

CONSOLIDATED FINANCIAL STATEMENTS AND
INDEPENDENT AUDITOR'S REPORT

**SOLERA NATIONAL BANCORP, INC.
AND SUBSIDIARY**

December 31, 2016 and 2015





Independent Auditor's Report

To the Audit Committee and Board of Directors
Solera National Bancorp, Inc. and Subsidiary
Lakewood, Colorado

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Solera National Bancorp, Inc. and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2016, and the related consolidated statements of comprehensive income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Solera National Bancorp, Inc. and Subsidiary as of December 31, 2016, and the results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information on pages 52 through 55 is presented for the purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Other Matter

The consolidated financial statements of Solera National Bancorp, Inc. and Subsidiary as of December 31, 2015, were audited by other auditors, whose report dated March 11, 2016, expressed an unmodified opinion on those statements.

A handwritten signature in cursive script that reads "Eide Bailly LLP".

Denver, Colorado
March 22, 2017

Solera National Bancorp, Inc. and Subsidiary

Consolidated Balance Sheets

December 31,

	2016	2015
ASSETS	(in thousands, except for shares outstanding)	
Cash and cash equivalents	\$ 799	\$ 2,489
Interest-bearing deposits with banks	261	750
Investment securities, available-for-sale	36,133	48,374
Investment securities, held-to-maturity	4,500	4,500
Loans held for sale	-	1,039
Loans, net	103,384	80,590
Nonmarketable equity securities	879	874
Bank-owned life insurance	4,495	4,369
Premises and equipment, net	1,831	1,918
Accrued interest receivable	798	571
Deferred tax asset, net	2,483	-
Other assets	528	599
Total Assets	\$ 156,091	\$ 146,073
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Deposits		
Noninterest-bearing demand	\$ 5,941	\$ 3,954
Interest-bearing demand	8,374	8,405
Savings and money market	42,569	42,320
Time deposits	69,441	66,160
Total deposits	126,325	120,839
Accrued interest payable	103	88
Accounts payable and other liabilities	776	309
FHLB advances	5,815	5,000
Total liabilities	133,019	126,236
Commitments and contingencies (see Notes H, Q, R)		
Stockholders' equity		
Common stock ¹	27	27
Additional paid-in capital	27,170	27,137
Accumulated deficit	(3,543)	(6,670)
Accumulated other comprehensive loss	(426)	(501)
Treasury stock, at cost; 25,776 shares	(156)	(156)
Total stockholders' equity	23,072	19,837
Total Liabilities and Stockholders' Equity	\$ 156,091	\$ 146,073

¹10,000,000 shares of \$0.01 par value authorized; 2,753,588 and 2,773,838 shares outstanding as of December 31, 2016 and 2015, respectively.

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

Solera National Bancorp, Inc. and Subsidiary
Consolidated Statements of Comprehensive Income

Years ended December 31,

	2016	2015
	(in thousands)	
Interest income		
Interest and fees on loans	\$ 4,384	\$ 4,237
Interest on investment securities	1,037	1,044
Dividends on nonmarketable equity securities	45	46
Other interest income	11	15
Total interest income	5,477	5,342
Interest expense		
Deposits	1,227	1,039
FHLB advances	73	96
Total interest expense	1,300	1,135
Net interest income	4,177	4,207
Provision for loan losses	-	(50)
Net interest income after provision for loan losses	4,177	4,257
 Noninterest income		
Service charges and fees	102	110
Other income	138	449
Gain on loans sold	125	-
Gain on sale of available-for-sale securities, net	157	186
Total noninterest income	522	745
Noninterest expense		
Employee compensation and benefits	1,617	1,581
Occupancy and equipment	233	203
Professional fees	280	205
Other general and administrative	1,651	1,235
Total noninterest expense	3,781	3,224
Income before income taxes	918	1,778
Income tax benefit	(2,209)	-
Net income	\$ 3,127	\$ 1,778
 Comprehensive income		
Net change in unrealized losses on securities	(18)	(213)
Income tax effect	192	-
Reclassification adjustment for net gains realized in net income	(157)	(186)
Income tax effect	58	-
Total other comprehensive income (loss)	75	(399)
Total comprehensive income	\$ 3,202	\$ 1,379

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

Solera National Bancorp, Inc. and Subsidiary

Consolidated Statements of Changes in Stockholders' Equity

Years ended December 31, 2016 and 2015

	Shares Outstanding	Common Stock	Additional Paid- in Capital	Accumulated Deficit	Treasury Stock	Accumulated Other Comprehensive Loss	Total
	(in thousands, except for shares outstanding)						
Balance at December 31, 2014	2,772,422	\$ 27	\$ 27,120	\$ (8,448)	\$ (156)	\$ (102)	\$ 18,441
Options exercised	1,416	-	5	-	-	-	5
Stock-based compensation	-	-	12	-	-	-	12
Net income	-	-	-	1,778	-	-	1,778
Other comprehensive loss	-	-	-	-	-	(399)	(399)
Balance at December 31, 2015	<u>2,773,838</u>	<u>\$ 27</u>	<u>\$ 27,137</u>	<u>\$ (6,670)</u>	<u>\$ (156)</u>	<u>\$ (501)</u>	<u>\$ 19,837</u>
Stock-based compensation	-	-	27	-	-	-	27
Stock compensation awards/(forfeitures), net	(20,250)	-	6	-	-	-	6
Net income	-	-	-	3,127	-	-	3,127
Other comprehensive income	-	-	-	-	-	75	75
Balance at December 31, 2016	<u><u>2,753,588</u></u>	<u><u>\$ 27</u></u>	<u><u>\$ 27,170</u></u>	<u><u>\$ (3,543)</u></u>	<u><u>\$ (156)</u></u>	<u><u>\$ (426)</u></u>	<u><u>\$ 23,072</u></u>

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

Solera National Bancorp, Inc. and Subsidiary

Consolidated Statements of Cash Flows

Years ended December 31,

	<u>2016</u>	<u>2015</u>
	(in thousands)	
Cash flows from operating activities		
Net income	\$ 3,127	\$ 1,778
Adjustments to reconcile net income to net cash used by operating activities:		
Depreciation and amortization	224	159
Provision for loan losses	-	(50)
Net amortization of premiums on investment securities	614	743
Recognition of stock-based compensation on stock options/ restricted stock awards	33	12
Gain on sale of available-for-sale securities, net	(157)	(186)
Loss on disposal of premises and equipment	7	34
Deferred income tax benefit	(2,242)	-
Federal Home Loan Bank stock dividend	(11)	(15)
Increase in bank-owned life insurance cash surrender value	(126)	(136)
Net change in:		
Accrued interest receivable	(227)	45
Other assets	(42)	270
Accrued interest payable	15	26
Accounts payable and other liabilities	522	(247)
Net cash provided by operating activities	<u>1,737</u>	<u>2,433</u>
Cash flows from investing activities		
Purchases of investment securities held to maturity	-	(4,500)
Activity in securities available for sale:		
Purchases	(18,080)	(26,234)
Maturities, prepayments, and calls	6,645	6,796
Sales	23,044	23,008
Redemption (purchase) of nonmarketable equity securities, net	5	(79)
Redemption of bank-owned life insurance	-	229
Loan (originations) / principal collections, net	(21,755)	(2,329)
Proceeds from the sale of OREO	-	1,392
Purchases of premises and equipment	(22)	(1,402)
Proceeds from the sale of premises and equipment	-	5
Purchase of interest bearing deposits in banks	-	(493)
Maturity of interest bearing deposits in banks	490	-
Net cash used by investing activities	<u>(9,673)</u>	<u>(3,607)</u>

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

Solera National Bancorp, Inc. and Subsidiary
Consolidated Statements of Cash Flows (Continued)

Years ended December 31,

	2016	2015
	(in thousands)	
Cash flows from financing activities		
Net change in repurchase agreements and federal funds purchased	\$ (55)	\$ -
Net change in deposits	5,486	1,726
Net change in short-term FHLB advances	2,415	-
Repayment of long-term FHLB borrowings	(1,600)	(1,500)
Proceeds from stock options exercised	-	5
Net cash provided by financing activities	6,246	231
 Net change in cash and cash equivalents	 (1,690)	 (943)
 Cash and cash equivalents at beginning of year	 2,489	 3,432
Cash and cash equivalents at end of year	\$ 799	\$ 2,489
 Supplemental Disclosures of Cash Flow Information:		
Cash paid during the year for interest	\$ 1,285	\$ 1,109
Cash paid during the year for income taxes	33	-
 Supplemental Disclosure of Noncash Activities:		
Loans transferred to held for sale	\$ -	\$ 1,039

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

Solera National Bancorp, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Solera National Bancorp, Inc. (the “Holding Company”) is a Delaware corporation that was incorporated to organize and serve as the holding company for Solera National Bank (the “Bank”), which opened for business in 2007. Solera National Bank is a full-service commercial bank headquartered in Lakewood. The entities collectively are referred to as “the Company”.

The Company offers 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. The Company believes that local ownership and control allows the Bank to serve customers efficiently and effectively. Solera National Bank competes on the basis of providing a personalized banking experience combined with a broad range of services, customized and tailored to fit the individual needs of its clients. The Company remains focused on executing its strategy of delivering prudent and controlled growth to efficiently leverage the Company’s capital while controlling its expense base to achieve sustained profitability.

The Company’s ultimate objective is to create shareholder value through its recognition as the premier community bank in Colorado. We are committed to running a lean and efficient organization that can execute on business decisions quickly. Additionally, the Company believes in providing transparent financial reporting to our stakeholders through publication of quarterly earnings releases and annual audited financial statements. The Company’s common stock is traded over-the-counter under the ticker symbol SLRK.

Since the Company operates in Colorado, the operating results are significantly influenced by economic conditions in Colorado, particularly the health of the real estate market. Additionally, the Company is subject to competition from other financial institutions and is impacted by fiscal and regulatory policies of the federal government as well as regulatory oversight by the Office of the Comptroller of the Currency, (the “OCC”) and the Federal Reserve Bank of Kansas City (the “FRB”).

Basis of Presentation and Consolidation

The accompanying consolidated financial statements include the accounts of Solera National Bancorp, Inc. and its wholly-owned subsidiary, Solera National Bank. All significant intercompany balances and transactions have been eliminated in consolidation. Certain reclassifications have been made to the consolidated financial statements and related notes of

Solera National Bancorp, Inc. and Subsidiary

Notes to Consolidated Financial Statements

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prior periods to conform to the current presentation. These reclassifications had no impact on stockholders' equity or net income for the periods. The accounting and reporting policies of the Company are in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") and prevailing practices within the banking industry.

Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses and the fair value of financial instruments.

In connection with the determination of the allowance for loan losses, management obtains independent appraisals for significant properties and assesses estimated future cash flows from borrowers' operations and the liquidation of loan collateral. Management believes that the allowance for loan losses and the valuation of other real estate owned, if any, are adequate. While management uses available information to recognize losses on loans and other real estate owned, changes in economic conditions may necessitate revisions in future years.

Business Segments

The Company uses the "management approach" for reporting information about segments and has determined that during 2016 and 2015, its business was comprised of one operating segment: community banking.

Presentation of Cash Flows

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

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

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Investment Securities

Securities are classified as held-to-maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Investments to be held for an indefinite amount of time, but not necessarily to maturity, are classified as available-for-sale and reported at fair value using Level 2 inputs. For these securities, the Company obtains fair value measurements from independent pricing services. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bonds' terms and conditions, among other things. Unrealized gains and losses are reported as a separate component of accumulated other comprehensive income. Premiums or discounts are amortized or accreted into income using the interest method. Realized gains or losses are recorded using the specific identification method.

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

Loans Held for Sale

Particular loans may be considered held for sale as of the Company's balance sheet date. From time to time, the Company sells SBA guaranteed loans and may designate select classified or nonaccrual loans as held for sale as part of the Company's strategy to dispose of non-earning assets. Once the decision to sell a loan has been made, the loan is designated held for sale and is carried at the lower of cost or fair value, with any required write-down being charged to earnings at the time of the reclassification.

Solera National Bancorp, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

Loan Commitments and Related Financial Instruments

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

Loans Held for Investment

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

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

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

Troubled debt restructurings are loans for which concessions in terms have been made as a result of the borrower experiencing financial difficulty. Generally, concessions granted to customers include lower interest rates and modification of the payment stream to lower or defer payments. Interest on troubled debt restructurings is accrued under the new terms if the loans are performing and full collection of principal and interest is expected. However, interest accruals are discontinued on troubled debt restructurings that meet the Company's nonaccrual criteria.

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Generally, loans are charged off in whole or in part on a loan-by-loan basis after they become significantly past due and based upon management's review of the collectability of all or a portion of the loan unless the loan is in the process of restructuring. Charge off amounts are determined based upon the carrying amount of loans and the amount estimated to be collectible as determined by analyses of expected future cash flows and the liquidation of loan collateral.

Interest and Fees on Loans

Interest income is recognized daily in accordance with the terms of each note based on the outstanding principal balance. Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. Generally, the accrual of interest on loans is discontinued when principal or interest is 90 days past due based on the contractual terms of the loan or when, in the opinion of management, there is reasonable doubt as to collectability. When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on nonaccrual loans is subsequently recognized only to the extent that cash is received and the Company's recorded investment in the loan (the customer's balance less any partial charge-offs) is deemed collectible. Interest accruals are resumed on such loans only when they are brought current and when, in the judgment of management, the loans are estimated to be fully collectible as to all interest and the Company's recorded investment.

Generally, for all classes of loans, loans are considered past due when contractual payments are delinquent by 30 days or more. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan using the effective interest method and without anticipating prepayments.

Provision and 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 loans being made and the creditworthiness of the borrowers over the terms of the loans. The allowance for loan losses represents the Company's recognition of the risks of extending credit and its evaluation of the loan portfolio. The evaluation of the allowance is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance for loan 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. The allowance for loan losses is increased by provisions charged to expense and reduced by loans charged-off, net of

Solera National Bancorp, Inc. and Subsidiary

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recoveries. Loan losses are charged against the allowance for loan losses when management believes the 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, impaired loans and leases are individually evaluated by either discounting the expected future cash flows or determining the fair value of the collateral, if repayment is expected solely from collateral. The fair value of the collateral is determined using internal analyses as well as third-party information, such as appraisals. That value, less estimated costs to sell, is compared to the recorded investment in the loan and any shortfall is charged-off. Unsecured loans and loans that are not collateral-dependent are evaluated by calculating the discounted cash flow of the payments expected over the life of the loan using the loan's effective interest rate and giving consideration to currently existing factors that would impact the amount or timing of the cash flows. The shortfall between the recorded investment in the loan and the discounted cash flows, or the fair value of the collateral less estimated costs to sell, represents the first component of the allowance for loan losses.

The second component of the allowance for loan losses represents contingent losses – the estimated probable losses inherent within the portfolio due to uncertainties. To determine this component, management calculates an historical loss rate based on the Bank's actual loss rate over its history. Management then adjusts the loss rate for environmental factors which 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 levels and trends in non-performing and past due loans; and 4) management's assessment of economic conditions and certain qualitative factors as defined by bank regulatory guidance, including but not limited to, changes in the size, composition and concentrations of the loan portfolio, changes in the legal and regulatory environment, and changes in lending management. The qualitative factors also consider the risk elements within each segment of the loan portfolio.

The risk of loss on any particular loan is primarily influenced by the difference between the expected and actual cash flows of the borrower and the type of collateral securing the loan. For real estate secured loans, conditions in the real estate markets as well as the general economy influence real estate values and may impact the Company's ability to recover its investment due to declines in the fair value of the underlying collateral. The risks in non-real estate secured loans include general economic conditions as well as interest rate changes.

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Additionally, classified and criticized loans, which are closely monitored by management, are taken out of their original category for calculating their contingent loss rate and are assigned an appropriate loss rate. The aggregate of the above described segments represents the contingent losses in the loan portfolio.

The recorded allowance for loan losses is the aggregate of the impaired loan component and the contingent loss component. The Company aggregates loans into five portfolio segments: Commercial Real Estate; Residential Real Estate; Commercial and Industrial; Construction and Land Development; and Consumer. These segments are based upon the loan's categorization in the Consolidated Report of Condition and Income, as set forth by banking regulators, (the "Call Report"). The methodology for estimating the allowance has not changed materially during the current or prior reporting period and is consistent across all portfolio segments and classes of loans.

At December 31, 2016, the Company had an allowance for loan losses of approximately \$1.6 million. The Company believes that this is adequate to cover probable losses based on currently available information. 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 be needed if the economy declines, asset quality deteriorates, or the loss experience changes.

Nonmarketable Equity Securities

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

Other Real Estate Owned

Other real estate owned represents real estate acquired through foreclosure or deed in lieu of foreclosure and is carried at its fair value less estimated costs to sell. Prior to foreclosure, the value of the underlying loan is written down to the fair market value of the real estate to be acquired by a charge to the allowance for loan losses, if necessary. Any subsequent write-downs are taken as a valuation allowance and charged to earnings as an operating expense. Operating income of such properties, net of related expenses, are included in other noninterest income. There was no other real estate owned as of December 31, 2016 or 2015.

Solera National Bancorp, Inc. and Subsidiary

Notes to Consolidated Financial Statements

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Premises and Equipment

Land is carried at cost. Buildings, equipment and software are carried at cost less accumulated depreciation and amortization computed on the straight-line method over the estimated useful life of the asset. Building and leasehold improvements carry an estimated useful life of 39 years and equipment and software carry estimated useful lives ranging from one to seven years. Expenditures for leasehold improvements or major repairs are capitalized and those for ordinary repairs and maintenance are charged to noninterest expense when incurred.

Core Deposit Intangible

The Company's core deposit intangible includes the deposit premium paid and other transaction costs incurred in conjunction with the acquisition of customer deposits. Intangible assets are amortized over their estimated useful lives, using the straight-line method. Intangible assets are assessed for impairment at least quarterly, or when events or circumstances indicate a possible inability to realize the carrying amount. The core deposit intangible is included in Other Assets on the Company's Consolidated Balance Sheets and the amortization of the core deposit intangible is included in Other General and Administrative expenses on the Company's Consolidated Statements of Comprehensive Income.

Share-Based Compensation

The Company can grant 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 employee compensation and benefits over the period in which the recipient is required to provide services in exchange for the award, generally the vesting period.

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

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Fair Value Measurement

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 – Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 – Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Applicable Accounting Standards Updates

In January 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. Under the new standard, certain equity investments are required to be carried at fair value, with changes in fair value recognized in net income. This applies to equity investments with readily determinable fair values that are not consolidated or carried on the equity method. Debt securities classified as available-for-sale will continue to be carried at fair value with changes in fair value recorded through other comprehensive income. The standard also reduces or eliminates several financial reporting disclosure requirements. The standard is effective for the Company beginning January 1, 2018. The provisions of the standard are not expected to have a significant impact to the consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)* (ASU 2016-02). ASU 2016-02 is intended to increase transparency and comparability among organizations by recognizing lease assets and liabilities on the balance sheet and disclosing key information about lease arrangements. For the Company, ASU 2016-02 is effective for the Company beginning January 1, 2019. The Company is still evaluating the effects of ASU 2016-02 on its financial statements, but given the Company's currently insignificant amount of operating leases, the provisions of ASU 2016-02 are not expected to have a significant impact on the Company's consolidated financial statements.

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Notes to Consolidated Financial Statements

December 31, 2016 and 2015

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (ASU 2016-13). The objective of ASU 2016-13 is to provide financial statement users with decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit. ASU 2016-13 includes provisions that require financial assets measured at amortized cost (such as loans and held to maturity (HTM) debt securities) to be presented at the net amount expected to be collected. This will be accomplished through recognition of an estimate of all current expected credit losses. The estimate will include forecasted information for the timeframe that an entity is able to develop reasonable and supportable forecasts. This is a change from the current practice of recognizing incurred losses based on the probable initial recognition threshold under current GAAP. In addition, credit losses on available for sale (AFS) debt securities will be recorded through an allowance for credit losses rather than as a write-down. Under ASU 2016-13, an entity will be able to record reversals of credit losses in current period income when the estimate of credit losses declines, whereas current GAAP prohibits reflecting those improvements in current period earnings.

ASU 2016-13 is effective for the Company beginning January 1, 2021, and early adoption is permitted for fiscal years, including interim periods, beginning January 1, 2019. ASU 2016-13 will be applied through a cumulative effect adjustment to retained earnings (modified-retrospective approach), except for debt securities for which an other-than-temporary impairment had been recognized before the effective date. A prospective transition approach is required for these debt securities. The Company is currently evaluating the effects of ASU 2016-13 on its financial statements and disclosures, and expects ASU 2016-13 to add complexity and costs to its current credit loss evaluation process.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments* (ASU 2016-15), regarding how certain cash receipts and cash payments are presented and classified in the statements of cash flows. ASU 2016-15 addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. The amendments of ASU 2016-15 are effective for the Company beginning January 1, 2018. Amendments in this ASU should be applied using a retrospective transition method to each period presented. The Company is evaluating the effects ASU 2016-15 will have on its financial statements and disclosures, and does not expect these effects to be material.

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Notes to Consolidated Financial Statements

December 31, 2016 and 2015

During 2016, and thus far in 2017, the FASB issued other ASU's which may impact banks or other entities but do not, or are not expected to, have a material impact on our financial position, results of operations or cash flows.

Income per Common Share

Basic earnings per common share (EPS) is based on the weighted-average number of common shares outstanding during the period. Diluted earnings per share is similar to basic EPS except that the weighted-average number of common shares outstanding is increased by the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued at the beginning of the period. When the Company's net operating results are a loss, all dilutive potential common shares are anti-dilutive so there is no difference between basic EPS and diluted EPS.

Income Taxes

Income taxes expense (benefit) is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred taxes relate primarily to differences between the timing of recognizing tax expense for items such as start-up costs, the allowance for loan losses, unrealized gains or losses on securities available for sale and accumulated depreciation. The deferred tax assets and liabilities represent the future tax return consequences of those differences, which will be either taxable or deductible when the assets and liabilities are recovered or settled. Deferred tax assets and liabilities are reflected at income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

The Company recognizes interest and penalties, if any, in Other General and Administrative expense. There were no material interest or penalties recorded or accrued at December 31, 2016 or 2015. Similarly, as of December 31, 2016 and 2015, the Company has no uncertain income tax positions as defined in Accounting Standards Codification ("ASC") 740, *Income Taxes*.

Comprehensive Income

For the years ended December 31, 2016 and 2015, the Company's comprehensive income included net income from operations and unrealized losses on investment securities, net of applicable taxes.

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Notes to Consolidated Financial Statements

December 31, 2016 and 2015

Dividend Restriction

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

Reclassifications

Certain reclassifications have been made to 2015 amounts to conform to the current year's presentation.

Solera National Bancorp, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE B - SECURITIES

The Company owns bonds in corporations, state and local municipalities, residential agency mortgage-backed securities (MBS), residential agency collateralized mortgage obligations (CMOs) and bonds issued directly by the United States Government (U.S. Agency). The amortized cost and fair values of securities, with gross unrealized gains and losses, follows:

	December 31, 2016			
	Amortized	Gross	Gross	Fair Value
	Cost	Unrealized	Unrealized	
		Gains	Losses	
		(in thousands)		
Securities Available-for-Sale:				
Corporate	\$ 10,220	\$ 8	\$ (279)	\$ 9,949
State and municipal	9,679	11	(216)	9,474
Residential agency MBS and CMOs	15,911	36	(220)	15,727
U.S. agency	999	-	(16)	983
Total securities available-for-sale	\$ 36,809	\$ 55	\$ (731)	\$ 36,133
Securities Held-to-Maturity:				
Corporate	\$ 4,500	\$ -	\$ (269)	\$ 4,231
Total securities held-to-maturity	\$ 4,500	\$ -	\$ (269)	\$ 4,231
		December 31, 2015		
	Amortized	Gross	Gross	Fair Value
	Cost	Unrealized	Unrealized	
		Gains	Losses	
		(in thousands)		
Securities Available-for-Sale:				
Corporate	\$ 6,683	\$ 26	\$ (185)	\$ 6,524
State and municipal	13,710	31	(200)	13,541
Residential Agency MBS and CMOs	26,466	41	(215)	26,292
U.S. agency	2,016	1	-	2,017
Total securities available-for-sale	\$ 48,875	\$ 99	\$ (600)	\$ 48,374
Securities Held-to-Maturity:				
Corporate	\$ 4,500	\$ 8	\$ (110)	\$ 4,398
Total securities held-to-maturity	\$ 4,500	\$ 8	\$ (110)	\$ 4,398

Solera National Bancorp, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

The amortized cost and estimated fair value of investment securities by contractual maturity at December 31, 2016 are shown below.

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
	(in thousands)			
Due in one year or less	\$ 999	\$ 1,002	\$ -	\$ -
Due after one year through five years	5,012	4,950	-	-
Due after five years through ten years	11,893	11,620	2,750	2,585
Due after ten years	2,994	2,834	1,750	1,646
	<u>20,898</u>	<u>20,406</u>	<u>4,500</u>	<u>4,231</u>
Residential agency MBS and CMOs	15,911	15,727	-	-
	<u>\$ 36,809</u>	<u>\$ 36,133</u>	<u>\$ 4,500</u>	<u>\$ 4,231</u>

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 December 31, 2016 and 2015.

	December 31, 2016					
	Less than 12 months		12 months or more		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
	(in thousands)					
<u>Securities Available-for-Sale</u>						
Corporate	\$ 7,040	\$ (237)	\$ 1,466	\$ (42)	\$ 8,506	\$ (279)
State and municipal	6,937	(172)	551	(44)	7,488	(216)
Residential agency MBS and CMOs	8,274	(151)	4,601	(69)	12,875	(220)
U.S. Agency	983	(16)	-	-	983	(16)
Total temporarily-impaired	<u>\$ 23,234</u>	<u>\$ (576)</u>	<u>\$ 6,618</u>	<u>\$ (155)</u>	<u>\$ 29,852</u>	<u>\$ (731)</u>

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Notes to Consolidated Financial Statements

December 31, 2016 and 2015

	December 31, 2015					
	Less than 12 months		12 months or more		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
	(in thousands)					
<u>Securities Available-for-Sale</u>						
Corporate	\$ 2,932	\$ (100)	\$ 2,778	\$ (86)	\$ 5,710	\$ (186)
State and municipal	7,428	(155)	2,015	(45)	9,443	(200)
Residential agency MBS and CMOs	14,478	(153)	4,948	(61)	19,426	(214)
U.S. Agency	1,014	-	-	-	1,014	-
Total temporarily-impaired	<u>\$ 25,852</u>	<u>\$ (408)</u>	<u>\$ 9,741</u>	<u>\$ (192)</u>	<u>\$ 35,593</u>	<u>\$ (600)</u>

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. At December 31, 2016, no declines were deemed to be other than temporary.

For the years ended December 31, 2016 and 2015, the Company received \$23.0 million in proceeds from the sale of investment securities with gross realized gains of \$159,000 and \$199,000, respectively. Gross realized losses amounted to \$2,000 and \$13,000, respectively.

Securities with carrying values of \$17.8 million and \$21.0 million at December 31, 2016 and 2015, respectively, 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 C – LOANS HELD FOR SALE

There were no loans held for sale as of December 31, 2016. As of December 31, 2015, the Company had approximately \$1.0 million in loans held for sale related to a single borrower whose commercial loans had been identified for sale to a third party and were carried at the lower of cost or fair value.

Solera National Bancorp, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE D – LOANS AND ALLOWANCE FOR LOAN LOSSES

The following table sets forth the composition of the loan portfolio, excluding loans held for sale:

	December 31,	
	2016	2015
	(in thousands)	
Commercial real estate ("CRE")	\$ 49,806	\$ 42,395
Residential real estate	28,767	26,080
Commercial and industrial	9,065	10,046
Construction and land development	3,110	3,571
Consumer and other	14,495	31
Subtotal	<u>105,243</u>	<u>82,123</u>
Less: Allowance for loan losses	(1,599)	(1,518)
Net deferred loan fees	(260)	(15)
Loans, net	<u>\$ 103,384</u>	<u>\$ 80,590</u>

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 loans secured by real estate located in Colorado, making the value of the portfolio more susceptible to declines in real estate values and other changes in economic conditions in Colorado. No single borrower can be approved for a loan over the Company's current legal lending limit of approximately \$3.2 million. This regulatory requirement helps to ensure the Company's exposure to one individual customer is limited.

Solera National Bancorp, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

Activity in the allowance for loan and lease losses for the years ended December 31, 2016 and 2015 is summarized as follows:

Rollforward of Allowance for Loan and Lease Losses by Portfolio Segment						
Twelve Months Ended December 31, 2016						
(in thousands)	Commercial Real Estate	Residential Real Estate	Commercial and Industrial	Construction and Land Development	Consumer	Total
Balance at December 31, 2015	\$ 866	\$ 322	\$ 206	\$ 123	\$ 1	\$ 1,518
Provision for loan losses	84	(41)	7	(95)	45	-
Charge-offs	-	-	-	-	(1)	(1)
Recoveries	-	35	3	44	-	82
Net (charge-offs) recoveries	-	35	3	44	(1)	81
Balance at December 31, 2016	<u>\$ 950</u>	<u>\$ 316</u>	<u>\$ 216</u>	<u>\$ 72</u>	<u>\$ 45</u>	<u>\$ 1,599</u>

Rollforward of Allowance for Loan and Lease Losses by Portfolio Segment						
Twelve Months Ended December 31, 2015						
(in thousands)	Commercial Real Estate	Residential Real Estate	Commercial and Industrial	Construction and Land Development	Consumer	Total
Balance at December 31, 2014	\$ 926	\$ 391	\$ 187	\$ 95	\$ 1	\$ 1,600
Provision for loan losses	(60)	(117)	136	(8)	(1)	(50)
Charge-offs	-	-	(117)	-	-	(117)
Recoveries	-	48	-	36	1	85
Net (charge-offs) recoveries	-	48	(117)	36	1	(32)
Balance at December 31, 2015	<u>\$ 866</u>	<u>\$ 322</u>	<u>\$ 206</u>	<u>\$ 123</u>	<u>\$ 1</u>	<u>\$ 1,518</u>

Solera National Bancorp, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

Components of the allowance for loan and lease losses, and the related carrying amount of loans for which the allowance is determined, are as follows:

Loan and Allowance for Loan and Lease Losses by Portfolio Segment						
December 31, 2016						
(in thousands)	Commercial Real Estate	Residential Real Estate	Commercial and Industrial	Construction and Land Development	Consumer	Total
<u>Loan Balance based on Evaluation of Impairment Method:</u>						
Individually	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively	49,806	28,767	9,065	3,110	14,495	105,243
Total	\$ 49,806	\$ 28,767	\$ 9,065	\$ 3,110	\$ 14,495	\$ 105,243

<u>Allowance for Loan Losses based on Evaluation of Impairment Method:</u>						
Individually	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively	950	316	216	72	45	1,599
Total	\$ 950	\$ 316	\$ 216	\$ 72	\$ 45	\$ 1,599

Loan and Allowance for Loan and Lease Losses by Portfolio Segment						
December 31, 2015						
(in thousands)	Commercial Real Estate	Residential Real Estate	Commercial and Industrial	Construction and Land Development	Consumer	Total
<u>Loan Balance based on Evaluation of Impairment Method:</u>						
Individually	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively	42,395	26,080	10,046	3,571	31	82,123
Total	\$ 42,395	\$ 26,080	\$ 10,046	\$ 3,571	\$ 31	\$ 82,123

<u>Allowance for Loan Losses based on Evaluation of Impairment Method:</u>						
Individually	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively	866	322	206	123	1	1,518
Total	\$ 866	\$ 322	\$ 206	\$ 123	\$ 1	\$ 1,518

Solera National Bancorp, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

Impaired Loans and Troubled Debt Restructurings

There were no impaired loans or troubled debt restructurings (TDRs) as of December 31, 2016. There was one impaired loan and no TDRs as of December 31, 2015. The impaired loan was a commercial and industrial loan with a recorded investment¹ of \$131,000, and an unpaid principal balance of \$147,000 as of December 31, 2015. The impaired loan had no valuation allowance at December 31, 2015, as the loan was held for sale at par value. No interest income was recognized during 2015 on this impaired loan.

No previously restructured loans subsequently defaulted and were charged-off during 2016 or 2015.

Past Due and Nonaccrual Loans

The following tables show past due loans, by class, as of December 31, 2016 and 2015:

(in thousands)	Age Analysis of Loans by Class				
	Year Ended December 31, 2016				
	30-59 Days Past Due	60-89 Days Past Due	Past Due 90 Days or More and Still Accruing	Nonaccrual	Total Past Due and Nonaccrual
CRE - owner occupied	\$ -	\$ -	\$ -	\$ -	\$ -
CRE - non-owner occupied	-	-	-	-	-
Commercial and industrial	-	-	-	-	-
Residential real estate	74	-	-	-	74
Construction and land development	-	-	-	-	-
Government guaranteed	1,220	727	3,595	-	5,542
Consumer	-	-	-	-	-
Total	\$ 1,294	\$ 727	\$ 3,595	\$ -	\$ 5,616

The increase in past due loans relates to the Company's purchase, in 2016, in a pool of government guaranteed rehabilitated student loans. Approximately 97.5% of the principal and interest is guaranteed by the full faith and credit of the United States Treasury under the Higher Education Act of 1965.

¹ The recorded investment represents the customer balance less partial charge-offs, if any, and excluding any accrued interest receivable since most impaired loans are on nonaccrual status.

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December 31, 2016 and 2015

(in thousands)	Age Analysis of Loans by Class				
	Year Ended December 31, 2015				
	30-59 Days Past Due	60-89 Days Past Due	Past Due 90 Days or More and Still Accruing	Nonaccrual	Total Past Due and Nonaccrual
CRE - owner occupied	\$ -	\$ -	\$ -	\$ -	\$ -
CRE - non-owner occupied	-	-	-	-	-
Commercial and industrial	-	20	-	-	20
Residential real estate	112	-	-	-	112
Construction and land development	-	-	-	-	-
Government guaranteed	-	-	-	-	-
Consumer	1	-	-	-	1
Total	<u>\$ 113</u>	<u>\$ 20</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 133</u>

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

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

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

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

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

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

Solera National Bancorp, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

As of December 31, 2016, and based on the most recent analysis performed during the month of December 2016, the recorded investment in each risk category of loans by class of loan is as follows:

(in thousands)	Credit Quality of Loans by Class				
	Year Ended December 31, 2016				
	Pass	Special Mention	Substandard	Doubtful	Total
CRE - owner occupied	\$ 15,674	\$ 754	\$ 3,048	\$ -	\$ 19,476
CRE - non-owner occupied	29,851	-	479	-	30,330
Commercial and industrial	6,527	410	628	-	7,565
Residential real estate	28,558	-	209	-	28,767
Construction and land development	3,110	-	-	-	3,110
Government guaranteed	15,968	-	-	-	15,968
Consumer	27	-	-	-	27
Total	\$ 99,715	\$ 1,164	\$ 4,364	\$ -	\$ 105,243

As of December 31, 2015, and based on the analysis performed during the month of December 2015, the recorded investment in each risk category of loans by class of loan is as follows:

(in thousands)	Credit Quality of Loans by Class				
	Year Ended December 31, 2015				
	Pass	Special Mention	Substandard	Doubtful	Total
CRE - owner occupied	\$ 20,391	\$ 740	\$ 2,093	\$ -	\$ 23,224
CRE - non-owner occupied	18,669	502	-	-	19,171
Commercial and industrial	7,978	-	307	-	8,285
Residential real estate	26,080	-	-	-	26,080
Construction and land development	3,571	-	-	-	3,571
Government guaranteed	1,761	-	-	-	1,761
Consumer	31	-	-	-	31
Total	\$ 78,481	\$ 1,242	\$ 2,400	\$ -	\$ 82,123

Solera National Bancorp, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE E – NONMARKETABLE EQUITY SECURITIES

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

(in thousands)	<u>2016</u>	<u>2015</u>
Federal Reserve Bank of Kansas City	\$ 599	\$ 545
Federal Home Loan Bank of Topeka	280	329
	<u>\$ 879</u>	<u>\$ 874</u>

NOTE F – BANK-OWNED LIFE INSURANCE

Bank-owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value. Increases in the cash surrender value are recognized as other noninterest income. In 2015, the Company received a one-time bank-owned life insurance benefit of \$293,000.

NOTE G – OTHER REAL ESTATE OWNED

The balance of other real estate owned as of December 31, 2016 and 2015 was \$0. The Company did not record any operating income or expense for its OREO property in 2015, which was sold for \$657,000 in early 2015.

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Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE H – PREMISES AND EQUIPMENT

At December 31, premises and equipment, less accumulated depreciation consisted of the following:

(in thousands)	2016	2015
Land	\$ 269	\$ 269
Leasehold improvements	1,476	1,476
Furniture, fixtures and equipment	948	946
	2,693	2,691
Accumulated depreciation	(862)	(773)
Total premises and equipment	\$ 1,831	\$ 1,918

Depreciation expense on premises and equipment was \$102,000 and \$115,000 for the years ended December 31, 2016 and 2015, respectively, and is included in occupancy expense in the accompanying consolidated statements of comprehensive income. Rent expense on premises was approximately \$12,000 for the year ended December 31, 2016. The Company reversed \$11,000 of expense for the year ended December 31, 2015 due to adjustments in the abandoned lease calculation as subleases were secured for office space previously occupied by the Company's mortgage division.

The Company has noncancelable operating leases for one former mortgage production office that expires in February 2017 and a copier/printer/scanner that expires in 2020. The following table shows future minimum noncancelable operating lease payments as of December 31, 2016:

Year ending December 31,	(in thousands)
2017	\$ 8
2018	3
2019	3
2020	2
2021	-
Thereafter	-
Total	\$ 16

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Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE I – DEPOSITS

The aggregate amount of time deposits in denominations of \$250,000 or more at December 31, 2016 and 2015 was \$13.8 million and \$12.5 million, respectively.

At December 31, 2016, the scheduled maturities of interest-bearing time deposits are as follows:

	<u>2016</u>
	(in thousands)
2017	27,085
2018	15,258
2019	7,163
2020	12,491
2021	6,930
Thereafter	514
Total	<u>\$ 69,441</u>

Time deposits at December 31, 2016 included approximately \$5.0 million in brokered deposits. The majority of this balance consisted of time deposits opened during 2016 that mature during 2017. There was \$1.0 million in reciprocal time deposits included in brokered deposits at December 31, 2016. Time deposits at December 31, 2015 included approximately \$5.5 million in brokered deposits. The majority of this balance consisted of time deposits opened during 2015 that matured during 2016. There were no reciprocal time deposits included in brokered deposits at December 31, 2015.

In 2013, the Company completed its acquisition of customer deposits, excluding certificates of deposit, and a nominal amount of overdraft lines of credit balances, totaling approximately \$6.0 million, associated with deposit accounts from the Lakewood branch of Liberty Savings Bank, FSB. The Company paid a deposit premium of \$468,000 based upon the average daily total deposits during the 30 calendar days immediately preceding the closing of the transaction. The deposit premium, as well as other transaction costs incurred, were capitalized as a core deposit intangible and are being amortized on a straight-line basis over a period of seven years. In 2016 and 2015, the Company recorded \$67,000 in amortization expense. As of December 31, 2016 and 2015, the core deposit intangible is \$228,000 and \$295,000 and is included in Other Assets on the Company's Consolidated Balance Sheets. Quarterly, the Company evaluates the core deposit intangible for impairment. As of December 31, 2016, no impairment has been noted.

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Notes to Consolidated Financial Statements

December 31, 2016 and 2015

NOTE J – FHLB ADVANCES

The Company is a member of the Federal Home Loan Bank of Topeka (FHLB) and, as a regular part of its business, obtains advances from this FHLB. Overnight advances bear interest at a variable rate while all other advances bear interest at a fixed rate. All advances are collateralized by certain securities pledged by the Company and some of the Company's qualifying loans. The Company's authorized borrowing line with the FHLB is capped at 40% of total assets, subject to the availability of sufficient collateral to pledge against such borrowings. As of December 31, 2016, the Company had \$1.4 million in fixed-rate borrowings and \$2.0 million in variable-rate, callable borrowings from the FHLB with varying maturity dates between November 2017 and October 2018 and a weighted-average effective interest rate of 1.05%. As of December 31, 2016, the contractual interest rates ranged from 0.70% to 1.81%. Additionally, the Company had \$2.4 million in variable-rate, overnight borrowings at 0.72% as of December 31, 2016.

As of December 31, 2015, the Company had \$3.0 million in fixed-rate borrowings and \$2.0 million in variable-rate, callable borrowings from the FHLB with varying maturity dates between June 2016 and October 2018 and a weighted-average effective interest rate of 1.54%. The Company had no overnight borrowings from the FHLB as of December 31, 2015.

In addition to FHLB borrowings, the Company may borrow overnight funds on an unsecured basis from its correspondent banks. As of December 31, 2016 and 2015, the Company had approved borrowing lines up to \$13.1 million, from correspondent banks. As of both December 31, 2016 and 2015, there were no outstanding borrowings under these arrangements. The Company also has the ability to borrow at the Federal Reserve Bank Discount Window on a secured basis.

At December 31, 2016, the scheduled maturities and weighted-average effective interest rate of FHLB borrowings are as follows:

(in thousands)	Amount Maturing	Weighted- Average Interest Rate
Overnight	\$ 2,415	0.72%
2017	2,400	1.09%
2018	1,000	1.76%
Total	<u>\$ 5,815</u>	<u>1.05%</u>

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NOTE K – INCOME TAXES

A deferred tax asset or liability is recognized for the tax consequences of temporary differences in the recognition of revenue and expense for financial reporting and tax purposes. Listed below are the components of the net deferred tax asset at December 31:

	2016	2015
	(in thousands)	
Deferred tax assets:		
Start-up and organizational expenses	\$ 456	\$ 535
Net operating loss carryforward	1,054	1,325
Net unrealized loss on available-for-sale securities	250	186
Allowance for loan losses	399	411
Non-qualified stock options	14	80
Other	316	115
Total deferred tax assets	2,489	2,652
Deferred tax liabilities:		
Federal Home Loan Bank dividends	(6)	(21)
Other	-	(99)
Total deferred tax liabilities	(6)	(120)
Valuation reserve	-	(2,532)
Net deferred tax asset (liability)	\$ 2,483	\$ -

During the twelve months ended December 31, 2016, the Company reversed the valuation allowance on its deferred tax asset. Realization of deferred tax assets is dependent upon the generation of sufficient future taxable income during the period that deductible temporary differences and carryforwards are expected to be available to reduce taxable income. After nine consecutive quarters of earnings, the Company believes it is more likely than not that the Company will generate sufficient taxable income to utilize the \$2.5 million net deferred tax asset.

During the period ended December 31, 2015, the Company had a full valuation allowance reducing its \$2.5 million net deferred tax asset to \$0. The valuation allowance was established because the Company had not reported earnings sufficient enough to support the recognition of the deferred tax assets.

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The Company has net operating loss carryforwards of approximately \$2.8 million for federal income tax purposes. Federal and state net operating loss carryforwards, to the extent not used, will expire starting in 2027. The Company is no longer subject to examination by Federal and State taxing authorities for years before 2013.

The income tax provision differs from the amount of income tax determined by applying the U.S. federal income tax rate of 34% to pretax income from continuing operations for the years ended December 31, 2016 and 2015, due to the following:

	Year ended December 31,	
	2016	2015
	(in thousands)	
Computed "expected" tax expense	\$ 312	\$ 605
Change in income taxes resulting from:		
Change in valuation allowance	(2,596)	(702)
Other	75	97
Income tax provision (benefit)	<u>\$ (2,209)</u>	<u>\$ -</u>

NOTE L - EMPLOYEE BENEFIT PLANS

The Company sponsors a Qualified Automatic Contribution Arrangement (QACA) 401(k) Plan whereby the Company contributes three percent of an employee's compensation to the Plan. Employer contributions cliff-vest after two years of service. Employees may also make volunteer contributions to the Plan, subject to certain limits based on federal tax laws. The employee's contributions vest immediately. For the years ended December 31, 2016 and 2015, expense attributable to the Plan amounted to \$4,000 and \$25,000, respectively. The decrease in expense in 2016 is attributed to the utilization of Plan forfeitures to offset the Company's current year contributions.

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NOTE M – STOCK-BASED COMPENSATION

In 2012, the Board of Directors adopted the Company's 2012 Long-Term Incentive Plan, (the "2012 Plan"). Under the terms of the 2012 Plan, the Company may grant incentive stock options, nonqualified stock options, restricted stock awards, and/or stock appreciation rights to eligible persons, including officers and directors of the Company. The 2012 Plan does not terminate or amend the Company's 2007 Stock Incentive Plan (the "2007 Plan"). The 2012 Plan reserves 250,000 shares of common stock of the Company for issuance. At December 31, 2016 and 2015, approximately 242,000 and 246,000 shares, respectively, were available for future grants. Stock options expire no later than 10 years from the date of the grant and generally vest over 4 years. The 2012 Plan provides for accelerated vesting if there is a change of control, as defined in the 2012 Plan.

Under the terms of the Company's 2007 Plan, 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 2007 Plan. At December 31, 2016, approximately 99,000 shares were available for future grants. The 2007 Plan provides for options to purchase shares of common stock at a price not less than 100% of the fair market value of the stock on the date of grant. Stock options expire no later than 10 years from the date of the grant and generally vest over 5 years. The 2007 Plan provides for accelerated vesting if there is a change of control, as defined in the 2007 Plan.

The Company recognized stock-based compensation costs of approximately \$33,000 during 2016, compared to \$12,000 during 2015.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes-Merton option pricing model. As of December 31, 2016, there was approximately \$98,000 of unrecognized compensation costs related to outstanding stock options that will be recognized over a weighted-average period of 2.4 years.

There were no options granted during 2016. The fair value of the 2015 stock option grants was estimated on the date of grant using the Black-Scholes-Merton option pricing model with the assumptions presented in the following table:

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	2015 Nonqualified Grants
Number of Options Granted	250,000
Expected Volatility	22.7%
Expected Term	4.2 - 6.0 years
Expected Dividend	0%
Risk-Free Rate	1.42% - 1.80%
Grant-Date Fair Value	\$0.71 - \$1.01

The expected volatility is based on the volatility of the Company's stock using historical activity. The expected term represents the estimated average period of time that the options will remain outstanding. The expected dividend is set to zero since the Company does not expect to pay dividends in the foreseeable future. The risk-free rate of return reflects the grant-date interest rate offered for zero coupon U.S. Treasury bonds with the same expected term as the options. The Company's estimated forfeiture rate is 36% for executive officers and 41% for employees. The different ranges result from certain groups of individuals exhibiting different behavior. The estimated forfeiture rate is reviewed at each reporting date to confirm that it is the best estimate to support the then-current trends within the Company. Options forfeited impact the amount of compensation expense recognized. Share-based compensation expense is based on awards that are ultimately expected to vest; accordingly, share-based compensation expense may be impacted if actual forfeitures differ from estimated forfeitures.

As of December 31, 2016 and 2015, the aggregate intrinsic value of in-the-money outstanding stock options was approximately \$18,000 and \$11,000, respectively. As of December 31, 2016, there were approximately 62,000 fully-vested and exercisable stock options outstanding with a weighted-average exercise price of \$6.93 per share, a weighted-average remaining contractual term of 3.5 years. As of December 31, 2016, there were 42,000 options expected to vest over the next 12 months.

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The following is a summary of the Company's outstanding stock options and related activity for the year ended December 31, 2016:

	Options	Weighted- Average Grant Date Fair Value	Weighted- Average Exercise Price
Outstanding at January 1, 2016	270,750	\$ 0.83	\$ 6.98
Granted	-	-	-
Exercised	-	-	-
Expired	(562)	1.86	7.15
Forfeited	(188)	1.86	7.15
Outstanding at December 31, 2016	<u>270,000</u>	\$ 0.83	\$ 6.98

The following is a summary of the Company's outstanding stock options and related activity for the year ended December 31, 2015:

	Options	Weighted- Average Grant Date Fair Value	Weighted- Average Exercise Price
Outstanding at January 1, 2015	90,362	\$ 2.18	\$ 8.29
Granted	250,000	0.76	7.00
Exercised	(1,416)	0.63	3.24
Expired	(67,014)	2.37	8.90
Forfeited	(1,182)	1.43	5.88
Outstanding at December 31, 2015	<u>270,750</u>	\$ 0.83	\$ 6.98

Restricted Stock

During 2015, the Company granted 4,750 performance-based restricted shares to its outside Directors. The fair value of these grants equaled the value of the Company's stock on the date of grant which ranged between \$6.00 and \$6.20 per share. As of December 31, 2016, 2,750 shares are expected to meet the performance criteria and vest in June 2017.

The Company recognized approximately \$6,000 and \$0 of stock-based compensation expense associated with stock awards for the year ended December 31, 2016 and December

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31, 2015, respectively. As of December 31, 2016, there was approximately \$7,000 of unrecorded compensation expense associated with restricted stock grants to be recognized in 2017. The entire 4,750 restricted stock awards are considered issued and outstanding as they have voting and dividend rights; however, since none of those shares are vested they are excluded from the computation of earnings per share.

A summary of the status of unearned stock awards and the change during the period is presented in the table below:

	Shares	Weighted-Average Fair Value on Award Date
Unearned at January 1, 2016	-	\$ -
Awarded	4,750	6.03
Forfeited	-	-
Vested	-	-
Unearned at December 31, 2016	4,750	\$ 6.03

NOTE N – WARRANTS

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

Warrants Outstanding and Exercisable				
Type	Exercise Price	Number	Average Remaining Contractual Life	Weighted Average Exercise Price
Organizer warrants	\$ 10.00	317,335	0.75	\$ 10.00

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

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NOTE O – EARNINGS PER SHARE

The following table presents the net earnings and weighted average common shares outstanding used to calculate earnings per share for the years ended December 31, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
<u>Basic earnings per share computation</u>		
Net earnings to common stockholders	\$ 3,126,582	\$ 1,778,199
Weighted average shares outstanding - basic	2,723,062	2,722,473
Basic earnings per share	<u>\$ 1.15</u>	<u>\$ 0.65</u>
<u>Diluted earnings share computation</u>		
Net earnings to common stockholders	\$ 3,126,582	\$ 1,778,199
Weighted average shares outstanding - basic	2,723,062	2,722,473
<u>Shares assumed issued:</u>		
Stock options	2,985	2,019
Unvested restricted stock	-	-
Organizer stock warrants	-	-
Weighted average shares outstanding - diluted	<u>2,726,047</u>	<u>2,724,492</u>
Diluted earnings per share	<u>\$ 1.15</u>	<u>\$ 0.65</u>

For the years ended December 31, 2016 and 2015, respectively, approximately 77,000 and 107,000 anti-dilutive options were not included in the calculation of diluted EPS. Additionally, approximately 217,000 and 281,000, organizer warrants were not included in the calculation of diluted EPS for the years ended December 31, 2016 and 2015, respectively, as their exercise prices were above the market price of the stock making them anti-dilutive.

As of December 31, 2016 and 2015, respectively, 4,750 and 25,000 unvested restricted stock awards were not included in the weighted average shares outstanding for the computation of basic earnings per share as they are only considered issued and outstanding due to their voting and dividend rights.

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NOTE P – RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Company may grant loans to or hold deposits of principal officers, directors and/or their affiliates. The following details the related party loan and deposit balances as of December 31:

	<u>2016</u>	<u>2015</u>
	(in thousands)	
Loans to principal officers, directors and/or their	\$ -	\$ 37
Deposits from related parties	854	252

NOTE Q – 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 consist of commitments to extend credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

At December 31, 2016 and 2015, the Company had \$15.1 million and \$16.2 million, respectively, in unfunded commitments outstanding whose contract amounts represent credit risk.

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 some 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.

NOTE R – LEGAL CONTINGENCIES

In the ordinary course of the business, the Company may be party to various legal actions,

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which it believes are incidental to the operation of the business and will not have a material impact on the financial condition, cash flow, or results of operations of the Company.

During 2016, the Company was involved in a legal proceeding. On August 20, 2015, the Company's former Chief Executive Officer, Mr. John Carmichael, filed a lawsuit against the Company in the District Court of Jefferson County, Colorado seeking approximately \$430,000 in salary compensation, 10,000 shares of common stock and stock options relating to 30,000 shares of common stock. The case went to trial in September 2016. The jury awarded Mr. Carmichael approximately \$515,000 as salary and interest due by the Company for breach of contract. This cost, as well as the \$138,000 in legal fees incurred were recorded to expense in 2016.

NOTE S – NONINTEREST EXPENSE

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

(in thousands)	Year Ended December 31,		Increase/ (Decrease)
	2016	2015	
<u>Other general and administrative expenses:</u>			
Data processing	\$ 515	\$ 524	\$ (9)
Other loan expenses	57	86	(29)
Marketing and promotions	13	17	(4)
Regulatory and reporting fees	127	115	12
FDIC assessment	133	159	(26)
Telephone/communication	21	26	(5)
Travel and entertainment	9	8	1
Printing, stationary and supplies	23	28	(5)
Training, education and conferences	16	11	5
Insurance	68	70	(2)
Dues and memberships	10	9	1
Core deposit intangible amortization	67	67	-
Postage and shipping	8	10	(2)
ATM and debit card fees	18	20	(2)
Franchise taxes	29	24	5
Operating losses / legal settlements	531	52	479
Miscellaneous other	6	9	(3)
Total	\$ 1,651	\$ 1,235	\$ 416

The increase in operating losses/legal settlements primarily relates to the loss contingency recorded in 2016. See Note R for more details.

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NOTE T – FAIR VALUE MEASUREMENTS

The Company carries its available-for-sale securities, at fair value measured on a recurring basis. Fair value measurements are determined based on the assumptions the market participants would use in pricing the asset. See additional discussion regarding fair value measurement in Note A under the discussion of significant accounting policies.

For available-for-sale 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. As of December 31, 2016 and 2015, all of the Company's available-for-sale securities were valued using Level 2 inputs.

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

Other real estate owned, if any, is valued at the time the loan is foreclosed upon and the asset is transferred to other real estate owned. The value is based primarily on third party appraisals, less costs to sell. The appraisals may be adjusted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the client and client's business. Such discounts are typically significant and result in a Level 3 classification of the inputs for determining fair value. Other real estate owned, if any, is reviewed and evaluated on at least an annual basis for additional impairment and adjusted accordingly.

There were no changes to management's valuation methodology during 2016 or 2015.

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Assets and Liabilities Measured on a Recurring Basis

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

(in thousands)

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets at December 31, 2016				
Securities available for sale				
Corporate	\$ -	\$ 9,949	\$ -	\$ 9,949
State and municipal	-	9,474	-	9,474
Residential agency MBS/CMOs	-	15,727	-	15,727
U.S. Agency	-	983	-	983
Assets at December 31, 2015				
Securities available for sale				
Corporate	\$ -	\$ 6,524	\$ -	\$ 6,524
State and municipal	-	13,541	-	13,541
Residential agency MBS/CMOs	-	26,293	-	26,293
U.S. Agency	-	2,016	-	2,016

Assets and Liabilities Measured on a Nonrecurring Basis

The Company had no assets and liabilities that were measured at fair value on a nonrecurring basis as of December 31, 2016 and 2015. Specifically, the Company had no impaired loans or other real estate owned as of December 31, 2016 and 2015.

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 such value is required by U.S. GAAP. 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.

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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 financial instruments held by the Company. Fair value estimates are based on financial instruments both on and off the balance sheet without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Additionally, tax consequences related to the realization of the unrealized gains and losses can have a potential effect on fair value estimates and have not been considered in many of the estimates.

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

Cash and cash equivalents: The carrying amounts of cash, 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 is estimated using a discounted cash flow calculation that applies interest rates currently being offered for deposits of similar remaining maturities.

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 held for sale: Loans held for sale are carried at the lower of cost or fair value. As of December 31, 2015, the value of loans held for sale approximated their fair value.

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

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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.

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

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

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

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

Securities sold under agreements to repurchase: The carrying amount of securities sold under agreements to repurchase approximates fair value due to the short-term nature of these agreements, which generally mature within one to four days from the transaction date. Securities sold under agreement to repurchase are included in accounts payable and other liabilities on the Company's Consolidated Balance Sheets.

Federal Home Loan Bank advances: Fair value of fixed rate FHLB advances are estimated using a discounted cash flow model based on current market rates for similar types of borrowing arrangements including similar remaining maturities. The fair value of variable rate FHLB advances is assumed to approximate the carrying value.

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

Loan commitments and letters of credit: The fair values of commitments are estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. The difference

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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.

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

(in thousands)	2016		2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<u>Financial Assets:</u>				
Cash and cash equivalents	\$ 799	\$ 799	\$ 2,489	\$ 2,489
Interest-bearing deposits with banks	261	273	750	765
Investment securities, available for sale	36,133	36,133	48,374	48,374
Investment securities, held to maturity	4,500	4,231	4,500	4,398
Loans held for sale	-	-	1,039	1,039
Loans, net	103,384	106,673	80,590	83,094
Nonmarketable equity securities	879	879	874	874
Bank-owned life insurance	4,495	4,495	4,369	4,369
Accrued interest receivable	798	798	571	571
<u>Financial Liabilities:</u>				
Deposits - demand, savings, and money market	\$ 56,884	\$ 56,884	\$ 54,679	\$ 54,679
Time deposits	69,441	70,062	66,160	66,383
Securities sold under agreements to repurchase	-	-	55	55
FHLB advances	5,815	5,808	5,000	4,987
Accrued interest payable	103	103	88	88

NOTE U – REGULATORY MATTERS

Banks and bank holding companies are subject to various regulatory capital requirements administered by state and federal banking agencies. Capital adequacy guidelines, and additionally for banks prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weighting and other factors.

The Basel III Capital Rules became effective for the Bank on January 1, 2015 subject to a phase-in for certain provisions. Quantitative measures established by the Basel III Capital Rules to ensure capital adequacy require the maintenance of minimum amounts and ratios (set forth in the table below) of common equity tier 1 capital, tier 1 capital and total capital

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(as defined in the regulations) to risk-weighted assets (as defined), and of tier 1 capital to quarterly average assets (as defined).

At December 31, 2016, the Bank's regulatory capital is comprised of the following: 1) Common equity tier 1 capital – consisting of common stock and related paid-in-capital, and retained earnings; 2) Additional tier 1 capital – there are no components of tier 1 capital beyond common equity tier 1 capital; 3) Tier 2 capital – consisting of a permissible portion of the allowance for loan losses; and 4) total capital – the aggregate of all tier 1 and tier 2 capital. In connection with the adoption of the Basel III Capital Rules, the Bank elected to opt-out of the requirement to include most components of accumulated other comprehensive income in common equity tier 1 capital. At December 31, 2015, the Bank's regulatory capital is comprised of the same components as at December 31, 2016, except that the regulations in effect at that time did not distinguish between common equity tier 1 and additional tier 1 capital.

When fully phased in on January 1, 2019, the Basel III capital rules will require the Bank to maintain a minimum ratio of common equity tier 1 capital to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% common equity tier 1 capital ratio as the buffer is phased in, effectively resulting in a minimum ratio of common equity tier 1 capital to risk-weighted assets of 7% upon full phase in). The Bank will also be required to maintain a tier 1 capital to risk-weighted assets ratio of 8.0% (10.5% including the capital conservation buffer), and a tier 1 capital to quarterly average assets ratio of 4.0%.

The aforementioned capital conservation buffer phases in at 0.625% annually over a four year period beginning January 1, 2016, and is designed to absorb losses during periods of economic stress. Banking institutions with capital ratios above the base minimums but below the effective minimums (which include the buffer) will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

The following tables present actual and required capital ratios as of December 31, 2016 and 2015 for the Bank under the Basel III Capital Rules. The minimum required capital amounts presented include the minimum required capital levels as of December 31, 2016 based on the phase-in provisions of the Basel III Capital Rules and the minimum required capital levels as of January 1, 2019 when the Basel III Capital Rules have been fully phased-in, and include the capital conservation buffer. Capital levels required to be considered well capitalized are based on prompt corrective action regulations, as amended to reflect changes under the Basel III Capital Rules.

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	December 31, 2016			
	Risk-based			Leverage
	Common			Tier 1
	Tier 1	Equity Tier	Total capital	
	(in thousands)			
Actual regulatory capital	\$ 20,968	\$ 20,968	\$ 22,372	\$ 20,968
Well-capitalized requirement	8,951	7,273	11,189	7,805
Excess regulatory capital	\$ 12,017	\$ 13,695	\$ 11,183	\$ 13,163
Capital ratios	18.7%	18.7%	20.0%	14.0%
Well-capitalized requirement	8.0%	6.5%	10.0%	5.0%
Minimum required for capital adequacy, purposes - Basel III phased-in schedule	7.3%	5.7%	9.3%	4.0%
Minimum required for capital adequacy, purposes - Basel III fully phased-in	8.5%	7.0%	10.5%	4.0%

	December 31, 2015			
	Risk-based			Leverage
	Equity Tier			Tier 1
	Tier 1	1	Total capital	
	(in thousands)			
Actual regulatory capital	\$ 18,557	\$ 18,557	\$ 19,797	\$ 18,557
Well-capitalized requirement	5,937	6,431	9,894	7,033
Excess regulatory capital	\$ 12,620	\$ 12,620	\$ 9,903	\$ 11,524
Capital ratios	18.8%	18.8%	20.0%	13.2%
Well-capitalized requirement	8.0%	6.5%	10.0%	5.0%
Minimum required for capital adequacy, purposes - Basel III phased-in schedule	6.6%	5.1%	8.6%	4.0%
Minimum required for capital adequacy, purposes - Basel III fully phased-in	8.5%	7.0%	10.5%	4.0%

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

The Bank is restricted as to the amount of dividends which can be paid. Dividends declared by national banks that exceed net income (as defined by OCC regulations) for the current year plus retained net income for the preceding two years must be approved by the OCC.

Solera National Bancorp, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2016 and 2015

Also, the Bank may not pay dividends until it has received a prior written determination of no supervisory objection from the Assistant Deputy Comptroller of the Western District of the OCC.

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

NOTE V – SUBSEQUENT EVENTS

Management evaluates events occurring subsequent to the balance sheet date, through the date the financial statements are eligible to be issued, to determine whether the events require recognition or disclosure in the financial statements. If a subsequent event evidences conditions existing at the balance sheet date, the effects are recognized in the financial statements (recognized subsequent event). If a subsequent event evidences conditions arising after the balance sheet date, the effects are not recognized in the financial statements but rather disclosed in the notes to the financial statements (non-recognized subsequent events). The effects of subsequent events are only recognized if material, or disclosed if the financial statements would otherwise be misleading.

With respect to the December 31, 2016 financial statements, management has considered subsequent events through March 22, 2017 and determined there are no recognized subsequent events.

Supplemental Consolidating Schedules
December 31, 2016 and 2015

**SOLERA NATIONAL BANCORP, INC.
AND SUBSIDIARY**



Solera National Bancorp, Inc. and Subsidiary

Consolidating Balance Sheet

December 31, 2016

(in thousands)	Solera National Bank	Solera National Bancorp, Inc.	Consolidating Entries	Consolidated
ASSETS				
Cash and cash equivalents	\$ 799	\$ 1,532	\$ (1,532)	\$ 799
Interest-bearing deposits with banks	261	-	-	261
Investment securities, available-for-sale	36,133	-	-	36,133
Investment securities, held-to-maturity	4,500	-	-	4,500
Loans held for sale	-	-	-	-
Loans, net	103,384	-	-	103,384
Nonmarketable equity securities	879	-	-	879
Investment in subsidiary	-	21,357	(21,357)	-
Bank-owned life insurance	4,495	-	-	4,495
Premises and equipment, net	1,831	-	-	1,831
Accrued interest receivable	798	-	-	798
Deferred tax asset, net	2,008	475	-	2,483
Other assets	540	(12)	-	528
Total Assets	<u>155,628</u>	<u>23,352</u>	<u>(22,889)</u>	<u>156,091</u>
LIABILITIES AND STOCKHOLDERS' EQUITY				
Liabilities				
Deposits				
Noninterest-bearing demand	5,941	-	-	5,941
Interest-bearing demand	8,374	-	-	8,374
Savings and money market	44,101	-	(1,532)	42,569
Time deposits	69,441	-	-	69,441
Total deposits	<u>127,857</u>	<u>-</u>	<u>(1,532)</u>	<u>126,325</u>
Accrued interest payable	103	-	-	103
Accrued payable and other liabilities	496	280	-	776
FHLB advances	5,815	-	-	5,815
Total liabilities	<u>134,271</u>	<u>280</u>	<u>(1,532)</u>	<u>133,019</u>
Stockholders' equity				
Common stock	10,500	27	(10,500)	27
Additional paid-in capital	11,594	27,170	(11,594)	27,170
Accumulated deficit	(311)	(3,543)	311	(3,543)
Accumulated other comprehensive loss	(426)	(426)	426	(426)
Treasury stock, at cost, 25,776 shares	-	(156)	-	(156)
Total stockholders' equity	<u>21,357</u>	<u>23,072</u>	<u>(21,357)</u>	<u>23,072</u>
Total Liabilities & Stockholders' Equity	<u>\$ 155,628</u>	<u>\$ 23,352</u>	<u>\$ (22,889)</u>	<u>\$ 156,091</u>

Solera National Bancorp, Inc. and Subsidiary

Consolidating Statement of Income

Year Ended December 31, 2016

(in thousands)	Solera National Bank	Solera National Bancorp, Inc.	Consolidating Entries	Consolidated
Interest income				
Interest and fees on loans	\$ 4,384	\$ -	\$ -	\$ 4,384
Interest on loans held for sale	-	-	-	-
Interest on investment securities	1,037	-	-	1,037
Dividends on FHLB and FRB stocks	45	-	-	45
Other interest income	11	2	(2)	11
Total interest income	5,477	2	(2)	5,477
Interest expense				
Deposits	1,229	-	(2)	1,227
FHLB advances	73	-	-	73
Total interest expense	1,302	-	(2)	1,300
Net interest income before provision	4,175	2	-	4,177
Provision for loan losses	-	-	-	-
Net interest income	4,175	2	-	4,177
Noninterest income				
Service charges and fees	102	-	-	102
Other income	138	-	-	138
Equity in undistributed earnings of subsidiary	-	3,081	(3,081)	-
Gain on loans sold	125	-	-	125
Gain on sale of available-for-sale securities, net	157	-	-	157
Total noninterest income	522	3,081	(3,081)	522
Noninterest expense				
Employee compensation and benefits	1,611	6	-	1,617
Occupancy and equipment	233	-	-	233
Professional fees	147	133	-	280
Other general and administrative	1,359	292	-	1,651
Total noninterest expense	3,350	431	-	3,781
Income before income taxes	1,347	2,652	(3,081)	918
Income tax benefit	(1,734)	(475)	-	(2,209)
Net income	\$ 3,081	\$ 3,127	\$ (3,081)	\$ 3,127

Solera National Bancorp, Inc. and Subsidiary

Consolidating Balance Sheet

December 31, 2015

(in thousands)	Solera National Bank	Solera National Bancorp, Inc.	Consolidating Entries	Consolidated
ASSETS				
Cash and cash equivalents	\$ 2,489	\$ 1,689	\$ (1,689)	\$ 2,489
Interest-bearing deposits with banks	750	-	-	750
Investment securities, available-for-sale	48,374	-	-	48,374
Investment securities, held-to-maturity	4,500	-	-	4,500
Loans held for sale	1,039	-	-	1,039
Loans, net	80,590	-	-	80,590
Nonmarketable equity securities	874	-	-	874
Investment in subsidiary	-	18,174	(18,174)	-
Bank-owned life insurance	4,369	-	-	4,369
Premises and equipment, net	1,918	-	-	1,918
Accrued interest receivable	571	-	-	571
Deferred tax asset, net	-	-	-	-
Other assets	620	(21)	-	599
Total Assets	<u>146,094</u>	<u>19,842</u>	<u>(19,863)</u>	<u>146,073</u>
LIABILITIES AND STOCKHOLDERS' EQUITY				
Liabilities				
Deposits				
Noninterest-bearing demand	3,954	-	-	3,954
Interest-bearing demand	8,405	-	-	8,405
Savings and money market	44,009	-	(1,689)	42,320
Time deposits	66,160	-	-	66,160
Total deposits	<u>122,528</u>	<u>-</u>	<u>(1,689)</u>	<u>120,839</u>
Accrued interest payable	88	-	-	88
Accrued payable and other liabilities	304	5	-	309
FHLB advances	5,000	-	-	5,000
Total liabilities	<u>127,920</u>	<u>5</u>	<u>(1,689)</u>	<u>126,236</u>
Stockholders' equity				
Common stock	10,500	27	(10,500)	27
Additional paid-in capital	11,566	27,137	(11,566)	27,137
Accumulated deficit	(3,391)	(6,670)	3,391	(6,670)
Accumulated other comprehensive loss	(501)	(501)	501	(501)
Treasury stock, at cost, 14,208 shares	-	(156)	-	(156)
Total stockholders' equity	<u>18,174</u>	<u>19,837</u>	<u>(18,174)</u>	<u>19,837</u>
Total Liabilities & Stockholders' Equity	<u>\$ 146,094</u>	<u>\$ 19,842</u>	<u>\$ (19,863)</u>	<u>\$ 146,073</u>

Solera National Bancorp, Inc. and Subsidiary

Consolidating Statement of Income

Year Ended December 31, 2015

(in thousands)	Solera National Bank	Solera National Bancorp, Inc.	Consolidating Entries	Consolidated
Interest income				
Interest and fees on loans	\$ 4,237	\$ -	\$ -	\$ 4,237
Interest on loans held for sale	-	-	-	-
Interest on investment securities	1,044	-	-	1,044
Dividends on FHLB and FRB stocks	46	-	-	46
Other interest income	15	2	(2)	15
Total interest income	<u>5,342</u>	<u>2</u>	<u>(2)</u>	<u>5,342</u>
Interest expense				
Deposits	1,041	-	(2)	1,039
FHLB advances	96	-	-	96
Total interest expense	<u>1,137</u>	<u>-</u>	<u>(2)</u>	<u>1,135</u>
Net interest income before provision	4,205	2	-	4,207
Provision for loan losses	(50)	-	-	(50)
Net interest income	<u>4,255</u>	<u>2</u>	<u>-</u>	<u>4,257</u>
Noninterest income				
Service charges and fees	110	-	-	110
Other income	449	-	-	449
Equity in undistributed earnings of subsidiary	-	1,873	(1,873)	-
Gain on loans sold	-	-	-	-
Gain on sale of available-for-sale securities, net	186	-	-	186
Total noninterest income	<u>745</u>	<u>1,873</u>	<u>(1,873)</u>	<u>745</u>
Noninterest expense				
Employee compensation and benefits	1,581	-	-	1,581
Occupancy and equipment	203	-	-	203
Professional fees	139	66	-	205
Other general and administrative	1,204	31	-	1,235
Total noninterest expense	<u>3,127</u>	<u>97</u>	<u>-</u>	<u>3,224</u>
Income before income taxes	<u>1,873</u>	<u>1,778</u>	<u>(1,873)</u>	<u>1,778</u>
Income tax expense (benefit)	-	-	-	-
Net income	<u>\$ 1,873</u>	<u>\$ 1,778</u>	<u>\$ (1,873)</u>	<u>\$ 1,778</u>