

Solera National Bancorp, Inc.
Form 10-Q
November 10, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

- QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2010

- 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)

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Delaware
(State or other jurisdiction
of incorporation or organization)

02-0774841
(IRS Employer Identification No.)

319 S. Sheridan Blvd.

Lakewood, CO 80226

303-209-8600

(Address and telephone number of principal executive offices and principal place of business)

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 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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the last practicable date: As of November 9, 2010, 2,553,671 shares of the registrant's common stock, \$0.01 par value, were issued and outstanding.

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

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 about Solera National Bancorp, Inc. (the Company) and our 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 quarterly 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's business may be adversely affected by conditions in the financial markets and economic conditions generally;
- continuation of the economic downturn could reduce our customer base, our level of deposits and demand for financial products such as loans;
- management of Solera National Bank may be unable to adequately measure and limit credit risk associated with the Bank's loan portfolio, which would affect our profitability;
- we are exposed to higher credit risk by commercial real estate, commercial business, and construction lending;
- our allowance for probable loan losses may be insufficient;

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- interest rate volatility could harm our business;
- funding to provide liquidity may not be available to us on favorable terms or at all;
- we may not be able to raise additional capital on terms favorable to us;
- the liquidity of our common stock is affected by its limited trading market;
- the departures of key personnel or directors may impair our operations;
- the Bank's legal lending limits may impair its ability to attract borrowers;
- the Company is subject to extensive government regulation which may have an adverse effect on the Company's profitability and growth;

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- managing reputational risk is important to attracting and maintaining customers, investors and employees;
- monetary policy and other economic factors could adversely affect the Company's profitability;
- the Company's certificate of incorporation and bylaws, and the employment agreements of our executive officers, contain provisions that could make a takeover more difficult;
- our directors and executive officers could have the ability to influence stockholder actions;
- the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds, and other financial institutions operating in our market area and elsewhere, including institutions operating regionally, nationally, and internationally, together with such competitors offering banking products and services by mail, telephone, computer, and the Internet; and
- management's ability to manage these and other risks.

For a discussion of these and other risks and uncertainties that could cause actual results to differ from those contained in the forward-looking statements, see "Risk Factors" in Item 1A of the Company's 2009 Annual Report filed on Form 10-K with the SEC, which is available on the SEC's website at www.sec.gov. All forward-looking statements are qualified in their entirety by this cautionary statement, and the Company undertakes no obligation to revise or update this Quarterly Report on Form 10-Q to reflect events or circumstances after the date hereof. New factors emerge from time to time, and it is not possible for us to predict which factors, if any, will arise. In addition, the Company cannot assess the impact of each factor on the Company's business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS (unaudited)****Solera National Bancorp, Inc.****Balance Sheets as of September 30, 2010 and December 31, 2009**

(unaudited)

| (\$ in thousands, except share data) | September 30, 2010 | December 31, 2009 |
|--|-----------------------|----------------------|
| ASSETS | | |
| Cash and due from banks | \$ 698 | \$ 1,696 |
| Federal funds sold | | 820 |
| Total cash and cash equivalents | 698 | 2,516 |
| Interest-bearing deposits with banks | 266 | 3,784 |
| Investment securities, available-for-sale | 72,876 | 73,441 |
| Gross loans | 60,378 | 50,504 |
| Net deferred (fees)/expenses | (85) | (114) |
| Allowance for loan losses | (1,200) | (830) |
| Net loans | 59,093 | 49,560 |
| Federal Home Loan Bank (FHLB) and Federal Reserve Bank stocks | 1,165 | 1,131 |
| Premises and equipment, net | 768 | 875 |
| Accrued interest receivable | 749 | 814 |
| Prepaid FDIC insurance | 320 | 471 |
| Other assets | 278 | 248 |
| Total assets | \$ 136,213 | \$ 132,840 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Deposits | | |
| Noninterest-bearing demand | \$ 1,894 | \$ 2,624 |
| Interest-bearing demand | 11,224 | 6,830 |
| Savings and money market | 53,535 | 55,318 |
| Time deposits | 41,708 | 39,629 |
| Total deposits | 108,361 | 104,401 |
| Federal funds purchased and securities sold under agreements to repurchase | 1,085 | 326 |
| Accrued interest payable | 99 | 82 |
| Accounts payable and other liabilities | 340 | 344 |
| Federal Home Loan Bank advances | 6,000 | 8,750 |
| Deferred rent liability | 95 | 85 |
| Capital lease liability | 87 | 118 |
| Total liabilities | \$ 116,067 | \$ 114,106 |

COMMITMENTS AND CONTINGENCIES (see Note 10)

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STOCKHOLDERS EQUITY

| | | | | |
|--|-----------|----------------|-----------|----------------|
| Common stock, \$0.01 par value; 5,000,000 shares authorized; 2,553,671 shares issued and outstanding at September 30, 2010 and December 31, 2009 | \$ | 26 | \$ | 26 |
| Additional paid-in capital | | 25,916 | | 25,768 |
| Accumulated deficit | | (8,298) | | (8,016) |
| Accumulated other comprehensive income | | 2,502 | | 956 |
| Total stockholders equity | \$ | 20,146 | \$ | 18,734 |
| Total liabilities and stockholders equity | \$ | 136,213 | \$ | 132,840 |

See Notes to Consolidated Financial Statements.

Table of Contents**Solera National Bancorp, Inc.****Statements of Operations for the Three and Nine Months Ended September 30, 2010 and 2009****(unaudited)**

| (\$ in thousands, except share data) | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|-----------------|--|-------------------|
| | 2010 | 2009 | 2010 | 2009 |
| Interest income: | | | | |
| Interest and fees on loans | \$ 901 | \$ 598 | \$ 2,503 | \$ 1,380 |
| Interest on federal funds sold | | 2 | 2 | 3 |
| Interest on investment securities | 713 | 752 | 2,261 | 2,000 |
| Other interest income | 1 | | 7 | 1 |
| Dividends on FHLB and Federal Reserve Bank stocks | 10 | 11 | 32 | 31 |
| Total interest income | 1,625 | 1,363 | 4,805 | 3,415 |
| Interest expense: | | | | |
| Deposits | 466 | 517 | 1,476 | 1,180 |
| Federal Home Loan Bank advances | 58 | 78 | 202 | 256 |
| Federal funds purchased and securities sold under agreements to repurchase | 2 | 2 | 5 | 10 |
| Other borrowings | 2 | 3 | 7 | 10 |
| Total interest expense | 528 | 600 | 1,690 | 1,456 |
| Net interest income | 1,097 | 763 | 3,115 | 1,959 |
| Provision for loan losses | 780 | 180 | 1,075 | 432 |
| Net interest income after provision for loan losses | 317 | 583 | 2,040 | 1,527 |
| Noninterest income: | | | | |
| Service charges and fees | 19 | 80 | 55 | 220 |
| Other income | 16 | | 16 | 4 |
| Gain on sale of other real estate owned | 10 | | 10 | |
| Gain on sale of investment securities | 332 | 98 | 863 | 205 |
| Total noninterest income | 377 | 178 | 944 | 429 |
| Noninterest expense: | | | | |
| Salaries and employee benefits | 619 | 591 | 1,756 | 1,889 |
| Occupancy | 137 | 142 | 418 | 417 |
| Professional fees | 134 | 53 | 319 | 237 |
| Other general and administrative | 297 | 236 | 773 | 680 |
| Total noninterest expense | 1,187 | 1,022 | 3,266 | 3,223 |
| Net loss before income taxes | (493) | (261) | (282) | (1,267) |
| Income taxes | | | | |
| Net loss | \$ (493) | \$ (261) | \$ (282) | \$ (1,267) |
| Basic earnings (loss) per share | (0.19) | (0.10) | (0.11) | (0.50) |
| Diluted earnings (loss) per share | (0.19) | (0.10) | (0.11) | (0.50) |

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Weighted-average common shares

| | | | | |
|---------|-----------|-----------|-----------|-----------|
| Basic | 2,553,671 | 2,553,671 | 2,553,671 | 2,553,671 |
| Diluted | 2,553,671 | 2,553,671 | 2,553,671 | 2,553,671 |

See Notes to Consolidated Financial Statements.

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Solera National Bancorp, Inc.

Statements of Changes in Stockholders' Equity for the Nine Months Ended September 30, 2010 and 2009

(unaudited)

| (\$ in thousands, except share data) | Shares Outstanding | Common Stock | Additional Paid-in Capital | Accumulated Deficit | Accumulated Other Comprehensive Income | Total |
|--|--------------------|--------------|----------------------------|---------------------|--|------------------|
| Balance at December 31, 2008 | 2,553,671 | \$ 26 | \$ 25,558 | \$ (6,740) | \$ 148 | \$ 18,992 |
| Stock-based compensation | | | 156 | | | 156 |
| Comprehensive income: | | | | | | |
| Net loss | | | | (1,267) | | (1,267) |
| Net change in unrealized gains on investment securities available-for-sale | | | | | 1,819 | 1,819 |
| Less: reclassification adjustment for net gains included in income | | | | | (205) | (205) |
| Total comprehensive income | | | | | | 347 |
| Balance at September 30, 2009 | 2,553,671 | \$ 26 | \$ 25,714 | \$ (8,007) | \$ 1,762 | \$ 19,495 |
| Balance at December 31, 2009 | 2,553,671 | \$ 26 | \$ 25,768 | \$ (8,016) | \$ 956 | \$ 18,734 |
| Stock-based compensation | | | 148 | | | 148 |
| Comprehensive income: | | | | | | |
| Net loss | | | | (282) | | (282) |
| Net change in unrealized gains on investment securities available-for-sale | | | | | 2,409 | 2,409 |
| Less: reclassification adjustment for net gains included in income | | | | | (863) | (863) |
| Total comprehensive income | | | | | | 1,264 |
| Balance at September 30, 2010 | 2,553,671 | \$ 26 | \$ 25,916 | \$ (8,298) | \$ 2,502 | \$ 20,146 |

See Notes to Consolidated Financial Statements.

Table of Contents**Solera National Bancorp, Inc.****Statements of Cash Flows for the Nine Months Ended September 30, 2010 and 2009****(unaudited)**

| (\$ in thousands) | For the Nine Months Ended September 30, | |
|---|--|--------------------|
| | 2010 | 2009 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net loss | \$ (282) | \$ (1,267) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 137 | 127 |
| Provision for loan losses | 1,075 | 432 |
| Net accretion of deferred loan fees/expenses | (29) | (48) |
| Net amortization of premiums on investment securities | 348 | 46 |
| Gain on sale of other real estate owned | (10) | |
| Gain on sale of investment securities | (863) | (205) |
| Federal Home Loan Bank stock dividend | (10) | (10) |
| Recognition of stock-based compensation on stock options | 148 | 156 |
| Changes in operating assets and liabilities: | | |
| Interest receivable | 65 | (294) |
| Other assets | (53) | (16) |
| Prepaid FDIC insurance | 151 | |
| Accrued interest payable | 17 | 59 |
| Accounts payable and other liabilities | (4) | (46) |
| Deferred loan fees/expenses, net | | 126 |
| Deferred rent liability | 10 | 19 |
| Net cash provided by (used in) operating activities | \$ 700 | \$ (921) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchase of investment securities, available-for-sale | \$ (46,154) | \$ (56,583) |
| Proceeds from sales of investment securities, available-for-sale | 30,461 | 18,118 |
| Proceeds from maturities/calls/pay downs of investment securities, available-for-sale | 18,319 | 9,790 |
| Originated loans, net of pay downs | (11,391) | (27,077) |
| Proceeds from sale of other real estate owned | 823 | |
| Purchase of premises and equipment | (8) | (12) |
| Purchase of stock in Federal Reserve Bank | (24) | (2) |
| Purchase of interest-bearing deposits with banks | (1,006) | (2,241) |
| Maturity of interest-bearing deposits with banks | 4,524 | |
| Net cash used in investing activities | \$ (4,456) | \$ (58,007) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Net increase in deposits | \$ 3,960 | \$ 65,240 |
| Net increase/(decrease) in federal funds purchased and securities sold under agreements to repurchase | 759 | (372) |
| Repayment of FHLB advances | (2,750) | (2,250) |
| Principal payments on capital lease | (31) | (29) |
| Net cash provided by financing activities | \$ 1,938 | \$ 62,589 |
| Net (decrease) / increase in cash and cash equivalents | \$ (1,818) | \$ 3,661 |

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CASH AND CASH EQUIVALENTS

| | | | | |
|---------------------|----|-------|----|-------|
| Beginning of period | | 2,516 | | 2,401 |
| End of period | \$ | 698 | \$ | 6,062 |

(continued)

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Solera National Bancorp, Inc.

Statements of Cash Flows for the Nine Months Ended September 30, 2010 and 2009, (continued)

(unaudited)

| (\$ in thousands) | For the Nine Months Ended September 30, | |
|--|--|----------|
| | 2010 | 2009 |
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION | | |
| Cash paid during the period for: | | |
| Interest | \$ 1,673 | \$ 1,397 |
| Non-cash investing transactions: | | |
| Unrealized gain on investment securities, available-for-sale | \$ 1,546 | \$ 1,614 |
| Loans transferred to other real estate owned | \$ 813 | \$ |

See Notes to Consolidated Financial Statements.

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SOLERA NATIONAL BANCORP, INC.

UNAUDITED CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF ORGANIZATION

Solera National Bancorp, Inc. (the Company), is a Delaware corporation that was incorporated in 2006 to organize and serve as the holding company for Solera National Bank (the Bank), a national bank that opened for business on September 10, 2007. Solera National Bank is a full-service community, commercial bank headquartered in Lakewood, Colorado serving the Denver metropolitan area.

NOTE 2 BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) which, in the opinion of management, are necessary to present fairly the financial position of the Company as of September 30, 2010, and the results of its operations for the three and nine months ended September 30, 2010 and 2009. Cash flows are presented for the nine months ended September 30, 2010 and 2009. Certain reclassifications have been made to the consolidated financial statements and related notes of prior periods to conform to the current presentation. These reclassifications had no impact on stockholders' equity or net loss for the periods. Additionally, certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to rules and regulations of the U.S. Securities and Exchange Commission. The Company believes that the disclosures in the unaudited condensed consolidated financial statements are adequate to make the information presented not misleading. However, these unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K as of and for the year ended December 31, 2009.

The Company received approval as a bank in organization in the first quarter of 2007, conducted an initial closing of its common stock offering and commenced banking operations during the third quarter of 2007. Successful completion of the Company's development program and, ultimately, the attainment of sustained profitable operations are dependent on future events, including the successful execution of the Company's business plan and achieving a level of revenue adequate to support the Company's cost structure.

Critical Accounting Policies

The following is a description of the Company's significant accounting policies used in the preparation of the accompanying consolidated financial statements.

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

The Company has established a formal process for determining an adequate allowance for loan losses. The allowance for loan losses calculation has two components. The first component represents the allowance for loan losses for impaired loans; that is loans where the Company believes collection of the contractual principal and interest payments is not probable. To determine this component of the calculation, collateral-dependent impaired loans are evaluated using internal analyses as well as third-party information, such as appraisals. If an impaired loan is unsecured, it is evaluated using a discounted cash flow of the payments expected over the life

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

At September 30, 2010, the Company had an allowance for loan losses of \$1.2 million. Management believes that this allowance for loan losses is adequate to cover probable losses based on all currently available evidence. Future additions to the allowance for loan losses may be required based on management's continuing evaluation of the inherent risks in the portfolio. Additional provisions for loan losses may need to be recorded if the economy declines, asset quality deteriorates, or the loss experience changes. Also, federal regulators, when reviewing the Bank's loan portfolio in the future, may require the Bank to increase the allowance for loan losses.

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

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 are volatile and may be influenced by a number of factors, including market interest rates, prepayment speeds, discount rates and the shape of the yield curve.

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 obligator, 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.

Recently Issued Accounting Pronouncements

In January 2010, the FASB issued guidance requiring increased fair value disclosures. There are two components to the increased disclosure requirements set forth in the update: (1) a description of, as well as the disclosure of, the dollar amount of transfers in or out of level one or level

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two; and (2) in the reconciliation for fair value measurements using significant unobservable inputs (level three), a reporting entity should present separately information about purchases, sales, issuances and settlements (that is, gross amounts shall be disclosed as opposed to a single net figure). Increased disclosures regarding the transfers in/out of level one and two are required for interim and annual periods beginning after December 15, 2009. The adoption of this portion of the standard did not have a material impact on the Company's consolidated financial position, results of operations or cash flows. Increased disclosures regarding the level three fair value reconciliation are required for fiscal years beginning after

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December 15, 2010. The adoption of this portion of the standard is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In April 2010, the FASB issued accounting guidance for loan modifications when the loan is part of a pool of loans accounted for as a single asset. Diversity in practice developed surrounding how to account for loans that are part of a pool subsequent to a modification that would constitute a troubled debt restructuring. To eliminate the diversity in practice, the new guidance requires loans that are accounted for as part of a pool to continue to be accounted for as part of the pool subsequent to a modification, even if the modification constitutes a troubled debt restructuring. Upon adoption of the update an entity may make a one time election to terminate accounting for loans in a pool, and the election may be applied on a pool by pool basis. This accounting treatment for the modification of loans accounted for as part of pools is effective for all interim and annual reporting periods beginning on or after July 15, 2010. As the Company does not currently have any pools of loans accounted for as a single asset, the adoption of this standard did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In July 2010, the FASB updated disclosure requirements with respect to the credit quality of loans and leases and the allowance for credit losses. According to the guidance there are two levels of detail at which credit information will be presented - the portfolio segment level and the class level. The portfolio segment level is the aggregated level used by the company in developing their systematic method for calculating the allowance for credit losses. The class level represents a more detailed level of categorization than the portfolio segment level. Companies will be required to provide the following new or amended disclosures as a result of this update:

1. A roll forward schedule of the allowance for credit losses from the beginning of the reporting period to the end of the reporting period on a portfolio segment basis, with the ending balance further disaggregated on the basis of the impairment method
2. For each disaggregated ending balance in item (1) above, the related recorded investment in loans and leases
3. The nonaccrual status of loans and leases by class
4. Impaired loans and leases by class
5. Credit quality indicators of loans and leases as of each balance sheet date, presented by class
6. The aging of past due loans and leases at the end of the reporting period by class
7. The nature and extent of troubled debt restructurings that occurred during the period by class and their effect on the allowance for credit losses
8. The nature and extent of loans and leases modified as troubled debt restructurings within the previous 12 months that defaulted during the period by class and their effect on the allowance for credit losses
9. Significant purchases and sales of loans and leases during the reporting period disaggregated by portfolio segment.

The increased disclosure requirements become effective for periods ending on or after December 15, 2010. The provisions of this update will expand our current disclosures with respect to the Allowance for Loan Losses.

NOTE 3 INVESTMENTS

The amortized costs and estimated fair values of investment securities as of September 30, 2010 and December 31, 2009 are as follows:

| (\$ in thousands) | September 30, 2010 | | | Estimated Fair Value |
|--|--------------------|------------------------------|-------------------------------|-------------------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | |
| Securities available-for-sale: | | | | |
| U.S. government agencies | \$ 6,871 | \$ 63 | \$ | \$ 6,934 |
| Corporate | 10,176 | 311 | (40) | 10,447 |
| State and municipal | 21,927 | 1,193 | (9) | 23,111 |
| Residential agency mortgage-backed securities (MBS) | 31,400 | 1,001 | (17) | 32,384 |
| Total securities available-for-sale | \$ 70,374 | \$ 2,568 | \$ (66) | \$ 72,876 |

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| (\$ in thousands) | December 31, 2009 | | | |
|--|-------------------|------------------------|-------------------------|----------------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Securities available-for-sale: | | | | |
| U.S. government agencies | \$ 5,176 | \$ 28 | \$ (35) | \$ 5,169 |
| Corporate | 9,822 | 306 | (5) | 10,123 |
| State and municipal | 22,101 | 395 | (295) | 22,201 |
| Residential agency MBS | 35,386 | 760 | (198) | 35,948 |
| Total securities available-for-sale | \$ 72,485 | \$ 1,489 | \$ (533) | \$ 73,441 |

The amortized cost and estimated fair value of debt securities by contractual maturity at September 30, 2010 and December 31, 2009 are shown below. Agency mortgage-backed securities are classified in accordance with their contractual lives. Expected maturities may differ from contractual maturities because borrowers may have the right to prepay obligations with or without call or prepay penalties. Additionally, accelerated principal payments are routinely received on agency mortgage-backed securities making it common for them to mature prior to the contractual maturity date.

| (\$ in thousands) | September 30, 2010 | | December 31, 2009 | |
|--|--------------------|----------------------|-------------------|----------------------|
| | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value |
| Securities available-for-sale | | | | |
| Due within one year | \$499 | \$507 | \$1,538 | \$1,560 |
| Due after one year through five years | 5,040 | 5,180 | 5,602 | 5,823 |
| Due after five years through ten years | 29,376 | 30,732 | 19,566 | 19,735 |
| Due after ten years | 35,459 | 36,457 | 45,779 | 46,323 |
| Total securities available-for-sale | \$70,374 | \$72,876 | \$72,485 | \$73,441 |

The following tables show the estimated fair value and gross unrealized losses, aggregated by investment category and length of time the individual securities have been in a continuous loss position as of September 30, 2010 and December 31, 2009.

| (\$ in thousands) | September 30, 2010 | | | September 30, 2010 | | | Total | | |
|-----------------------------------|---------------------|----------------------|-----------------|--------------------|-----------|-----------------|----------------------|-------------------|-----------------|
| | Less than 12 months | | # of Securities | 12 months or more | | # of Securities | Estimated Fair Value | Unrealized Losses | # of Securities |
| Estimated Fair Value | Unrealized Losses | Estimated Fair Value | | Unrealized Losses | | | | | |
| Description of securities: | | | | | | | | | |
| U.S. government agencies | \$ | \$ | | \$ | \$ | | \$ | \$ | |
| Corporate | 2,960 | (40) | 4 | | | | 2,960 | (40) | 4 |
| State and municipal | 1,725 | (9) | 3 | | | | 1,725 | (9) | 3 |
| Residential agency MBS | 2,943 | (17) | 3 | | | | 2,943 | (17) | 3 |
| Total temporarily-impaired | \$ 7,628 | \$ (66) | 10 | \$ | \$ | \$ | \$ 7,628 | \$ (66) | 10 |

| (\$ in thousands) | December 31, 2009 | | | December 31, 2009 | | | Total | | |
|----------------------|---------------------|----------------------|-----------------|-------------------|--|-----------------|----------------------|-------------------|-----------------|
| | Less than 12 months | | # of Securities | 12 months or more | | # of Securities | Estimated Fair Value | Unrealized Losses | # of Securities |
| Estimated Fair Value | Unrealized Losses | Estimated Fair Value | | Unrealized Losses | | | | | |

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| Description of securities: | | | | | | | | | | | | | | | |
|----------------------------|----|--------|----|-------|----|----|-----|------|-------|----|--------|--------|----|-------|----|
| U.S. government agencies | \$ | 3,726 | \$ | (35) | 7 | \$ | \$ | \$ | 3,726 | \$ | (35) | 7 | | | |
| Corporate | | 517 | | (5) | 1 | | | | 517 | | (5) | 1 | | | |
| State and municipal | | 7,768 | | (243) | 10 | | 945 | (52) | 3 | | 8,713 | (295) | 13 | | |
| Residential agency MBS | | 10,520 | | (198) | 21 | | | | | | 10,520 | (198) | 21 | | |
| Total temporarily-impaired | \$ | 22,531 | \$ | (481) | 39 | \$ | 945 | \$ | (52) | 3 | \$ | 23,476 | \$ | (533) | 42 |

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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, whether the Company has the intent to retain the security and 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. As of September 30, 2010, no securities were in a continuous unrealized loss position for 12 months or longer. The Company has the intent to hold the ten securities in an unrealized loss position as of September 30, 2010 and does not anticipate that these securities will be required to be sold before recovery of value, which may be upon maturity. Accordingly, as of September 30, 2010, no decline in value was deemed to be other than temporary. Similarly, management's evaluation of the three securities in a continuous unrealized loss position for 12 months or longer at December 31, 2009, determined these securities were not other than temporarily impaired.

The Company recorded a net unrealized gain in the investment portfolio of \$2.5 million at September 30, 2010. This was an increase over the \$956,000 unrealized gain at December 31, 2009.

In an effort to both capitalize on current market conditions, while funding our loan portfolio growth, as well as to liquidate some odd-lots within the investment portfolio, the Company sold securities for gross realized gains of \$885,000 and gross realized losses of \$22,000 during the first nine months of 2010. The Company sold securities for gross realized gains of \$332,000 during the third quarter 2010. The Company sold securities for gross realized gains of \$213,000 and gross realized losses of \$8,000 during the first nine months of 2009. The Company sold securities for gross realized gains of \$101,000 and gross realized losses of \$3,000 during the third quarter 2009. Realized gains and losses on sales are computed on a specific identification basis based on amortized cost on the date of sale.

Securities with carrying values of \$17.5 million at September 30, 2010 and \$16.9 million at December 31, 2009, were pledged as collateral to secure public deposits, borrowings from the FHLB, repurchase agreements and for other purposes as required or permitted by law.

NOTE 4 LOANS

The composition of the loan portfolio follows:

| (\$ in thousands) | September 30, 2010 | December 31, 2009 |
|-----------------------------------|--|-------------------|
| Real estate commercial | \$ 39,347 | \$ 26,063 |
| Real estate residential | 8,054 | 8,059 |
| Construction and land development | 2,007 | 7,067 |
| Commercial and industrial | 8,954 | 8,324 |
| Lease financing | 1,452 | |
| Consumer | 564 | 991 |
| Gross loans | 60,378 | 50,504 |
| | Deferred loan (fees) / expenses, net Allowance for | |
| Less: | loan losses | (85) |
| | Allowance for loan losses | (114) |
| Loans, net | \$ 59,093 | \$ 49,560 |

As of September 30, 2010, the Bank had two nonaccrual loans totaling \$650,000 after partial charge-offs of \$520,000 taken during the third quarter. Also during the third quarter, the Bank had one loan that was transferred to Other Real Estate Owned (OREO) property and sold for a

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gain of approximately \$10,000. The Bank had \$0 in OREO properties as of September 30, 2010. There were no loans past due more than 90 days and still accruing interest as of the end of the third quarter 2010. During all of 2009, no loans were impaired, no loans were transferred to foreclosed properties and one loan, with a principal balance of approximately \$3,000, was past due more than 90 days but still accruing interest.

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.

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There were approximately \$2.1 million and \$2.6 million in loans receivable from related parties at September 30, 2010 and December 31, 2009, respectively.

NOTE 5 ALLOWANCE FOR LOAN LOSSES

Activity in the allowance for loan losses for the three and nine months ended September 30, 2010 and 2009 is summarized as follows:

| (\$ in thousands) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|--------|------------------------------------|--------|
| | 2010 | 2009 | 2010 | 2009 |
| Balance, beginning of period | \$ 940 | \$ 520 | \$ 830 | \$ 268 |
| Loans charged off | (520) | | (705) | |
| Recoveries on loans previously charged off | | | | |
| Provision for loan losses | 780 | 180 | 1,075 | 432 |
| Balance, end of period | \$ 1,200 | \$ 700 | \$ 1,200 | \$ 700 |

The following table details information regarding impaired loans at the dates indicated:

| (\$ in thousands) | September 30, 2010 | December 31, 2009 |
|---|-----------------------|----------------------|
| Impaired loans with a valuation allowance: | \$ | \$ |
| Impaired loans without a valuation allowance: | | 749 |
| Total impaired loans | \$ 749 | \$ |
| Valuation allowance related to impaired loans | \$ | \$ |

Two of the three impaired loans did not have a specific valuation allowance, as the loans were partially charged-off during the third quarter 2010, bringing them to their net realizable value. The other impaired loan is considered impaired because it is a troubled debt restructuring; however, the loan is performing in accordance with its new contractual terms and has an abundance of collateral and, therefore, does not have a specific valuation allowance. Interest income recognized while these loans have been classified as impaired was approximately \$2,000. The gross interest income that would have been recorded for the nine months ended September 30, 2010 if all impaired loans had been current throughout this period in accordance with their original terms was approximately \$16,000.

Troubled debt restructurings are included in impaired loans above. At September 30, 2010, there was one loan for \$99,000 with terms that were modified in a troubled debt restructuring, with no specific allowance for loan losses because the loan is well collateralized. The Company has not committed additional funds to the borrower whose loan is classified as a troubled debt restructuring. There were no troubled debt restructurings at December 31, 2009.

NOTE 6 DEPOSITS

Deposits are summarized as follows:

| (\$ in thousands) | September 30, 2010 | | December 31, 2009 | |
|---|--------------------|------------|-------------------|------------|
| | Amount | % of Total | Amount | % of Total |
| Noninterest-bearing demand | \$ 1,894 | 2% | \$ 2,624 | 2% |
| Interest-bearing demand | 11,224 | 10 | 6,830 | 7 |
| Money market accounts | 7,640 | 7 | 3,555 | 3 |
| Savings accounts | 45,895 | 42 | 51,763 | 50 |
| Certificates of deposit, less than \$100,000 | 10,212 | 10 | 16,624 | 16 |
| Certificates of deposit, greater than \$100,000 | 31,496 | 29 | 23,005 | 22 |
| Total deposits | \$ 108,361 | 100% | \$ 104,401 | 100% |

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In the ordinary course of business, certain officers, directors, 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 September 30, 2010 and December 31, 2009 was approximately \$4.4 million and \$4.0 million, respectively.

NOTE 7 STOCK-BASED COMPENSATION

The Company's 2007 Stock Incentive Plan (the "Plan") was approved by the Company's Board of Directors (the "Board") with an effective date of September 10, 2007 and was approved by the Company's stockholders at the annual meeting held on September 17, 2008. Under the terms of the Plan, officers and key employees may be granted both nonqualified and incentive stock options and directors and other consultants, who are not also officers or employees, may only be granted nonqualified stock options. The Board reserved 510,734 shares of common stock for issuance under the Plan. The 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 Plan provides for accelerated vesting if there is a change of control, as defined in the Plan. The Company recognized stock-based compensation cost of approximately \$148,000 and \$156,000 during the nine months ended September 30, 2010 and 2009, respectively. During the third quarter 2010, the Company revised its estimated forfeiture rate on the nonqualified stock options granted to Directors in September 2007 to decrease the rate from 33% to 10%, which more accurately reflects the turnover rate of our Directors. This resulted in approximately \$7,000 of additional stock-based compensation expense during the third quarter 2010.

The Company accounts for its stock-based compensation under the provisions of ASC 718-20 *Stock Compensation Awards Classified as Equity*. The fair value of each option grant is estimated on the date of grant using the Black-Scholes-Merton option pricing model. The Company granted 10,000 options during the third quarter 2010 as incentive compensation to an executive officer and 45,000 nonqualified options to directors. The director options vest over one year, expire ten years from the date of grant and directors have one year to exercise vested options upon termination. The Company granted 1,250 options during the second quarter 2010 as incentive compensation to newly hired employees and 16,500 options during the first quarter 2010 as incentive compensation to existing and newly hired employees. Similarly, the Company granted 42,000 options as incentive compensation primarily to the President & CEO and also to newly hired employees during the third quarter of 2009.

During the nine months ended September 30, 2010, 5,688 options were forfeited and 5,125 vested options expired unexercised. No options were exercised during the nine months ended September 30, 2010 or 2009. The Company recognized expense for approximately 20,000 options, representing a pro-rata amount of the options earned during the third quarter 2010 that are expected to vest. As of September 30, 2010, there was approximately \$272,000 of total unrecognized compensation cost related to the outstanding stock options that will be recognized over a weighted-average period of 1.3 years.

The following is a summary of the Company's outstanding stock options at September 30, 2010:

| | Options | Weighted-Average Grant Date Fair Value | Weighted- Average Exercise Price |
|--------------------------------|---------|---|--|
| Outstanding at January 1, 2010 | 305,353 | \$ 2.44 | \$ 9.19 |
| Granted | 72,750 | 0.79 | 4.67 |
| Exercised | | | |

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| | | | |
|-----------------------------------|------------|---------|------|
| Forfeited | (5,688) | 1.77 | 7.52 |
| Expired | (5,125) | 2.46 | 9.39 |
| Outstanding at September 30, 2010 | 367,290 \$ | 2.12 \$ | 8.32 |

NOTE 8 WARRANTS

During our initial public offering, each of the Company's initial stockholders were granted one warrant to purchase an additional share, at an exercise price of \$12.50 per share, for every five shares purchased. All of these stockholder warrants expired unexercised on September 10, 2010.

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

| (\$ in thousands) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-----------------------------------|-------------------------------------|---------------|------------------------------------|---------------|
| | 2010 | 2009 | 2010 | 2009 |
| Data processing | \$ 80 | \$ 70 | \$ 211 | \$ 200 |
| FDIC assessment | 52 | 45 | 147 | 125 |
| Regulatory and reporting fees | 26 | 22 | 90 | 75 |
| Marketing and promotions | 38 | 34 | 80 | 90 |
| Travel and entertainment | 18 | 16 | 39 | 33 |
| Telephone/communication | 10 | 10 | 31 | 30 |
| Loan and collection expenses | 14 | 1 | 24 | 3 |
| Printing, stationery and supplies | 7 | 11 | 24 | 31 |
| Dues and memberships | 7 | 7 | 24 | 23 |
| Directors fees | 20 | | 23 | |
| Insurance | 6 | 5 | 17 | 14 |
| Franchise taxes | 3 | 2 | 14 | 7 |
| Postage and shipping | 5 | 5 | 13 | 16 |
| ATM and debit card fees | 4 | 3 | 12 | 11 |
| Training and education | 2 | 1 | 6 | 9 |
| Miscellaneous | 5 | 4 | 18 | 13 |
| Total | \$ 297 | \$ 236 | \$ 773 | \$ 680 |

NOTE 10 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 September 30, 2010 and December 31, 2009, the following financial instruments were outstanding whose contract amounts represent credit risk:

| (\$ in thousands) | September 30, 2010 | December 31, 2009 |
|--|--------------------|-------------------|
| Financial instruments whose contractual amounts represent credit risk: | | |
| Commitments to extend credit | \$ 7,212 | \$ 7,182 |
| Letters of credit | | |
| Total commitments | \$ 7,212 | \$ 7,182 |

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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 obtained is based on management's credit evaluation. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment and income producing commercial properties.

Letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

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NOTE 11 FAIR VALUE

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 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 September 30, 2010 and December 31, 2009, all of the Company's available-for-sale securities were valued using Level 2 inputs.

Impaired loans are valued at the lower of cost or fair value and are generally classified as Level 3 in the fair value hierarchy. Fair value is measured based on the value of the collateral securing the loan or discounting estimated future cash flows. Collateral is valued based on appraisals performed by qualified licensed appraisers. Such appraisal values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation and/or similar factors. Impaired loans that are not secured by collateral are valued by using the discounted estimated future cash flows at the loans' effective interest rate. The cash flow estimates are made by management using historical knowledge, market conditions, and knowledge of the borrower's business, among other factors.

Table of Contents*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 September 30, 2010 | | | | |
| Investment securities, available-for-sale: | | | | |
| U.S. government agencies | \$ | \$ 6,934 | \$ | \$ 6,934 |
| Corporate | | 10,447 | | 10,447 |
| State and municipal | | 23,111 | | 23,111 |
| Agency MBS | | 32,384 | | 32,384 |
| Total | \$ | \$ 72,876 | \$ | \$ 72,876 |
| Assets at December 31, 2009 | | | | |
| Investment securities, available-for-sale: | | | | |
| U.S. government agencies | \$ | \$ 5,169 | \$ | \$ 5,169 |
| Corporate | | 10,123 | | 10,123 |
| State and municipal | | 22,201 | | 22,201 |
| Agency MBS | | 35,948 | | 35,948 |
| Total | \$ | \$ 73,441 | \$ | \$ 73,441 |

There were no transfers in or out of Level 1 and Level 2 during the periods presented.

Assets and Liabilities Measured on a Nonrecurring Basis

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 September 30, 2010 | | | | |
| Impaired loans | \$ | \$ | \$ 749 | \$ 749 |
| Assets at December 31, 2009 | | | | |
| Impaired loans | \$ | \$ | \$ | \$ |

Fair Value of Financial Instruments

Disclosure of fair value information about financial instruments, whether or not recognized in the consolidated balance sheets, for which it is practicable to estimate that value is required. 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 the 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.

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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: The carrying amount of interest-bearing deposits with banks approximates fair values due to the relatively stable level of short-term interest rates.

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.

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.

Investment in FHLB and Federal Reserve Bank (FRB) 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 FRB stock.

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 utilizes 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.

Federal funds purchased and securities sold under agreements to repurchase: The carrying amount of federal funds purchased and 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.

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Capital lease liability: Management did not fair value the capital lease liability as it is specifically excluded from the disclosure requirements.

Federal Home Loan Bank advances: Fair value of the Federal Home Loan Bank advances is estimated using a discounted cash flow model that utilizes current market rates for similar types of borrowing arrangements with similar remaining maturities.

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

| (\$ in thousands) | September 30, 2010 | | December 31, 2009 | |
|--|--------------------|----------------------|-------------------|----------------------|
| | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| Financial Assets: | | | | |
| Cash and cash equivalents | \$ 698 | \$ 698 | \$ 2,516 | \$ 2,516 |
| Interest-bearing deposits with banks | 266 | 266 | 3,784 | 3,784 |
| Investment securities | 72,876 | 72,876 | 73,441 | 73,441 |
| Loans, net | 59,093 | 59,052 | 49,560 | 49,230 |
| FHLB and FRB stocks | 1,165 | 1,165 | 1,131 | 1,131 |
| Interest receivable | 749 | 749 | 814 | 814 |
| Financial Liabilities: | | | | |
| Deposits, demand, savings and money market | \$ 66,653 | \$ 66,653 | \$ 64,772 | \$ 64,772 |
| Time deposits | 41,708 | 42,180 | 39,629 | 39,036 |
| Federal funds purchased and securities sold under agreements to repurchase | 1,085 | 1,085 | 326 | 326 |
| Federal Home Loan Bank advances | 6,000 | 5,928 | 8,750 | 8,508 |
| Interest payable | 99 | 99 | 82 | 82 |

NOTE 12 PENDING TRANSACTION

On August 5, 2010, the Bank entered into a purchase and assumption agreement with Liberty Savings Bank, FSB (Liberty), a wholly-owned subsidiary of Liberty Capital, Inc. to assume approximately \$40 million in customer deposits from Liberty's branch located in Lakewood, Colorado. Additionally, the Bank agreed to acquire approximately \$30 million in Colorado-based, performing loans. The transaction is expected to close in the fourth quarter 2010 conditioned upon receiving approval from the appropriate bank regulatory agencies. The Bank will pay a 3.8% premium for deposits and will acquire the loans at par value.

The Bank expects to account for this as a purchase of assets in accordance with ASC 805-50, *Acquisition of Assets Rather than a Business*. The assets purchased and liabilities assumed will be recognized at cost plus allocated transaction costs, which will be allocated based on the relative fair values of the assets acquired and liabilities assumed. Since the Bank is assuming \$10 million more deposits than loans, the Company will have a net increase in cash rather than a cash outflow.

NOTE 13 SUBSEQUENT EVENTS

As of the date of issuance of this Report on Form 10-Q, the Company has determined that no subsequent event disclosure is necessary.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis presents the Company's consolidated financial condition as of September 30, 2010 and results of operations for the three and nine months ended September 30, 2010 and 2009. The discussion should be read in conjunction with the financial statements and the notes related thereto which appear elsewhere in this Quarterly Report on Form 10-Q.

Executive Overview

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

Earnings are derived primarily from our net interest income, which is interest income less interest expense, and our noninterest income earned from gains on investment securities and banking service fees, offset by noninterest expense. As the majority of our assets are interest-earning and our liabilities are interest-bearing, changes in interest rates impact our net interest margin. We manage our interest-earning assets and interest-bearing liabilities to reduce the impact of interest rate changes on our operating results.

We offer a broad range of commercial and consumer banking services to small and medium-sized businesses, licensed professionals and individuals who are particularly responsive to the personalized service that Solera National Bank provides to its customers. We believe that local ownership and control allows the Bank to serve customers efficiently and effectively. Solera National Bank competes on the basis of providing a unique and personalized banking experience combined with a full range of services, customized and tailored to fit the individual needs of its clients. Solera National Bank serves the entire market area and, in addition, has a special focus serving the local Hispanic population due to the significant growth of this demographic. Since opening the bank in September of 2007, management has successfully executed its strategy of delivering prudent and controlled growth to efficiently leverage the Company's capital and expense base with the goal of achieving sustained profitability.

During the third quarter, the Bank entered into a definitive purchase and assumption agreement (the Agreement) with Liberty Savings Bank, FSB (Liberty) to assume approximately \$40 million in customer deposits from Liberty's branch located in Lakewood, Colorado. Additionally, the Bank agreed to acquire approximately \$30 million in Colorado-based, performing loans from Liberty. Pursuant to the Agreement, the Bank will pay a deposit premium of 3.8% and will acquire the loans at par value. For further disclosure, see Note 13, *Pending Transaction*, to our consolidated financial statements.

Dodd-Frank Wall Street Reform and Consumer Protection Act

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act, (the Act), was signed into legislation. The Act includes, among others, the creation of a new Consumer Financial Protection Bureau with power to promulgate and enforce consumer protection laws; the

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creation of a Financial Stability Oversight Council with authority to identify institutions and practices that might pose a systemic risk; provisions affecting corporate governance and executive compensation of all companies whose securities are registered with the SEC; a provision that would broaden the base for FDIC insurance assessments; a provision under which interchange fees for debit cards would be set by the Federal Reserve; a provision that would require bank regulators to set minimum capital levels for bank holding companies that are as strong as those required for their insured depository subsidiaries; and new restrictions on how mortgage brokers and loan originators may be compensated. Certain provisions of the Act only apply to institutions with more than \$10 billion in assets.

We are monitoring developments as the various agencies draft regulations required by the Act. We expect that some provisions of the Act may have an adverse impact due to, among others, the cost of complying with the numerous new regulations and reporting requirements mandated by the Act. Some provisions of the Act will benefit our

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business, such as the permanent exemption from Sarbanes-Oxley Section 404(b) for companies with market capitalization of less than \$75 million, which should maintain our external audit fees at current levels as our external auditors will not be required to provide an attestation report on our internal control over financial reporting in our annual report on Form 10-K.

Comparative Results of Operations for the Three Months Ended September 30, 2010 and 2009

The following discussion focuses on the Company's financial condition and results of operations for the three months ended September 30, 2010 compared to the financial condition and results of operations for the three months ended September 30, 2009.

Net loss for the quarter ended September 30, 2010 was \$493,000, or (\$0.19) per share, compared with a loss of \$261,000, or (\$0.10) per share for the third quarter of 2009. The increased loss during the third quarter 2010 was primarily the result of a \$600,000 increase in provision expense partially offset by increases in net interest income and increased gains on the sale of investment securities.

As of September 30, 2010, the Company had total assets of \$136.2 million, an increase of \$3.4 million, or 3%, from December 31, 2009. Net loans increased \$9.5 million, or 19%, from \$49.6 million at December 31, 2009 to \$59.1 million at September 30, 2010. Similarly, the Company's total deposits grew \$4.0 million, or 4%, from \$104.4 million at December 31, 2009 to \$108.4 million as of September 30, 2010. This growth was achieved as a result of an effective business development program.

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The following table presents, for the periods indicated, average assets, liabilities and stockholders equity, as well as the net interest income from average interest-earning assets and the resultant annualized yields expressed in percentages.

Table 1

| (\$ in thousands) | Three Months Ended September 30, 2010 | | | Three Months Ended September 30, 2009 | | |
|--|--|----------|----------------|--|----------|----------------|
| | Average Balance | Interest | Yield/ Cost | Average Balance | Interest | Yield/ Cost |
| Assets: | | | | | | |
| Interest-earning assets: | | | | | | |
| Gross loans, net of unearned fees | \$ 60,632 | \$ 901 | 5.89% | \$ 43,485 | \$ 598 | 5.46% |
| Investment securities** | 70,747 | 713 | 4.00 | 58,203 | 752 | 5.13 |
| FHLB and FRB stocks | 1,150 | 10 | 3.41 | 1,081 | 11 | 4.00 |
| Federal funds sold | 908 | | | 2,885 | 2 | 0.25 |
| Interest-bearing deposits with banks | 787 | 1 | 0.58 | 441 | | |
| Total interest-earning assets | 134,224 | \$ 1,625 | 4.81% | 106,095 | \$ 1,363 | 5.10% |
| Noninterest-earning assets | 4,589 | | | 3,170 | | |
| Total assets | \$ 138,813 | | | \$ 109,265 | | |
| Liabilities and Stockholders | | | | | | |
| Equity: | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Money market and savings deposits | \$ 54,625 | \$ 203 | 1.48% | \$ 25,441 | \$ 172 | 2.68% |
| Interest-bearing checking accounts | 11,197 | 43 | 1.51 | 6,302 | 40 | 2.55 |
| Time deposits | 43,865 | 220 | 1.99 | 45,092 | 305 | 2.68 |
| Federal funds purchased and securities sold under agreements to repurchase | 646 | 2 | 1.25 | 610 | 2 | 1.48 |
| Federal Home Loan Bank advances | 5,645 | 58 | 4.09 | 8,120 | 78 | 3.81 |
| Other borrowings | 93 | 2 | 9.31 | 134 | 3 | 9.26 |
| Total interest-bearing liabilities | 116,071 | \$ 528 | 1.81% | 85,699 | \$ 600 | 2.78% |
| Noninterest-bearing checking accounts | 1,801 | | | 4,353 | | |
| Noninterest-bearing liabilities | 537 | | | 531 | | |
| Stockholders equity | 20,404 | | | 18,682 | | |
| Total liabilities and stockholders equity | \$ 138,813 | | | \$ 109,265 | | |
| Net interest income | | \$ 1,097 | | | \$ 763 | |
| Net interest spread | | 3.00% | | | 2.32% | |
| Net interest margin | | 3.24% | | | 2.85% | |

**Yields on investment securities have not been adjusted to a tax-equivalent basis.

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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.

Table 2

| (\$ in thousands) | Three Months Ended September 30, 2010 Compared to Three Months Ended September 30, 2009 | | |
|--|--|-------------------|-----------------|
| | Net Change | Rate | Volume |
| Interest income: | | | |
| Gross loans, net of unearned fees | \$ 303 | \$ 51 | \$ 252 |
| Investment securities | (39) | (2,144) | 2,105 |
| FHLB and FRB stocks | (1) | (2) | 1 |
| Federal funds sold | (2) | (2) | |
| Interest-bearing deposits with banks | 1 | | 1 |
| Total interest income | \$ 262 | \$ (2,097) | \$ 2,359 |
| Interest expense: | | | |
| Money market and savings deposits | \$ 31 | \$ (20) | \$ 51 |
| Interest-bearing checking accounts | 3 | (2) | 5 |
| Time deposits | (85) | (76) | (9) |
| Federal funds purchased and securities sold under agreements to repurchase | | (1) | 1 |
| Federal Home Loan Bank advances | (20) | 6 | (26) |
| Other borrowings | (1) | | (1) |
| Total interest expense | \$ (72) | \$ (93) | \$ 21 |
| Net interest income | \$ 334 | \$ (2,004) | \$ 2,338 |

Net Interest Income and Net Interest Margin

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

The Federal Reserve Board influences the general market rates of short-term interest, including the deposit and loan rates offered by the Bank. The Bank's loan portfolio is significantly affected by changes in the prime interest rate. The prime interest rate, which is the rate offered on loans to borrowers with strong credit, has remained unchanged throughout 2009 and thus far in 2010 at 3.25%. Rates on our loan portfolio have increased slightly, up 43 basis points over the third quarter 2009, primarily due to a shift in the loan mix to more fixed-rate loans at higher interest rates.

The 113 basis points decrease in the Bank's investment portfolio compared to the third quarter of 2009 is primarily due to the sale of longer-maturity, higher-yielding investments which were reinvested in shorter-term, lower-yielding bonds to help shorten the duration of the investment portfolio.

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The impact of the 29 basis point decrease in the Company's yield on interest-earning assets was more than offset by decreases in the cost of interest-bearing liabilities, resulting in a 39 basis point increase in net interest margin year-over-year. As reflected in Table 1, the cost of money market and savings deposits decreased 120 basis points, the cost of interest-bearing checking decreased 104 basis points and the cost of time deposits decreased 69 basis points year-over-year, primarily due to eliminating the promotional rates that were offered during our first two years of business and the general decline in the level of interest rates compared to the prior year.

The Company's balance sheet is marginally asset sensitive, meaning that interest-earning assets generally reprice quicker than interest-bearing liabilities. Therefore, the Company could experience expansion in its net interest margin during periods of rising interest rates.

Total interest income was \$1.6 million for the third quarter 2010, consisting primarily of interest on loans of \$901,000 and interest on investment securities of \$713,000. This compared to total interest income of \$1.4 million for the same period of 2009, consisting primarily of interest on investment securities of \$752,000 and interest on loans of \$598,000. Average loans, net of unearned fees, increased \$17.1 million, from \$43.5 million for the three months ended September 30, 2009 to \$60.6 million for the three months ended September 30, 2010. Average investment securities increased \$12.5 million from \$58.2 million for the three months ended September 30, 2009 to \$70.7 million for the three months ended September 30, 2010. These increases were funded with increased average deposits which grew \$32.9 million from \$76.8 million for the three months ended September 30, 2009 to \$109.7 million for the three months ended September 30, 2010. Additionally, the growth in deposits enabled the Company to reduce its reliance on FHLB advances which decreased, on average, \$2.5 million year-over-year.

Total interest expense was \$528,000 in the third quarter of 2010, a decrease of \$72,000 from \$600,000 during the third quarter of 2009. As evident in Table 2 above, this cost savings was attributable to decreases in rate as volume increased significantly in all deposit categories except time deposits which only decreased marginally, 3%, year-over-year. Overall, the interest rate on total interest-bearing liabilities decreased 97 basis points from 2.78% at September 30, 2009 to 1.81% at September 30, 2010.

Net interest income was \$1.1 million in the third quarter 2010, an increase of \$334,000, or 44%, from \$763,000 in the third quarter of 2009. Our annualized net interest margin was 3.24% for the three months ended September 30, 2010, a 39 basis point improvement over the 2.85% net interest margin for the three months ended September 30, 2009.

Provision for Loan Losses

We determine a provision for loan losses that we consider sufficient to maintain an allowance to absorb probable losses inherent in our portfolio as of the balance sheet date. For additional information concerning this determination, see the section of this discussion and analysis captioned *Allowance for Loan Losses*.

During the third quarter of 2010, our provision for loan losses was \$780,000 reflecting the growth of our loan portfolio and the estimated probable losses inherent within the portfolio due to uncertainties in economic conditions. There were three impaired loans at September 30, 2010, two of which were written down to their estimated net realizable value during the third quarter, resulting in a charge-off of \$520,000 (see additional discussion below under *Financial Condition - Loan Portfolio*).

Noninterest Income

Noninterest income for the quarter ended September 30, 2010 was \$377,000, an increase of \$199,000 from \$178,000 for the third quarter ended September 30, 2009. The Company sold securities for net gains of \$332,000 during the third quarter 2010 compared to net gains of \$98,000 during the third quarter of 2009. Service charges on deposits decreased \$61,000 from \$80,000 during the third quarter 2009 to \$19,000 during the third quarter 2010 due to the loss of a significant money-services-business customer in October 2009. Other income increased to \$16,000 during the third quarter 2010 primarily due to the Bank's new residential mortgage lending partnership. Additionally, during the third quarter of 2010 the Bank had a gain on sale of other real estate owned which generated \$10,000 of noninterest income during the quarter.

Table of Contents**Noninterest Expense**

Our total noninterest expense for the quarter ended September 30, 2010 was \$1.2 million, an increase of \$165,000 from the quarter ended September 30, 2009. This consisted of an increase in salaries and employee benefits of \$28,000, or 5%, primarily related to increased incentive compensation expense during the third quarter 2010. Occupancy expense remained constant quarter-over-quarter decreasing only \$5,000 during the third quarter 2010. Professional fees increased \$81,000, or 153%, quarter-over-quarter, primarily due to the timing of outsourced internal audit reviews, which were conducted during the third quarter this year and during the second quarter last year as well as the timing of interim testing by our external auditors which was accelerated to the third quarter 2010, versus the fourth quarter last year, as well as increased Compliance and Bank Secrecy Act consulting costs.

Other general and administrative expenses increased \$61,000, or 26%, quarter-over-quarter, as detailed in the following table:

| (\$ in thousands) | Three Months Ended | | | Increase/ (Decrease) | | |
|---|--------------------|---------------|-----------|-------------------------|-----------|-----------|
| | 2010 | September 30, | 2009 | | | |
| Other general and administrative expenses: | | | | | | |
| Data processing | \$ | 80 | \$ | 70 | \$ | 10 |
| FDIC assessment | | 52 | | 45 | | 7 |
| Regulatory and reporting fees | | 26 | | 22 | | 4 |
| Marketing and promotions | | 38 | | 34 | | 4 |
| Travel and entertainment | | 18 | | 16 | | 2 |
| Telephone/communication | | 10 | | 10 | | |
| Loan and collection expenses | | 14 | | 1 | | 13 |
| Printing, stationery and supplies | | 7 | | 11 | | (4) |
| Dues and memberships | | 7 | | 7 | | |
| Directors fees | | 20 | | | | 20 |
| Insurance | | 6 | | 5 | | 1 |
| Franchise taxes | | 3 | | 2 | | 1 |
| Postage and shipping | | 5 | | 5 | | |
| ATM and debit card fees | | 4 | | 3 | | 1 |
| Training and education | | 2 | | 1 | | 1 |
| Miscellaneous | | 5 | | 4 | | 1 |
| Total | \$ | 297 | \$ | 236 | \$ | 61 |

The most significant changes include an increase of \$20,000 in directors fees as the Company began compensating directors for their attendance at meetings in July 2010; an increase of \$13,000 in loan and collection expenses related to two new loan products that were added to the Bank in late 2009/early 2010 that are outsourced to third parties who collect transaction-based fees; a \$10,000 increase in data processing due to overall increases in customer and account activity; and a \$7,000 increase in Federal Deposit Insurance Corporation (FDIC) fees due to increases in average deposit volumes.

Comparative Results of Operations for the Nine Months Ended September 30, 2010 and 2009

The following discussion focuses on the Company's financial condition and results of operations for the nine months ended September 30, 2010 compared to the financial condition and results of operations for the nine months ended September 30, 2009. The Company's principal

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operations for each of these periods consisted of the operations of Solera National Bank, which opened for business September 10, 2007.

Net loss for the nine months ended September 30, 2010 was \$282,000, or (\$0.11) per share compared with a net loss \$1.3 million, or (\$0.50) per share for the nine months ended September 30, 2009. The improved results of the nine months ended September 30, 2010 were primarily the result of increases in net interest income combined with increased gains on the sale of investment securities while holding noninterest expenses relatively flat.

The following table presents, for the periods indicated, average assets, liabilities and stockholders' equity, as well as the net interest income from average interest-earning assets and the resultant annualized yields expressed in percentages.

Table of Contents**Table 3**

| (\$ in thousands) | Nine Months Ended September 30, 2010 | | | Nine Months Ended September 30, 2009 | | |
|--|---|----------|-----------------|---|----------|-----------------|
| | Average Balance | Interest | Yield / Cost | Average Balance | Interest | Yield / Cost |
| Assets: | | | | | | |
| Interest-earning assets: | | | | | | |
| Gross loans, net of unearned fees | \$ 57,243 | \$ 2,503 | 5.85% | \$ 34,095 | \$ 1,380 | 5.41% |
| Investment securities** | 72,462 | 2,261 | 4.17 | 52,623 | 2,000 | 5.08 |
| FHLB and FRB stocks | 1,131 | 32 | 3.78 | 1,073 | 31 | 3.82 |
| Federal funds sold | 1,358 | 2 | 0.21 | 1,526 | 3 | 0.25 |
| Interest-bearing deposits with banks | 1,295 | 7 | 0.76 | 149 | 1 | 0.65 |
| Total interest-earning assets | 133,489 | \$ 4,805 | 4.81% | 89,466 | \$ 3,415 | 5.10% |
| Noninterest-earning assets | 4,022 | | | 1,862 | | |
| Total assets | \$ 137,511 | | | \$ 91,328 | | |
| Liabilities and Stockholders | | | | | | |
| Equity: | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Money market and savings deposits | \$ 56,513 | \$ 692 | 1.66% | \$ 13,986 | \$ 271 | 2.59% |
| Interest-bearing checking accounts | 8,413 | 101 | 1.61 | 4,593 | 73 | 2.13 |
| Time deposits | 42,863 | 683 | 2.13 | 39,167 | 836 | 2.85 |
| Federal funds purchased and securities sold under agreements to repurchase | 496 | 5 | 1.35 | 1,181 | 10 | 1.11 |
| Federal Home Loan Bank advances | 6,973 | 202 | 3.87 | 9,467 | 256 | 3.62 |
| Other borrowings | 103 | 7 | 9.43 | 143 | 10 | 9.39 |
| Total interest-bearing liabilities | 115,361 | \$ 1,690 | 1.96% | 68,537 | \$ 1,456 | 2.84% |
| Noninterest-bearing checking accounts | 2,001 | | | 3,546 | | |
| Noninterest-bearing liabilities | 448 | | | 466 | | |
| Stockholders equity | 19,701 | | | 18,779 | | |
| Total liabilities and stockholders equity | \$ 137,511 | | | \$ 91,328 | | |
| Net interest income | | \$ 3,115 | | | \$ 1,959 | |
| Net interest spread | | 2.85% | | | 2.26% | |
| Net interest margin | | 3.12% | | | 2.93% | |

** Yields on investment securities have not been adjusted to a tax-equivalent basis.

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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.

Table 4

| (\$ in thousands) | Nine Months Ended September 30, 2010 Compared to Nine Months Ended September 30, 2009 | | |
|--|--|---------------|---------------|
| | Net Change | Rate | Volume |
| Interest income: | | | |
| Gross loans, net of unearned fees | \$ 1,123 | \$ 118 | \$ 1,005 |
| Investment securities | 261 | (236) | 497 |
| FHLB and FRB stocks | 1 | | 1 |
| Federal funds sold | (1) | (1) | |
| Interest-bearing deposits with banks | 6 | | 6 |
| Total interest income | \$ 1,390 | \$ (119) | \$ 1,509 |
| Interest expense: | | | |
| Money market and savings deposits | \$ 421 | \$ (58) | \$ 479 |
| Interest-bearing checking accounts | 28 | (11) | 39 |
| Time deposits | (153) | (244) | 91 |
| Federal funds purchased and securities sold under agreements to repurchase | (5) | 3 | (8) |
| Federal Home Loan Bank advances | (54) | 19 | (73) |
| Other borrowings | (3) | | (3) |
| Total interest expense | \$ 234 | \$ (291) | \$ 525 |
| Net interest income | \$ 1,156 | \$ 172 | \$ 984 |

Net Interest Income and Net Interest Margin

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

The Federal Reserve Board influences the general market rates of short-term interest, including the deposit and loan rates offered by the Bank. The Bank's loan portfolio is significantly affected by changes in the prime interest rate. The prime interest rate has remained at 3.25% since December 2008 and, thus, has had no impact on the change in loan yields during this time period.

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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.

The Company's net interest margin increased slightly, up 19 basis points, from 2.93% at September 30, 2009 to 3.12% at September 30, 2010. Overall, the Bank has recorded a lower yield on interest-earning assets of 29 basis points from 5.10% for the nine months ended September 30, 2009 to 4.81% for the nine months ended September 30, 2010. This decline is primarily due to a decrease in the Bank's yield on its investment securities which

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decreased 91 basis points during this time period. This decrease is primarily due to the sale of longer-maturity, higher-yielding investments which were reinvested in shorter-term, lower-yielding bonds to shorten the duration of the investment portfolio. Also contributing to the decrease was the action taken by Fannie Mae and the Federal Home Loan Mortgage Corporation to repurchase delinquent mortgages during the first and second quarters of 2010. This resulted in higher than normal pay downs on our agency mortgage-backed securities causing an increase in premium amortization on those securities which adversely impacted the portfolio's yield. The loss in yield on the investment portfolio was partially offset by an increase in the loan yield, which increased 44 basis points year-over-year. This increase was primarily due to a shift in the loan mix to more fixed-rate loans at higher interest rates.

The decrease in the cost of interest-bearing liabilities was more than sufficient to offset the loss of yield on interest-earning assets, which enabled the Bank's overall net interest margin to increase slightly. The cost of all deposit accounts decreased as the Bank eliminated the promotional rates that were offered during the first two years in business along with the general decline in the level of interest rates compared to the prior year. This combined with decreased volumes in FHLB advances enabled the Bank to reduce the cost of interest-bearing liabilities by 88 basis points during the nine months ended September 30, 2010 as compared to the same period of 2009.

The Company's balance sheet is currently marginally asset sensitive, meaning that interest-earning assets generally reprice more quickly than interest-bearing assets. Therefore, the Company could experience gains in its net interest margin during periods of rising short-term interest rates.

Total interest income was \$4.8 million for the nine months ended September 30, 2010, consisting primarily of interest on loans of \$2.5 million and interest on investment securities of \$2.3 million. This compared to total interest income of \$3.4 million during the nine months ended September 30, 2009, consisting primarily of interest on investment securities of \$2.0 million and interest on loans of \$1.4 million. Average gross loans, net of unearned fees, increased \$23.1 million, from \$34.1 million for the nine months ended September 30, 2009 to \$57.2 million for the nine months ended September 30, 2010. Average investment securities increased \$19.8 million from \$52.6 million for the nine months ended September 30, 2009 to \$72.5 million for the nine months ended September 30, 2010.

Total interest expense was \$1.7 million for the nine months ended September 30, 2010, an increase of \$234,000 from \$1.5 million during the same period of 2009. This increase was due to increased deposit volumes which grew, on average, \$50.0 million from September 2009 to September 2010.

Net interest income was \$3.1 million for the first nine months of 2010, an increase of \$1.2 million, or 59%, from \$2.0 million for the same period of 2009. Our annualized net interest margin was 3.12% for the nine months ended September 30, 2010 compared to 2.93% for the nine months ended September 30, 2009.

Provision for Loan Losses

We determine a provision for loan losses that we consider sufficient to maintain an allowance to absorb probable losses inherent in our portfolio as of the balance sheet date. For additional information concerning this determination, see the section of this discussion and analysis captioned *Allowance for Loan Losses*.

During the first nine months of 2010, our provision for loan losses was \$1.1 million compared to \$432,000 for the same time period of 2009. The amount of the provision reflects the growth of our loan portfolio and the estimated probable losses inherent within the portfolio due to uncertainties in economic conditions. There have been four impaired loans during the nine months ended September 30, 2010, three of which were written-down to their net realizable value during the year resulting in charge-offs of \$705,000 and one troubled debt restructuring (see additional discussion below under *Financial Condition - Loan Portfolio*). One previously impaired loan is no longer on the Bank's books as it was sold for a gain of \$10,000 during the third quarter. There were no impaired or charged-off loans during the same period in 2009.

Noninterest Income

Noninterest income for the nine months ended September 30, 2010 was \$944,000, an increase of \$515,000 from \$429,000 for the nine months ended September 30, 2009. The increase was due to a \$658,000 increase in gains on sales of investment securities as the Bank capitalized on current market conditions and sold securities for gains, while shortening the overall duration of the investment portfolio. This increase was offset by a decrease of \$165,000 in service charges and fees on deposits - a direct result of the loss of a significant money-services-business

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deposit customer. Also contributing to the increase was a \$10,000 gain on the sale of other real estate owned and a \$12,000 increase in other income primarily due to the Bank's new residential mortgage lending partnership.

Noninterest Expense

Our total noninterest expense was \$3.3 million for the nine months ended September 30, 2010, a 1%, or \$43,000, increase from the nine months ended September 30, 2009. This consisted of an increase in professional fees of \$82,000, or 35%, due primarily to increased Compliance and Bank Secrecy Act consulting costs, and timing differences for internal and external audits. This increase was offset by a decrease in salaries and employee benefits of \$133,000, or 7%, related primarily to reduced incentive compensation expense during 2010. Occupancy expense remained unchanged and other general and administrative expenses increased \$93,000, or 14%, year-over-year, as detailed in the following table:

| (\$ in thousands) | Nine Months Ended | | | Increase/ (Decrease) | | |
|---|-------------------|-----------------------|-----------|-------------------------|-----------|-----------|
| | 2010 | September 30, 2009 | 2009 | | | |
| Other general and administrative expenses: | | | | | | |
| Data processing | \$ | 211 | \$ | 200 | \$ | 11 |
| FDIC assessment | | 147 | | 125 | | 22 |
| Regulatory and reporting fees | | 90 | | 75 | | 15 |
| Marketing and promotions | | 80 | | 90 | | (10) |
| Travel and entertainment | | 39 | | 33 | | 6 |
| Telephone/communication | | 31 | | 30 | | 1 |
| Loan and collection expenses | | 24 | | 3 | | 21 |
| Printing, stationery and supplies | | 24 | | 31 | | (7) |
| Dues and memberships | | 24 | | 23 | | 1 |
| Directors' fees | | 23 | | | | 23 |
| Insurance | | 17 | | 14 | | 3 |
| Franchise taxes | | 14 | | 7 | | 7 |
| Postage and shipping | | 13 | | 16 | | (3) |
| ATM and debit card fees | | 12 | | 11 | | 1 |
| Training and education | | 6 | | 9 | | (3) |
| Miscellaneous | | 18 | | 13 | | 5 |
| Total | \$ | 773 | \$ | 680 | \$ | 93 |

The most significant other general and administrative expense changes included a \$23,000 increase in directors' fees as the Company began compensating directors for their attendance at meetings in July 2010; a \$22,000 increase in FDIC assessments due to increased deposit volumes; a \$21,000 increase in loan and collection expense due to transaction-based fees paid to third parties for various loan products that are partially outsourced. These loan products were added in late 2009/early 2010 which accounts for the variance between years. Additionally, there was a \$15,000 increase in regulatory and reporting fees due to increases in OCC assessment fees that correlate with the Company's overall growth; an increase of \$11,000 in data processing charges related to increases in customer and account activity; and a \$7,000 increase in franchise taxes due to an increase in the tax rate.

Income Taxes

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No federal or state tax expense has been recorded for the three or nine months ended September 30, 2010 and 2009, based upon significant operating loss carry-forwards that can be used to offset approximately \$3.6 million of taxable income. Since it is uncertain that the Company will become profitable, the deferred tax benefit accumulated to date has a full valuation allowance so that the net deferred tax benefit at September 30, 2010 is \$0.

Financial Condition

At September 30, 2010, the Company had total assets of \$136.2 million, a \$3.4 million increase from \$132.8 million in total assets at December 31, 2009. The increase in assets is primarily due to the \$9.9 million increase in gross loans during this period, offset primarily by decreases in interest-bearing deposits with banks which were not renewed in order to help fund loan growth.

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As of September 30, 2010, stockholders' equity was \$20.1 million, an increase of \$1.4 million from December 31, 2009, as a result of increases in accumulated other comprehensive income, which increased \$1.5 million during this period, partially offset by a small increase in the accumulated deficit, due to the \$282,000 net loss for the nine months ended September 30, 2010.

Federal Home Loan Bank (FHLB) and Federal Reserve Bank Stocks

At September 30, 2010, the Bank had a total of \$1.2 million invested in FHLB and Federal Reserve Bank stocks carried at cost consisting of \$523,000 in Federal Reserve Bank stock and \$642,000 in FHLB stock. These investments allow Solera National Bank to conduct business with these entities. As of September 30, 2010, the Federal Reserve Bank stock is yielding an average of 6.0% and the FHLB stock is yielding an average rate of 2.1%.

Investment Securities

Our investment portfolio serves as a source of interest income and, secondarily, as a source of liquidity and a management tool for our interest rate sensitivity. We manage our investment portfolio according to a written investment policy established by our Board of Directors.

At September 30, 2010, Solera National Bank's securities consisted of available-for-sale securities of \$73.0 million. 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 September 30, 2010 and December 31, 2009:

| (\$ in thousands) | At September 30, 2010 | | | | | | | | |
|--|-----------------------|-------|---|-------|---|-------|-----------------|-------|--|
| | Within One Year | | After One Year but within Five Years | | After Five Years but within Ten Years | | After Ten Years | | |
| | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield | |
| Securities available-for-sale | | | | | | | | | |
| U.S. government agencies | \$ | % | \$ | % | \$ 2,911 | 3.33% | \$ 4,023 | 2.50% | |
| Corporate | 507 | 5.05 | 4,344 | 3.84 | 5,596 | 4.85 | | | |
| State and municipal | | | 836 | 5.47 | 21,761 | 4.52 | 514 | 5.23 | |
| Residential agency MBS | | | | | 464 | 4.31 | 31,920 | 3.83 | |
| Total | \$ 507 | 5.05% | \$ 5,180 | 4.11% | \$ 30,732 | 4.46% | \$ 36,457 | 3.70% | |

| (\$ in thousands) | At December 31, 2009 | | | | | | | | |
|--|----------------------|-------|---|-------|---|-------|-----------------|-------|--|
| | Within One Year | | After One Year but within Five Years | | After Five Years but within Ten Years | | After Ten Years | | |
| | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield | |
| Securities available-for-sale | | | | | | | | | |
| U.S. government agencies | \$ | % | \$ | % | \$ 2,954 | 3.81% | \$ 2,215 | 5.43% | |

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| | | | | | | | | | |
|------------------------|----------|-------|----------|-------|-----------|-------|-----------|-------|--|
| Corporate | 1,560 | 5.99 | 4,845 | 5.35 | 3,718 | 5.09 | | | |
| State and municipal | | | 978 | 5.66 | 12,563 | 5.23 | 8,660 | 5.59 | |
| Residential agency MBS | | | | | 500 | 3.05 | 35,448 | 4.52 | |
| Total | \$ 1,560 | 5.99% | \$ 5,823 | 5.49% | \$ 19,735 | 4.97% | \$ 46,323 | 4.77% | |

As evidenced by the above tables, the weighted-average book yield decreased during the first nine months of 2010 in nearly every category. This was due partially to declines in market rates, the sale of longer-maturity state and municipal bonds to reduce price risk, and partially due to the Federal Home Loan Mortgage Corporation's (FHLMC) and Fannie Mae's repurchase of substantially all 120 days or more delinquent mortgage loans, which resulted in larger than normal principal pay downs on our agency mortgage-backed securities. The FHLMC's and Fannie Mae's repurchase of delinquent loans caused increased amortization on the purchase premiums associated with these securities. The increased premium amortization negatively impacted our investment yields.

Table of Contents**Loan Portfolio**

The following table presents the composition of our loan portfolio by category as of the dates indicated:

| (\$ in thousands) | September 30, 2010 | | December 31, 2009 | |
|--|--------------------|------------|-------------------|------------|
| | Amount | % of Total | Amount | % of Total |
| Real estate commercial | \$ 39,347 | 65% | \$ 26,063 | 52% |
| Real estate residential | 8,054 | 13 | 8,059 | 16 |
| Construction and land development | 2,007 | 3 | 7,067 | 14 |
| Commercial and industrial | 8,954 | 15 | 8,324 | 16 |
| Lease financing | 1,452 | 3 | | |
| Consumer | 564 | 1 | 991 | 2 |
| Gross loans | 60,378 | 100% | 50,504 | 100% |
| Less: Deferred loan (fees) / expenses, net | (85) | | (114) | |
| Allowance for loan losses | (1,200) | | (830) | |
| Loans, net | \$ 59,093 | | \$ 49,560 | |

As of September 30, 2010, net loans were \$59.1 million, a \$9.5 million, or 19%, increase from \$49.6 million at December 31, 2009. Net loans as a percentage of total assets were 43% as of September 30, 2010, compared to 37% at December 31, 2009. Given the tepid economic recovery underway, loan demand has been weakening during the course of the year.

The real estate commercial loan portfolio consists primarily of lines of credit or term loans to businesses that are secured by real estate. Our primary focus is on owner-occupied commercial real estate, including SBA 504 loans. At September 30, 2010, there were \$39.3 million of commercial real estate loans in the loan portfolio, an increase of 51%, or \$13.3 million, from \$26.1 million at December 31, 2009. Given our focus on this loan category, it now represents 65% of our total portfolio, which is well within our established concentration guidelines.

The real estate residential loan portfolio consists of residential second mortgage loans, home equity loans and lines of credit and home improvement loans. The \$8.1 million of residential real estate loans outstanding at September 30, 2010 remained unchanged from December 31, 2009.

The construction and land development loan portfolio is comprised of construction loans for owner-occupied construction and development loans for property being constructed and sold to third parties. At September 30, 2010, construction and land development loans totaled \$2.0 million, a decrease of \$5.1 million, or 72%, from \$7.1 million at December 31, 2009. This decrease is primarily the result of the weak economy which has dampened new construction opportunities.

The commercial and industrial loan portfolio consists of loans to businesses primarily for working capital lines of credit. At September 30, 2010, commercial and industrial loans totaled \$9.0 million, a \$630,000, or 8%, increase from \$8.3 million at December 31, 2009.

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During the second quarter 2010, the Bank closed its first lease financing agreement for the purchase of equipment. At September 30, 2010, lease financing comprised 3% of the Bank's loan portfolio.

The consumer and other loan portfolio consists of personal lines of credit, loans to acquire personal assets such as automobiles and overdraft protection balances for our deposit customers. As of September 30, 2010, consumer and other loans comprised 1% of the total loan portfolio at \$564,000, a decrease of \$427,000 from December 31, 2009.

Loan concentrations are considered to exist when there are amounts loaned to a multiple number of borrowers engaged in similar activities that would cause them to be similarly impacted by economic or other conditions. 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. As the Bank's loan portfolio continues to grow, the concentration to any single borrower diminishes. As of

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September 30, 2010, the Bank's five largest loans represented approximately 17% of the total loan portfolio compared to 20% of the total loan portfolio as of December 31, 2009. No single borrower can be approved for a loan over the Bank's current legal lending limit of approximately \$2.4 million. This regulatory requirement helps to ensure the Bank's exposure to one individual customer is limited.

Management may renew loans at maturity when requested by a customer whose financial strength appears to support such a renewal or when such a renewal appears to be in the best interest of Solera National Bank. Solera National Bank requires payment of accrued interest in such instances and may adjust the rate of interest, require a principal reduction, or modify other terms of the loan at the time of renewal.

The following tables set forth information at September 30, 2010 and December 31, 2009, regarding the dollar amount of loans maturing in the Bank's portfolio based on the contractual terms to maturity. The tables do not give effect to potential prepayments or contractual principal payments.

| (\$ in thousands) | | September 30, 2010 | | | | |
|-----------------------------------|-------------|--------------------|-------------|--------------|---------------|-------------|
| | | <1 Year | 1 - 5 Years | 5 - 15 Years | Over 15 Years | Total Loans |
| Real estate | commercial | \$ 6,100 | \$ 11,482 | \$ 21,765 | \$ | \$ 39,347 |
| Real estate | residential | | 344 | | 7,710 | 8,054 |
| Construction and land development | | 2,007 | | | | 2,007 |
| Commercial and industrial | | 4,032 | 3,102 | 1,820 | | 8,954 |
| Lease financing | | | 1,452 | | | 1,452 |
| Consumer | | 10 | 399 | | 155 | 564 |
| Gross Loans Receivable | | \$ 12,149 | \$ 16,779 | \$ 23,585 | \$ 7,865 | \$ 60,378 |

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

Table of Contents***Nonperforming Loans, Leases and Assets***

Nonperforming assets consist of loans and leases on nonaccrual status, loans 90 days or more past due and still accruing interest, loans that have been restructured resulting in a reduction or deferral of interest or principal, other real estate owned (OREO), and other repossessed assets. As of September 30, 2010, there was \$749,000 in nonperforming assets, consisting of three loans.

The following table summarizes information regarding nonperforming assets:

| (\$ in thousands) | September 30, 2010 | December 31, 2009 |
|---|-----------------------|----------------------|
| Nonaccrual loans and leases | \$ 650 | \$ |
| Other impaired loans | 99 | |
| Total nonperforming loans | \$ 749 | \$ |
| Impaired loans | \$ 749 | \$ |
| Allocated allowance for loan losses to impaired loans | | |
| Net investment in impaired loans | \$ 749 | |
| Accruing loans past due 90 days or more | | 3 |
| Loans past due 30-89 days | \$ 2,200 | \$ 1,298 |
| Loans charged-off, year-to-date | \$ 705 | \$ |
| Recoveries, year-to-date | | |
| Net charge-offs, year-to-date | \$ 705 | \$ |
| Allowance for loan losses | \$ 1,200 | \$ 830 |
| Allowance for loan losses to loans, net of deferred fees/expenses | 1.99% | 1.64% |
| Allowance for loan losses to nonaccrual loans | 184.62% | NA |
| Allowance for loan losses to nonperforming loans | 160.21% | NA |
| Nonaccrual loans to loans, net of deferred fees/expenses | 1.08% | NA |
| Loans 30-89 days past due to loans, net of deferred fees/expenses | 3.65% | 2.56% |

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 moved 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 September 30, 2010, Solera National Bank had substandard loans totaling \$5.2 million, a doubtful loan totaling \$176,000, and no loans classified as loss. Of the \$5.2 million in substandard loans, only \$674,000 was 30 days or more past due. As of December 31, 2009, the Bank had no loans classified as doubtful or loss and had substandard loans totaling \$3.8 million. Of the \$3.8 million of substandard loans, only \$953,000 was 30 days or more past due.

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Allowance for Loan Losses

Implicit in Solera National Bank'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. To reflect the currently perceived risk of loss associated with the loan portfolio, additions are made to the allowance for loan losses in the form of direct charges against income to ensure that the allowance is available to absorb possible loan losses. The Bank's allowance for estimated loan losses is 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 during the Bank's de novo period of operation.

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.

The amount of the allowance equals the cumulative total of the provisions made from time to time, reduced by loan charge-offs and increased by recoveries of loans previously charged-off. The allowance was \$1.2 million, or 1.99% of outstanding principal as of September 30, 2010 compared to \$830,000, or 1.64% of outstanding principal as of December 31, 2009. The provision for loan losses increased \$600,000 from \$180,000 during the three months ended September 30, 2009 to \$780,000 during the three months ended September 30, 2010. This increase was primarily the result of net credit losses on two real estate development loan participations from the Bank's early stages of operation. The Bank does not have any other purchased loan participations on its balance sheet and minimal remaining exposure to real estate construction or development.

Credit and loan decisions are made by management and the Board of Directors in conformity with loan policies established by the Board of Directors. Solera National Bank'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 deteriorating or deteriorated financial condition, the depreciation of the underlying collateral, the loan's classification as a loss by regulatory examiners, or other reasons. During the nine months ended September 30, 2010, the Bank recorded charge-offs of \$705,000 related to three impaired loans. No charge-offs were recorded during the nine months ended September 30, 2009.

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. The total amounts of off-balance-sheet financial instruments with credit risk were as follows:

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| (\$ in thousands) | September 30, 2010 | | December 31, 2009 | |
|--|--------------------|-------|-------------------|-------|
| Financial instruments whose contractual amounts represent credit risk: | | | | |
| Commitments to extend credit | \$ | 7,212 | \$ | 7,182 |
| Letters of credit | | | | |
| Total commitments | \$ | 7,212 | \$ | 7,182 |

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. Commitments also include revolving lines of credit arrangements and unused commitments for commercial and real estate secured loans. Since many of the commitments are expected to expire without being drawn upon, the commitments do not necessarily represent future cash requirements.

Letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending

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loan facilities to customers and, therefore, the Company applies the same rigorous underwriting standards to letters of credit.

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.

Borrowings

As of September 30, 2010, the Bank had \$5.5 million in fixed-rate borrowings from the Federal Home Loan Bank of Topeka (FHLB) with varying maturity dates between April 2011 and June 2013 and a weighted-average fixed interest rate of 4.19%. Additionally, the Bank had \$500,000 in variable-rate, overnight borrowings from the FHLB. As of September 30, 2010, the overnight advance rate was 0.28%.

The Bank has also established unsecured Federal Funds lines-of-credit totaling \$8.7 million with various correspondent banks. Additionally, the Bank has access to secured Federal Funds lines with two correspondent banks and access to the Federal Discount window. As of September 30, 2010, the Company had no balances outstanding on these lines.

Loan Commitments

At September 30, 2010, the Company had \$7.2 million in outstanding loan origination commitments. Management believes Solera National Bank has sufficient funds available to meet current origination and other lending commitments.

Capital Resources and Capital Adequacy Requirements

The risk-based capital regulations established and administered by the banking regulatory agencies are applicable to Solera National Bank. Risk-based capital guidelines are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks, to account for off-balance-sheet exposure, and to minimize disincentives for holding liquid assets. Under the regulations, assets and off-balance-sheet items are assigned to broad risk categories, each with appropriate weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance-sheet items. Under the prompt corrective action regulations, to be adequately capitalized a bank must maintain minimum ratios of total capital to risk-weighted assets of 8.0%, Tier 1 capital to risk-weighted assets of 4.0%, and Tier 1 capital to total average assets of 4.0%. Failure to meet these capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on Solera National Bank's financial statements.

As of September 30, 2010, Solera National Bank was categorized as well-capitalized. A well-capitalized institution must maintain a minimum ratio of total capital to risk-weighted assets of at least 10.0%, a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, and a minimum ratio of Tier 1 capital to total average assets of at least 5.0% and must not be subject to any written order, agreement, or directive

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requiring it to meet or maintain a specific capital level.

The following table summarizes the ratios of the Bank and the regulatory minimum capital requirements at September 30, 2010:

| As of September 30, 2010 (\$ in thousands) | Actual | | For Capital Adequacy Purposes | | To Be Well-Capitalized Under Prompt Corrective Action Provisions | |
|---|-----------|-------|----------------------------------|-------|--|--------|
| | Amount | % | Amount | % | Amount | % |
| Total capital (to risk-weighted assets) | \$ 16,075 | 18.7% | \$ 6,894 | >8.0% | \$ 8,617 | >10.0% |
| Tier 1 capital (to risk-weighted assets) | \$ 14,996 | 17.4% | \$ 3,447 | >4.0% | \$ 5,170 | >6.0% |
| Tier 1 capital (to average assets) | \$ 14,996 | 10.9% | \$ 5,509 | >4.0% | \$ 6,886 | >5.0% |

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Liquidity

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 without regulatory approval that will not be granted until the accumulated deficit has been eliminated.

Solera National Bank's liquidity is monitored by its staff, the Asset Liability Committee and the Board of Directors, who review historical funding requirements, the current liquidity position, 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 more influenced by interest rates, general economic conditions, and competition. Solera National Bank will maintain 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.

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 - 90% over time. Given this goal, Solera National Bank will not aggressively pursue lending opportunities if sufficient funding sources (e.g., deposits, Federal Funds, etc.) are not available, nor will Solera National Bank seek to attract transient volatile, non-local deposits with above market interest rates. As of September 30, 2010, the loan to deposit ratio was 56% an increase from 48% at December 31, 2009.

Solera National Bank had cash and cash equivalents of \$698,000, or 0.5% of total Bank assets, at September 30, 2010. Additionally, the Bank had \$72.9 million in available-for-sale investment securities, or 54% of the Company's total assets, at September 30, 2010. Management feels Solera National Bank should have adequate liquidity to meet anticipated future funding needs.

During the third quarter, the Bank signed a purchase and assumption agreement with Liberty Savings Bank, FSB, to acquire approximately \$30 million in loans and assume approximately \$40 million in deposits. This transaction, if consummated, will provide approximately \$8 million in additional cash and cash equivalents during the fourth quarter 2010, when the transaction is expected to close. However, our liquidity position could be affected by a higher than anticipated run-off of acquired deposits.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a smaller reporting company, the Company is not required to provide the information required by this Item.

ITEM 4(T). CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Management is responsible for maintaining effective disclosure controls and procedures. As of the end of the period covered by this Quarterly Report on Form 10-Q, management 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 Chief 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.

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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 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

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PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Not applicable.

ITEM 1A. RISK FACTORS

As a smaller reporting company, the Company is not required to provide the information required by this Item.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. [Removed and Reserved]

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

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- 2.1 Purchase and Assumption Agreement dated August 5, 2010 (incorporated by reference to Exhibit 2.1 to the Company's Form 8-K filed on August 11, 2010).
- 10.1 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 8-K filed on September 14, 2010).
- 31.1 Certification of the Principal Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act.*
- 31.2 Certification of the Principal Accounting and 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.*

* Filed herewith.

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SOLERA NATIONAL BANCORP, INC.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SOLERA NATIONAL BANCORP, INC.
(Registrant)

Date: November 10, 2010

/s/ Douglas Crichfield
Douglas Crichfield
President and Chief Executive Officer
(Principal Executive Officer)

/s/ Robert J. Fenton
Robert J. Fenton
Executive Vice President, Chief Financial Officer
(Principal Accounting and Financial Officer)

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EXHIBIT INDEX

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