

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

Washington, D.C. 20549

FORM 10 - K

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

For the fiscal year ended December 31, 2010

OR

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

Commission File Number 000-53181

SOLERA NATIONAL BANCORP, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of

02-0774841
(I.R.S. Employer

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incorporation or organization)

Identification No.)

319 South Sheridan Boulevard Lakewood, CO 80226

(Address of principal executive offices, including zip code)

(303) 209-8600

(Registrant's telephone number, including area code)

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

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

Common Stock, par value

\$.01 per share

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

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

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

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

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

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

Large accelerated filer ☐

Accelerated filer ☐

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

Smaller reporting company ☒

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

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

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

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

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ANNUAL REPORT ON FORM 10-K

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PART I

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

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

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

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

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

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

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

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

Item 1. Business

Overview

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

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

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

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

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

Available Information

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

Philosophy and Strategy

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

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

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

Market Opportunities

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Business Strategy

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

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

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

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

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

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

Lending Services

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

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

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

among other reasons.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Asset Quality

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

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

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

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The following table summarizes information regarding nonperforming assets:

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

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

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

of the aforementioned factors.

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

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

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

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

(\$ in thousands)	Amount	December 31, 2010		
		Percentage of loans in each category to total loans	Percentage of year-end allowance	Percentage of reserves to total loans by category
Real estate commercial	\$ 470	65.4%	40.0%	1.22%
Construction and land development	240	3.2	20.4	12.67
Real estate residential	90	13.4	7.7	1.14
Commercial and industrial	353	14.8	30.0	4.04
Consumer	8	0.9	0.7	1.48
Lease financing	14	2.3	1.2	1.03
Total Allowance for Loan Losses	\$ 1,175	100.0%	100%	2.00%

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

		December 31, 2008		
		Percentage of	Percentage of	Percentage of
		loans in each	year-end	reserves to total
		category to	allowance	loans by category
		total loans		
(\$ in thousands)	Amount			
Real estate commercial	\$ 68	34.9%	25.4%	0.91%
Construction and land development				