

CITIGROUP INC  
Form 424B2  
October 22, 2018

**October 18, 2018**

**Medium-Term Senior Notes, Series N**

Citigroup Global Markets Holdings Inc. **Pricing Supplement No. 2018-USNCH1522**

**Filed Pursuant to Rule 424(b)(2)**

**Registration Statement Nos. 333-216372 and 333-216372-01**

Autocallable Contingent Coupon Equity Linked Securities Linked to Intel Corporation Due October 23, 2019

The securities offered by this pricing supplement are unsecured debt securities issued by Citigroup Global Markets Holdings Inc. and guaranteed by Citigroup Inc. The securities offer the potential for periodic contingent coupon payments at an annualized rate that, if all are paid, would produce a yield that is generally higher than the yield on our conventional debt securities of the same maturity. In exchange for this higher potential yield, you must be willing to accept the risks that (i) your actual yield may be lower than the yield on our conventional debt securities of the same maturity because you may not receive one or more, or any, contingent coupon payments, (ii) your actual yield may be negative because the value of what you receive at maturity may be significantly less than the stated principal amount of your securities, and may be zero, and (iii) the securities may be automatically redeemed prior to maturity beginning on the first potential autocall date specified below. Each of these risks will depend on the performance of the underlying specified below. Although you will have downside exposure to the underlying, you will not receive dividends with respect to the underlying or participate in any appreciation of the underlying.

Investors in the securities must be willing to accept (i) an investment that may have limited or no liquidity and (ii) the risk of not receiving any payments due under the securities if we and Citigroup Inc. default on our obligations. **All payments on the securities are subject to the credit risk of Citigroup Global Markets Holdings Inc. and Citigroup Inc.**

#### **KEY TERMS**

**Issuer:** Citigroup Global Markets Holdings Inc., a wholly owned subsidiary of Citigroup Inc.  
**Guarantee:** All payments due on the securities are fully and unconditionally guaranteed by Citigroup Inc.  
**Underlying:** Intel Corporation  
**Stated principal amount:** \$1,000 per security  
**Pricing date:** October 18, 2018  
**Issue date:** October 23, 2018  
January 18, 2019, April 18, 2019, July 18, 2019 and October 18, 2019 (the “final valuation date”),  
**Valuation dates:** each subject to postponement if such date is not a scheduled trading day or certain market disruption events occur  
**Maturity date:** Unless earlier redeemed, October 23, 2019  
**Contingent coupon payment dates:** The fifth business day after each valuation date, except that the contingent coupon payment date following the final valuation date will be the maturity date  
**Contingent coupon:** On each contingent coupon payment date, unless previously redeemed, the securities will pay a contingent coupon equal to 2.125% of the stated principal amount of the securities (equivalent to a contingent coupon rate of 8.50% per annum) **if and only if** the closing value of the underlying on

the immediately preceding valuation date is greater than or equal to the coupon barrier value. **If the closing value of the underlying on any valuation date is less than the coupon barrier value, you will not receive any contingent coupon payment on the immediately following contingent coupon payment date.**

If the securities are not automatically redeemed prior to maturity, you will receive at maturity for each security you then hold:

If the final underlying value is **greater than or equal to** the final barrier value: \$1,000 *plus* the contingent coupon payment due at maturity

**Payment at maturity:**

If the final underlying value is **less than** the final barrier value: a fixed number of underlying shares of the underlying equal to the equity ratio (or, if we elect, the cash value of those shares based on the final underlying value)

**If the securities are not automatically redeemed prior to maturity and the final underlying value is less than the final barrier value, you will receive underlying shares (or, in our sole discretion, cash) expected to be worth significantly less than the stated principal amount of your securities, and possibly nothing, at maturity, and you will not receive any contingent coupon payment at maturity.**

**Initial underlying value:** \$44.97, the closing value of the underlying on the pricing date  
**Coupon barrier value:** \$35.976, 80% of the initial underlying value  
**Final barrier value:** \$35.976, 80% of the initial underlying value  
**Equity ratio:** 22.23705, the stated principal amount *divided by* the initial underlying value  
**Listing:** The securities will not be listed on any securities exchange  
**Underwriter:** Citigroup Global Markets Inc. (“CGMI”), an affiliate of the issuer, acting as principal

<b>Underwriting fee and issue price:</b>	<b>Issue price<sup>(1)(2)</sup></b>	<b>Underwriting fee<sup>(3)</sup></b>	<b>Proceeds to issuer</b>
<b>Per security:</b>	\$1,000	\$10	\$990
<b>Total:</b>	\$396,000	\$3,960	\$392,040

(Key Terms continued on next page)

(1) On the date of this pricing supplement, the estimated value of the securities is \$958.70 per security, which is less than the issue price. The estimated value of the securities is based on CGMI’s proprietary pricing models and our internal funding rate. It is not an indication of actual profit to CGMI or other of our affiliates, nor is it an indication of the price, if any, at which CGMI or any other person may be willing to buy the securities from you at any time after issuance. See “Valuation of the Securities” in this pricing supplement.

(2) The issue price for investors purchasing the securities in fee-based advisory accounts will be \$990 per security, assuming no custodial fee is charged by a selected dealer, and up to \$995 per security, assuming the maximum custodial fee is charged by a selected dealer. See “Supplemental Plan of Distribution” in this pricing supplement.

(3) CGMI will receive an underwriting fee of \$10 for each security sold in this offering. Selected dealers and their financial advisors will collectively receive from CGMI a selling concession of \$10 for each security they sell. In

addition, CGMI will pay selected dealers not affiliated with CGMI a structuring fee of up to \$5 for each security they sell. We may also engage other firms to provide marketing or promotional services in connection with the distribution of the securities. CGMI will pay these service providers a fee of up to \$5 per security in consideration for providing marketing, education, structuring or referral services with respect to financial advisors or selected dealers. For more information on the distribution of the securities, see “Supplemental Plan of Distribution” in this pricing supplement. In addition to the underwriting fee, CGMI and its affiliates may profit from hedging activity related to this offering, even if the value of the securities declines. See “Use of Proceeds and Hedging” in the accompanying prospectus.

**Investing in the securities involves risks not associated with an investment in conventional debt securities. See “Summary Risk Factors” beginning on page PS-3.**

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the securities or determined that this pricing supplement and the accompanying product supplement, prospectus supplement and prospectus are truthful or complete. Any representation to the contrary is a criminal offense.**

*You should read this pricing supplement together with the accompanying product supplement, prospectus supplement and prospectus, which can be accessed via the hyperlinks below:*

**Product Supplement No. EA-04-07 dated June 15, 2018, Prospectus Supplement and Prospectus each dated April 7, 2017**

**The securities are not bank deposits and are not insured or guaranteed by the Federal Deposit Insurance Corporation or any other governmental agency, nor are they obligations of, or guaranteed by, a bank.**

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**KEY TERMS**

(continued)

- Automatic early redemption:** If, on any potential autocall date, the closing value of the underlying is greater than or equal to the initial underlying value, each security you then hold will be automatically redeemed on the immediately following contingent coupon payment date for an amount in cash equal to \$1,000 *plus* the related contingent coupon payment.
- Potential autocall dates:** Each valuation date beginning in January 2019 and ending in July 2019
- Final underlying value:** The closing value of the underlying on the final valuation date
- CUSIP / ISIN:** 17324XEH9 / US17324XEH98

Additional Information

**General.** The terms of the securities are set forth in the accompanying product supplement, prospectus supplement and prospectus, as supplemented by this pricing supplement. The accompanying product supplement, prospectus supplement and prospectus contain important disclosures that are not repeated in this pricing supplement. For example, the accompanying product supplement contains important information about how the closing value of the underlying will be determined and about adjustments that may be made to the terms of the securities upon the occurrence of market disruption events and other specified events with respect to the underlying. It is important that you read the accompanying product supplement, prospectus supplement and prospectus together with this pricing supplement in deciding whether to invest in the securities. Certain terms used but not defined in this pricing supplement are defined in the accompanying product supplement.

**Closing Value.** The “closing value” of the underlying on any date is the closing price of its underlying shares on such date, as provided in the accompanying product supplement. The “underlying shares” of the underlying are its shares of common stock. Please see the accompanying product supplement for more information.

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## Hypothetical Examples

The table below illustrates hypothetical total returns you might receive on the securities for a range of hypothetical final underlying values and a varying number of contingent coupon payments hypothetically received over the term of the securities, assuming the securities are not automatically redeemed prior to maturity. You should understand that the term of the securities, and your opportunity to receive the contingent coupon payments on the securities, may be limited by the automatic early redemption feature of the securities, which is not reflected in the table below. The hypothetical total return figures in the table below represent a total return on your investment if the securities are held to maturity. The outcomes illustrated in the table below are not exhaustive, and your actual total return on the securities may differ from any example illustrated below. For ease of analysis, figures in the table below have been rounded.

The table below is based on the following hypothetical values and does not reflect the actual initial underlying value or final barrier value. For the actual initial underlying value and final barrier value, see the cover page of this pricing supplement. We have used these hypothetical values, rather than the actual values, to simplify the calculations and aid understanding of how the securities work. However, you should understand that the actual payments on the securities will be calculated based on the actual initial underlying value and final barrier value, and not the hypothetical values indicated below.

Hypothetical initial underlying value: 100

Hypothetical coupon barrier value: 80 (80% of the hypothetical initial underlying value)

Hypothetical final barrier value: 80 (80% of the hypothetical initial underlying value)

The table below assumes that the closing value of the underlying on the final valuation date is the same as the closing value of the underlying on the maturity date.

Hypothetical final underlying value	Hypothetical percentage change from initial underlying value to final underlying value	Hypothetical value of the underlying shares or cash amount you receive at maturity <sup>1</sup> per security	Hypothetical total return on the securities <sup>2</sup> if the closing value of the underlying is greater than or equal to the coupon barrier value on:				
			All valuation dates	3 dates	2 dates	1 date	No valuation dates
115.00	15.00%	\$1,000.00	8.500%	6.375%	4.250%	2.125%	N/A
100.00	0.00%	\$1,000.00	8.500%	6.375%	4.250%	2.125%	N/A
85.00	-15.00%	\$1,000.00	8.500%	6.375%	4.250%	2.125%	N/A
80.00	-20.00%	\$1,000.00	8.500%	6.375%	4.250%	2.125%	N/A
79.99	-20.01%	\$799.90	N/A	-13.635%	-15.760%	-17.885%	-20.010%
50.00	-50.00%	\$500.00	N/A	-43.625%	-45.750%	-47.875%	-50.000%
25.00	-75.00%	\$250.00	N/A	-68.625%	-70.750%	-72.875%	-75.000%

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0.00	-100.00%	\$0.00	N/A	-93.625%	-95.750%	-97.875%	-100.000%
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(1) Excluding the final contingent coupon payment, if any. Based on the closing value of the underlying on the final valuation date. If we elect to deliver any underlying shares as payment at maturity, you will receive such underlying shares on the maturity date.

(2) The hypothetical total return on the securities is calculated as (a) (i) the value of the underlying shares or cash amount received at maturity (excluding the final contingent coupon payment, if any) per security *plus* the aggregate contingent coupon payments per security received over the term of the securities *minus* (ii) the \$1,000 stated principal amount per security *divided by* (b) the \$1,000 stated principal amount per security.

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## Summary Risk Factors

An investment in the securities is significantly riskier than an investment in conventional debt securities. The securities are subject to all of the risks associated with an investment in our conventional debt securities (guaranteed by Citigroup Inc.), including the risk that we and Citigroup Inc. may default on our obligations under the securities, and are also subject to risks associated with the underlying. Accordingly, the securities are suitable only for investors who are capable of understanding the complexities and risks of the securities. You should consult your own financial, tax and legal advisors as to the risks of an investment in the securities and the suitability of the securities in light of your particular circumstances.

The following is a summary of certain key risk factors for investors in the securities. You should read this summary together with the more detailed description of risks relating to an investment in the securities contained in the section “Risk Factors Relating to the Securities” beginning on page EA-7 in the accompanying product supplement. You should also carefully read the risk factors included in the accompanying prospectus supplement and in the documents incorporated by reference in the accompanying prospectus, including Citigroup Inc.’s most recent Annual Report on Form 10-K and any subsequent Quarterly Reports on Form 10-Q, which describe risks relating to the business of Citigroup Inc. more generally.

**You may lose a significant portion or all of your investment.** Unlike conventional debt securities, the securities do not provide for the repayment of the stated principal amount at maturity in all circumstances. If the securities are not automatically redeemed prior to maturity and the final underlying value is less than the final barrier value, you will not receive the stated principal amount of your securities at maturity and, instead, will receive underlying shares (or, in our sole discretion, cash based on the value thereof) expected to be worth significantly less than the stated principal amount and may be worth nothing. There is no minimum payment at maturity on the securities, and you may lose up to all of your investment.

**You will not receive any contingent coupon on the contingent coupon payment date following any valuation date on which the closing value of the underlying is less than the coupon barrier value.** A contingent coupon payment will be made on a contingent coupon payment date if and only if the closing value of the underlying on the immediately preceding valuation date is greater than or equal to the coupon barrier value. If the closing value of the underlying is less than the coupon barrier value on any valuation date, you will not receive any contingent coupon payment on the immediately following contingent coupon payment date. If the closing value of the underlying is below the coupon barrier value on each valuation date, you will not receive any contingent coupon payments over the term of the securities.

**Higher contingent coupon rates are associated with greater risk.** The securities offer contingent coupon payments at an annualized rate that, if all are paid, would produce a yield that is generally higher than the yield on our conventional debt securities of the same maturity. This higher potential yield is associated with greater levels of expected risk as of the pricing date for the securities, including the risk that you may not receive a contingent coupon

payment on one or more, or any, contingent coupon payment dates and the risk that the securities will not be automatically redeemed and the value of what you receive at maturity may be significantly less than the stated principal amount of your securities and may be zero. The volatility of the closing value of the underlying is an important factor affecting these risks. Greater expected volatility of the closing value of the underlying as of the pricing date may result in a higher contingent coupon rate, but would also represent a greater expected likelihood as of the pricing date that (i) the closing value of the underlying on one or more valuation dates will be less than the coupon barrier value, such that you will not receive one or more, or any, contingent coupon payments during the term of the securities, (ii) the closing value of the underlying on each potential autocall date will be less than the initial underlying value, such that the securities are not automatically redeemed and (iii) the final underlying value will be less than the final barrier value, such that you will not be repaid the stated principal amount of your securities at maturity.

**You may not be adequately compensated for assuming the downside risk of the underlying.** The potential contingent coupon payments on the securities are the compensation you receive for assuming the downside risk of the underlying, as well as all the other risks of the securities. That compensation is effectively “at risk” and may, therefore, be less than you currently anticipate. First, the actual yield you realize on the securities could be lower than you anticipate because the coupon is “contingent” and you may not receive a contingent coupon payment on one or more, or any, of the contingent coupon payment dates. Second, the contingent coupon payments are the compensation you receive not only for the downside risk of the underlying, but also for all of the other risks of the securities, including the risk that the securities may be automatically redeemed prior to maturity, interest rate risk and our and Citigroup Inc.’s credit risk. If those other risks increase or are otherwise greater than you currently anticipate, the contingent coupon payments may turn out to be inadequate to compensate you for all the risks of the securities, including the downside risk of the underlying.

**The securities may be automatically redeemed prior to maturity, limiting your opportunity to receive contingent coupon payments.** On any potential autocall date, the securities will be automatically redeemed if the closing value of the underlying on that potential autocall date is greater than or equal to the initial underlying value. Thus, the term of the securities may be limited. If the securities are redeemed prior to maturity, you will not receive any additional contingent coupon payments. Moreover, you may not be able to reinvest your funds in another investment that provides a similar yield with a similar level of risk.

**The securities offer downside exposure to the underlying, but no upside exposure to the underlying.** You will not participate in any appreciation in the value of the underlying over the term of the securities. Consequently, your return on the securities will be limited to the contingent coupon payments you receive, if any, and may be significantly less than the return on the

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underlying over the term of the securities. In addition, as an investor in the securities, you will not receive any dividends or other distributions or have any other rights with respect to the underlying.

**The performance of the securities will depend on the closing value of the underlying solely on the valuation dates, which makes the securities particularly sensitive to volatility of the closing value of the underlying.** Whether the contingent coupon will be paid on any given contingent coupon payment date and whether the securities will be automatically redeemed prior to maturity will depend on the closing value of the underlying solely on the applicable valuation dates, regardless of the closing value of the underlying on other days during the term of the securities. If the securities are not automatically redeemed prior to maturity, what you receive at maturity will depend solely on the closing value of the underlying on the final valuation date, and not on any other day during the term of the securities. Because the performance of the securities depends on the closing value of the underlying on a limited number of dates, the securities will be particularly sensitive to volatility of the closing value of the underlying. You should understand that the closing value of the underlying has historically been highly volatile.

**The securities are subject to the credit risk of Citigroup Global Markets Holdings Inc. and Citigroup Inc.** If we default on our obligations under the securities and Citigroup Inc. defaults on its guarantee obligations, you may not receive anything owed to you under the securities.

**The securities will not be listed on any securities exchange and you may not be able to sell them prior to maturity.** The securities will not be listed on any securities exchange. Therefore, there may be little or no secondary market for the securities. CGMI currently intends to make a secondary market in relation to the securities and to provide an indicative bid price for the securities on a daily basis. Any indicative bid price for the securities provided by CGMI will be determined in CGMI's sole discretion, taking into account prevailing market conditions and other relevant factors, and will not be a representation by CGMI that the securities can be sold at that price, or at all. CGMI may suspend or terminate making a market and providing indicative bid prices without notice, at any time and for any reason. If CGMI suspends or terminates making a market, there may be no secondary market at all for the securities because it is likely that CGMI will be the only broker-dealer that is willing to buy your securities prior to maturity. Accordingly, an investor must be prepared to hold the securities until maturity.

**The estimated value of the securities on the pricing date, based on CGMI's proprietary pricing models and our internal funding rate, is less than the issue price.** The difference is attributable to certain costs associated with selling, structuring and hedging the securities that are included in the issue price. These costs include (i) any selling concessions or other fees paid in connection with the offering of the securities, (ii) hedging and other costs incurred by us and our affiliates in connection with the offering of the securities and (iii) the expected profit (which may be more or less than actual profit) to CGMI or other of our affiliates in connection with hedging our obligations under the securities. These costs adversely affect the economic terms of the securities because, if they were lower, the economic terms of the securities would be more favorable to you. The economic terms of the securities are also likely to be adversely affected by the use of our internal funding rate, rather than our secondary market rate, to price the securities. See "The estimated value of the securities would be lower if it were calculated based on our secondary market rate" below.

**The estimated value of the securities was determined for us by our affiliate using proprietary pricing models.** CGMI derived the estimated value disclosed on the cover page of this pricing supplement from its proprietary pricing models. In doing so, it may have made discretionary judgments about the inputs to its models, such as the volatility of the closing value of the underlying, the dividend yield on the underlying and interest rates. CGMI's views on these inputs may differ from your or others' views, and as an underwriter in this offering, CGMI's interests may conflict with yours. Both the models and the inputs to the models may prove to be wrong and therefore not an accurate reflection of the value of the securities. Moreover, the estimated value of the securities set forth on the cover page of this pricing supplement may differ from the value that we or our affiliates may determine for the securities for other purposes, including for accounting purposes. You should not invest in the securities because of the estimated value of the securities. Instead, you should be willing to hold the securities to maturity irrespective of the initial estimated value.

**The estimated value of the securities would be lower if it were calculated based on our secondary market rate.**

The estimated value of the securities included in this pricing supplement is calculated based on our internal funding rate, which is the rate at which we are willing to borrow funds through the issuance of the securities. Our internal funding rate is generally lower than our secondary market rate, which is the rate that CGMI will use in determining the value of the securities for purposes of any purchases of the securities from you in the secondary market. If the estimated value included in this pricing supplement were based on our secondary market rate, rather than our internal funding rate, it would likely be lower. We determine our internal funding rate based on factors such as the costs associated with the securities, which are generally higher than the costs associated with conventional debt securities, and our liquidity needs and preferences. Our internal funding rate is not an interest rate that is payable on the securities.

Because there is not an active market for traded instruments referencing our outstanding debt obligations, CGMI determines our secondary market rate based on the market price of traded instruments referencing the debt obligations of Citigroup Inc., our parent company and the guarantor of all payments due on the securities, but subject to adjustments that CGMI makes in its sole discretion. As a result, our secondary market rate is not a market-determined measure of our creditworthiness, but rather reflects the market's perception of our parent company's creditworthiness as adjusted for discretionary factors such as CGMI's preferences with respect to purchasing the securities prior to maturity.

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**The estimated value of the securities is not an indication of the price, if any, at which CGMI or any other person may be willing to buy the securities from you in the secondary market.** Any such secondary market price will fluctuate over the term of the securities based on the market and other factors described in the next risk factor. Moreover, unlike the estimated value included in this pricing supplement, any value of the securities determined for purposes of a secondary market transaction will be based on our secondary market rate, which will likely result in a lower value for the securities than if our internal funding rate were used. In addition, any secondary market price for the securities will be reduced by a bid-ask spread, which may vary depending on the aggregate stated principal amount of the securities to be purchased in the secondary market transaction, and the expected cost of unwinding related hedging transactions. As a result, it is likely that any secondary market price for the securities will be less than the issue price.

**The value of the securities prior to maturity will fluctuate based on many unpredictable factors.** The value of your securities prior to maturity will fluctuate based on the closing value of the underlying, the volatility of the closing value of the underlying, the dividend yield on the underlying, interest rates generally, the time remaining to maturity and our and Citigroup Inc.'s creditworthiness, as reflected in our secondary market rate, among other factors described under "Risk Factors Relating to the Securities—Risk Factors Relating to All Securities—The value of your securities prior to maturity will fluctuate based on many unpredictable factors" in the accompanying product supplement. Changes in the closing value of the underlying may not result in a comparable change in the value of your securities. You should understand that the value of your securities at any time prior to maturity may be significantly less than the issue price.

**Immediately following issuance, any secondary market bid price provided by CGMI, and the value that will be indicated on any brokerage account statements prepared by CGMI or its affiliates, will reflect a temporary upward adjustment.** The amount of this temporary upward adjustment will steadily decline to zero over the temporary adjustment period. See "Valuation of the Securities" in this pricing supplement.

**Our offering of the securities is not a recommendation of the underlying.** The fact that we are offering the securities does not mean that we believe that investing in an instrument linked to the underlying is likely to achieve favorable returns. In fact, as we are part of a global financial institution, our affiliates may have positions (including short positions) in the underlying or in instruments related to the underlying, and may publish research or express opinions, that in each case are inconsistent with an investment linked to the underlying. These and other activities of our affiliates may affect the closing value of the underlying in a way that negatively affects the value of and your return on the securities.

**The closing value of the underlying may be adversely affected by our or our affiliates' hedging and other trading activities.** We expect to hedge our obligations under the securities through CGMI or other of our affiliates, who may take positions in the underlying or in financial instruments related to the underlying and may adjust such positions during the term of the securities. Our affiliates also take positions in the underlying or in financial instruments related to the underlying on a regular basis (taking long or short positions or both), for their accounts, for other accounts under their management or to facilitate transactions on behalf of customers. These activities could affect the closing value of the underlying in a way that negatively affects the value of and your return on the securities. They could also result in substantial returns for us or our affiliates while the value of the securities declines.

**We and our affiliates may have economic interests that are adverse to yours as a result of our affiliates' business activities.** Our affiliates engage in business activities with a wide range of companies. These activities include extending loans, making and facilitating investments, underwriting securities offerings and providing advisory services. These activities could involve or affect the underlying in a way that negatively affects the value of and your return on the securities. They could also result in substantial returns for us or our affiliates while the value of the securities declines. In addition, in the course of this business, we or our affiliates may acquire non-public information, which will not be disclosed to you.

**The calculation agent, which is an affiliate of ours, will make important determinations with respect to the securities.** If certain events occur during the term of the securities, such as market disruption events and other events with respect to the underlying, CGMI, as calculation agent, will be required to make discretionary judgments that could significantly affect your return on the securities. In making these judgments, the calculation agent's interests as an affiliate of ours could be adverse to your interests as a holder of the securities. See "Risks Relating to the Securities—Risks Relating to All Securities—The calculation agent, which is an affiliate of ours, will make important determinations with respect to the securities" in the accompanying product supplement.

**Even if the underlying pays a dividend that it identifies as special or extraordinary, no adjustment will be required under the securities for that dividend unless it meets the criteria specified in the accompanying product supplement.** In general, an adjustment will not be made under the terms of the securities for any cash dividend paid by the underlying unless the amount of the dividend per share, together with any other dividends paid in the same quarter, exceeds the dividend paid per share in the most recent quarter by an amount equal to at least 10% of the closing value of the underlying on the date of declaration of the dividend. Any dividend will reduce the closing value of the underlying by the amount of the dividend per share. If the underlying pays any dividend for which an adjustment is not made under the terms of the securities, holders of the securities will be adversely affected. See "Description of the Securities—Certain Additional Terms for Securities Linked to an Underlying Company or an Underlying ETF—Dilution and Reorganization Adjustments—Certain Extraordinary Cash Dividends" in the accompanying product supplement.

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**The securities will not be adjusted for all events that may have a dilutive effect on or otherwise adversely affect the closing value of the underlying.** For example, we will not make any adjustment for ordinary dividends or extraordinary dividends that do not meet the criteria described above, partial tender offers or additional underlying share issuances. Moreover, the adjustments we do make may not fully offset the dilutive or adverse effect of the particular event. Investors in the securities may be adversely affected by such an event in a circumstance in which a direct holder of the underlying shares would not.

**The securities may become linked to an underlying other than the original underlying upon the occurrence of a reorganization event or upon the delisting of the underlying shares.** For example, if the underlying enters into a merger agreement that provides for holders of the underlying shares to receive shares of another entity and such shares are marketable securities, the closing value of the underlying following consummation of the merger will be based on the value of such other shares. Additionally, if the underlying shares are delisted, the calculation agent may select a successor underlying. See “Description of the Securities—Certain Additional Terms for Securities Linked to an Underlying Company or an Underlying ETF” in the accompanying product supplement.

**If the underlying shares are delisted, we may call the securities prior to maturity for an amount that may be less than the stated principal amount.** If we exercise this call right, you will receive the amount described under “Description of the Securities—Certain Additional Terms for Securities Linked to an Underlying Company or an Underlying ETF—Delisting of an Underlying Company” in the accompanying product supplement. This amount may be less, and possibly significantly less, than the stated principal amount of the securities.

**You will have no rights with respect to the underlying unless and until you receive underlying shares at maturity.** If any change to the underlying shares is proposed, such as an amendment to the underlying’s organizational documents, you will not have the right to vote on such change, but you will be subject to such change in the event you receive its underlying shares at maturity. Any such change may adversely affect the market value of the underlying shares.

**The U.S. federal tax consequences of an investment in the securities are unclear.** There is no direct legal authority regarding the proper U.S. federal tax treatment of the securities, and we do not plan to request a ruling from the Internal Revenue Service (the “IRS”). Consequently, significant aspects of the tax treatment of the securities are uncertain, and the IRS or a court might not agree with the treatment of the securities as described in “United States Federal Tax Considerations” below. If the IRS were successful in asserting an alternative treatment, the tax consequences of ownership and disposition of the securities might be materially and adversely affected. Moreover, as described in the accompanying product supplement under “United States Federal Tax Considerations,” in 2007 the U.S. Treasury Department and the IRS released a notice requesting comments on various issues regarding the U.S. federal income tax treatment of “prepaid forward contracts” and similar instruments. While it is not clear whether the securities would be viewed as similar to the typical prepaid forward contract described in the notice, it is possible that any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the securities, including the character and timing of income or loss recognized by U.S. investors, possibly with retroactive effect. You should read carefully the discussion under “United States Federal Tax Considerations” and “Risk Factors Relating to the Securities” in the accompanying product supplement and “United States Federal Tax Considerations” in this pricing supplement. You should also consult your tax adviser regarding the U.S. federal tax consequences of an investment in the securities, as well as tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.

Non-U.S. investors should note that persons having withholding responsibility in respect of the securities may withhold on any coupon payment paid to a non-U.S. investor, generally at a rate of 30%. To the extent that we have withholding responsibility in respect of the securities, we intend to so withhold.

In addition, Section 871(m) of the Internal Revenue Code of 1986, as amended (the “Code”), imposes a withholding tax of up to 30% on “dividend equivalents” paid or deemed paid to non-U.S. investors in respect of certain financial instruments linked to U.S. equities. In light of Treasury regulations, as modified by an IRS notice, that provide a general exemption for financial instruments issued prior to January 1, 2021 that do not have a “delta” of one, the securities should not be subject to withholding under Section 871(m). However, the IRS could challenge this conclusion.

We will not be required to pay any additional amounts with respect to amounts withheld.

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Citigroup Global Markets Holdings Inc.

### Information About Intel Corporation

Intel Corporation offers computing, networking, data storage, and communications solutions to customers spanning multiple industries. The underlying shares of Intel Corporation are registered under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Information provided to or filed with the SEC by Intel Corporation pursuant to the Exchange Act can be located by reference to the SEC file number 000-06217 through the SEC’s website at <http://www.sec.gov>. In addition, information regarding Intel Corporation may be obtained from other sources including, but not limited to, press releases, newspaper articles and other publicly disseminated documents. The underlying shares of Intel Corporation trade on the Nasdaq Global Select Market under the ticker symbol “INTC.”

We have derived all information regarding Intel Corporation from publicly available information and have not independently verified any information regarding Intel Corporation. This pricing supplement relates only to the securities and not to Intel Corporation. We make no representation as to the performance of Intel Corporation over the term of the securities.

The securities represent obligations of Citigroup Global Markets Holdings Inc. (guaranteed by Citigroup Inc.) only. Intel Corporation is not involved in any way in this offering and has no obligation relating to the securities or to holders of the securities.

### Historical Information

The closing value of Intel Corporation on October 18, 2018 was \$44.97.

The graph below shows the closing value of Intel Corporation for each day such value was available from January 2, 2013 to October 18, 2018. We obtained the closing values from Bloomberg L.P., without independent verification. If certain corporate transactions occurred during the historical period shown below, including, but not limited to, spin-offs or mergers, then the closing values shown below for the period prior to the occurrence of any such transaction have been adjusted by Bloomberg L.P. as if any such transaction had occurred prior to the first day in the period shown below. You should not take historical closing values as an indication of future performance.

### **Intel Corporation – Historical Closing Values**

**January 2, 2013 to October 18, 2018**

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Citigroup Global Markets Holdings Inc.

## United States Federal Tax Considerations

You should read carefully the discussion under “United States Federal Tax Considerations” and “Risk Factors Relating to the Securities” in the accompanying product supplement and “Summary Risk Factors” in this pricing supplement.

Due to the lack of any controlling legal authority, there is substantial uncertainty regarding the U.S. federal tax consequences of an investment in the securities. In connection with any information reporting requirements we may have in respect of the securities under applicable law, we intend (in the absence of an administrative determination or judicial ruling to the contrary) to treat the securities for U.S. federal income tax purposes as prepaid forward contracts with associated coupon payments that will be treated as gross income to you at the time received or accrued in accordance with your regular method of tax accounting. In the opinion of our counsel, Davis Polk & Wardwell LLP, which is based on current market conditions, this treatment of the securities is reasonable under current law; however, our counsel has advised us that it is unable to conclude affirmatively that this treatment is more likely than not to be upheld, and that alternative treatments are possible. This discussion does not address the U.S. federal tax consequences of the ownership or disposition of the underlying shares that you may receive at maturity. You should consult your tax adviser regarding the particular U.S. federal tax consequences of the ownership and disposition of the underlying shares.

Assuming this treatment of the securities is respected and subject to the discussion in “United States Federal Tax Considerations” in the accompanying product supplement, the following U.S. federal income tax consequences should result under current law:

Any coupon payments on the securities should be taxable as ordinary income to you at the time received or accrued in accordance with your regular method of accounting for U.S. federal income tax purposes.

Upon a sale or exchange of a security (including retirement at maturity for cash), you should recognize capital gain or loss equal to the difference between the amount realized and your tax basis in the security. For this purpose, the amount realized does not include any coupon paid on retirement and may not include sale proceeds attributable to an accrued coupon, which may be treated as a coupon payment. Such gain or loss should be short-term capital gain or loss. If, upon retirement of the securities, you receive underlying shares, you should not recognize gain or loss with respect to the underlying shares received, other than any fractional underlying share for which you receive cash. Your basis in any underlying shares received, including any fractional underlying share deemed received, should be equal to your tax basis in the securities.

We do not plan to request a ruling from the IRS regarding the treatment of the securities, and the IRS or a court might not agree with the treatment described herein. In addition, the U.S. Treasury Department and the IRS have released a notice requesting comments on the U.S. federal income tax treatment of “prepaid forward contracts.” While it is not clear whether the securities would be viewed as similar to the typical prepaid forward contract described in the notice,

it is possible that any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the securities, including the character and timing of income or loss, possibly with retroactive effect. You should consult your tax adviser regarding possible alternative tax treatments of the securities and potential consequences of the IRS notice.

**Withholding Tax on Non-U.S. Holders.** Because significant aspects of the tax treatment of the securities are uncertain, persons having withholding responsibility in respect of the securities may withhold on any coupon payment paid to Non-U.S. Holders (as defined in the accompanying product supplement), generally at a rate of 30%. To the extent that we have (or an affiliate of ours has) withholding responsibility in respect of the securities, we intend to so withhold. In order to claim an exemption from, or a reduction in, the 30% withholding, you may need to comply with certification requirements to establish that you are not a U.S. person and are eligible for such an exemption or reduction under an applicable tax treaty. You should consult your tax adviser regarding the tax treatment of the securities, including the possibility of obtaining a refund of any amounts withheld and the certification requirement described above.

Moreover, as discussed under “United States Federal Tax Considerations – Tax Consequences to Non-U.S. Holders – Possible Withholding Under Section 871(m) of the Code” in the accompanying product supplement, Section 871(m) of the Code and Treasury regulations promulgated thereunder (“Section 871(m)”) generally impose a 30% withholding tax on dividend equivalents paid or deemed paid to Non-U.S. Holders with respect to certain financial instruments linked to U.S. equities (“U.S. Underlying Equities”) or indices that include U.S. Underlying Equities. Section 871(m) generally applies to instruments that substantially replicate the economic performance of one or more U.S. Underlying Equities, as determined based on tests set forth in the applicable Treasury regulations (a “Specified Security”). However, the regulations, as modified by an IRS notice, exempt financial instruments issued prior to January 1, 2021 that do not have a “delta” of one. Based on the terms of the securities and representations provided by us, our counsel is of the opinion that the securities should not be treated as transactions that have a “delta” of one within the meaning of the regulations with respect to any U.S. Underlying Equity and, therefore, should not be Specified Securities subject to withholding tax under Section 871(m).

A determination that the securities are not subject to Section 871(m) is not binding on the IRS, and the IRS may disagree with this treatment. Moreover, Section 871(m) is complex and its application may depend on your particular circumstances. For example, if you enter into other transactions relating to a U.S. Underlying Equity, you could be subject to withholding tax or income tax liability under Section 871(m) even if the securities are not Specified Securities subject to Section 871(m) as a general matter. You should consult your tax adviser regarding the potential application of Section 871(m) to the securities.

We will not be required to pay any additional amounts with respect to amounts withheld.

Citigroup Global Markets Holdings Inc.

**You should read the section entitled “United States Federal Tax Considerations” in the accompanying product supplement. The preceding discussion, when read in combination with that section, constitutes the full opinion of Davis Polk & Wardwell LLP regarding the material U.S. federal tax consequences of owning and disposing of the securities.**

**You should also consult your tax adviser regarding all aspects of the U.S. federal income and estate tax consequences of an investment in the securities and any tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.**

#### Supplemental Plan of Distribution

CGMI, an affiliate of Citigroup Global Markets Holdings Inc. and the underwriter of the sale of the securities, is acting as principal and will receive an underwriting fee of \$10 for each security sold in this offering. The actual underwriting fee will be equal to \$10 for each security sold by CGMI directly to the public and will otherwise be equal to the selling concession provided to selected dealers, as described in this paragraph. Selected dealers and their financial advisors will collectively receive from CGMI a selling concession of \$10 for each security they sell to accounts other than fee-based advisory accounts. In addition, CGMI will pay selected dealers not affiliated with CGMI a structuring fee of up to \$5 for each security they sell to accounts other than fee-based advisory accounts. Selected dealers not affiliated with CGMI, which may include dealers acting as custodians, will receive from CGMI a selling concession of up to \$5 for each \$1,000 security they sell to fee-based advisory accounts. Broker-dealers affiliated with CGMI, including Citi International Financial Services, Citigroup Global Markets Singapore Pte. Ltd. and Citigroup Global Markets Asia Limited, and financial advisors employed by such affiliated broker-dealers will collectively receive a fixed selling concession of \$10 for each security they sell. CGMI will pay the registered representatives of CGMI a selling concession of \$10 for each security they sell directly to the public. We may also engage other firms to provide marketing or promotional services in connection with the distribution of the securities. CGMI will pay these service providers a fee of up to \$5 per security in consideration for providing marketing, education, structuring or referral services with respect to financial advisors or selected dealers. For the avoidance of doubt, the fees and selling concessions described in this pricing supplement will not be rebated if the securities are automatically redeemed prior to maturity.

See “Plan of Distribution; Conflicts of Interest” in the accompanying product supplement and “Plan of Distribution” in each of the accompanying prospectus supplement and prospectus for additional information.

#### Valuation of the Securities

CGMI calculated the estimated value of the securities set forth on the cover page of this pricing supplement based on proprietary pricing models. CGMI's proprietary pricing models generated an estimated value for the securities by estimating the value of a hypothetical package of financial instruments that would replicate the payout on the securities, which consists of a fixed-income bond (the "bond component") and one or more derivative instruments underlying the economic terms of the securities (the "derivative component"). CGMI calculated the estimated value of the bond component using a discount rate based on our internal funding rate. CGMI calculated the estimated value of the derivative component based on a proprietary derivative-pricing model, which generated a theoretical price for the instruments that constitute the derivative component based on various inputs, including the factors described under "Summary Risk Factors—The value of the securities prior to maturity will fluctuate based on many unpredictable factors" in this pricing supplement, but not including our or Citigroup Inc.'s creditworthiness. These inputs may be market-observable or may be based on assumptions made by CGMI in its discretionary judgment.

For a period of approximately three months following issuance of the securities, the price, if any, at which CGMI would be willing to buy the securities from investors, and the value that will be indicated for the securities on any brokerage account statements prepared by CGMI or its affiliates (which value CGMI may also publish through one or more financial information vendors), will reflect a temporary upward adjustment from the price or value that would otherwise be determined. This temporary upward adjustment represents a portion of the hedging profit expected to be realized by CGMI or its affiliates over the term of the securities. The amount of this temporary upward adjustment will decline to zero on a straight-line basis over the three-month temporary adjustment period. However, CGMI is not obligated to buy the securities from investors at any time. See "Summary Risk Factors—The securities will not be listed on any securities exchange and you may not be able to sell them prior to maturity."

#### Certain Selling Restrictions

#### Hong Kong Special Administrative Region

The contents of this pricing supplement and the accompanying product supplement, prospectus supplement and prospectus have not been reviewed by any regulatory authority in the Hong Kong Special Administrative Region of the People's Republic of China ("Hong Kong"). Investors are advised to exercise caution in relation to the offer. If investors are in any doubt about any of the contents of this pricing supplement and the accompanying product supplement, prospectus supplement and prospectus, they should obtain independent professional advice.

The securities have not been offered or sold and will not be offered or sold in Hong Kong by means of any document, other than

- (i) to persons whose ordinary business is to buy or sell shares or debentures (whether as principal or agent); or

Citigroup Global Markets Holdings Inc.

(ii) to “professional investors” as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong (the “Securities and Futures Ordinance”) and any rules made under that Ordinance; or

in other circumstances which do not result in the document being a “prospectus” as defined in the Companies Ordinance (Cap. 32) of Hong Kong or which do not constitute an offer to the public within the meaning of that Ordinance; and

There is no advertisement, invitation or document relating to the securities which is directed at, or the contents of which are likely to be accessed or read by, the public of Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to securities which are or are intended to be disposed of only to persons outside Hong Kong or only to “professional investors” as defined in the Securities and Futures Ordinance and any rules made under that Ordinance.

Non-insured Product: These securities are not insured by any governmental agency. These securities are not bank deposits and are not covered by the Hong Kong Deposit Protection Scheme.

Singapore

This pricing supplement and the accompanying product supplement, prospectus supplement and prospectus have not been registered as a prospectus with the Monetary Authority of Singapore, and the securities will be offered pursuant to exemptions under the Securities and Futures Act, Chapter 289 of Singapore (the “Securities and Futures Act”). Accordingly, the securities may not be offered or sold or made the subject of an invitation for subscription or purchase nor may this pricing supplement or any other document or material in connection with the offer or sale or invitation for subscription or purchase of any securities be circulated or distributed, whether directly or indirectly, to any person in Singapore other than (a) to an institutional investor pursuant to Section 274 of the Securities and Futures Act, (b) to a relevant person under Section 275(1) of the Securities and Futures Act or to any person pursuant to Section 275(1A) of the Securities and Futures Act and in accordance with the conditions specified in Section 275 of the Securities and Futures Act, or (c) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the Securities and Futures Act. Where the securities are subscribed or purchased under Section 275 of the Securities and Futures Act by a relevant person which is:

a corporation (which is not an accredited investor (as defined in Section 4A of the Securities and Futures Act)) the (a) sole business of which is to hold investments and the entire share capital of which is owned by one or more individuals, each of whom is an accredited investor; or

(b) a trust (where the trustee is not an accredited investor) whose sole purpose is to hold investments and each beneficiary is an individual who is an accredited investor, securities (as defined in Section 239(1) of the Securities

and Futures Act) of that corporation or the beneficiaries' rights and interests (howsoever described) in that trust shall not be transferable for 6 months after that corporation or that trust has acquired the relevant securities pursuant to an offer under Section 275 of the Securities and Futures Act except:

to an institutional investor or to a relevant person defined in Section 275(2) of the Securities and Futures Act or to (i) any person arising from an offer referred to in Section 275(1A) or Section 276(4)(i)(B) of the Securities and Futures Act; or

(ii) where no consideration is or will be given for the transfer; or

(iii) where the transfer is by operation of law; or

(iv) pursuant to Section 276(7) of the Securities and Futures Act; or

(v) as specified in Regulation 32 of the Securities and Futures (Offers of Investments) (Shares and Debentures) Regulations 2005 of Singapore.

Any securities referred to herein may not be registered with any regulator, regulatory body or similar organization or institution in any jurisdiction.

The securities are Specified Investment Products (as defined in the Notice on Recommendations on Investment Products and Notice on the Sale of Investment Product issued by the Monetary Authority of Singapore on 28 July 2011) that is neither listed nor quoted on a securities market or a futures market.

Non-insured Product: These securities are not insured by any governmental agency. These securities are not bank deposits. These securities are not insured products subject to the provisions of the Deposit Insurance and Policy Owners' Protection Schemes Act 2011 of Singapore and are not eligible for deposit insurance coverage under the Deposit Insurance Scheme.

#### Validity of the Securities

In the opinion of Davis Polk & Wardwell LLP, as special products counsel to Citigroup Global Markets Holdings Inc., when the securities offered by this pricing supplement have been executed and issued by Citigroup Global Markets Holdings Inc. and authenticated by the

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Citigroup Global Markets Holdings Inc.

trustee pursuant to the indenture, and delivered against payment therefor, such securities and the related guarantee of Citigroup Inc. will be valid and binding obligations of Citigroup Global Markets Holdings Inc. and Citigroup Inc., respectively, enforceable in accordance with their respective terms, subject to applicable bankruptcy, insolvency and similar laws affecting creditors' rights generally, concepts of reasonableness and equitable principles of general applicability (including, without limitation, concepts of good faith, fair dealing and the lack of bad faith), provided that such counsel expresses no opinion as to the effect of fraudulent conveyance, fraudulent transfer or similar provision of applicable law on the conclusions expressed above. This opinion is given as of the date of this pricing supplement and is limited to the laws of the State of New York, except that such counsel expresses no opinion as to the application of state securities or Blue Sky laws to the securities.

In giving this opinion, Davis Polk & Wardwell LLP has assumed the legal conclusions expressed in the opinions set forth below of Scott L. Flood, General Counsel and Secretary of Citigroup Global Markets Holdings Inc., and Barbara Politi, Assistant General Counsel—Capital Markets of Citigroup Inc. In addition, this opinion is subject to the assumptions set forth in the letter of Davis Polk & Wardwell LLP dated April 7, 2017, which has been filed as an exhibit to a Current Report on Form 8-K filed by Citigroup Inc. on April 7, 2017, that the indenture has been duly authorized, executed and delivered by, and is a valid, binding and enforceable agreement of, the trustee and that none of the terms of the securities nor the issuance and delivery of the securities and the related guarantee, nor the compliance by Citigroup Global Markets Holdings Inc. and Citigroup Inc. with the terms of the securities and the related guarantee respectively, will result in a violation of any provision of any instrument or agreement then binding upon Citigroup Global Markets Holdings Inc. or Citigroup Inc., as applicable, or any restriction imposed by any court or governmental body having jurisdiction over Citigroup Global Markets Holdings Inc. or Citigroup Inc., as applicable.

In the opinion of Scott L. Flood, Secretary and General Counsel of Citigroup Global Markets Holdings Inc., (i) the terms of the securities offered by this pricing supplement have been duly established under the indenture and the Board of Directors (or a duly authorized committee thereof) of Citigroup Global Markets Holdings Inc. has duly authorized the issuance and sale of such securities and such authorization has not been modified or rescinded; (ii) Citigroup Global Markets Holdings Inc. is validly existing and in good standing under the laws of the State of New York; (iii) the indenture has been duly authorized, executed and delivered by Citigroup Global Markets Holdings Inc.; and (iv) the execution and delivery of such indenture and of the securities

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157

215

Interest on investment securities  
397

411

813

857

Dividends on FHLB and FRB stocks

16

19

31

34

Other interest income

3

2

5

3

TOTAL INTEREST INCOME

1,618

1,421

3,226

2,767

INTEREST EXPENSE:

Deposits

274

257

543

514

FHLB advances

40

40

80

79

TOTAL INTEREST EXPENSE

314

297

623

593

NET INTEREST INCOME BEFORE PROVISION

1,304

1,124

2,603

2,174

Provision for loan and lease losses

150

—

150

—

NET INTEREST INCOME AFTER PROVISION

1,154

1,124

2,453

2,174

NONINTEREST INCOME:

Service charges and fees

30

23

57

42

Other income

36

36

73

55

Gain on loans sold

1,542

2,487

2,432

4,012

Gain on sale of available-for-sale securities, net

59

145

109

245

TOTAL NONINTEREST INCOME

1,667

2,691

2,671

4,354

NONINTEREST EXPENSE:

Employee compensation and benefits

1,520

2,407

3,203

4,080

Occupancy

242

264

492

520

Professional fees

271

103

507

237

Other general and administrative

811

602

1,314

1,071

TOTAL NONINTEREST EXPENSE

2,844

3,376

5,516

5,908

(LOSS) INCOME BEFORE INCOME TAXES

(23

)

439

(392

)

620

Provision for income taxes

—

—

—

—

NET (LOSS) INCOME

\$

(23

)

\$

439

\$

(392

)

\$  
620

OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX

Net change in unrealized gains on securities  
709

(1,892  
)

1,523

(1,692  
)

Less: net gains included in net (loss) income  
(59  
)

(145  
)

(109  
)

(245  
)

OTHER COMPREHENSIVE INCOME (LOSS)

\$  
650

\$  
(2,037  
)

\$  
1,414

\$  
(1,937  
)  
COMPREHENSIVE INCOME (LOSS)  
\$  
627

\$  
(1,598  
)

\$  
1,022

\$  
(1,317  
)  
PER SHARE DATA

(Loss) earnings per share - basic  
\$  
(0.01  
)

\$  
0.17

\$  
(0.15  
)

\$  
0.24

Weighted-average common shares outstanding - basic  
2,634,146

2,554,141

2,619,485

2,553,907

(Loss) earnings per share - diluted

\$

(0.01

)

\$

0.17

\$

(0.15

)

\$

0.24

Weighted-average common shares outstanding - diluted

2,634,146

2,636,456

2,619,485

2,628,877

See Notes to Consolidated Financial Statements.

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Solera National Bancorp, Inc.

Consolidated Statements of Changes in Stockholders' Equity for the  
Six Months Ended June 30, 2014 and 2013 (unaudited)

(\$ in thousands, except share data)	Shares Outstanding	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Treasury Stock	Accumulated Comprehensive (Loss)	Other Income	Total
Balance at December 31, 2012	2,553,671	\$26	\$ 26,206	\$(7,359)	\$—	\$ 1,068		\$19,941
Options exercised	2,375	—	9	—	—	—		9
Stock-based compensation	—	—	100	—	—	—		100
Net income	—	—	—	620	—	—		620
Other comprehensive loss	—	—	—	—	—	(1,937)		(1,937)
Balance at June 30, 2013	2,556,046	\$26	\$ 26,315	\$(6,739)	\$—	\$ (869)		\$18,733
Balance at December 31, 2013	2,654,890	\$26	\$ 26,558	\$(8,015)	\$(102)	\$ (1,492)		\$16,975
Options exercised	49,720	1	180	—	—	—		181
Stock-based compensation	—	—	102	—	—	—		102
Net loss	—	—	—	(392)	—	—		(392)
Other comprehensive income	—	—	—	—	—	1,414		1,414
Balance at June 30, 2014	2,704,610	\$27	\$ 26,840	\$(8,407)	\$(102)	\$ (78)		\$18,280

See Notes to Consolidated Financial Statements.

Solera National Bancorp, Inc.

Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2014 and 2013 (unaudited)

	For the Six Months Ended June 30,	
(\$ in thousands)	2014	2013
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net (loss) income	\$(392	) \$620
Adjustments to reconcile net (loss) income to cash flows from operating activities:		
Depreciation and amortization	158	110
Provision for loan and lease losses	150	—
Net amortization of deferred loan fees/expenses	8	31
Net amortization of premiums on investment securities	458	714
Recognition of stock-based compensation on stock options/restricted stock awards	102	100
Loans originated for sale	(85,307	) (138,049
Proceeds from the sale of loans held for sale	81,173	124,879
Gain on sale of loans held for sale	(2,299	) (3,901
Gain on sale of available-for-sale securities, net	(109	) (245
Gain on sale of SBA loans	(133	) (111
Proceeds from the sale of SBA loans	1,840	1,510
Impairment charge on OREO property	261	—
Federal Home Loan Bank stock dividend	(16	) (17
Increase in bank-owned life insurance cash surrender value	(73	) (54
Changes in operating assets and liabilities:		
Accrued interest receivable	53	(19
Other assets	(828	) (490
Accrued interest payable	11	14
Accounts payable and other liabilities	(658	) 719
Deferred loan fees/expenses, net	(35	) 66
Net cash used in operating activities	(5,636	) (14,123
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of investment securities, available-for-sale	(12,913	) (14,170
Proceeds from sales of investment securities, available-for-sale	20,392	12,848
Proceeds from maturity/paydown of investment securities, available-for-sale	3,773	8,251
Redemptions/(purchases) of FHLB / FRB bank stocks, net	959	(1,180
Purchases of bank-owned life insurance	—	(2,000
Loan originations, net	(5,856	) (7,564
Purchases of premises and equipment	(8	) (86
Net cash provided by (used in) investing activities	6,347	(3,901
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net (decrease)/increase in deposits	(4,758	) 3
Cash paid for acquisition of core deposits	—	(468
Net increase in securities sold under agreements to repurchase and federal funds purchased	60	—
Net increase in short-term FHLB advances	4,333	16,807
Repayment of long-term FHLB borrowings	(2,000	) —
Proceeds from stock options exercised	180	9
Net cash (used in) provided by financing activities	(2,185	) 16,351
Net decrease in cash and cash equivalents	(1,474	) (1,673
<b>CASH AND CASH EQUIVALENTS</b>		

Beginning of period	2,342	2,738
End of period (continued)	\$868	\$1,065

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Solera National Bancorp, Inc.

Consolidated Statements of Cash Flows for the  
Six Months Ended June 30, 2014 and 2013, (continued)  
(unaudited)

(\$ in thousands)	For the Six Months Ended June 30,	
	2014	2013
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Cash paid during the period for:		
Interest	\$921	\$579
Income taxes paid	\$—	\$—
Non-cash investing transactions:		
Unrealized gain (loss) on investment securities, available-for-sale	\$1,414	\$(1,937 )

See Notes to Consolidated Financial Statements.

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SOLERA NATIONAL BANCORP, INC.

UNAUDITED CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 — SUMMARY OF ORGANIZATION

Solera National Bancorp, Inc., a bank holding company, is a Delaware corporation formed in 2006 to organize and serve as the holding company for Solera National Bank (the “Bank”). The Bank, which is chartered as a national bank by the Office of the Comptroller of the Currency, (“OCC”), is a wholly-owned subsidiary of Solera National Bancorp, Inc. The Bank is a full-service commercial bank headquartered in Lakewood, Colorado that commenced banking operations in the third quarter of 2007. The Bank provides a variety of financial services to individuals, businesses, and not-for-profit organizations primarily located in the six-county Denver metropolitan area. Its primary lending products are residential mortgage loans, commercial loans and home-equity lines of credit. Its primary deposit products are checking, money market, savings and time deposit accounts.

NOTE 2 — BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) which, in the opinion of management, are necessary to present fairly the financial position of the Company as of June 30, 2014, and the results of its operations for the three and six months ended June 30, 2014 and 2013. Cash flows are presented for the six months ended June 30, 2014 and 2013. Certain reclassifications have been made to the consolidated financial statements and related notes of prior periods to conform to the current presentation. These reclassifications had no impact on stockholders’ equity or net (loss) income for the periods. Additionally, certain information and footnote disclosures normally included in financial statements have been condensed or omitted pursuant to rules and regulations of the U.S. Securities and Exchange Commission. The Company believes that the disclosures in the unaudited condensed consolidated financial statements are adequate to make the information presented not misleading. However, these unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013.

Critical Accounting Policies

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

**Provision and Allowance for Loan and Lease Losses:** Implicit in the Company’s lending activities is the fact that loan and lease 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 and lease losses represents the Company’s recognition of the risks of extending credit and its evaluation of the loan portfolio. The evaluation of the allowance is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance for loan and lease losses is maintained at a level considered adequate to provide for probable loan and lease losses based on management’s assessment of various factors affecting the loan portfolio, including a review of problem loans, business conditions, historical loss experience, evaluation of the quality of the underlying collateral, and holding and disposal costs. In addition, because the Bank has limited history on which to base future loan and lease losses, a comparison of peer group allowance ratios to gross loans is made with the intention of maintaining similar levels until the Bank has sufficient historical data to see trends in our own loss history. The allowance for loan and lease losses is increased by provisions charged to expense and reduced by loans and leases charged-off, net of recoveries. Loan and lease losses are charged against the allowance for loan and lease

losses when management believes the balance is uncollectible.

The Company has established a formal process for determining an adequate allowance for loan and lease losses. The allowance for loan and lease losses calculation has two components. The first component represents the allowance for loan and lease losses for impaired loans; that is, loans where the Company believes collection of the contractual principal and interest payments is not probable. To determine this component of the calculation, impaired loans 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 analysis as well as third-party information, such as appraisals. That value, less estimated costs to sell, is compared to the recorded investment in the loan and any shortfall is charged-off. Unsecured loans and loans that are not collateral-dependent are evaluated by calculating the discounted cash flow of the payments expected over the life of the loan using the loan's effective interest rate and giving consideration to currently existing factors that would impact the amount or timing of the cash flows. The shortfall between the recorded

investment in the loan and the discounted cash flows, or the fair value of the collateral less estimated costs to sell, represents the first component of the allowance for loan and lease losses.

The second component of the allowance for loan and lease losses represents contingent losses – the estimated probable losses inherent within the portfolio due to uncertainties. To determine this component, management calculates a weighted-average loss rate based on actual loss rates over the last two to three years for all banks in Colorado and for similarly-sized commercial banks with two or fewer locations in a metropolitan area. 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 primary risk comes from the difference between the expected and actual cash flows of the borrower and is influenced by the type of collateral securing the loans. For real estate secured loans, conditions in the real estate markets as well as the general economy influence real estate values and may impact the Company’s ability to recover its investment due to declines in the fair value of the underlying collateral. The risks in non-real estate secured loans include general economic conditions as well as interest rate changes. 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 a loss rate ranging between 2.50% and 15.75% of the loan’s principal balance. The aggregate of above described segments represents the contingent losses in the loan portfolio.

The recorded allowance for loan and lease losses is the aggregate of the impaired loan and lease component and the contingent loss component. We aggregate our loans into four portfolio segments: Commercial Real Estate Secured; Residential Real Estate Secured; Commercial and Industrial; 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”). Our 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 June 30, 2014, the Company had an allowance for loan and lease losses of \$1.3 million. We believe that this is adequate to cover probable losses based on currently available information. Future additions to the allowance for loan and lease losses may be required based on management’s continuing evaluation of the inherent risks in the portfolio. Additional provisions for loan and lease losses may be needed if the economy declines, asset quality deteriorates, or the loss experience changes.

**Loans Receivable:** 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 and lease 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).

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. The accrual of interest on loans is discontinued when principal or interest is 90 days past due based on contractual terms of the loan or when, in the opinion of management, there is reasonable doubt as to collectability. When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Income on nonaccrual loans is subsequently recognized only to the extent that cash is received and the Bank'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 Bank'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.

Loans Held for Sale / Gains and Losses on Sales of Mortgage Loans: Residential mortgage loans originated and held for sale are marked to market with gains and losses recognized in noninterest income. The market value is based on committed secondary market prices.

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 11. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

Interest Rate Lock Commitments and Forward Sales Commitments: Interest rate lock commitments are commitments to fund residential mortgage loans at specified interest rates within a specified time, generally up to 60 days from the time of the rate lock. An interest rate lock commitment related to a loan that will be held for sale is a derivative instrument under accounting principles generally accepted in the United States (U.S. GAAP), and is recognized at fair value on the consolidated balance sheets in other assets and other liabilities with changes in its value recorded in gain on loans sold within noninterest income on the consolidated statements of operations and comprehensive income. To eliminate the exposure of changes in interest rates impacting the fair value of interest rate lock commitments, the Company utilizes “best efforts” forward loan sale commitments. These contracts are entered into at the same time as the interest rate lock commitments, and lock in the sale and price of the loan with the Company's secondary market investors. Since these are “best efforts” contracts, the Company does not incur a penalty in the event the committed loans are not delivered. These forward loan sales commitments are not considered derivative instruments under U.S. GAAP, but in accordance with U.S. GAAP, the Company has elected to mark these instruments to market. As such, both the interest rate lock commitments and forward sales commitments are accounted for at fair value. See additional discussion in Note 6, Loans Held for Sale and Interest Rate Lock Commitments.

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

Estimation of Fair Value: The estimation of fair value is significant to a number of the Company's assets, including available-for-sale investment securities, interest rate lock commitments, forward sales commitments and other real estate owned. Additionally, U.S. GAAP requires disclosure of the fair value of financial instruments as a part of the notes to the consolidated financial statements. Fair values are volatile and may be influenced by a number of factors, including market interest rates, prepayment speeds, discount rates and the shape of the yield curve. Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the most advantageous market for the asset or liability in an orderly transaction between market participants. The fair value hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Current accounting standards describe three levels of inputs that may be used to measure fair values:

Level 1 –

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

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

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

Impairment of Investment Securities: Investment securities are evaluated for impairment on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value below

amortized cost is other-than-temporary. Securities are evaluated for impairment utilizing criteria such as the magnitude and duration of the decline, current market conditions, payment history, the credit worthiness of the obligor, the intent of the Company to retain the security or whether it is more likely than not that the Company will be required to sell the security before recovery of the value, as well as other qualitative factors. If a decline in value below amortized cost is determined to be other-than-temporary, which does not necessarily indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value is not favorable, the security is reviewed in more detail in order to determine the portion of the impairment that relates to credit (resulting in a charge to earnings) versus the portion of the impairment that is noncredit related (resulting in a charge to accumulated other comprehensive income). 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.

Income (Loss) per Common Share: Basic earnings (loss) per common share, (EPS), is based on the weighted-average number of common shares outstanding during the period. Diluted earnings (loss) 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. Given the loss for the three and six months ended June 30, 2014, diluted EPS did not differ from basic EPS as all dilutive-potential shares were anti-dilutive. Diluted EPS did not differ from basic EPS for the three and six months ended June 30, 2013, given the small amount of dilutive-potential stock options/restricted stock. For the three months and six months ended June 30, 2014, respectively, approximately 416,000 and 392,000 anti-dilutive options were not included in the calculation of diluted EPS. Similarly, for the three and six months ended June 30, 2013, approximately 351,000 and 416,000 anti-dilutive options were not included in the calculation of diluted EPS. Finally, 11,000 anti-dilutive unvested shares of restricted stock were not included in the calculation of diluted EPS for the three and six months ended June 30, 2014. Amounts used in the determination of basic and diluted earnings per share for the three and six months ended June 30, 2014 and 2013, are shown below:

(\$ in thousands, except share data)	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2014	2013	2014	2013
Basic earnings (loss) per share computation				
Net (loss) earnings to common stockholders	\$(23 )	\$439	\$(392 )	\$620
Weighted average shares outstanding - basic	2,634,146	2,554,141	2,619,485	2,553,907
Basic (loss) earnings per share	\$(0.01 )	\$0.17	\$(0.15 )	\$0.24
Diluted earnings (loss) per share computation				
Net (loss) earnings to common stockholders	\$(23 )	\$439	\$(392 )	\$620
Weighted average shares outstanding - basic	2,634,146	2,554,141	2,619,485	2,553,907
Shares assumed issued:				
Stock options	—	66,265	—	59,884
Restricted stock	—	16,050	—	15,086
Weighted average shares outstanding - diluted	2,634,146	2,636,456	2,619,485	2,628,877
Diluted (loss) earnings per share	\$(0.01 )	\$0.17	\$(0.15 )	\$0.24

Business Segments: The Company uses the "management approach" for reporting information about segments and has determined that as of June 30, 2014, its business is comprised of two operating segments: community banking and residential mortgage banking.

Recent Accounting Pronouncements

In July 2013, the FASB issued an accounting standards update (ASU) on the presentation of unrecognized tax benefits. This update requires separate presentation of tax benefits related to net operating loss carryforwards and credit carryforwards apart from other deferred tax assets. This accounting standards update became effective for us in first quarter 2014. Currently, there is no impact on the Company due to this update as our deferred tax assets have a full valuation allowance and we do not have any unrecognized tax benefits.

In January 2014, the FASB issued an ASU on troubled debt restructurings by creditors which clarifies when reclassification of real estate collateralized consumer mortgage loans occurs upon foreclosure. This update clarifies when a creditor should be considered to have received physical possession of residential real estate property such that the loan should be derecognized and other real estate owned recognized on the company's balance sheet. This update is effective for us beginning in first quarter 2015. The Company does not expect this update to have a material impact on the Company's financial statements and disclosures.

During the first six months of 2014, the FASB issued other accounting standards updates which may impact banks or other entities but do not, and are not expected to, have a material impact on our financial position, results of operations or cash flows.

### NOTE 3 — INVESTMENTS

The amortized costs and estimated fair values of investment securities as of June 30, 2014 and December 31, 2013 are as follows:

(\$ in thousands)	June 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available-for-sale:				
Corporate	\$11,988	\$143	\$(148)	) \$11,983
State and municipal	14,316	74	(235)	) 14,155
Residential agency mortgage-backed securities (MBS) and collateralized mortgage obligations (CMOs)	33,426	303	(215)	) 33,514
Total securities available-for-sale	\$59,730	\$520	\$(598)	) \$59,652
(\$ in thousands)	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available-for-sale:				
Corporate	\$13,210	\$113	\$(344)	) \$12,979
State and municipal	19,157	69	(986)	) 18,240
Residential agency MBS/CMOs	38,964	171	(515)	) 38,620
Total securities available-for-sale	\$71,331	\$353	\$(1,845)	) \$69,839

The amortized cost and estimated fair value of investment securities by contractual maturity at June 30, 2014 and December 31, 2013 are shown below. The timing of principal payments received differs from the contractual maturity because borrowers may be required to make contractual principal payments and often have the right to prepay obligations with or without prepayment penalties. As a result, the timing with which principal payments are received on mortgage-backed securities ("MBS") is not represented in the tables below. For instance, we received \$3.8 million from the maturity / prepayment of securities during the six months ended June 30, 2014 (see our Consolidated Statements of Cash Flows ) versus no dollars contractually maturing within one year as of December 31, 2013, as set forth in the table below.



(\$ in thousands)	June 30, 2014		December 31, 2013	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Securities available-for-sale:				
Due within one year	\$—	\$—	\$—	\$—
Due after one year through five years	6,929	7,059	6,442	6,557
Due after five years through ten years	18,334	18,048	25,435	24,339
Due after ten years	34,467	34,545	39,454	38,943
Total securities available-for-sale	\$59,730	\$59,652	\$71,331	\$69,839

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 June 30, 2014 and December 31, 2013.

(\$ in thousands)	June 30, 2014								
	Less than 12 months			12 months or more			Total		
Description of securities:	Estimated Fair Value	Unrealized Losses	# of Securities	Estimated Fair Value	Unrealized Losses	# of Securities	Estimated Fair Value	Unrealized Losses	# of Securities
Corporate	\$1,492	\$(8)	3	\$6,142	\$(140)	10	\$7,634	\$(148)	13
State and municipal	2,060	(13)	3	8,269	(222)	18	10,329	(235)	21
Residential agency MBS/CMOs	5,695	(96)	7	7,991	(119)	10	13,686	(215)	17
Total temporarily-impaired	\$9,247	\$(117)	13	\$22,402	\$(481)	38	\$31,649	\$(598)	51

(\$ in thousands)	December 31, 2013								
	Less than 12 months			12 months or more			Total		
Description of securities:	Estimated Fair Value	Unrealized Losses	# of Securities	Estimated Fair Value	Unrealized Losses	# of Securities	Estimated Fair Value	Unrealized Losses	# of Securities
Corporate	\$5,544	\$(223)	10	\$3,488	\$(121)	6	\$9,032	\$(344)	16
State and municipal	15,482	(932)	33	719	(54)	2	16,201	(986)	35
Residential agency MBS/CMOs	19,505	(311)	23	8,121	(204)	10	27,626	(515)	33
Total temporarily-impaired	\$40,531	\$(1,466)	66	\$12,328	\$(379)	18	\$52,859	\$(1,845)	84

Management evaluates investment securities for other-than-temporary impairment taking into consideration the extent and length of time the fair value has been less than cost, the financial condition of the issuer, whether the Company has the intent to retain the security and whether it is more-likely-than-not that the Company will be required to sell the security before recovery of the value, as well as other qualitative factors. As of June 30, 2014, no declines were deemed to be other than temporary. Despite the fact that the number of bonds in a continuous unrealized loss position for 12 months or longer has increased 111% at June 30, 2014, as compared to December 31, 2013, the amount of loss has increased only 27% during this period.

The ten corporate securities that were in a continuous loss position for 12 months or longer at June 30, 2014, reflect changes in market interest rates primarily on financial services/banking securities since the time the Company purchased these bonds.

The 18 municipal bonds that were in a continuous loss position for 12 months or longer at June 30, 2014 were due to changes in interest rates, as the bonds were purchased when the ten year treasury rate was near its historical low. The bonds continue to maintain high credit ratings.

Significant prepayment speeds is the primary driver of the loss on the ten mortgage-backed securities in a continuous loss position for 12 months or longer at June 30, 2014. The Company has determined there is no credit impairment on these bonds because they carry the implicit guarantee of the U.S. government.

The Company has the intent to hold the securities in an unrealized loss position as of June 30, 2014 and does not anticipate that these securities will be required to be sold before recovery of value, which may be upon maturity. Accordingly, the securities detailed in the table above are not other than temporarily impaired.

Similarly, management's evaluation of the securities in an unrealized loss position at December 31, 2013, determined these securities were not other than temporarily impaired.

The Company recorded a net unrealized loss in the investment portfolio of \$78,000 at June 30, 2014, a \$1.4 million improvement from the \$1.5 million net unrealized loss at December 31, 2013. The increase in the value of the portfolio since year-end was primarily due to the decline in interest rates that occurred during the first six months of 2014.

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

(\$ in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Proceeds	\$10,995	\$7,119	\$20,392	\$12,848
Gross gains	\$63	\$152	\$113	\$252
Gross losses	\$(4	) \$(7	) \$(4	) \$(7

Realized gains and losses on sales are computed on a specific identification basis based on amortized cost on the date of sale.

Securities with carrying values of \$26.5 million at June 30, 2014 and \$26.4 million at December 31, 2013, were pledged as collateral to secure public deposits, borrowings from the FHLB, repurchase agreements and for other purposes as required or permitted by law.

#### NOTE 4 — LOANS

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

(\$ in thousands)	June 30, 2014	December 31, 2013
Commercial real estate ("CRE")	\$45,233	\$47,063
Commercial and industrial	11,095	11,730
Residential real estate	23,925	17,889
Construction and land development	3,003	2,044
Consumer	167	514
GROSS LOANS	83,423	79,240
Net deferred loan expenses / (fees)	73	46
Allowance for loan and lease losses	(1,300	) (1,116
LOANS, NET	\$82,196	\$78,170

During the first six months of 2014, the Bank purchased one loan with a principal balance of \$157,000 compared to the first six months of 2013, when the Bank purchased three loans with aggregate principal balances of approximately \$225,000. During the first six months of 2014, the Bank sold the guaranteed portion of five SBA 7(a) loans totaling approximately \$1.7 million resulting in a gain of \$172,000, of which \$133,000 was recognized in income upon sale.

During the first six months of 2013, the Bank sold the guaranteed portion of two SBA 7(a) notes totaling approximately \$1.4 million resulting in gains of \$144,000, of which \$111,000 was recognized in income upon sale.

In the ordinary course of business, and only if consistent with permissible exceptions to Section 402 of the Sarbanes-Oxley Act of 2002, the Bank may make loans to directors, executive officers, principal stockholders (holders of more than five percent of the outstanding common shares) and the businesses with which they are associated. In the Company's opinion, all loans and loan commitments to such parties are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons. There were no loans receivable from related parties at June 30, 2014 and approximately \$141,000 in loans receivable from related parties at December 31, 2013.

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 Bank's current legal lending limit of approximately \$2.7 million. This regulatory requirement helps to ensure the Bank's exposure to one individual customer is limited.

#### NOTE 5 — ALLOWANCE FOR LOAN AND LEASE LOSSES

Activity in the allowance for loan and lease losses for the three and six months ended June 30, 2014 and 2013 is summarized as follows:

(\$ in thousands)	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Balance, beginning of period	\$1,126	\$1,074	\$1,116	\$1,063
Charge-offs	—	(7	) —	(7
Recoveries	24	21	34	32
Provision for loan and lease losses	150	—	150	—
Balance, end of period	\$1,300	\$1,088	\$1,300	\$1,088

The following allowance for loan and lease loss disclosures are broken out by portfolio segment. Portfolio segment is defined, under current U.S. GAAP, as the level of aggregation used by the Company to calculate its allowance for loan and lease losses. Our portfolio segments are based on how loans are categorized on the Call Report, which is primarily based on the collateral securing the loan. We have four portfolio segments as follows:

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

The portfolio segment categorization of loans differs from the categorization shown in Note 4 – Loans. Portfolio segment categorization is based on the Call Report and the loan's underlying collateral while the loan categorization in Note 4 – Loans is based on the loan's purpose as determined during the underwriting process.

The tables below provide a rollforward, by portfolio segment, of the allowance for loan and lease losses for the three and six months ended June 30, 2014 and 2013, respectively.

Rollforward of Allowance for Loan and Lease Losses by Portfolio Segment  
 Three Months Ended June 30, 2014

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(\$ in thousands)	Commercial Real Estate Secured	Residential Real Estate Secured	Commercial and Industrial	Consumer	Total
Balance at March 31, 2014	\$662	\$332	\$132	\$—	\$1,126
Charge-offs	—	—	—	—	—
Recoveries	—	14	10	—	24
Provision for loan and lease losses	200	7	(57	) —	150
Balance at June 30, 2014	\$862	\$353	\$85	\$—	\$1,300

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Rollforward of Allowance for Loan and Lease Losses by Portfolio Segment  
Six Months Ended June 30, 2014

(\$ in thousands)	Commercial Real Estate Secured	Residential Real Estate Secured	Commercial and Industrial	Consumer	Total
Balance at December 31, 2013	\$655	\$312	\$149	\$—	\$1,116
Charge-offs	—	—	—	—	—
Recoveries	—	23	11	—	34
Provision for loan and lease losses	207	18	(75	) —	150
Balance at June 30, 2014	\$862	\$353	\$85	\$—	\$1,300

Rollforward of Allowance for Loan and Lease Losses by Portfolio Segment  
Three Months Ended June 30, 2013

(\$ in thousands)	Commercial Real Estate Secured	Residential Real Estate Secured	Commercial and Industrial	Consumer	Total	
Balance at March 31, 2013	\$760	\$227	\$76	\$11	\$1,074	
Charge-offs	(7	) —	—	—	(7	)
Recoveries	—	19	2	—	21	
Provision for loan and lease losses	(79	) 62	27	(10	) —	
Balance at June 30, 2013	\$674	\$308	\$105	\$1	\$1,088	

Rollforward of Allowance for Loan and Lease Losses by Portfolio Segment  
Six Months Ended June 30, 2013

(\$ in thousands)	Commercial Real Estate Secured	Residential Real Estate Secured	Commercial and Industrial	Consumer	Total	
Balance at December 31, 2012	\$784	\$222	\$57	\$—	\$1,063	
Charge-offs	(7	) —	—	—	(7	)
Recoveries	—	28	4	—	32	
Provision for loan and lease losses	(103	) 58	44	1	—	
Balance at June 30, 2013	\$674	\$308	\$105	\$1	\$1,088	

The following tables present the ending balance in loans and allowance for loan and lease losses, broken down by portfolio segment as of June 30, 2014 and December 31, 2013. The tables also identify the recorded investment in loans and the related allowance that correspond to individual versus collective impairment evaluation as derived from the Company's methodology of estimating the allowance for loan and lease losses (see additional discussion about our allowance methodology under Note 2: Critical Accounting Policies, Provision and Allowance for Loan and Lease Losses).

Ending Balances in Loans and Allowance for Loan and Lease Losses by Portfolio Segment  
June 30, 2014

(\$ in thousands)	Commercial Real Estate Secured	Residential Real Estate Secured	Commercial and Industrial	Consumer	Total
Loans					
Individually evaluated for impairment	\$—	\$—	\$161	\$—	\$161
Collectively evaluated for impairment	37,291	32,517	13,404	50	83,262
Total	\$37,291	\$32,517	\$13,565	\$50	\$83,423
Allowance for loan losses					
Individually evaluated for impairment	\$—	\$—	\$16	\$—	\$16
Collectively evaluated for impairment	862	353	69	—	1,284
Total	\$862	\$353	\$85	\$—	\$1,300

Ending Balances in Loans and Allowance for Loan and Lease Losses by Portfolio Segment  
December 31, 2013

(\$ in thousands)	Commercial Real Estate Secured	Residential Real Estate Secured	Commercial and Industrial	Consumer	Total
Loans					
Individually evaluated for impairment	\$—	\$—	\$—	\$—	\$—
Collectively evaluated for impairment	38,924	26,230	14,036	50	79,240
Total	\$38,924	\$26,230	\$14,036	\$50	\$79,240
Allowance for loan losses					
Individually evaluated for impairment	\$—	\$—	\$—	\$—	\$—
Collectively evaluated for impairment	655	312	149	—	1,116
Total	\$655	\$312	\$149	\$—	\$1,116

The remaining tables in the allowance for loan and lease losses footnote provide detail about loans according to their class, rather than their segment, as reflected above. The class level provides more detail than the portfolio segment level. The following tables contain reconciliation information between the portfolio segment levels and class levels:

Reconciliation between Portfolio Segment and Class

June 30, 2014 (Principal Balance)

(\$ in thousands)	Portfolio Segment				
Class	Commercial Real Estate Secured	Residential Real Estate Secured	Commercial and Industrial	Consumer	Total
CRE – owner occupied	\$18,067	\$—	\$—	\$—	\$18,067
CRE – non-owner occupied	18,260	—	—	—	18,260

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Commercial and industrial	—	—	11,135	—	11,135
Residential real estate	—	29,360	—	—	29,360
Construction and land development	964	3,157	—	—	4,121
Government guaranteed	—	—	2,430	—	2,430
Consumer	—	—	—	50	50
Total	\$37,291	\$32,517	\$13,565	\$50	\$83,423

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## Reconciliation between Portfolio Segment and Class

December 31, 2013 (Principal Balance)

(\$ in thousands)

Class	Portfolio Segment		Commercial and Industrial	Consumer	Total
	Commercial Real Estate Secured	Residential Real Estate Secured			
CRE – owner occupied	\$20,964	\$—	\$—	\$—	\$20,964
CRE – non-owner occupied	17,960	—	—	—	17,960
Commercial and industrial	—	—	11,431	—	11,431
Residential real estate	—	24,186	—	—	24,186
Construction and land development	—	2,044	—	—	2,044
Government guaranteed	—	—	2,605	—	2,605
Consumer	—	—	—	50	50
Total	\$38,924	\$26,230	\$14,036	\$50	\$79,240

## Impaired Loans

The following table provides detail of impaired loans broken out according to class as of June 30, 2014. There was one impaired loan, which was also a troubled debt restructuring (TDR) as of June 30, 2014. There were no impaired loans or TDRs as of December 31, 2013. The recorded investment represents the customer balance less any partial charge-offs and excludes any accrued interest receivable since the majority of the loans are on nonaccrual status and therefore do not have interest accruing. The unpaid principal balance represents the unpaid principal prior to any partial charge-off.

(\$ in thousands)

## Impaired Loans by Class as of June 30, 2014

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment YTD	Interest Income Recognized YTD
Impaired loans with a related allowance					
CRE – owner occupied	\$—	\$—	\$—	\$—	\$—
CRE – non-owner occupied	—	—	—	—	—
Commercial and industrial	145	161	16	166	3
Residential real estate	—	—	—	—	—
Construction and land development	—	—	—	—	—
Government guaranteed	—	—	—	—	—
Consumer	—	—	—	—	—
Total	\$145	\$161	\$16	\$166	\$3

Troubled debt restructurings (TDRs) are included in impaired loans above. The one loan above was the only loan restructured as a TDR during the last 12 months. The restructuring of this note included an extension of maturity and a restructuring of payments. The pre-modification outstanding recorded investment was \$170,000, and the post-modification outstanding recorded investment was \$162,000. No loans were modified as TDRs during the three and six months ended June 30, 2013.

## Age Analysis of Loans

There were only two loans past due 30 - 59 days including one commercial and industrial loan totaling \$132,000, and one residential loan totaling \$18,000 as of June 30, 2014. No other loans were past due. There was one nonaccrual

loan, as shown in the table above, as of June 30, 2014 and there were no past due or nonaccrual loans as of December 31, 2013.

#### Credit Quality Information

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

Special Mention:	Loans in this category have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment at some future date.
Substandard:	Loans in this category are inadequately protected by the current sound worth and paying capacity of the borrower or of the collateral pledged, if any. These loans have well-defined weaknesses that jeopardize the liquidation of the debt and have the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.
Doubtful:	Loans in this category have all the weaknesses inherent in those classified as substandard, above, with the added characteristic that the weaknesses make the collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.
Loss:	Loans in this category are deemed not collectible and are charged-off.

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

As of June 30, 2014, and based on the most recent analysis performed during the month of June 2014, the recorded investment in each risk category of loans by class of loan is as follows:

(\$ in thousands)	Credit Quality of Loans by Class as of June 30, 2014				
	Pass	Special Mention	Substandard	Doubtful	Total
CRE – owner occupied	\$13,424	\$176	\$4,467	\$—	\$18,067
CRE – non-owner occupied	15,360	2,900	—	—	18,260
Commercial and industrial	10,607	45	483	—	11,135
Residential real estate	28,578	—	782	—	29,360
Construction and land development	3,157	964	—	—	4,121
Government guaranteed	2,430	—	—	—	2,430
Consumer	50	—	—	—	50
Total	\$73,606	\$4,085	\$5,732	\$—	\$83,423

As of December 31, 2013, and based on the most recent analysis performed during the month of December 2013, the recorded investment in each risk category of loans by class of loan is as follows:

(\$ in thousands)	Credit Quality of Loans by Class as of December 31, 2013				
	Pass	Special Mention	Substandard	Doubtful	Total
CRE – owner occupied	\$18,533	\$179	\$2,252	\$—	\$20,964
CRE – non-owner occupied	17,124	836	—	—	17,960
Commercial and industrial	11,134	127	170	—	11,431
Residential real estate	23,393	—	793	—	24,186
Construction and land development	2,044	—	—	—	2,044
Government guaranteed	2,605	—	—	—	2,605
Consumer	50	—	—	—	50
Total	\$74,883	\$1,142	\$3,215	\$—	\$79,240

NOTE 6 — LOANS HELD FOR SALE AND INTEREST RATE LOCK COMMITMENTS

In December 2012, the Bank began originating traditional residential mortgage loans. These loans are generally conventional, conforming loans for the purchase or refinance of one-to-four family properties. These loans are recorded as loans held for sale on the Company's consolidated balance sheets as they will be sold to purchasers on the secondary market which significantly reduces our credit risk. The Bank had loans held for sale of \$14.4 million and \$8.0 million as of June 30, 2014 and December 31, 2013, respectively.

The Bank has entered into interest rate lock commitments to originate residential mortgage loans held for sale that are considered derivative instruments. The Bank enters into an interest rate lock commitment with the customer and simultaneously enters into a forward sales commitment with the secondary market investor which locks the pricing on the subsequent sale of the loan thereby mitigating the Bank's exposure to interest rate risk.

The fair value of these commitments is recorded on the consolidated balance sheets with the changes in fair value recorded in the consolidated statements of operations as a component of gain on loans sold. These derivative contracts are designated as free standing derivative contracts and are not designated against specific assets and liabilities on the balance sheet or forecasted transactions and therefore do not qualify for hedge accounting treatment.

The table below identifies the balance sheet category and fair values of the Bank's derivative instruments not designated as hedging instruments at June 30, 2014 and December 31, 2013.

(\$ in thousands)

Interest Rate Lock Commitments (Mortgage)	Notional Amount	Fair Value	Balance Sheet Category
June 30, 2014	\$14,538	\$114	Other assets
December 31, 2013	\$6,280	\$62	Other assets

#### NOTE 7 — DEPOSITS

Deposits are summarized as follows:

(\$ in thousands)	June 30, 2014		December 31, 2013		
	Amount	% of Total	Amount	% of Total	%
Noninterest-bearing demand	\$4,747	4	% \$6,362	5	%
Interest-bearing demand	8,197	6	% 10,559	8	%
Money market accounts	18,276	14	% 14,929	11	%
Savings accounts	30,883	24	% 36,256	28	%
Time deposits, less than \$100,000	4,447	4	% 4,485	3	%
Time deposits, \$100,000 or more	61,536	48	% 60,253	45	%
Total deposits	\$128,086	100	% \$132,844	100	%

In the ordinary course of business, certain officers, directors, stockholders, and employees of the Bank have deposits with the Bank. In the Bank's opinion, all deposit relationships with such parties are made on substantially the same terms including interest rates and maturities, as those prevailing at the time for comparable transactions with other persons. The balances of related party deposits were approximately \$182,000 and \$3.1 million at June 30, 2014 and December 31, 2013, respectively. The decline in related party deposits as of June 30, 2014 relates to the changes in the composition of our board of directors.

On June 7, 2013, the Bank 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 Bank 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. As of June 30, 2014, the core deposit intangible is \$395,000 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 both June 30, 2014 and December 31, 2013, no impairment has been noted.

NOTE 8 — FHLB ADVANCES

The Bank 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 Bank and some of the Bank's qualifying loans. The Bank's authorized borrowing line with the FHLB is capped at 40% of total assets, subject to the availability of sufficient collateral to pledge against such borrowings. As of June 30, 2014, the Bank had \$6.5 million in fixed-rate borrowings from the

FHLB with varying maturity dates between November 2014 and October 2018 and a weighted-average effective interest rate of 1.99%. As of December 31, 2013, the Bank had \$8.5 million in fixed-rate borrowings from the FHLB with varying maturity dates between April 2014 and October 2018 and a weighted-average effective interest rate of 1.73%. Additionally, the Bank had \$14.1 million in variable-rate, overnight borrowings at 0.24% as of June 30, 2014. The Bank is primarily using overnight borrowings at the FHLB to fund residential mortgage loans which are held for sale. The Bank had \$9.8 million in overnight borrowings from the FHLB as of December 31, 2013 at 0.19%. During the three months ended June 30, 2014, approximately \$5,000 of the \$40,000 in total interest expense on FHLB advances pertained to short-term borrowings. During the six months ended June 30, 2014, approximately \$9,000 of the \$80,000 in total interest expense on FHLB advances pertained to short-term borrowings. During the three months ended June 30, 2013, approximately \$8,000 of the \$40,000 in total interest expense on FHLB advances pertained to short-term borrowings. During the six months ended June 30, 2013, approximately \$14,000 of the \$79,000 in total interest expense on FHLB advances pertained to short-term borrowings.

In addition to FHLB borrowings, the Company may borrow overnight funds on an unsecured basis from its correspondent banks. As of June 30, 2014 and December 31, 2013, the Company had approved borrowing lines up to \$13.1 million from correspondent banks and had \$60,000 and \$0, respectively, in outstanding borrowings under these arrangements. The Bank also has the ability to borrow at the Federal Reserve Bank Discount Window on a secured basis.

#### NOTE 9 — STOCK-BASED COMPENSATION

On September 20, 2012, the Board of Directors adopted the Company's 2012 Long-Term Incentive Plan, (the "2012 Plan"). Under the terms of the 2012 Plan, the Company may grant stock-based awards including stock options, nonqualified stock options, restricted stock awards, stock appreciation rights, and performance awards 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 June 30, 2014, approximately 133,500 shares were available for future grants. Stock options expire no later than ten years from the date of grant and generally vest over four years. The 2012 Plan provides for accelerated vesting if there is a change of control, as defined in the 2012 Plan. As of June 30, 2014, the Company does not believe there has been a change of control per the terms of 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 June 30, 2014, approximately 143,000 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 ten years from the date of the grant and generally vest over four years. The 2007 Plan provides for accelerated vesting if there is a change of control, as defined in the 2007 Plan. Effective June 13, 2014, a change of control, as defined in the 2007 Plan, occurred. As such all options granted prior to June 13, 2014 and not forfeited before June 13, 2014 became fully vested and exercisable. This resulted in approximately \$33,000 of accelerated compensation expense recorded during the second quarter 2014.

The Company recognized stock-based compensation costs of approximately \$62,000 during the three months ended June 30, 2014, which represents approximately 50,600 stock options earned. The Company recognized stock-based compensation costs of approximately \$52,000 during the three months ended June 30, 2013, which represented approximately 16,200 stock options earned. The Company recognized stock-based compensation costs of approximately \$102,000 for the six months ended June 30, 2014 compared to \$100,000 for the six months ended June 30, 2013. No tax benefit related to stock-based compensation will be recognized until the Company demonstrates an ability to maintain profitability.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes-Merton option pricing model. As of June 30, 2014, there was approximately \$85,000 of total unrecognized compensation cost related to the outstanding stock options that will be recognized over a weighted-average period of 2.3 years. However, the Company does not anticipate recognizing all of this expense given the increased turnover that occurred in July 2014 which resulted in higher than expected forfeitures. See additional discussion in Note 13, Segment Reporting.

The following is a summary of the Company's outstanding stock options and related activity for the six months ended June 30, 2014:

	Options	Weighted-Average Grant Date Fair Value	Weighted-Average Exercise Price
Outstanding at December 31, 2013	610,177	\$ 1.66	\$ 6.70
Granted	—	—	—
Exercised	(49,720)	) 0.71	3.63
Forfeited	(55,322)	) 1.33	5.56
Expired	(101,960)	) 2.45	9.19
Outstanding at June 30, 2014	403,175	\$ 1.62	\$ 6.60

The following is a summary of the Company's outstanding stock options and related activity for the six months ended June 30, 2013:

	Options	Weighted-Average Grant Date Fair Value	Weighted-Average Exercise Price
Outstanding at December 31, 2012	523,500	\$ 1.65	\$ 6.72
Granted	126,000	1.28	5.44
Exercised	(2,375)	) 0.84	3.94
Forfeited	(2,625)	) 0.81	3.86
Expired	(4,479)	) 1.40	6.00
Outstanding at June 30, 2013	640,021	\$ 1.59	\$ 6.49

#### Restricted Stock

During 2012, the Company granted 50,000 shares of restricted stock as inducement awards to officers of the Company's residential mortgage division. The awards originally cliff-vested on November 30, 2014 conditioned upon the officers' continued employment with the Bank. In August 2013, the Company accelerated the vesting of 25,000 shares making them fully vested as of August 30, 2013. In December 2013, an additional 12,500 shares vested in conjunction with the separation of an officer. The remaining shares vest on November 30, 2014, conditioned upon the officer's continued employment with the Bank. The shares have a grant-date fair value of \$4.80 per share.

An additional 25,000 performance-based restricted shares were issued to an officer on November 30, 2012. The number of performance-based restricted shares that will vest will be calculated in accordance with the performance goals annually set by the Compensation Committee of the Board of Directors and will be a maximum of 5,000 shares for each of the years ending December 31, 2014, 2015, 2016, 2017 and 2018. The fair value of the performance-based restricted shares will be determined annually on the date the performance goals are established. In February 2014, 5,000 of these performance-based restricted shares were granted. The shares have a grant-date fair value of \$5.76 and as of June 30, 2014, \$12,000 of expense was recognized representing the value of the shares expected to fully vest.

In September 2013, the Company granted 10,000 shares of restricted stock as incentive compensation to the Company's then President and Chief Executive Officer, Mr. Carmichael. The shares had a grant-date fair value of \$7.15 per share. 2,000 shares were scheduled to vest on September 30, 2014, with the remaining shares vesting ratably over 48 months beginning October 31, 2014, conditioned upon the officer's continued employment with the Bank. Mr. Carmichael, an at-will employee, was terminated for cause in July 2014, and as a result the restricted stock was forfeited in July 2014.

The Company recognized \$16,000 and \$34,000 of stock-based compensation expense associated with the stock awards for the three and six months ended June 30, 2014, respectively. This compared to \$30,000 and \$60,000 for the three and six months ended June 30, 2013, respectively. As of June 30, 2014, compensation cost of \$73,000 related to

unearned awards is expected to be recognized over a weighted-average period of 2.4 years. As of June 30, 2014, 47,500 restricted stock awards are considered issued and outstanding as they have voting and dividend rights.

## NOTE 10 — NONINTEREST EXPENSE

The following table details the individual expense items that comprise other general and administrative expenses for amounts greater than \$25,000 for the three months ended June 30, 2014 or greater than \$50,000 for the six months ended June 30, 2014 compared to the expense for the same period of 2013.

(\$ in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Other general and administrative expenses:				
Data processing	\$ 150	\$ 187	\$ 301	\$ 304
Other loan expenses	98	89	172	162
Marketing and promotions	50	63	82	100
Regulatory and reporting fees	42	36	75	69
FDIC assessment	34	30	67	65
Telephone/communication	28	29	54	52
OREO expense	270	12	270	24
All other	139	156	293	295
Total	\$ 811	\$ 602	\$ 1,314	\$ 1,071

## NOTE 11 — 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 June 30, 2014 and December 31, 2013, \$27.9 million and \$21.0 million, respectively, in unfunded commitments were outstanding whose contract amounts represent credit risk. Of the \$27.9 million in total commitments outstanding at June 30, 2014, \$10.4 million were at variable rates and \$17.1 million were at fixed rates and \$400,000 have terms that are still being negotiated. Of the \$21.0 million in total commitments outstanding at December 31, 2013, \$7.6 million were at variable rates and \$9.5 million were at fixed rates and \$3.9 million have terms that were being negotiated. Additionally, as of June 30, 2014 and December 31, 2013, the Company had approximately \$14.1 million and \$7.8 million, respectively, in commitments to sell residential mortgage loans to third-party investors.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since 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.

The Bank enters into commitments to sell residential mortgage loans to reduce interest rate risk on certain residential mortgage loans held for sale and loan commitments which were recorded in the consolidated balance sheets at their fair values. The Bank does not anticipate any material loss as a result of the commitments and contingent liabilities. Residential mortgage loans sold to others are predominantly conventional residential first lien mortgages originated

under the Bank's usual underwriting procedures, and are most often sold on a nonrecourse basis. The Bank's agreements to sell residential mortgage loans in the normal course of business usually require certain representations and warranties on the underlying loans sold, related to credit information, loan documentation, collateral, first payment default and insurability, which if subsequently are untrue or breached, could require the Bank to repurchase certain loans affected. Inception to date, the Bank has experienced \$40,000 of loss related to early pay off fees and other payment defaults. Beginning in the first quarter of 2014, the Bank established a recourse reserve liability, which is included in accounts payable and other liabilities on the consolidated balance sheets, to reserve for estimated losses due to early payoffs, losses associated with payment default and repurchases under other

representations and warranties. This estimate is reviewed on a quarterly basis to account for changes in the volume of loans sold, delinquencies and economic conditions. As of June 30, 2014, the recourse reserve liability balance was \$14,000.

#### NOTE 12 — FAIR VALUE

The Company carries its available-for-sale securities, loans held for sale, and interest rate lock commitments 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 2 under the discussion of our critical 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 June 30, 2014 and December 31, 2013, all of the Company's available-for-sale securities were valued using Level 2 inputs.

For loans held for sale and interest rate lock commitments, fair value measurement is obtained using observable inputs, Level 2 on the fair value hierarchy, including what secondary markets are currently offering for loans with similar characteristics.

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 are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly.

Other real estate owned is valued at the time the 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 is reviewed and evaluated on at least an annual basis for additional impairment and adjusted accordingly.

## Assets and Liabilities Measured on a Recurring Basis

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

(\$ in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets at June 30, 2014				
Investment securities, available-for-sale:				
Corporate	\$—	\$ 11,983	\$—	\$ 11,983
State and municipal	—	14,155	—	14,155
Residential agency MBS/CMOs	—	33,514	—	33,514
Loans held for sale	—	14,383	—	14,383
Interest rate lock commitments	—	114	—	114
Assets at December 31, 2013				
Investment securities, available-for-sale:				
Corporate	\$—	\$ 12,979	\$—	\$ 12,979
State and municipal	—	18,240	—	18,240
Residential agency MBS/CMOs	—	38,620	—	38,620
Loans held for sale	—	7,951	—	7,951
Interest rate lock commitments	—	62	—	62

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

## Assets and Liabilities Measured on a Nonrecurring Basis

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

(\$ in thousands)	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets at June 30, 2014				
Impaired loans (Financial)	\$—	\$—	\$ 145	\$ 145
Other real estate owned (Non-financial)	\$—	\$—	\$ 1,560	\$ 1,560
Assets at December 31, 2013				
Impaired loans (Financial)	\$—	\$—	\$—	\$—
Other real estate owned (Non-financial)	\$—	\$—	\$ 1,921	\$ 1,921

There was one impaired loan as of June 30, 2014 and no impaired loans as of December 31, 2013.

Other real estate owned (OREO) is real property taken by the Company either through foreclosure or through deed in lieu of foreclosure. As of June 30, 2014, the fair value of OREO is based on sales negotiations with interested buyers

for transactions that are expected to close within the year. The estimated sales price has been adjusted to reflect costs to sell and a time value discount attributed to the time to sell. Therefore, the inputs used to determine the fair value of OREO fall within Level 3. OREO had carrying amounts of \$1.5 million at June 30, 2014 and \$1.7 million at December 31, 2013, after considering estimated costs to sell and less partial charge-offs recorded in 2011, 2013 and 2014.

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

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

### Fair Value of Financial Instruments

Disclosure of fair value 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.

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, net:** The fair value of fixed rate loans is estimated by discounting the future cash flows using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are estimated to be equivalent to carrying

values. Variable rate loans that are currently priced at their contractual floor or ceiling, and thus similar to fixed rate loans, are reviewed to determine the interest rate that would be currently offered on similar credits. If the current floor/ceiling rate is equivalent to current market rates, fair value is estimated to be equivalent to carrying value. If the current market rates differ from the loan's current rate, the contractual cash flows are discounted using the current market rate to derive the loan's estimated fair value. Both the estimated fair value and the carrying value have been reduced by specific and general reserves for loan losses.

Loans held for sale: Loans originated and held for sale are carried at fair value which is estimated using secondary market pricing currently being offered on loans with similar characteristics.

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

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

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

Interest rate lock commitments and forward sales commitments: The fair value of interest rate lock commitments (to originate residential mortgage loans held for sale) and forward sales commitments (to sell residential mortgage loans held for sale to third parties) is primarily based on quoted prices for similar assets in active markets that the Bank has the ability to access.

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

Federal Home Loan Bank 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 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)	Carrying Value	Fair Value Measurements at June 30, 2014			
		Level 1	Level 2	Level 3	Total
<b>Financial Assets:</b>					
Cash and cash equivalents	\$868	\$868	\$—	\$—	\$868
Interest-bearing deposits with banks	257	—	272	—	272
Investment securities	59,652	—	59,652	—	59,652
Loans, net	82,196	—	—	84,441	84,441
Loans held for sale	14,383	—	14,383	—	14,383
FHLB and FRB stocks	1,403	—	—	NA	NA
Bank-owned life insurance	4,389	—	—	4,389	4,389
Accrued interest receivable	652	—	384	268	652
Interest rate lock commitments	114	—	114	—	114
<b>Financial Liabilities:</b>					
Deposits, demand, savings and money market	\$62,103	\$—	\$62,103	\$—	\$62,103
Time deposits	65,983	—	66,476	—	66,476
Securities sold under agreements to repurchase and federal funds purchased	204	—	204	—	204
FHLB advances	20,641	—	20,744	—	20,744
Accrued interest payable	74	—	74	—	74

(\$ in thousands)	Carrying Value	Fair Value Measurements at December 31, 2013			
		Level 1	Level 2	Level 3	Total
<b>Financial Assets:</b>					
Cash and cash equivalents	\$2,342	\$2,342	\$—	\$—	\$2,342
Interest-bearing deposits with banks	257	—	272	—	272
Investment securities	69,839	—	69,839	—	69,839
Loans, net	78,170	—	—	79,153	79,153
Loans held for sale	7,951	—	7,951	—	7,951
FHLB and FRB stocks	2,346	—	—	NA	NA
Bank-owned life insurance	4,316	—	—	4,316	4,316
Accrued interest receivable	705	—	471	234	705
Interest rate lock commitments	62	—	62	—	62
<b>Financial Liabilities:</b>					
Deposits, demand, savings and money market	\$68,106	\$—	\$68,106	\$—	\$68,106
Time deposits	64,738	—	65,254	—	65,254
Securities sold under agreements to repurchase	54	—	54	—	54
FHLB advances	18,308	—	18,429	—	18,429
Accrued interest payable	63	—	63	—	63

#### NOTE 13 — SEGMENT REPORTING

Reportable segments include community banking and residential mortgage banking services. These segments were determined based on the products and services provided and are consistent with the information that is used by the Bank's key decision makers to make operating decisions and to assess the Company's performance. Community banking involves making loans to and generating deposits primarily from individuals and businesses in the Bank's primary market - the six-county Denver metropolitan area. Residential mortgage banking involves the origination of residential loans and subsequent sale of those loans to investors. The residential mortgage banking segment is a strategic business unit that offers different products and services. It is managed separately because the segment

appeals to different markets and, accordingly, requires different technology and marketing strategies. As of June 30, 2014, our residential mortgage department had loan production offices in

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Boulder, two locations in Colorado Springs, the Denver Tech Center and Durango. This segment's most significant revenue item is noninterest income and its most significant expense item is noninterest expense. The Bank does not have other reportable operating segments. The accounting policies of the mortgage banking division are the same as those described in the summary of critical accounting policies.

The following table presents the financial information from the Bank's two operating segments for the periods presented:

(\$ in thousands)	Community Banking	Residential Mortgage Banking	Total
<b>Three Months Ended June 30, 2014</b>			
Net interest income	\$1,102	\$202	\$1,304
Provision for loan and lease losses	60	90	150
Total noninterest income	224	1,443	1,667
Total noninterest expense	1,513	1,331	2,844
(Loss) income before income taxes	\$(247	) \$224	\$(23 )
<b>Six Months Ended June 30, 2014</b>			
Net interest income	\$2,264	\$339	\$2,603
Provision for loan and lease losses	60	90	150
Total noninterest income	372	2,299	2,671
Total noninterest expense	3,016	2,500	5,516
(Loss) income before income taxes	\$(440	) \$48	\$(392 )
<b>Three Months Ended June 30, 2013</b>			
Net interest income	\$1,069	\$55	\$1,124
Provision for loan and lease losses	—	—	—
Total noninterest income	204	2,487	2,691
Total noninterest expense	1,289	2,087	3,376
(Loss) income before income taxes	\$(16	) \$455	\$439
<b>Six Months Ended June 30, 2013</b>			
Net interest income	\$2,094	\$80	\$2,174
Provision for loan and lease losses	—	—	—
Total noninterest income	453	3,901	4,354
Total noninterest expense	2,449	3,459	5,908
Income before income taxes	\$98	\$522	\$620
<b>Segment Assets</b>			
June 30, 2014	\$133,771	\$34,199	\$167,970
December 31, 2013	\$151,255	\$18,422	\$169,677
<b>Average Loans</b>			
YTD June 30, 2014	\$68,410	\$14,995	\$83,405
YTD December 31, 2013	\$66,717	\$12,841	\$79,558

The second quarter 2014 mortgage activity increased over first quarter 2014, primarily due to the seasonal nature of the business. However, first and second quarter 2014 results were down significantly from first and second quarter

2013 primarily due to the sharp reduction in refinancing activity from approximately \$51.0 million during the first six months of 2013 to

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approximately \$14.0 million for the first six months of 2014. During July 2014, all of our mortgage loan officers and the majority of their support staff resigned from the Bank to join other institutions. Management and the Board are committed to this line of business and are actively exploring opportunities to revamp our residential mortgage banking segment. However, during this time we are not accepting new residential mortgage loan applications. As such, we anticipate third quarter mortgage activity to be significantly less as it will only include the loans that were already in the pipeline before our mortgage loan officers resigned. After closing out the mortgage loans in the pipeline, our loan production offices in Colorado Springs, the Denver Tech Center and Boulder will be vacant. However, management believes the spaces will either be re-occupied or subleased/assigned in the near term.

The second quarter 2014 results for the community banking division were adversely impacted from increased legal costs of approximately \$130,000 associated with our contested proxy surrounding the election of directors at our 2014 annual meeting of stockholders, as well as write-downs on our two OREO properties totaling \$261,000. Both properties are expected to be sold before the end of the year with no further write-downs anticipated. The year-to-date 2014 community banking results were also impacted by approximately \$102,000 of severance costs incurred during the first quarter, as well as \$80,000 incurred during the first quarter due to the contested annual meeting.

#### NOTE 14 — LEGAL CONTINGENCIES

On July 9, 2014, the Company dismissed the lawsuit filed on March 12, 2014 against Mr. Michael D. Quagliano.

On August 7, 2014, the Company received a demand for payment from Mr. Carmichael, former President & CEO of the Company, related to severance and other compensation he believes he is entitled to receive. The Company believes Mr. Carmichael's claims have no merit as he was an at-will employee terminated for cause. As such, the Company has not established any reserve for potential liabilities associated with this claim.

In addition, in the ordinary course of our business, we may be party to various legal actions, which we believe are incidental to the operation of our business.

#### NOTE 15 — SUBSEQUENT EVENTS

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

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

The following discussion and analysis presents the Company's consolidated financial condition as of June 30, 2014 and results of operations for the three and six months ended June 30, 2014 and 2013. The discussion should be read in conjunction with the financial statements and the notes related thereto which appear elsewhere in this Quarterly Report on Form 10-Q.

### Executive Overview

We are a Delaware corporation that was incorporated to organize and serve as the holding company for Solera National Bank, which opened for business in 2007. Solera National Bank is a full-service commercial bank headquartered in Lakewood. We have two operating segments: community banking and residential mortgage banking.

We offer a broad range of commercial and consumer banking services to small and medium-sized businesses, licensed professionals and individuals who are particularly responsive to the personalized service that Solera National Bank provides to its customers. We believe that local ownership and control allows the Bank to serve customers efficiently and effectively. Solera National Bank competes on the basis of providing a personalized banking experience combined with a broad range of services, customized and tailored to fit the individual needs of its clients. The Bank has an emphasis in serving the local Hispanic and other minority populations which it believes are underserved. The Company remains focused on executing its strategy since its inception of delivering prudent and controlled growth to efficiently leverage the Company's capital and expense base with the goal of achieving sustained profitability. In addition to our bank branch located in Lakewood, we have four residential mortgage loan production offices in Colorado including Boulder, two locations in Colorado Springs, and the Denver Tech Center. As of June 30, 2014, the Bank has 64 full-time equivalent employees.

The Company was subject to a contentious proxy contest in the first half of 2014 and now has a reconstituted board of directors with one primary goal - to be the premier community bank in Colorado with a focus on serving traditionally underserved populations with the ultimate objective of creating shareholder value. We are in the process of rebuilding as there has been turnover in key management positions. We believe the changes that have been made are in the best interest of all stakeholders - our employees, our customers and our shareholders. We expect the third quarter of 2014 to show materially reduced noninterest income as all of our residential mortgage loan officers, and the majority of related operations staff, tendered their resignations in July 2014 to join other organizations. Thus, we do not have any residential mortgage business as this time. The new Board is committed to this line of business and is exploring strategic opportunities to re-establish this line of business. In the interim, we will continue to focus on our traditional strength as a commercial bank and operate a lean and efficient structure. To help reduce costs, we have decided to de-register as an SEC reporting company. We expect this to significantly reduce accounting, legal and auditing costs as well as allow management to devote more time to the Bank's operations rather than SEC reporting and compliance. We are committed to providing transparent financial reporting through publication of quarterly earnings releases and annual audited financial statements. Importantly, we will remain traded over-the-counter and expect the liquidity of our stock to be unaffected by this change.

Since we operate in Colorado, our operating results are significantly influenced by economic conditions in Colorado, particularly the health of the real estate market. Additionally, we are subject to competition from other financial institutions and are 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").

Results of operations are primarily the product of (i) net interest income, which is interest income less interest expense, offset by noninterest expense and provision for loan and lease losses and (ii) noninterest income earned from gains on the sale of residential mortgage loans. The majority of our assets are interest-earning and liabilities are interest-bearing, and as a result, changes in interest rates impact our net interest margin. Margin refers to net interest income divided by average interest-earning assets, and is influenced by the level and relative mix of interest-earning assets and interest-bearing liabilities. We manage interest-earning assets and interest-bearing liabilities to reduce the impact of interest rate changes on operating results.

Comparative Results of Operations for the Three Months Ended June 30, 2014 and 2013

The following discussion focuses on the Company's financial condition and results of operations for the three months ended June 30, 2014 compared to the three months ended June 30, 2013.

Net loss for the quarter ended June 30, 2014 was \$23,000, or \$(0.01) per share, compared to net income of \$439,000, or \$0.17 per share, for the second quarter of 2013. The \$462,000 decrease was primarily the result of the following:

- 1) a \$1.0 million decrease in noninterest income, due to decreased gains on the sale of mortgage loans given the sharp reduction in refinancing activity attributable to the increase in long-term mortgage rates;
- 2) a \$168,000 increase in professional fees primarily due to increased legal costs associated with our contested proxy surrounding the election of directors at our 2014 annual meeting of stockholders;
- 3) a \$209,000 increase in other general and administrative costs primarily due to the \$261,000 of impairment charges recognized on our two OREO properties, and
- 4) a \$150,000 provision for loan and lease losses.

These items were partially offset by a \$180,000 increase in net interest income before provision expense and a \$887,000 reduction in employee compensation and benefits which pertains to both a reduced number of employees and reduced mortgage loan activity which reduces commissions expense.

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

(\$ in thousands)	Three Months Ended June 30, 2014			Three Months Ended June 30, 2013			
	Average Balance	Interest	Yield / Cost	Average Balance	Interest	Yield / Cost	
<b>Assets:</b>							
<b>Interest-earning assets:</b>							
Gross loans, net of unearned fees <sup>(1)</sup> <sub>(2)</sub>	\$85,489	\$1,098	5.15	% \$67,123	\$868	5.19	%
Loans held for sale	9,580	104	4.36	14,411	121	3.38	
Investment securities <sup>(3)</sup>	62,500	397	2.55	75,994	411	2.17	
FHLB and FRB stocks	1,454	16	4.47	2,110	19	3.56	
Federal funds sold	705	1	0.28	245	—	0.21	
Interest-bearing deposits with banks	257	2	3.01	257	2	2.94	
Total interest-earning assets	159,985	\$1,618	4.06	% 160,140	\$1,421	3.56	%
Noninterest-earning assets	8,585			8,417			
Total assets	\$168,570			\$168,557			
<b>Liabilities and Stockholders' Equity:</b>							
<b>Interest-bearing liabilities:</b>							
Money market and savings deposits	\$51,353	\$59	0.46	% \$50,910	\$58	0.45	%
Interest-bearing checking accounts	9,910	19	0.74	8,245	16	0.77	
Time deposits	64,034	196	1.23	59,214	183	1.24	
Short-term FHLB advances	9,752	5	0.23	16,103	8	0.20	
Long-term FHLB advances	7,565	35	1.87	8,500	32	1.52	
Total interest-bearing liabilities	142,614	\$314	0.88	% 142,972	\$297	0.83	%
Noninterest-bearing checking accounts	7,093			4,663			
Noninterest-bearing liabilities	756			656			
Stockholders' equity	18,107			20,266			
Total liabilities and stockholders' equity	\$168,570			\$168,557			
Net interest income		\$1,304			\$1,124		
Net interest spread		3.18	%		2.73	%	
Net interest margin		3.27	%		2.82	%	

- (1) The loan average balances and rates include nonaccrual loans, if any.
- (2) Net loan expenses of \$5,000 and \$11,000 for the three months ended June 30, 2014 and 2013, respectively, are included in the yield computation.
- (3) Yields on investment securities have not been adjusted to a tax-equivalent basis since the Company does not own any tax-free securities.

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

(\$ in thousands)	Three Months Ended June 30, 2014 Compared to Three Months Ended June 30, 2013		
	Net Change	Rate	Volume
Interest income:			
Gross loans, net of unearned fees	\$230	\$(6 )	\$236
Loans held for sale	(17 )	110	(127 )
Investment securities	(14 )	739	(753 )
FHLB and FRB stocks	(3 )	12	(15 )
Federal funds sold	1	1	—
Interest-bearing deposits with banks	—	—	—
Total interest income	\$197	\$856	\$(659 )
Interest expense:			
Money market and savings deposits	\$1	\$—	\$1
Interest-bearing checking accounts	3	—	3
Time deposits	13	(2 )	15
ST FHLB advances	\$(3 )	1	(4 )
LT FHLB advances	3	6	(3 )
Total interest expense	\$17	\$5	\$12
Net interest income	\$180	\$851	\$(671 )

#### Net Interest Income and Net Interest Margin

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

For the three months ended June 30, 2014, the Company's net interest income before the provision for loan and lease losses increased \$180,000, or 16%, compared to the three months ended June 30, 2013 and net interest margin increased 45 basis points from 2.82% to 3.27%. Most notable was the \$230,000 increase in interest income on loans primarily due to the \$18.4 million increase in average loan balance during the second quarter 2014 compared to the second quarter 2013. This increase was partially offset by 1) an unfavorable decrease in interest income on loans held for sale of \$17,000, due to the \$4.8 million decrease in average balance, but partially offset by the increase in average rate, and 2) an unfavorable decrease in interest income on investment securities, which decreased \$14,000, due to a decrease in average balances (down \$13.5 million), but partially offset by a favorable increase in yield (up 38 basis points).

The increases in yields on our interest-earning assets were slightly dampened by a 5 basis point increase on the cost of interest-bearing liabilities from second quarter 2013 to second quarter 2014, primarily due to a volume shift from lower-costing short-term FHLB advances to higher-costing time deposits. Despite this unfavorable variance, our net interest spread (the yield earned on interest-earning assets less the cost of interest-bearing liabilities), increased 45 basis points.

## Provision for Loan and Lease Losses

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

During the second quarter 2014, we recognized \$150,000 of provision expense partially due to the increase in gross loans and partially due to the increase in criticized and classified loans. We did not recognize any provision for loan and lease losses in 2013. See additional discussion below under Financial Condition, Loan Portfolio.

## Noninterest Income

Noninterest income for the quarter ended June 30, 2014 was \$1.7 million, a decrease of \$1.0 million from \$2.7 million for the second quarter 2013. The largest contributor to the decline was the \$1.0 million decline in gain on residential mortgage loans sold which was primarily related to the decline in refinancing activity experienced due to the increase in longer-term interest rates from the near historical lows in May of 2013. It is important to note that since we have elected to fair value loans held for sale, the gain on loans sold is recognized at the time the loan is funded. As such, this gain correlates more closely with the volume of loans originated during the period rather than with the volume of loans sold during the period.

Also contributing to the decline in noninterest income was the \$86,000 decrease in gains on the sale of investment securities dropping from \$145,000 during the second quarter 2013 to \$59,000 during the second quarter 2014.

The following table summarizes the Bank's residential mortgage loan activity during the second quarter of 2014 and 2013.

(\$ in thousands)	For the Quarter Ended			
	June 30, 2014		June 30, 2013	
Gain on Loans Sold	1,443		2,487	
Average Service Release Premium	2.62	%	2.67	%
Residential Mortgage Loans Originated	\$54,367		\$86,091	
Residential Mortgage Loans Sold	\$48,392		\$88,125	
Purpose of Loan: <sup>(1)</sup>				
Purchase	83	%	64	%
Refinance	17	%	36	%

<sup>(1)</sup> indicates the percentage of loans originated during the period

Refinancing activity slowed significantly beginning in July 2013 due to the rise in longer-term interest rates in the second quarter of 2013. We expect this trend to continue throughout 2014 as most economic forecasts expect longer-term interest rates to remain stable or increase in the near-term. During July 2014, all of our mortgage loan officers and the majority of their support staff left our Bank to join other institutions. Thus, we do not have a mortgage loan business at this time. Management and the Board are committed to this line of business and are actively exploring opportunities to re-launch the residential mortgage banking segment. However, during this time we are not accepting new residential mortgage loan applications. As such, we anticipate third quarter 2014 mortgage activity to be significantly less than second quarter 2014 as it will only include the loans that were already in the pipeline before our mortgage loan officers resigned. After closing out the mortgage loans in the pipeline, our loan production offices in Colorado Springs, Denver Tech Center and Boulder will be vacant and we will continue to incur the fixed costs of those offices. However, management believes the spaces will either be re-occupied or subleased/assigned in the near

term. We cannot be certain how long it will take to re-launch this line of business or how our future residential mortgage volumes will compare to our prior results.

## Noninterest Expense

Our total noninterest expense for the quarter ended June 30, 2014 was \$2.8 million, which was \$532,000, or 16%, lower than the \$3.4 million for the quarter ended June 30, 2013. The reasons for this decrease are as follows:

### Employee Compensation and Benefits

Employee compensation and benefit expense decreased \$887,000 from second quarter 2013. \$346,000 of this pertained to lower commission expense and is directly correlated with the decrease in residential mortgage loan volumes. An additional \$382,000 relates to reduced personnel costs for our mortgage division as management worked to right-size the organization given the decrease in loan volumes. The remaining \$159,000 reduction pertains to lower personnel costs from the community banking division.

### Occupancy

Occupancy expense decreased \$22,000, or 8%, for second quarter 2014 as compared to second quarter 2013.

### Professional Fees

Professional fees increased \$168,000, or 163%, due primarily to legal expenses associated with our 2014 annual meeting of stockholders in which a proxy contest was brought. We do not expect to continue to incur additional expenses for this matter as the lawsuit brought by the Company against the current Chairman of the Board, Michael Quagliano and his slate of nominees, has been dismissed.

Other General and Administrative Expenses: The following table details the individual expense items greater than \$25,000 for the most recent quarter that comprise other general and administrative expenses:

(\$ in thousands)	Three Months Ended		Increase/ (Decrease)
	June 30, 2014	2013	
Other general and administrative expenses:			
Data processing	\$150	\$187	\$(37)
Other loan expenses	98	89	9
Marketing and promotions	50	63	(13)
Regulatory and reporting fees	42	36	6
Telephone/communication	28	29	(1)
FDIC assessment	34	30	4
OREO expense/write-down	270	12	258
All other	139	156	(17)
Total	\$811	\$602	\$209

The most significant increases in other general and administrative were \$258,000 in OREO expenses/write-downs which largely represents the \$261,000 impairment recognized during the second quarter 2014 on two properties, one of which is now under contract. Both are expected to be sold before the end of the year. The \$37,000 decline in data processing costs is due to the fact that the second quarter of 2013 included a \$50,000 charge related to the integration of acquired deposits. After removing that non-recurring item, data processing increased \$13,000 in second quarter 2014 compared to second quarter 2013 which is primarily due to increased fees from our core bank processing system due to increased activity.

The significant changes included in the "all other" category include an \$11,000 increase associated with the amortization of our core deposit intangible related to the acquisition of deposit accounts in June 2013 and a \$10,000 increase in miscellaneous losses primarily pertaining to ongoing negotiations to settle a disputed claim with a third party.

All other general and administrative costs remained relatively stable.

Income Taxes

No federal or state tax expense was recorded for the three months ended June 30, 2014 and 2013, based upon net operating loss carry-forwards that can be used to offset taxable income for federal tax purposes. Since it is uncertain when the Company will

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achieve sustained profitability, the deferred tax benefit accumulated to date has a full valuation allowance so that the net deferred tax benefit at June 30, 2014 and December 31, 2013 was \$0.

#### Comparative Results of Operations for the Six Months Ended June 30, 2014 and 2013

The following discussion focuses on the Company's financial condition and results of operations for the six months ended June 30, 2014 compared to the six months ended June 30, 2013.

Net loss for the six months ended June 30, 2014 was \$392,000, or (\$0.15) per share, compared to net income of \$620,000, or 0.24 per share, for the six months ended June 30, 2013. The \$1.0 million decrease was primarily the result of a \$1.7 million decline in noninterest income due to reduced gains on the sale of mortgage loans given the sharp reduction in refinancing activity attributable to the increase in long-term mortgage rates. Long-term mortgage rates began to rise in May 2013 and the refinancing of loans dramatically declined beginning in July 2013 after all the loans that were locked prior to the increase in rates were closed and funded. This \$1.7 million decrease in noninterest income was partially offset by a \$392,000 decrease in noninterest expenses and a \$279,000 increase in net interest income after provision for loan and leases losses. These and other changes are described in more detail in the ensuing discussion.

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

(\$ in thousands)	Six Months Ended June 30, 2014			Six Months Ended June 30, 2013				
	Average Balance	Interest	Yield / Cost	Average Balance	Interest	Yield / Cost		
<b>Assets:</b>								
<b>Interest-earning assets:</b>								
Gross loans, net of unearned fees <sup>(1)</sup> <sub>(2)</sub>	\$83,405	\$2,220	5.37	%	\$64,754	\$1,658	5.16	%
Loans held for sale	7,281	157	4.34		12,815	215	3.38	
Investment securities <sup>(3)</sup>	65,575	813	2.50		77,751	857	2.22	
FHLB and FRB stocks	1,884	31	3.29		1,840	34	3.68	
Federal funds sold	924	1	0.25		245	—	0.23	
Interest-bearing deposits with banks	257	4	2.98		257	3	2.94	
Total interest-earning assets	159,326	\$3,226	4.08	%	157,662	\$2,767	3.54	%
Noninterest-earning assets	7,938				7,856			
Total assets	\$167,264				\$165,518			
<b>Liabilities and Stockholders' Equity:</b>								
<b>Interest-bearing liabilities:</b>								
Money market and savings deposits	\$51,424	\$119	0.47	%	\$53,107	\$121	0.46	%
Interest-bearing checking accounts	10,217	38	0.74		7,980	30	0.76	
Time deposits	63,410	386	1.23		58,376	363	1.25	
Short-term FHLB advances	8,483	9	0.22		13,059	14	0.22	
Long-term FHLB advances	8,030	71	1.79		8,058	65	1.63	
Total interest-bearing liabilities	141,564	\$623	0.89	%	140,580	\$593	0.85	%
Noninterest-bearing checking accounts	7,066				4,339			
Noninterest-bearing liabilities	815				645			
Stockholders' equity	17,819				19,954			
Total liabilities and stockholders' equity	\$167,264				\$165,518			

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Net interest income	\$2,603		\$2,174	
Net interest spread	3.19	%	2.69	%
Net interest margin	3.29	%	2.78	%

(1) The loan average balances and rates include nonaccrual loans, if any.

(2) Net loan expenses of \$8,000 and \$31,000 for the six months ended June 30, 2014 and 2013, respectively, are included in the yield computation.

(3) Yields on investment securities have not been adjusted to a tax-equivalent basis since the Company does not own any tax-free securities.

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

(\$ in thousands)	Six Months Ended June 30, 2014 Compared to Six Months Ended June 30, 2013		
	Net Change	Rate	Volume
<b>Interest income:</b>			
Gross loans, net of unearned fees	\$562	\$68	\$494
Loans held for sale	(58)	) 111	(169)
Investment securities	(44)	) 174	(218)
FHLB and FRB stocks	(3)	) (4)	) 1
Federal funds sold	1	—	1
Interest-bearing deposits with banks	1	1	—
<b>Total interest income</b>	<b>\$459</b>	<b>\$350</b>	<b>\$109</b>
<b>Interest expense:</b>			
Money market and savings deposits	\$(2)	) \$2	\$(4)
Interest-bearing checking accounts	8	—	8
Time deposits	23	(7)	) 30
ST FHLB advances	(5)	) —	(5)
LT FHLB advances	6	6	—
<b>Total interest expense</b>	<b>\$30</b>	<b>\$1</b>	<b>\$29</b>
<b>Net interest income</b>	<b>\$429</b>	<b>\$349</b>	<b>\$80</b>

#### Net Interest Income and Net Interest Margin

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

For the six months ended June 30, 2014, the Company's net interest income increased \$429,000, or 20%, compared to the six months ended June 30, 2013 resulting in a 51 basis point increase in net interest margin which rose from 2.78% to 3.29%. Most notable was the \$562,000 increase in interest income from loans due primarily to the \$18.7 million increase in average balance combined with the 21 basis point increase in yield. The increase in the 2014 yield on loans was partially due to a pre-payment penalty collected in the first quarter and partially due to a more favorable interest rate environment. The increased interest income on loans was partially offset by a decrease in interest income on loans held for sale, which declined \$58,000 during the six months ended June 30, 2014 as compared to the same period of 2013. This decline was primarily driven by the decrease in average balances (down \$5.5 million) but was also

mitigated by a 96 basis point increase in yield. These changes reflect the changes in the residential mortgage lending environment that occurred during this period - increased long-term rates and, therefore, reduced volumes. Additionally, the interest income on investment securities declined \$44,000 again largely due to a decrease in volume (down \$12.2 million) mitigated by an increase in yield (up 28 basis points). The decline in volume was due to a concentrated effort to sell investment securities to fund new loans.

The increased interest income from interest-earning assets was dampened by increased interest expense primarily due to an additional \$23,000 of interest expense associated with an increased volume in time deposits and interest-bearing checking

accounts. Overall, the cost of interest-bearing liabilities increased 4 basis points from the prior year. The reduced average balance in short-term FHLB advances correlates with the reduced average balance in loans held for sale as overnight FHLB borrowings are used to fund mortgage loans that are held for sale. The combination of the aforementioned changes resulted in a 50 basis point increase in net interest spread (the yield earned on interest-earning assets less the cost of interest-bearing liabilities), which improved from 2.69% for the six months ended June 2013 to 3.19% for the same period in 2014.

#### Provision for Loan and Lease Losses

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

During the first six months of 2014, we recognized \$150,000 of provision expense partially due to the increase in gross loans and partially due to the increase in criticized and classified loans. We did not recognize any provision for loan and lease losses in 2013. See additional discussion below under Financial Condition, Loan Portfolio.

#### Noninterest Income

Noninterest income for the six months ended June 30, 2014 was \$2.7 million, a decrease of \$1.7 million from the \$4.4 million earned during the six months ended June 30, 2013. The most notable decrease was a decline in gains on loans sold of \$1.6 million due to reduced gains on residential mortgage loans sold to secondary market purchasers. Approximately \$133,000 of the gains on loans sold during the six months ended 2014 pertain to the sale of the guaranteed portion of SBA 7(a) loans. This compared to \$111,000 of gains on the sale of SBA 7(a) loans during the same period of 2013. The Company sold securities for gains of \$109,000 during the first six months of 2014 compared to \$245,000 during the first six months of 2013.

The following table summarizes the Bank's residential mortgage loan activity during the first six months of 2014 and 2013.

(\$ in thousands)	For the Six Months Ended			
	June 30, 2014		June 30, 2013	
Gain on Loans Sold	2,299		3,901	
Average Service Release Premium	2.59	%	2.65	%
Residential Mortgage Loans Originated	\$85,175		\$138,049	
Residential Mortgage Loans Sold	\$78,874		\$121,221	
Purpose of Loan: <sup>(1)</sup>				
Purchase	83	%	63	%
Refinance	17	%	37	%

<sup>(1)</sup> indicates the percentage of loans originated during the period

During the first six months of 2014, residential mortgage results were down significantly from the same period of 2013 primarily due to the sharp reduction in refinancing activity which declined from approximately \$51.0 million during the first six months of 2013 to approximately \$14.0 million for the first six months of 2014. During July 2014, all of our mortgage loan officers and the majority of their support staff left our Bank to join other institutions. Thus, we do not have a mortgage loan business at this time. Management and the Board are committed to this line of business and are actively exploring opportunities to re-launch our residential mortgage banking segment. However, during this time we are not accepting new residential mortgage loan applications. As such, we anticipate third quarter

mortgage activity to be significantly less as it will only include the loans that were already in the pipeline before our mortgage loan officers resigned. After closing out the mortgage loans in the pipeline, our loan production offices in Colorado Springs, Denver Tech Center and Boulder will be vacant and we will continue to incur the fixed costs of these offices. However, management believes the spaces will either be re-occupied or subleased/assigned in the near term. We cannot be certain how long it will take to re-launch this line of business or how our future residential mortgage volumes will compare to our prior results.

#### Noninterest Expense

Our total noninterest expense for the six months ended June 30, 2014 was \$5.5 million, which was \$392,000, or 7%, less than the \$5.9 million for the six months ended June 30, 2013. The reasons for this decrease are discussed in more detail

below.

#### Employee Compensation and Benefits

Employee compensation and benefit expense decreased \$877,000. This decline primarily relates to \$390,000 of lower commission expense which directly correlates with the decrease in residential mortgage loan volumes. An additional \$499,000 relates to reduced personnel costs for our mortgage division as management worked to right-size the organization given the decrease in loan volumes. Additionally, employee compensation expense was reduced by \$202,000 in 2014 for deferred loan origination expenses that were capitalized and will be amortized over the life of the loan. This compared to \$103,000 of capitalized loan origination expenses recorded during the same period in 2013. The change in deferred loan origination expenses corresponds directly with the increase in loans funded in the first half of 2014 as compared to the same period in 2013. These reductions in employee compensation and benefit expenses were partially offset by \$113,000 of severance expense incurred during the first quarter 2014.

#### Occupancy

Occupancy expense decreased \$28,000, or 5%, during 2014 primarily due to the additional expenses incurred in 2013 associated with getting our mortgage department's five loan production offices fully equipped.

#### Professional Fees

Professional fees increased \$270,000, or 114%, primarily due to legal expenses associated with our 2014 annual meeting of stockholders in which a proxy contest was held. We do not expect to continue to incur additional expenses for this matter as the lawsuit brought by the Company against the current Chairman of the Board, Michael Quagliano and his slate of nominees, has been dismissed.

#### Other General and Administrative Expenses:

The following table details the individual expense items greater than \$50,000 for the current year-to-date that comprise other general and administrative expenses:

(\$ in thousands)	Six Months Ended		Increase/ (Decrease)
	June 30,		
	2014	2013	
Other general and administrative expenses:			
Data processing	\$301	\$304	\$(3)
Other loan expenses	172	162	\$10
Marketing and promotions	82	100	\$(18)
Regulatory and reporting fees	75	69	\$6
Telephone/communication	54	52	\$2
FDIC assessment	67	65	\$2
OREO expense/write-downs	270	24	\$246
All other	293	295	\$(2)
Total	\$1,314	\$1,071	\$243

The most significant increases in other general and administrative were \$246,000 in OREO expenses/write-downs which largely represents the \$261,000 impairment recognized during the second quarter 2014 on two properties, one of which is now under contract. Both are expected to be sold before the end of the year. The \$3,000 decline in data processing costs is due to a \$50,000 charge in the second quarter of 2013 related to the integration of acquired deposits. Excluding that non-recurring item, data processing increased \$47,000 during 2014 compared to the same period of 2013 which is primarily due to increased fees from our core bank processing system due to increased activity. Marketing and promotions expense is down \$18,000 from 2013 due primarily due to the increased marketing costs incurred in 2013 to raise awareness about our new residential mortgage department.

The significant changes included in the "all other" category included a \$28,000 increase associated with the amortization of our core deposit intangible related to the acquisition of deposit accounts in June 2013 and a \$22,000 increase in franchise taxes pertaining to increased taxes paid to the State of Delaware due to the increase in the number of authorized shares outstanding.

All other general and administrative costs remained relatively stable.

## Income Taxes

No federal or state tax expense was recorded for the six months ended June 30, 2014 and 2013, based upon net operating loss carry-forwards that can be used to offset taxable income for federal tax purposes. Since it is uncertain when the Company will achieve sustained profitability, the deferred tax benefit accumulated to date has a full valuation allowance so that the net deferred tax benefit at June 30, 2014 and December 31, 2013 was \$0.

## Financial Condition

At June 30, 2014, total assets were \$168.0 million, a \$1.7 million, or 1% decrease from \$169.7 million in total assets at December 31, 2013 primarily due to a \$10.2 million, or 16%, decrease in investment securities, partially offset by a \$4.2 million, or 5%, increase in gross loans and a \$6.4 million increase in loans held for sale. The sale of investment securities was used to fund the growth in loans and offset the \$4.8 million, or 4%, decline in deposits.

As of June 30, 2014, stockholders' equity was \$18.3 million, a \$1.3 million increase versus \$17.0 million at December 31, 2013. The increase was primarily due to the \$1.4 million increase in the fair value of available-for-sale securities, the \$180,000 of proceeds from the exercise of stock options and the \$102,000 of stock-based compensation expense related to the Company's stock incentive plan for the six months ended June 30, 2014, partially offset by the \$392,000 net loss for the year to date.

## Key Ratios

Ratio	June 30, 2014	December 31, 2013
Return on Average Assets	(0.47)%	(0.39)%
Return on Average Equity	(4.33)%	(3.42)%
Average Equity to Average Assets	10.74%	11.39%

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

At June 30, 2014, the Bank had a total of \$1.4 million invested in FHLB and Federal Reserve Bank stocks carried at cost consisting of \$474,000 in Federal Reserve Bank stock and \$929,000 in FHLB stock. These investments allow the Bank to conduct business with these entities. As of June 30, 2014, the Federal Reserve Bank stock was yielding an average annual rate of 6.1% and the FHLB stock was yielding an average annual rate of 2.3%.

## Investment Securities

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

At June 30, 2014, the Bank's investment portfolio consisted of available-for-sale securities of \$59.7 million. See Note 3 - Investments, of the Unaudited Condensed Notes to Consolidated Financial Statements, for information on the composition, maturities and fair value of the portfolio.

## Loan Portfolio

The following table presents the composition of our loan portfolio (excluding residential mortgage loans held for sale) by category as of the dates indicated:

(\$ in thousands)	June 30, 2014		December 31, 2013		
	Amount	% of Total	Amount	% of Total	%
Commercial real estate	\$45,233	54	% \$47,063	59	%
Commercial and industrial	11,095	13	11,730	15	
Residential real estate	23,925	29	17,889	23	
Construction and land development	3,003	4	2,044	2	
Consumer	167	—	514	1	
<b>GROSS LOANS</b>	<b>83,423</b>	<b>100</b>	<b>% 79,240</b>	<b>100</b>	<b>%</b>
Deferred loan expenses / (fees)	73		46		
Allowance for loan and lease losses	(1,300 )		(1,116 )		
<b>LOANS, NET</b>	<b>\$82,196</b>		<b>\$78,170</b>		

As of June 30, 2014, gross loans were \$83.4 million, an increase of \$4.2 million, or 5%, from \$79.2 million at December 31, 2013. Net loans were 48.9% and 46.1% of total assets at June 30, 2014 and December 31, 2013, respectively. The following table compares the Bank's loan activity during the first six months of 2014 with the activity from the first six months of 2013.

	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Beginning Balance - Gross Loans	\$79,240	\$59,632
New originations	11,763	14,973
Total principal reductions	(7,580 )	(8,783 )
Ending Balance - Gross Loans	\$83,423	\$65,822
Principal balance of loans purchased	\$157	\$225
Principal balance of SBA 7(a) loans sold	\$1,707	\$1,510
Gain on SBA 7(a) loans sold	\$133	\$111

The Company's loan portfolio generally consists of loans to borrowers within Colorado that are primarily secured by real estate located in Colorado. This makes the value of the portfolio more susceptible to declines in real estate values and other changes in economic conditions in Colorado. To mitigate this risk, no single borrower can be approved for a loan over the Bank's current legal lending limit of approximately \$2.7 million.

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

The following tables set forth information at June 30, 2014 and December 31, 2013, regarding the dollar amount of loans maturing in the Bank's portfolio based on the contractual terms to maturity. The tables do not give effect to potential prepayments or contractual principal payments.

(\$ in thousands)	June 30, 2014				Total Loans
	<1 Year	1 - 5 Years	5 - 15 Years	Over 15 Years	
Commercial real estate	\$8,393	\$15,331	\$20,769	\$740	\$45,233
Commercial and industrial	3,322	4,732	2,403	638	11,095
Residential real estate	65	655	164	23,041	23,925
Construction and land development	3,003	—	—	—	3,003
Consumer	109	9	14	35	167
Gross Loans Receivable	\$14,892	\$20,727	\$23,350	\$24,454	\$83,423

(\$ in thousands)	December 31, 2013				Total Loans
	<1 Year	1 - 5 Years	5 - 15 Years	Over 15 Years	
Commercial real estate	\$7,143	\$11,637	\$28,136	\$147	\$47,063
Commercial and industrial	3,099	4,336	3,401	894	11,730
Residential real estate	47	1,819	168	15,855	17,889
Construction and land development	2,044	—	—	—	2,044
Consumer	11	475	13	15	514
Gross Loans Receivable	\$12,344	\$18,267	\$31,718	\$16,911	\$79,240

## Nonperforming Loans, Leases and Assets

Nonperforming assets consist of loans and leases on nonaccrual status, loans 90 days or more past due and still accruing interest, loans that have been restructured resulting in a reduction or deferral of interest or principal, other real estate owned (OREO), and other repossessed assets.

(\$ in thousands)	June 30, 2014		December 31, 2013	
Nonaccrual loans and leases	\$ 161		\$—	
Other impaired loans	—		—	
Total nonperforming loans	161		—	
Other real estate owned	1,485		1,746	
Substandard, nonaccrual assets	—		—	
Total nonperforming assets	\$ 1,646		\$ 1,746	
Nonperforming loans	\$ 161		\$—	
Allocated allowance for loan and lease losses to nonperforming loans	(16	)	—	
Net investment in nonperforming loans	\$ 145		\$—	
Accruing loans past due 90 days or more	\$—		\$—	
Loans past due 30-89 days	\$ 150		\$—	
Loans charged-off, year-to-date	\$—		\$7	
Recoveries, year-to-date	(34	)	(60	)
Net (recoveries) charge-offs, year-to-date	\$(34	)	\$(53	)
Allowance for loan and lease losses	\$ 1,300		\$ 1,116	
Allowance for loan and lease losses to gross loans	1.56	%	1.41	%
Allowance for loan and lease losses to nonaccrual loans	807.45	%	NM <sup>(1)</sup>	
Allowance for loan and lease losses to nonperforming loans	807.45	%	NM <sup>(1)</sup>	
Nonaccrual loans to gross loans, net of deferred fees/expenses	0.20	%	—	%
Loans 30-89 days past due to gross loans, net of deferred fees/expenses	0.18	%	—	%
Nonperforming assets to total assets	0.88	%	1.03	%

<sup>(1)</sup> Not meaningful due to no nonperforming loans at December 31, 2013.

The Company had substandard assets, not including substandard loans, totaling \$1.1 million as of June 30, 2014 and December 31, 2013 representing the amortized cost of two corporate bond positions in Dell, Inc. The corporate credit rating on Dell, Inc. was lowered during the third quarter 2013 by Standards and Poor's rating service to below investment grade due to the company's proposed leveraged buy-out which was consummated in the fourth quarter of 2013. Management does not believe these investments are other than temporarily impaired and management intends to hold these investments until recovery of value, which may be until maturity. As such, the investments are still accruing interest in accordance with their contractual terms.

Federal regulations require that each insured financial institution classify its assets on a regular basis. In addition, in connection with examinations of insured institutions, regulatory examiners have authority to identify problem assets and, if appropriate, classify them. The Bank has established three classifications for potential problem assets: "substandard," "doubtful" and "loss." Loans classified as "substandard" are those loans with well-defined weaknesses, such that future capacity to repay the loan has been negatively impacted. Loans classified as "doubtful" are those loans that have characteristics similar to substandard loans, but the weaknesses have moved to the point where complete collection of the obligation from all sources is unlikely and a portion of the principal may be charged-off. Although

loans classified as substandard do not duplicate loans classified as doubtful, both substandard and doubtful loans may include some loans that are past due at least 90 days, are on nonaccrual status or have been restructured. Loans classified as "loss" are those loans that are in the process of being charged-off. At June 30, 2014, the Bank had substandard loans totaling \$5.7 million, and no loans classified as doubtful or loss. Of the \$5.7 million in substandard loans, none were 30 days or more past due. Additionally, in July 2014, a substandard note, totaling \$2.2 million, paid off. As of December 31, 2013, the Bank had \$3.2 million classified as substandard and no loans classified as doubtful or loss.

## Allowance for Loan and Lease Losses

Implicit in Solera National Bank's lending activities is the fact that loan losses will be experienced and that the risk of loss will vary with the type of loan being made and the creditworthiness of the borrower over the term of the loan. To reflect the currently perceived risk of loss associated with the loan portfolio, additions are made to the allowance for loan and lease losses in the form of direct charges against income to ensure that the allowance is available to absorb possible loan losses. The Bank's allowance for estimated loan and lease losses is based on a number of quantitative and qualitative factors. Factors used to assess the adequacy of the allowance for loan and lease losses are established based upon management's assessment of the credit risk in the portfolio, historical loan loss, changes in the size, composition and concentrations of the loan portfolio, general economic conditions, and changes in the legal and regulatory environment, among others. In addition, because the Bank has a limited history on which to base future loan losses, a comparison of peer group allowance ratios to gross loans is made with the intention of maintaining similar levels of reserves.

Provisions for loan and lease losses may be provided both on a specific and general basis. Specific and general valuation allowances are increased by provisions charged to expense and decreased by charge-offs of loans, net of recoveries. Specific allowances are provided for impaired loans for which the expected loss is measurable. General valuation allowances are provided based on a formula that incorporates the factors discussed above. The Bank periodically reviews the assumptions and formula by which additions are made to the specific and general valuation allowances for losses in an effort to refine such allowances in light of the current status of the aforementioned factors.

The amount of the allowance equals the cumulative total of the provisions made from time to time, reduced by loan charge-offs and increased by recoveries of loans previously charged-off. The allowance was \$1.3 million, or 1.56% of outstanding principal as of June 30, 2014. During the first six months of 2014, we recognized \$150,000 of provision expense partially due to the increase in gross loans and partially due to the increase in criticized and classified loans. We did not recognize any provision for loan and lease losses in 2013.

The following table sets forth the allowance for loan and lease losses activity for the three and six months ended June 30, 2014 and 2013:

(\$ in thousands)	Three Months Ended		Six Months Ended		
	June 30, 2014	2013	June 30, 2014	2013	
Balance at beginning of period	\$1,126	\$1,074	\$1,116	\$1,063	
Provision charged to expense	150	—	150	—	
Loans charged-off:					
Commercial real estate	—	—	—	—	
Commercial and industrial	—	—	—	—	
Residential real estate	—	—	—	—	
Construction and land development	—	(7	)	(7	)
Consumer	—	—	—	—	
Total loans charged-off	—	(7	)	(7	)
Recoveries on loans previously charged-off:					
Commercial real estate	14	—	23	—	
Commercial and industrial	10	2	11	4	
Residential real estate	—	19	—	28	
Construction and land development	—	—	—	—	
Consumer	—	—	—	—	
Total recoveries	24	21	34	32	

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Balance at end of period	\$1,300		\$1,088		\$1,300		\$1,088	
Annualized net (recoveries) charge-offs to average gross loans	(0.11	)%	(0.08	)%	(0.08	)%	(0.08	)%

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

#### Recourse Reserve Liability

Residential mortgage loans sold to investors are predominantly conventional residential first lien mortgages originated under the Bank's usual underwriting procedures, and are most often sold on a nonrecourse basis. The Bank's agreements to sell residential mortgage loans in the normal course of business usually require certain representations and warranties on the underlying loans sold, related to credit information, loan documentation, collateral, first payment default and insurability, which if subsequently are untrue or breached, could require the Bank to repurchase certain loans affected. Inception to date, the Bank has experienced \$40,000 of loss related to early pay off fees and other payment defaults under these representations and warranties. Beginning in the first quarter of 2014, the Bank established a recourse reserve liability, which is included in accounts payable and other liabilities on the consolidated balance sheets, to reserve for estimated losses due to early payoffs, losses associated with payment default and repurchases under other representations and warranties. This estimate is reviewed on a quarterly basis to account for changes in the volume of loans sold, delinquencies and economic conditions. As of June 30, 2014, the recourse reserve liability balance was \$14,000.

#### Off-Balance-Sheet Arrangements

In the ordinary course of business, the Company enters into various off-balance-sheet commitments and other arrangements to extend credit that are not reflected in the consolidated balance sheets of the Company. The business purpose of these off-balance-sheet commitments is the routine extension of credit. The total amounts of off-balance-sheet financial instruments with credit risk were \$27.9 million and \$21.0 million as of June 30, 2014 and December 31, 2013, respectively, including \$14.5 million and \$6.3 million, respectively, in interest rate lock commitments for residential mortgage loans that had been committed but not yet funded. At the time the Bank enters into the interest rate lock commitment with the customer, the Bank simultaneously enters into a forward sales commitment with the secondary market investor locking the price on the subsequent sale of the loan thereby mitigating the Bank's exposure to interest rate risk. These interest rate lock commitments, when closed and funded, become loans held for sale on the Bank's balance sheet. These loans are held on the Bank's balance sheet for generally less than 30 days until sold to the investor at the previously-agreed price.

The remaining commitment balances represent commitments to lend to a customer as long as there is no violation of any condition established in the commitment contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Commitments also include revolving lines of credit arrangements and unused commitments for commercial and real estate secured loans. Since many of the commitments are expected to expire without being drawn upon, the commitments do not necessarily represent future cash requirements.

The Bank faces the risk of deteriorating credit quality of borrowers to whom a commitment to extend credit has been made; however, no significant credit losses are expected from these commitments and arrangements.

#### Borrowings

The Bank 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 Bank and some of the Bank's qualifying loans. The Bank's authorized borrowing line with the FHLB is capped at 40% of total assets, subject to the availability of sufficient collateral to pledge against such borrowings. As of June 30, 2014, the Bank had \$6.5 million in fixed-rate borrowings from the FHLB with varying maturity dates between November 2014 and October 2018 and a weighted-average effective interest rate of 1.99%. As of December 31, 2013, the Bank had \$8.5 million in fixed-rate borrowings from the FHLB with varying maturity dates between April 2014 and October 2018 and a weighted-average effective interest rate of 1.73%. Additionally, the Bank had \$14.1 million in variable-rate, overnight borrowings at 0.24% as of June 30, 2014. The Bank is primarily using overnight borrowings at the FHLB to fund residential mortgage loans which are held for sale. The Bank had \$9.8 million in overnight borrowings from the FHLB as of December 31, 2013 at 0.19%.

#### Capital Resources and Capital Adequacy Requirements

The risk-based capital regulations established and administered by the federal banking regulatory agencies are applicable to Solera National Bank. Risk-based capital guidelines are designed to make regulatory capital requirements more sensitive to differences in

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

A well-capitalized institution must maintain a minimum ratio of total capital to risk-weighted assets of at least 10.0%, a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, and a minimum ratio of Tier 1 capital to total average assets of at least 5.0% and must not be subject to any written order, agreement, or directive requiring it to meet or maintain a specific capital level.

The following table summarizes the ratios of the Bank and the regulatory minimum capital requirements at June 30, 2014:

(\$ in thousands)	Risk-based		Leverage	
	Tier 1	Total capital	Tier 1	
Actual regulatory capital of the Bank	\$ 16,388	\$ 17,688	\$ 16,388	
Well-capitalized requirement (regulatory standard)	6,794	11,323	8,398	
Excess regulatory capital of the Bank	\$9,594	\$6,365	\$7,990	
Capital ratios of the Bank	14.5	% 15.6	% 9.8	%
Minimum capital requirement (regulatory standard)	4.0	% 8.0	% 4.0	%
Well-capitalized requirement (regulatory standard)	6.0	% 10.0	% 5.0	%

On July 9, 2013, bank regulators approved the final rule to implement the Basel III regulatory capital reforms. The final rule becomes effective for the Bank beginning on January 1, 2015, as we are considered a non-advanced approaches bank. The final rule minimizes the impact on smaller, less complex financial institutions, although it does increase both the quantity and quality of capital required to be held in order to meet the minimum capital requirements. Based on management's review, we expect to exceed all capital requirements under the new rule. Some key highlights of the final rule as they pertain to the Bank include:

- A one-time irrevocable option to permanently exclude accumulated other comprehensive income from inclusion in regulatory capital.
- The residential mortgage risk-weighting approach in the notice of proposed rulemaking was removed in the final rule. Institutions will continue to use the existing risk-weighting approach.

## Dividends

The Board of Directors intends to retain earnings to promote growth, build capital and recover any losses incurred in prior periods. Accordingly, we do not expect to receive dividends from the Bank, or to pay dividends to our stockholders, in the foreseeable future. In addition, banks and bank holding companies are subject to certain regulatory restrictions on the payment of cash dividends.

## Liquidity

The Bank's liquidity is monitored by its management, the Asset Liability Committee and the Board of Directors, who review historical funding requirements, the current liquidity position, sources and stability of funding, marketability of assets, options for attracting additional funds, and anticipated future funding needs, including the level of unfunded

commitments.

The Bank's primary sources of funds are retail and commercial deposits, loan and securities repayments, other short-term borrowings, and other funds provided by operations. While scheduled loan repayments and maturing investments are relatively predictable, deposit flows and early loan prepayments are more influenced by interest rates, general economic conditions, and competition. The Bank will maintain investments in liquid assets based upon management's assessment of (1) the need for funds, (2) expected deposit flows, (3) yields available on short-term liquid assets, and (4) objectives of the asset/liability management program.

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During the second quarter 2013, the Bank assumed approximately \$6 million of customer deposits, excluding certificates of deposit, from another bank's nearby branch. This increase in deposits enhanced the Bank's liquidity.

Additionally, the Bank is a member of the Certificate of Deposit Account Registry Service (“CDARS<sup>®</sup>”) program. Through CDARS<sup>®</sup>, the Bank's customers can increase their FDIC insurance by up to \$50 million through reciprocal deposit accounts. This is accomplished by the Bank entering into reciprocal depository relationships with other member banks. The individual customer's large deposit is broken into amounts below the \$250,000 FDIC-insured amount and placed with other banks that are members of the network. The reciprocal member bank issues deposits in amounts that ensure the entire deposit is eligible for FDIC insurance. These sources provide secondary liquidity to the Bank to service its depositors' needs. As of June 30, 2014 and December 31, 2013, the Bank had \$8.5 million and \$8.2 million, respectively, in CDARS<sup>®</sup> deposits.

The Bank does not intend to aggressively pursue lending opportunities if sufficient funding sources (e.g., deposits, Federal Funds, etc.) are not available. Additionally, management does not anticipate the need to access capital markets to obtain additional liquidity in the near term, nor will the Bank seek to attract volatile, non-local deposits with above market interest rates. As of June 30, 2014 and December 31, 2013, the Bank's loan to deposit ratio was 65% and 60%, respectively.

The Bank is a member of the FHLB of Topeka, which gives the Bank access to a secured line of credit with approximately \$67.2 million of available funding as of June 30, 2014, subject to the availability of sufficient collateral to pledge against such borrowings. Additionally, the Bank has approved, unsecured federal funds purchase lines totaling \$13.1 million with three correspondent banks. These lines either expire during 2014, or can be terminated at any time; however, it is not anticipated that these lines will be terminated and the Bank expects to be approved for new lines once the existing lines expire. The Bank also has the ability to borrow at the Federal Reserve Discount Window on a secured basis. As of June 30, 2014, the Company had federal funds purchased of \$60,000. As of December 31, 2013, the Bank had no amounts outstanding on overnight borrowing lines.

The Company had cash and cash equivalents of \$868,000, or 0.5% of total assets, at June 30, 2014. Additionally, the Company had \$59.7 million in available-for-sale investment securities, or 35.5% of total assets, at June 30, 2014. Management believes the Bank will have adequate liquidity to meet anticipated future funding needs.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

### ITEM 4. CONTROLS AND PROCEDURES

#### Disclosure Controls and Procedures

Management is responsible for maintaining effective disclosure controls and procedures. As of the end of the period covered by this Quarterly Report on Form 10-Q, management evaluated the effectiveness and operation of the Company's disclosure controls and procedures (as defined in Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)). Based on that evaluation, both the Company's Principal Executive Officer and Principal Accounting and Financial Officer have concluded that the Company's disclosure controls and procedures are effective to ensure that the information required to be disclosed by the Company in reports that are filed or submitted under the Exchange Act are recorded, processed, summarized and reported to management within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to management

as appropriate to allow timely decisions regarding disclosure.

#### Changes in Internal Control over Financial Reporting

Subsequent to the end of the quarter, our Principal Executive Officer, who during the first quarter had also assumed the responsibilities of the Principal Accounting and Financial Officer, was terminated. Immediately following this termination, our Board appointed our former Principal Accounting and Financial Officer as President and Chief Executive Officer. For most of the quarter-end close and reporting process, our former Principal Accounting and Financial Officer assumed the role of Principal Executive Officer. Additionally, shortly after these changes in management, we promoted our Controller to the position of Chief Financial Officer. As such, she assumed the responsibilities of the Principal Accounting and Financial Officer. Other than this, there have been no changes in internal controls over financial reporting during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On July 9, 2014, the Company dismissed the lawsuit filed on March 12, 2014 against Mr. Michael D. Quagliano and his nominees.

ITEM 1A. RISK FACTORS

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

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

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURE

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

Please see the exhibit index following the signature page of this Report.

SIGNATURES

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

SOLERA NATIONAL BANCORP, INC.  
(Registrant)

Dated: August 13, 2014

/s/ Robert J. Fenton  
Robert J. Fenton  
President and Chief Executive Officer  
(Principal Executive Officer)

Dated: August 13, 2014

/s/ Melissa K. Larkin  
Melissa K. Larkin  
Senior Vice President, Chief Financial Officer  
(Principal Accounting and Financial Officer)

EXHIBIT INDEX

Exhibit Number Description of Exhibit

3.1	Certificate of Amendment to the Certificate of Incorporation of Solera National Bancorp, Inc. dated June 3, 2013 (incorporated by reference to Exhibit 3.1 to the Company's Form 8-K filed on June 6, 2013).
3.2 (ii)	Amended and Restated Bylaws dated July 15, 2013 (incorporated by reference to Exhibit 3.2(ii) to the Company's Form 8-K filed on July 31, 2013).
10.1+	Separation Agreement between Solera National Bancorp, Inc., Solera National Bank and Robert J. Fenton (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on April 2, 2014).
31.1*	Certification of Chief Executive Officer.
31.2*	Certification of Chief Financial Officer.
32.1*	Certification Pursuant to Rule 13a-14(b) of the Securities Exchange Act and 18 U.S.C. §1350.
101.INS**	XBRL Instance Document
101.SCH**	XBRL Taxonomy Extension Schema Document
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase
101.LAB**	XBRL Taxonomy Extension Label Linkbase
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase
101.DEF**	XBRL Taxonomy Extension Definition Linkbase document
(*)	Filed herewith.
(+)	Indicates a compensatory plan or contract.
(**)	Pursuant to applicable securities laws and regulations, we are deemed to have complied with the reporting obligation relating to the submission of interactive data files in such exhibits and are not subject to liability under any anti-fraud provisions of the federal securities laws as long as we have made a good faith attempt to comply with the submission requirements and promptly amend the interactive data files after becoming aware that the interactive data files fail to comply with the submission requirements. In accordance with Rule 406T of Regulation S-T, the information in these exhibits is furnished and deemed not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing.