potential new customers. The Company faces the risk of deteriorating credit quality of borrowers to whom a commitment to extend credit has been made; however, no significant credit losses are expected from these commitments and arrangements.

Interest rate lock commitments and forward sales commitments

As of December 31, 2012, the Bank had $16.7 million in interest rate lock commitments for residential mortgage loans that had been committed but not yet funded. At the time the Bank enters into the interest rate lock commitment with the customer, the Bank simultaneously enters into a forward sales commitment with the secondary market investor locking the price on the subsequent sale of the loan thereby eliminating the Bank's exposure to interest rate risk. These interest rate lock commitments, when closed and funded, become loans held for sale on the Bank's balance sheet. These loans are held on the Bank's balance sheet for generally less than 30 days until sold to the investor at the previously-agreed price. Management has concluded that no material derivative instruments exist as of December 31, 2012. There were no interest rate lock commitments or forward sales commitments as of December 31, 2011.

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Capital adequacy

There are two primary measures of capital adequacy for banks: (i) risk-based capital guidelines, and (ii) the leverage ratio. The risk-based capital guidelines measure the amount of a bank's required capital in relation to the degree of risk perceived in its assets and its off-balance-sheet items. Under the risk-based capital guidelines, capital is divided into two "tiers." Tier 1 capital consists of common stockholders' equity, noncumulative and cumulative perpetual preferred stock, and minority interests. Goodwill, if any, is subtracted from the total. Tier 2 capital consists of the allowance for loan and lease losses, hybrid capital instruments, term subordinated debt and intermediate term preferred stock. Banks are required to maintain a minimum risk-based capital ratio of 8%, with at least 4% consisting of Tier 1 capital.

The second measure of capital adequacy relates to the leverage ratio. The OCC has established a 3% minimum leverage ratio requirement. The leverage ratio is computed by dividing Tier 1 capital into average total assets. In the case of the Bank and other banks that are experiencing growth or have not received the highest regulatory rating from their primary regulator, the minimum leverage ratio should be 3% plus an additional cushion of at least 1% to 2%, depending upon risk profiles and other factors.

For the years ended December 31, 2012 and 2011, the Bank met all capital adequacy requirements and was considered well-capitalized for all three measures, as follows: (1) Total capital to risk-weighted assets were 19% and 20%, as of December 31, 2012 and 2011 respectively; (2) Tier 1 capital to risk-weighted assets were 18% and 19%, at December 31, 2012 and 2011, respectively; and (3) Tier 1 capital to average assets were 11% at both December 31, 2012 and 2011. Additionally, Solera National Bancorp, Inc. has approximately $2 million in cash which can be used to purchase additional shares of the Bank's common stock. Such transaction would immediately increase the Bank's capital. See Note 21 to the Consolidated Financial Statements for more information as to our capital ratios and regulatory compliance.

In December 2010, the OCC established individual minimum capital ratios on the Bank which required Tier 1 capital to average assets of 9% and total risk-based capital to risk-weighted assets of 12%. As of June 29, 2012, adherence to these individual minimum capital ratios was no longer required as the OCC terminated the Bank's Consent Order and removed the individual minimum capital ratio directive.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The consolidated financial statements of the Company, including the notes thereto, and the report of the independent registered public accounting firm is included in this Annual Report and begins on page F-1.

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Management is responsible for maintaining effective disclosure controls and procedures. As of the end of the period covered by this Annual Report on Form 10-K, management, including the Principal Executive Officer and Principal Accounting and Financial Officer, evaluated the effectiveness and operation of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)). Based on that evaluation, both the Company's Principal Executive Officer and Principal Accounting and Financial Officer have concluded that the Company's disclosure controls and procedures are effective to ensure that the information required to be disclosed by the Company in reports that are filed or submitted under the Exchange Act are recorded, processed, summarized and reported to management within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to management as appropriate to allow timely decisions regarding disclosure.

Management's Report on Internal Control Over Financial Reporting

The management of Solera National Bancorp, Inc. including its consolidated subsidiary, is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control system was designed to provide reasonable assurance to the Company's management and Board of Directors regarding the preparation and fair presentation of published financial statements in accordance with U.S. generally accepted accounting principles. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management maintains a comprehensive system of controls intended to ensure that transactions are executed in accordance with management's authorization, assets are safeguarded, and financial records are reliable. Management also takes steps to see that information and communication flows are effective and to monitor performance, including performance of internal control procedures.

As of December 31, 2012, Solera National Bancorp, Inc.'s management assessed the effectiveness of the Company's internal control over financial reporting based on the framework established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on this assessment, management has determined that the Company's internal control over financial reporting as of December 31, 2012, is effective.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements should they occur. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree or compliance with the control procedures may deteriorate.

This Annual Report does not include an attestation report of our independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our independent registered public accounting firm pursuant to the rules of the Securities and Exchange Commission that

permit us to provide only management's report in this Annual Report on Form 10-K.

Changes in Internal Control over Financial Reporting

There have been no changes in internal controls over financial reporting during the Company's last fiscal quarter of 2012 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

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# PART III

## ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The required information for this item is incorporated by reference to the Company's Proxy Statement for the 2013 Annual Meeting of Stockholders, since such Proxy Statement will be filed with the Securities and Exchange Commission no later than 120 days after the end of the Company's fiscal year pursuant to Regulation 14A.

## ITEM 11. EXECUTIVE COMPENSATION

The required information for this item is incorporated by reference to the Company's Proxy Statement for the 2013 Annual Meeting of Stockholders, since such Proxy Statement will be filed with the Securities and Exchange Commission no later than 120 days after the end of the Company's fiscal year pursuant to Regulation 14A.

## ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The required information for this item is incorporated by reference to the Company's Proxy Statement for the 2013 Annual Meeting of Stockholders, since such Proxy Statement will be filed with the Securities and Exchange Commission no later than 120 days after the end of the Company's fiscal year pursuant to Regulation 14A.

## ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The required information for this item is incorporated by reference to the Company's Proxy Statement for the 2013 Annual Meeting of Stockholders, since such Proxy Statement will be filed with the Securities and Exchange Commission no later than 120 days after the end of the Company's fiscal year pursuant to Regulation 14A.

## ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The required information for this item is incorporated by reference to the Company's Proxy Statement for the 2013 Annual Meeting of Stockholders, since such Proxy Statement will be filed with the Securities and Exchange Commission no later than 120 days after the end of the Company's fiscal year pursuant to Regulation 14A.

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PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Documents Filed as Part of this Report

(1) Financial Statements. The consolidated financial statements of Solera National Bancorp, Inc., are listed on the Index to Consolidated Financial Statements appearing on page F-1 of this Annual Report.

(2) Financial Statement Schedules. All schedules for which provision is made in the applicable accounting regulations of the SEC are omitted because of the absence of conditions under which they are required or because the required information is included in the consolidated financial statements and related notes thereto.

(3) Exhibits. The following is a list of exhibits filed as part of this Annual Report on Form 10-K.

| Number | Description |
|---|---|
| 3.1 | Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's Registration Statement on Form SB-2 (No. 333-138042) filed on October 17, 2006). |
| 3.2 | Amendment to Certificate of Incorporation (incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form SB-2 (No. 333-145861) filed on September 4, 2007). |
| 3.3 | Amended and Restated Bylaws of Solera National Bancorp, Inc. (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on June 21, 2010). |
| 4.1 | Specimen common stock certificate (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form SB-2 (No. 333-138042) filed on October 17, 2006). |
| 4.2 | Form of Solera National Bancorp, Inc. Organizers' Warrant Agreement (incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form SB-2 (No. 333-138042) filed on October 17, 2006). |
| 4.3 | See Exhibits 3.1, 3.2, and 3.3 for provisions of the certificate of incorporation and bylaws defining rights of holders of the common stock. |
| 10.1 | Solera National Bancorp, Inc. 2007 Stock Incentive Plan (incorporated by reference to Exhibit 10.3 to the Company's Registration Statement on Form SB-2 (No. 333-138042) filed on October 17, 2006).+ |
| 10.2 | Lease Agreement dated June 16, 2006, by and between 319 South Sheridan LLC and Solera National Bancorp, Inc. (incorporated by reference to Exhibit 10.13 to the Company's Registration Statement on Form SB-2 (No. 333-138042) filed on October 17, 2006). |
| 10.3 | Executive Employment Agreement by and between Solera National Bank, Solera National Bancorp, Inc. and Douglas Crichfield (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed on August 12, 2009).+ |
| 10.4 | Form of Consent Order dated March 18, 2010 issued by the Office of the Comptroller of the Currency in the matter of Solera National Bank and Stipulation and Consent to the Issuance of a Consent Order (incorporated by reference to Exhibit 10.13 to the Company's Annual Report on Form 10-K filed on March 19, 2010). |
| 10.5 | Employment Agreement dated September 10, 2010 by and between the Company, the Bank and Robert J. Fenton (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on September 14, 2010).+ |

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(3) Exhibits - continued.

| Number | Description |
|---|---|
| 10.6 | Stipulation and Consent to the Issuance of a Consent Order (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 22, 2010). |
| 10.7 | Amended Consent Order issued and effective December 16, 2010 (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on December 22, 2010). |
| 10.8 | Termination of the Amended Consent Order dated June 29, 2012 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on July 5, 2012). |
| 10.9 | Solera National Bancorp, Inc. 2012 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on September 24, 2012).+ |
| 10.10 | Asset Purchase Agreement among Solera National Bank, Residential Mortgage of Colorado, LLC, Kathleen A. Stout and Scott Hovey dated November 30, 2012 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on December 6, 2012). |
| 10.11 | Executive Employment Agreement by and between Solera National Bank and Kathleen A. Stout (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on December 6, 2012).+ |
| 10.12 | Form of Restricted Stock Agreement (incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K filed on December 6, 2012).+ |
| 10.13 | Form of Performance Based Restricted Stock Agreement (incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K filed on December 6, 2012).+ |
| 10.14 | Form of Cash-Based Performance Agreement (incorporated by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K filed on December 6, 2012).+ |
| 10.15 | Purchase and Assumption Agreement between Liberty Savings Bank, FSB and Solera National Bank, dated as of February 15, 2013 (incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on February 20, 2013). |
| 14.1 | Code of Ethics (incorporated by reference to Exhibit 14.1 to the Company's Form 10-KSB filed on March 27, 2008). |
| 21.1 | Subsidiaries of Registrant (incorporated by reference to Exhibit 21.1 to the Company's Form 10-KSB for the year ended December 31, 2007). |
| 23.1 | Consent of McGladrey LLP.* |
| 24.1 | Powers of Attorney (incorporated by reference to Signature page attached hereto). |
| 31.1 | Certification of Principal Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act.* |
| 31.2 | Certification of Principal Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act.* |
| 32.1 | Certification pursuant to Rule 13a-14(b) of the Securities Exchange Act and 18 U.S.C. §1350.* |
| 101.INS** | XBRL Instance Document |
| 101.SCH** | XBRL Taxonomy Extension Schema Document |
| 101.CAL** | XBRL Taxonomy Extension Calculation Linkbase |
| 101.LAB** | XBRL Taxonomy Extension Label Linkbase |
| 101.PRE** | XBRL Taxonomy Extension Presentation Linkbase |
| 101.DEF** | XBRL Taxonomy Extension Definition Linkbase document |

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* Filed herewith.

\+ Indicates a compensatory plan or contract.

** Pursuant to applicable securities laws and regulations, we are deemed to have complied with the reporting obligation relating to the submission of interactive data files in such exhibits and are not subject to liability under any

anti-fraud provisions of the federal securities laws as long as we have made a good faith attempt to comply with the submission requirements and promptly amend the interactive data files after becoming aware that the interactive data files fail to comply with the submission requirements. In accordance with Rule 406T of Regulation S-T, the information in these exhibits is furnished and deemed not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Annual Report to be signed on its behalf by the undersigned, thereunto duly authorized.

| | SOLERA NATIONAL BANCORP, INC. |
|---|---|
| Dated: March 21, 2013 | By: /s/ Douglas Crichfield<br>Douglas Crichfield<br>President & Chief Executive Officer<br>(Principal Executive Officer) |
| Dated: March 21, 2013 | By: /s/ Robert J. Fenton<br>Robert J. Fenton<br>Executive Vice President, Chief Financial Officer<br>(Principal Accounting and Financial Officer) |

POWER OF ATTORNEY

Know all persons by these presents, that each person whose signature appears below constitutes and appoints Douglas Crichfield or Robert J. Fenton as his or her true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution, for him or her and in his or her name, place, stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, including all amendments thereto, with the Securities and Exchange Commission, granting unto said attorney-in-fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agent or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

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Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| SIGNATURE | TITLE | DATE |
|---|---|---|
| /s/ Douglas Crichfield<br>Douglas Crichfield | President & Chief Executive Officer, Director<br>(Principal Executive Officer) | March 21, 2013 |
| /s/ Robert J. Fenton<br>Robert J. Fenton | Executive Vice President, Chief Financial Officer<br>(Principal Accounting and Financial Officer) | March 21, 2013 |
| /s/ Norma R. Akers<br>Norma R. Akers | Director | March 21, 2013 |
| /s/ Rob L. Alvarado<br>Rob L. Alvarado | Director | March 21, 2013 |
| /s/ Maria G. Arias<br>Maria G. Arias | Director | March 21, 2013 |
| /s/ Ron Eller<br>Ron Eller | Director | March 21, 2013 |
| /s/ Robert M. Gallegos<br>Robert M. Gallegos | Director | March 21, 2013 |
| /s/ Ronald E. Montoya<br>Ronald E. Montoya | Director, Chairman | March 21, 2013 |
| /s/ Ray L. Nash<br>Ray L. Nash | Director | March 21, 2013 |
| /s/ David N. Roberts<br>David N. Roberts | Director | March 21, 2013 |
| /s/ Basil Sabbah<br>Basil Sabbah | Director | March 21, 2013 |
| /s/ F. Stanley Sena<br>F. Stanley Sena | Director, Vice Chairman | March 21, 2013 |
| /s/ Larry D. Trujillo<br>Larry D. Trujillo | Director | March 21, 2013 |
| /s/ Kent C. Veio<br>Kent C. Veio | Director | March 21, 2013 |

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FINANCIAL STATEMENTS

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders
Solera National Bancorp, Inc.

We have audited the accompanying consolidated balance sheets of Solera National Bancorp, Inc. and subsidiary (the Company) as of December 31, 2012 and 2011, and the related consolidated statements of income and comprehensive income, stockholders' equity/ (deficit), and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Solera National Bancorp, Inc. and subsidiary as of December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

/s/ McGladrey LLP

Denver, Colorado
March 21, 2013

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SOLERA NATIONAL BANCORP, INC.

CONSOLIDATED BALANCE SHEETS
December 31, 2012 and 2011

($ in thousands)

ASSETS

| | 2012 | 2011 |
|---|---|---|
| Cash and due from banks | $1,038 | $1,445 |
| Federal funds sold | 1,700 | 355 |
| TOTAL CASH AND CASH EQUIVALENTS | 2,738 | 1,800 |
| Interest-bearing deposits with banks | 257 | 1,357 |
| Investment securities, available-for-sale | 84,710 | 83,195 |
| Gross loans | 59,632 | 55,645 |
| Net deferred expenses/(fees) | 175 | (77) |
| Allowance for loan and lease losses | (1,063) | (1,067) |
| NET LOANS | 58,744 | 54,501 |
| Loans held for sale | 180 | — |
| Federal Home Loan Bank (“FHLB”) and Federal Reserve Bank stock, at cost | 1,189 | 1,134 |
| Bank-owned life insurance | 2,067 | — |
| Other real estate owned | 1,776 | 1,776 |
| Premises and equipment, net | 998 | 599 |
| Accrued interest receivable | 707 | 584 |
| Other assets | 531 | 420 |
| TOTAL ASSETS | $153,897 | $145,366 |

| | | |
|---|---|---|
| LIABILITIES AND STOCKHOLDERS’ EQUITY | | |
| Deposits | | |
| Noninterest-bearing demand | $3,387 | $3,550 |
| Interest-bearing demand | 8,218 | 9,355 |
| Savings and money market | 55,358 | 58,854 |
| Time deposits | 57,769 | 47,225 |
| TOTAL DEPOSITS | 124,732 | 118,984 |
| Securities sold under agreements to repurchase | 54 | 253 |
| Accrued interest payable | 56 | 56 |
| Accounts payable and other liabilities | 614 | 534 |
| FHLB borrowings | 8,500 | 6,500 |
| TOTAL LIABILITIES | 133,956 | 126,327 |
| Commitments and contingencies (see Notes 17 and 18) | | |
| Stockholders' equity | | |
| Common stock (1) | 26 | 26 |
| Additional paid-in capital | 26,206 | 26,146 |
| Accumulated deficit | (7,359) | (7,640) |
| Accumulated other comprehensive income | 1,068 | 507 |
| TOTAL STOCKHOLDERS' EQUITY | 19,941 | 19,039 |
| TOTAL LIABILITIES AND STOCKHOLDERS’ EQUITY | $153,897 | $145,366 |

(1) $0.01 par value; 5,000,000 shares authorized; 2,653,671 shares issued and outstanding at December 31, 2012, which includes 100,000 shares of unvested restricted stock; 2,553,671 shares issued and outstanding at December 31, 2011.

The accompanying notes are an integral part of these consolidated financial statements.

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SOLERA NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
Years Ended December 31, 2012 and 2011

| ($ in thousands, except share data) | 2012 | 2011 |
|---|---|---|
| Interest and dividend income | | |
| Interest and fees on loans | $3,272 | $3,300 |
| Investment securities, taxable | 2,013 | 2,407 |
| Dividends on FHLB and Federal Reserve Bank stock | 40 | 35 |
| Other | 10 | 7 |
| Total interest and dividend income | 5,335 | 5,749 |
| Interest expense | | |
| Deposits | 1,140 | 1,389 |
| FHLB borrowings | 131 | 197 |
| Other borrowings | 5 | 11 |
| Total interest expense | 1,276 | 1,597 |
| Net interest and dividend income | 4,059 | 4,152 |
| Provision for loan and lease losses | — | 155 |
| Net interest and dividend income after provision for loan losses | 4,059 | 3,997 |
| Noninterest income | | |
| Customer service and other fees | 73 | 68 |
| Gain on loans sold | 149 | — |
| Gain on sale of available-for-sale securities | 730 | 871 |
| Loss on sale of other real estate owned | — | (25) |
| Other income | 96 | 6 |
| Total noninterest income | 1,048 | 920 |
| Noninterest expense | | |
| Salaries and employee benefits | 2,516 | 2,489 |
| Occupancy | 480 | 525 |
| Professional fees | 451 | 436 |
| Other general and administrative | 1,379 | 1,225 |
| Total noninterest expense | 4,826 | 4,675 |
| Income before income taxes | 281 | 242 |
| Provision for income taxes | — | — |
| Net income | $281 | $242 |
| Other comprehensive income, net of tax: | | |
| Increase in net unrealized gains on securities | $1,291 | $1,177 |
| Less: Net gains included in net income | (730) | (871) |
| Other comprehensive income | $561 | $306 |
| Comprehensive income | $842 | $548 |
| | | |
| Per share data | | |
| Earnings per share – basic | $0.11 | $0.09 |
| Earnings per share – diluted | $0.11 | $0.09 |
| Weighted average common shares | | |
| Basic | 2,553,671 | 2,553,671 |
| Diluted | 2,573,688 | 2,553,671 |

The accompanying notes are an integral part of these consolidated financial statements.

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SOLERA NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY/ (DEFICIT)
Years Ended December 31, 2012 and 2011

| ($ in thousands, except share data) | Shares Outstanding | Common Stock | Additional Paid-in Capital | Accumulated (Deficit) | Accumulated Other Comprehensive Income | Total |
|---|---|---|---|---|---|---|
| Balance at December 31, 2010 | 2,553,671 | $26 | $ 25,980 | $ (7,882 ) | $ 201 | $18,325 |
| Stock-based compensation | — | — | 166 | — | — | 166 |
| Net income | — | — | — | 242 | — | 242 |
| Other comprehensive income | — | — | — | — | 306 | 306 |
| Balance at December 31, 2011 | 2,553,671 | $26 | $ 26,146 | $ (7,640 ) | $ 507 | $19,039 |
| Stock-based compensation | — | — | 60 | — | — | 60 |
| Stock compensation awards | 100,000 | — | — | — | — | — |
| Net income | — | — | — | 281 | — | 281 |
| Other comprehensive income | — | — | — | — | 561 | 561 |
| Balance at December 31, 2012 | 2,653,671 | $26 | $ 26,206 | $ (7,359 ) | $ 1,068 | $19,941 |

The accompanying notes are an integral part of these consolidated financial statements.

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SOLERA NATIONAL BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2012 and 2011

($ in thousands)

| Cash flows from operating activities: | 2012 | 2011 |
|---|---|---|
| Net income | $281 | $242 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 113 | 145 |
| Provision for loan losses | — | 155 |
| Amortization of deferred loan fees/expenses, net | (3) | (31) |
| Amortization of premiums/discounts on investment securities, net | 1,515 | 937 |
| Stock-based compensation | 60 | 166 |
| Loans originated for sale | (180) | — |
| Gain on sale of available-for-sale securities | (730) | (871) |
| Gain on sale of SBA loans | (149) | — |
| Proceeds from the sale of SBA loans | 2,537 | — |
| Loss on sale of other real estate owned | — | 25 |
| Federal Home Loan Bank stock dividends | (9) | (4) |
| Increase in bank-owned life insurance cash surrender value | (67) | — |
| Net changes in operating assets and liabilities: | | |
| Accrued interest receivable | (123) | 175 |
| Other assets | (111) | 69 |
| Accrued interest payable | — | (35) |
| Accounts payable and other liabilities | 109 | 147 |
| Deferred loan fees/expenses, net | (249) | 33 |
| Net cash provided by operating activities | 2,994 | 1,153 |
| Cash flows from investing activities: | | |
| Purchases of investment securities, available-for-sale | (59,066) | (60,770) |
| Proceeds from sales of investment securities, available-for-sale | 41,526 | 42,900 |
| Proceeds from maturity/call/pay down of investment securities, available-for-sale | 15,801 | 11,228 |
| Purchases of interest-bearing deposits with banks | — | (1,251) |
| Maturity of interest-bearing deposits with banks | 1,100 | 160 |
| (Purchase) / redemption of Federal Reserve Bank stock | (46) | 38 |
| Purchase of bank-owned life insurance | (2,000) | — |
| Proceeds from sale of foreclosed properties | — | 1,813 |
| Loan (originations) / principal collections, net | (6,379) | 1,213 |
| Purchases of premises and equipment | (512) | (13) |
| Net cash used in investing activities | (9,576) | (4,682) |
| Cash flows from financing activities: | | |
| Net increase in deposits | 5,748 | 8,029 |
| Net decrease in securities sold under agreements to repurchase | (199) | (90) |
| Principal payments on capital lease | (29) | (46) |
| Net proceeds from / (repayment of) Federal Home Loan Bank borrowings | 2,000 | (3,500) |
| Net cash provided by financing activities | 7,520 | 4,393 |
| | | |
| Net increase in cash and cash equivalents | 938 | 864 |
| Cash and cash equivalents at beginning of year | 1,800 | 936 |

| | | |
|---|---|---|
| Cash and cash equivalents at end of year | $2,738 | $1,800 |
| Supplemental disclosure of cash flow information: | | |
| Interest paid | $1,276 | $1,632 |
| Income taxes paid | $— | $— |
| Non-cash investing and financing activities: | | |
| Increase in net unrealized gain on investment securities | $561 | $306 |
| Loans transferred to other real estate owned | $— | $1,776 |

The accompanying notes are an integral part of these consolidated financial statements.

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SOLERA NATIONAL BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Solera National Bancorp, Inc., a bank holding company, is a Delaware corporation that incorporated in 2006 to organize and serve as the holding company for Solera National Bank (the "Bank"). The Bank, which is chartered as a national bank by the Office of the Comptroller of the Currency, ("OCC"), is a wholly-owned subsidiary of Solera National Bancorp, Inc. The Bank is a full-service commercial bank headquartered in Lakewood, Colorado that commenced banking operations in the third quarter of 2007. The Bank provides a variety of financial services to individuals, businesses, and not-for-profit organizations primarily located in the six-county Denver metropolitan area. Its primary lending products are commercial loans and home-equity lines of credit. Its primary deposit products are checking, money market, savings and time deposit accounts. In December 2012, the Company launched a residential mortgage division with five loan production offices in Colorado including Boulder, two locations in Colorado Springs, the Denver Tech Center and Durango. With the addition of more than 50 mortgage professionals, the Bank now offers residential mortgage loans, the vast majority of which will be sold on the secondary market.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Solera National Bancorp and its wholly-owned subsidiary, Solera National Bank. All entities are collectively referred to as the Company. All significant intercompany balances and transactions have been eliminated in consolidation.

Basis of Presentation

The Company uses the "management approach" for reporting information about segments and has determined that as of December 31, 2012 its business is comprised of one operating segment: banking. The Company anticipates reporting two operating segments in the future when the operations of the residential mortgage division are more significant.

The accounting and reporting policies of the Company are in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") and prevailing practices within the banking industry. A summary of the significant accounting policies consistently applied in preparation of the accompanying consolidated financial statements follows:

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and contingent assets and liabilities at the date of the financial statements and the reported amounts of certain revenues and expenses during the reporting period. Actual results could differ from those estimates. The significant areas requiring management estimates include determination of the allowance for loan and lease losses, assessment of possible impairment for investment securities, valuation of deferred tax assets and liabilities, stock compensation expense, and fair value of investment securities and other financial instruments. Assumptions and factors used in making estimates are evaluated regularly or whenever events or circumstances indicate that the previous assumptions and factors may have changed. Estimates may be adjusted as a result of assumptions and factors being evaluated.

Presentation of Cash Flows

For the purposes of reporting cash flows, cash and cash equivalents includes cash, balances due from banks and federal funds sold. Generally, federal funds are sold for one day periods. Cash flows from loans, deposits, and securities sold under agreements to repurchase are reported net.

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SOLERA NATIONAL BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Cash and Due from Banks

The Company may maintain amounts due from banks which exceed federally insured limits. The Company has not experienced nor does it anticipate any losses in such accounts.

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. 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 may be volatile. They may be influenced by a number of factors, including market interest rates, prepayment speeds, discount rates and the shape of the yield curve. Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the most advantageous market for the asset or liability in an orderly transaction between market participants. The fair value hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair values:

Level 1 – inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

Level 2 – inputs are other than quoted prices included in Level 1 that are observable for the asset or liability either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 – valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

The Company's estimated fair value amounts have been determined using available market information and appropriate valuation methodologies. However, considerable judgment is required to develop the estimates of fair value. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements subsequent to the balance sheet date and, therefore, estimates of fair value obtained at dates later than the balance sheet date may differ significantly from the amounts presented in the accompanying statements and notes.

Investment Securities

Investments to be held for an indefinite amount of time, but not necessarily to maturity, are classified as available-for-sale and reported at fair value using Level 2 inputs. For these securities, the Company obtains fair value measurements from independent pricing services. The fair value measurements consider observable data that may

include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bonds' terms and conditions, among other things. Unrealized gains and losses are reported as a separate component of accumulated other comprehensive income. Premiums or discounts are amortized or accreted into income using the interest method. Realized gains or losses are recorded using the specific identification method.

Securities are also 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, if any, 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.

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Loans Receivable

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding unpaid principal balances reduced by any charge-offs, the allowance for loan and lease losses, and net of any deferred fees or costs on originated loans.

Credit and loan decisions are made by management and the Board of Directors in conformity with loan policies established by the Board of Directors. The Company's practice is to charge-off any loan or portion of a loan when the loan is determined by management to be uncollectible due to the borrower's failure to meet repayment terms, the borrower's deteriorated financial condition, the depreciation of the underlying collateral, the loan's classification as a loss by regulatory examiners, or other reasons.

The Company considers a loan to be impaired when it is probable that the Company will be unable to collect all amounts due (principal and interest) according to the contractual terms of the loan agreement.  Measurement of impairment is based on the expected future cash flows of an impaired loan, which are discounted at the loan's effective interest rate, or measured by reference to an observable market value, if one exists, or the fair value of the collateral for a collateral-dependent loan. The Company selects the measurement method on a loan-by-loan basis except that collateral-dependent loans for which foreclosure is probable are measured at the fair value of the collateral. The Company recognizes interest income on impaired loans based on its existing methods of recognizing interest income on nonaccrual loans (see Interest and Fees on Loans, below).

Provision and Allowance for Loan and Lease 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 and lease losses represents the Company's recognition of the risks of extending credit and its evaluation of the loan portfolio.  The evaluation of the allowance is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.  The allowance for loan and lease 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 and lease 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 and lease losses when management believes the loan balance is uncollectible.

The Company has established a formal process for determining an adequate allowance for loan and lease losses.  The allowance for loan and lease losses calculation has two components.  The first component represents the allowance for loan and lease 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, impaired loans are individually evaluated by either discounting the expected future cash flows or determining the fair value of the collateral, if repayment is expected solely from collateral.  The fair value of the collateral is determined using internal analyses as well as third-party information, such as appraisals.  That value, less estimated costs to sell, is compared to the recorded investment in the loan and any shortfall is charged-off.  Unsecured loans and loans that are not

collateral-dependent are evaluated by calculating the 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 shortfall between the recorded investment in the loan and the discounted cash flows, or the fair value of the collateral less estimated costs to sell, represents the first component of the allowance for loan and lease losses.



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The second component of the allowance for loan and lease 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 qualitative factors also consider the risk elements within each segment of the loan portfolio. The primary risk comes from the difference between the expected and actual cash flows of the borrower and is influenced by the type of collateral securing the loans. For real estate secured loans, conditions in the real estate markets as well as the general economy influence real estate values and may impact the Company's ability to recover its investment due to declines in the fair value of the underlying collateral. The risks in non real-estate secured loans include general economic conditions as well as interest rate changes. For purposes of evaluating the allowance for loan and lease losses, we aggregate our loans into portfolio segments including: Commercial Real Estate Secured; Residential Real Estate Secured; Commercial and Industrial; and Consumer. We then evaluate the above factors by segment and assign probable loss ranges to each segment. The aggregate of these segments represents the contingent losses in the portfolio.

The recorded allowance for loan and lease losses is the aggregate of the impaired loans component and the contingent loss component. Our methodology for estimating the allowance has not changed during the current or prior reporting period and is consistent across all portfolio segments and classes of loans.

Interest and Fees on Loans

Interest income is recognized daily in accordance with the terms of the note based on the outstanding principal balance. Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. The accrual of interest on loans is discontinued when principal or interest is 90 days past due based on contractual terms of the loan or when, in the opinion of management, there is reasonable doubt as to collectability. When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on nonaccrual loans is subsequently recognized only to the extent that cash interest payments are received and the loan's principal balance is deemed collectible. Interest accruals are resumed on such loans only when they are brought current with respect to interest and principal and when, in the judgment of management, the loans are estimated to be fully collectible as to all principal and interest. Generally, for all classes of loans, loans are considered past due when contractual payments are delinquent by 30 days or more.

Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan using the effective interest method and without anticipating prepayments.

Loans Held for Sale / Gains and Losses on Sales of Mortgage Loans

Residential mortgage loans originated and held for sale are marked to market with gains and losses recognized in noninterest income. The market value is based on committed secondary market prices.

Premises and Equipment

Premises and equipment are carried at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives, which ranges from three to seven years. Leasehold improvements are amortized over the shorter of their estimated useful life or the lease term. Expenditures for leasehold improvements or major repairs are capitalized and those for ordinary repairs and maintenance are charged to operations as incurred.

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FHLB and Federal Reserve Bank Stock

The Bank is a member of the Federal Home Loan Bank of Topeka ("FHLB") and the Federal Reserve Bank of Kansas City ("FRB"). In both banks, members are required to own a certain amount of stock. As such, the Bank owns stock in both the FHLB and FRB. Bank stocks are carried at cost, classified as restricted securities and periodically reviewed for impairment. Both cash and stock dividends are reported as income in the period declared.

Other Real Estate Owned

Other real estate owned represents real estate acquired through foreclosure and is carried at its fair value less estimated costs to sell. Prior to foreclosure, the value of the underlying loan is written down to the fair market value of the real estate to be acquired by a charge to the allowance for loan and lease losses, if necessary. Any subsequent write-downs are charged against operating expenses. Operating expenses of such properties, net of related income, are included in other expenses.

Income Taxes

Deferred income taxes are computed using the asset and liability method, which recognizes a liability or asset representing the tax effects, based on current tax law, of future deductible or taxable amounts attributable to events that have been recognized in the financial statements. A valuation allowance is established to reduce the deferred tax asset to the level at which it is "more likely than not" that the tax asset or benefits will be realized. Realization of tax benefits of deductible temporary differences and operating loss carryforwards depends on having sufficient taxable income of an appropriate character within the carryforwards periods.

The Company recognizes interest and penalties, if any, in other general and administrative expense. There were no interest or penalties recorded or accrued at December 31, 2012 or 2011. Similarly, as of December 31, 2012 and 2011, the Company has no uncertain income tax positions as defined in of Accounting Standards Codification ("ASC") 740, Income Taxes.

Comprehensive Income

For the years ended December 31, 2012 and 2011, the Company had $1.1 million and $507,000, respectively, of unrealized gain on investment securities, net of applicable taxes and no other components of comprehensive income other than net income from operations. It should be noted that taxes are estimated to be $0 for both 2012 and 2011, as a full valuation allowance has been established for all deferred tax assets and liabilities until it is more likely than not that the tax assets or liabilities will be realized.

Loan Commitments and Related Financial Instruments

In the ordinary course of business, the Company has entered into off-balance-sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit as described in Note 17. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

Interest Rate Lock Commitments and Forward Sales Commitments

Interest rate lock commitments are commitments to fund residential mortgage loans at specified interest rates within a specified time, generally up to 60 days from the time of the rate lock. An interest rate lock commitment related to a loan that will be held for sale is a derivative instrument under U.S. GAAP, and is recognized at fair value on the consolidated balance sheets in other assets and other liabilities with changes in its value recorded in income from mortgage banking operations within noninterest income on the consolidated statements of income and comprehensive income. To eliminate the exposure of changes in interest rates impacting the fair value of interest rate lock commitments, the Company utilizes "best efforts" forward loan sale commitments. These contracts are entered into at the same time as the interest rate lock commitment, and lock in the sale and price of the loan with the Company's secondary market investors. Since these are "best efforts" contracts, the Company does not incur a penalty in the event the committed loans are not delivered. These forward loan sales commitments are not considered derivative instruments under U.S. GAAP, but in accordance with U.S. GAAP the Company has elected to mark these instruments to market. As such, both the interest rate lock commitments and forward sales commitments are accounted for at fair value. The fair value of interest rate lock commitments and forward sales commitments was not significant as of December 31, 2012. There were no interest rate lock commitments or forward sales commitments as of December 31, 2011.

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Earnings Per Share

Basic earnings per common share is based on the weighted-average number of common shares outstanding during the period. Diluted earnings per share is similar to basic earnings per share except that the weighted-average number of common shares outstanding is increased by the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued.

Stock-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.

The Company recorded compensation costs for stock-based compensation issued to directors in the amount of $5,000 and $68,000 in 2012 and 2011, respectively. The Company recorded compensation costs for stock-based compensation issued to employees in the amount of $55,000 and $98,000 in 2012 and 2011, respectively.

Additionally, the Company may grant restricted stock awards. These stock awards may vest based on a performance or service condition. For awards that vest based on a service condition, the compensation expense is recognized over the service period based on the grant-date fair value of the award (as determined by the quoted market price on the date of grant). For awards that vest based on a performance condition, the expense is recognized based on the number of awards that are expected to vest based on then-current projections. Should these expectations change in future periods, additional expense could be recorded or expense previously recorded could be reversed. Prior to the vesting of stock awards, each grantee shall have the rights of a stockholder with respect to voting and dividend rights of the granted stock.

Dividend Restriction

Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to the holding company or by the holding company to stockholders. With certain exceptions, the Company may not pay a dividend to its stockholders unless its retained earnings equal at least the amount of the proposed dividend.

Impact of Newly Issued Accounting Standards

In May 2011, the Financial Accounting Standards Board, (“FASB”), issued an accounting standards update intended to improve the comparability of fair value accounting and reporting requirements between U.S. GAAP and International Financial Reporting Standards (IFRS). Additional disclosures required by the update are incorporated in Note 20 and include: (i) disclosure of quantitative information regarding the unobservable inputs used in any Level 3 measurement including an explanation of the valuation techniques used and the sensitivity to changes in the values assigned to unobservable inputs; (ii) categorization by level for the fair value of financial instruments; and (iii) instances where the fair values disclosed for non-financial assets were based on a highest and best use assumption when in fact the assets are not being utilized in that capacity. The amendments in the update were effective for the Company’s interim and annual reports beginning with the first quarter 2012. The provisions of this update did not

have a material impact on the Company's financial position, results of operations or cash flows but did cause changes to the Company's fair value disclosure (see Note 20 — Fair Value).

In June 2011, the FASB issued an accounting standards update to increase the prominence of items included in other comprehensive income and facilitate the convergence of U.S. GAAP with IFRS. The update prohibits continued exclusive presentation of other comprehensive income in the statement of stockholders' equity. The update requires that all non-owner changes in stockholders' equity be presented in either a single continuous statement of comprehensive income or in two separate but continuous statements. The amendments in the update were effective for the Company's interim and annual reports beginning with the first quarter 2012. The provisions of this update did not have a material impact on the Company's financial position, results of operations or cash flows but did cause changes to the presentation of the Company's Statements of Income and Comprehensive Income.

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During 2012, the FASB issued other accounting standards updates which may impact the banking community or other entities but do not, and are not expected to, have a material impact on our financial position, results of operations or cash flows.

Reclassifications

Certain reclassifications have been made, with no effect on net income or stockholders' equity, to the previous consolidated financial statements to conform to the 2012 presentation.

NOTE 2 — INVESTMENT SECURITIES

The amortized costs and estimated fair values of investment securities are as follows:

| ($ in thousands) | December 31, 2012 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Securities available-for-sale: | | | | |
| Corporate | $14,148 | $457 | $(155) | $14,450 |
| State and municipal | 21,752 | 412 | (47) | 22,117 |
| Residential agency mortgage-backed securities ("MBS") and collateralized mortgage obligations ("CMOs") | 47,742 | 570 | (169) | 48,143 |
| Total securities available-for-sale | $83,642 | $1,439 | $(371) | $84,710 |

| ($ in thousands) | December 31, 2011 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Securities available-for-sale: | | | | |
| Corporate | $15,117 | $161 | $(460) | $14,818 |
| State and municipal | 3,691 | 198 | (4) | 3,885 |
| Residential agency MBS and CMOs | 63,880 | 747 | (135) | 64,492 |
| Total securities available-for-sale | $82,688 | $1,106 | $(599) | $83,195 |

The amortized cost and estimated fair value of debt securities by contractual maturity at December 31, 2012 and 2011 are shown below. The timing of principal payments received differs from the contractual maturity because borrowers may be required to make contractual principal payments and often have the right to call or prepay obligations with or without call or prepayment penalties. As a result, the timing with which principal payments are received on mortgage-backed securities is not represented in the table below. For instance, we received $15.8 million in proceeds from the maturity/call/prepayment of securities during 2012 (see our Consolidated Statements of Cash Flows on page F-6) versus no dollars contractually maturing within one year as of December 31, 2011 as set forth in the table below.

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| ($ in thousands) | 2012 | | 2011 | |
|---|---|---|---|---|
| Securities available-for-sale | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value |
| Due within one year | $ 1,003 | $ 1,023 | $ — | $ — |
| Due after one year through five years | 6,180 | 6,455 | 8,540 | 8,583 |
| Due after five years through ten years | 22,869 | 23,242 | 13,799 | 13,720 |
| Due after ten years | 53,590 | 53,990 | 60,349 | 60,892 |
| Total securities available-for-sale | $ 83,642 | $ 84,710 | $ 82,688 | $ 83,195 |

The following table presents the estimated fair value, the unrealized losses and the number of securities that were temporarily impaired and the length of time the individual securities have been in a continuous unrealized loss position as of December 31, 2012 and 2011, respectively:

| December 31, 2012 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| ($ in thousands) | Less than 12 months | | | 12 months or more | | | Total | | |
| Description of securities: | Estimated Fair Value | Unrealized Losses | # of Securities | Estimated Fair Value | Unrealized Losses | # of Securities | Estimated Fair Value | Unrealized Losses | # of Securities |
| Corporate | $ 1,436 | $ (8 ) | 2 | $ 3,353 | $ (147 ) | 6 | $ 4,789 | $ (155 ) | 8 |
| State and municipal | 4,512 | (47 ) | 9 | — | — | — | 4,512 | (47 ) | 9 |
| Residential agency MBS/ CMOs | 17,267 | (164 ) | 16 | 1,134 | (5 ) | 2 | 18,401 | (169 ) | 18 |
| Total temporarily-impaired | $ 23,215 | $ (219 ) | 27 | $ 4,487 | $ (152 ) | 8 | $ 27,702 | $ (371 ) | 35 |

| December 31, 2011 | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| ($ in thousands) | Less than 12 months | | | 12 months or more | | | Total | | |
| Description of securities: | Estimated Fair Value | Unrealized Losses | # of Securities | Estimated Fair Value | Unrealized Losses | # of Securities | Estimated Fair Value | Unrealized Losses | # of Securities |
| Corporate | $ 4,033 | $ (180 ) | 8 | $ 4,220 | $ (280 ) | 7 | $ 8,253 | $ (460 ) | 15 |
| State and municipal | 502 | (4 ) | 1 | — | — | — | 502 | (4 ) | 1 |
| Residential agency MBS/ CMOs | 18,266 | (135 ) | 20 | — | — | — | 18,266 | (135 ) | 20 |
| Total temporarily-impaired | $ 22,801 | $ (319 ) | 29 | $ 4,220 | $ (280 ) | 7 | $ 27,021 | $ (599 ) | 36 |

Management evaluates investment securities for other-than-temporary impairment taking into consideration the extent and length of time the fair value has been less than cost, the financial condition of the issuer and whether the Company has the intent to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value.  As of December 31, 2012 and 2011, no declines were deemed to be other than temporary.

The six corporate securities that were in a continuous loss position for 12 months or longer at December 31, 2012 fluctuated in value primarily as a result of changes in market interest rates and the widening of spreads due to an increase in the perceived risk of these bonds largely due to an unsettled economy and problems with European banks

rather than due to a material deterioration in credit quality. Further, the amount of unrealized loss on these corporate bonds has declined from December 2011. Anticipated increases in prepayment speeds on residential agency MBS, especially those with relatively high coupons, is the primary driver for the two mortgage-backed securities in a continuous loss position for 12 months or longer at December 31, 2012. The Company has determined there is no credit impairment on these securities since they carry the implicit guarantee of the U.S. government.

The Company has the intent to hold all securities in an unrealized loss position as of December 31, 2012 and does not anticipate that these securities will be required to be sold before recovery of value, which may be upon maturity. Accordingly, the securities detailed in the table above, are not other than temporarily impaired. Similarly, management's evaluation of the securities in an unrealized loss position at December 31, 2011, determined these securities were not other than temporarily impaired.

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During the first quarter 2011, the Company recognized $67,000 of loss on available-for-sale securities related to other than temporary impairment on five securities that management had the intent to sell before recovery of value. Those five securities were sold during the second quarter of 2011 for a net loss of $48,000, a $19,000 improvement from their March 31, 2011 estimated fair values. No other than temporary impairment was recognized during 2012.

Sales of available-for-sale securities were as follows:

| | Year Ended December 31, | |
|---|---|---|
| ($ in thousands) | 2012 | 2011 |
| Proceeds | $ 41,526 | $ 42,900 |
| Gross gains | 763 | 1,000 |
| Gross losses | (33) | (129) |

Realized gains and losses on the sale of securities are computed using the specific identification method, based on the amortized cost on the date of sale.

Securities with carrying values of $25.5 million and $20.4 million at December 31, 2012 and 2011, respectively, were pledged as collateral to secure borrowings from the FHLB, public deposits and for other purposes as required or permitted by law.

NOTE 3 — LOANS

The following table sets forth the composition of the loan portfolio according to the loan's purpose, which may differ from the categorization of the loan in subsequent tables which may categorize the loan according to its underlying collateral:

| ($ in thousands) | December 31, | |
|---|---|---|
| | 2012 | 2011 |
| Commercial real estate ("CRE") | $ 38,230 | $ 37,862 |
| Commercial and industrial | 9,383 | 5,971 |
| Residential real estate | 10,608 | 10,460 |
| Construction and development | 791 | 1,307 |
| Consumer | 620 | 45 |
| GROSS LOANS | 59,632 | 55,645 |
| Net deferred expenses / (fees) | 175 | (77) |
| Allowance for loan and lease losses | (1,063) | (1,067) |
| LOANS, NET | $ 58,744 | $ 54,501 |

During 2012, the Company purchased loans totaling approximately $4.8 million from banks and other entities. No loans were purchased during 2011. Also during 2012, the Company sold the guaranteed portion of five SBA 7(a) loans totaling approximately $2.5 million and resulting in total gains of $187,000, of which $149,000 was recognized in income immediately. The remaining $38,000 of gains pertains to the unguaranteed portion of the note that was retained by the Bank and will be amortized over the remaining term of the note as an adjustment to yield. No loans were sold during 2011.

In the ordinary course of business, and only if consistent with permissible exceptions to Section 402 of the Sarbanes-Oxley Act of 2002, the Bank may make loans to directors, executive officers, principal stockholders (holders of more than five percent of the outstanding common shares) and the businesses with which they are associated. In the Company's opinion, all loans and loan commitments to such parties are made on substantially the same terms, including interest rates and collateral requirements, as those prevailing at the time for comparable transactions with other persons. There were approximately $163,000 and $481,000 in loans receivable from related parties at December 31, 2012 and December 31, 2011, respectively.

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The Company's loan portfolio generally consists of loans to borrowers within Colorado. Although the Company seeks to avoid concentrations of loans to a single industry or based upon a single class of collateral, the Company's loan portfolio consists primarily of real estate loans secured by real estate located in Colorado, making the value of the portfolio more susceptible to declines in real estate values and other changes in economic conditions in Colorado. No single borrower can be approved for a loan over the Bank's current legal lending limit of approximately $2.7 million. This regulatory requirement helps to ensure the Bank's exposure to one individual customer is limited.

NOTE 4 — ALLOWANCE FOR LOAN AND LEASE LOSSES

Activity in the allowance for loan and lease losses for the twelve months ended December 31, 2012 and 2011, respectively, is summarized as follows:

| ($ in thousands) | 2012 | 2011 |
|---|---|---|
| Balance at beginning of year | $ 1,067 | $ 1,175 |
| Charge-offs | (88) | (276) |
| Recoveries | 84 | 13 |
| Provision for loan and lease losses | — | 155 |
| Balance at end of year | $ 1,063 | $ 1,067 |

The following allowance for loan and lease loss disclosures are broken out by portfolio segment. Portfolio segment is defined, under current US GAAP, as the level of aggregation used by the Company to calculate its allowance for loan and lease losses. Our portfolio segments are based on how loans are categorized on the Consolidated Report of Condition and Income, as set forth by banking regulators, (the "Call Report"), which is primarily based on the collateral securing the loan. We have four main portfolio segments as follows:

Commercial Real Estate (CRE) Secured – loans secured by nonfarm, nonresidential properties
Residential Real Estate Secured – loans secured by 1-4 family residential properties or land
Commercial and Industrial – loans to businesses not secured by real estate, and
Consumer – loans to individuals not secured by real estate.

The portfolio segment categorization of loans differs from the categorization shown in Note 3 — Loans. Portfolio segment categorization is based on the Call Report and the loan's underlying collateral while the loan categorization in Note 3 — Loans is based on the loan's purpose as determined during the underwriting process.

The table below provides a roll forward by portfolio segment of the allowance for loan and lease losses for the twelve months ended December 31, 2012 and 2011, respectively.

Roll forward of Allowance for Loan and Lease Losses by Portfolio Segment
Twelve Months Ended December 31, 2012

| ($ in thousands) | Commercial Real Estate Secured | Residential Real Estate Secured | Commercial and Industrial | Consumer | Total |
|---|---|---|---|---|---|
| Balance at January 1, 2012 | $726 | $244 | $97 | $— | $1,067 |

| | | | | | |
|---|---|---|---|---|---|
| Charge-offs | — | — | (85) | (3) | (88) |
| Recoveries | — | 70 | 14 | — | 84 |
| Provision for loan and lease losses | 58 | (92) | 31 | 3 | — |
| Balance at December 31, 2012 | $ 784 | $ 222 | $ 57 | $ — | $ 1,063 |

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Roll forward of Allowance for Loan and Lease Losses by Portfolio Segment
Twelve Months Ended December 31, 2011

| ($ in thousands) | Commercial Real Estate Secured | Residential Real Estate Secured | Commercial and Industrial | Consumer | Total |
|---|---|---|---|---|---|
| Balance at January 1, 2011 | $524 | $314 | $336 | $1 | $1,175 |
| Charge-offs | (51) | (109) | (116) | — | (276) |
| Recoveries | — | 13 | — | — | 13 |
| Provision for loan and lease losses | 253 | 26 | (123) | (1) | 155 |
| Balance at December 31, 2011 | $726 | $244 | $97 | $— | $1,067 |

The following tables present the ending balance in loans and allowance for loan and lease losses, broken down by portfolio segment as of December 31, 2012 and 2011. The tables also identify the recorded investment in loans and the related allowance that correspond to individual versus collective impairment evaluation as derived from the Company's systematic methodology of estimating the allowance for loan and lease losses (see additional discussion about our allowance methodology under Note 1 —Summary of Significant Accounting Policies, Provision and Allowance for Loan and Lease Losses).

| | December 31, 2012 | | | | |
|---|---|---|---|---|---|
| ($ in thousands) | Commercial Real Estate Secured | Residential Real Estate Secured | Commercial and Industrial | Consumer | Total |
| Loans | | | | | |
| Individually evaluated for impairment | $— | $— | $13 | $— | $13 |
| Collectively evaluated for impairment | 34,634 | 15,873 | 9,062 | 50 | 59,619 |
| Total | $34,634 | $15,873 | $9,075 | $50 | $59,632 |
| Allowance for loan and lease losses | | | | | |
| Individually evaluated for impairment | $— | $— | $— | $— | $— |
| Collectively evaluated for impairment | 784 | 222 | 57 | — | 1,063 |
| Total | $784 | $222 | $57 | $— | $1,063 |

| | December 31, 2011 | | | | |
|---|---|---|---|---|---|
| ($ in thousands) | Commercial Real Estate Secured | Residential Real Estate Secured | Commercial and Industrial | Consumer | Total |
| Loans | | | | | |
| Individually evaluated for impairment | $274 | $— | $336 | $— | $610 |
| Collectively evaluated for impairment | 35,159 | 14,586 | 5,245 | 45 | 55,035 |
| Total | $35,433 | $14,586 | $5,581 | $45 | $55,645 |
| Allowance for loan and lease losses | | | | | |
| Individually evaluated for impairment | $— | $— | $— | $— | $— |
| Collectively evaluated for impairment | 726 | 244 | 97 | — | 1,067 |

| | | | | | |
|---|---|---|---|---|---|
| Total | $726 | $244 | $97 | $— | $1,067 |

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The remaining tables in the allowance for loan and lease losses footnote provide detail about loans according to their class, rather than their segment, as reflected above. The class level provides more detail than the portfolio segment level. During 2012, the Company added an additional class for loans secured by the full faith and credit of the United States government. This class includes loans the Bank purchased during 2012 that are guaranteed by the United States Department of Agriculture. The following tables are provided to explain how the portfolio segments are further disaggregated into portfolio classes:

| ($ in thousands) | December 31, 2012 (Principal Balance) Portfolio Segment | | | | |
|---|---|---|---|---|---|
| Class | Commercial Real Estate Secured | Residential Real Estate Secured | Commercial and Industrial | Consumer | Total |
| CRE – owner occupied | $13,544 | $— | $— | $— | $13,544 |
| CRE – non-owner occupied | 20,462 | — | — | — | 20,462 |
| Commercial and industrial | — | — | 6,156 | — | 6,156 |
| Residential real estate | — | 15,515 | — | — | 15,515 |
| Construction and development | 628 | 358 | — | — | 986 |
| Government guaranteed | — | — | 2,919 | — | 2,919 |
| Consumer | — | — | — | 50 | 50 |
| Total | $34,634 | $15,873 | $9,075 | $50 | $59,632 |

| ($ in thousands) | December 31, 2011 (Principal Balance) Portfolio Segment | | | | |
|---|---|---|---|---|---|
| Class | Commercial Real Estate Secured | Residential Real Estate Secured | Commercial and Industrial | Consumer | Total |
| CRE – owner occupied | $16,337 | $— | $— | $— | $16,337 |
| CRE – non-owner occupied | 18,367 | — | — | — | 18,367 |
| Commercial and industrial | — | — | 5,581 | — | 5,581 |
| Residential real estate | — | 14,008 | — | — | 14,008 |
| Construction and development | 729 | 578 | — | — | 1,307 |
| Consumer | — | — | — | 45 | 45 |
| Total | $35,433 | $14,586 | $5,581 | $45 | $55,645 |

Impaired Loans

The following tables provide detail of impaired loans broken out according to class as of December 31, 2012 and 2011, respectively. The recorded investment represents the customer balance less any partial charge-offs and excludes any accrued interest receivable since the majority of the loans were on nonaccrual status and therefore did not have interest accruing. The unpaid balance represents the unpaid principal prior to any partial charge-off. There were no impaired loans with a related allowance as of December 31, 2012 or December 31, 2011.

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| ($ in thousands) | December 31, 2012 | | | | |
|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment YTD | Interest Income Recognized YTD |
| Impaired loans with no related allowance | | | | | |
| CRE – owner occupied | $— | $— | $— | $— | $— |
| CRE – non-owner occupied | — | — | — | — | — |
| Commercial and industrial | 13 | 13 | — | 58 | 2 |
| Residential real estate | — | — | — | — | — |
| Construction and development | — | — | — | — | — |
| Government guaranteed | — | — | — | — | — |
| Consumer | — | — | — | — | — |
| Total | $13 | $13 | $— | $58 | $2 |

The impaired loans without a valuation allowance did not have a related allowance because they are well-secured.

| ($ in thousands) | December 31, 2011 | | | | |
|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment YTD | Interest Income Recognized YTD |
| Impaired loans with no related allowance | | | | | |
| CRE – owner occupied | $— | $— | $— | $— | $— |
| CRE – non-owner occupied | 274 | 494 | — | 345 | — |
| Commercial and industrial | 336 | 336 | — | 517 | 15 |
| Residential real estate | — | — | — | — | — |
| Construction and development | — | — | — | — | — |
| Consumer | — | — | — | — | — |
| Total | $610 | $830 | $— | $862 | $15 |

The impaired loans without a valuation allowance did not have a related allowance because they were either partially charged-off during the year, bringing them to their net realizable value or are well-secured.

If the nonaccrual loans as of December 31, 2012 and 2011 had been current in accordance with their original terms an additional $7,000 and $63,000 of interest income would have been recorded during the twelve months ended December 31, 2012 and 2011, respectively.

Troubled debt restructurings (TDRs) are included in impaired loans above. There were no loans modified as TDRs during the twelve months ended 2012. A TDR is considered to be in payment default once it is 90 days past due under the modified terms or when the loan is determined to be uncollectible and is classified as loss and charged-off. There were no loans restructured during the last 12 months that subsequently defaulted. One loan, totaling $85,000, that was restructured during the third quarter of 2011 defaulted and was charged-off during the second quarter of 2012.

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The following table presents loans, by class, that were modified as TDRs during the twelve months ended December 31, 2011:

TDRs during the Twelve Months Ended December 31, 2011

($ in thousands)

| Loan Class | # of Loans | Pre-Modification Recorded Investment | Recorded Investment as of December 31, 2011 |
|---|---|---|---|
| CRE – owner occupied | — | $ — | $ — |
| CRE – non-owner occupied | 1 | 369 | 274 |
| Commercial and industrial | 1 | 99 | 93 |
| Residential real estate | 1 | 161 | — |
| Construction and development | — | — | — |
| Consumer | — | — | — |
| Total | 3 | $ 629 | $ 367 |

The commercial real estate restructuring involves an extended maturity date and the commercial and industrial modification involves a rate concession and an extension of terms. The residential real estate restructuring included partial debt forgiveness and a rate concession but was deemed uncollectible and fully charged-off during the third quarter of 2011.

Because TDRs are impaired loans, they are reviewed individually for impairment and either charged-off to their net realizable value or allocated a specific reserve in the calculation of the allowance for loan and lease losses. None of the TDRs as of December 31, 2011 had a specific valuation allowance because the loans are well collateralized or have been partially charged-off to their net realizable values. Year to date charge-offs on TDRs totaled $120,000 as of December 31, 2011.

The Company has not committed additional funds to any of the borrowers whose loans are classified as a TDR. As further represented in the table below, as of December 31, 2011, the Company had two loans that were restructured within the last twelve months that subsequently defaulted. One loan was moved to other real estate owned during the third quarter 2011 and the other loan was deemed uncollectible and fully charged-off during the third quarter 2011.

TDRs that subsequently defaulted as of December 31, 2011

($ in thousands)

| Loan Class | # of Loans | Recorded Investment at Time of Default | Recorded Investment as of December 31, 2011 |
|---|---|---|---|
| CRE – owner occupied | 1 | $ 879 | $ — |
| CRE – non-owner occupied | — | — | — |
| Commercial and industrial | — | — | — |
| Residential real estate | 1 | 110 | — |

| | | | | | |
|---|---|---|---|---|---|
| Construction and development | — | | — | | — |
| Consumer | — | | — | | — |
| Total | 2 | $ | 989 | $ | — |

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Age Analysis of Loans

The following tables summarize by class our past due and nonaccrual loans as of the dates indicated.

| ($ in thousands) | December 31, 2012 | | | | |
|---|---|---|---|---|---|
| | 30-59 Days Past Due | 60-89 Days Past Due | Past Due 90 Days or More and Still Accruing | Non-accrual | Total Past Due and Non-accrual |
| CRE – owner occupied | $ — | $ — | $ — | $ — | $ — |
| CRE – non-owner occupied | — | — | — | — | — |
| Commercial and industrial | — | — | — | 13 | 13 |
| Residential real estate | 135 | — | — | — | 135 |
| Construction and development | — | — | — | — | — |
| Government guaranteed | — | — | — | — | — |
| Consumer | — | 12 | — | — | 12 |
| Total | $ 135 | $ 12 | $ — | $ 13 | $ 160 |

| ($ in thousands) | December 31, 2011 | | | | |
|---|---|---|---|---|---|
| | 30-59 Days Past Due | 60-89 Days Past Due | Past Due 90 Days or More and Still Accruing | Non-accrual | Total Past Due and Non-accrual |
| CRE – owner occupied | $ — | $ 1,040 | $ — | $ — | $ 1,040 |
| CRE – non-owner occupied | — | — | — | 274 | 274 |
| Commercial and industrial | — | — | — | 336 | 336 |
| Residential real estate | 139 | 170 | — | — | 309 |
| Construction and development | — | — | — | — | — |
| Consumer | — | — | — | — | — |
| Total | $ 139 | $ 1,210 | $ — | $ 610 | $ 1,959 |

Credit Quality Information

The Company uses the following definitions for risk ratings, which are consistent with the definitions used in supervisory guidance and are the same for all classes of loans:

Special Mention: Loans in this category have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects at some future date.

Substandard:

Loans in this category are inadequately protected by the current sound worth and paying capacity of the borrower or of the collateral pledged, if any. These loans have well-defined weaknesses that jeopardize the liquidation of the debt and have the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful: Loans in this category have all the weaknesses inherent in those classified as substandard, above, with the added characteristic that the weaknesses make the collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.

Loss: Loans in this category are deemed not collectible and are charged-off.

Loans not meeting any of the definitions above are considered to be pass-rated loans.

As of December 31, 2012, and based on the most recent analysis performed during the month of December 2012, the recorded investment in each risk category of loans by class of loan is as follows:

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Credit Quality of Loans by Class as of December 31, 2012

| ($ in thousands) | Pass | Special Mention | Substandard | Doubtful | Total |
|---|---|---|---|---|---|
| CRE – owner occupied | $ 10,628 | $ 1,008 | $ 1,908 | $ — | $ 13,544 |
| CRE – non-owner occupied | 18,343 | 1,090 | 1,029 | — | 20,462 |
| Commercial and industrial | 5,973 | 170 | 13 | — | 6,156 |
| Residential real estate | 14,567 | 135 | 813 | — | 15,515 |
| Construction and development | 195 | — | 791 | — | 986 |
| Government guaranteed | 2,919 | — | — | — | 2,919 |
| Consumer | 38 | 12 | — | — | 50 |
| Total | $ 52,663 | $ 2,415 | $ 4,554 | $ — | $ 59,632 |

As of December 31, 2011, and based on the analysis performed during the month of December 2011, the recorded investment in each risk category of loans by class of loan were as follows:

Credit Quality of Loans by Class as of December 31, 2011

| ($ in thousands) | Pass | Special Mention | Substandard | Doubtful | Total |
|---|---|---|---|---|---|
| CRE – owner occupied | $ 14,068 | $ 1,135 | $ 1,134 | $ — | $ 16,337 |
| CRE – non-owner occupied | 15,395 | 1,796 | 1,176 | — | 18,367 |
| Commercial and industrial | 5,021 | — | 560 | — | 5,581 |
| Residential real estate | 13,344 | — | 664 | — | 14,008 |
| Construction and development | 232 | — | 1,075 | — | 1,307 |
| Consumer | 45 | — | — | — | 45 |
| Total | $ 48,105 | $ 2,931 | $ 4,609 | $ — | $ 55,645 |

NOTE 5 — FHLB AND FEDERAL RESERVE BANK STOCK

The Company, through its subsidiary bank, is a member of both the Federal Reserve Bank of Kansas City and the Federal Home Loan Bank of Topeka. Membership in these banks requires the Company to maintain an investment in the capital stock of each. These investments are restricted in that they can only be redeemed by the issuer at par value. The Company’s investments at December 31 were as follows:

| ($ in thousands) | 2012 | 2011 |
|---|---|---|
| Federal Reserve Bank of Kansas City | $ 533 | $ 487 |
| Federal Home Loan Bank of Topeka | 656 | 647 |
| Total | $ 1,189 | $ 1,134 |

NOTE 6 — BANK-OWNED LIFE INSURANCE

During the first quarter of 2012, the Company invested $2.0 million in bank-owned life insurance on certain key employees. Bank-owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value. Increases in the cash surrender value are recognized as other noninterest income.

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NOTE 7— OTHER REAL ESTATE OWNED

Changes in the balance of other real estate owned for the years ended December 31, 2012 and 2011 were as follows:

| ($ in thousands) | 2012 | 2011 |
|---|---|---|
| Balance at beginning of year | $ 1,776 | $ 1,838 |
| Additions to OREO | — | 1,776 |
| Sales proceeds | — | (1,813 ) |
| Net (losses) / gains | — | (25 ) |
| Balance at end of year | $ 1,776 | $ 1,776 |

Expenses related to other real estate owned included insurance, taxes and operating expenses of $55,000 and $21,000 during 2012 and 2011, respectively.

NOTE 8— PREMISES AND EQUIPMENT

The composition of Company premises and equipment at December 31, 2012 and 2011 is as follows:

| ($ in thousands) | 2012 | 2011 |
|---|---|---|
| Leasehold improvements | $ 607 | $ 608 |
| Furniture, fixtures and equipment | 1,127 | 628 |
| | 1,734 | 1,236 |
| Less accumulated depreciation | (736 ) | (637 ) |
| Premises and equipment, net | $ 998 | $ 599 |

Depreciation and amortization expense on premises and equipment was $113,000 and $145,000 for the years ended December 31, 2012 and 2011, respectively, and is included in occupancy expense in the accompanying consolidated statements of income and comprehensive income. There are no definitive agreements regarding acquisition or disposition of owned or leased facilities. Rent expense on premises was approximately $203,000 and $220,000 for the years ended December 31, 2012 and 2011, respectively. Rent expense will increase during 2013 as the Company occupied five new leased facilities during December 2012 in conjunction with the opening of the new residential mortgage division.

The Company has noncancelable operating leases for its main banking office, one administrative office, five mortgage loan production offices, and several copiers/printers that expire at various dates not later than the year 2017. Each of the leases for office space has a renewal option that extends through various dates not later than 2037. The cost of such renewals is not included below. The following table shows future minimum noncancelable operating lease payments as of December 31, 2012:

| Year ending December 31, | ($ in thousands) |
|---|---|
| 2013 | $ 392 |
| 2014 | 370 |

| | | |
|---|---|---|
| 2015 | | 358 |
| 2016 | | 293 |
| 2017 | | 62 |
| Thereafter | | — |
| | Total $ | 1,475 |

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NOTE 9— DEPOSITS

Deposits at December 31, 2012 and 2011 consist of the following:

| ($ in thousands) | 2012 Amount | % of Total | 2011 Amount | % of Total |
|---|---|---|---|---|
| Noninterest-bearing demand | $ 3,387 | 3 % | $ 3,550 | 3 % |
| Interest-bearing demand | 8,218 | 7 | 9,355 | 8 |
| Money market accounts | 10,511 | 8 | 9,781 | 8 |
| Savings accounts | 44,847 | 36 | 49,073 | 41 |
| Time deposits, less than $100,000 | 4,559 | 3 | 5,193 | 4 |
| Time deposits, $100,000 or more | 53,210 | 43 | 42,032 | 36 |
| Total | $ 124,732 | 100 % | $ 118,984 | 100 % |

Public deposits over $250,000 are collateralized by investment securities with estimated market values of $17.6 million and $12.4 million as of December 31, 2012 and 2011, respectively.

Scheduled maturities of time deposits for the next five years, as of December 31, are as follows:

| ($ in thousands) | 2012 | 2011 |
|---|---|---|
| 2012 | $ — | $ 22,668 |
| 2013 | 19,116 | 5,032 |
| 2014 | 9,200 | 4,053 |
| 2015 | 12,111 | 5,514 |
| 2016 | 11,754 | 9,215 |
| 2017 | 4,460 | — |
| Thereafter | 1,128 | 743 |
| Total | $ 57,769 | $ 47,225 |

Time deposits at December 31, 2012 included approximately $5.2 million in brokered deposits. The majority of this balance consisted of time deposits purchased during 2012 that mature during 2013. Additionally, the $5.2 million in brokered deposits included approximately $761,000 in reciprocal time deposits. Time deposits at December 31, 2011 included approximately $11.3 million in brokered deposits. The majority of this balance consisted of time deposits purchased during 2011 that matured during 2012. Additionally, the $11.3 million in brokered deposits included approximately $1.3 million in reciprocal time deposits.

NOTE 10— SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The Company had ending balances in securities sold under agreements to repurchase of $54,000 and $253,000 at December 31, 2012 and 2011, respectively, with weighted-average interest rates at year-end of 0.72% and 1.00%, respectively. Securities sold under agreements to repurchase, which are classified as secured borrowings, generally mature within one to four days from the transaction date. Securities sold under agreements to repurchase are reflected at the amount of cash received for the transaction. The Company may be required to provide additional collateral

based on the fair value of the underlying securities. The securities sold under agreements to repurchase are collateralized by government agency and/or mortgage-backed securities held by the Company.

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NOTE 11— OTHER BORROWINGS

The Bank is a member of the FHLB of Topeka and, as a regular part of its business, obtains advances from this FHLB. Overnight advances bear interest at a variable rate while all other advances bear interest at a fixed rate. All advances are collateralized by certain securities pledged by the Bank and some of the Bank's qualifying loans. The Bank's authorized borrowing line with the FHLB is capped at 40% of total assets, subject to the availability of sufficient collateral to pledge against such borrowings. The outstanding balance at December 31, 2012 was $8.5 million with interest rates ranging from 0.43% to 3.01%, and a weighted-average interest rate of 1.57%. As of December 31, 2011, the balance outstanding was $6.5 million with interest rates ranging from 1.16% to 3.01% and a weighted-average interest rate of 1.90%.

During the fourth quarter of 2011, the Bank restructured $3.5 million of its fixed-rate FHLB advances which reduced our effective annual interest rate from 4.37% to 2.14% and extended the average maturity. This restructuring qualified as a debt modification, rather than a debt extinguishment, per U.S. GAAP. As such, the prepayment penalty, of approximately $133,000, is being amortized over the life of the new borrowings through the effective-interest method and is included in the 2.14% new effective interest rate.

In addition to FHLB borrowings, as of December 31, 2012 and 2011, the Company may borrow up to $9.1 million overnight on an unsecured basis from its correspondent banks. As of both December 31, 2012 and 2011, there were no outstanding borrowings under these arrangements. The Bank also has the ability to borrow at the Federal Reserve Bank Discount Window on a secured basis.

At December 31, 2012, the scheduled maturities and weighted-average effective interest rate of FHLB borrowings are as follows:

| ($ in thousands) | | $ Amount Maturing | Weighted-Average Interest Rate | |
|---|---|---|---|---|
| Overnight | $ | — | — | % |
| 2013 | | 1,000 | 0.43 | |
| 2014 | | 4,000 | 1.26 | |
| 2015 | | 1,500 | 1.89 | |
| 2016 | | 1,600 | 2.39 | |
| 2017 | | 400 | 3.01 | |
| Total borrowings | $ | 8,500 | 1.57 | % |

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NOTE 12— INCOME TAXES

Deferred taxes are a result of differences between income tax accounting and generally accepted accounting principles with respect to income and expense recognition. The following is a summary of the components of the net deferred tax asset accounts recognized in the accompanying statements of financial condition at December 31:

| ($ in thousands) | 2012 | 2011 |
|---|---|---|
| Deferred tax assets: | | |
| Start-up and organizational expenses | $ 856 | $ 944 |
| Net operating loss carryforward | 1,257 | 1,266 |
| Allowance for loan and lease losses | 272 | 272 |
| Non-qualified stock options | 78 | 76 |
| Other | 95 | 101 |
| Total deferred tax assets | 2,558 | 2,659 |
| Deferred tax liabilities: | | |
| Net unrealized gain on securities available-for-sale | (396) | (188) |
| Federal Home Loan Bank stock dividends | (19) | (15) |
| Total deferred tax liabilities | (415) | (203) |
| Net deferred tax assets | 2,143 | 2,456 |
| Valuation allowance | (2,143) | (2,456) |
| Net deferred taxes | $ — | $ — |

The valuation allowance was established because the Company has not reported earnings sufficient enough to support the recognition of the deferred tax assets. The Company has net operating loss carryforwards of approximately $3.4 million for federal income tax purposes. Federal and state net operating loss carryforwards, to the extent not used, will expire starting in 2027. The Company is no longer subject to examination by Federal and State taxing authorities for years before 2007.

The income tax provision differs from the amount of income tax determined by applying the U.S. federal income tax rate of 34% to pretax income from continuing operations for the years ended December 31, 2012 and 2011, due to the following:

($ in thousands)

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| Computed “expected” tax expense (benefit) | $ 96 | $ 82 |
| Change in income taxes resulting from: | | |
| Change in valuation allowance | (105) | (111) |
| Other | 9 | 29 |
| Income tax provision | $ — | $ — |

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NOTE 13— STOCK-BASED COMPENSATION

Stock Options
On September 20, 2012, the Board of Directors adopted the Company's 2012 Long-Term Incentive Plan, (the "2012 Plan"). Under the terms of the 2012 Plan, the Company may grant incentive stock options ("ISO"), nonqualified stock options, restricted stock awards, and/or stock appreciation rights to eligible persons, including officers and directors of the Company. The 2012 Plan reserves 250,000 shares of common stock of the Company for issuance and does not terminate or amend the Company's 2007 Stock Incentive Plan (the "2007 Plan"). As of December 31, 2012, the Company granted 25,000 options as incentive compensation to an executive officer under the 2012 Plan.

The 2007 Plan provides for options to purchase shares of common stock at a price not less than 100% of the fair market value of the stock on the date of grant. Stock options expire no later than ten years from the date of the grant and generally vest over four years. The 2007 Plan provides for accelerated vesting if there is a change of control, as defined in the 2007 Plan. Under the terms of the 2007 Plan, employees may be granted both nonqualified stock options and ISOs and directors and other consultants, who are not also officers or employees, may only be granted nonqualified stock options. The Board reserved approximately 510,700 options for issuance under the 2007 Plan. Of that, approximately 499,000 are issued and outstanding, leaving approximately 12,000 available for future grants as of December 31, 2012.

During 2012, the Company recognized stock-based compensation expense of approximately $50,000 representing expense for approximately 44,000 options that vested during the year, plus a pro-rata amount for the options that are expected to vest on the anniversary of the date granted. During 2011, the Company recognized stock-based compensation expense of approximately $166,000 representing expense for approximately 103,000 options that vested during the year, plus a pro-rata amount for the options that are expected to vest on the anniversary of the date granted. No tax benefit related to stock-based compensation will be recognized until the Company demonstrates an ability to maintain profitability.

The fair value of each option grant was estimated on the date of grant using the Black-Scholes-Merton option pricing model with the assumptions presented in the tables below:

| | 2012 ISO Grants | 2012 Nonqualified Grants | 2011 ISO Grants |
|---|---|---|---|
| Number of Options Granted | 85,000 | 51,000 | 59,500 |
| Expected Volatility | 15.53% - 20.77 % | 15.53% - 20.77 % | 14.46% – 14.56 % |
| Expected Term | 6.25 years | 6.25 years | 6.25 years |
| Expected Dividend | 0.00 % | 0.00 % | 0.00 % |
| Risk-Free Rate | 0.90% - 1.12 % | 0.90% - 1.21 % | 1.19% – 2.72 % |
| Grant-Date Fair Value | $ 0.62 – $1.21 | $ 0.62 - $1.21 | $ 0.53 – $0.68 |

The Company did not grant any nonqualified stock options during 2011. During the third quarter of 2011, the Company changed its methodology for calculating the expected volatility and began using data from the Company's

actual historical stock activity. Prior to that, the expected volatility was based on the historical volatility of similar banks that had a longer trading history since the Company did not have sufficient historical data of its own. The expected term represents the estimated average period of time that the options will remain outstanding. Since the Company does not have sufficient historical data on the exercise of stock options, the expected term is based on the "simplified" method that measures the expected term as the average of the vesting period and the contractual term. The risk-free rate of return reflects the grant-date interest rate offered for zero coupon U.S. Treasury bonds with the same expected term as the options. The weighted-average grant-date fair value of options granted during the years 2012 and 2011 was $0.70 and $0.62, respectively. Currently, the Company's estimated forfeiture rate is 0% for executive officers, 28% for employees and ranges from 0% to 10% for directors. The different ranges result from certain groups of individuals exhibiting different behavior. Options forfeited impact the amount of compensation expense recognized. Share-based compensation expense is based on awards that are ultimately expected to vest; accordingly, share-based compensation expense may be impacted if actual forfeitures differ from estimated forfeitures. The estimated forfeiture rate is reviewed at each reporting date to confirm that it is the best estimate to support the then-current trends within the Company. During the third quarter 2011, the Company revised its estimated forfeiture rate on ISO grants increasing the estimated forfeiture rate for employees from 25% to 28%, which more accurately reflects the turnover rate experienced by the Company.

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As of December 31, 2012, there was approximately $121,000 of unrecognized compensation cost related to non-vested stock options granted that will be recognized over a weighted-average period of 2.03 years. This compared to approximately $72,000 of unrecognized compensation cost to be recognized over a weighted-average period of 1.62 years as of December 31, 2011. As of December 31, 2012 and 2011, the aggregate intrinsic value of in-the-money outstanding stock options was approximately $155,000 and $7,000, respectively.

The following table summarizes option activity as of and for the year ended December 31, 2012:

| | Options | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term |
|---|---|---|---|
| Outstanding at January 1, 2012 | 400,312 | $ 7.61 | 6.04 years |
| Granted | 136,000 | 4.02 | 9.37years |
| Exercised | — | — | — |
| Forfeited | (5,468) | 3.42 | — |
| Expired | (7,344) | 7.95 | — |
| Outstanding at December 31, 2012 | 523,500 | $ 6.72 | 6.54 years |
| | | | |
| Exercisable at December 31, 2012 | 364,911 | $ 7.87 | 5.48 years |

The following table summarizes option activity as of and for the year ended December 31, 2011:

| | Options | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term |
|---|---|---|---|
| Outstanding at January 1, 2011 | 367,790 | $ 8.31 | 7.60 years |
| Granted | 59,500 | 3.02 | 9.23 years |
| Exercised | — | — | — |
| Forfeited | (24,561) | 7.11 | — |
| Expired | (2,417) | 5.40 | — |
| Outstanding at December 31, 2011 | 400,312 | $ 7.61 | 6.04 years |
| | | | |
| Exercisable at December 31, 2011 | 315,630 | $ 8.54 | 5.65 years |

Restricted Stock

During 2012, the Company granted restricted stock to officers of the Company's new mortgage division. The 50,000 shares granted as an inducement award cliff-vest on November 30, 2014 conditioned upon the officers continued employment with the Bank. The 50,000 shares have a grant-date fair value of $4.80 per share. The Company recognized $10,000 of stock-based compensation expense associated with these awards for the year ended December 31, 2012. At December 31, 2012, compensation cost of $230,000 related to unearned awards not yet recognized is

expected to be recognized over a weighted-average period of 1.48 years. An additional 50,000 performance-based shares were issued on November 30, 2012, however, they were not deemed granted as the conditions for the vesting have not yet been established. The number of performance-based restricted shares that will vest will be calculated in accordance with the performance goals annually set by the Compensation Committee of the Board of Directors and will be a maximum of 10,000 shares for each of the years ended December 31, 2014, 2015, 2016, 2017 and 2018. The fair value of the performance-based restricted shares will be determined annually on the date the performance goals are established. The entire 100,000 restricted stock awards are considered issued and outstanding as of December 31, 2012 as they have voting and dividend rights, however, they are unvested and therefore not included in the computation of earnings per share until the performance or time-based restrictions have been met.

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SOLERA NATIONAL BANCORP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 14— WARRANTS

In recognition of the substantial financial risks undertaken by the members of the organizing group, the Company granted an aggregate of 317,335 warrants to its organizers and one non-organizer director. These warrants are exercisable at a price of $10.00 per share, subject to an effective registration statement, and may be exercised any time prior to September 10, 2017.

Warrants Outstanding and Exercisable

| Type | Exercise Price | Number | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price |
|---|---|---|---|---|
| Organizer warrants | $ 10.00 | 317,335 | 4.69 years | $ 10.00 |

Organizer warrants to purchase fractional shares were not issued. Instead, rounding down to the next whole number was used in calculating the number of warrants issued to any stockholder. Holders of warrants will be able to profit from any rise in the market price of the Company's common stock over the exercise price of the warrants because they will be able to purchase shares of the Company's common stock at a price that is less than the then-current market value. If the Bank's capital falls below the minimum level required by the OCC, management may be directed to require the holders to exercise or forfeit their warrants.

NOTE 15— EARNINGS PER SHARE

The following table presents the net earnings and weighted average common shares outstanding used to calculate earnings per share for the years ended December 31, 2012 and 2011:

| ($ in thousands, except share data) | 2012 | 2011 |
|---|---|---|
| Basic earnings per share computation | | |
| Net earnings to common stockholders | $ 281 | $ 242 |
| Weighted average shares outstanding – basic | 2,553,671 | 2,553,671 |
| Basic earnings per share | $ 0.11 | $ 0.09 |
| Diluted earnings per share computation | | |
| Net earnings to common stockholders | $ 281 | $ 242 |
| Weighted average shares outstanding – basic | 2,553,671 | 2,553,671 |
| Shares assumed issued: | | |
| Stock options | 8,689 | — |
| Restricted stock | 11,328 | — |
| Organizer stock warrants | — | — |

| | | |
|---|---|---|
| Weighted average shares outstanding – diluted | 2,573,688 | 2,553,671 |
| Diluted earnings per share | $0.11 | $0.09 |

The vast majority of the Company's stock options and warrants were out-of-the-money as of December 31, 2011 and were, therefore, anti-dilutive. The 100,000 unvested restricted stock awards were not included in the weighted average shares outstanding for the computation of basic earnings per share as they are only considered issued and outstanding as of December 31, 2012 due to their voting and dividend rights. The treasury stock method was used to estimate the weighted-average diluted shares outstanding for the 50,000 shares of restricted stock that were considered granted as of December 31, 2012 and resulted in 11,328 dilutive-potential shares.

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NOTE 16— RELATED PARTY TRANSACTIONS

In the ordinary course of business, and only if consistent with permissible exceptions to Section 402 of the Sarbanes-Oxley Act of 2002, the Bank may make loans to directors, executive officers, principal stockholders (holders of more than five percent of the outstanding common shares) and the businesses with which they are associated. In the Company's opinion, all loans and loan commitments to such parties are made on substantially the same terms including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons. There were approximately $163,000 and $481,000 in loans receivable from related parties at December 31, 2012 and 2011, respectively.

Also in the course of ordinary business, certain officers, directors, principal stockholders, and employees of the Bank have deposits with the Bank. In the Bank's opinion, all deposit relationships with such parties are made on substantially the same terms including interest rates and maturities, as those prevailing at the time for comparable transactions with other persons. The balance of related party deposits at December 31, 2012 and 2011 was approximately $3.1 million and $2.8 million, respectively.

NOTE 17— COMMITMENTS AND CONTINGENCIES

The Company is a party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheet. The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

At December 31, 2012 and 2011, the Company had $28.5 million and $6.3 million, respectively, in unfunded commitments outstanding whose contract amounts represent credit risk. Of the $28.5 million in total commitments outstanding at December 31, 2012, $7.7 million were at variable rates and $20.8 million were at fixed rates. Of the $6.3 million in total commitments outstanding at December 31, 2011, $5.1 million were at variable rates and $1.2 million were at fixed rates. Additionally, as of December 31, 2012, the Company had approximately $16.8 million in commitments to sell residential mortgage loans to third-party investors.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the commitments do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral securing the extension is based on management's credit evaluation. The type of collateral varies but may include accounts receivable, inventory, property, plant and equipment and income producing commercial properties.

NOTE 18—LEGAL CONTINGENCIES

At December 31, 2012, neither the Company nor the Bank was involved in any pending legal proceedings believed by management to be material to the Company's financial condition or results of operations. During 2012, we were party to two legal matters, which were incidental to the operation of our business. These matters were settled prior to trial

and resulted in $135,000 of legal settlement costs incurred by the Bank. Although the Company was confident it could successfully defend against the claims, we agreed to settle to avoid costly litigation and business distraction. Based upon information currently available to us, no further legal liability is likely to have a materially adverse effect on the Company's consolidated financial position, results of operations or cash flows.

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NOTE 19— OTHER GENERAL AND ADMINISTRATIVE EXPENSE

The following table details the items comprising other general and administrative expenses:

| ($ in thousands) | Year Ended December 31, | | |
|---|---|---|---|
| Other general and administrative expenses: | 2012 | 2011 | Increase/ (Decrease) |
| Data processing | $ 319 | $ 304 | $ 15 |
| FDIC assessments | 152 | 212 | (60) |
| Other regulatory and reporting fees | 131 | 150 | (19) |
| Marketing and promotions | 107 | 84 | 23 |
| Directors fees | 101 | 88 | 13 |
| Loan and collection expense | 90 | 104 | (14) |
| OREO expense | 55 | 21 | 34 |
| Telephone | 48 | 48 | — |
| Travel and entertainment | 47 | 33 | 14 |
| Insurance | 47 | 32 | 15 |
| Dues and memberships | 35 | 29 | 6 |
| Printing, stationery and supplies | 34 | 32 | 2 |
| ATM and debit card fees | 16 | 14 | 2 |
| Franchise taxes | 15 | 14 | 1 |
| Postage, shipping and courier | 13 | 13 | — |
| Customer checks and other customer expenses | 11 | 15 | (4) |
| Training and education | 9 | 15 | (6) |
| Operating losses / legal settlements | 138 | 11 | 127 |
| Miscellaneous | 11 | 6 | 5 |
| Total | $ 1,379 | $ 1,225 | $ 154 |

NOTE 20— FAIR VALUE

The Company carries its available-for-sale securities at fair value.  Fair value measurement is obtained from independent pricing services which utilize observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bonds' terms and conditions, among other things.  As of December 31, 2012 and 2011, all of the Company's available-for-sale securities were valued using Level 2 inputs.

Impaired loans are evaluated and valued at the time the loan is identified as impaired, at the lower of cost or fair value. Fair value is measured based on the value of the collateral securing these loans or the present value of expected cash flows and is classified as Level 3 in the fair value hierarchy. Collateral may be real estate and/or business assets including equipment, inventory and/or accounts receivable and is determined based on appraisals performed by qualified licensed appraisers hired by the Company. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the client and client's business.  Such discounts are typically significant and result in a Level 3 classification of the inputs for determining fair value. Impaired loans are reviewed and evaluated on at least a

quarterly basis for additional impairment and adjusted accordingly.

Other real estate owned is valued at the time the asset is transferred to other real estate owned. The value is based primarily on third party appraisals, less costs to sell. The appraisals are done according to the asset's highest and best use. The appraisals may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the property and underlying business. Such discounts are typically significant and result in a Level 3 classification of the inputs for determining fair value. Other real estate owned is reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly.

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There were no changes to management's valuation methodology during 2012.

Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below:

| ($ in thousands) | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|---|---|---|---|---|
| Assets at December 31, 2012 | | | | |
| Investment securities, available-for-sale: | | | | |
| Corporate | $ — | $ 14,450 | $ — | $ 14,450 |
| State and municipal | — | 22,117 | — | 22,117 |
| Residential agency MBS and CMOs | — | 48,143 | — | 48,143 |
| Total | $ — | $ 84,710 | $ — | $ 84,710 |
| Assets at December 31, 2011 | | | | |
| Investment securities, available-for-sale: | | | | |
| Corporate | $ — | $ 14,818 | $ — | $ 14,818 |
| State and municipal | — | 3,885 | — | 3,885 |
| Residential agency MBS and CMOs | — | 64,492 | — | 64,492 |
| Total | $ — | $ 83,195 | $ — | $ 83,195 |

There were no transfers in or out of levels during the periods presented.

Assets and Liabilities Measured on a Nonrecurring Basis

Financial assets and liabilities measured at fair value on a nonrecurring basis are summarized below:

| ($ in thousands) | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|---|---|---|---|---|
| Assets at December 31, 2012 | | | | |
| Impaired loans (Financial) | $— | $— | $ — | — |
| Other real estate owned (Non-financial) | $— | $— | $ 1,989 | $1,989 |
| | | | | |
| Assets at December 31, 2011 | | | | |
| Impaired loans (Financial) | $— | $— | $ 311 | $311 |

| | | | | |
|---|---|---|---|---|
| Other real estate owned (Non-financial) | $— | $— | $ 1,989 | $1,989 |

Other real estate owned (OREO) is real property taken by the Company either through foreclosure or through deed in lieu of foreclosure. The fair value of OREO is based on property appraisals adjusted at management's discretion to reflect further decline in fair value since the time the appraisal analysis was completed, if warranted. OREO had a carrying amount of $1.8 million at both December 31, 2012 and 2011, based on the current appraisals less reasonable costs to sell of approximately $253,000 for the Company's two OREO properties. This value included a partial charge-off of $40,000 which was recorded during 2011.

Impaired loans are measured for impairment using either the fair value of collateral or the present value of expected cash flows. The $13,000 impaired loan at December 31, 2012 was carried at cost, because the fair value of the expected cash flows exceeded the book value, as such it is not presented in the table above.

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Impaired loans at December 31, 2011 had carrying amounts totaling $610,000 after partial charge-offs of $220,000. These impaired loans had no specific valuation allowance. In addition, these impaired loans have $37,000 of estimated selling costs which reduced the carrying value. Of the $610,000 of impaired loans, $311,000 was carried at fair value adjusted for the aforementioned charge-offs and estimated selling costs. The remaining $336,000 was carried at cost at December 31, 2011, as the fair value of collateral or expected cash flows on these loans exceeded the book value.

The following table provides information describing the valuation process used to determine recurring and nonrecurring fair value measurements categorized within Level 3 of the fair value hierarchy:

| Asset Type | Valuation Method | Unobservable Inputs | Range |
|---|---|---|---|
| Impaired Loans | Property appraisals | Management discount for property type and/or recent market volatility | 0% - 20% discount |
| | Discounted cash flow | Estimated loss probability based on management’s knowledge of client or client’s business | 0% - 50% discount |
| OREO | Property appraisals | Management discount for property type, recent market volatility, and/or management’s knowledge of the property | 0% - 20% discount |

Fair Value of Financial Instruments

Disclosure of fair value about financial instruments, for which it is practicable to estimate the value, is required whether or not recognized in the consolidated balance sheets. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instrument. Because no market value exists for a significant portion of certain financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature, involve uncertainties and matters of judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value information is not required to be disclosed for certain financial instruments and all nonfinancial instruments. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company. Fair value estimates are based on financial instruments both on and off the balance sheet without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Additionally, tax consequences related to the realization of the unrealized gains and losses can have a potential effect on fair value estimates and have not been considered in many of the estimates.

The following methods and assumptions were used to estimate the fair value of significant financial instruments:

Cash and cash equivalents: The carrying amounts of cash and due from banks and federal funds sold approximate their fair values.

Interest-bearing deposits with banks:  As of December 31, 2012 and 2011, respectively, the Bank owned $250,000 and $350,000, in fixed-rate certificates of deposit with other FDIC-insured financial institutions whose fair values were estimated using a discounted cash flow calculation using interest rates currently being offered for deposits with similar remaining maturities. The carrying value of all other interest-bearing deposits with banks approximated their fair values as of December 31, 2012 and 2011 due to the balances being payable upon demand.

Investment securities:  Fair value measurement is obtained from independent pricing services which utilize observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bonds' terms and conditions, among other things.

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Loans, net: The fair value of fixed rate loans is estimated by discounting the future cash flows using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are estimated to be equivalent to carrying values. Variable rate loans that are currently priced at their contractual floor or ceiling, and thus similar to fixed rate loans, are reviewed to determine the interest rate that would be currently offered on similar credits. If the current floor/ceiling rate is equivalent to current market rates, fair value is estimated to be equivalent to carrying value. If the current market rates differ from the loan's current rate, the contractual cash flows are discounted using the current market rate to derive the loan's estimated fair value. Both the estimated fair value and the carrying value have been reduced by specific and general reserves for loan losses.

Loans held for sale: Loans originated and held for sale are carried at the lower of cost or market. No fair value adjustments were recorded on loans held for sale during 2012. The Company holds loans in the held for sale category for a period generally less than two months and, as a result, the fair value approximates the carrying value.

Investment in FHLB and Federal Reserve Bank stocks: It is not practical to determine the fair value of bank stocks due to the restrictions placed on the transferability of FHLB stock and Federal Reserve Bank stock.

Bank-owned life insurance: The carrying amount of bank-owned life insurance is based on the cash surrender value of the policies which is a reasonable estimate of fair value.

Accrued interest receivable: The carrying value of interest receivable approximates fair value due to the short period of time between accrual and receipt of payment.

Deposits: The fair value of noninterest-bearing demand deposits, interest-bearing demand deposits and savings and money market accounts is determined to be the amount payable on demand at the reporting date. The fair value of fixed-rate time deposits is estimated using a discounted cash flow calculation that applies interest rates currently being offered for deposits of similar remaining maturities. Carrying value is assumed to approximate fair value for all variable rate time deposits.

Securities sold under agreements to repurchase: The carrying amount of securities sold under agreements to repurchase approximates fair value due to the short-term nature of these agreements, which generally mature within one to four days from the transaction date.

Federal Home Loan Bank borrowings: Fair value of the Federal Home Loan Bank borrowings is estimated using a discounted cash flow model based on current market rates for similar types of borrowing arrangements including similar remaining maturities.

Accrued interest payable: The carrying value of interest payable approximates fair value due to the short period of time between accrual and payment.

Loan commitments and letters of credit: The fair values of commitments are estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. The difference between the carrying value of commitments to fund loans or standby letters of credit and their fair values are not significant and, therefore, are not included in the following table.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The carrying amounts and estimated fair values of financial instruments at December 31 are summarized as follows:

| ($ in thousands) | Carrying | Fair Value Measurements at December 31, 2012 | | | |
|---|---|---|---|---|---|
| Financial Assets: | Value | Level 1 | Level 2 | Level 3 | Total |
| Cash and cash equivalents | $ 2,738 | $ 2,738 | $ — | $ — | $ 2,738 |
| Interest-bearing deposits with banks | 257 | — | 273 | — | 273 |
| Investment securities | 84,710 | — | 84,710 | — | 84,710 |
| Loans, net | 58,744 | — | — | 58,785 | 58,785 |
| Loans held for sale | 180 | — | 180 | — | 180 |
| FHLB and FRB stocks | 1,189 | — | — | NA | NA |
| Bank-owned life insurance | 2,067 | — | — | 2,067 | 2,067 |
| Accrued interest receivable | 707 | — | 537 | 170 | 707 |
| | | | | | |
| Financial Liabilities: | | | | | |
| Deposits, demand, savings and money market | $ 66,963 | $ — | $ 66,963 | $ — | $ 66,963 |
| Time deposits | 57,769 | — | 58,671 | — | 58,671 |
| Securities sold under agreements to repurchase | 54 | — | 54 | — | 54 |
| FHLB borrowings | 8,500 | — | 8,722 | — | 8,722 |
| Accrued interest payable | 56 | — | 56 | — | 56 |

| ($ in thousands) | Carrying | Fair Value Measurements at December 31, 2011 | | | |
|---|---|---|---|---|---|
| Financial Assets: | Value | Level 1 | Level 2 | Level 3 | Total |
| Cash and cash equivalents | $ 1,800 | $ 1,800 | $ — | $ — | $ 1,800 |
| Interest-bearing deposits with banks | 1,357 | — | 1,374 | — | 1,374 |
| Investment securities | 83,195 | — | 83,195 | — | 83,195 |
| Loans, net | 54,501 | — | — | 54,788 | 54,788 |
| FHLB and FRB stocks | 1,134 | — | — | NA | NA |
| Accrued interest receivable | 584 | — | 423 | 161 | 584 |
| | | | | | |
| Financial Liabilities: | | | | | |
| Deposits, demand, savings and money market | $ 71,759 | $ — | $ 71,759 | $ — | $ 71,759 |
| Time deposits | 47,225 | — | 47,917 | — | 47,917 |
| Securities sold under agreements to repurchase | 253 | — | 253 | — | 253 |
| FHLB borrowings | 6,500 | — | 6,692 | — | 6,692 |
| Accrued interest payable | 56 | — | 56 | — | 56 |

NOTE 21— REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a material adverse effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank’s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Undercapitalized institutions are subject to certain prompt corrective action requirements, regulatory controls and restrictions, which become more extensive as an institution becomes more severely undercapitalized.

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Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of Total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). As of December 31, 2012 and 2011, the Bank met all capital adequacy requirements to which it is subject.

As of December 31, 2012 and 2011, the Bank was categorized as well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, an institution must maintain minimum Total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following table. There are no conditions that have occurred since December 31, 2012 that management believes has changed the Bank's status as well-capitalized.

The Bank's actual capital amounts as of December 31, 2012 are presented below:

| ($ in thousands) | Risk-based Tier 1 | Total Capital | Leverage Tier 1 |
|---|---|---|---|
| Actual regulatory capital | $ 16,712 | $ 17,775 | $ 16,712 |
| Well-capitalized requirement | 5,529 | 9,215 | 7,726 |
| Excess regulatory capital | $ 11,183 | $ 8,560 | $ 8,986 |
| Capital ratios | 18.1 % | 19.3 % | 10.8 % |
| Minimum capital requirement | 4.0 % | 8.0 % | 4.0 % |
| Well-capitalized requirement | 6.0 % | 10.0 % | 5.0 % |

The Bank's actual capital amounts as of December 31, 2011 are presented below:

| ($ in thousands) | Risk-based Tier 1 | Total Capital | Leverage Tier 1 |
|---|---|---|---|
| Actual regulatory capital | $ 16,143 | $ 17,193 | $ 16,143 |
| Well-capitalized requirement | 5,041 | 8,401 | 7,181 |
| Excess regulatory capital | $ 11,102 | $ 8,792 | $ 8,962 |
| Capital ratios | 19.2 % | 20.5 % | 11.2 % |
| Minimum capital requirement | 4.0 % | 8.0 % | 4.0 % |
| Individual minimum capital requirement | NA | 12.0 % | 9.0 % |
| Well-capitalized requirement | 6.0 % | 10.0 % | 5.0 % |

In December 2010, the OCC established minimum capital ratios for the Bank which required Tier 1 capital to average assets of 9% and total risk-based capital to risk-weighted assets of 12%. Using these individual minimum capital ratios, Tier 1 capital could have been as low as $12.5 million and total risk-based capital could have been as low as $10.7 million and still have been in compliance with the Bank's revised thresholds. As of June 29, 2012, adherence to these individual minimum capital ratios was no longer required as the OCC terminated the Bank's Consent Order (see additional discussion in Note 22—Termination of Consent Order).

Capital adequacy ratios are not presented on a consolidated basis, as they are only applicable for bank holding companies with consolidated assets of $500 million or more, or for those bank holding companies that are engaged in significant nonbanking activities.

The Bank is restricted as to the amount of dividends which can be paid. Dividends declared by national banks that exceed net income (as defined by OCC regulations) for the current year plus retained net income for the preceding two years must be approved by the OCC. Also, the Bank may not pay dividends until we have received a prior written determination of no supervisory objection from the Assistant Deputy Comptroller of the Western District of the OCC.

With certain exceptions, the Company may not pay a dividend to its stockholders unless its retained earnings equal at least the amount of the proposed dividend.

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NOTE 22—TERMINATION OF CONSENT ORDER

On June 29, 2012, the OCC terminated the Amended Consent Order (the "Consent Order") by and between the OCC and Solera National Bank which was entered into on December 16, 2010. The Consent Order replaced and superseded the consent order entered into on March 18, 2010 by the Bank. As such, the Bank is no longer subject to any formal or informal regulatory agreement.

NOTE 23— SOLERA NATIONAL BANCORP, INC.

Solera National Bancorp, Inc. (the "Bancorp") has no significant business activity other than its investment in Solera National Bank. Financial information pertaining only to the Bancorp is as follows:

($ in thousands)

| Condensed Balance Sheets | December 31, 2012 | December 31, 2011 |
|---|---|---|
| ASSETS | | |
| Cash | $2,179 | $2,402 |
| Investment in Solera National Bank | 17,780 | 16,650 |
| TOTAL ASSETS | $19,959 | $19,052 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Other liabilities | $18 | $13 |
| | | |
| Stockholders' equity | 19,941 | 19,039 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $19,959 | $19,052 |

($ in thousands)

| | For the year ended December 31, | |
|---|---|---|
| Condensed Statements of Income | 2012 | 2011 |
| Income | | |
| Earnings from undistributed earnings of Solera National Bank | $515 | $541 |
| Other | 2 | 3 |
| TOTAL INCOME | 517 | 544 |
| Expenses | | |
| Salaries, benefits and other compensation | 5 | 68 |
| Professional fees | 164 | 163 |
| General and administrative | 67 | 71 |
| TOTAL EXPENSES | 236 | 302 |
| Income before income taxes | 281 | 242 |
| Income tax expense | — | — |
| NET INCOME | $281 | $242 |

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($ in thousands)

| Condensed Statements of Cash Flows | For the year ended December 31, 2012 | 2011 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $281 | $242 |
| Adjustments to reconcile net income to net cash used by operating activities: | | |
| Earnings from undistributed income of subsidiary | (515) | (541) |
| Stock-based compensation | 5 | 68 |
| Change in other liabilities | 6 | (8) |
| Net cash used by operating activities | (223) | (239) |
| | | |
| Cash flows from investing activities: | | |
| Net cash used by investing activities | — | — |
| | | |
| Cash flows from financing activities: | | |
| Net cash used in financing activities | — | — |
| | | |
| Net decrease in cash | (223) | (239) |
| | | |
| Cash at beginning of year | 2,402 | 2,641 |
| Cash at end of year | $2,179 | $2,402 |

NOTE 24— SUBSEQUENT EVENTS

On February 15, 2013, the Company and the Bank entered into a Purchase and Assumption Agreement with Liberty Savings Bank, FSB, (Liberty) whereby the Bank will assume approximately $12 million of customer deposits, excluding certificates of deposit, and a nominal amount of overdraft lines of credit balances associated with deposit accounts from Liberty's Lakewood, Colorado branch. The transaction is subject to regulatory approvals and is expected to close in the second quarter of 2013. The Bank will pay Liberty a deposit premium of 5.85% based upon the average daily total deposits during the thirty calendar days immediately preceding the closing of the transaction, not to exceed $775,000. The Bank does not currently expect to assume any real estate, buildings, fixtures or equipment from Liberty.

The Company has considered subsequent events through the date of issuance of this Report on Form 10-K, and has determined that no additional disclosure is necessary.