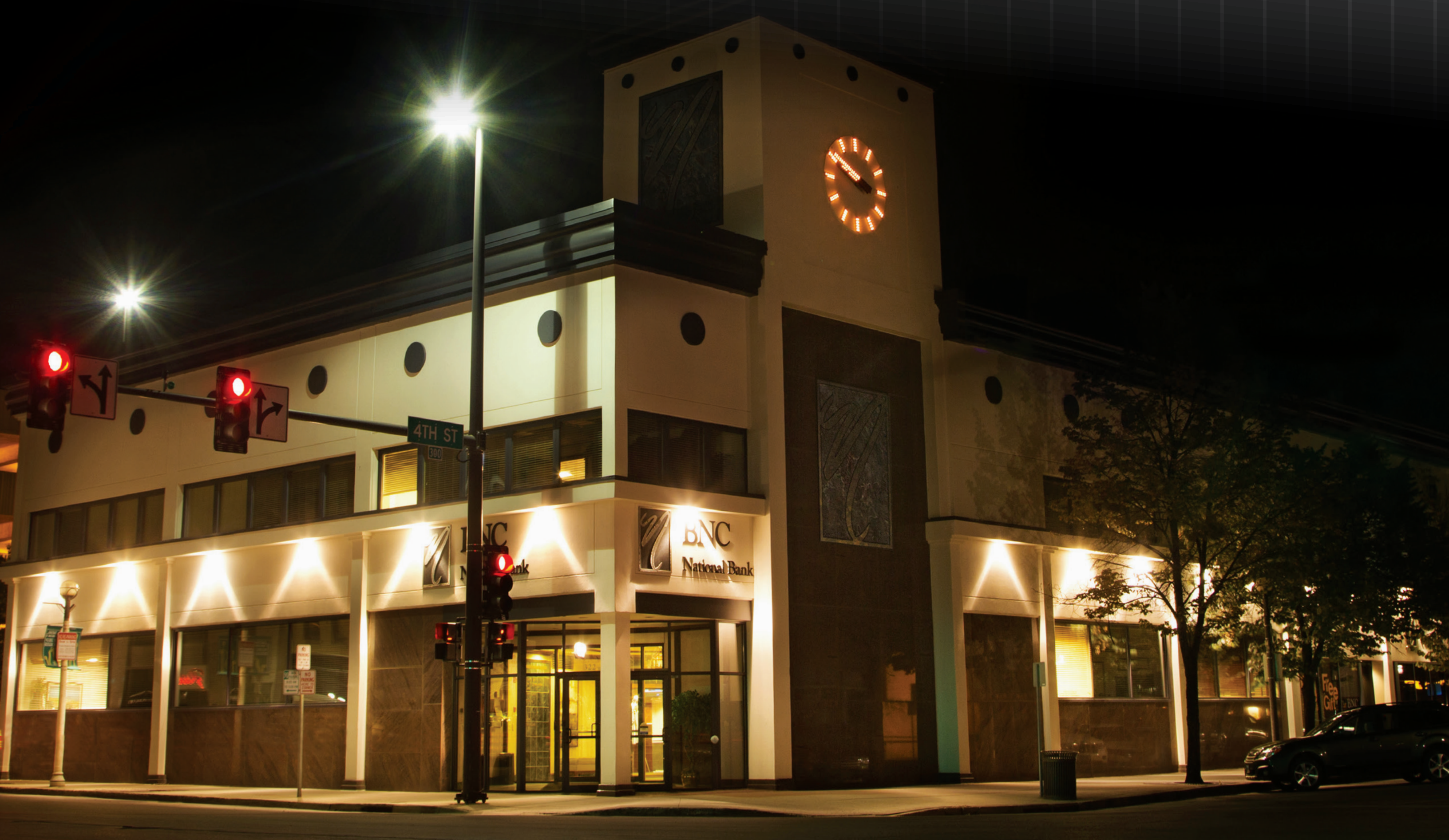
# BNCCORP

# 2015 ANNUAL REPORT

BNC National Bank
25th Anniversary



BNCCORP, INC. (BNCCORP or the Company) is a bank holding company registered under the Bank Holding Company Act of 1956 headquartered in Bismarck, North Dakota. It is the parent company of BNC National Bank (the Bank). The Company operates community banking and wealth management businesses in North Dakota, Arizona and Minnesota from 15 locations. BNC also conducts mortgage banking from 14 locations in Arizona, Minnesota, North Dakota, Illinois, Kansas, Arkansas and Missouri.

Timothy J. Franz
President and CEO

# TO OUR SHAREHOLDERS, CUSTOMERS, EMPLOYEES AND COMMUNITY:

BNC's operating performance in 2015 was highlighted by strong earnings growth, the redemption of our most expensive capital, and consistently exceptional credit quality metrics despite the challenges facing the energy sector. These operational successes created value for common shareholders.

It is important to emphasize that our team members and our clients are the heart of BNC's value proposition. Our people did a great job this year serving clients, strengthening our franchise and participating actively in our communities. We retained key employees and expanded our talent pool with new producers. Because of their efforts, we have maintained solid relationships with existing clients and are continually adding new clients. BNC is a community bank at its core, and the active engagement among our people, clients and communities is a hallmark of our competitive difference.

**Recent Operating Performance – Creating Value and Fortifying BNC**
In 2015, net income per common share was $7.5 million, up from $6.7 million in 2014. We increased diluted earnings per share by 13.1% to $2.16, our return on average assets was 1.01% and our return on average common equity was 12.21%. Our increased profitability was largely driven by four key factors:

- Our core banking business continued to operate profitably; loans held for investment increased and we maintained a cost-efficient funding base of deposits.

- Mortgage banking operations increased revenue by 37% and created value by taking advantage of an interest rate environment favorable to housing finance.

- We maintained exceptional credit quality metrics: our nonperforming assets were 0.09 % of total assets at the end of 2015. As a result there was no charge for credit losses in earnings. Rather, we increased earnings by $400 thousand to reflect recovery of amounts previously charged-off.

- We monetized value in our investment portfolios as gains on sales and revenue from small business investment funds exceeded $2.4 million. These revenues are the direct result of sound investment decisions.

We significantly lowered our cost of capital by utilizing the value created from earnings to delever our balance sheet. Specifically, we redeemed $21 million of preferred stock which cost 9%, after tax. The redemption was funded by using $11 million of retained earnings and borrowings of $10 million costing 6.35%, before tax. This redemption significantly changed the profile of our capital structure. In 2016 and beyond, the capital that previously would have been needed for dividends to preferred shareholders will be available to create value for common shareholders.

2015 was the latest year in a sequence of years of noteworthy performance. I encourage you to look a summary of our performance for the last five years on page 5. During this period we have increased our book value per common share by more than 210% and generated returns on common equity in excess of 12% every year. BNC's capital structure is dramatically improved. As of December 31, 2015, the weighted average cost of debt at the holding company is 3.55% and our least expensive debt does not mature until 2037. Importantly, we grew the assets of BNC Bank by 35% during this period, which improved core bank earnings. We are better, bigger and more fortified.

**The Current Operating Environment and How We Fit**

On a macro level, the global economy is characterized by low-growth, highly indebted nations that are increasingly linked economically. The world's central banks have relied on low interest rates to stimulate economic engines and ease debt service requirements: negative interest rate policies are increasingly common. In the United States, the Federal Reserve Bank has signaled policy that would raise interest rates, but in 2015 and early 2016 that strategy was constrained by soft economic metrics and low global rates. If interest rates remain low, we think our mortgage banking business is positioned to continue creating value.

Whether interest rates will increase in 2016 is something we cannot predict. We only know that over time rates will go up and down and we manage our business accordingly. For several reasons, including the possibility that interest rates may go up, more of our investment securities at the end of 2015 are positioned to earn more in a higher rate environment than in prior years. As 2016 begins we own $121 million of variable rate investment securities, the interest rate on which rises when short term indices increase (e.g. prime rate). These securities can be characterized as defensive, as the price sensitivity of these bonds should generally be less than fixed income investments with longer repricing characteristics. We believe the defensive nature of these securities can preserve shareholder value in a raising rate environment. Further, our loans held for investment typically have predetermined dates at which they reprice. If rates increase and the yield curves to which repricing is linked steepen, these assets will earn a higher rate. Our steady growth of loans held for investment in recent years has created vintages whereby portions of our loan portfolio rotate eligibility for repricing. A full discussion of asset and liability management is not feasible in this forum, none-the-less, our process has consistently added value.

A significant portion of our business is in western North Dakota. This region is heavily influenced by the energy industry. As evidenced by our low nonperforming asset ratios and delinquency rates, the decrease in oil prices has not yet had a significant effect on our credit quality though the end of 2015. However, caution is warranted. The energy industry is currently subdued and significant loss of wealth has occurred due to the approximately $70 per barrel drop in oil prices. Prolonged declines in energy prices will have an adverse affect on the North Dakota economy and our loan portfolio. Fortunately, we begin 2016 with a delevered balance sheet, fortified by healthy reserves and a strong capital base. We will continue to manage credit diligently in this environment and we will be prudent in response to market conditions.

In recent years the regulatory burden for all community banks has increased significantly. We do not foresee relief in the near term. The current regulatory environment increases operating costs and presents operational challenges. Fortunately, compliance has been a core competency for us and it is an integral part of our culture. We will work hard to remain in good standing.

Technology is changing the competitive landscape. Customers expect the convenience offered by mobile products and prospective new hires want to know that we can offer competitive products. Analysis of account activity indicates our customers across all locations are increasingly accessing their accounts via electronic channels. We will continue to make investments in technology to keep us competitive.

**Looking Forward**

In banking, performance is measured with a variety of financial metrics. According to many of these measures, including earnings growth, returns on assets and equity, book value per share and asset quality, BNC has excelled in recent periods. We are well positioned to continue our recent successes.

Value is created by working hard, maintaining integrity, and nurturing lasting relationships with customers and colleagues by properly distinguishing between good ideas and bad ideas. The people inside BNC do these things well. I am fortunate to work with such an outstanding group.

We thank you for your confidence in us and look forward to more success in 2016 and beyond.

Timothy J. Franz

Timothy J. Franz

President and Chief Executive Officer

BNCCORP

# Year End Financial Report

**For the Year Ended December 31, 2015**

## BNCCORP, INC.

**(OTCQX: BNCC)**

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Bismarck, North Dakota 58501
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# Selected Financial Data

The selected consolidated financial data presented below should be read in conjunction with our consolidated financial statements and the notes thereto (dollars in thousands, except share and per share data):

| | For the Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2012 | 2011 |
| **Income Statement Data from Continuing Operations:** | | | | | |
| Total interest income | $ 27,915 | $ 29,264 | $ 23,706 | $ 23,992 | $ 25,749 |
| Total interest expense | 2,570 | 3,308 | 3,861 | 5,521 | 6,272 |
| Net interest income | 25,345 | 25,956 | 19,845 | 18,471 | 19,477 |
| Provision (reduction) for credit losses | (400) | (800) | 700 | 100 | 1,625 |
| Non-interest income | 24,950 | 20,454 | 29,285 | 42,938 | 20,237 |
| Non-interest expense | 37,544 | 34,683 | 35,981 | 39,965 | 33,859 |
| Income tax expense (benefit) | 3,945 | 4,071 | 3,822 | (5,280) | 22 |
| Net income | $ 9,206 | $ 8,456 | $ 8,627 | $ 26,624 | $ 4,208 |
| Preferred stock costs | 1,656 | 1,796 | 1,320 | 1,462 | 1,394 |
| Net income available to common shareholders | $ 7,550 | $ 6,660 | $ 7,307 | $ 25,162 | $ 2,814 |
| **Balance Sheet Data:** (at end of period) | | | | | |
| Total assets | $ 904,246 | $ 934,419 | $ 843,123 | $ 770,776 | $ 665,158 |
| Investments securities available for sale | 419,346 | 449,333 | 435,719 | 300,549 | 242,630 |
| Loans held for sale-mortgage banking | 50,445 | 47,109 | 32,870 | 95,095 | 68,622 |
| Loans and leases held for investment, net of unearned income | 379,903 | 360,789 | 317,928 | 289,469 | 293,211 |
| Allowance for credit losses | (8,611) | (8,601) | (9,847) | (10,091) | (10,630) |
| Total deposits | 780,449 | 811,231 | 723,229 | 649,604 | 576,255 |
| Core deposits | 760,937 | 773,279 | 678,670 | 596,304 | 525,071 |
| Short-term borrowings | 13,851 | 16,002 | 19,967 | 11,700 | 8,635 |
| Federal Home Loan Bank advances | 7,300 | - | - | - | - |
| Long-term borrowings | 10,000 | - | - | - | - |
| Guaranteed preferred beneficial interests in Company's subordinated debentures | 15,015 | 15,018 | 22,432 | 22,430 | 22,427 |
| Preferred stockholders' equity | - | 21,098 | 21,098 | 20,888 | 20,687 |
| Common stockholders' equity | 68,988 | 62,390 | 48,767 | 47,842 | 21,180 |
| Book value per common share outstanding | $ 20.12 | $ 18.28 | $ 14.45 | $ 14.49 | $ 6.42 |
| Book value per common share outstanding, excluding accumulated other comprehensive income | $ 18.93 | $ 16.72 | $ 14.89 | $ 12.99 | $ 5.35 |
| Tangible book value | $ 20.12 | $ 18.28 | $ 14.45 | $ 14.49 | $ 6.42 |
| Tangible common equity ratio | 7.62% | 6.67% | 5.78% | 6.21% | 3.17% |
| **Earnings Performance / Share Data from Continuing Operations:** | | | | | |
| Return on average total assets | 1.01% | 0.94% | 1.07% | 3.74% | 0.61% |
| Return on average common stockholders' equity | 12.21% | 12.37% | 15.15% | 90.04% | 17.32% |
| Efficiency ratio | 74.65% | 74.73% | 73.24% | 65.08% | 85.26% |
| Net interest margin | 2.96% | 3.07% | 2.65% | 2.85% | 3.11% |
| Net interest spread | 2.86% | 2.97% | 2.54% | 2.63% | 2.89% |
| Basic earnings per common share | $ 2.23 | $ 1.98 | $ 2.22 | $ 7.64 | $ 0.86 |
| Diluted earnings per common share | $ 2.16 | $ 1.91 | $ 2.11 | $ 7.52 | $ 0.86 |
| Average common shares outstanding | 3,386,600 | 3,369,021 | 3,297,235 | 3,294,562 | 3,282,182 |
| Average common and common equivalent shares | 3,497,740 | 3,491,254 | 3,468,390 | 3,344,280 | 3,282,182 |
| Shares outstanding at year end | 3,428,416 | 3,413,854 | 3,374,601 | 3,300,652 | 3,301,007 |
| **Other Key Ratios** | | | | | |
| Nonperforming assets to total assets | 0.09% | 0.03% | 0.79% | 2.03% | 2.45% |
| Nonperforming loans to total assets | 0.06% | 0.01% | 0.67% | 1.36% | 0.93% |
| Nonperforming loans to loans and leases held for investment | 0.15% | 0.02% | 1.77% | 3.63% | 2.10% |
| Net loan recovery (charge-offs) to average loans and leases held for investment | 0.117% | (0.134)% | (0.332)% | (0.225)% | (1.780)% |
| Allowance for credit losses to total loans | 2.00% | 2.11% | 2.81% | 2.62% | 2.94% |

# Quarterly Financial Data

| | 2015 | | | | |
|---|---|---|---|---|---|
| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter | YTD |
| Interest income | $ 7,218 | $ 7,112 | $ 6,662 | $ 6,923 | $ 27,915 |
| Interest expense | 611 | 696 | 557 | 706 | 2,570 |
| Net interest income | 6,607 | 6,416 | 6,105 | 6,217 | 25,345 |
| Provision (reduction) for credit losses | - | - | (400) | - | (400) |
| Net interest income after provision (reduction) for credit losses | 6,607 | 6,416 | 6,505 | 6,217 | 25,745 |
| Non-interest income | 7,651 | 6,740 | 5,232 | 5,327 | 24,950 |
| Non-interest expense | 9,666 | 9,658 | 8,980 | 9,240 | 37,544 |
| Income before income taxes | 4,592 | 3,498 | 2,757 | 2,304 | 13,151 |
| Income tax expense | 1,378 | 1,211 | 882 | 474 | 3,945 |
| Net Income | $ 3,214 | $ 2,287 | $ 1,875 | $ 1,830 | $ 9,206 |
| Preferred stock costs | 475 | 474 | 475 | 232 | 1,656 |
| Net income available to common shareholders | $ 2,739 | $ 1,813 | $ 1,400 | $ 1,598 | $ 7,550 |
| Basic earnings per common share | $ 0.81 | $ 0.53 | $ 0.41 | $ 0.47 | $ 2.23 |
| Diluted earnings per common share | $ 0.78 | $ 0.52 | $ 0.40 | $ 0.46 | $ 2.16 |
| Average common shares: | | | | | |
| Basic | 3,386,175 | 3,387,718 | 3,388,706 | 3,390,864 | 3,386,600 |
| Diluted | 3,500,273 | 3,500,089 | 3,501,322 | 3,496,340 | 3,497,740 |

| | 2014 | | | | |
|---|---|---|---|---|---|
| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter | YTD |
| Interest income | $ 7,104 | $ 7,271 | $ 7,540 | $ 7,349 | $ 29,264 |
| Interest expense | 899 | 948 | 791 | 670 | 3,308 |
| Net interest income | 6,205 | 6,323 | 6,749 | 6,679 | 25,956 |
| Provision (reduction) for credit losses | (200) | (400) | (200) | - | (800) |
| Net interest income after provision (reduction) for credit losses | 6,405 | 6,723 | 6,949 | 6,679 | 26,756 |
| Non-interest income | 4,284 | 5,361 | 4,814 | 5,995 | 20,454 |
| Non-interest expense | 8,090 | 8,887 | 8,765 | 8,941 | 34,683 |
| Income before income taxes | 2,599 | 3,197 | 2,998 | 3,733 | 12,527 |
| Income tax expense | 807 | 990 | 1,017 | 1,257 | 4,071 |
| Net Income | $ 1,792 | $ 2,207 | $ 1,981 | $ 2,476 | $ 8,456 |
| Preferred stock costs | 372 | 475 | 474 | 475 | 1,796 |
| Net income available to common shareholders | $ 1,420 | $ 1,732 | $ 1,507 | $ 2,001 | $ 6,660 |
| Basic earnings per common share | $ 0.42 | $ 0.51 | $ 0.44 | $ 0.59 | $ 1.98 |
| Diluted earnings per common share | $ 0.41 | $ 0.50 | $ 0.43 | $ 0.57 | $ 1.91 |
| Average common shares: | | | | | |
| Basic | 3,349,588 | 3,364,235 | 3,386,187 | 3,386,187 | 3,369,021 |
| Diluted | 3,477,459 | 3,491,255 | 3,502,444 | 3,503,972 | 3,491,254 |

# Business

## General

BNCCORP, INC. (BNCCORP or BNC) is a registered bank holding company incorporated under the laws of Delaware. It is the parent company of BNC National Bank (the Bank or BNC Bank). BNC operates community banking and wealth management businesses in North Dakota, Arizona and Minnesota from 15 locations. BNC Bank also conducts mortgage banking from 14 locations in Arizona, Minnesota, North Dakota, Illinois, Kansas, Arkansas and Missouri.

## Operating Strategy

**We are a community bank that focuses on business banking, mortgage banking, and wealth management.** We build value for shareholders by providing relationship-based financial services to small and mid-sized businesses, business owners, their employees and professionals. The key elements of our strategy include:

- *Providing individualized, high-level customer service*. We provide a high level of customer service to establish and maintain long-term relationships. We believe that many of our competitors emphasize retail banking or focus on large companies, leaving the small and mid-sized business market underserved. Our consistent focus on the needs of such small and mid-sized businesses allows us to compete effectively in this market segment.

- *Diversification of products and services.* We offer a wide variety of banking, mortgage banking, and wealth management products and services to meet the financial needs of our customers, establish new relationships and expand our business opportunities. We seek to leverage our existing relationships by cross-selling our products and services.

- *Expand opportunistically*. We emphasize organic growth within the markets that we serve and look to opportunistically expand into new lines of business and attractive markets. Organic growth in North Dakota is an emphasis as we believe in the viability of the energy and agricultural industries over the long term. In Arizona, our organic growth focuses on small businesses and the SBA arena. We are also willing to opportunistically grow through acquisitions.

- *Managing risk*. Community banking is faced with several forms of inherent risk. We strive to manage risk by balancing the potential costs of various risks and the various rewards of banking opportunities.

- *Emphasize deposit growth.* Growing low-cost core deposits is a key strategy. Our platforms and technology offers us a strategic opportunity to deliver high level deposit services to the businesses and professionals we serve and permits us to attract funds at a low cost.

# Management's Discussion and Analysis of Financial Condition and Results of Operations

## Overview

The following table summarizes selected income statement data and earnings per share data (in thousands, except per share data):

| | 2015 | 2014 |
|---|---|---|
| **SELECTED INCOME STATEMENT DATA** | | |
| Interest income | $ 27,915 | $ 29,264 |
| Interest expense | 2,570 | 3,308 |
| Net interest income | 25,345 | 25,956 |
| Provision (reduction) for credit losses | (400) | (800) |
| Non-interest income | 24,950 | 20,454 |
| Non-interest expense | 37,544 | 34,683 |
| Income before income taxes | 13,151 | 12,527 |
| Income tax expense | 3,945 | 4,071 |
| Net income | 9,206 | 8,456 |
| Preferred stock costs | 1,656 | 1,796 |
| Net income available to common shareholders | $ 7,550 | $ 6,660 |
| **EARNINGS PER SHARE DATA** | | |
| Basic earnings per common share | $ 2.23 | $ 1.98 |
| Diluted earnings per common share | $ 2.16 | $ 1.91 |

The following is a brief overview of recent periods:

- In 2015, net interest income decreased from 2014 as earnings on higher loan balances was offset by reduced yields, particularly in the investment portfolio.
- Excluding the impact of non-recurring revenue on Small Business Investment Company investments, aggregating $928 thousand and $1.718 million in 2015 and 2014, respectively, non-interest income increased $5.2 million or 28% over 2014. The increase is largely attributable to increased mortgage banking revenue and gains on the sale of securities. Wealth management revenue increased $92 thousand, or 7%, while bank charges and service fees remained steady at $2.9 million in 2015. Gains on sale of loans declined in 2015 as Small Business Administration (SBA) loan production softened in 2015.
- Credit quality remained steady in 2015. At December 31, 2015 our non-performing assets were 0.09% of total assets compared to 0.03% at December 31, 2014.
- Non-interest expense increased in 2015 by $2.9 million or 8%. Compensation increased due to mortgage banking activity and producer awards. Professional and marketing expense increased in response to significantly higher mortgage loan production. Other expense declined compared to 2014 due to lower provision for mortgage banking obligation expenses in 2015 and costs incurred in 2014 in connection with the redemption of trust preferred securities.
- In 2015, the effective tax rate decreased to 30.0% from 32.5% in 2014 as the 2015 tax expense benefited from greater non-taxable income as municipal bonds became a larger segment of the investment portfolio.

## General

Net income in 2015 was $9.206 million compared to net income of $8.456 million in 2014. Earnings per diluted share was $2.16 in 2015 and $1.91 in 2014.

### Net Interest Income

The following table sets forth information relating to our average balance sheet, yields on interest-earning assets and costs on interest-bearing liabilities (dollars are in thousands):

| | For the Year ended December 31, 2015 | | | For the Year ended December 31, 2014 | | | For the Year ended December 31, 2013 | | |
|---|---|---|---|---|---|---|---|---|---|
| | Average balance | Interest earned or owed | Average yield or cost | Average balance | Interest earned or owed | Average yield or cost | Average balance | Interest earned or owed | Average yield or cost |
| **Assets** | | | | | | | | | |
| Federal funds sold/interest-bearing due from banks | $ 22,691 | $ 50 | 0.22% | $ 41,896 | $ 98 | 0.23% | $ 54,726 | $ 144 | 0.26% |
| Taxable investments | 357,802 | 6,549 | 1.83% | 381,253 | 9,311 | 2.44% | 315,722 | 5,948 | 1.88% |
| Tax-exempt investments | 87,495 | 2,706 | 3.09% | 68,097 | 2,241 | 3.29% | 46,086 | 1,496 | 3.25% |
| Loans held for sale-mortgage banking | 46,829 | 1,603 | 3.42% | 30,513 | 1,143 | 3.75% | 56,779 | 1,890 | 3.33% |
| Loans and leases held for investment | 350,840 | 17,007 | 4.85% | 331,982 | 16,471 | 4.96% | 284,344 | 14,228 | 5.00% |
| Allowance for credit losses | (8,670) | - | | (9,184) | - | | (9,928) | - | |
| Total interest-earning assets | 856,987 | 27,915 | 3.26% | 844,557 | 29,264 | 3.47% | 747,729 | 23,706 | 3.17% |
| Non-interest-earning assets: | | | | | | | | | |
| Cash and due from banks | 9,150 | | | 10,994 | | | 10,337 | | |
| Other | 43,214 | | | 43,858 | | | 49,483 | | |
| Total assets | $ 909,351 | | | $ 899,409 | | | $ 807,549 | | |
| **Liabilities and Stockholders' Equity** | | | | | | | | | |
| Deposits: | | | | | | | | | |
| Interest checking and money market accounts | $ 430,838 | $ 530 | 0.12% | $ 409,519 | $ 541 | 0.13% | $ 341,128 | $ 576 | 0.17% |
| Savings | 29,724 | 9 | 0.03% | 24,249 | 9 | 0.04% | 19,857 | 15 | 0.08% |
| Certificates of deposit: | | | | | | | | | |
| Under $100,000 | 93,169 | 1,313 | 1.41% | 113,769 | 1,442 | 1.27% | 125,641 | 1,535 | 1.22% |
| $100,000 and over | 59,999 | 296 | 0.49% | 77,812 | 421 | 0.54% | 81,196 | 534 | 0.66% |
| Total interest-bearing deposits | 613,730 | 2,148 | 0.35% | 625,349 | 2,413 | 0.39% | 567,822 | 2,660 | 0.47% |
| Borrowings: | | | | | | | | | |
| Short-term borrowings | 16,299 | 26 | 0.16% | 20,575 | 36 | 0.17% | 18,948 | 41 | 0.22% |
| FHLB advances | 3,357 | 10 | 0.30% | 425 | 1 | 0.24% | - | - | 0.00% |
| Long-term borrowings | 2,016 | 128 | 6.35% | 899 | 36 | 4.00% | - | - | 0.00% |
| Subordinated debentures | 15,016 | 258 | 1.72% | 19,693 | 822 | 4.17% | 22,431 | 1,160 | 5.17% |
| Total interest-bearing liabilities | 650,418 | 2,570 | 1.15% | 666,941 | 3,308 | 0.50% | 609,201 | 3,861 | 0.63% |
| Non-interest-bearing demand | 163,755 | - | 0.00% | 147,884 | - | 0.00% | 118,783 | - | 0.00% |
| Total deposits and interest-bearing liabilities | 814,173 | | | 814,825 | | | 727,984 | | |
| Other non-interest-bearing liabilities | 9,428 | | | 7,589 | | | 9,093 | | |
| Total liabilities | 823,601 | | | 822,414 | | | 737,077 | | |
| Stockholders' equity | 85,750 | | | 76,995 | | | 70,472 | | |
| Total liabilities and stockholders' equity | $ 909,351 | | | $ 899,409 | | | $ 807,549 | | |
| Net interest income | | $ 25,345 | | | $ 25,956 | | | $ 19,845 | |
| Net interest spread | | | 2.86% | | | 2.97% | | | 2.54% |
| Net interest margin | | | 2.96% | | | 3.07% | | | 2.65% |
| Ratio of average interest-earning assets to average interest-bearing liabilities | 131.76% | | | 126.63% | | | 122.74% | | |

The following table allocates changes in our interest income and interest expense between the changes related to volume and rates (in thousands):

| | For the Years Ended December 31, 2015 Compared to 2014 | | | For the Years Ended December 31, 2014 Compared to 2013 | | |
|---|---|---|---|---|---|---|
| | Change Due to | | | Change Due to | | |
| | Volume | Rate | Total | Volume | Rate | Total |
| **Interest Earned on Interest-Earning Assets** | | | | | | |
| Federal funds sold/interest-bearing due from banks | $ (43) | $ (5) | $ (48) | $ (31) | $ (15) | $ (46) |
| Taxable investments | (544) | (2,218) | (2,762) | 1,385 | 1,978 | 3,363 |
| Tax-exempt investments | 607 | (142) | 465 | 724 | 21 | 745 |
| Loans held for sale- mortgage banking | 566 | (106) | 460 | (961) | 214 | (747) |
| Loans held for investment | 920 | (384) | 536 | 2,364 | (121) | 2,243 |
| Total increase (decrease) in interest income | 1,506 | (2,855) | (1,349) | 3,481 | 2,077 | 5,558 |
| **Interest Expense on Interest-Bearing Liabilities** | | | | | | |
| Interest checking and money market accounts | 27 | (38) | (11) | 103 | (138) | (35) |
| Savings | 2 | (2) | - | 3 | (9) | (6) |
| Certificates of Deposit: | | | | | | |
| Under $100,000 | (279) | 150 | (129) | (149) | 56 | (93) |
| $100,000 and over | (90) | (35) | (125) | (22) | (91) | (113) |
| Short-term borrowings | (7) | (3) | (10) | 3 | (8) | (5) |
| FHLB advances | 8 | 1 | 9 | 1 | - | 1 |
| Long-term borrowings | 63 | 29 | 92 | 36 | - | 36 |
| Subordinated debentures | (162) | (402) | (564) | (189) | (149) | (338) |
| Total increase (decrease) in interest expense | (438) | (300) | (738) | (214) | (339) | (553) |
| Increase (decrease) in net interest income | $ 1,944 | $ (2,555) | $ (611) | $ 3,695 | $ 2,416 | $ 6,111 |

Net interest income was $25.345 million in 2015 compared to $25.956 million in 2014, a decrease of $611 thousand or 2.4%. The net interest margin decreased to 2.96% for the year ended December 31, 2015 from 3.07% in 2014. In 2015, net interest income was lower as the impact of lower interest rates was not offset by higher balances of interest-earning assets. The cost of interest bearing deposits decreased to 0.35% in 2015 from 0.39% in 2014. Our ability to lower our cost of funds in the future may be limited because interest rates are currently at historically low levels. In 2015, average earning assets increased as loans held for investment and investments available for sale increased as we deployed funds from new deposits and liquidity built in prior periods. While loan balances were impacted during the year by significant loan repayments, we funded $36.2 million of new loans during the fourth quarter of 2015. Due to strong mortgage loan production in 2015, loans held for sale contributed meaningfully to net interest income in 2015.

Net interest income was $25.956 million in 2014 compared to $19.845 million in 2013, an increase of $6.111 million or 30.8%. The net interest margin increased to 3.07% for the year ended December 31, 2014 from 2.65% in 2013. In 2014, net interest income was higher as the impact of lower interest rates was offset by higher balances of assets and liabilities. In 2014, earning assets increased as loans held for investment and investments available for sale increased as we deployed funds from new deposits and liquidity built in prior periods. As 2014 progressed, we continued to increase loans held for investment.

## Non-interest Income

The following table presents the major categories of our non-interest income (dollars are in thousands):

| | For the Years Ended December 31, | | Increase (Decrease) | | |
|---|---|---|---|---|---|
| | 2015 | 2014 | $ | % | |
| Bank charges and service fees | $ 2,901 | $ 2,962 | $ (61) | (2) % | (a) |
| Wealth management revenues | 1,476 | 1,384 | 92 | 7 % | |
| Mortgage banking revenues | 16,214 | 11,818 | 4,396 | 37 % | (b) |
| Gains on sales of loans, net | 1,138 | 1,915 | (777) | (41) % | (c) |
| Gains on sales of securities, net | 1,655 | 53 | 1,602 | 3,023 % | (d) |
| Other | 1,566 | 2,322 | (756) | (33) % | (e) |
| Total non-interest income | $ 24,950 | $ 20,454 | $ 4,496 | 22 % | |

(a) These fees remained stable despite decreased deposit balances as we continue to open new accounts.
(b) Mortgage banking revenues were positively impacted in 2015 by the low interest rate environment and the national reach of our mortgage platform.
(c) Gains and losses on sales will vary significantly from period to period. While the Company's 2015 loan growth was less robust in the SBA sector, secondary market demand for SBA loans remain strong and loans can be sold at attractive prices.
(d) Gains and losses on sales of securities will vary significantly from period to period.
(e) The Company recorded revenue from SBIC investments of $928 thousand and $1.718 million in 2015 and 2014, respectively. While it is difficult to predict the timing, or amount of distributions, we currently anticipate distributions in future periods.

**Non-interest Expense**

The following table presents the major categories of our non-interest expense (dollars are in thousands):

| | For the Years Ended December 31, | | Increase (Decrease) | | |
|---|---|---|---|---|---|
| | 2015 | 2014 | $ | % | |
| Salaries and employee benefits | $ 19,692 | $ 17,783 | $ 1,909 | 11 % | (a) |
| Professional services | 3,923 | 3,032 | 891 | 29 % | (b) |
| Data processing fees | 3,059 | 2,932 | 127 | 4 % | |
| Marketing and promotion | 3,523 | 2,974 | 549 | 18 % | (c) |
| Occupancy | 1,981 | 2,064 | (83) | (4) % | (d) |
| Regulatory costs | 696 | 640 | 56 | 9 % | (e) |
| Depreciation and amortization | 1,415 | 1,268 | 147 | 12 % | (f) |
| Office supplies and postage | 648 | 687 | (39) | (6) % | |
| Other real estate costs | 18 | 72 | (54) | (75) % | (g) |
| Other | 2,589 | 3,231 | (642) | (20) % | (h) |
| Total non-interest expense | $ 37,544 | $ 34,683 | $ 2,861 | 8 % | |
| Efficiency ratio | 74.65% | 74.73% | (0.08)% | | |

(a) Salary expense increased due to higher mortgage loan production and rewards for producers.

(b) The increase of professional services is primarily due to the increase in mortgage production volume.

(c) Marketing costs have increased for the banking and mortgage banking operations to drive volume and support the opening of a new branch in North Dakota.

(d) Occupancy costs decreased slightly in 2015 due to investment in facility improvements and office relocations in prior years and temporary rent concessions in 2015.

(e) The increase is due to higher regulatory assessments.

(f) Increased due to additional capital expenditures over recent years, including a new bank branch in Mandan, ND, facility improvements in various locations and technology.

(g) Other real estate costs will vary from period to period depending on valuation adjustments on our foreclosed properties– see Note 6. At December 31, 2015, the Company held only one remaining property in other real estate.

(h) Other expense declined compared to 2014 due to lower provision for mortgage banking obligation expenses as well as the absence of costs incurred in 2014 in connection with the redemption of trust preferred securities.

**Income Tax Expense**

During 2015, we recorded tax expense of $3.945 million which resulted in an effective tax rate of 30.0%. Subject to certain statutory limitations, the Company is able to carry forward state tax net operating losses aggregating $456 thousand as of December 31, 2015. The state net operating losses expire between 2016 and 2032.

During 2014, we recorded tax expense of $4.071 million which resulted in an effective tax rate of 32.5%. The Company is able to carry forward state tax net operating losses aggregating $1.9 million as of December 31, 2014. The state net operating losses expire between 2017 and 2031.

The change in effective tax rate from 2015 to 2014 is primarily due to the increased tax-exempt investment income.

## Financial Condition

### Assets

The following table presents our assets by category (dollars are in thousands):

| | As of December 31, | | Increase (Decrease) 2015-2014 | | |
|---|---|---|---|---|---|
| | 2015 | 2014 | $ | % | |
| Cash and cash equivalents | $ 15,189 | $ 41,124 | $ (25,935) | (63) % | (a) |
| Investment securities available for sale | 419,346 | 449,333 | (29,987) | (7) % | (b) |
| Federal Reserve Bank and Federal Home Loan Bank of Des Moines stock | 3,219 | 2,817 | 402 | 14 % | |
| Loans held for sale-mortgage banking | 50,445 | 47,109 | 3,336 | 7 % | (c) |
| Loans and leases held for investment, net | 371,292 | 352,188 | 19,104 | 5 % | (d) |
| Other real estate, net | 242 | 256 | (14) | (5) % | (e) |
| Premises and equipment, net | 17,574 | 16,228 | 1,346 | 8 % | (f) |
| Accrued interest receivable | 4,027 | 3,931 | 96 | 2 % | |
| Other assets | 22,912 | 21,433 | 1,479 | 7 % | (g) |
| Total assets | $ 904,246 | $ 934,419 | $ (30,173) | (3) % | |

(a) Cash balances can fluctuate significantly. The decrease is primarily attributable to the decline in deposits.
(b) The decrease in investments is primarily attributable to the decline in deposits in 2015.
(c) Loans held for sale increased as production increased in 2015 as rates decreased late in 2014 and remained at low levels throughout 2015.
(d) In 2013, with stable credit quality, we implemented measures to increase our loan portfolio and enjoyed double-digit loan growth in 2013 and 2014. For most of 2015, we experienced increased levels of repayment as the North Dakota economy softened. This trend reversed at year end 2015.
(e) Decrease is due to an adjustment to the carrying value of the one property remaining in OREO.
(f) Premises and equipment increased largely due to the completion of construction of a new bank branch in Mandan, ND and the construction of an additional branch in Bismarck, ND.
(g) Other assets increased primarily due to the increase in net deferred tax assets and an increase in the Company's Bank Owned Life Insurance assets.

**Investment Securities Available for Sale**

The following table presents the composition of the available-for-sale investment portfolio (in thousands):

| | December 31, | | | |
|---|---|---|---|---|
| | 2015 | | 2014 | |
| | Amortized cost | Estimated fair market value | Amortized cost | Estimated fair market value |
| U.S. Treasury securities | $ 32,925 | $ 32,649 | $ 19,861 | $ 19,921 |
| U.S. government agency mortgage-backed securities guaranteed by GNMA | 105,407 | 104,431 | 101,833 | 101,637 |
| U.S. government agency small business administration pools guaranteed by SBA | 105,150 | 105,678 | 83,990 | 84,379 |
| Collateralized mortgage obligations guaranteed by GNMA/VA | 61,418 | 61,893 | 96,988 | 98,188 |
| Collateralized mortgage obligations issued by FNMA or FHLMC | 21,607 | 21,662 | 62,638 | 63,334 |
| State and municipal bonds | 87,779 | 93,033 | 76,958 | 81,874 |
| Total investments | $ 414,286 | $ 419,346 | $ 442,268 | $ 449,333 |

There were no securities that management concluded were other-than-temporarily impaired during 2015 or 2014. See Note 2 of our Consolidated Financial Statements.

The following table presents contractual maturities for securities available for sale and yields thereon at December 31, 2015 (dollars are in thousands):

| | Within 1 year | | After 1 but within 5 years | | After 5 but within 10 years | | After 10 years | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Amount | Yield(1) | Amount | Yield (1) | Amount | Yield(1) | Amount | Yield(1) | Amount | Yield(1) |
| U.S. Treasury securities(2) | $ - | -% | $ 17,918 | 1.54% | $ 15,007 | 1.87% | $ - | -% | $ 32,925 | 1.69% |
| U.S. government agency mortgage-backed securities guaranteed by GNMA(2) (3) | - | -% | - | -% | - | -% | 105,407 | 1.87% | 105,407 | 1.87% |
| U.S. government agency small business administration pools guaranteed by SBA(2) (3) | - | -% | - | -% | 1,326 | 1.09% | 103,824 | 1.66% | 105,150 | 1.65% |
| Collateralized mortgage obligations guaranteed by GNMA/VA(2) (3) | - | -% | - | -% | - | -% | 61,418 | 2.75% | 61,418 | 2.75% |
| Collateralized mortgage obligations issued by FNMA or FHLMC(2) (3) | - | -% | - | -% | - | -% | 21,606 | 2.96% | 21,606 | 2.96% |
| State and municipal bonds(1) (2) | - | -% | - | -% | 1,100 | 4.92% | 86,680 | 5.27% | 87,780 | 5.26% |
| Total book value of investment securities | $ - | -% | $ 17,918 | 1.54% | $ 17,433 | 2.00% | $ 378,935 | 2.79% | 414,286 | 2.71% |
| Net unrealized gain on securities available for sale | | | | | | | | | 5,060 | |
| Total investment in securities available for sale | | | | | | | | | $ 419,346 | 2.67% |

(1) Yields include adjustments for tax-exempt income.
(2) Based on amortized cost rather than fair value.
(3) Maturities of mortgage-backed securities and collateralized obligations are based on contractual maturities. Actual maturities may vary because obligors may have the right to call or prepay obligations with or without call or prepayment penalties.

As of December 31, 2015, we had $419.3 million of available-for-sale securities in the investment portfolio compared to $449.3 million at December 31, 2014.

In 2015, available-for-sale investment securities decreased as we deployed proceeds from maturities and sales of securities toward other earning assets, funded customer's redeployment of deposited funds and redeemed $20.0 million of brokered certificates of deposit.

In 2014, available-for-sale investment securities increased as we deployed cash and funds from new deposits. The net unrealized gain of investment securities increased as of December 31, 2014 as compared to December 31, 2013 due to the general decrease in interest rates and flattening of the yield curve over the course of 2014.

At December 31, 2015, we held no securities, other than U.S. Treasury securities, U.S. Government Agency mortgage-backed securities, U.S. Government agency small business administration pools, and U.S. Government Agency collateralized mortgage obligations that exceeded 10% of stockholders' equity. A portion of our investment securities portfolio was pledged as collateral.

See Note 2 of our Consolidated Financial Statements for more information about investment securities.

**Federal Reserve Bank and Federal Home Loan Bank of Des Moines Stock**
Our equity securities consisted of $1.8 million of Federal Reserve Bank ("FRB") stock as of December 31, 2015 and December 31, 2014, and $1.4 million and $1.0 million of FHLB of Des Moines stock as of December 31, 2015 and 2014, respectively.

**Loans**
The following table presents our loan portfolio as of December 31 (dollars are in thousands):

| | 2015 | | 2014 | | 2013 | | 2012 | | 2011 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Amount | % | Amount | % | Amount | % | Amount | % | Amount | % |
| Loans held for sale-mortgage banking | $ 50,445 | 100.0 | $ 47,109 | 100.0 | $ 32,870 | 100.0 | $ 95,095 | 100.0 | $ 68,622 | 100.0 |
| Loans Held for Investment: | | | | | | | | | | |
| Commercial and industrial | 125,009 | 32.9 | 132,229 | 36.6 | 132,983 | 41.8 | 116,891 | 40.4 | 109,746 | 37.4 |
| Commercial real estate | 149,099 | 39.3 | 108,122 | 30.0 | 93,330 | 29.3 | 87,258 | 30.1 | 115,704 | 39.4 |
| SBA | 25,860 | 6.8 | 26,972 | 7.5 | 18,215 | 5.7 | 15,823 | 5.5 | 9,958 | 3.4 |
| Consumer | 47,073 | 12.4 | 40,470 | 11.2 | 32,612 | 10.3 | 26,614 | 9.2 | 23,038 | 7.9 |
| Land and land development | 17,627 | 4.6 | 28,220 | 7.8 | 27,582 | 8.7 | 31,065 | 10.7 | 29,350 | 10.0 |
| Construction | 15,187 | 4.0 | 24,916 | 6.9 | 13,286 | 4.2 | 11,814 | 4.1 | 5,545 | 1.9 |
| | 379,855 | 100.0 | 360,929 | 100.0 | 318,008 | 100.0 | 289,465 | 100.0 | 293,341 | 100.0 |
| Unearned income and net unamortized deferred fees and costs | 48 | - | (140) | - | (80) | - | 4 | - | (130) | - |
| Loans, net of unearned income and unamortized fees and costs | $ 379,903 | 100.0 | $ 360,789 | 100.0 | $ 317,928 | 100.0 | $ 289,469 | 100.0 | $ 293,211 | 100.0 |

The following table presents the change in our loan portfolio (dollars are in thousands):

| | December 31, | | Increase (Decrease) 2015–2014 | | |
|---|---|---|---|---|---|
| | 2015 | 2014 | $ | % | |
| Loans held for sale-mortgage banking | $ 50,445 | $ 47,109 | $ 3,336 | 7.1 % | (a) |
| | | | | | |
| Loans Held for Investment: | | | | | |
| Commercial and industrial | 125,009 | 132,229 | (7,220) | (5.5) % | |
| Commercial real estate | 149,099 | 108,122 | 40,977 | 37.9 % | |
| SBA | 25,860 | 26,972 | (1,112) | (4.1) % | |
| Consumer | 47,073 | 40,470 | 6,603 | 16.3 % | |
| Land and land development | 17,627 | 28,220 | (10,593) | (37.5) % | |
| Construction | 15,187 | 24,916 | (9,729) | (39.0) % | |
| | 379,855 | 360,929 | 18,926 | 5.2 % | |
| Unearned income and net unamortized deferred fees and costs | 48 | (140) | 188 | (134.3) % | |
| Loans, net of unearned income and unamortized fees and costs | $ 379,903 | $ 360,789 | $ 19,114 | 5.3 % | (b) |

(a) Loans held for sale increased in 2015 as interest rates remained low.

(b) In 2015, after strong loan growth in 2014, we experienced significant loan repayments throughout much of the year but were successful in increasing balances in the fourth quarter of 2015.

## Loan Participations

Pursuant to our lending policy, loans may not exceed 85% of the Bank’s legal lending limit (except to the extent collateralized by U.S. Treasury securities or Bank deposits and, accordingly, excluded from the Bank’s legal lending limit) unless the Chief Credit Officer and the Executive Credit Committee grant prior approval. To accommodate customers whose financing needs exceed lending limits and internal loan concentration limits, the Bank sells loan participations to outside participants without recourse.

Loan participations sold on a nonrecourse basis to outside financial institutions were as follows as of December 31 (in thousands):

| | | |
|---|---|---|
| 2015 | $ | 176,439 |
| 2014 | | 180,192 |
| 2013 | | 222,765 |
| 2012 | | 218,068 |
| 2011 | | 220,177 |

**Concentrations of Credit**

The following table summarizes the location of our borrowers as of December 31 (dollars are in thousands):

| | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|
| North Dakota | $ | 259,271 | 68 % | $ | 228,145 | 63 % |
| Minnesota | | 26,022 | 7 % | | 34,029 | 9 % |
| Arizona | | 68,796 | 18 % | | 52,679 | 15 % |
| Other | | 25,766 | 7 % | | 46,076 | 13 % |
| Total gross loans held for investment | $ | 379,855 | 100 % | $ | 360,929 | 100 % |

Our borrowers use loan proceeds for projects in various geographic areas. The following table summarizes the locations where our borrowers are using loan proceeds as of December 31 (dollars are in thousands):

| | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|
| North Dakota | $ | 244,797 | 65 % | $ | 232,533 | 64 % |
| Arizona | | 83,086 | 22 % | | 63,463 | 18 % |
| California | | 10,837 | 3 % | | 15,609 | 4 % |
| Minnesota | | 10,685 | 3 % | | 11,045 | 3 % |
| Colorado | | 9,197 | 2 % | | 8,922 | 3 % |
| Ohio | | 8,732 | 2 % | | 9,000 | 3 % |
| Other | | 12,521 | 3 % | | 20,357 | 5 % |
| Total gross loans held for investment | $ | 379,855 | 100 % | $ | 360,929 | 100 % |

The following table presents loans by type as of December 31 (in thousands):

| | 2015 | | 2014 | |
|---|---|---|---|---|
| | Total Loans and Leases Held for Investment | | Total Loans and Leases Held for Investment | |
| **North Dakota** | | | | |
| Commercial and industrial | $ | 46,311 | $ | 56,681 |
| Construction | | 11,937 | | 20,894 |
| Agricultural | | 16,159 | | 16,732 |
| Land and land development | | 11,549 | | 10,468 |
| Owner-occupied commercial real estate | | 37,832 | | 38,035 |
| Commercial real estate | | 79,119 | | 55,349 |
| Small business administration | | 2,662 | | 1,247 |
| Consumer | | 39,228 | | 33,127 |
| Subtotal | $ | 244,797 | $ | 232,533 |
| **Consolidated** | | | | |
| Commercial and industrial | $ | 62,940 | $ | 67,533 |
| Construction | | 15,187 | | 24,916 |
| Agricultural | | 18,003 | | 17,478 |
| Land and land development | | 17,627 | | 28,220 |
| Owner-occupied commercial real estate | | 44,066 | | 47,218 |
| Commercial real estate | | 149,099 | | 108,122 |
| Small business administration | | 25,860 | | 26,972 |
| Consumer | | 47,073 | | 40,470 |
| Subtotal | $ | 379,855 | $ | 360,929 |

At December 31, 2015, the North Dakota commercial and industrial category above includes $11.7 million of oil exploration and production (E&P) loans. Oil prices have a direct impact on the underlying collateral for our E&P loans. Advances on E&P lines are generally limited to 50% of the value of proven, developed and producing oil reserves with valuations generally being performed on a semi-annual basis. As of December 31, 2015, no E&P loans were considered classified and $196 thousand were considered watch list loans.

**Loan Maturities** (1)

The following table sets forth the remaining maturities of loans in our portfolio as of December 31, 2015 (in thousands):

| | | Over 1 year through 5 years | | Over 5 years | | |
|---|---|---|---|---|---|---|
| | **One year or less** | **Fixed Rate** | **Floating Rate** | **Fixed Rate** | **Floating rate** | **Total Loans and Leases Held for Investment** |
| Commercial and industrial | $ 19,238 | $ 625 | $ 33,992 | $ 41,111 | $ 30,043 | $ 125,009 |
| Commercial real estate | - | 6,334 | 22,027 | 26,626 | 94,112 | 149,099 |
| SBA | 160 | - | 412 | 2,333 | 22,955 | 25,860 |
| Consumer | 1,952 | 24 | 3,738 | 34,435 | 6,924 | 47,073 |
| Land and land development | 542 | 1,129 | 3,243 | 7,055 | 5,658 | 17,627 |
| Construction | 415 | 1,173 | 13,599 | - | - | 15,187 |
| Total principal amount of loans | $ 22,307 | $ 9,285 | $ 77,011 | $ 111,560 | $ 159,692 | $ 379,855 |

(1) Maturities are based on contractual maturities. Floating rate loans include loans that would reprice prior to maturity if base rates change.

Actual maturities may differ from the contractual maturities shown above as a result of renewals and prepayments. Loan renewals are evaluated in substantially the same manner as new credit applications.

**Provision for Credit Losses**

We provide for credit losses to maintain our allowance for credit losses at a level adequate to cover estimated probable losses inherent in the portfolio as of each balance sheet date. In 2015, we reversed previously recorded provisions for credit losses aggregating $400 thousand as a result of improved credit quality. This compared to a 2014 reversal of previously recorded provisions for credit losses aggregating $800 thousand as a result of improved credit quality. The provision for credit losses continues to remain low due to stable credit quality.

**Allowance for Credit Losses**

See Notes 1 and 5 of our Consolidated Financial Statements and "Accounting Policies" for further information concerning accounting policies associated with the allowance for credit losses.

The following table summarizes activity in the allowance for credit losses and certain ratios (dollars are in thousands):

## Analysis of Allowance for Credit Losses

| | For the Years ended December 31, | | | | |
|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2012** | **2011** |
| Balance of allowance for credit losses, beginning of period | $ 8,601 | $ 9,847 | $ 10,091 | $ 10,630 | $ 14,765 |
| **Charge-offs:** | | | | | |
| Commercial and industrial | (47) | - | (916) | (70) | (83) |
| Commercial real estate | - | (439) | (87) | (767) | (4,549) |
| SBA | (145) | (109) | - | (10) | (105) |
| Consumer | (43) | (42) | (106) | (58) | (1,049) |
| Land and land development | - | (190) | - | - | (731) |
| Construction | - | - | - | - | - |
| Total charge-offs | (235) | (780) | (1,109) | (905) | (6,517) |
| **Recoveries:** | | | | | |
| Commercial and industrial | 7 | - | 69 | 11 | 49 |
| Commercial real estate | 551 | 8 | 8 | 38 | 506 |
| SBA | 68 | 5 | 2 | 12 | 21 |
| Consumer | 19 | 21 | 15 | 18 | 34 |
| Land and land development | - | 300 | 71 | 187 | 67 |
| Construction | - | - | - | - | - |
| Total recoveries | 645 | 334 | 165 | 266 | 677 |
| Net recoveries (charge-offs) | 410 | (446) | (944) | (639) | (5,840) |
| Provision (reduction) for credit losses charged to operations | (400) | (800) | 700 | 100 | 1,625 |
| | 8,611 | 8,601 | 9,847 | 10,091 | 10,550 |
| Transferred from other loans held for sale | - | - | - | - | 80 |
| Balance of allowance for credit losses, end of period | $ 8,611 | $ 8,601 | $ 9,847 | $ 10,091 | $ 10,630 |
| Ratio of net recoveries (charge-offs) to average total loans | 0.103% | (0.123)% | (0.277)% | (0.182)% | (1.611)% |
| Ratio of net recoveries (charge-offs) to average loans and leases held for investment | 0.117% | (0.134)% | (0.332)% | (0.225)% | (1.780)% |
| Average gross loans and leases held for investment | $ 350,840 | $ 331,982 | $ 284,344 | $ 284,507 | $ 328,091 |
| Ratio of allowance for credit losses to loans and leases held for investment | 2.27% | 2.38% | 3.10% | 3.49% | 3.63% |
| Allowance for credit losses to total loans | 2.00% | 2.11% | 2.81% | 2.62% | 2.94% |
| Ratio of nonperforming loans to total assets | 0.06% | 0.01% | 0.67% | 1.36% | 0.93% |

### Allocation of the Allowance for Loan Losses

The table below presents an allocation of the allowance for credit losses among the various loan categories and sets forth the percentage of loans in each category to gross loans. The allocation of the allowance for credit losses as shown in the table should neither be interpreted as an indication of future charge-offs, nor as an indication that charge-offs in future periods will necessarily occur in these amounts or in the indicated proportions as of December 31 (dollars are in thousands).

| | 2015 | | 2014 | | 2013 | | 2012 | | 2011 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Allocation of Allowance | Loans as a % of Gross Loans Held for Investment | Allocation of Allowance | Loans as a % of Gross Loans Held for Investment | Allocation of Allowance | Loans as a % of Gross Loans Held for Investment | Allocation of Allowance | Loans as a % of Gross Loans Held for Investment | Allocation of Allowance | Loans as a % of Gross Loans Held for Investment |
| Commercial and industrial | $ 3,205 | 33% | $ 2,686 | 37% | $ 2,215 | 42% | $ 2,546 | 40% | $ 1,639 | 37% |
| Commercial real estate | 1,999 | 39% | 2,496 | 30% | 4,041 | 29% | 4,790 | 30% | 5,518 | 40% |
| SBA | 1,578 | 7% | 1,190 | 7% | 579 | 6% | 616 | 6% | 436 | 3% |
| Consumer | 640 | 12% | 516 | 11% | 478 | 10% | 382 | 9% | 448 | 8% |
| Land and land development | 1,041 | 5% | 1,436 | 8% | 2,371 | 9% | 1,609 | 11% | 2,532 | 10% |
| Construction | 148 | 4% | 277 | 7% | 163 | 4% | 148 | 4% | 57 | 2% |
| Total | $ 8,611 | 100% | $ 8,601 | 100% | $ 9,847 | 100% | $ 10,091 | 100% | $ 10,630 | 100% |

The amount of the allowance for losses can vary depending on macroeconomic conditions and risk in the portfolio. The allocation of the allowance for losses can vary depending on relative volume of asset groups in the portfolio and risks therein.

### Allowance for Credit Losses; Impact on Earnings

We have established the allowance for credit losses to cover probable losses inherent within the loan and lease portfolio at December 31, 2015 and December 31, 2014. The allowance for credit losses is an estimate based upon several judgmental factors. We are not aware of known trends, commitments or other events that could reasonably occur that would materially affect our methodology or the assumptions used to estimate the allowance for credit losses. However, changes in qualitative and quantitative factors could occur at any time and such changes could be of a material nature. In addition, economic situations, financial conditions of borrowers, and other factors we consider in arriving at our estimates may change. To the extent that these matters have negative developments, our future earnings could be reduced by provisions for credit losses.

## Nonperforming Loans and Assets

The following table sets forth nonperforming assets, the allowance for credit losses and certain related ratios (dollars are in thousands):

| | As of December 31, | | | | |
|---|---|---|---|---|---|
| | 2015 | 2014 | 2013 | 2012 | 2011 |
| **Nonperforming loans:** | | | | | |
| Loans 90 days or more delinquent and still accruing interest | $ 175 | $ 5 | $ 961 | $ 12 | $ - |
| Non-accrual loans | 390 | 56 | 4,656 | 10,500 | 6,169 |
| Total nonperforming loans | 565 | 61 | 5,617 | 10,512 | 6,169 |
| Other real estate, net | 242 | 256 | 1,056 | 5,131 | 10,145 |
| Total nonperforming assets | $ 807 | $ 317 | $ 6,673 | $ 15,643 | $ 16,314 |
| Allowance for credit losses | $ 8,611 | $ 8,601 | $ 9,847 | $ 10,091 | $ 10,630 |
| Ratio of total nonperforming loans to total loans | 0.13% | 0.01% | 1.60% | 2.73% | 1.70% |
| Ratio of total nonperforming loans to loans and leases held for investment | 0.15% | 0.02% | 1.77% | 3.63% | 2.10% |
| Ratio of total nonperforming assets to total assets | 0.09% | 0.03% | 0.79% | 2.03% | 2.45% |
| Ratio of nonperforming loans to total assets | 0.06% | 0.01% | 0.67% | 1.36% | 0.93% |
| Ratio of allowance for credit losses to total nonperforming loans | 1,524% | 14,100% | 175% | 96% | 172% |

## Nonperforming Loans

The following table sets forth information concerning our nonperforming loans as of December 31 (in thousands):

| | 2015 | 2014 |
|---|---|---|
| Balance, beginning of period | $ 61 | $ 5,617 |
| Additions to nonperforming | 1,178 | 203 |
| Charge-offs | (168) | (692) |
| Reclassified back to performing | (455) | (3,235) |
| Principal payments received | (51) | (1,135) |
| Transferred to other real estate | - | (697) |
| Balance, end of period | $ 565 | $ 61 |

In 2015, the level of nonperforming loans increased to $565 thousand from $61 thousand at December 31, 2014. The outstanding balance of $565 thousand is comprised of 8 relationships with balances ranging from $5 thousand to $208 thousand.

The following table indicates the effect on income if interest on non-accrual and restructured loans outstanding at year end had been recognized at original contractual rates during the year ended December 31 (in thousands):

| | 2015 | 2014 |
|---|---|---|
| Interest income that would have been recorded | $ 236 | $ 483 |
| Interest income recorded | 93 | 145 |
| Effect on interest income | $ 143 | $ 338 |

**Loans 90 days or more delinquent and still accruing interest** include loans over 90 days past due which we believe, based on our specific analysis of the loans, do not present doubt about the collection of interest and principal in accordance with the loan contract. Loans in this category must be well secured and in the process of collection.

**Non-accrual loans** include loans on which the accrual of interest has been discontinued. Accrual of interest is discontinued when we believe that the borrower's financial condition is such that the collection of interest is doubtful. A delinquent loan is generally placed on non-accrual status when it becomes 90 days or more past due unless the loan is well secured and in the process of collection. When a loan is placed on non-accrual status, accrued but uncollected interest income applicable to the current reporting period is reversed against interest income. Accrued but uncollected interest income applicable to previous reporting periods is charged against the allowance for credit losses. No additional interest is accrued on the loan balance until the collection of both principal and interest becomes reasonably certain.

**Troubled Debt Restructuring (TDR)**
The table below summarizes the amounts of restructured loans as of December 31 (in thousands):

| | Total | Accrual | Non-accrual |
|---|---|---|---|
| 2015 | $ 2,197 | $ 1,884 | $ 313 |
| 2014 | 5,105 | 5,105 | - |
| 2013 | 8,544 | 4,356 | 4,188 |
| 2012 | 12,368 | 7,871 | 4,497 |
| 2011 | 12,848 | 7,270 | 5,578 |

See Note 5 of our Consolidated Financial Statements for information on troubled debt restructuring.

**Other real estate owned and repossessed assets** represent properties and other assets acquired through, or in lieu of, loan foreclosure, and property transferred from premises and equipment. They are initially recorded at fair value less cost to sell at the date of acquisition establishing a new cost basis. Write-downs to fair value at the time of acquisition are charged to the allowance for credit losses. After foreclosure, we perform valuations periodically and the real estate is recorded at fair value less cost to sell. Reductions to other real estate owned and repossessed assets are considered valuation allowances. Expenses incurred to record valuation allowances subsequent to foreclosure are charged to non-interest expense.

See Note 6 of our Consolidated Financial Statements for information on other real estate owned.

**Impaired loans**
See Note 5 of our Consolidated Financial Statements for information on impaired loans.

**Potential Problem Loans**
We attempt to quantify potential problem loans with more immediate credit risk. We estimate there are loans risk rated "watch list" which are not impaired aggregating $7.9 million and $473,000 at December 31, 2015 and 2014, respectively. Also, we estimate there are loans risk rated "substandard" which are not impaired aggregating $9.4 million and $9.1 million at December 31, 2015 and 2014, respectively.

A significant portion of these potential problem loans are not in default but may have characteristics such as recent adverse operating cash flows or general risk characteristics that the loan officer feels might jeopardize the future timely collection of principal and interest payments. The ultimate resolution of these credits is subject to changes in economic conditions and other factors. These loans are closely monitored to ensure that our position as creditor is protected to the fullest extent possible.

## Liabilities and Stockholders' Equity

The following table presents our liabilities and stockholders' equity (dollars are in thousands):

| | As of December 31, | | Increase (Decrease) 2015 – 2014 | | |
|---|---|---|---|---|---|
| | 2015 | 2014 | $ | % | |
| Deposits: | | | | | |
| Non-interest-bearing | $ 168,259 | $ 187,400 | $ (19,141) | (10) % | (a) |
| Interest-bearing- | | | | | |
| Savings, interest checking and money market | 460,385 | 455,282 | 5,103 | 1 % | (a) |
| Time deposits under $100,000 | 86,817 | 107,668 | (20,851) | (19) % | (a) |
| Time deposits $100,000 and over | 64,988 | 60,881 | 4,107 | 7 % | (a) |
| Short-term borrowings | 13,851 | 16,002 | (2,151) | (13) % | (b) |
| Federal Home Loan Bank advances | 7,300 | - | 7,300 | 100 % | (c) |
| Long-term borrowings | 10,000 | - | 10,000 | 100 % | (d) |
| Guaranteed preferred beneficial interests in Company's subordinated debentures | 15,015 | 15,018 | (3) | - % | |
| Accrued interest payable | 487 | 338 | 149 | 44 % | |
| Accrued expenses | 7,398 | 7,279 | 119 | 2 % | |
| Other liabilities | 758 | 1,063 | (305) | (29) % | (e) |
| Total liabilities | 835,258 | 850,931 | (15,673) | (2) % | |
| Stockholders' equity | 68,988 | 83,488 | (14,500) | (17) % | (f) |
| Total liabilities and stockholders' equity | $ 904,246 | $ 934,419 | $ (30,173) | (3) % | |

(a) Total deposits have decreased as customers deployed funds previously deposited in our North Dakota branches and the redemption of $20.0 million in brokered certificates of deposit.
(b) Short term borrowings will vary depending on our customers need to use repurchase agreements.
(c) The Company borrows on a short-term basis from the Federal Home Loan Bank as a source of liquidity.
(d) BNC issued $10.0 million of subordinated debt issued to partially fund the redemption of the Company's Preferred Stock in the fourth quarter of 2015.
(e) Other liabilities decreased primarily due to changes in the value of mortgage banking derivatives.
(f) The increase in stockholders' equity from retained earnings was offset by the redemption of $21 million of preferred stock resulting in a net decrease of stockholders' equity. Managing capital has been a focus of management in recent periods and this will continue in the future.

## Mortgage Banking Obligations

Included in accrued expenses is an estimate of mortgage banking reimbursement obligations which aggregated $1.8 million and $1.9 million at December 31, 2015 and 2014, respectively. Although we sell mortgage banking loans without recourse, industry standards require standard representations and warranties which require sellers to reimburse investors for economic losses if loans default or prepay after the sale. Repurchase risk is also evident within the mortgage banking industry as disputes arise between lenders and investors. Such requests for repurchase are commonly due to purported fraudulent or faulty representations and generally emerge at varied timeframes subsequent to the original sale of the loan. To estimate the obligation, we track historical reimbursements and calculate the ratio of reimbursement to loan production volumes. Using reimbursement ratios and recent production levels, we estimate the future reimbursement amounts and record the estimated obligation. See Note 18 of our Consolidated Financial Statements for a description of financial instruments with off-balance-sheet risk.

## Deposits

The following table sets forth, for the periods indicated, the distribution of our average deposit account balances and average cost of funds rates on each category of deposits (dollars are in thousands):

| | For the Years Ended December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2015 | | | 2014 | | | 2013 | | |
| | Average balance | Percent of deposits | Wgtd. avg. rate | Average balance | Percent of deposits | Wgtd. avg. rate | Average balance | Percent of deposits | Wgtd. avg. rate |
| Interest checking and MMDAs | $ 430,838 | 55.41% | 0.12% | $ 409,519 | 52.96% | 0.13% | $ 341,128 | 49.68% | 0.17% |
| Savings deposits | 29,724 | 3.82% | 0.03% | 24,249 | 3.14% | 0.04% | 19,857 | 2.89% | 0.08% |
| Time deposits (CDs): | | | | | | | | | |
| CDs under $100,000 | 93,169 | 11.98% | 1.41% | 113,769 | 14.71% | 1.27% | 125,641 | 18.30% | 1.22% |
| CDs $100,000 and over | 59,999 | 7.72% | 0.49% | 77,812 | 10.06% | 0.54% | 81,196 | 11.83% | 0.66% |
| Total time deposits | 153,168 | 19.70% | 1.05% | 191,581 | 24.78% | 0.97% | 206,837 | 30.12% | 1.39% |
| Total interest-bearing deposits | 613,730 | 78.94% | 0.35% | 625,349 | 80.87% | 0.39% | 567,822 | 82.70% | 0.47% |
| Non-interest-bearing demand deposits | 163,755 | 21.06% | - | 147,884 | 19.13% | - | 118,783 | 17.30% | - |
| Total deposits (1) | $ 777,485 | 100.00% | 0.28% | $ 773,233 | 100.00% | 0.31% | $ 686,605 | 100.00% | 0.39% |

(1) Included in average total deposits are $41.0 million, $57.0 million, and $65.0 million of average brokered deposits for the years ending 2015, 2014, and 2013, respectively. The brokered deposits are callable at the Company's discretion and are maintained as a hedge against rising interest rates. Excluding brokered deposits our weighted average rate of total deposits would be 0.16%, 0.17%, and 0.23% for 2015, 2014, and 2013, respectively.

In recent years, we have grown deposits, primarily by capitalizing on strong relationships built over time in North Dakota.

Time deposits, in denominations of $100,000 and over, totaled $65.0 million at December 31, 2015 as compared to $60.9 million at December 31, 2014. The following table sets forth the amount and maturities of time deposits of $100,000 and over as of December 31, 2015 (in thousands):

| **Maturing in:** | | |
|---|---|---|
| 3 months or less | $ | 19,688 |
| Over 3 months through 6 months | | 13,614 |
| Over 6 months through 12 months | | 12,760 |
| Over 12 months | | 18,926 |
| | $ | 64,988 |

## Borrowed Funds

The following table provides a summary of our short-term borrowings and related cost information as of, or for the years ended, December 31 (dollars are in thousands):

| | 2015 | 2014 | 2013 |
|---|---|---|---|
| Short-term borrowings outstanding at period end | $ 13,851 | $ 16,002 | $ 19,967 |
| Weighted average interest rate at period end | 0.14% | 0.15% | 0.17% |
| Maximum month end balance during the period | $ 20,799 | $ 24,833 | $ 27,071 |
| Average borrowings outstanding for the period | $ 16,299 | $ 20,575 | $ 18,948 |
| Weighted average interest rate for the period | 0.16% | 0.17% | 0.22% |

Note 9 of our Consolidated Financial Statements summarizes the general terms of our short-term borrowings outstanding at December 31, 2015 and 2014.

FHLB advances totaled $7.3 million at December 31, 2015 and $0 at December 31, 2014, respectively.

Notes 10, 11 and 12 of our Consolidated Financial Statements summarize the general terms of our FHLB advances, long-term borrowings and other borrowings at December 31, 2015 and 2014.

**Guaranteed Preferred Beneficial Interests in Company's Subordinated Debentures**
See Note 13 of our Consolidated Financial Statements for a description of the subordinated debentures.

**Capital Resources**

| | 2015 | 2014 | 2013 | 2012 | 2011 |
|---|---|---|---|---|---|
| Tier 1 leverage (Consolidated) | 9.00% | 9.94% | 10.94% | 11.17% | 7.59% |
| Total risk based capital (Consolidated) | 20.07% | 21.10% | 23.15% | 22.43% | 17.56% |
| Common equity tier 1 risk based capital (Consolidated) | 13.57% | N/A | N/A | N/A | N/A |
| Tier 1 risk based capital (Consolidated) | 16.72% | 19.85% | 21.67% | 20.49% | 13.71% |
| Tangible common equity (Consolidated) | 7.62% | 6.67% | 5.79% | 6.21% | 3.17% |
| Tier 1 leverage (BNC Bank) | 9.45% | 9.13% | 10.06% | 10.68% | 9.41% |
| Total risk based capital (BNC Bank) | 18.71% | 19.73% | 21.40% | 21.06% | 18.22% |
| Common equity tier 1 risk based capital (BNC Bank) | 17.45% | N/A | N/A | N/A | N/A |
| Tier 1 risk based capital (BNC Bank) | 17.45% | 18.48% | 20.13% | 19.80% | 16.95% |

See Note 14 and Note 15 of our Consolidated Financial Statements for a discussion of stockholders equity and regulatory capital and the current operating environment.

In July of 2013, the Federal Reserve issued new regulatory capital standards for community banks which incorporate some of the capital requirements addressed in the Basel III framework and became effective January 1, 2015. The new common equity tier 1 (CET 1) ratio, which is generally a comparison of a bank's core equity capital with its total risk weighted assets, is a measure of the current risk profile of our asset base from a regulatory perspective. The Tier 1 leverage ratio, which is calculated by dividing Tier 1 capital by average total assets, does not consider the mix of risk weighted assets. In recent periods, regulators have required Tier 1 ratios that significantly exceed the "Well Capitalized" ratio levels. As such, we are managing our Tier 1 leverage ratio to levels significantly above the "Well Capitalized" thresholds as evidenced in the table below. Although Tangible Common Equity (TCE) is not a regulatory capital measure, TCE is a ratio that is commonly used to assess the capital strength of banking entities. Accordingly, we have included the ratio in the regulatory capital table below.

The Company routinely evaluates the sufficiency of capital in order to insure compliance with regulatory capital standards and be a source of strength for the Bank. We manage capital by assessing the composition of capital and amounts available for growth, risk or other purposes. In recent periods, capital has grown through retention of earnings and the Company has reduced certain higher cost forms of capital such as the redemption in 2014 of $7.5 million in Guaranteed Preferred Beneficial Interests in Subordinated Debt costing 12.05% and the redemption in 2015 of $21.1 million of Series A and B Preferred Stock costing 9%. Management will continue to evaluate capital requirements and prudent capital management opportunities. See Note 13 and Note 14 of our Consolidated Financial Statements for a detailed description of Subordinated Debentures and Preferred Stock.

**Off-Balance-Sheet Arrangements**
In the normal course of business, we are a party to various financial instruments with off-balance-sheet risk. These instruments include commitments to extend credit, commercial letters of credit, performance and financial standby letters of credit and interest rate swaps, caps and floors. Such instruments help us to meet the needs of our customers, manage our interest rate risk and effectuate various transactions. These instruments and commitments, which we enter into for purposes other than trading, carry varying degrees of credit, interest rate or liquidity risk. See Notes 18 and 19 of our Consolidated Financial Statements for a detailed description of each of these instruments.

## Contractual Obligations, Contingent Liabilities and Commitments

We are a party to financial instruments with risks that can be subdivided into two categories:

Cash financial instruments, generally characterized as on-balance-sheet items, include investments, loans, mortgage-backed securities, deposits and debt obligations.

Credit-related financial instruments, generally characterized as off-balance-sheet items, include such instruments as commitments to extend credit, commitments to sell mortgage loans, commercial letters of credit and performance and financial standby letters of credit. See Note 19 of our Consolidated Financial Statements.

At December 31, 2015, the aggregate contractual obligations (excluding bank deposits) and commitments were as follows (in thousands):

| | Payments due by period | | | | |
|---|---|---|---|---|---|
| **Contractual Obligations:** | **Less than 1 year** | **1 to 3 years** | **3 to 5 years** | **After 5 years** | **Total** |
| Total borrowings | $ 21,151 | $ - | $ - | $ 25,015 | $ 46,166 |
| Commitments to sell loans | 49,307 | - | - | - | 49,307 |
| Annual rental commitments under non-cancelable operating leases | 900 | 1,109 | 651 | 1,134 | 3,794 |
| Total | $ 71,358 | $ 1,109 | $ 651 | $ 26,149 | $ 99,267 |

| | Amount of Commitment - Expiration by Period | | | | |
|---|---|---|---|---|---|
| **Other Commitments:** | **Less than 1 year** | **1 to 3 years** | **3 to 5 years** | **After 5 years** | **Total** |
| Commitments to originate loans | $ 137,437 | $ - | $ 2,797 | $ 456 | $ 140,690 |
| Commitments to sell loans | 143,569 | - | - | - | 143,569 |
| Standby and commercial letters of credit | 1,281 | - | 13 | - | 1,294 |
| Total | $ 282,287 | $ - | $ 2,810 | $ 456 | $ 285,553 |

## Liquidity Risk Management

Liquidity risk is the possibility of being unable to meet all present and future financial obligations in a timely manner. Liquidity risk management encompasses our ability to meet all present and future financial obligations in a timely manner. The objectives of our liquidity management policies are to maintain adequate liquid assets, liability diversification among instruments, maturities and customers and a presence in both the wholesale purchased funds market and the retail deposit market.

The Consolidated Statements of Cash Flows in the Consolidated Financial Statements present data on cash and cash equivalents provided by and used in operating, investing and financing activities. In addition to liquidity from core deposit growth, together with repayments and maturities of loans and investments, we utilize brokered deposits, sell securities under agreements to repurchase and borrow overnight Federal funds. The Bank is a member of the FHLB of Des Moines. Advances from the FHLB are collateralized by the Bank's mortgage loans and various investment securities. We have also obtained funding through the issuance of subordinated notes, subordinated debentures and long-term borrowings.

Our liquidity is defined by our ability to meet our cash and collateral obligations at a reasonable cost and with a minimum loss of income. Given the uncertain nature of our customers' demands as well as our desire to take advantage of earnings enhancement opportunities, we must have adequate sources of on- and off-balance-sheet funds that can be acquired in time of need.

We measure our liquidity position on an as needed basis, but no less frequently than monthly. We measure our liquidity position using the total of the following items:

1. Estimated liquid assets less estimated volatile liabilities using the aforementioned methodology ($198.8 million as of December 31, 2015);
2. Borrowing capacity from the FHLB ($77.6 million as of December 31, 2015); and
3. Capacity to issue brokered deposits with maturities of less than 12 months ($127.1 million as of December 31, 2015).

On an on-going basis, we use a variety of factors to assess our liquidity position including, but not limited to, the following items:

- Stability of our deposit base,
- Amount of pledged investments,
- Amount of unpledged investments,
- Liquidity of our loan portfolio, and
- Potential loan demand.

Our liquidity assessment process segregates our balance sheet into liquid assets and short-term liabilities assumed to be vulnerable to non-replacement over a 30 day horizon in abnormally stringent conditions. Assumptions for the vulnerable short-term liabilities are based upon historical factors. We have a targeted range for our liquidity position over this horizon and manage operations to achieve these targets.

We further project cash flows over a 12 month horizon based on our assets and liabilities and sources and uses of funds for anticipated events.

Pursuant to our contingency funding plan, we also estimate cash flows over a 12 month horizon under a variety of stressed scenarios to identify potential funding needs and funding sources. Our contingency plan identifies actions that could be taken in response to adverse liquidity events.

We believe this process, combined with our policies and guidelines, should provide for adequate levels of liquidity to fund the anticipated needs of on- and off- balance sheet items.

## Forward-Looking Statements

Statements included in "Management's Discussion and Analysis of Financial Condition and Results of Operations" which are not historical in nature are intended to be, and are hereby identified as "forward-looking statements" for purposes of the safe harbor provided by Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. We caution readers that these forward-looking statements, including without limitation, those relating to our future business prospects, revenues, working capital, liquidity, capital needs, interest costs, income and expenses, are subject to certain risks and uncertainties that could cause actual results to differ materially from those indicated in the forward-looking statements due to several important factors. These factors include, but are not limited to: risks of loans and investments, including dependence on local and regional economic conditions; the impact of lower oil prices in our major market; competition for our customers from other providers of financial services; possible adverse effects of changes in interest rates including the effects of such changes on derivative contracts and associated accounting consequences; risks associated with our acquisition and growth strategies; and other risks which are difficult to predict and many of which are beyond our control.

## Recently Issued and Adopted Accounting Pronouncements

Note 1 of our Consolidated Financial Statements includes a summary of recently issued and adopted accounting pronouncements and their related or anticipated impact on the Company.

## Accounting Policies

Note 1 of our Consolidated Financial Statements includes a summary of our accounting policies and their related impact on the Company.

## Quantitative and Qualitative Disclosures About Market Risk

Market risk arises from changes in interest rates, exchange rates, and commodity prices and equity prices and represents the possibility that changes in future market rates or prices will have a negative impact on our earnings or value. Our principal market risk is interest rate risk.

Interest rate risk arises from changes in interest rates. Interest rate risk can result from: (1) Repricing risk – timing differences in the maturity/repricing of assets, liabilities, and off-balance-sheet contracts; (2) Options risk – the effect of embedded options, such as loan prepayments, interest rate caps/floors, and deposit withdrawals; (3) Basis risk – risk resulting from unexpected changes in the spread between two or more different rates of similar maturity, and the resulting impact on the behavior of lending and funding rates; and (4) Yield curve risk – risk resulting from unexpected changes in the spread between two or more rates of different maturities from the same type of instrument. We have risk management policies to monitor and limit exposure to interest rate risk. To date we have not conducted trading activities as a means of managing interest rate risk. Our asset/liability management process is utilized to manage our interest rate risk. The measurement of interest rate risk associated with financial instruments is meaningful only when all related and offsetting on-and off-balance-sheet transactions are aggregated, and the resulting net positions are identified.

Our interest rate risk exposure is actively managed with the objective of managing the level and potential volatility of net interest income in addition to the long-term growth of equity, bearing in mind that we will always be in the business of taking on rate risk and that rate risk immunization is not entirely possible. Also, it is recognized that as exposure to interest rate risk is reduced, so too may the overall level of net interest income and equity. In general, the assets and liabilities generated through ordinary business activities do not naturally create offsetting positions with respect to repricing or maturity characteristics. Access to the derivatives market can be an important element in maintaining our interest rate risk position within policy guidelines. Using derivative instruments, principally interest rate floors, caps, and interest rate swaps, the interest rate sensitivity of specific transactions, as well as pools of assets or liabilities, can be adjusted to maintain the desired interest rate risk profile. See Note 1 of our Consolidated Financial Statements for a summary of our accounting policies pertaining to such instruments.

Our primary tool for measuring and managing interest rate risk is net interest income simulation. This exercise includes our assumptions regarding the changes in interest rates and the impact on our current balance sheet. Interest rate caps and floors are included to the extent that they are exercised in the 12-month simulation period. Additionally, changes in prepayment behavior of the residential mortgage, CMOs, and mortgage-backed securities portfolios in each rate environment are captured using industry estimates of prepayment speeds for various coupon segments of the portfolio. For purposes of this simulation, projected month end balances of the various balance sheet accounts are held constant at their December 31, 2015 levels. Cash flows from a given account are reinvested back into the same account so as to keep the month end balance constant at its December 31, 2015 level. The static balance sheet assumption is made so as to project the interest rate risk to net interest income embedded in the existing balance sheet. With knowledge of the balance sheet's existing net interest income profile, more informed strategies and tactics may be developed as it relates to the structure/mix of growth.

We monitor the results of net interest income simulation on a regular basis. Net interest income is generally simulated for the upcoming 12-month horizon in seven interest rate scenarios. The scenarios generally modeled are parallel interest rate ramps of +/- 100bp, 200bp, and 300bp along with a rates unchanged scenario. Given the current low absolute level of interest rates as of December 31, 2015, the downward scenarios for interest rate movements is limited to -100bp but a +400bp scenario has been added. The parallel movement of interest rates means all projected market interest rates move up or down by the same amount. A ramp in interest rates means that the projected change in market interest rates occurs over the 12-month horizon on a pro-rata basis. For example, in the +100bp scenario, the projected Prime rate is projected to increase from 3.50% to 4.50% 12 months later. The Prime rate in this example will increase 1/12th of the overall increase of 100 basis points each month.

The net interest income simulation result for the 12-month horizon that covers the calendar year of 2015 is shown below:

**Net Interest Income Simulation**

| Movement in interest rates | -100bp | Unchanged | +100bp | +200bp | +300bp | +400bp |
|---|---|---|---|---|---|---|
| Projected 12-month net interest income | $ 25,180 | $ 26,297 | $ 26,052 | $ 25,806 | $ 25,546 | $ 25,275 |
| Dollar change from unchanged scenario | $ (1,117) | - | $ (245) | $ (491) | $ (751) | $ (1,022) |
| Percentage change from unchanged scenario | (4.25)% | - | (0.93)% | (1.87)% | (2.86)% | (3.89)% |

Since there are limitations inherent in any methodology used to estimate the exposure to changes in market interest rates, these analyses are not intended to be a forecast of the actual effect of changes in market interest rates such as those indicated above on the Company. Further, these analyses are based on our assets and liabilities as of December 31, 2015 (without forward adjustments for planned growth and anticipated business activities) and do not contemplate any actions we might undertake in response to changes in market interest rates.

Static gap analysis is another tool that may be used for interest rate risk measurement. The net differences between the amount of assets, liabilities, equity and off-balance-sheet instruments repricing within a cumulative calendar period is typically referred to as the "rate sensitivity position" or "gap position." The following table sets forth our rate sensitivity position as of December 31, 2015. Assets and liabilities are classified by the earliest possible repricing date or maturity, whichever occurs first.

## Interest Sensitivity Gap Analysis

| | Estimated maturity or repricing at December 31, 2015 | | | | |
|---|---|---|---|---|---|
| | 0–3 Months | 4–12 Months | 1–5 Years | Over 5 years | Total |
| | (dollars are in thousands) | | | | |
| **Interest-earning assets:** | | | | | |
| Interest-bearing deposits with banks | $ 15,189 | $ - | $ - | $ - | $ 15,189 |
| Investment securities (a) | 112,014 | 15,575 | 122,605 | 135,778 | 385,972 |
| FRB and FHLB stock | 3,219 | - | - | - | 3,219 |
| Fed funds sold | - | - | - | - | - |
| Loans held for sale-mortgage banking, fixed rate | - | 50,445 | - | - | 50,445 |
| Loans held for sale-mortgage banking, floating rate | - | - | - | - | - |
| Loans held for investment, fixed rate | 12,671 | 26,615 | 68,425 | 26,765 | 134,476 |
| Loans held for investment, floating rate | 91,189 | 13,491 | 123,849 | 16,898 | 245,427 |
| Total interest-earning assets | $ 234,282 | $ 106,126 | $ 314,879 | $ 179,441 | $ 834,728 |
| **Interest-bearing liabilities:** | | | | | |
| Interest checking and money market accounts | $ 429,097 | $ - | $ - | $ - | $ 429,097 |
| Savings | 31,288 | - | - | - | 31,288 |
| Time deposits under $100,000 | 12,509 | 22,418 | 23,003 | 28,887 | 86,817 |
| Time deposits $100,000 and over | 26,253 | 26,373 | 12,159 | 203 | 64,988 |
| Short-term borrowings | 13,851 | - | - | - | 13,851 |
| FHLB advances | 7,300 | - | - | - | 7,300 |
| Long-term borrowings | - | - | - | 10,000 | 10,000 |
| Subordinated debentures | 15,000 | - | - | 15 | 15,015 |
| Total interest-bearing liabilities | $ 535,298 | $ 48,791 | $ 35,162 | $ 39,105 | $ 658,356 |
| Interest rate gap | $ (301,016) | $ 57,335 | $ 279,717 | $ 140,336 | $ 176,372 |
| Cumulative interest rate gap at December 31, 2015 | $ (301,016) | $ (243,681) | $ 36,036 | $ 176,372 | |
| Cumulative interest rate gap to total assets | (33.29%) | (26.95%) | 3.99% | 19.50% | |

(a) Values for investment securities reflect the timing of the estimated principal cash flows from the securities based on par values, which vary from the amortized cost and fair value of our investments.

The table assumes that all savings and interest-bearing demand deposits reprice in the earliest period presented, however, we believe a significant portion of these accounts constitute a core component and are generally not rate sensitive. Our position is supported by the fact that reductions in interest rates paid on these deposits historically have not caused notable reductions in balances in net interest income because the repricing of certain assets and liabilities is discretionary and is subject to competitive and other pressures. As a result, assets and liabilities indicated as repricing within the same period may in fact reprice at different times and at different rate levels.

Static gap analysis does not fully capture the impact of embedded options, lagged interest rate changes, administered interest rate products, or certain off-balance-sheet sensitivities to interest rate movements. Therefore, this tool generally cannot be used in isolation to determine the level of interest rate risk exposure in banking institutions.

Since there are limitations inherent in any methodology used to estimate the exposure to changes in market interest rates, these analyses are not intended to be a forecast of the actual effect of changes in market interest rates such as those indicated above on the Company. Further, these analyses are based on our assets and liabilities as of December 31, 2015 and do not contemplate any actions we might undertake in response to changes in market interest rates.

# INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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# Independent Auditors' Report

The Board of Directors
BNCCORP, INC.

We have audited the accompanying consolidated financial statements of BNCCORP, INC., and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

***Management's Responsibility for the Financial Statements***

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

***Auditors' Responsibility***

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

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

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

KPMG

*Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of BNCCORP, INC., and its subsidiaries as of December 31, 2015 and 2014, and the results of their operations and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Omaha, Nebraska
March 25, 2016

# FINANCIAL INFORMATION
## Financial Statements
### BNCCORP, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
As of December 31
(In thousands, except share data)

| | 2015 | 2014 |
|---|---|---|
| **ASSETS** | | |
| CASH AND CASH EQUIVALENTS | $ 15,189 | $ 41,124 |
| INVESTMENT SECURITIES AVAILABLE FOR SALE | 419,346 | 449,333 |
| FEDERAL RESERVE BANK AND FEDERAL HOME LOAN BANK STOCK | 3,219 | 2,817 |
| LOANS HELD FOR SALE-MORTGAGE BANKING | 50,445 | 47,109 |
| LOANS AND LEASES HELD FOR INVESTMENT | 379,903 | 360,789 |
| ALLOWANCE FOR CREDIT LOSSES | (8,611) | (8,601) |
| Net loans and leases held for investment | 371,292 | 352,188 |
| OTHER REAL ESTATE, net | 242 | 256 |
| PREMISES AND EQUIPMENT, net | 17,574 | 16,228 |
| ACCRUED INTEREST RECEIVABLE | 4,027 | 3,931 |
| OTHER | 22,912 | 21,433 |
| Total assets | $ 904,246 | $ 934,419 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| DEPOSITS: | | |
| Non-interest-bearing | $ 168,259 | $ 187,400 |
| Interest-bearing – | | |
| Savings, interest checking and money market | 460,385 | 455,282 |
| Time deposits under $100,000 | 86,817 | 107,668 |
| Time deposits $100,000 and over | 64,988 | 60,881 |
| Total deposits | 780,449 | 811,231 |
| SHORT-TERM BORROWINGS | 13,851 | 16,002 |
| FEDERAL HOME LOAN BANK ADVANCES | 7,300 | - |
| LONG-TERM BORROWINGS | 10,000 | - |
| GUARANTEED PREFERRED BENEFICIAL INTERESTS IN COMPANY'S SUBORDINATED DEBENTURES | 15,015 | 15,018 |
| ACCRUED INTEREST PAYABLE | 487 | 338 |
| ACCRUED EXPENSES | 7,398 | 7,279 |
| OTHER | 758 | 1,063 |
| Total liabilities | 835,258 | 850,931 |
| STOCKHOLDERS' EQUITY: | | |
| Preferred stock, $.01 par value – Authorized 2,000,000 shares: | | |
| Preferred stock - 9% Series A 20,093 shares; | - | 20,093 |
| Preferred stock - 9% Series B 1,005 shares; | - | 1,005 |
| Common stock, $.01 par value – Authorized 35,000,000 shares; 3,428,416 and 3,413,854 shares issued and outstanding | 34 | 34 |
| Capital surplus – common stock | 25,979 | 25,831 |
| Retained earnings | 42,172 | 34,622 |
| Treasury stock (240,237 and 254,799 shares, respectively) | (3,278) | (3,421) |
| Accumulated other comprehensive income, net | 4,081 | 5,324 |
| Total stockholders' equity | 68,988 | 83,488 |
| Total liabilities and stockholders' equity | $ 904,246 | $ 934,419 |

See accompanying notes to consolidated financial statements.

**BNCCORP, INC. AND SUBSIDIARIES**
Consolidated Statements of Operations
For the Years Ended December 31
(In thousands, except per share data)

| | 2015 | 2014 |
|---|---|---|
| INTEREST INCOME: | | |
| Interest and fees on loans | $ 18,610 | $ 17,614 |
| Interest and dividends on investments | | |
| Taxable | 6,480 | 9,295 |
| Tax-exempt | 2,706 | 2,241 |
| Dividends | 119 | 114 |
| Total interest income | 27,915 | 29,264 |
| INTEREST EXPENSE: | | |
| Deposits | 2,148 | 2,413 |
| Short-term borrowings | 26 | 36 |
| Federal Home Loan Bank advances | 10 | 1 |
| Long-term borrowings | 128 | 36 |
| Subordinated debentures | 258 | 822 |
| Total interest expense | 2,570 | 3,308 |
| Net interest income | 25,345 | 25,956 |
| PROVISION (REDUCTION) FOR CREDIT LOSSES | (400) | (800) |
| NET INTEREST INCOME AFTER PROVISION (REDUCTION) FOR CREDIT LOSSES | 25,745 | 26,756 |
| NON-INTEREST INCOME: | | |
| Bank charges and service fees | 2,901 | 2,962 |
| Wealth management revenues | 1,476 | 1,384 |
| Mortgage banking revenues, net | 16,214 | 11,818 |
| Gains on sales of loans, net | 1,138 | 1,915 |
| Gains on sales of securities, net | 1,655 | 53 |
| Other | 1,566 | 2,322 |
| Total non-interest income | 24,950 | 20,454 |
| NON-INTEREST EXPENSE: | | |
| Salaries and employee benefits | 19,692 | 17,783 |
| Professional services | 3,923 | 3,032 |
| Data processing fees | 3,059 | 2,932 |
| Marketing and promotion | 3,523 | 2,974 |
| Occupancy | 1,981 | 2,064 |
| Regulatory costs | 696 | 640 |
| Depreciation and amortization | 1,415 | 1,268 |
| Office supplies and postage | 648 | 687 |
| Other real estate costs | 18 | 72 |
| Other | 2,589 | 3,231 |
| Total non-interest expense | 37,544 | 34,683 |
| Income before income taxes | 13,151 | 12,527 |
| Income tax expense | 3,945 | 4,071 |
| Net income | 9,206 | 8,456 |
| Preferred stock costs | 1,656 | 1,796 |
| Net income available to common shareholders | $ 7,550 | $ 6,660 |
| Basic earnings per common share | $ 2.23 | $ 1.98 |
| Diluted earnings per common share | $ 2.16 | $ 1.91 |

See accompanying notes to consolidated financial statements.

**BNCCORP, INC. AND SUBSIDIARIES**

Consolidated Statements of Comprehensive Income
For the Years Ended December 31
(In thousands)

| | 2015 | | 2014 | |
|---|---|---|---|---|
| NET INCOME | | $ 9,206 | | $ 8,456 |
| Unrealized (loss) gain on securities available for sale | $ (350) | | $ 10,910 | |
| Reclassification adjustment for gains included in net income | (1,655) | | (53) | |
| Other comprehensive (loss) income before tax | (2,005) | | 10,857 | |
| Income tax benefit (expense) related to items of other comprehensive (loss) income | 762 | | (4,065) | |
| Other comprehensive (loss) income | (1,243) | (1,243) | 6,792 | 6,792 |
| TOTAL COMPREHENSIVE INCOME | | $ 7,963 | | $ 15,248 |

See accompanying notes to consolidated financial statements.

## BNCCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Stockholders' Equity

For the Years Ended December 31

(In thousands, except share data)

| | Preferred Stock | | Common Stock | | Capital Surplus Common | Retained | Treasury | Accumulated Other Comprehensive | |
|---|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | Stock | Earnings | Stock | Income (Loss) | Total |
| BALANCE, December 31, 2013 | 21,098 | $ 21,098 | 3,374,601 | $ 34 | $ 26,133 | $ 27,962 | $ (3,894) | $ (1,468) | $ 69,865 |
| Net income | - | - | - | - | - | 8,456 | - | - | 8,456 |
| Other comprehensive income | - | - | - | - | - | - | - | 6,792 | 6,792 |
| Dividend on preferred stock | - | - | - | - | - | (1,796) | - | - | (1,796) |
| Impact of share-based compensation | - | - | 39,253 | - | (302) | - | 473 | - | 171 |
| BALANCE, December 31, 2014 | 21,098 | $ 21,098 | 3,413,854 | $ 34 | $ 25,831 | $ 34,622 | $ (3,421) | $ 5,324 | $ 83,488 |
| Net income | - | - | - | - | - | 9,206 | - | - | 9,206 |
| Other comprehensive loss | - | - | - | - | - | - | - | (1,243) | (1,243) |
| Redemption of preferred stock | (21,098) | (21,098) | - | - | - | - | - | - | (21,098) |
| Dividend on preferred stock | - | - | - | - | - | (1,656) | - | - | (1,656) |
| Impact of share-based compensation | - | - | 14,562 | - | 148 | - | 143 | - | 291 |
| BALANCE, December 31, 2015 | - | $ - | 3,428,416 | $ 34 | $ 25,979 | $ 42,172 | $ (3,278) | $ 4,081 | $ 68,988 |

See accompanying notes to consolidated financial statements

**BNCCORP, INC. AND SUBSIDIARIES**
Consolidated Statements of Cash Flows
For the Years Ended December 31
(In thousands)

| | 2015 | 2014 |
|---|---|---|
| OPERATING ACTIVITIES: | | |
| Net income | $ 9,206 | $ 8,456 |
| Adjustments to reconcile net income to net cash provided by operating activities - | | |
| Reduction for credit losses | (400) | (800) |
| Provision for other real estate losses | 14 | - |
| Depreciation and amortization | 1,415 | 1,268 |
| Net amortization of premiums and (discounts) on investment securities and subordinated debentures | 8,152 | 6,023 |
| Share-based compensation | 291 | 171 |
| Change in accrued interest receivable and other assets, net | (2,347) | 5,094 |
| Gain on sale of other real estate | (7) | (90) |
| (Gain) loss on sale of bank premises and equipment | (56) | 4 |
| Net realized gains on sales of investment securities | (1,655) | (53) |
| (Increase) decrease in deferred taxes | (148) | 1,605 |
| Change in other liabilities, net | 1,219 | (2,598) |
| Funding of loans held for sale, mortgage banking | (942,729) | (651,310) |
| Proceeds from sales of loans held for sale, mortgage banking | 939,345 | 637,669 |
| Fair value adjustment for loans held for sale, mortgage banking | 151 | (598) |
| Fair value adjustment on mortgage banking derivatives | (189) | (882) |
| Proceeds from sales of loans | 11,881 | 17,321 |
| Gains on sales of loans, net | (1,138) | (1,915) |
| Net cash provided by operating activities | 23,005 | 19,365 |
| INVESTING ACTIVITIES: | | |
| Purchases of investment securities | (176,781) | (164,844) |
| Proceeds from sales of investment securities | 152,736 | 100,066 |
| Proceeds from maturities of investment securities | 46,291 | 53,367 |
| Purchases of Federal Reserve and Federal Home Loan Bank Stock | (7,892) | (1,284) |
| Sales of Federal Reserve and Federal Home Loan Bank Stock | 7,490 | 1,196 |
| Net increase in loans held for investment | (29,448) | (59,410) |
| Proceeds from sales of other real estate | 7 | 1,587 |
| Proceeds from sales of bank premises and equipment | 163 | 788 |
| Additions to bank premises and equipment | (2,867) | (3,418) |
| Net cash used in investing activities | (10,301) | (71,952) |

See accompanying notes to consolidated financial statements.

**BNCCORP, INC. AND SUBSIDIARIES**
Consolidated Statements of Cash Flows, continued
For the Years Ended December 31
(In thousands)

| | 2015 | 2014 |
|---|---|---|
| FINANCING ACTIVITIES: | | |
| Net (decrease) increase in deposits | $ (30,782) | $ 88,003 |
| Net decrease in short-term borrowings | (2,151) | (3,965) |
| Decrease in subordinate debentures | - | (7,500) |
| Increase in long-term borrowings | 10,000 | 2,700 |
| Decrease in long-term borrowings | - | (2,700) |
| Repayments of Federal Home Loan Bank advances | (178,150) | (29,900) |
| Proceeds from Federal Home Loan Bank advances | 185,450 | 29,900 |
| Redemption of preferred stock | (21,098) | - |
| Dividends paid on preferred stock | (1,908) | (1,698) |
| Net cash (used in) provided by financing activities | (38,639) | 74,840 |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (25,935) | 22,253 |
| CASH AND CASH EQUIVALENTS, beginning of period | 41,124 | 18,871 |
| CASH AND CASH EQUIVALENTS, end of period | $ 15,189 | $ 41,124 |
| | | |
| SUPPLEMENTAL CASH FLOW INFORMATION: | | |
| Interest paid | $ 2,421 | $ 3,742 |
| Income taxes paid | $ 3,804 | $ 2,523 |
| | | |
| SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES: | | |
| Additions to other real estate in the settlement of loans | $ - | $ 697 |

See accompanying notes to consolidated financial statements.

# NOTE 1. Description of Business and Significant Accounting Policies

**Description of Business**
BNCCORP, INC. (BNCCORP or BNC) is a registered bank holding company incorporated under the laws of Delaware. It is the parent company of BNC National Bank (the Bank or BNC Bank). BNC operates community banking and wealth management businesses in North Dakota, Arizona and Minnesota from 15 locations. The Bank also conducts mortgage banking from 14 locations in Arizona, Minnesota, North Dakota, Illinois, Kansas, Arkansas and Missouri.

The consolidated financial statements included herein are for BNCCORP and its subsidiaries. The accounting and reporting policies of BNCCORP and its subsidiaries (collectively, the Company) conform to U.S. generally accepted accounting principles and general practices within the financial services industry. The more significant accounting policies are summarized below.

**Principles of Consolidation**
The accompanying consolidated financial statements include the accounts of BNCCORP and its wholly owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

**Use of Estimates**
The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the allowance for credit losses, valuation of other real estate, reserve for potential mortgage banking obligations, fair values of financial instruments (including derivatives), fair value of investments, impairments and income taxes. Ultimate results could differ from those estimates.

## SIGNIFICANT ACCOUNTING POLICIES

Accounting policies are significantly dependent on subjective assessments or estimates that may be susceptible to significant change. The following items have been identified as “accounting policies”.

**Cash and Cash Equivalents**
For purposes of the Consolidated Statements of Cash Flows, cash and cash equivalents include cash on hand, cash due from banks and federal funds sold.

**Investment Securities**
Investment securities that the Bank intends to hold indefinitely as part of its asset/liability strategy, or that may be sold in response to changes in interest rates or prepayment risk are classified as available for sale. Available for sale securities are carried at fair value. Net unrealized gains and losses, net of deferred income taxes, on securities available for sale are reported as a separate component of stockholders’ equity until realized (see Comprehensive Income). All securities were classified as available for sale as of December 31, 2015 and 2014, except for Federal Reserve Bank (FRB) and the Federal Home Loan Bank (FHLB) stock, which have an indeterminable maturity.

Investment securities that the Bank intends to hold until maturity are carried at cost, adjusted for amortization of premiums and accretion of discounts using a level yield method over the period to maturity. There were no such securities as of December 31, 2015 or 2014.

Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield using the effective interest method. Dividend and interest income is recognized when earned. Realized gains and losses on the sale of investment securities are determined using the specific-identification method and recognized in non-interest income on the trade date.

**Other-Than-Temporary Impairment**
Declines in the fair value of individual available-for-sale or held-to-maturity securities below amortized cost, which are deemed other-than-temporary, could result in a charge to earnings and establishment of a new cost basis. The Company assesses available information about our securities to determine whether impairment is other-than-temporary. The information we consider includes, but is not limited to, the following:

- Recent and expected performance of the securities;
- Financial condition of issuers or guarantors;
- Recent cash flows;
- Seniority of invested tranches and subordinated credit support;
- Vintage of origination;
- Location of collateral;
- Ratings of securities (ratings are not relied upon);
- Value of underlying collateral;
- Delinquency and foreclosure data;
- Historical losses and estimated severity of future losses;
- Credit surveillance data which summarize retrospective performance; and
- Anticipated future cash flows and prospective performance assessments.

Determining whether other-than-temporary impairment has occurred requires judgment of factors that may indicate an impairment loss has incurred. The Company follows the guidance on other-than-temporary impairments Accounting Standards Codification (ASC) 320, *Investments-Debt and Equity Securities*. Any credit-related impairments are realized through a charge to earnings. The amount of non-credit related impairments is recognized through comprehensive income, net of income taxes.

Note 2 to these consolidated financial statements includes a summary of investment securities in a loss position at December 31, 2015 and 2014.

**Federal Reserve Bank and Federal Home Loan Bank of Des Moines Stock**
Investments in FRB and FHLB stock are carried at cost, which approximates fair value.

**Loans Held For Sale-Mortgage Banking**
Loans held for sale-mortgage banking are accounted for at fair value pursuant to the fair value option permitted by FASB ASC 825, *Financial Instruments.* Gains and losses from the changes in fair value are included in mortgage banking revenue.

**Loans and Leases**
Loans and leases held for investment are stated at their outstanding principal amount net of unearned income, net of unamortized deferred fees and costs and an allowance for credit losses. Interest income is recognized on the accrual basis using the interest method prescribed in the loan agreement except when collectability is in doubt.

Loans and leases are reviewed regularly by management and are placed on non-accrual status when the collection of interest or principal is 90 days or more past due, unless the loan or lease is adequately secured and in the process of collection. When a loan or lease is placed on non-accrual status, uncollected interest accrued in prior years is charged off against the allowance for credit losses, unless collection of the principal and interest is assured. Interest accrued in the current year is reversed against interest income in the current period. Interest payments received on non-accrual loans and leases are generally applied to principal unless the remaining principal balance has been determined to be fully collectible. Accrual of interest may be resumed when it is determined that all amounts due are expected to be collected and the loan has exhibited a sustained level of performance, generally at least six months.

A loan is considered impaired when it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans are reviewed for impairment on an individual basis. Impaired loans are measured at the present value of expected future cash flows discounted at the loan's initial effective interest rate. The fair value of collateral of an impaired collateral-dependent loan or an observable market price is also used as an alternative to discounting cash flows. If the measure of the impaired loan is less than the recorded investment in the loan, impairment will be recognized as a charge-off through the allowance for credit losses.

Restructured loans are loans for which concessions, including a reduced interest rate or a deferral of interest or principal, have been granted due to the borrower's weakened financial condition. Once a loan is restructured, interest is accrued at the restructured rates when no loss of principal is anticipated. A loan that has performed in accordance with restructured terms for one year is no longer reported as a restructured loan, but will continue to be reported as impaired.

Cash receipts on impaired loans are generally applied to principal except when the loan is well collateralized or there are other circumstances that support recognition of interest. When an impaired loan is in non-accrual status, cash receipts are applied to principal.

**Loan Origination Fees and Costs; Other Lending Fees**
For Loans and Leases Held for Investment, origination fees and costs incurred to extend credit are deferred and amortized over the term of the loan as an adjustment to yield using the interest method, except where the net amount is deemed to be immaterial.

The Company occasionally originates lines of credit where the customer is charged a non-usage fee if the line of credit is not used. In such instances, we periodically review use of lines on a retrospective basis and recognize non-usage fees in non-interest income.

**Loan Servicing and Transfers of Financial Assets**
The Bank sells commercial business loans to third parties. The loans are generally sold on a non-recourse basis. Sold loans are not included in the accompanying consolidated balance sheets.

The sales of loans are accounted for pursuant to FASB ASC 860, *Transfers and Servicing*.

**Allowance for Credit Losses**
The Bank maintains its allowance for credit losses at a level considered adequate to provide for probable losses related to the loan and lease portfolio as of the balance sheet dates. The loan and lease portfolio and other credit exposures are reviewed regularly to evaluate the adequacy of the allowance for credit losses.

The methodology used to establish the allowance for credit losses incorporates quantitative and qualitative risk considerations. Quantitative factors include our historical loss experience, delinquency information, charge-off trends, collateral values, changes in nonperforming loans and other factors. Quantitative factors also incorporate known information about individual borrowers, including sensitivity to interest rate movements or other quantifiable external factors.

Qualitative factors include the general economic environment, the state of certain industries and factors unique to our market areas. Size, complexity of individual credits, loan structure, variances from loan policies and pace of portfolio growth are other qualitative factors that are considered when we estimate the allowance for credit losses.

Our methodology has been consistently applied. However, we enhance our methodology as circumstances dictate to keep pace with the complexity of the portfolio.

The allowance for credit losses has three components as follows:

**Specific Reserves**. The amount of specific reserves is determined through a loan-by-loan analysis of problematic loans over a minimum size. Included in problem loans are non-accrual or restructured loans that meet the impairment criteria in FASB ASC 310. A loan is impaired when, based on current information, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. Any allowance on impaired loans is generally based on one of three methods: the present value of expected cash flows at the loan's effective interest rate, the loan's observable market price or the fair value of the collateral of the loan. Specific reserves may also be established for credits that have been internally classified as credits requiring management's attention due to underlying problems in the borrower's business or collateral concerns.

**Reserves for Homogeneous Loan Pools**. The Bank makes a significant number of loans and leases that, due to their underlying similar characteristics, are assessed for loss as "homogeneous" pools. Included in the homogeneous pools are loans which have been excluded from the specific reserve allocation.

**Qualitative Reserve.** Management also allocates reserves for other circumstances pertaining to the measurement period. The factors considered include, but are not limited to, prevailing trends, economic conditions, geographic influence, industry segments within the portfolio, management's assessment of credit risk inherent in the loan portfolio, delinquency data, historical loss experience and peer-group information.

Monitoring loans and analysis of loss components are the principal means by which management determines estimated credit losses are reflected in the Bank's allowance for credit losses on a timely basis. Management also considers regulatory guidance in addition to the Bank's own experience. Various regulatory agencies, as an integral part of their examination process, periodically review the allowance for credit losses. Such agencies may require additions to the allowance based on their judgment about information available to them at the time of their examination.

Loans, leases and other extensions of credit deemed uncollectible are charged off against the allowance for losses. Subsequent recoveries, if any, are credited to the allowance.

The allowance for credit losses is highly dependent upon variables affecting valuation, including appraisals of collateral, evaluations of performance as well as the amounts and timing of future cash flows expected to be received on impaired loans. These variables are reviewed periodically. Actual losses may vary from the current estimated allowance for credit losses. For nonperforming or impaired loans, appraisals are generally performed annually or whenever circumstances warrant a new appraisal. Management regularly evaluates the appraised value and costs to liquidate in order to estimate fair value. A provision for credit losses is made to adjust the allowance to the amount determined appropriate through application of the above processes.

**Other Real Estate Owned and Repossessed Property**

Real estate properties and other assets acquired through loan foreclosures are recorded at fair value less estimated costs to sell. If the carrying amount of an asset acquired through foreclosure is in excess of the fair value less estimated costs to sell, the excess amount is charged to the allowance for credit losses. Fair value is primarily determined based upon appraisals of the assets involved and management periodically assesses appraised values to ascertain continued relevancy of the valuation. Subsequent declines in the estimated fair value, net operating results and gains and losses on disposition of the asset are included in other non-interest expense. Operating expenses of properties are charged to other real estate costs.

**Premises and Equipment**

Land is carried at cost. Premises and equipment are reported at cost less accumulated depreciation and amortization. Depreciation and amortization for financial reporting purposes is charged to operating expense using the straight-line method over the estimated useful lives of the assets. Estimated useful lives are up to 40 years for buildings and three to 10 years for furniture and equipment. Leasehold improvements are amortized over the shorter of the lease term or the estimated useful life of the improvement. The costs of improvements are capitalized. Maintenance and repairs, as well as gains and losses on dispositions of premises and equipment, are included in non-interest income or expense as incurred.

**Impairment of Long-Lived Assets**

The Company reviews long-lived assets for impairment periodically or whenever events or changes in circumstances indicate that the carrying amount of any such asset may not be recoverable. If impairment is identified, the assets are written down to their fair value through a charge to non-interest expense.

**Securities Sold Under Agreements to Repurchase**

From time to time, the Bank enters into sales of securities under agreements to repurchase, generally for periods of less than 90 days. These agreements are treated as financings, and the obligations to repurchase securities sold are reflected as a liability in the consolidated balance sheets as short-term borrowings. The costs of securities underlying the agreements remain in the asset accounts.

**Fair Value**

Several accounting standards require recording assets and liabilities based on their fair values. Determining the fair value of assets and liabilities can be highly subjective. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. The Company determines fair value based on assumptions that market participants would use in pricing an asset or liability in the principal or most advantageous market.

FASB ASC 820, *Fair Value Measurements and Disclosures,* defines fair value and establishes a framework for measuring fair value of assets and liabilities using a hierarchy system consisting of three levels based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

> Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets that the Company has the ability to access.
>
> Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which significant assumptions are observable in the market.
>
> Level 3: Valuation is generated from model-based techniques that use significant assumptions not observable in the market and are used only to the extent that observable inputs are not available. These unobservable assumptions reflect our own estimates of assumptions that market participants would use in pricing the asset or liability.

Management assigns a level to assets and liabilities accounted for at fair value and uses the methodologies prescribed by ASC 820 to determine fair value.

**Fair Values of Financial Instruments**

The Company is required to disclose the estimated fair value of financial instruments. Fair value estimates are subjective in nature, involving uncertainties and matters of significant judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates. The following methods and assumptions are used by the Company in estimating fair value disclosures for its financial instruments.

**Cash and Cash Equivalents, Non-interest-Bearing Deposits and Demand Deposits.** The carrying amounts approximate fair value due to the short maturity of the instruments. The fair value of deposits with no stated maturity, such as interest checking, savings and money market accounts, is equal to the amount payable on demand at the reporting date. The intangible value of long-term customer relationships with depositors is not taken into account in the fair values disclosed.

**Investment Securities Available for Sale.** The fair value of the Company's securities are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which significant assumptions are observable in the market.

**Federal Reserve Bank and Federal Home Loan Bank Stock.** The carrying amount of FRB and FHLB stock is their cost, which approximates fair value.

**Loans Held for Sale-Mortgage Banking.** Loans held for sale-mortgage banking are accounted for at fair value pursuant to the fair value option permitted by FASB ASC 825, *Financial Instruments*.

**Accrued Interest Receivable.** The fair value of accrued interest receivable equals the amount receivable due to the current nature of the amounts receivable.

**Derivative Financial Instruments.** The fair value of the Company's derivatives are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which significant assumptions are observable in the market.

**Interest-Bearing Deposits.** Fair values of interest-bearing deposit liabilities are estimated by discounting future cash flow payment streams using rates at which comparable current deposits with comparable maturities are being issued.

**Borrowings and Advances**. The carrying amount of short-term borrowings approximates fair value due to the short maturity and the instruments' floating interest rates, which are tied to market conditions. The fair values of long-term borrowings are estimated by discounting future cash flow payment streams using rates at which comparable borrowings are currently being offered.

**Accrued Interest Payable**. The fair value of accrued interest payable equals the amount payable due to the current nature of the amounts payable.

**Guaranteed Preferred Beneficial Interests in Company's Subordinated Debentures**. The fair values of the Company's subordinated debentures are estimated by discounting future cash flow payment streams using discount rates estimated to reflect those at which comparable instruments could currently be offered.

**Financial Instruments with Off-Balance-Sheet Risk**. The fair values of the Company's commitments to extend credit and commercial and standby letters of credit are estimated using fees currently charged to enter into similar agreements.

**Derivative Financial Instruments**

FASB ASC 815, *Derivatives and Hedging*, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. Accordingly, the Company records all derivatives at fair value.

The Company enters into interest rate lock commitments on certain mortgage loans related to our mortgage banking operations on a best efforts basis, which are commitments to originate loans whereby the interest rate on the loan is determined prior to funding. The Company also has corresponding forward sales contracts related to these interest rate lock commitments. Both the mortgage loan commitments and the related forward sales contracts are accounted for as derivatives and carried at fair value with changes in fair value recorded in income.

The Company also commits to originate and sell certain loans related to our mortgage banking operations on a mandatory delivery basis. To hedge interest rate risk the Company sells short positions in mortgage backed securities related to the loans sold on a mandatory delivery basis. The commitments to originate and short positions are accounted for as derivatives and carried at fair value with changes in fair value recorded in income.

**Share-Based Compensation**

FASB ASC 718 requires the Company to measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award on the grant date.

At December 31, 2015, the Company had four stock-based employee compensation plans, which are described more fully in Note 23 and Note 25 to these consolidated financial statements.

**Income Taxes**

The Company files consolidated federal and unitary state income tax returns where allowed.

The determination of current and deferred income taxes is based on analyses of many factors including interpretation of federal and state income tax laws, differences between tax and financial reporting basis of assets and liabilities, expected reversals of temporary differences, estimates of amounts due or owed and current financial accounting standards. Actual results could differ significantly from the estimates and interpretations used in determining the current and deferred income taxes.

Deferred income taxes are accounted for using the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date.

Management assesses net deferred tax assets to determine whether they are realizable based upon accounting standards and specific facts and circumstances. A valuation allowance is established to reduce net deferred tax assets to amounts that are more likely than not expected to be realized.

**Earnings Per Share**
Basic earnings per share (EPS) excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding during the applicable period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the Company. Such potential dilutive instruments include stock options and contingently issuable stock. Note 22 to these consolidated financial statements includes disclosure of the Company's EPS calculations.

**Comprehensive Income (Loss)**
Comprehensive income (loss) is the total of net income and accumulated other comprehensive income (loss), which for the Company, is generally comprised of unrealized gains and losses on securities available for sale and unrealized gains and losses on hedging instruments qualifying for cash flow hedge accounting treatment pursuant to FASB ASC 815.

## RECENTLY ISSUED OR ADOPTED ACCOUNTING PRONOUNCEMENTS

ASU 2014-14, *Receivables - Troubled Debt Restructuring by Creditors (Subtopic 310-40) – Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure,* will require creditors to derecognize certain foreclosed government-guaranteed mortgage loans and to recognize a separate other receivable that is measured at the amount the creditor expects to recover from the guarantor, and to treat the guarantee and the receivable as a single unit of account. ASU 2014-14 is effective for entities other than public business entities, for annual periods ending after December 15, 2015, and interim periods beginning after December 15, 2015. An entity can elect a prospective or a modified retrospective transition method, but must use the same transition method that it elected under FASB ASU No. 2014-04, *Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*. Early adoption, including adoption in an interim period, is permitted if the entity already adopted ASU 2014-04. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606),* which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in GAAP when it becomes effective. The new standard is effective for the Company for annual periods beginning after December 15, 2017 and interim periods within annual periods beginning after December 15, 2017. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures.

ASU No. 2014-04, *Receivables – Troubled Debt Restructuring by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure*, was issued to clarify that when an in substance repossession or foreclosure occurs, a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. ASU 2014-04 is effective for annual reporting periods beginning after December 15, 2014. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In December 2012, the FASB issued for public comment a draft proposal designed to improve financial reporting about expected credit losses on loans and other financial assets held by banks, financial institutions and other organizations. The proposed ASU, *Financial Instruments - Credit Losses*, proposes a new accounting model which would change the definition from inherent credit losses to expected credit losses, which could result in more timely recognition of credit losses, and also would provide additional transparency about credit risk. The FASB has not yet established a proposed effective date, but a final standard is expected to be issued in 2016.

ASU No. 2015-03, *Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs* was issued to clarify that debt issuance costs are to be presented in the balance sheet as a direct reduction from the carrying value of the related debt liability. ASU 2015-03 is effective for entities, other than public entities, for annual reporting periods beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016. Early adoption of the amendment is permitted. The adoption of this ASU is not expected to have a material impact on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842).* This ASU requires lessees to recognize a lease liability and a right-to-use asset for all leases, including operating leases, with a term greater than twelve months on its balance sheet. This ASU is effective in annual and interim periods in fiscal years beginning after December 15, 2018, with early adoption permitted, and requires a modified retrospective transition method. We are currently in the process of evaluating the impact that this new guidance will have on our Financial Statements.

## RECLASSIFICATIONS

Certain amounts in the consolidated financial statements for the prior year have been reclassified to conform to the current year's presentation. These reclassifications had no effect on net income or stockholders' equity.

## NOTE 2. Investment Securities Available For Sale

Investment securities have been classified in the consolidated balance sheets according to management's intent. The Company had no securities designated as trading or held-to-maturity in its portfolio at December 31, 2015 or 2014. The carrying amount of available-for-sale securities and their approximate fair values were as follows as of December 31 (in thousands):

| | 2015 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| U.S. Treasury securities | $ 32,925 | $ 9 | $ (285) | $ 32,649 |
| U.S. government agency mortgage-backed securities guaranteed by GNMA | 105,407 | 46 | (1,022) | 104,431 |
| U.S. government agency small business administration pools guaranteed by SBA | 105,150 | 737 | (209) | 105,678 |
| Collateralized mortgage obligations guaranteed by GNMA/VA | 61,418 | 678 | (203) | 61,893 |
| Collateralized mortgage obligations issued by FNMA or FHLMC | 21,607 | 206 | (151) | 21,662 |
| State and municipal bonds | 87,779 | 5,413 | (159) | 93,033 |
| | $ 414,286 | $ 7,089 | $ (2,029) | $ 419,346 |

| | 2014 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| U.S. Treasury securities | $ 19,861 | $ 70 | $ (10) | $ 19,921 |
| U.S. government agency mortgage-backed securities guaranteed by GNMA | 101,833 | 667 | (863) | 101,637 |
| U.S. government agency small business administration pools guaranteed by SBA | 83,990 | 687 | (298) | 84,379 |
| Collateralized mortgage obligations guaranteed by GNMA/VA | 96,988 | 1,500 | (300) | 98,188 |
| Collateralized mortgage obligations issued by FNMA or FHLMC | 62,638 | 923 | (227) | 63,334 |
| State and municipal bonds | 76,958 | 4,990 | (74) | 81,874 |
| | $ 442,268 | $ 8,837 | $ (1,772) | $ 449,333 |

The amortized cost and estimated fair market value of available-for-sale securities classified according to their contractual maturities at December 31, 2015, were as follows (in thousands):

| | Amortized Cost | Estimated Fair Value |
|---|---|---|
| Due in one year or less | $ - | $ - |
| Due after one year through five years | 17,918 | 17,820 |
| Due after five years through ten years | 17,433 | 17,317 |
| Due after ten years | 378,935 | 384,209 |
| Total | $ 414,286 | $ 419,346 |

For many types of investments, the actual payments will vary significantly from contractual maturities.

Securities carried at approximately $77.1 million and $76.6 million at December 31, 2015 and 2014, respectively, were pledged as collateral for public and trust deposits and borrowings, including borrowings from the FHLB and repurchase agreements with customers.

Sales proceeds and gross realized gains and losses on available-for-sale securities were as follows for the years ended December 31 (in thousands):

| | 2015 | 2014 |
|---|---|---|
| Sales proceeds | $ 152,736 | $ 100,066 |
| Gross realized gains | 2,565 | 911 |
| Gross realized losses | (910) | (858) |
| Net realized gains | $ 1,655 | $ 53 |

The following table shows the Company's investments' gross unrealized losses and fair value aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31 (in thousands):

| | 2015 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Less than 12 months | | | 12 months or more | | | Total | | |
| Description of Securities | # | Fair Value | Unrealized Loss | # | Fair Value | Unrealized Loss | # | Fair Value | Unrealized Loss |
| U.S. Treasury securities | 2 | $ 24,673 | $ (285) | - | $ - | $ - | 2 | $ 24,673 | $ (285) |
| U.S. government agency mortgage-backed securities guaranteed by GNMA | 15 | 99,357 | (1,022) | - | - | - | 15 | 99,357 | (1,022) |
| U.S. government agency small business administration pools guaranteed by SBA | 9 | 32,910 | (138) | 3 | 4,691 | (71) | 12 | 37,601 | (209) |
| Collateralized mortgage obligations guaranteed by GNMA/VA | 7 | 21,299 | (203) | - | - | - | 7 | 21,299 | (203) |
| Collateralized mortgage obligations issued by FNMA or FHLMC | 1 | 4,854 | (74) | 2 | 3,577 | (77) | 3 | 8,431 | (151) |
| State and municipal bonds | 2 | 8,147 | (159) | - | - | - | 2 | 8,147 | (159) |
| Total temporarily impaired securities | 36 | $ 191,240 | $ (1,881) | 5 | $ 8,268 | $ (148) | 41 | $ 199,508 | $ (2,029) |

| | 2014 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Less than 12 months | | | 12 months or more | | | Total | | |
| Description of Securities | # | Fair Value | Unrealized Loss | # | Fair Value | Unrealized Loss | # | Fair Value | Unrealized Loss |
| U.S. Treasury securities | 1 | $ 7,949 | $ (10) | - | $ - | $ - | 1 | $ 7,949 | $ (10) |
| U.S. government agency mortgage-backed securities guaranteed by GNMA | 7 | 47,031 | (275) | 2 | 16,853 | (588) | 9 | 63,884 | (863) |
| U.S. government agency small business administration pools guaranteed by SBA | 8 | 32,354 | (241) | 3 | 6,246 | (57) | 11 | 38,600 | (298) |
| Collateralized mortgage obligations guaranteed by GNMA/VA | 5 | 12,874 | (99) | 3 | 13,239 | (201) | 8 | 26,113 | (300) |
| Collateralized mortgage obligations issued by FNMA or FHLMC | 3 | 14,453 | (149) | 1 | 3,799 | (78) | 4 | 18,252 | (227) |
| State and municipal bonds | 4 | 10,430 | (74) | - | - | - | 4 | 10,430 | (74) |
| Total temporarily impaired securities | 28 | $ 125,091 | $ (848) | 9 | $ 40,137 | $ (924) | 37 | $ 165,228 | $ (1,772) |

Management regularly evaluates each security with unrealized losses to determine whether losses are other-than-temporary. When determining whether a security is other-than-temporarily impaired, management assesses whether it has the intent to sell the security or whether it is more likely than not that it will be required to sell the security prior to its anticipated recovery. When evaluating a security, management considers several factors including, but not limited to, the amount of the unrealized loss, the length of time the security has been in a loss position, guarantees provided by third parties, ratings on the security, cash flow from the security, the level of credit support provided by subordinate tranches, and the collateral underlying the security.

There were no securities that were other-than-temporarily impaired during 2015 or 2014.

## NOTE 3. Federal Reserve Bank and Federal Home Loan Bank Stock

The carrying amounts of FRB and FHLB stock, which approximate their fair values, consisted of the following as of December 31 (in thousands):

| | 2015 | 2014 |
|---|---|---|
| Federal Reserve Bank Stock, at cost | $ 1,807 | $ 1,807 |
| Federal Home Loan Bank of Des Moines Stock, at cost | 1,412 | 1,010 |
| Total | $ 3,219 | $ 2,817 |

There is no contractual maturity on these investments; the investments are required by counterparties.

## NOTE 4. Loans and Leases

The composition of loans and leases is as follows at December 31 (in thousands):

| | 2015 | 2014 |
|---|---|---|
| Loans held for sale-mortgage banking | $ 50,445 | $ 47,109 |
| Commercial and industrial | $ 125,009 | $ 132,229 |
| Commercial real estate | 149,099 | 108,122 |
| SBA | 25,860 | 26,972 |
| Consumer | 47,073 | 40,470 |
| Land and land development | 17,627 | 28,220 |
| Construction | 15,187 | 24,916 |
| Gross loans and leases held for investment | 379,855 | 360,929 |
| Unearned income and net unamortized deferred fees and costs | 48 | (140) |
| Loans, net of unearned income and unamortized fees and costs | 379,903 | 360,789 |
| Allowance for credit losses | (8,611) | (8,601) |
| Net loans and leases held for investment | $ 371,292 | $ 352,188 |

**Loans to Related Parties**
Note 20 to these consolidated financial statements includes information relating to loans to executive officers, directors, principal shareholders and associates of such persons.

**Loans Pledged as Collateral**
The table below presents loans pledged as collateral to the Federal Home Loan Bank, Federal Reserve Bank, and the Bank of North Dakota as of December 31(in thousands):

| | 2015 | 2014 |
|---|---|---|
| Commercial and industrial | $ 37,130 | $ 27,004 |
| Commercial real estate | 88,948 | 64,938 |
| Consumer | 22,487 | 20,185 |
| Construction | 644 | 1,099 |
| | $ 149,209 | $ 113,226 |

# NOTE 5. Allowance for Credit Losses

Transactions in the allowance for credit losses were as follows for the years ended December 31 (in thousands):

| | 2015 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Commercial and industrial | Commercial real estate | SBA | Consumer | Land and land development | Construction | Total |
| Balance, beginning of period | $ 2,686 | $ 2,496 | $ 1,190 | $ 516 | $ 1,436 | $ 277 | $ 8,601 |
| Provision (reduction) | 559 | (1,048) | 465 | 148 | (395) | (129) | (400) |
| Loans charged off | (47) | - | (145) | (43) | - | - | (235) |
| Loan recoveries | 7 | 551 | 68 | 19 | - | - | 645 |
| Balance, end of period | $ 3,205 | $ 1,999 | $ 1,578 | $ 640 | $ 1,041 | $ 148 | $ 8,611 |

| | 2014 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Commercial and industrial | Commercial real estate | SBA | Consumer | Land and land development | Construction | Total |
| Balance, beginning of period | $ 2,215 | $ 4,041 | $ 579 | $ 478 | $ 2,371 | $ 163 | $ 9,847 |
| Provision (reduction) | 471 | (1,114) | 715 | 59 | (1,045) | 114 | (800) |
| Loans charged off | - | (439) | (109) | (42) | (190) | - | (780) |
| Loan recoveries | - | 8 | 5 | 21 | 300 | - | 334 |
| Balance, end of period | $ 2,686 | $ 2,496 | $ 1,190 | $ 516 | $ 1,436 | $ 277 | $ 8,601 |

The following table shows the balance in the allowance for credit losses at December 31, 2015, and December 31, 2014, and the related loan balances, segregated on the basis of impairment methodology (in thousands). Impaired loans are loans on nonaccrual status and troubled debt restructurings, which are individually evaluated for impairment, and other loans deemed to have similar risk characteristics. All other loans are collectively evaluated for impairment.

| | Allowance For Credit Losses | | | Gross Loans and Leases Held for Investment | | |
|---|---|---|---|---|---|---|
| | Impaired | Other | Total | Impaired | Other | Total |
| **December 31, 2015** | | | | | | |
| Commercial and industrial | $ - | $ 3,205 | $ 3,205 | $ - | $ 125,009 | $ 125,009 |
| Commercial real estate | - | 1,999 | 1,999 | 1,578 | 147,521 | 149,099 |
| SBA | 313 | 1,265 | 1,578 | 313 | 25,547 | 25,860 |
| Consumer | 33 | 607 | 640 | 383 | 46,690 | 47,073 |
| Land and land development | - | 1,041 | 1,041 | - | 17,627 | 17,627 |
| Construction | - | 148 | 148 | - | 15,187 | 15,187 |
| Total | $ 346 | $ 8,265 | $ 8,611 | $ 2,274 | $ 377,581 | $ 379,855 |
| **December 31, 2014** | | | | | | |
| Commercial and industrial | $ 18 | $ 2,668 | $ 2,686 | $ 90 | $ 132,139 | $ 132,229 |
| Commercial real estate | 574 | 1,922 | 2,496 | 4,741 | 103,381 | 108,122 |
| SBA | - | 1,190 | 1,190 | - | 26,972 | 26,972 |
| Consumer | - | 516 | 516 | 330 | 40,140 | 40,470 |
| Land and land development | - | 1,436 | 1,436 | - | 28,220 | 28,220 |
| Construction | - | 277 | 277 | - | 24,916 | 24,916 |
| Total | $ 592 | $ 8,009 | $ 8,601 | $ 5,161 | $ 355,768 | $ 360,929 |

**Performing and non-accrual loans**

The Bank's key credit quality indicator is the loan's performance status, defined as accrual or non-accrual. Performing loans are considered to have a lower risk of loss and are on accrual status. Non-accrual loans include loans on which the accrual of interest has been discontinued. Accrual of interest is discontinued when we believe that the borrower's financial condition is such that the collection of principal and interest is doubtful. A delinquent loan is generally placed on non-accrual status when it becomes 90 days or more past due unless the loan is well secured and in the process of collection. When a loan is placed on non-accrual status, accrued but uncollected interest income applicable to the current reporting period is reversed against interest income. Accrued but uncollected interest income applicable to previous reporting periods is charged against the allowance for credit losses. No additional interest is accrued on the loan balance until the collection of both principal and interest becomes reasonably certain. Delinquent balances are determined based on the contractual terms of the loan adjusted for charge-offs and payments applied to principal.

The following table sets forth information regarding the Bank's performing and non-accrual loans at December 31 (in thousands):

| | 2015 | | | | | |
|---|---|---|---|---|---|---|
| | Current | 31-89 Days Past Due | 90 Days or More Past Due And Accruing | Total Performing | Non-accrual | Total |
| Commercial and industrial: | | | | | | |
| Business loans | $ 62,563 | $ 377 | $ - | $ 62,940 | $ - | $ 62,940 |
| Agriculture | 18,003 | - | - | 18,003 | - | 18,003 |
| Owner-occupied commercial real estate | 44,066 | - | - | 44,066 | - | 44,066 |
| Commercial real estate | 149,099 | - | - | 149,099 | - | 149,099 |
| SBA | 24,632 | 915 | - | 25,547 | 313 | 25,860 |
| Consumer: | | | | | | |
| Automobile | 6,057 | 69 | - | 6,126 | 51 | 6,177 |
| Home equity | 8,134 | - | - | 8,134 | - | 8,134 |
| 1st mortgage | 12,161 | - | - | 12,161 | - | 12,161 |
| Other | 20,564 | 11 | - | 20,575 | 26 | 20,601 |
| Land and land development | 17,452 | - | 175 | 17,627 | - | 17,627 |
| Construction | 15,187 | - | - | 15,187 | - | 15,187 |
| Total loans held for investment | 377,918 | 1,372 | 175 | 379,465 | 390 | 379,855 |
| Loans held for sale | 50,444 | 1 | - | 50,445 | - | 50,445 |
| Total gross loans | $ 428,362 | $ 1,373 | $ 175 | $ 429,910 | $ 390 | $ 430,300 |

| | 2014 | | | | | |
|---|---|---|---|---|---|---|
| | Current | 31-89 Days Past Due | 90 Days or More Past Due And Accruing | Total Performing | Non-accrual | Total |
| Commercial and industrial: | | | | | | |
| Business loans | $ 67,335 | $ 161 | $ - | $ 67,496 | $ 37 | $ 67,533 |
| Agriculture | 17,478 | - | - | 17,478 | - | 17,478 |
| Owner-occupied commercial real estate | 47,218 | - | - | 47,218 | - | 47,218 |
| Commercial real estate | 108,122 | - | - | 108,122 | - | 108,122 |
| SBA | 26,972 | - | - | 26,972 | - | 26,972 |
| Consumer: | | | | | | |
| Automobile | 6,343 | 25 | - | 6,368 | 19 | 6,387 |
| Home equity | 9,798 | - | - | 9,798 | - | 9,798 |
| 1st mortgage | 9,790 | - | - | 9,790 | - | 9,790 |
| Other | 14,470 | 20 | 5 | 14,495 | - | 14,495 |
| Land and land development | 28,220 | - | - | 28,220 | - | 28,220 |
| Construction | 24,916 | - | - | 24,916 | - | 24,916 |
| Total loans held for investment | 360,662 | 206 | 5 | 360,873 | 56 | 360,929 |
| Loans held for sale | 47,109 | - | - | 47,109 | - | 47,109 |
| Total gross loans | $ 407,771 | $ 206 | $ 5 | $ 407,982 | $ 56 | $ 408,038 |

The following table indicates the effect on income if interest on non-accrual loans outstanding at year end had been recognized at original contractual rates during the year ended December 31 (in thousands):

| | 2015 | 2014 |
|---|---|---|
| Interest income that would have been recorded | $ 14 | $ 20 |
| Interest income recorded | - | - |
| Effect on interest income | $ 14 | $ 20 |

**Credit Risk by Internally Assigned Grade**

The Company maintains an internal risk rating process in order to increase the precision and effectiveness of credit risk management. Internal grade is generally categorized into the following four categories: pass, watch List, substandard, and doubtful.

At December 31, 2015 the Company had $362.1 million of loans categorized as pass rated loans. This compares to $349.7 million at December 31, 2014.

Loans designated as watch list are loans that possess some credit deficiency that deserves close attention due to emerging problems. Such loans pose unwarranted financial risk that, if left uncorrected, may result in deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date. At December 31, 2015 the Company had $7.9 million of loans categorized as watch list loans compared to $2.1 million at December 31, 2014.

Loans graded as Substandard or Doubtful are considered "Classified" loans for regulatory purposes. Loans classified as substandard are loans that are generally inadequately protected by the current net worth and paying capacity of the obligor, or by the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Substandard loans are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loans classified as doubtful have the weaknesses of those classified as substandard, with additional characteristics that make collection in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. At December 31, 2015 the Company had $9.4 million of substandard loans and $379 thousand of doubtful loans. This compares to $9.1 million of substandard loans and no doubtful loans as of December 31, 2014.

**Impaired loans**
Impaired loans include loans the Bank will not be able to collect all amounts due in accordance with the terms of the loan agreement. Impaired loans include non-accruing and loans that have been modified in a troubled debt restructuring. All loans are individually reviewed for impairment.

The following table summarizes impaired loans and related allowances as of and for the years ended December 31, 2015 and 2014 (in thousands):

| | 2015 | | | | |
|---|---|---|---|---|---|
| | **Unpaid Principal** | **Recorded Investment** | **Related Allowance** | **Average Recorded Balance** | **Interest Income Recognized (12 months)** |
| Impaired loans with an allowance recorded: | | | | | |
| Commercial and industrial: | | | | | |
| Business loans | $ - | $ - | $ - | $ - | $ - |
| Agriculture | - | - | - | - | - |
| Owner-occupied commercial real estate | - | - | - | - | - |
| Commercial real estate | - | - | - | - | - |
| SBA | 325 | 313 | 313 | 324 | - |
| Consumer: | | | | | |
| Automobile | 39 | 39 | 20 | 40 | - |
| Home equity | - | - | - | - | - |
| 1st mortgage | - | - | - | - | - |
| Other | 26 | 26 | 13 | 26 | - |
| Land and land development | - | - | - | - | - |
| Construction | - | - | - | - | - |
| Loans held for sale | - | - | - | - | - |
| **Total impaired loans with an allowance recorded** | $ 390 | $ 378 | $ 346 | $ 390 | $ - |
| Impaired loans without an allowance recorded: | | | | | |
| Commercial and industrial: | | | | | |
| Business loans | $ - | $ - | $ - | $ - | $ - |
| Agriculture | - | - | - | - | - |
| Owner-occupied commercial real estate | - | - | - | - | - |
| Commercial real estate | 1,876 | 1,578 | - | 1,579 | 80 |
| SBA | - | - | - | - | - |
| Consumer: | | | | | |
| Automobile | 29 | 12 | - | 15 | - |
| Home equity | - | - | - | - | - |
| 1st mortgage | 1,878 | 306 | - | 308 | 13 |
| Other | - | - | - | - | - |
| Land and land development | - | - | - | - | - |
| Construction | - | - | - | - | - |
| Loans held for sale | - | - | - | - | - |
| **Total impaired loans without an allowance recorded** | $ 3,783 | $ 1,896 | $ - | $ 1,902 | $ 93 |
| **TOTAL IMPAIRED LOANS** | $ 4,173 | $ 2,274 | $ 346 | $ 2,292 | $ 93 |

| | 2014 | | | | |
|---|---|---|---|---|---|
| | **Unpaid Principal** | **Recorded Investment** | **Related Allowance** | **Average Recorded Balance** | **Interest Income Recognized (12 months)** |
| Impaired loans with an allowance recorded: | | | | | |
| Commercial and industrial: | | | | | |
| Business loans | $ 90 | $ 90 | $ 18 | $ 93 | $ 4 |
| Agriculture | - | - | - | - | - |
| Owner-occupied commercial real estate | - | - | - | - | - |
| Commercial real estate | 8,642 | 4,741 | 574 | 5,077 | 136 |
| SBA | - | - | - | - | - |
| Consumer: | | | | | |
| Automobile | - | - | - | - | - |
| Home equity | - | - | - | - | - |
| 1st mortgage | - | - | - | - | - |
| Other | - | - | - | - | - |
| Land and land development | - | - | - | - | - |
| Construction | - | - | - | - | - |
| Loans held for sale | - | - | - | - | - |
| **Total impaired loans with an allowance recorded** | $ 8,732 | $ 4,831 | $ 592 | $ 5,170 | $ 140 |
| Impaired loans without an allowance recorded: | | | | | |
| Commercial and industrial: | | | | | |
| Business loans | $ - | $ - | $ - | $ - | $ - |
| Agriculture | - | - | - | - | - |
| Owner-occupied commercial real estate | - | - | - | - | - |
| Commercial real estate | - | - | - | - | - |
| SBA | - | - | - | - | - |
| Consumer: | | | | | |
| Automobile | 35 | 19 | - | 23 | - |
| Home equity | - | - | - | - | - |
| 1st mortgage | 1,878 | 311 | - | 395 | 16 |
| Other | - | - | - | - | - |
| Land and land development | - | - | - | - | - |
| Construction | - | - | - | - | - |
| Loans held for sale | - | - | - | - | - |
| **Total impaired loans without an allowance recorded** | $ 1,913 | $ 330 | $ - | $ 418 | $ 16 |
| **TOTAL IMPAIRED LOANS** | $ 10,645 | $ 5,161 | $ 592 | $ 5,588 | $ 156 |

**Troubled Debt Restructuring (TDR)**
Included in loans receivable, net, are certain loans that have been modified in order to maximize collection of loan balances. If the Company, for legal or economic reasons related to the borrower's financial difficulties, grants a concession compared to the original terms and conditions of the loan, the modified loan is considered a troubled debt restructuring.

The Company follows FASB ASU No. 2011-02, *Receivables (Topic 310), A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring,* which modified guidance for identifying restructurings of receivables that constitute a TDR.

The table below summarizes the amounts of restructured loans as of December 31 (in thousands):

| | 2015 | | | |
|---|---|---|---|---|
| | Accrual | Non-accrual | Total | Allowance |
| Commercial and industrial: | | | | |
| Business loans | $ - | $ - | $ - | $ - |
| Agriculture | - | - | - | - |
| Owner-occupied commercial real estate | - | - | - | - |
| Commercial real estate | 1,578 | - | 1,578 | - |
| SBA | - | 313 | 313 | 313 |
| Consumer: | | | | |
| Automobile | - | - | - | - |
| Home equity | - | - | - | - |
| 1st mortgage | 306 | - | 306 | - |
| Other | - | - | - | - |
| Land and land development | - | - | - | - |
| Construction | - | - | - | - |
| Loans held for sale | - | - | - | - |
| | $ 1,884 | $ 313 | $ 2,197 | $ 313 |

| | 2014 | | | |
|---|---|---|---|---|
| | Accrual | Non-accrual | Total | Allowance |
| Commercial and industrial: | | | | |
| Business loans | $ 53 | $ - | $ 53 | $ 10 |
| Agriculture | - | - | - | - |
| Owner-occupied commercial real estate | - | - | - | - |
| Commercial real estate | 4,741 | - | 4,741 | 574 |
| SBA | - | - | - | - |
| Consumer: | | | | |
| Automobile | - | - | - | - |
| Home equity | - | - | - | - |
| 1st mortgage | 311 | - | 311 | - |
| Other | - | - | - | - |
| Land and land development | - | - | - | - |
| Construction | - | - | - | - |
| Loans held for sale | - | - | - | - |
| | $ 5,105 | $ - | $ 5,105 | $ 584 |

TDR concessions can include reduction of interest rates, extension of maturity dates, forgiveness of principal and/or interest due, or acceptance of real estate or other assets in full or partial satisfaction of the debt. Loan modifications are not reported as TDR's after 12 months if the loan was modified at a market rate of interest for comparable risk loans, and the loan is performing in accordance with the terms of the restructured agreement for at least six months.

When a loan is modified as a TDR, there may be a direct, material impact on the loans within the Balance Sheet, as principal balances may be partially forgiven. For the year ending December 31, 2015 there were three new TDRs with a pre-modification balance of $329 thousand and a post-modification balance of $313 thousand. There were no new TDRs for the year ending December 31, 2014.

Loans that were non-accrual prior to modification remain on non-accrual for at least six months following modification. Non-accrual TDR loans that have performed according to the modified terms for six months may be returned to accruing status. Loans that were accruing prior to modification remain on accrual status after the modification as long as the loan continues to perform under the new terms.

The following table indicates the effect on income if interest on restructured loans outstanding at year end had been recognized at original contractual rates during the year ended December 31 (in thousands):

| | 2015 | 2014 |
|---|---|---|
| Interest income that would have been recorded | $ 222 | $ 463 |
| Interest income recorded | 93 | 145 |
| Effect on interest income | $ 129 | $ 318 |

There were no additional funds committed to borrowers who are in TDR status at December 31, 2015 and December 31, 2014.

TDRs are evaluated separately in the Bank's allowance methodology based on the expected cash flows or collateral values for loans in this status.

As of December 31, 2015 and December 31, 2014, the Bank had no restructured loans that were modified in a troubled-debt restructuring within the previous 12 months for which there was a payment default (i.e. 90 days delinquent).

## NOTE 6. Other Real Estate, net

Other real estate (ORE), net includes property acquired through foreclosure, property in judgment and in-substance foreclosures, and property transferred from premises and equipment. ORE is carried at fair value less estimated selling costs. Each property is evaluated regularly and the amounts provided to decrease the carrying amount are included in non-interest expense. A summary of the activity related to ORE is presented below for the years ended December 31 (in thousands):

| | 2015 | | 2014 | |
|---|---|---|---|---|
| **Balance, beginning of period** | $ | 256 | $ | 1,056 |
| Transfers from nonperforming loans | | - | | 697 |
| Real estate sold | | (7) | | (1,587) |
| Net gains on sale of assets | | 7 | | 90 |
| Provision | | (14) | | - |
| **Balance, end of period** | $ | 242 | $ | 256 |

The following is a summary of ORE as of December 31 (in thousands):

| | 2015 | | 2014 | |
|---|---|---|---|---|
| Other real estate | $ | 954 | $ | 954 |
| Valuation allowance | | (712) | | (698) |
| Other real estate, net | $ | 242 | $ | 256 |

## NOTE 7. Premises and Equipment, net

Premises and equipment, net consisted of the following at December 31 (in thousands):

| | 2015 | | 2014 | |
|---|---|---|---|---|
| Land and improvements | $ | 4,326 | $ | 4,417 |
| Buildings and improvements | | 14,499 | | 12,459 |
| Leasehold improvements | | 545 | | 510 |
| Furniture, fixtures and equipment | | 10,103 | | 10,076 |
| Total cost | | 29,473 | | 27,462 |
| Less accumulated depreciation and amortization | | (11,899) | | (11,234) |
| Net premises and equipment | $ | 17,574 | $ | 16,228 |

Depreciation and amortization expense totaled approximately $1.4 million and $1.3 million for the years ended December 31, 2015 and 2014, respectively.

## NOTE 8. Deposits

The scheduled maturities of time deposits as of December 31, 2015 are as follows (in thousands):

| | | |
|---|---|---|
| 2016 | $ | 77,175 |
| 2017 | | 23,607 |
| 2018 | | 9,143 |
| 2019 | | 8,274 |
| 2020 | | 4,516 |
| Thereafter | | 29,090 |
| | $ | 151,805 |

At December 31, 2015 and 2014, the Bank had $33.4 million and $54.0 million, respectively, of time deposits that had been acquired through a broker.

At December 31, 2015 and 2014, the Bank had $11.6 million and $17.2 million, respectively, in time deposits greater than $250 thousand.

The following table shows a summary of interest expense by product type as of December 31 (in thousands):

| | 2015 | | 2014 | |
|---|---|---|---|---|
| Savings | $ | 9 | $ | 9 |
| Interest checking | | 64 | | 75 |
| Money market | | 466 | | 467 |
| Time deposits | | 1,609 | | 1,862 |
| | $ | 2,148 | $ | 2,413 |

**Deposits Received from Related Parties**
Note 20 to these consolidated financial statements includes information relating to deposits received from executive officers, directors, principal shareholders and associates of such persons.

## NOTE 9. Short-Term Borrowings

The following table sets forth selected information for short-term borrowings (borrowings with an original maturity of less than one year) as of December 31 (in thousands):

| | 2015 | | 2014 | |
|---|---|---|---|---|
| Federal reserve borrowings - U. S. Treasury tax and loan retainer | $ | - | $ | - |
| Repurchase agreements with customers, renewable daily, interest payable monthly, rates ranging from 0.05% to 0.40% in 2015, and from 0.05% to 0.40% in 2014, secured by government agency collateralized mortgage obligations and general obligations of municipalities | | 13,851 | | 16,002 |
| | $ | 13,851 | $ | 16,002 |

The weighted average interest rate on short-term borrowings outstanding as of December 31, 2015 and 2014 was 0.14% and 0.15%, respectively.

Customer repurchase agreements are used by the Bank to acquire funds from customers where the customers are required, or desire, to have their funds supported by collateral consisting of government, government agency or other types of securities. The repurchase agreement is a promise to sell these securities to a customer at a certain price and repurchase them at a future date at that same price plus interest accrued at an agreed upon rate. The Bank uses customer repurchase agreements in its liquidity plan as well as an accommodation to customers. At December 31, 2015, $13.9 million of securities sold under repurchase agreements, with a weighted average interest rate of 0.14%, were collateralized by government agency collateralized mortgage obligations and general obligations of municipalities having a market value of $34.5 million and unamortized principal balances of $32.0 million. At December 31, 2014, $16.0 million of securities sold under repurchase agreements, with a weighted average interest rate of 0.15%, were collateralized by government agency collateralized mortgage obligations and general obligations of municipalities having a market value of $30.3 million and unamortized principal balances of $31.3 million.

## NOTE 10. Federal Home Loan Bank Advances

As of December 31, 2015, the Bank had $7.3 million of FHLB advances outstanding. At December 31, 2015, the Bank has mortgage loans pledged as collateral to the FHLB with unamortized principal balances of approximately $127.4 million. The Bank has the ability to draw advances up to approximately $77.6 million based upon the mortgage loans that are currently pledged, subject to a requirement to purchase additional FHLB stock.

As of December 31, 2014, the Bank had $0 of FHLB advances outstanding. At December 31, 2014, the Bank has mortgage loans pledged as collateral to the FHLB with unamortized principal balances of approximately $109.6 million.

## NOTE 11. Long-Term Borrowings

The following table sets forth selected information for long-term borrowings (borrowings with an original maturity of greater than one year) as of December 31 (in thousands):

| | 2015 | 2014 |
|---|---|---|
| Note payable, interest due each quarter, beginning on April 1, 2016 ending October 19, 2025, interest payable at a fixed rate of 6.35% | $ 10,000 | $ - |

On October 19, 2015, the Company entered into a $10.0 million term loan agreement with another bank. The long term borrowing is subordinated debt that qualifies as Tier 2 capital for the Company. The loan includes various covenants that are primarily operational rather than financial in nature. As of December 31, 2015, the Company was in compliance with these covenants. The note may be repaid by the Company at par in whole or in part beginning October 19, 2020.

## NOTE 12. Other Borrowings

The following table presents selected information regarding other borrowings at December 31 (in thousands):

**2015**

| Unsecured Borrowing Lines: | | Line | Outstanding | Available |
|---|---|---|---|---|
| BNC Bank Lines (1) | | $ 34,500 | $ - | $ 34,500 |

| Secured Borrowing Lines: | Collateral Pledged | Line | Outstanding | Available |
|---|---|---|---|---|
| BNC Bank Line | $ 650 | $ 387 | $ - | $ 387 |
| BNC Line | 87,862 | 10,000 | - | 10,000 |
| Total | $ 88,512 | $ 10,387 | $ - | $ 10,387 |

(1) The unsecured BNC Bank Lines consists of three separate lines with three institutions in individual amounts of $12.5 million, $10 million, and $12 million.

At December 31, 2015, the pledged collateral for the BNC Bank line was comprised of collateralized mortgage obligations and the pledged collateral for the BNC line is the common stock of BNC Bank.

**2014**

| Unsecured Borrowing Line: | | Line | Outstanding | Available |
|---|---|---|---|---|
| BNC Bank Lines (1) | | $ 32,000 | $ - | $ 32,000 |

| Secured Borrowing Line: | Collateral Pledged | Line | Outstanding | Available |
|---|---|---|---|---|
| BNC Bank Lines (2) | $ 2,424 | $ 1,490 | $ - | $ 1,490 |
| BNC Line | 91,882 | 10,000 | - | 10,000 |
| Total | $ 94,306 | $ 11,490 | $ - | $ 11,490 |

(1) The unsecured BNC Bank Lines consists of three separate lines with three institutions in individual amounts of $10 million, $10 million, and $12 million.

(2) The secured BNC Bank Lines consisted of two separate lines with two institutions in individual amounts of $1,241 thousand and $249 thousand.

At December 31, 2014, the pledged collateral for the BNC Bank Lines was comprised of collateralized mortgage obligations. The pledged collateral for the BNC Line is the common stock of BNC Bank.

## NOTE 13. Guaranteed Preferred Beneficial Interest's in Company's Subordinated Debentures

In July 2000, BNC issued $7.5 million of subordinated debentures at a fixed rate of 12.05%. In the third quarter of 2014, these subordinated debentures were redeemed and the corresponding debentures were prepaid. Redemption costs totaling $356 thousand were recorded in the second quarter of 2014.

In July 2007, BNC issued $15.0 million of floating rate subordinated debentures. The interest rate paid on the securities is equal to the three month LIBOR plus 1.40%. The interest rate at December 31, 2015 and December 31, 2014 was 1.73% and 1.64%, respectively. The subordinated debentures mature on October 1, 2037. The subordinated debentures may be redeemed at par and the corresponding debentures may be prepaid at the option of BNC, subject to approval by the FRB.

## NOTE 14. Stockholders' Equity

On January 16, 2009, BNCCORP received net proceeds of approximately $20.1 million through the sale of its Series A shares of non-voting senior perpetual preferred stock to the U.S. Department of the Treasury under the Capital Purchase Program (CPP). The Treasury Department also received a warrant exercisable for shares of an additional class of BNCCORP, INC. Series B perpetual non-voting preferred stock, which had an aggregate liquidation preference of approximately $1.0 million. The Treasury Department exercised this warrant on January 16, 2009.

During 2015, the Company, after receiving approval from its regulator, redeemed the Series A and Series B preferred stock. The redemption price for these shares of preferred stock was the stated liquidation preference amount of $1,000 per share or an aggregate $21,098,000.

Prior to the redemption, the Series A preferred stock (20,093 shares) accrued and paid dividends at 5% per annum until February 2014 and 9% per annum thereafter. Series B preferred stock (1,005 shares) accrued and paid dividends at 9% per annum.

Regulatory restrictions exist regarding the ability of the Bank to transfer funds to BNCCORP in the form of cash dividends. Approval of the Office of the Comptroller of the Currency (OCC), the Bank's principal regulator, is required for the Bank to pay dividends to BNCCORP in excess of the Bank's net profits from the current year plus retained net profits for the preceding two years.

On May 30, 2001, BNCCORP's Board of Directors adopted a rights plan intended to protect stockholder interests in the event BNCCORP becomes the subject of a takeover initiative that BNCCORP's Board believes could deny BNCCORP's stockholders the full value of their investment. This plan does not prohibit the Board from considering any offer that it deems advantageous to its stockholders.

The rights were issued to each common stockholder of record on May 30, 2001, and they will be exercisable only if a person acquires, or announces a tender offer, that would result in ownership of, 15% or more of BNCCORP's outstanding common stock. The rights plan was amended in 2011 such that it now expires on May 30, 2021.

# NOTE 15. Regulatory Capital and Current Operating Environment

BNCCORP and the Bank are subject to various regulatory capital requirements administered by the Federal banking agencies. Failure to meet capital requirements mandated by regulators can trigger certain mandatory and discretionary actions by regulators. Such actions, if undertaken, could have a direct material adverse effect on the Company's financial condition and results of operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, BNCCORP and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. With increasing frequency, regulators are imposing capital requirements that are specific to individual institutions. The requirements are generally above the statutory ratios.

In the first quarter of 2015, regulatory capital requirements for community banks changed to incorporate certain capital requirements addressed in the Basel III framework. These standards introduced a new requirement, Common Equity Tier 1 ("CET 1"), and increased certain previously existing capital requirements.

The capital amounts and ratios presented below for December 31, 2015 conform to the current BASEL III risk based capital standards. The capital amounts and ratios presented for December 31, 2014 conform to the former general risk based capital standards (dollars in thousands):

| | Actual | | For Capital Adequacy Purposes | | To be Well Capitalized | | Amount in Excess of Well Capitalized | |
|---|---|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| **2015** | | | | | | | | |
| **Total Risk Based Capital**: | | | | | | | | |
| Consolidated | $ 95,770 | 20.07 % | $ 38,172 | ≥8.0 % | $ N/A | N/A % | $ N/A | N/A% |
| BNC National Bank | 89,178 | 18.71 | 38,130 | ≥8.0 | 47,662 | 10.0 | 41,516 | 8.71 |
| **Tier 1 Risk Based Capital**: | | | | | | | | |
| Consolidated | 79,773 | 16.72 | 28,629 | ≥6.0 | N/A | N/A | N/A | N/A |
| BNC National Bank | 83,187 | 17.45 | 28,597 | ≥6.0 | 38,130 | 8.0 | 45,057 | 9.45 |
| **Common Equity Tier 1 Risk Based Capital** | | | | | | | | |
| Consolidated | 64,758 | 13.57 | 21,472 | ≥4.5 | N/A | N/A | N/A | N/A |
| BNC National Bank | 83,187 | 17.45 | 21,448 | ≥4.5 | 30,980 | 6.5 | 52,207 | 10.95 |
| **Tier 1 Leverage Capital**: | | | | | | | | |
| Consolidated | 79,773 | 9.00 | 35,471 | ≥4.0 | N/A | N/A | N/A | N/A |
| BNC National Bank | 83,187 | 9.45 | 35,212 | ≥4.0 | 44,015 | 5.0 | 39,172 | 4.45 |
| **Tangible Equity** (to total assets): | | | | | | | | |
| Consolidated | 68,860 | 7.62 | N/A | N/A | N/A | N/A | N/A | N/A |
| BNC National Bank | 87,733 | 9.71 | N/A | N/A | N/A | N/A | N/A | N/A |
| **Tangible Common Equity** (to total assets): | | | | | | | | |
| Consolidated | 68,860 | 7.62 | N/A | N/A | N/A | N/A | N/A | N/A |
| BNC National Bank | 87,733 | 9.71 | N/A | N/A | N/A | N/A | N/A | N/A |
| **2014** | | | | | | | | |
| **Total Risk Based Capital**: | | | | | | | | |
| Consolidated | $ 99,085 | 21.10 % | $ 37,562 | ≥8.0 % | $ N/A | N/A % | $ N/A | N/A% |
| BNC National Bank | 91,967 | 19.73 | 37,285 | ≥8.0 | 46,606 | 10.0 | 45,361 | 9.73 |
| **Tier 1 Risk Based Capital** : | | | | | | | | |
| Consolidated | 93,182 | 19.85 | 18,781 | ≥4.0 | N/A | N/A | N/A | N/A |
| BNC National Bank | 86,107 | 18.48 | 18,642 | ≥4.0 | 27,964 | 6.0 | 58,143 | 12.48 |
| **Tier 1 Leverage Capital**: | | | | | | | | |
| Consolidated | 93,182 | 9.94 | 37,485 | ≥4.0 | N/A | N/A | N/A | N/A |
| BNC National Bank | 86,107 | 9.13 | 37,725 | ≥4.0 | 47,157 | 5.0 | 38,950 | 4.13 |
| **Tangible Equity** (to total assets): | | | | | | | | |
| Consolidated | 83,412 | 8.93 | N/A | N/A | N/A | N/A | N/A | N/A |
| BNC National Bank | 91,806 | 9.83 | N/A | N/A | N/A | N/A | N/A | N/A |
| **Tangible Common Equity** (to total assets): | | | | | | | | |
| Consolidated | 62,314 | 6.67 | N/A | N/A | N/A | N/A | N/A | N/A |
| BNC National Bank | 91,806 | 9.83 | N/A | N/A | N/A | N/A | N/A | N/A |

The most recent notifications from the Office of the Comptroller of the Currency (OCC) categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. Management believes the Bank remains well capitalized through the date for which subsequent events have been evaluated.

# NOTE 16. Fair Value Measurements

The following table summarizes the financial assets and liabilities of the Company for which fair values are determined on a recurring basis as of December 31 (in thousands):

| | Carrying Value at December 31, 2015 | | | | Twelve Months Ended December 31, 2015 |
|---|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 | Total gains/(losses) |
| **ASSETS** | | | | | |
| Securities available for sale | $ 419,346 | $ 32,649 | $ 386,697 | $ - | $ 1,655 |
| Loans held for sale | 50,445 | - | 50,445 | - | (151) |
| Commitments to originate mortgage loans | 1,859 | - | 1,859 | - | (185) |
| Total assets at fair value | $ 471,650 | $ 32,649 | $ 439,001 | $ - | $ 1,319 |
| **LIABILITIES** | | | | | |
| Commitments to sell mortgage loans | $ 83 | $ - | $ 83 | $ - | $ 162 |
| Mortgage banking short positions | 23 | - | 23 | - | 212 |
| Total liabilities at fair value | $ 106 | $ - | $ 106 | $ - | $ 374 |

| | Carrying Value at December 31, 2014 | | | | Twelve Months Ended December 31, 2014 |
|---|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 | Total gains/(losses) |
| **ASSETS** | | | | | |
| Securities available for sale | $ 449,333 | $ 19,921 | $ 429,412 | $ - | $ 53 |
| Loans held for sale | 47,109 | - | 47,109 | - | 622 |
| Commitments to originate mortgage loans | 2,015 | - | 2,015 | - | 1,122 |
| Total assets at fair value | $ 498,457 | $ 19,921 | $ 478,536 | $ - | $ 1,797 |
| **LIABILITIES** | | | | | |
| Commitments to sell mortgage loans | $ 295 | $ - | $ 295 | $ - | $ (403) |
| Mortgage banking short positions | 185 | - | 185 | - | (459) |
| Total liabilities at fair value | $ 480 | $ - | $ 480 | $ - | $ (862) |

The Company sells short positions in mortgage-backed securities to hedge interest rate risk on the loans committed for mandatory delivery. The commitments to originate and sell mortgage banking loans and our short positions are derivatives and are recorded at fair value.

The Company may also be required from time to time to measure certain other assets at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These adjustments to fair value usually result from the application of the lower of cost or market accounting or write-down of individual assets. For assets measured at fair value on a nonrecurring basis the following table provides the level of valuation assumptions used to determine the carrying value at December 31 (in thousands):

| | 2015 | | | | |
|---|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 | Total gains/(losses) |
| Impaired loans[1] | $ 1,928 | $ - | $ 1,928 | $ - | $ 192 |
| Other real estate[2] | 242 | - | 242 | - | (7) |
| Total | $ 2,170 | $ - | $ 2,170 | $ - | $ 185 |

| | 2014 | | | | |
|---|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 | Total gains/(losses) |
| Impaired loans[1] | $ 4,569 | $ - | $ 4,569 | $ - | $ (75) |
| Other real estate[2] | 256 | - | 256 | - | 90 |
| Total | $ 4,825 | $ - | $ 4,825 | $ - | $ 15 |

(1) Represents the carrying value and related write-downs of loans based on the appraised value of the collateral.
(2) Represents the fair value of the collateral less estimated selling costs and are based upon appraised values.

## NOTE 17. Fair Value of Financial Instruments

The estimated fair values of the Company's financial instruments are as follows as of December 31 (in thousands):

| | Level in Fair Value Measurement Hierarchy | December 31, 2015 | | December 31, 2014 | |
|---|---|---|---|---|---|
| | | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Assets: | | | | | |
| Cash and cash equivalents | Level 1 | $ 15,189 | $ 15,189 | $ 41,124 | $ 41,124 |
| Investment securities available for sale | Level 1 | 32,649 | 32,649 | 19,921 | 19,921 |
| Investment securities available for sale | Level 2 | 386,697 | 386,697 | 429,412 | 429,412 |
| Federal Reserve Bank and Federal Home Loan Bank stock | Level 2 | 3,219 | 3,219 | 2,817 | 2,817 |
| Loans held for sale-mortgage banking | Level 2 | 50,445 | 50,445 | 47,109 | 47,109 |
| Commitments to originate mortgage loans | Level 2 | 1,859 | 1,859 | 2,015 | 2,015 |
| Loans and leases held for investment, net | Level 2 | 371,292 | 370,243 | 352,188 | 352,506 |
| Accrued interest receivable | Level 2 | 4,027 | 4,027 | 3,931 | 3,931 |
| | | $ 865,377 | $ 864,328 | $ 898,517 | $ 898,835 |
| Liabilities and Stockholders' Equity: | | | | | |
| Deposits, noninterest-bearing | Level 2 | $ 168,259 | $ 168,259 | $ 187,400 | $ 187,400 |
| Deposits, interest-bearing | Level 2 | 612,190 | 612,449 | 623,831 | 624,044 |
| Borrowings and advances | Level 2 | 31,151 | 31,204 | 16,002 | 16,002 |
| Accrued interest payable | Level 2 | 487 | 487 | 338 | 338 |
| Accrued expenses | Level 2 | 7,398 | 7,398 | 7,279 | 7,279 |
| Commitments to sell mortgage loans | Level 2 | 83 | 83 | 295 | 295 |
| Mortgage banking short positions | Level 2 | 23 | 23 | 185 | 185 |
| Guaranteed preferred beneficial interests in Company's subordinated debentures | Level 2 | 15,015 | 9,426 | 15,018 | 9,125 |
| | | $ 834,606 | $ 829,329 | $ 850,348 | $ 844,668 |
| Financial instruments with off-balance-sheet risk: | | | | | |
| Commitments to extend credit | Level 2 | $ - | $ 203 | $ - | $ 265 |
| Standby and commercial letters of credit | Level 2 | $ - | $ 13 | $ - | $ 13 |

The Company is required to disclose the estimated fair value of financial instruments. Fair value estimates are subjective in nature, involving uncertainties and matters of significant judgment, and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

## NOTE 18. Financial Instruments with Off-Balance-Sheet Risk

In the normal course of business, the Company is a party to various financial instruments with off-balance-sheet risk, primarily to meet the needs of our customers as well as to manage our interest rate risk. These instruments, which are issued by the Company for purposes other than trading, carry varying degrees of credit, interest rate or liquidity risk in excess of the amounts reflected in the consolidated balance sheets.

**Commitments to Extend Credit**

Commitments to extend credit are agreements to lend to a customer, which are binding, provided there is no violation of any condition in the contract, and generally have fixed expiration dates or other termination clauses. The contractual amount represents the Bank's exposure to credit loss in the event of default by the borrower. At December 31, 2015, based on current information, no losses were anticipated as a result of these commitments. The Bank manages this credit risk by using the same credit policies it applies to loans. Collateral is obtained to secure commitments based on management's credit assessment of the borrower. The collateral may include marketable securities, receivables, inventory, equipment or real estate. Since the Bank expects many of the commitments to expire without being drawn, total commitment amounts do not necessarily represent the Bank's future liquidity requirements related to such commitments.

In our mortgage banking operations, we commit to extend credit for purposes of originating residential loans. We underwrite these commitments to determine whether each loan meets criteria established by the secondary market for residential loans. See Note 1 and 16 to these consolidated financial statements for more information on financial instruments and derivatives related to our mortgage banking operations.

**Standby and Commercial Letters of Credit**

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Commercial letters of credit are issued on behalf of customers to ensure payment or collection in connection with trade transactions. In the event of a customer's nonperformance, the Bank's credit loss exposure is up to the letter's contractual amount. At December 31, 2015, based on current information, no losses were anticipated as a result of these commitments. Management assesses the borrower's credit to determine the necessary collateral, which may include marketable securities, real estate, accounts receivable and inventory. Since the conditions requiring the Bank to fund letters of credit may not occur, the Bank expects our liquidity requirements related to such letters of credit to be less than the total outstanding commitments.

The contractual amounts of these financial instruments were as follows as of December 31 (in thousands):

| | 2015 | | 2014 | |
|---|---|---|---|---|
| | Fixed Rate | Variable Rate | Fixed Rate | Variable Rate |
| Commitments to extend credit | $ 14,747 | $ 51,298 | $ 19,515 | $ 62,728 |
| Standby and commercial letters of credit | 585 | 709 | 604 | 731 |

In addition to the amounts in the table above, our mortgage banking commitments to fund loans totaled $94.3 million at December 31, 2015 and $91.1 million at December 31, 2014. Also, our mortgage banking commitments to sell loans totaled $143.6 million at December 31, 2015 and $136.8 million at December 31, 2014.

**Mortgage Banking Obligations**
Through its mortgage banking operations, the Company originates and sells residential mortgage loans servicing released to third parties. These loans are sold without recourse to the Company. However, standard industry practices require representations and warranties which generally require sellers to reimburse a portion of the sales proceeds if a sold loan defaults or pays off shortly after the sale of the loan (i.e. generally within four months of the sale). The following is a summary of activity related to mortgage banking reimbursement obligations at December 31 (in thousands):

| | 2015 | 2014 |
|---|---|---|
| Balance, beginning of period | $ 1,879 | $ 1,679 |
| Provision | 145 | 552 |
| Write offs, net | (243) | (352) |
| Balance, end of period | $ 1,781 | $ 1,879 |

# NOTE 19. Guarantees and Contingent Consideration

**Guaranteed Preferred Beneficial Interests in Company's Subordinated Debentures**
BNCCORP fully and unconditionally guarantees the Company's subordinated debentures.

**Performance and Financial Standby Letters of Credit**
As of December 31, 2015 and 2014, the Bank had outstanding $131 thousand and $190 thousand, respectively, of performance standby letters of credit and $5.5 million and $5.9 million, respectively, of financial standby letters of credit. Performance standby letters of credit are irrevocable obligations to the beneficiary on the part of the Bank to make payment on account in an event of default by the account party in the performance of a nonfinancial or commercial obligation. Financial standby letters of credit are irrevocable obligations to the beneficiary on the part of the Bank to repay money for the account of the account party or to make payment on account of any indebtedness undertaken by the account party, in the event that the account party fails to fulfill its obligation to the beneficiary. Under these arrangements, the Bank could, in the event of the account party's nonperformance, be required to pay a maximum of the amount of issued letters of credit. The Bank has recourse against the account party up to and including the amount of the performance standby letter of credit. The Bank evaluates each account party's creditworthiness on a case-by-case basis and the amount of collateral obtained varies and is based on management's credit evaluation of the account party.

# NOTE 20. Related-Party/Affiliate Transactions

The Bank has entered into transactions with related parties, such as opening deposit accounts for and extending credit to employees of the Company. The related party transactions have been made under terms substantially the same as those offered by the Bank to unrelated parties.

In the normal course of business, loans are granted to, and deposits are received from, executive officers, directors, principal stockholders and associates of such persons. The aggregate dollar amount of these loans was $2.3 million and $3.2 million at December 31, 2015 and 2014, respectively. Advances of loans to related parties in 2015 and 2014 totaled $486,000 and $503,000, respectively. Loan pay downs by related parties in 2015 and 2014 were $1.5 million and $353,000, respectively. Commitments to extend credit to related parties decreased to $179,000 at December 31, 2015 from $605,000 at December 31, 2014. The total amount of deposits received from these parties was $2.7 million at December 31, 2015 and $2.6 million at December 31, 2014. Loans to, and deposits received from, these parties were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than the normal risk of collection.

The Federal Reserve Act limits amounts of, and requires collateral on, extensions of credit by the Bank to BNCCORP, and with certain exceptions, its non-bank affiliates. There are also restrictions on the amounts of investment by the Bank in stocks and other subsidiaries of BNCCORP and such affiliates and restrictions on the acceptance of their securities as collateral for loans by the Bank. As of December 31, 2015, BNCCORP and its affiliates were in compliance with these requirements.

# NOTE 21. Income Taxes

The expense (benefit) for income taxes on operations consists of the following for the years ended December 31 (in thousands):

| | 2015 | 2014 |
|---|---|---|
| Current: | | |
| Federal | $ 3,528 | $ 2,113 |
| State | 565 | 353 |
| | 4,093 | 2,466 |
| Deferred: | | |
| Federal | (182) | 1,174 |
| State | 34 | 431 |
| | (148) | 1,605 |
| Total | $ 3,945 | $ 4,071 |

The expense for federal income taxes on operations expected at the statutory rate differs from the actual expense for the years ended December 31 (in thousands):

| | 2015 | 2014 |
|---|---|---|
| Tax expense at 34% statutory rate | $ 4,471 | $ 4,259 |
| State taxes (net of Federal benefit) | 395 | 517 |
| Tax-exempt interest | (910) | (727) |
| Cash surrender values of bank-owned life insurance | (148) | (149) |
| Other, net | 137 | 171 |
| Total | $ 3,945 | $ 4,071 |

Temporary differences between the financial statement carrying amounts and tax bases of assets and liabilities that result in significant portions of the Company's deferred tax assets and liabilities are as follows as of December 31 (in thousands):

| | | 2015 | | 2014 |
|---|---|---|---|---|
| Deferred tax asset: | | | | |
| Loans, primarily due to credit losses | $ | 3,808 | $ | 3,968 |
| Compensation | | 562 | | 274 |
| Acquired intangibles | | 199 | | 204 |
| Net operating loss carryforwards | | 21 | | 111 |
| Alternative minimum tax credits | | - | | 179 |
| Other real estate owned | | 65 | | 95 |
| Other | | 204 | | 180 |
| Deferred tax asset | | 4,859 | | 5,011 |
| Deferred tax liability: | | | | |
| Unrealized gain on securities available for sale | | 1,929 | | 2,691 |
| Discount accretion on securities | | 13 | | 221 |
| Premises and equipment | | 727 | | 816 |
| Other | | 229 | | 232 |
| Deferred tax liability | | 2,898 | | 3,960 |
| | | 1,961 | | 1,051 |
| Valuation allowance | | (14) | | (14) |
| Net deferred tax asset | $ | 1,947 | $ | 1,037 |

Subject to certain limiting statutes, the Company is able to carry forward state tax net operating losses aggregating $456,000 as of December 31, 2015. The state net operating losses expire between 2017 and 2031.

The Company files consolidated federal and unitary state income tax returns where allowed. Tax years ended December 31, 2012 through 2015 remain open to federal examination. Tax years ended December 31, 2011 through 2015 remain open to state examinations.

## NOTE 22. Earnings Per Share

The following table shows the amounts used in computing per share results (in thousands, except share and per share data):

| | | 2015 | | 2014 |
|---|---|---|---|---|
| Denominator for basic earnings per share: | | | | |
| Average common shares outstanding | | 3,386,600 | | 3,369,021 |
| Dilutive effect of stock compensation | | 111,140 | | 122,233 |
| Denominator for diluted earnings per share | | 3,497,740 | | 3,491,254 |
| Numerator (in thousands): | | | | |
| Net income | $ | 9,206 | $ | 8,456 |
| Preferred stock costs | | 1,656 | | 1,796 |
| Net income available to common shareholders | $ | 7,550 | $ | 6,660 |
| Basic earnings per common share | $ | 2.23 | $ | 1.98 |
| Diluted earnings per common share | $ | 2.16 | $ | 1.91 |

## NOTE 23. Benefit Plans

BNCCORP has a qualified 401(k) savings plan covering all employees of BNCCORP and its subsidiaries who meet specified age and service requirements. Under the plan, eligible employees may elect to defer up to 75% of compensation each year not to exceed the dollar limits set by law. At their discretion, BNCCORP and its subsidiaries may provide matching contributions to the plan. In 2015 and 2014, BNCCORP and its subsidiaries made matching contributions of up to 50% of eligible employee deferrals up to a maximum employer contribution of 5% of employee compensation. Generally, all participant contributions and earnings are fully and immediately vested. The Company makes its matching contribution during the first calendar quarter following the last day of each calendar year and an employee must be employed by the Company on the last day of the calendar year in order to receive the current year's employer match. The anticipated matching contribution is expensed monthly over the course of the calendar year based on employee contributions made throughout the year. The Company made matching contributions of $559,000 and $466,000 for 2015 and 2014, respectively. Under the investment options available under the 401(k) savings plan, prior to January 28, 2008, employees could elect to invest their salary deferrals in BNCCORP common stock. At December 31, 2015, the assets in the plan totaled $19.6 million and included $570,000 (35,000 shares) invested in BNCCORP common stock. At December 31, 2014, the assets in the plan totaled $18.3 million and included $602,000 (35,000 shares) invested in BNCCORP common stock. On January 28, 2008, the Company voluntarily delisted from the NASDAQ Global Market and deregistered its common stock under the Securities Exchange Act of 1934 (as amended). As a result, the participants are prohibited from making new investments of the Company's common stock in the plan.

During 2015, the Company adopted a non-qualified deferred compensation plan for the benefit of select employees. The plan structure permits the Company to make discretionary awards into an in-service account or a retirement account of a plan participant established under the plan. BNC recognizes the expense for discretionary awards in the period it commits to such awards. Additionally, plan participants may defer some or all of their annual incentive awards into their in-service accounts. Company discretionary awards to the participant's in-service account are generally vested 50% upon initial participation with the remainder vesting over 5 years. A participant's retirement account generally vests 50% upon an initial contribution and thereafter over 10 years. Participants may allocate their in-service account balance among a fixed number of investment options. The value of the payout from the in-service account will depend on the performance of such investment options. Company discretionary awards into a participant's retirement account are denominated in shares of BNC common stock and upon retirement, the plan participant will receive the number of shares of BNC common stock credited to the participant's retirement account at that time. A separate Rabbi Trust has been established by the Company to hedge the change in value of this liability. Assets in the trust hedging in-service liabilities are recorded in other assets. BNC stock held in the trust related to the Company's retirement account obligation is recorded in treasury stock and equates to 11,000 shares as of December 31, 2015. As of December 31, 2015, the plan obligation totaled $330 thousand.

## NOTE 24. Commitments and Contingencies

**Leases**

The Bank has entered into operating lease agreements for certain facilities and equipment used in its operations. Rent expense for the years ended December 31, 2015 and 2014 was $975,000 and $1.1 million, respectively, for facilities, and $20,000 and $26,000, respectively, for equipment and other items. At December 31, 2015, the total minimum annual base lease payments for operating leases were as follows (in thousands):

| | |
|---|---|
| 2016 | $ 900 |
| 2017 | 712 |
| 2018 | 397 |
| 2019 | 383 |
| 2020 | 268 |
| Thereafter | 1,134 |

# NOTE 25. Share-Based Compensation

The Company has four share-based plans for certain key employees and directors whereby shares of common stock have been reserved for awards in the form of stock options or restricted stock awards. Pursuant to each plan, the compensation committee may grant options at prices equal to the fair value of the stock at the grant date.

Total shares in plan and total shares available as of December 31, 2015 are as follows:

| | 1995 | 2002 | 2006 | 2010 | Total |
|---|---|---|---|---|---|
| Total Shares in Plan | 250,000 | 125,000 | 200,000 | 250,000 | 825,000 |
| Total Shares Available | 48,751 | - | 7,850 | 250,000 | 306,601 |

The Company recognized share-based compensation expense of $136,000 and $119,000 for the years ended December 31, 2015 and 2014, respectively, related to restricted stock.

The tax benefits associated with share-based compensation was approximately $59,000 for the year ended December 31, 2015 and was approximately $17,000 for the year ended December 31, 2014.

At December 31, 2015, the Company had $111,000 of unamortized restricted stock compensation. At December 31, 2014, the Company had $215,000 of unamortized restricted stock compensation. Restricted shares of stock granted generally have vesting and amortization periods of at least three years.

Following is a summary of restricted stock activities for the years ended December 31:

| | 2015 | | 2014 | |
|---|---|---|---|---|
| | Number Restricted Stock Shares | Weighted Average Grant Date Fair Value | Number Restricted Stock Shares | Weighted Average Grant Date Fair Value |
| Nonvested, beginning of year | 27,667 | $ 12.29 | 25,000 | $ 11.88 |
| Granted | 2,000 | 16.65 | 6,000 | 13.19 |
| Vested | (15,333) | 12.28 | (3,333) | 10.83 |
| Forfeited | - | - | - | - |
| Nonvested, end of year | 14,334 | 12.91 | 27,667 | 12.29 |

The Company granted 240,000 stock options on March 17, 2010. The stock options had a two year vesting period and a ten year contractual term. The exercise price is equal to the market price on grant date, which was $3.00. The fair value of each stock option is estimated on the date of grant using a Black-Scholes methodology with the assumptions noted below:

| | |
|---|---|
| Expected volatility | 32.56% |
| Dividend yield | 0.00% |
| Risk-free interest rate – seven year treasury yield | 3.201% |
| Expected life of stock option | 7 years |

The Company did not recognize share-based compensation expense for the years ended December 31, 2015 and 2014, respectively, related to stock options. At December 31, 2015, the Company had no unamortized compensation cost related to non-vested stock options.

The Company is permitted to issue shares from treasury shares already held when options are exercised.

Following is a summary of vested stock options and options expected to vest as of December 31, 2015:

| | Stock Options Outstanding | Stock Options Currently Exercisable | Stock Options Vested and Expected to Vest |
|---|---|---|---|
| Number | 107,200 | 107,200 | 107,200 |
| Weighted-average exercise price | $3.00 | $3.00 | $3.00 |
| Weighted-average remaining contractual term | 4.21 years | 4.21 years | 4.21 years |

Following is a summary of stock option transactions for the years ended December 31:

| | 2015 | | 2014 | |
|---|---|---|---|---|
| | Options to Purchase Shares | Weighted Average Exercise Price | Options to Purchase Shares | Weighted Average Exercise Price |
| Outstanding, beginning of year | 125,800 | $ 3.00 | 163,200 | $ 3.00 |
| Granted | - | - | - | - |
| Exercised | (18,600) | 3.00 | (37,400) | 3.00 |
| Forfeited | - | - | - | - |
| Outstanding, end of year | 107,200 | 3.00 | 125,800 | 3.00 |
| Exercisable, end of year | 107,200 | 3.00 | 125,800 | 3.00 |
| Weighted average fair value of options: | | | | |
| Granted | $ - | | $ - | |
| Exercised | $ 1.47 | | $ 1.47 | |
| Forfeited | $ - | | $ - | |

Following is a summary of the status of options outstanding at December 31, 2015:

| | Outstanding Options | | | Exercisable Options | |
|---|---|---|---|---|---|
| | Number | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Number | Weighted Average Exercise Price |
| Options with exercise prices of: | | | | | |
| $3.00 | 107,200 | 4.21 years | $ 3.00 | 107,200 | $ 3.00 |

# NOTE 26. Condensed Financial Information-Parent Company Only

Condensed financial information of BNCCORP, INC. on a parent company only basis is as follows:

**Parent Company Only**
Condensed Balance Sheets
As of December 31
(In thousands, except per share data)

| | 2015 | 2014 |
|---|---|---|
| Assets: | | |
| Cash and cash equivalents | $ 5,351 | $ 6,194 |
| Investment in subsidiaries | 83,332 | 86,109 |
| Receivable from subsidiaries | 964 | 454 |
| Other | 482 | 935 |
| Total assets | $ 90,129 | $ 93,692 |
| Liabilities and stockholders' equity: | | |
| Subordinated debentures | $ 15,015 | $ 15,018 |
| Long-term borrowings | 10,000 | - |
| Payable to subsidiaries | 54 | 50 |
| Accrued expenses and other liabilities | 604 | 911 |
| Total liabilities | 25,673 | 15,979 |
| Preferred stock, $.01 par value. Authorized 2,000,000 shares: | | |
| Preferred Stock - 9% Series A 20,093 shares issued; | - | 20,093 |
| Preferred Stock - 9% Series B 1,005 shares issued; | - | 1,005 |
| Common stock, $.01 par value – Authorized 35,000,000 shares; 3,428,416 and 3,413,854 shares issued and outstanding | 34 | 34 |
| Capital surplus – common stock | 25,979 | 25,831 |
| Retained earnings | 42,172 | 34,622 |
| Treasury stock (240,237 and 254,799 shares, respectively) | (3,278) | (3,421) |
| Accumulated other comprehensive loss, net of income taxes | (451) | (451) |
| Total stockholders' equity | 64,456 | 77,713 |
| Total liabilities and stockholders' equity | $ 90,129 | $ 93,692 |

**Parent Company Only**
Condensed Statements of Operations
For the Years Ended December 31
(In thousands)

| | 2015 | 2014 |
|---|---|---|
| Income: | | |
| Management fee income | $ 1,820 | $ 1,448 |
| Interest | 4 | 8 |
| Other | 9 | 26 |
| Total income | 1,833 | 1,482 |
| Expenses: | | |
| Interest | 394 | 884 |
| Salaries and benefits | 1,404 | 1,197 |
| Legal and other professional | 603 | 490 |
| Other | 779 | 1,075 |
| Total expenses | 3,180 | 3,646 |
| Loss before income tax benefit and equity in earnings of subsidiaries | (1,347) | (2,164) |
| Income tax benefit | 330 | 686 |
| Loss before equity in earnings of subsidiaries | (1,017) | (1,478) |
| Equity in earnings of subsidiaries | 10,223 | 9,934 |
| Net income | $ 9,206 | $ 8,456 |

**Parent Company Only**
Condensed Statements of Cash Flows
For the Years Ended December 31
(In thousands)

| | 2015 | 2014 |
|---|---|---|
| Operating activities: | | |
| Net income | $ 9,206 | $ 8,456 |
| Adjustments to reconcile net income to net cash used in operating activities - | | |
| Equity in earnings of subsidiaries | (10,223) | (9,934) |
| Share based compensation | 291 | 171 |
| Change in prepaid expenses and other receivables | (57) | 732 |
| Change in accrued expenses and other liabilities | (54) | (601) |
| Net cash used in operating activities | (837) | (1,176) |
| Investing activities: | | |
| Dividend paid by subsidiaries | 13,000 | 7,500 |
| Net cash provided by investing activities | 13,000 | 7,500 |
| Financing activities: | | |
| Redemption of preferred stock | (21,098) | - |
| Dividends paid on preferred stock | (1,908) | (1,698) |
| Decrease in subordinate debentures | - | (7,500) |
| Decrease in long-term borrowings | - | (2,700) |
| Increase in long-term borrowings | 10,000 | 2,700 |
| Net cash used in financing activities | (13,006) | (9,198) |
| Net decrease in cash and cash equivalents | (843) | (2,874) |
| Cash and cash equivalents, beginning of year | 6,194 | 9,068 |
| Cash and cash equivalents, end of year | $ 5,351 | $ 6,194 |
| | | |
| Supplemental cash flow information: | | |
| Interest paid | $ 527 | $ 468 |
| Income taxes paid | $ 3,463 | $ 2,218 |

## NOTE 27. Subsequent Events

The Company has evaluated subsequent events from the balance sheet date through March 25, 2016, the date at which the financial statements were available to be issued, and determined there are no other items to disclose.

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# CORPORATE DATA

## Investor Relations

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corp@bncbank.com

General Inquiries:
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322 East Main Avenue
Bismarck, North Dakota 58501
Telephone (701) 250-3040
Facsimile (701) 222-3653

Daniel Collins
*Chief Financial Officer*
612-305-2210

Timothy J. Franz
*President/CEO*
612-305-2213

## Annual Meeting

The 2016 annual meeting of stockholders will be held on Wednesday, June 15, 2016 at 8:30 a.m. (Central Daylight Time) at BNC National Bank, Second Floor Conference Room, 322 East Main Avenue, Bismarck, ND 58501.

## Independent Public Accountants

KPMG LLP
233 South 13th Street
Suite 1600
Lincoln, NE 68508

## Securities Listing

BNCCORP, INC.'s common stock is traded on the OTCQX Markets under the symbol: "BNCC."

## Common Stock Prices

For the Years Ended December 31,

| | 2015[1] | | 2014[1] | |
|---|---|---|---|---|
| | **High** | **Low** | **High** | **Low** |
| First Quarter | $17.10 | $15.30 | $13.79 | $12.03 |
| Second Quarter | $17.20 | $15.09 | $18.00 | $13.24 |
| Third Quarter | $17.35 | $16.00 | $18.40 | $17.55 |
| Fourth Quarter | $16.85 | $15.95 | $18.22 | $16.60 |

[1] The quotes represent the high and low closing sales prices as reported by OTCQX Markets.

## Stock Transfer Agent and Registrar

American Stock Transfer & Trust Company
59 Maiden Lane, Plaza Level
New York, NY 10038
(800) 937-5449

## Corporate Broker

D. A. Davidson Community Banking and Wealth Management Group
1-800-288-2811
cbwm@dadco.com

## Directors, BNCCORP, INC.

Tracy Scott
*Chairman of the Board and*
*Retired Co-Founder of BNCCORP, INC.*

Timothy J. Franz
*President and*
*Chief Executive Officer of BNCCORP, INC.*

Nathan P. Brenna
*Owner, Brenna Farm and Ranch*
*Former Attorney*

Gaylen Ghylin
*EVP, Secretary and CFO of*
*Tiller Corporation d/b/a Barton Sand & Gravel Co., Commercial Asphalt Co. and Barton Enterprises, Inc.*

Richard M. Johnsen, Jr.
*Chairman of the Board and*
*Chief Executive Officer of*
*Johnsen Trailer Sales, Inc.*

Michael O'Rourke
*Attorney / Author*

## Directors, BNC National Bank

Doug Brendel
Shawn Cleveland
Daniel J. Collins
Timothy J. Franz
Dave Hoekstra
Mark E. Peiler
Scott Spillman
Cheryl A. Stanton

## BNC National Bank

**Bank Branches – North Dakota**

Bismarck Main[2]
322 East Main Avenue
Bismarck, ND 58501

Bismarck South
219 South 3rd Street
Bismarck, ND 58504

Bismarck North[2]
801 East Century Avenue
Bismarck, ND 58503

Bismarck Sunrise[2]
3000 Yorktown Drive
Bismarck, ND 58503

Primrose Assisted Living Apartments
1144 College Drive
Bismarck, ND 58501

Touchmark on West Century
1000 West Century Avenue
Bismarck, ND 58503

Crosby
107 North Main Street
Crosby, ND 58730

Garrison
92 North Main
Garrison, ND 58540

Kenmare
103 1st Avenue SE
Kenmare, ND 58746

Linton
104 North Broadway
Linton, ND 58552

Stanley
210 South Main
Stanley, ND 58784

Watford City
205 North Main
Watford City, ND 58854

Mandan[2]
2711 Sunset Drive NW
Mandan, ND 58554

**Bank Branches - Arizona**

Glendale – Charter Address
20175 North 67th Ave
Glendale, AZ 85308

Perimeter
17550 North Perimeter Drive
Scottsdale, AZ 85255

**Bank Branches - Minnesota**

Golden Valley[2]
650 North Douglas Drive
Golden Valley, MN 55422

**Mortgage Banking Offices:**

Glendale
6685 W. Beardsley
Glendale, AZ 85383

Scottsdale
17550 North Perimeter Drive, Ste 260
Scottsdale, AZ 85255

Wichita
2868 North Ridge Road
Wichita, KS 67205

Wichita
1718 North Webb Road
Wichita, KS 67206

Wichita
12031 East 13th Street
Wichita, KS 67206

Overland Park
7007 College Boulevard
Overland Park, KS 66211

Moline
800 36th Avenue
Moline, IL 61265

Bentonville
1120 South Walton Boulevard
Bentonville, AK 72712

Lee's Summit
600 SW Jefferson
Lee's Summit, MO 64063

Lebanon
1403 West Elm Street
Lebanon, MO 65336

[2] Bank branches offering mortgage banking services.

BNCCORP

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322 East Main Avenue
Bismarck, ND 58501
(701) 250-3040
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OTCQX