

2016

ANNUAL REPORT



BNCCORP

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 17 locations. BNC also conducts mortgage banking from 14 locations in Arizona, Minnesota, North Dakota, Illinois, Kansas, and Missouri.

BNC was established in the belief that business relationships must be built on a foundation of trust and ethical practices.

BNC: EXCELLENCE IN COMMUNITY BANKING

From the beginning, BNCCORP, INC. (“BNC”) has been defined – and driven – by a deep commitment to serving our clients and communities. In launching the Company and its BNC National Bank subsidiary over 25 years ago, we envisioned a bank that would focus on the needs of businesses, as well as their owners and employees, that were not being met by larger national and regional banks. To turn that vision into a reality, we created a business model that is differentiated by a relationship-first approach, enabling us to deliver value-added financial solutions and high touch customer service. We encourage our people to understand our clients’ businesses, to work collaboratively as one businessperson to another, and to align our clients’ needs with the right set of products and services.

In the process, we have grown from our roots and we now deliver community banking and wealth management services in North Dakota, Arizona and Minnesota. BNC also offers mortgage banking through a consumer-direct channel, complemented by retail channels, from locations in Arizona, Minnesota, North Dakota, Illinois, Kansas and Missouri.

Ethical, Entrepreneurial and Evolving

Even as we have expanded our reach and enhanced our services, our strategy remains the same as on day one: deliver solutions to help businesses in our community to thrive – and do it in an ethical and entrepreneurial way. Our founders, Greg Cleveland and Tracy Scott, approached banking from a business perspective and the fundamental belief that business relationships must be built on a foundation of trust and ethical practices. This principle still guides our decision-making today.

Our commercial banking clients are very entrepreneurial. We are, too. This is an important part of who and what we are. We leverage our entrepreneurial energy to stay in step with our clients’ changing needs and the ever evolving marketplace in which we operate and compete. Responding to clients’ needs and market forces, we have expanded our offerings beyond core banking products. We now offer wealth management services, including employee benefit plan administration and tax services. By employing innovative technologies, such as internet mortgage applications and remote and mobile banking, we are able to provide convenient, effective and secure access to services for clients who wish to conduct business digitally.

Twenty-five years on, BNC remains dedicated to our core ethical and entrepreneurial principles – while evolving to meet the changing needs of our clients. In doing so, we help create value and opportunity for businesses, our own team members, our shareholders and the communities we serve.



CORPORATE PROFILE: THE BUSINESS OF BNC

BNC is a diversified community bank with three primary areas of focus: commercial banking, retail and mortgage banking, and wealth management.

Commercial Banking. We meet the needs of small to middle-market businesses with a range of commercial banking services, including: business financing, commercial real estate lending, SBA loans, business checking, cash management, corporate credit cards and merchant services. The core of our commercial banking relationships are in North Dakota, mainly in the capital region of Bismarck/Mandan. From Bismarck, and locations to the north and west, we serve communities in North Dakota that are economically influenced by oil and energy, and to a lesser extent, the agricultural communities of central North Dakota. We also have a commercial banking presence in Phoenix, Arizona and Minnesota, which serves to create further opportunities for growth while diversifying our credit exposure.

Retail and Mortgage Banking. BNC's services to consumers include retail banking, provided through a network of locations in North Dakota, Arizona and Minnesota. Among our broad array of retail banking services are personal checking and savings products, health savings accounts, personal loans and card services. Our branch network is concentrated in North Dakota, where we are responsive to the preference of our customers for convenient face-to-face transactional banking. BNC has been rewarded with our customers' loyalty as our deposit growth and retention has been remarkable.

Our mortgage banking operations generate residential loans through a consumer direct channel, as well as a retail channel with locations in Arizona, Minnesota, North Dakota, Illinois, Kansas and Missouri. The consumer direct model emphasizes the use of technology, including internet-generated leads and a call center, to originate loans throughout the U.S. The retail model is more traditional and emphasizes relationships to originate loans near our branch network.

Wealth Management. A trusted partner for our clients as they plan for retirement and manage their investments, BNC's wealth management solutions include: 401(k) and other retirement plans, trust services, personal wealth advisory, and professional services such as tax, accounting, payroll and business planning. Many of our wealth management clients are derived from commercial banking relationships. For example, we administer retirement savings plans for the employees of our business clients. We are well positioned to help clients manage wealth and transfer assets in a manner that enables them to accomplish their financial goals.

TO OUR SHAREHOLDERS, CUSTOMERS, EMPLOYEES AND COMMUNITY

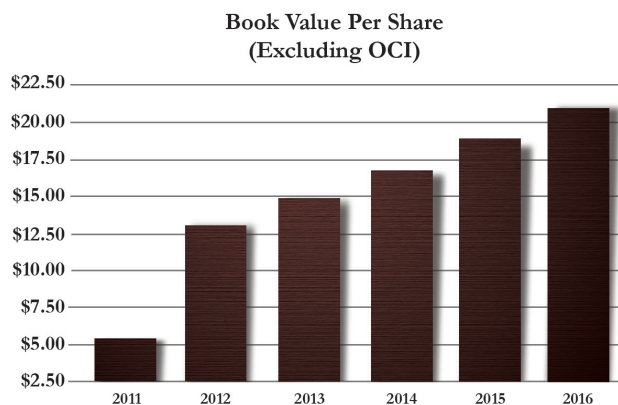
Traditionally, our Annual Report has been more focused on BNC's operating and financial performance for the past year. This year, we thought we would share with you an expanded discussion, including key elements of our entrepreneurial spirit; operating philosophy, community involvement; and particularly how we strive to be long-term business partners with our clients. We are expanding our discussion because community banks like BNC need to balance the interests of multiple constituencies: clients, employees, regulators, and the communities where we live and work, while creating value for our shareholders. We thought it would be important to provide a perspective on how we balance the needs of all these constituencies, because doing so is essential to good community banking and drives value for our shareholders.

Increasing Shareholder Value

Shareholders, of course, are particularly concerned with how we create value. In 2016, we delivered strong financial performance, with net income available to common shareholders of \$7.2 million, or \$2.03 per diluted share. Our return on average common shareholder equity was 10.35% in 2016, continuing a trend over the past several years of impressive returns on shareholder equity. In the five-year period since the beginning of 2012, our book value per common share has increased from \$5.35 to \$20.98, an increase of 292%. During this period, the average return on average common equity was 28% and our longer-term shareholders have been significantly rewarded. Summary information of BNC's book value per share, net income available to common shareholders, return on equity and earnings per share is shown below:



Timothy J. Franz
President and Chief Executive Officer

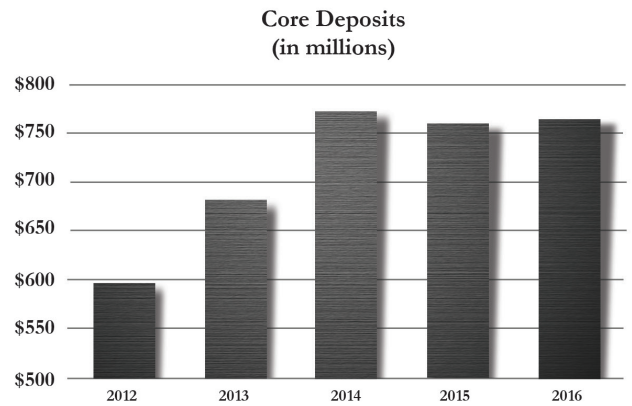
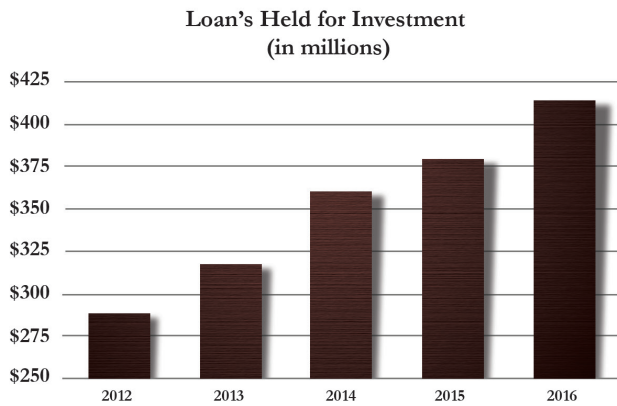


Performance Ratios Table

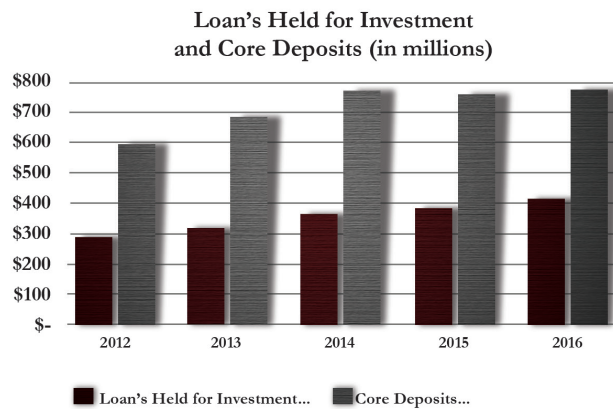
	For the Years Ended December 31,					
	2011	2012	2013	2014	2015	2016
Book Value Per Common Share (Excluding OCI)	\$5.35	\$12.99	\$14.89	\$16.72	\$18.93	\$20.98
Net Income available to common shareholder	\$2,814	\$25,162	\$7,307	\$6,660	\$7,550	\$7,156
Return on average common stockholders' equity	17.32%	90.04%	15.15%	12.37%	12.21%	10.35%
Basic earnings per common share	\$0.86	\$7.64	\$2.22	\$1.98	\$2.23	\$2.08
Diluted earnings per common share	\$0.86	\$7.52	\$2.11	\$1.91	\$2.16	\$2.03

Balancing Growth and Risk

We have generated these returns by nurturing our mortgage banking operations and growing our core bank opportunistically and judiciously. Growing core deposits in a cost-effective manner is a key value proposition in community banking. Our core deposits have increased \$240 million, or 46%, since the beginning of 2012. We believe that deposit rich franchises provide enhanced value to shareholders. We achieved this growth by capturing wealth created by the energy boom in western North Dakota and, more recently, by growing deposits in the Phoenix market. Many people currently anticipate interest rates will continue to increase. If they do, the value of core deposits should also increase, which also is positive for shareholder value.



While the organic growth in deposits has been strong, we have also grown our loans held for investment by \$121 million, or 41%, since the beginning of 2012. Very importantly, we have maintained excellent credit quality metrics while growing loans. The charts above show the recent growth of our loans and deposits.



The gap between our total deposits and total loans in the table above represents an opportunity to improve earnings. As we grow into our deposit base, our earnings can improve because the yield on our earning assets should increase. We will continue to work hard at this profit improving opportunity, but we will also balance our desire to improve earnings with maintaining strong risk management practices.

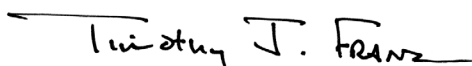
Investing in BNC's Future

Interest rates have been at historic lows in recent periods and mortgage banking is a very good way of creating value in a low interest rate environment. We have been both opportunistic and entrepreneurial with regard to our mortgage banking operations during this period. We generated significant revenues from these operations and used the profits to build capital and pay off debt to fortify BNC's balance sheet and benefit common shareholders. During this period we also invested in our mortgage banking operations to build a consumer direct model driven by technology to complement our traditional retail channel. In 2016, the consumer direct channel represented 79% of the total dollar volume of our mortgage loan originations. Recent results prove this model captures value in a refinance market. We are seeing early signs that a significant number of people are willing to use this channel to finance the purchase of homes and the housing market remains very strong as we move into early 2017.

Putting it All Together

At BNC, we are pleased to have delivered strong performance in 2016 and recent years. We believe BNC has fulfilled the promise of the community banking model: we are meeting the needs of our customers and communities and growing value for shareholders. We have also balanced generating current profits while investing in activities and people that will drive future revenue.

I would like to personally thank the people working at BNC, as well as our clients, shareholders and communities. Every day, I am more grateful to be associated with you. I am confident that, together, we have a strong foundation and the ingenuity to deliver more success in the years to come.


 Timothy J. Franz
 President and Chief Executive Officer

GROWING WITH OUR BUSINESS CLIENTS

At BNC, we are honored that our customers, particularly our commercial banking relationships, view us as long-term business partners. We enjoy relationships with thousands of business customers today. The core of our customer base continues to be Commercial and Industrial and Commercial Real Estate businesses, a high proportion of whom have been with us for more than a decade. Our team is proven and highly capable of serving a wide base of industries. The length of these relationships is important to BNC, as it fosters stability, results in loans and deposits with long lives and recurring revenues, and provides the opportunity to grow along with our clients.

We have helped customers launch, grow, transform and transition their businesses for over 25 years. We work hard to help them achieve their strategic goals by employing exceptional people, encouraging an entrepreneurial approach to providing quality individualized service, and adapting products and services to our customers' changing needs. We want to partner with customers in all phases of their business life cycle and BNC offers products suited for each phase. For example, we offer our start-up business customers flexible small business financing options, cash management solutions and tax preparation services. As a relationship bank, we work with customers as their needs grow and change, providing financing to expand a facility or support a higher level of business activity. Our Wealth Management team is a trusted partner to our clients as they plan for retirement, manage their personal investments, or consider ways to help their employees save for retirement.

Each customer is offered a primary point of contact, responsible for managing the relationship and "delivering the bank" in terms of accessing our full range of services. We surround and support our primary contacts with professionals who have the specialized skills required to deliver on our high level of customer care promise. At the heart of all of our relationships is the open and candid dialogue we maintain with customers. We listen and learn their needs, and strive to provide the right solution at the right time. More than once, a client has told us, "You know me better than my previous bank." Nothing makes us more proud than the thought that our people help customers create opportunity every day.

INNOVATION

To satisfy the changing needs of our clients, BNC is committed to innovations that enable us to deliver services in the most convenient, agile and effective way possible. As advances in technology offer opportunities for our customers to redefine how, when and where they want products and services delivered, BNC is regularly adding innovative technology enhancements to augment traditional service delivery models. In recent years, this has meant introducing mobile banking applications, remote and mobile deposit capture, person-to-person payments, interbank transfers and mobile wallet, to allow customers to manage their business without visiting a branch.

Our approach to mortgage banking provides a great example of how we bring innovation to traditional banking services. While many homeowners still prefer the relationship-based service our retail mortgage-banking channel provides, increasingly this industry is moving toward technology-based solutions to facilitate loan originations. To participate and compete in this changing marketplace, we built our consumer direct mortgage banking channel. We use internet-generated leads and a call-in center to serve consumers who are comfortable using technology to source financial products. The consumer direct channel expands our presence in the loan origination marketplace, allowing us to monetize quickly in a refinance market, and can shift readily to purchase originations in a market where homebuyers are more prevalent.

We will continue to add innovative solutions that our customers value. In all that we do, we consider the protection of our customers' information a fundamental element of our customer promise and are vigilant in maintaining rigorous security standards – as we combine high-touch personalized service with high-tech convenience and efficiency.

Nothing makes us more proud than the thought that our people help customers create opportunity every day.

BNC has fulfilled the promise of the community banking model: meeting the needs of our customers and communities and growing value for shareholders.

We will continue to combine high-touch personalized service with high-tech convenience and efficiency.

*The people of BNC
value being part of
an organization that
respects their abilities,
commitment and drive.*

VALUING OUR PEOPLE

The importance of having a dedicated team of talented and experienced people cannot be over-emphasized. BNC's people are our most important assets across every aspect of our operations. Approximately 30% of our banking operations employees have been with the bank for 10 years or more and almost 50% have been with us for over 5 years. We believe we have one of the most experienced banking teams in our core market area.

We strive to create an environment based on shared values, mutual respect, collegiality and fairness. Team members know what is expected of them and are given the opportunity for learning, personal development and growth, and a rewarding professional career.

Our relationship-first model attracts customers that value bankers who are willing to make the effort to learn their business, offer solutions to their challenges and help them capitalize on new opportunities. In return, our people value being part of an organization that respects their abilities, commitment and drive – leading to a strong, stable employee base. Our people demonstrate how much they value our company, its culture, the communities we serve and our customers by bringing their energy and passion to work each and every day.

CONTRIBUTING TO OUR COMMUNITIES

BNC is built on the principle that community banking is an essential part of the fabric of a vibrant community. Community banks occupy a unique space in the matrix of the American economy. Our position as a supporter for consumer and business assets to local economies is relatively obvious. Less obvious to some people is the degree to which good community banks are interwoven into the social fabric of their communities.

When community banking is done well, we become more than a commoditized source of loans and deposits. We actively participate in improving the quality of life in the communities we serve. BNC enthusiastically participates in the arts, education, business development and youth programs that bring vitality to our communities. Our people embrace this vision and devote their time and talent to community activities of all varieties.

BNC employees understand and embrace the connection between community banking and the vibrancy of their neighborhoods.

Forward-Looking Statements

Statements included in this cover letter to our Annual Report 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. Important factors that could cause our actual results and financial condition to differ materially from those indicated in the forward-looking statements include, but are not limited to: the impact of current and future regulation; the risks of loans and investments, including dependence on local and regional economic conditions; 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 mortgage banking revenues and 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. All statements in this news release, including forward-looking statements, speak only of the date they are made, and the Company undertakes no obligation to update any statement in light of new information or future events. In addition, we encourage readers to review the financial information included in this cover letter in conjunction with the Consolidated Financial Statements of BNCCORP, INC. and Subsidiaries included in the accompanying Annual Report.



BNCCORP

Year End Financial Report

For the Year Ended December 31, 2016

BNCCORP, INC.

(OTCQX: BNCC)

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BNCCORP, INC.
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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,				
	2016	2015	2014	2013	2012
Income Statement Data:					
Total interest income	\$ 29,346	\$ 27,915	\$ 29,264	\$ 23,706	\$ 23,992
Total interest expense	3,343	2,570	3,308	3,861	5,521
Net interest income	26,003	25,345	25,956	19,845	18,471
Provision (reduction) for credit losses	800	(400)	(800)	700	100
Non-interest income	25,777	24,950	20,454	29,285	42,938
Non-interest expense	41,193	37,544	34,683	35,981	39,965
Income tax expense (benefit)	2,631	3,945	4,071	3,822	(5,280)
Net income	\$ 7,156	\$ 9,206	\$ 8,456	\$ 8,627	\$ 26,624
Preferred stock costs	-	1,656	1,796	1,320	1,462
Net income available to common shareholders	\$ 7,156	\$ 7,550	\$ 6,660	\$ 7,307	\$ 25,162
Balance Sheet Data: (at end of period)					
Total assets	\$ 910,400	\$ 904,246	\$ 934,419	\$ 843,123	\$ 770,776
Investments securities available for sale	400,136	419,346	449,333	435,719	300,549
Loans held for sale-mortgage banking	39,641	50,445	47,109	32,870	95,095
Loans and leases held for investment, net of unearned income	414,673	379,903	360,789	317,928	289,469
Allowance for credit losses	(8,285)	(8,611)	(8,601)	(9,847)	(10,091)
Total deposits	752,627	780,449	811,231	723,229	649,604
Core deposits	765,138	760,937	773,279	678,670	596,304
Short-term borrowings	12,510	13,851	16,002	19,967	11,700
Federal Home Loan Bank advances	38,000	7,300	-	-	-
Long-term borrowings	10,000	10,000	-	-	-
Guaranteed preferred beneficial interests in Company's subordinated debentures	15,013	15,015	15,018	22,432	22,430
Preferred stockholders' equity	-	-	21,098	21,098	20,888
Common stockholders' equity	74,195	68,988	62,390	48,767	47,842
Book value per common share outstanding	\$ 21.47	\$ 20.12	\$ 18.28	\$ 14.45	\$ 14.49
Book value per common share outstanding, excluding accumulated other comprehensive income	\$ 20.98	\$ 18.93	\$ 16.72	\$ 14.89	\$ 12.99
Tangible book value	\$ 21.47	\$ 20.12	\$ 18.28	\$ 14.45	\$ 14.49
Tangible common equity ratio	8.13%	7.62%	6.67%	5.78%	6.21%
Earnings Performance / Share Data:					
Return on average total assets	0.78%	1.01%	0.94%	1.07%	3.74%
Return on average common stockholders' equity	10.35%	12.21%	12.37%	15.15%	90.04%
Efficiency ratio	79.55%	74.65%	74.73%	73.24%	65.08%
Net interest margin	3.03%	2.96%	3.07%	2.65%	2.85%
Net interest spread	2.93%	2.86%	2.97%	2.54%	2.63%
Basic earnings per common share	\$ 2.08	\$ 2.23	\$ 1.98	\$ 2.22	\$ 7.64
Diluted earnings per common share	\$ 2.03	\$ 2.16	\$ 1.91	\$ 2.11	\$ 7.52
Average common shares outstanding	3,447,635	3,386,600	3,369,021	3,297,235	3,294,562
Average common and common equivalent shares	3,520,818	3,497,740	3,491,254	3,468,390	3,344,280
Shares outstanding at year end	3,456,008	3,428,416	3,413,854	3,374,601	3,300,652
Other Key Ratios					
Nonperforming assets to total assets	0.29%	0.09%	0.03%	0.79%	2.03%
Nonperforming loans to total assets	0.27%	0.06%	0.01%	0.67%	1.36%
Nonperforming loans to loans and leases held for investment	0.59%	0.15%	0.02%	1.77%	3.63%
Net loan (charge-offs) recovery to average loans and leases held for investment	(0.282)%	0.117%	(0.134)%	(0.332)%	(0.225)%
Allowance for credit losses to total loans	1.82%	2.00%	2.11%	2.81%	2.62%

Quarterly Financial Data

	2016				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	YTD
Interest income	\$ 7,175	\$ 7,346	\$ 7,408	\$ 7,417	\$ 29,346
Interest expense	899	864	776	804	3,343
Net interest income	6,276	6,482	6,632	6,613	26,003
Provision for credit losses	-	400	400	-	800
Net interest income after provision for credit losses	6,276	6,082	6,232	6,613	25,203
Non-interest income	5,651	7,495	7,759	4,872	25,777
Non-interest expense	9,846	10,628	10,718	10,001	41,193
Income before income taxes	2,081	2,949	3,273	1,484	9,787
Income tax expense	666	914	1,014	37	2,631
Net Income	\$ 1,415	\$ 2,035	\$ 2,259	\$ 1,447	\$ 7,156
Preferred stock costs	-	-	-	-	-
Net income available to common shareholders	<u>\$ 1,415</u>	<u>\$ 2,035</u>	<u>\$ 2,259</u>	<u>\$ 1,447</u>	<u>\$ 7,156</u>
Basic earnings per common share	<u>\$ 0.41</u>	<u>\$ 0.59</u>	<u>\$ 0.65</u>	<u>\$ 0.42</u>	<u>\$ 2.08</u>
Diluted earnings per common share	<u>\$ 0.40</u>	<u>\$ 0.58</u>	<u>\$ 0.64</u>	<u>\$ 0.41</u>	<u>\$ 2.03</u>
Average common shares:					
Basic	3,444,797	3,447,687	3,453,949	3,459,033	3,447,635
Diluted	3,519,855	3,522,033	3,529,279	3,527,030	3,520,818

	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	<u>\$ 2,739</u>	<u>\$ 1,813</u>	<u>\$ 1,400</u>	<u>\$ 1,598</u>	<u>\$ 7,550</u>
Basic earnings per common share	<u>\$ 0.81</u>	<u>\$ 0.53</u>	<u>\$ 0.41</u>	<u>\$ 0.47</u>	<u>\$ 2.23</u>
Diluted earnings per common share	<u>\$ 0.78</u>	<u>\$ 0.52</u>	<u>\$ 0.40</u>	<u>\$ 0.46</u>	<u>\$ 2.16</u>
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

Creating Value through a Sharp Strategic Focus

BNC is 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 loan 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):

	<u>2016</u>	<u>2015</u>
<u>SELECTED INCOME STATEMENT DATA</u>		
Interest income	\$ 29,346	\$ 27,915
Interest expense	3,343	2,570
Net interest income	26,003	25,345
Provision (reduction) for credit losses	800	(400)
Non-interest income	25,777	24,950
Non-interest expense	41,193	37,544
Income before income taxes	9,787	13,151
Income tax expense	2,631	3,945
Net income	7,156	9,206
Preferred stock costs	-	1,656
Net income available to common shareholders	<u>\$ 7,156</u>	<u>\$ 7,550</u>
<u>EARNINGS PER SHARE DATA</u>		
Basic earnings per common share	\$ 2.08	\$ 2.23
Diluted earnings per common share	\$ 2.03	\$ 2.16

The following is a brief overview of recent periods:

- In 2016, net interest income increased 3% from 2015 due primarily to higher loans held for investment balances.
- Non-interest income increased \$827 thousand or 2% in 2016 compared to 2015. The increase primarily relates to a \$3.2 million, or 20%, increase in mortgage banking revenue, which was partially offset by a decrease in gains on sales of assets of \$1.8 million. During 2016, we recorded a net gain on sales of loans and investments aggregating \$963 thousand, compared to a \$2.8 million net gain on sale of such assets in the same period of 2015.
- Credit quality remained steady in 2016. At December 31, 2016 our non-performing assets were 0.29% of total assets, compared to 0.09% at December 31, 2015.
- Non-interest expense increased by \$3.7 million, or 10%, in 2016. Compensation expense increased due to mortgage banking activity and producer incentive payments. Professional and marketing expense increased in response to significantly higher mortgage loan production and higher legal expenses.
- In 2016, the effective tax rate decreased to 26.9% from 30.0% in 2015 primarily due to a decrease in pre-tax book income, which resulted in tax-exempt income having a greater percentage effect of the effective tax rate.

General

Net income in 2016 was \$7.156 million compared to net income of \$9.206 million in 2015. Earnings per diluted share was \$2.03 in 2016 and \$2.16 in 2015.

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,			For the Year ended December 31,			For the Year ended December 31,		
	2016			2015			2014		
	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	\$ 1,937	\$ 11	0.57%	\$ 22,691	\$ 50	0.22%	\$ 41,896	\$ 98	0.23%
Taxable investments	324,350	6,127	1.89%	357,802	6,549	1.83%	381,253	9,311	2.44%
Tax-exempt investments	91,431	2,704	2.96%	87,495	2,706	3.09%	68,097	2,241	3.29%
Loans held for sale-mortgage banking	49,944	1,649	3.30%	46,829	1,603	3.42%	30,513	1,143	3.75%
Loans and leases held for investment	399,669	18,855	4.72%	350,840	17,007	4.85%	331,982	16,471	4.96%
Allowance for credit losses	(8,562)	-	0.00%	(8,670)	-	0.00%	(9,184)	-	0.00%
Total interest-earning assets	858,769	29,346	3.42%	856,987	27,915	3.26%	844,557	29,264	3.47%
Non-interest-earning assets:									
Cash and due from banks	8,774			9,150			10,994		
Other	46,474			43,214			43,858		
Total assets	<u>\$ 914,017</u>			<u>\$ 909,351</u>			<u>\$ 899,409</u>		
Liabilities and Stockholders' Equity									
Deposits:									
Interest checking and money market accounts	\$ 424,393	\$ 571	0.13%	\$ 430,838	\$ 530	0.12%	\$ 409,519	\$ 541	0.13%
Savings	32,146	10	0.03%	29,724	9	0.03%	24,249	9	0.04%
Certificates of deposit:									
Under \$100,000	68,612	1,044	1.52%	93,169	1,313	1.41%	113,769	1,442	1.27%
\$100,000 and over	82,108	549	0.67%	59,999	296	0.49%	77,812	421	0.54%
Total interest-bearing deposits	607,259	2,174	0.36%	613,730	2,148	0.35%	625,349	2,413	0.39%
Borrowings:									
Short-term borrowings	13,919	22	0.16%	16,299	26	0.16%	20,575	36	0.17%
FHLB advances	36,942	198	0.54%	3,357	10	0.30%	425	1	0.24%
Long-term borrowings	10,000	634	6.34%	2,016	128	6.35%	899	36	4.00%
Subordinated debentures	15,013	315	2.10%	15,016	258	1.72%	19,693	822	4.17%
Total interest-bearing liabilities	683,133	3,343	1.54%	650,418	2,570	1.15%	666,941	3,308	0.50%
Non-interest-bearing demand	145,842	-	0.00%	163,755	-	0.00%	147,884	-	0.00%
Total deposits and interest-bearing liabilities	828,975			814,173			814,825		
Other non-interest-bearing liabilities	9,525			9,428			7,589		
Total liabilities	838,500			823,601			822,414		
Stockholders' equity	75,517			85,750			76,995		
Total liabilities and stockholders' equity	<u>\$ 914,017</u>			<u>\$ 909,351</u>			<u>\$ 899,409</u>		
Net interest income		<u>\$ 26,003</u>			<u>\$ 25,345</u>			<u>\$ 25,956</u>	
Net interest spread			<u>2.93%</u>			<u>2.86%</u>			<u>2.97%</u>
Net interest margin			<u>3.03%</u>			<u>2.96%</u>			<u>3.07%</u>
Ratio of average interest-earning assets to average interest-bearing liabilities	<u>125.71%</u>			<u>131.76%</u>			<u>126.63%</u>		

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

	<u>For the Years Ended December 31,</u>			<u>For the Years Ended December 31,</u>		
	<u>2016 Compared to 2015</u>			<u>2015 Compared to 2014</u>		
	<u>Change Due to</u>			<u>Change Due to</u>		
	<u>Volume</u>	<u>Rate</u>	<u>Total</u>	<u>Volume</u>	<u>Rate</u>	<u>Total</u>
Interest Earned on Interest-Earning Assets						
Federal funds sold/interest-bearing due from banks	\$ (72)	\$ 33	\$ (39)	\$ (43)	\$ (5)	\$ (48)
Taxable investments	(627)	205	(422)	(544)	(2,218)	(2,762)
Tax-exempt investments	119	(121)	(2)	607	(142)	465
Loans held for sale- mortgage banking	104	(58)	46	566	(106)	460
Loans held for investment	2,314	(466)	1,848	920	(384)	536
Total increase (decrease) in interest income	1,838	(407)	1,431	1,506	(2,855)	(1,349)
Interest Expense on Interest-Bearing Liabilities						
Interest checking and money market accounts	(8)	49	41	27	(38)	(11)
Savings	1	-	1	2	(2)	-
Certificates of Deposit:						
Under \$100,000	(367)	98	(269)	(279)	150	(129)
\$100,000 and over	129	124	253	(90)	(35)	(125)
Short-term borrowings	(4)	-	(4)	(7)	(3)	(10)
FHLB advances	174	14	188	8	1	9
Long-term borrowings	506	-	506	63	29	92
Subordinated debentures	-	57	57	(162)	(402)	(564)
Total increase (decrease) in interest expense	431	342	773	(438)	(300)	(738)
Increase (decrease) in net interest income	\$ 1,407	\$ (749)	\$ 658	\$ 1,944	\$ (2,555)	\$ (611)

Net interest income was \$26.003 million in 2016 compared to \$25.345 million in 2015, an increase of \$658 thousand or 2.6%. The net interest margin increased to 3.03% for the year ended December 31, 2016 from 2.96% in 2015. Overall, yields on earning assets increased to 3.42% in 2016, compared to 3.26% in the same period of 2015. Average loans held for investment increased \$48.8 million in 2016 compared to 2015, while average loans held for sale increased \$3.1 million and average investments decreased \$29.5 million. The cost of interest bearing deposits remained mostly unchanged from 2015 at 0.35% in 2016. The cost of interest bearing liabilities increased to 0.49% from 0.40% related to the issuance of \$10 million of subordinated debt in the fourth quarter of 2015 that was used to redeem preferred stock and increased utilization of short-term FHLB advances as flexible borrowings in periods of higher mortgage lending volume.

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 entirely 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. 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.

Non-interest Income

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

	For the Years Ended		Increase (Decrease)	
	December 31,		\$	%
	2016	2015		
Bank charges and service fees	\$ 2,731	\$ 2,901	\$ (170)	(6) %
Wealth management revenues	1,532	1,476	56	4 %
Mortgage banking revenues	19,465	16,214	3,251	20 % (a)
Gains on sales of loans, net	234	1,138	(904)	(79) % (b)
Gains on sales of securities, net	729	1,655	(926)	(56) % (c)
Other	1,086	1,566	(480)	(31) % (d)
Total non-interest income	<u>\$ 25,777</u>	<u>\$ 24,950</u>	<u>\$ 827</u>	3 %

- (a) Mortgage banking revenues have increased due to the continued low interest rate environment, investments in loan producers and our ability to capture loan volume through our existing platforms.
- (b) Gains on sales of SBA loans have declined as the Company's loan growth favored conventional loans in 2016. Gains on sale of loans can vary significantly from period to period.
- (c) Gains and losses on sales of securities may vary significantly from period to period.
- (d) The Company recorded revenue from SBIC investments of \$309 thousand and \$929 thousand in 2016 and 2015, 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		Increase (Decrease)	
	December 31,		\$	%
	2016	2015		
Salaries and employee benefits	\$ 21,432	\$ 19,692	\$ 1,740	9 % (a)
Professional services	4,581	3,923	658	17 % (b)
Data processing fees	3,666	3,059	607	20 % (c)
Marketing and promotion	3,798	3,523	275	8 %
Occupancy	2,160	1,981	179	9 % (d)
Regulatory costs	675	696	(21)	(3) %
Depreciation and amortization	1,519	1,415	104	7 %
Office supplies and postage	687	648	39	6 %
Other real estate costs	34	18	16	89 % (e)
Other	2,641	2,589	52	2 %
Total non-interest expense	<u>\$ 41,193</u>	<u>\$ 37,544</u>	<u>\$ 3,649</u>	10 %
Efficiency ratio	<u>79.55%</u>	<u>74.65%</u>	4.90%	

- (a) Salaries and benefits reflect a new branch in North Dakota and investments in producers and functions supporting growth.
- (b) The increase of professional services is primarily due to an increase in legal costs in 2016.
- (c) Data processing fees have increased due to continued investment in information technology.
- (d) Occupancy increased due to higher maintenance costs on existing locations and an increase in locations and expansion of existing space for our loan production offices.
- (e) Other real estate costs will vary from period to period depending on valuation adjustments on our foreclosed properties— see Note 6. At December 31, 2016, the Company held one property in other real estate.

Income Tax Expense

During 2016, we recorded tax expense of \$2.631 million which resulted in an effective tax rate of 26.9%. Subject to certain statutory limitations, the Company is able to carry forward state tax net operating losses aggregating \$483 thousand as of December 31, 2016. The state net operating losses expire between 2017 and 2031.

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 2017 and 2031.

The change in the effective tax rate from 2016 to 2015 is primarily due to a decrease in pre-tax book income, which resulted in tax-exempt income having a greater percentage effect of the effective tax rate.

Financial Condition

Assets

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

	As of December 31,		Increase (Decrease)	
	2016	2015	\$	%
Cash and cash equivalents	\$ 11,113	\$ 15,189	\$ (4,076)	(27) % (a)
Investment securities available for sale	400,136	419,346	(19,210)	(5) % (b)
Federal Reserve Bank and Federal Home Loan Bank of Des Moines stock	4,411	3,219	1,192	37 % (c)
Loans held for sale-mortgage banking	39,641	50,445	(10,804)	(21) % (d)
Loans and leases held for investment, net	406,388	371,292	35,096	9 % (e)
Other real estate, net	218	242	(24)	(10) % (f)
Premises and equipment, net	19,381	17,574	1,807	10 % (g)
Accrued interest receivable	4,444	4,027	417	10 %
Other assets	24,668	22,912	1,756	8 %
Total assets	<u>\$ 910,400</u>	<u>\$ 904,246</u>	<u>\$ 6,154</u>	1 %

- (a) Cash balances can fluctuate significantly.
- (b) Investments decreased as we deployed proceeds from maturities and sales of securities toward other earning assets and repayment of liabilities.
- (c) The balance of FHLB stock varies in proportion to the level of FHLB advances outstanding.
- (d) Loans held for sale decreased as loan originations decreased in the fourth quarter of 2016.
- (e) Loans held for investment balances have risen in 2016 due to continued loan production in our core market areas.
- (f) The decrease in other real estate, net is due to an increase in the other real estate owned reserve.
- (g) Premises and equipment increased largely due to the completion of construction of a new bank branch in Bismarck, ND.

Investment Securities Available for Sale

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

	December 31,			
	2016		2015	
	Amortized cost	Estimated fair market value	Amortized cost	Estimated fair market value
U.S. Treasury securities	\$ 24,967	\$ 24,715	\$ 32,925	\$ 32,649
U.S. government agency mortgage-backed securities guaranteed by GNMA	46,003	45,270	105,407	104,431
U.S. government agency small business administration pools guaranteed by SBA	122,519	122,863	105,150	105,678
Collateralized mortgage obligations guaranteed by GNMA/VA	85,462	84,220	61,418	61,893
Collateralized mortgage obligations issued by FNMA or FHLMC	35,849	35,342	21,607	21,662
State and municipal bonds	84,143	87,726	87,779	93,033
Total investments	\$ 398,943	\$ 400,136	\$ 414,286	\$ 419,346

There were no securities that management concluded were other-than-temporarily impaired during 2016 or 2015. 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, 2016 (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	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
	U.S. Treasury securities ⁽¹⁾	\$ -	0.00%	\$ 9,961	1.48%	\$ 15,006	1.87%	\$ -	0.00%	\$ 24,967
U.S. government agency mortgage-backed securities guaranteed by GNMA ⁽¹⁾⁽²⁾	-	0.00%	-	0.00%	-	0.00%	46,003	2.47%	46,003	2.47%
U.S. government agency small business administration pools guaranteed by SBA ⁽¹⁾⁽²⁾	-	0.00%	1,095	1.82%	15,994	1.14%	105,430	1.70%	122,519	1.63%
Collateralized mortgage obligations guaranteed by GNMA/VA ⁽¹⁾⁽²⁾	-	0.00%	-	0.00%	-	0.00%	85,462	2.53%	85,462	2.53%
Collateralized mortgage obligations issued by FNMA or FHLMC ⁽¹⁾⁽²⁾	-	0.00%	-	0.00%	-	0.00%	35,849	2.41%	35,849	2.41%
State and municipal bonds ⁽²⁾⁽³⁾	-	0.00%	4,148	5.91%	9,603	5.52%	70,392	5.26%	84,143	5.33%
Total book value of investment securities	<u>\$ -</u>	<u>0.00%</u>	<u>\$ 15,204</u>	<u>2.72%</u>	<u>\$ 40,603</u>	<u>2.44%</u>	<u>\$ 343,136</u>	<u>2.81%</u>	398,943	2.77%
Net unrealized gain on securities available for sale									<u>1,193</u>	
Total investment in securities available for sale									<u>\$ 400,136</u>	2.77%

(1) Based on amortized cost rather than fair value.

(2) 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.

(3) Yields include adjustment for tax exempt income.

As of December 31, 2016, we had \$400.1 million of available-for-sale securities in the investment portfolio compared to \$419.3 million at December 31, 2015.

In 2016, available-for-sale investment securities decreased as we deployed proceeds from maturities and sales of securities toward other earning assets and redeemed \$33.4 million of brokered certificates of deposit.

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.

At December 31, 2016, 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, 2016 and December 31, 2015, and \$2.6 million and \$1.4 million of FHLB of Des Moines stock as of December 31, 2016 and 2015, respectively.

Loans

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

	2016		2015		2014		2013		2012	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Loans held for sale- mortgage banking	\$ 39,641	100.0	\$ 50,445	100.0	\$ 47,109	100.0	\$ 32,870	100.0	\$ 95,095	100.0
Loans Held for Investment:										
Commercial and industrial	123,604	29.8	125,009	32.9	132,229	36.6	132,983	41.8	116,891	40.4
Commercial real estate	171,972	41.5	149,099	39.3	108,122	30.0	93,330	29.3	87,258	30.1
SBA	31,518	7.6	25,860	6.8	26,972	7.5	18,215	5.7	15,823	5.5
Consumer	59,183	14.3	47,073	12.4	40,470	11.2	32,612	10.3	26,614	9.2
Land and land development	15,982	3.9	17,627	4.6	28,220	7.8	27,582	8.7	31,065	10.7
Construction	12,215	2.9	15,187	4.0	24,916	6.9	13,286	4.2	11,814	4.1
	414,474	100.0	379,855	100.0	360,929	100.0	318,008	100.0	289,465	100.0
Unearned income and net unamortized deferred fees and costs	199	-	48	-	(140)	-	(80)	-	4	-
Loans, net of unearned income and unamortized fees and costs	\$ 414,673	100.0	\$ 379,903	100.0	\$ 360,789	100.0	\$ 317,928	100.0	\$ 289,469	100.0

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

	December 31,		Increase (Decrease)	
	2016	2015	\$	%
Loans held for sale-mortgage banking	\$ 39,641	\$ 50,445	\$ (10,804)	(21.4) % (a)
Loans Held for Investment:				
Commercial and industrial	123,604	125,009	(1,405)	(1.1) %
Commercial real estate	171,972	149,099	22,873	15.3 %
SBA	31,518	25,860	5,658	21.9 %
Consumer	59,183	47,073	12,110	25.7 %
Land and land development	15,982	17,627	(1,645)	(9.3) %
Construction	12,215	15,187	(2,972)	(19.6) %
	<u>414,474</u>	<u>379,855</u>	<u>34,619</u>	<u>9.1 %</u>
Unearned income and net unamortized deferred fees and costs	199	48	151	314.6 %
Loans, net of unearned income and unamortized fees and costs	<u>\$ 414,673</u>	<u>\$ 379,903</u>	<u>\$ 34,770</u>	<u>9.2 % (b)</u>

(a) Loans held for sale decreased in 2016 as rising interest rates impacted loan production in the fourth quarter of 2016.

(b) Loans held for investment increased due to continued loan production in our core markets.

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):

2016	\$	182,224
2015		176,439
2014		180,192
2013		222,765
2012		218,068

Concentrations of Credit

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

	<u>2016</u>		<u>2015</u>	
North Dakota	\$ 291,412	70 %	\$ 259,271	68 %
Minnesota	23,083	6 %	26,022	7 %
Arizona	67,751	16 %	68,796	18 %
Other	<u>32,228</u>	<u>8 %</u>	<u>25,766</u>	<u>7 %</u>
Total gross loans held for investment	<u>\$ 414,474</u>	<u>100 %</u>	<u>\$ 379,855</u>	<u>100 %</u>

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):

	<u>2016</u>		<u>2015</u>	
North Dakota	\$ 272,717	66 %	\$ 244,797	65 %
Arizona	88,196	21 %	83,086	22 %
Minnesota	14,628	4 %	10,685	3 %
California	10,422	3 %	10,837	3 %
Colorado	9,141	2 %	9,197	2 %
Ohio	8,440	2 %	8,732	2 %
Other	<u>10,930</u>	<u>2 %</u>	<u>12,521</u>	<u>3 %</u>
Total gross loans held for investment	<u>\$ 414,474</u>	<u>100 %</u>	<u>\$ 379,855</u>	<u>100 %</u>

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

	<u>2016</u>		<u>2015</u>	
	<u>Total Loans and Leases Held for Investment</u>		<u>Total Loans and Leases Held for Investment</u>	
North Dakota				
Commercial and industrial	\$ 41,769		\$ 46,311	
Construction	6,819		11,937	
Agricultural	19,351		16,159	
Land and land development	9,674		11,549	
Owner-occupied commercial real estate	45,350		37,832	
Commercial real estate	100,975		79,119	
Small business administration	4,512		2,662	
Consumer	<u>44,267</u>		<u>39,228</u>	
Subtotal	<u>\$ 272,717</u>		<u>\$ 244,797</u>	
Consolidated				
Commercial and industrial	\$ 54,037		\$ 62,940	
Construction	12,215		15,187	
Agricultural	20,273		18,003	
Land and land development	15,982		17,627	
Owner-occupied commercial real estate	49,294		44,066	
Commercial real estate	171,972		149,099	
Small business administration	31,518		25,860	
Consumer	<u>59,183</u>		<u>47,073</u>	
Subtotal	<u>\$ 414,474</u>		<u>\$ 379,855</u>	

At December 31, 2016, the North Dakota commercial and industrial category above includes \$9.7 million of oil exploration and production (E&P) loans. Oil prices most directly impact on the value of 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, 2016, no E&P loans were considered classified or watch list loans.

As of December 31, 2016, the decrease in oil and agricultural commodity prices have yet to have a significant negative effect on our credit quality. However, the economic activity in western North Dakota is subdued relative to a few years ago. Prolonged periods of lower agricultural and oil prices could have an adverse economic impact on the North Dakota economy, commodity dependent businesses, and our loan portfolio. In addition to E&P loans, loans to customers serving the energy industries in western North Dakota are impacted by protracted low energy prices, as depressed energy prices in recent periods have reduced economic activity and collateral values in western North Dakota. Customers in, or serving the North Dakota agricultural sector have been experiencing lower commodity prices for multiple years, which has had a dampening effect on economic activity in the region.

Loan Maturities⁽¹⁾

The following table sets forth the remaining maturities of loans in our portfolio as of December 31, 2016 (in thousands):

	One year or less	Over 1 year through 5 years		Over 5 years		Total Loans and Leases Held for Investment
		Fixed Rate	Floating Rate	Fixed Rate	Floating Rate	
Commercial and industrial	\$ 12,877	\$ 1,489	\$ 29,215	\$ 39,943	\$ 40,080	\$ 123,604
Commercial real estate	4,122	6,728	10,512	26,682	123,928	171,972
SBA	1,199	-	5,777	2,127	22,415	31,518
Consumer	1,819	24	4,542	44,708	8,090	59,183
Land and land development	350	545	1,922	6,753	6,412	15,982
Construction	3,484	3,525	3,877	-	1,329	12,215
Total principal amount of loans	<u>\$ 23,851</u>	<u>\$ 12,311</u>	<u>\$ 55,845</u>	<u>\$ 120,213</u>	<u>\$ 202,254</u>	<u>\$ 414,474</u>

(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 2016, we recorded a provision for credit losses of \$800 thousand. This compared to a 2015 reversal of previously recorded provisions for credit losses aggregating \$400 thousand as a result of net recoveries of loans previously charged-off. 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,				
	2016	2015	2014	2013	2012
Balance of allowance for credit losses, beginning of period	\$ 8,611	\$ 8,601	\$ 9,847	\$ 10,091	\$ 10,630
Charge-offs:					
Commercial and industrial	(1,004)	(47)	-	(916)	(70)
Commercial real estate	-	-	(439)	(87)	(767)
SBA	(71)	(145)	(109)	-	(10)
Consumer	(99)	(43)	(42)	(106)	(58)
Land and land development	-	-	(190)	-	-
Construction	-	-	-	-	-
Total charge-offs	(1,174)	(235)	(780)	(1,109)	(905)
Recoveries:					
Commercial and industrial	-	7	-	69	11
Commercial real estate	13	551	8	8	38
SBA	15	68	5	2	12
Consumer	20	19	21	15	18
Land and land development	-	-	300	71	187
Construction	-	-	-	-	-
Total recoveries	48	645	334	165	266
Net (charge-offs) recoveries	(1,126)	410	(446)	(944)	(639)
Provision (reduction) for credit losses charged to operations	800	(400)	(800)	700	100
Balance of allowance for credit losses, end of period	\$ 8,285	\$ 8,611	\$ 8,601	\$ 9,847	\$ 10,091
Ratio of net (charge-offs) recoveries to average total loans	(0.250)%	0.103%	(0.123)%	(0.277)%	(0.182)%
Ratio of net (charge-offs) recoveries to average loans and leases held for investment	(0.282)%	0.117%	(0.134)%	(0.332)%	(0.225)%
Average gross loans and leases held for investment	\$ 399,669	\$ 350,840	\$ 331,982	\$ 284,344	\$ 284,507
Ratio of allowance for credit losses to loans and leases held for investment	2.00%	2.27%	2.38%	3.10%	3.49%
Allowance for credit losses to total loans	1.82%	2.00%	2.11%	2.81%	2.62%
Ratio of nonperforming loans to total assets	0.27%	0.06%	0.01%	0.67%	1.36%

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).

	2016		2015		2014		2013		2012	
	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	\$ 2,323	30%	\$ 3,205	33%	\$ 2,686	37%	\$ 2,215	42%	\$ 2,546	40%
Commercial real estate	3,231	41%	1,999	39%	2,496	30%	4,041	29%	4,790	30%
SBA	1,433	8%	1,578	7%	1,190	7%	579	6%	616	6%
Consumer	772	14%	640	12%	516	11%	478	10%	382	9%
Land and land development	413	4%	1,041	5%	1,436	8%	2,371	9%	1,609	11%
Construction	113	3%	148	4%	277	7%	163	4%	148	4%
Total	<u>\$ 8,285</u>	<u>100%</u>	<u>\$ 8,611</u>	<u>100%</u>	<u>\$ 8,601</u>	<u>100%</u>	<u>\$ 9,847</u>	<u>100%</u>	<u>\$ 10,091</u>	<u>100%</u>

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, 2016 and December 31, 2015. 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. See the Concentrations of Credit section within this report for additional information.

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,				
	2016	2015	2014	2013	2012
Nonperforming loans:					
Loans 90 days or more delinquent and still accruing interest	\$ 20	\$ 175	\$ 5	\$ 961	\$ 12
Non-accrual loans	2,425	390	56	4,656	10,500
Total nonperforming loans	2,445	565	61	5,617	10,512
Other real estate and repossessed assets, net	218	242	256	1,056	5,131
Total nonperforming assets	<u>\$ 2,663</u>	<u>\$ 807</u>	<u>\$ 317</u>	<u>\$ 6,673</u>	<u>\$ 15,643</u>
Allowance for credit losses	<u>\$ 8,285</u>	<u>\$ 8,611</u>	<u>\$ 8,601</u>	<u>\$ 9,847</u>	<u>\$ 10,091</u>
Ratio of total nonperforming loans to total loans	0.54%	0.13%	0.01%	1.60%	2.73%
Ratio of total nonperforming loans to loans and leases held for investment	0.59%	0.15%	0.02%	1.77%	3.63%
Ratio of total nonperforming assets to total assets	0.29%	0.09%	0.03%	0.79%	2.03%
Ratio of nonperforming loans to total assets	0.27%	0.06%	0.01%	0.67%	1.36%
Ratio of allowance for credit losses to total nonperforming loans	339%	1,524%	14,100%	175%	96%

Nonperforming Loans

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

	2016	2015
Balance, beginning of period	\$ 565	\$ 61
Additions to nonperforming	3,086	1,178
Charge-offs	(912)	(168)
Reclassified back to performing	(176)	(455)
Principal payments received	(114)	(51)
Transferred to repossessed assets	(4)	-
Balance, end of period	<u>\$ 2,445</u>	<u>\$ 565</u>

In 2016, the level of nonperforming loans increased to \$2.4 million from \$565 thousand at December 31, 2015. The increase in nonperforming loans primarily relates to one relationship greater than \$1 million in the energy sector, which was partially charged off in the third quarter of 2016, and several additional relationships that were deemed to be nonperforming in the fourth quarter of 2016.

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):

	2016	2015
Interest income that would have been recorded	\$ 314	\$ 236
Interest income recorded	92	93
Effect on interest income	<u>\$ 222</u>	<u>\$ 143</u>

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
2016	\$ 2,153	\$ 1,845	\$ 308
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

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

	Watch List			Substandard		
	Impaired	Other	Total	Impaired	Other	Total
2016	\$ -	\$ 8,125	\$ 8,125	\$ 6	\$ 10,511	\$ 10,517
2015	-	7,945	7,945	11	9,398	9,409
2014	1,587	473	2,060	56	9,077	9,133
2013	-	176	176	4,656	8,062	12,718
2012	-	5,235	5,235	10,490	3,065	13,555

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)		
	2016	2015	\$	%	
Deposits:					
Non-interest-bearing	\$ 147,027	\$ 168,259	\$ (21,232)	(13) %	(a)
Interest-bearing-					
Savings, interest checking and money market	453,897	460,385	(6,488)	(1) %	(a)
Time deposits under \$100,000	58,789	86,817	(28,028)	(32) %	(b)
Time deposits \$100,000 and over	92,914	64,988	27,926	43 %	(c)
Short-term borrowings	12,510	13,851	(1,341)	(10) %	(d)
Federal Home Loan Bank advances	38,000	7,300	30,700	421 %	(e)
Long-term borrowings	10,000	10,000	-	- %	
Guaranteed preferred beneficial interests in Company's subordinated debentures	15,013	15,015	(2)	- %	
Accrued interest payable	777	487	290	60 %	(f)
Accrued expenses	6,685	7,398	(713)	(10) %	
Other liabilities	593	758	(165)	(22) %	(g)
Total liabilities	836,205	835,258	947	0 %	
Stockholders' equity	74,195	68,988	5,207	8 %	
Total liabilities and stockholders' equity	\$ 910,400	\$ 904,246	\$ 6,154	1 %	

- (a) Non-interest bearing and savings deposits have decreased as customers deployed funds previously deposited in our North Dakota branches.
- (b) In 2016, BNC redeemed \$33.4 million of higher rate callable brokered certificates of deposit.
- (c) BNC has increased retail certificates of deposit, primarily in North Dakota.
- (d) Short-term borrowings will vary depending on our customers need to use repurchase agreements.
- (e) The Company has borrowed on a short-term basis from the Federal Home Loan Bank as an efficient source of liquidity for flexible borrowings in higher periods of mortgage lending volume.
- (f) The increase is primarily due to accrued interest on the subordinated debt, issued in October 2015, and growth in retail certificates of deposit, which are offset by reduced brokered deposit balances.
- (g) Other liabilities decreased primarily due to the change in taxes payable.

Mortgage Banking Obligations

Included in accrued expenses is an estimate of mortgage banking reimbursement obligations which aggregated \$1.3 million and \$1.8 million at December 31, 2016 and 2015, 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,								
	2016			2015			2014		
	Average balance	Percent of deposits	Wgt'd. avg. rate	Average balance	Percent of deposits	Wgt'd. avg. rate	Average balance	Percent of deposits	Wgt'd. avg. rate
Interest checking and MMDAs	\$ 424,393	56.4%	0.13%	\$ 430,838	55.4%	0.12%	\$ 409,519	53.0%	0.13%
Savings deposits	32,146	4.3%	0.03%	29,724	3.8%	0.03%	24,249	3.1%	0.04%
Time deposits (CDs):									
CDs under \$100,000	68,612	9.1%	1.52%	93,169	12.0%	1.41%	113,769	14.7%	1.27%
CDs \$100,000 and over	82,108	10.9%	0.67%	59,999	7.7%	0.49%	77,812	10.1%	0.54%
Total time deposits	150,720	20.0%	1.05%	153,168	19.7%	1.05%	191,581	24.8%	0.97%
Total interest-bearing deposits	607,259	80.7%	0.36%	613,730	78.9%	0.35%	625,349	80.9%	0.39%
Non-interest-bearing demand deposits	145,842	19.3%	-	163,755	21.1%	-	147,884	19.1%	-
Total deposits (1)	\$ 753,101	100.0%	0.29%	\$ 777,485	100.0%	0.28%	\$ 773,233	100.0%	0.31%

- (1) Included in average total deposits are \$11.7 million, \$41.0 million, and \$57.0 million of average brokered deposits for the years ending 2016, 2015, and 2014, 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 0.23%, 0.16%, and 0.17% for 2016, 2015, and 2014, respectively.

During the period of higher energy prices our North Dakota deposits grew rapidly. In recent periods, deposits in Arizona have grown significantly. The table below shows total deposits since 2012 (in thousands):

	As of December 31,				
	2016	2015	2014	2013	2012
ND Bakken Branches	\$ 178,677	\$ 190,670	\$ 178,565	\$ 166,904	\$ 144,662
ND Non-Bakken Branches	384,476	388,630	433,129	382,225	335,452
Total ND Branches	563,153	579,300	611,694	549,129	480,114
Brokered Time Deposits	-	33,363	53,955	64,525	65,000
Other	189,474	167,786	145,582	109,575	104,490
Total Deposits	\$ 752,627	\$ 780,449	\$ 811,231	\$ 723,229	\$ 649,604

Time deposits, in denominations of \$100,000 and over, totaled \$92.9 million at December 31, 2016 as compared to \$65.0 million at December 31, 2015. The following table sets forth the amount and maturities of time deposits of \$100,000 and over as of December 31, 2016 (in thousands):

Maturing in:

3 months or less	\$	17,068
Over 3 months through 6 months		8,162
Over 6 months through 12 months		24,549
Over 12 months		43,135
	\$	<u>92,914</u>

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):

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Short-term borrowings outstanding at period end	\$ 12,510	\$ 13,851	\$ 16,002
Weighted average interest rate at period end	0.15%	0.14%	0.15%
Maximum month end balance during the period	\$ 16,901	\$ 20,799	\$ 24,833
Average borrowings outstanding for the period	\$ 13,919	\$ 16,299	\$ 20,575
Weighted average interest rate for the period	0.16%	0.16%	0.17%

Note 9 of our Consolidated Financial Statements summarizes the general terms of our short-term borrowings outstanding at December 31, 2016 and 2015.

FHLB advances totaled \$38 million at December 31, 2016 and \$7.3 million at December 31, 2015, 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, 2016 and 2015.

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

	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
Tier 1 leverage (Consolidated)	9.47%	9.00%	9.94%	10.94%	11.17%
Total risk based capital (Consolidated)	19.96%	20.07%	21.10%	23.15%	22.43%
Common equity tier 1 risk based capital (Consolidated)	13.90%	13.57%	N/A	N/A	N/A
Tier 1 risk based capital (Consolidated)	16.78%	16.72%	19.85%	21.67%	20.49%
Tangible common equity (Consolidated)	8.13%	7.62%	6.67%	5.79%	6.21%
Tier 1 leverage (BNC Bank)	9.67%	9.45%	9.13%	10.06%	10.68%
Total risk based capital (BNC Bank)	18.41%	18.71%	19.73%	21.40%	21.06%
Common equity tier 1 risk based capital (BNC Bank)	17.16%	17.45%	N/A	N/A	N/A
Tier 1 risk based capital (BNC Bank)	17.16%	17.45%	18.48%	20.13%	19.80%

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. 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, 2016, the aggregate contractual obligations (excluding bank deposits) and commitments were as follows (in thousands):

	Payments due by period				
	Less than 1 year	1 to 3 years	3 to 5 years	After 5 years	Total
Contractual Obligations:					
Total borrowings	\$ 50,510	\$ -	\$ -	\$ 25,013	\$ 75,523
Commitments to sell loans	38,516	-	-	-	38,516
Annual rental commitments under non-cancelable operating leases	956	1,050	703	938	3,647
Total	\$ 89,982	\$ 1,050	\$ 703	\$ 25,951	\$ 117,686

	Amount of Commitment - Expiration by Period				
	Less than 1 year	1 to 3 years	3 to 5 years	After 5 years	Total
Other Commitments:					
Commitments to originate loans	\$ 125,309	\$ 23,516	\$ 2,950	\$ 454	\$ 152,229
Commitments to sell loans	123,132	-	-	-	123,132
Standby and commercial letters of credit	749	234	-	-	983
Total	\$ 249,190	\$ 23,750	\$ 2,950	\$ 454	\$ 276,344

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 (\$137.4 million as of December 31, 2016);
2. Borrowing capacity from the FHLB (\$122.6 million as of December 31, 2016); and
3. Capacity to issue brokered deposits with maturities of less than 12 months (\$127.8 million as of December 31, 2016).

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, 2016 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, 2016 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, 2016, 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 3.75% to 4.75% 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 2017 is shown below:

Net Interest Income Simulation

Movement in interest rates	<u>-100bp</u>	<u>Unchanged</u>	<u>+100bp</u>	<u>+200bp</u>	<u>+300bp</u>	<u>+400bp</u>
Projected 12-month net interest income	\$ 28,193	\$ 28,667	\$ 28,191	\$ 27,738	\$ 27,405	\$ 27,246
Dollar change from unchanged scenario	\$ (474)	-	\$ (476)	\$ (929)	\$ (1,262)	\$ (1,421)
Percentage change from unchanged scenario	(1.65)%	-	(1.66)%	(3.24)%	(4.40)%	(4.96)%

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, 2016 (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, 2016. 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, 2016				
	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	\$ 11,113	\$ -	\$ -	\$ -	\$ 11,113
Investment securities (a)	111,518	9,392	98,511	141,853	361,274
FRB and FHLB stock	4,411	-	-	-	4,411
Fed funds sold	-	-	-	-	-
Loans held for sale-mortgage banking, fixed rate	-	39,641	-	-	39,641
Loans held for sale-mortgage banking, floating rate	-	-	-	-	-
Loans held for investment, fixed rate	9,382	24,157	80,471	23,334	137,344
Loans held for investment, floating rate	88,227	9,868	173,654	5,580	277,329
Total interest-earning assets	<u>\$ 224,651</u>	<u>\$ 83,058</u>	<u>\$ 352,636</u>	<u>\$ 170,767</u>	<u>\$ 831,112</u>
Interest-bearing liabilities:					
Interest checking and money market accounts	\$ 421,092	\$ -	\$ -	\$ -	\$ 421,092
Savings	32,805	-	-	-	32,805
Time deposits under \$100,000	20,666	18,922	18,803	398	58,789
Time deposits \$100,000 and over	45,731	27,368	19,610	205	92,914
Short-term borrowings	12,510	-	-	-	12,510
FHLB advances	38,000	-	-	-	38,000
Long-term borrowings	-	-	-	10,000	10,000
Subordinated debentures	15,000	-	-	13	15,013
Total interest-bearing liabilities	<u>\$ 585,804</u>	<u>\$ 46,290</u>	<u>\$ 38,413</u>	<u>\$ 10,616</u>	<u>\$ 681,123</u>
Interest rate gap	<u>\$ (361,153)</u>	<u>\$ 36,768</u>	<u>\$ 314,223</u>	<u>\$ 160,151</u>	<u>\$ 149,989</u>
Cumulative interest rate gap at December 31, 2016	<u>\$ (361,153)</u>	<u>\$ (324,385)</u>	<u>\$ (10,162)</u>	<u>\$ 149,989</u>	
Cumulative interest rate gap to total assets	(39.67)%	(35.63)%	(1.12)%	16.48%	

(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, 2016 and do not contemplate any actions we might undertake in response to changes in market interest rates.

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Financial Statements
December 31, 2016 and 2015
(With Independent Auditors' Report Thereon)

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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, 2016 and 2015, and the related consolidated statements of income, 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.

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, 2016 and 2015, 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

March 23, 2017

KPMG LLP is a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

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

	2016	2015
ASSETS		
CASH AND CASH EQUIVALENTS	\$ 11,113	\$ 15,189
INVESTMENT SECURITIES AVAILABLE FOR SALE	400,136	419,346
FEDERAL RESERVE BANK AND FEDERAL HOME LOAN BANK STOCK	4,411	3,219
LOANS HELD FOR SALE-MORTGAGE BANKING	39,641	50,445
LOANS AND LEASES HELD FOR INVESTMENT	414,673	379,903
ALLOWANCE FOR CREDIT LOSSES	(8,285)	(8,611)
Net loans and leases held for investment	406,388	371,292
OTHER REAL ESTATE and REPOSSESSED ASSETS, net	218	242
PREMISES AND EQUIPMENT, net	19,381	17,574
ACCRUED INTEREST RECEIVABLE	4,444	4,027
OTHER	24,668	22,912
Total assets	\$ 910,400	\$ 904,246
LIABILITIES AND STOCKHOLDERS' EQUITY		
DEPOSITS:		
Non-interest-bearing	\$ 147,027	\$ 168,259
Interest-bearing –		
Savings, interest checking and money market	453,897	460,385
Time deposits under \$100,000	58,789	86,817
Time deposits \$100,000 and over	92,914	64,988
Total deposits	752,627	780,449
SHORT-TERM BORROWINGS	12,510	13,851
FEDERAL HOME LOAN BANK ADVANCES	38,000	7,300
LONG-TERM BORROWINGS	10,000	10,000
GUARANTEED PREFERRED BENEFICIAL INTERESTS IN COMPANY'S SUBORDINATED DEBENTURES	15,013	15,015
ACCRUED INTEREST PAYABLE	777	487
ACCRUED EXPENSES	6,685	7,398
OTHER	593	758
Total liabilities	836,205	835,258
STOCKHOLDERS' EQUITY:		
Common stock, \$.01 par value – Authorized 35,000,000 shares; 3,456,008 and 3,428,416 shares issued and outstanding	35	34
Capital surplus – common stock	25,996	25,979
Retained earnings	49,328	42,172
Treasury stock (212,645 and 240,237 shares, respectively)	(2,847)	(3,278)
Accumulated other comprehensive income, net	1,683	4,081
Total stockholders' equity	74,195	68,988
Total liabilities and stockholders' equity	\$ 910,400	\$ 904,246

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Income

For the Years Ended December 31

(In thousands, except per share data)

	<u>2016</u>	<u>2015</u>
INTEREST INCOME:		
Interest and fees on loans	\$ 20,504	\$ 18,610
Interest and dividends on investments		
Taxable	5,970	6,480
Tax-exempt	2,705	2,706
Dividends	167	119
Total interest income	<u>29,346</u>	<u>27,915</u>
INTEREST EXPENSE:		
Deposits	2,174	2,148
Short-term borrowings	22	26
Federal Home Loan Bank advances	198	10
Long-term borrowings	634	128
Subordinated debentures	315	258
Total interest expense	<u>3,343</u>	<u>2,570</u>
Net interest income	26,003	25,345
PROVISION (REDUCTION) FOR CREDIT LOSSES	<u>800</u>	<u>(400)</u>
NET INTEREST INCOME AFTER PROVISION (REDUCTION) FOR CREDIT LOSSES	<u>25,203</u>	<u>25,745</u>
NON-INTEREST INCOME:		
Bank charges and service fees	2,731	2,901
Wealth management revenues	1,532	1,476
Mortgage banking revenues, net	19,465	16,214
Gains on sales of loans, net	234	1,138
Gains on sales of securities, net	729	1,655
Other	1,086	1,566
Total non-interest income	<u>25,777</u>	<u>24,950</u>
NON-INTEREST EXPENSE:		
Salaries and employee benefits	21,432	19,692
Professional services	4,581	3,923
Data processing fees	3,666	3,059
Marketing and promotion	3,798	3,523
Occupancy	2,160	1,981
Regulatory costs	675	696
Depreciation and amortization	1,519	1,415
Office supplies and postage	687	648
Other real estate costs	34	18
Other	2,641	2,589
Total non-interest expense	<u>41,193</u>	<u>37,544</u>
Income before income taxes	9,787	13,151
Income tax expense	2,631	3,945
Net income	7,156	9,206
Preferred stock costs	-	1,656
Net income available to common shareholders	<u>\$ 7,156</u>	<u>\$ 7,550</u>
Basic earnings per common share	<u>\$ 2.08</u>	<u>\$ 2.23</u>
Diluted earnings per common share	<u>\$ 2.03</u>	<u>\$ 2.16</u>

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income
For the Years Ended December 31
(In thousands)

	2016	2015
NET INCOME	\$ 7,156	\$ 9,206
Unrealized loss on securities available for sale	\$ (3,138)	\$ (350)
Reclassification adjustment for gains included in net income	(729)	(1,655)
Other comprehensive loss before tax	(3,867)	(2,005)
Income tax benefit related to items of other comprehensive loss	1,469	762
Other comprehensive loss	(2,398)	(1,243)
TOTAL COMPREHENSIVE INCOME	\$ 4,758	\$ 7,963

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)

	<u>Preferred Stock</u>		<u>Common Stock</u>		<u>Capital Surplus</u>		<u>Treasury</u>	<u>Accumulated Other Comprehensive</u>	
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>	<u>Common</u>	<u>Retained</u>	<u>Stock</u>	<u>Income (Loss)</u>	<u>Total</u>
					<u>Stock</u>	<u>Earnings</u>			
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
Net income	-	-	-	-	-	7,156	-	-	7,156
Other comprehensive loss	-	-	-	-	-	-	-	(2,398)	(2,398)
Impact of share-based compensation	-	-	27,592	1	17	-	431	-	449
BALANCE, December 31, 2016	-	\$ -	3,456,008	\$ 35	\$ 25,996	\$ 49,328	\$ (2,847)	\$ 1,683	\$ 74,195

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

For the Years Ended December 31

(In thousands)

	<u>2016</u>	<u>2015</u>
OPERATING ACTIVITIES:		
Net income	\$ 7,156	\$ 9,206
Adjustments to reconcile net income to net cash provided by operating activities -		
Provision (reduction) for credit losses	800	(400)
Provision for other real estate losses	28	14
Depreciation and amortization	1,519	1,415
Net amortization of premiums and (discounts) on investment securities and subordinated debentures	7,524	8,152
Share-based compensation	449	291
Change in accrued interest receivable and other assets, net	(4,134)	(2,347)
Gain on sale of other real estate	(4)	(7)
Gain on sale of bank premises and equipment	(1)	(56)
Net realized gains on sales of investment securities	(729)	(1,655)
Decrease (increase) in deferred taxes	300	(148)
Change in other liabilities, net	990	1,219
Funding of loans held for sale, mortgage banking	(1,026,734)	(942,729)
Proceeds from sales of loans held for sale, mortgage banking	1,037,524	939,345
Fair value adjustment for loans held for sale, mortgage banking	23	151
Fair value adjustment on mortgage banking derivatives	67	(189)
Proceeds from sales of loans	1,532	11,881
Gains on sales of loans, net	(234)	(1,138)
Net cash provided by operating activities	<u>26,076</u>	<u>23,005</u>
INVESTING ACTIVITIES:		
Purchases of investment securities	(122,052)	(176,781)
Proceeds from sales of investment securities	97,415	152,736
Proceeds from maturities of investment securities	34,655	46,291
Purchases of Federal Reserve and Federal Home Loan Bank Stock	(24,042)	(7,892)
Sales of Federal Reserve and Federal Home Loan Bank Stock	22,850	7,490
Net increase in loans held for investment	(37,194)	(29,448)
Proceeds from sales of other real estate	4	7
Proceeds from sales of bank premises and equipment	14	163
Additions to bank premises and equipment	(3,339)	(2,867)
Net cash used in investing activities	<u>(31,689)</u>	<u>(10,301)</u>

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)

	2016	2015
FINANCING ACTIVITIES:		
Net decrease in deposits	\$ (27,822)	\$ (30,782)
Net decrease in short-term borrowings	(1,341)	(2,151)
Increase in long-term borrowings	-	10,000
Repayments of Federal Home Loan Bank advances	(635,450)	(178,150)
Proceeds from Federal Home Loan Bank advances	666,150	185,450
Redemption of preferred stock	-	(21,098)
Dividends paid on preferred stock	-	(1,908)
Net cash provided by (used in) financing activities	1,537	(38,639)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(4,076)	(25,935)
CASH AND CASH EQUIVALENTS, beginning of period	15,189	41,124
CASH AND CASH EQUIVALENTS, end of period	\$ 11,113	\$ 15,189
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	\$ 3,052	\$ 2,421
Income taxes paid	\$ 3,209	\$ 3,804

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
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 17 locations. The Bank also conducts mortgage banking through a consumer-direct channel complimented by retail channels from 14 locations in Arizona, Minnesota, North Dakota, Illinois, Kansas and Missouri. The consumer direct channel emphasizes technology (internet leads and call-in center) to originate mortgage loans throughout the United States. The retail channel is more relationship driven and origination are generally near our mortgage banking locations.

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), 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, 2016 and 2015, except for Federal Reserve Bank (FRB) and the Federal Home Loan Bank (FHLB) stock, which have an indeterminable maturity.

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 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 the Company considers 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, 2016 and 2015.

Federal Reserve Bank and Federal Home Loan Bank of Des Moines Stock

Investments in Federal Reserve Bank (FRB) and Federal Home Loan Bank (FHLB) of Des Moines 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. The Company's methodology incorporates an estimated loss emergence period for each risk group. The loss emergence period is the period of time from when a borrower experiences a loss event and when the actual loss is recognized in the financial statements, generally at the time of initial charge-off of the loan balance. The Company's methodology also includes qualitative risk factors that allow management to adjust its estimates of losses based on the most recent information available and to address other limitations in the quantitative component that is based on historical loss rates.

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 income. 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, other than treasury 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. Treasury securities are based upon quoted prices for identical instruments traded in active markets.

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*. Fair value measurements on loans held for sale are based on quoted market prices for similar loans in the secondary market, market quotes from anticipated sales contracts and commitments, or contract prices from firm sales commitments.

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 mortgage banking revenues, net.

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, 2016, the Company had four stock-based 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 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 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

Comprehensive income is the total of net income and accumulated other comprehensive income, which for the Company, is generally comprised of unrealized gains and losses on securities available for sale, net of corresponding tax effects.

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*, required 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 was 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.

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 did not 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. Impact on the income statement will generally be through amortization of a right of use asset and recognition of expense for lease payments. 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 consolidated financial statements.

ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Statements* was issued to improve financial reporting about expected credit losses on loans and other financial assets held by banks, financial institutions and other organizations. The new standard will require financial institutions to forecast future conditions considering expected credit losses on the life of the asset and record a provision for credit losses at the origination of the asset. ASU 2016-13 is effective for public entities, who are non-SEC filers, for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. We are currently in the process of evaluating the impact that this new guidance will have on our consolidated financial statements and related disclosures.

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, 2016 or 2015. The carrying amount of available-for-sale securities and their estimated fair values were as follows as of December 31 (in thousands):

	2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities	\$ 24,967	\$ -	\$ (252)	\$ 24,715
U.S. government agency mortgage-backed securities guaranteed by GNMA	46,003	295	(1,028)	45,270
U.S. government agency small business administration pools guaranteed by SBA	122,519	731	(387)	122,863
Collateralized mortgage obligations guaranteed by GNMA/VA	85,462	607	(1,849)	84,220
Collateralized mortgage obligations issued by FNMA or FHLMC	35,849	180	(687)	35,342
State and municipal bonds	84,143	3,918	(335)	87,726
	<u>\$ 398,943</u>	<u>\$ 5,731</u>	<u>\$ (4,538)</u>	<u>\$ 400,136</u>
	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
	<u>\$ 414,286</u>	<u>\$ 7,089</u>	<u>\$ (2,029)</u>	<u>\$ 419,346</u>

The amortized cost and estimated fair market value of available-for-sale securities classified according to their contractual maturities at December 31, 2016, were as follows (in thousands):

	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ -	\$ -
Due after one year through five years	15,204	15,420
Due after five years through ten years	40,603	41,023
Due after ten years	343,136	343,693
Total	<u>\$ 398,943</u>	<u>\$ 400,136</u>

The table above is not intended to reflect actual maturities, cash flows, or interest rate risk. Actual maturities may differ from the contractual maturities shown above as a result of prepayments.

Securities carried at approximately \$117.8 million and \$77.1 million at December 31, 2016 and 2015, 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):

	2016	2015
Sales proceeds	\$ 97,415	\$ 152,736
Gross realized gains	796	2,565
Gross realized losses	(67)	(910)
Net realized gains	<u>\$ 729</u>	<u>\$ 1,655</u>

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):

Description of Securities	2016								
	Less than 12 months			12 months or more			Total		
	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss
U.S. Treasury securities	2	\$ 24,715	\$ (252)	-	\$ -	\$ -	2	\$ 24,715	\$ (252)
U.S. government agency mortgage-backed securities guaranteed by GNMA	5	28,357	(1,028)	-	-	-	5	28,357	(1,028)
U.S. government agency small business administration pools guaranteed by SBA	7	31,123	(182)	7	13,152	(205)	14	44,275	(387)
Collateralized mortgage obligations guaranteed by GNMA/VA	6	44,257	(1,849)	-	-	-	6	44,257	(1,849)
Collateralized mortgage obligations issued by FNMA or FHLMC	3	16,618	(649)	1	2,330	(38)	4	18,948	(687)
State and municipal bonds	7	15,643	(335)	-	-	-	7	15,643	(335)
Total temporarily impaired securities	<u>30</u>	<u>\$ 160,713</u>	<u>\$ (4,295)</u>	<u>8</u>	<u>\$ 15,482</u>	<u>\$ (243)</u>	<u>38</u>	<u>\$ 176,195</u>	<u>\$ (4,538)</u>

Description of Securities	2015								
	Less than 12 months			12 months or more			Total		
	#	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	<u>36</u>	<u>\$ 191,240</u>	<u>\$ (1,881)</u>	<u>5</u>	<u>\$ 8,268</u>	<u>\$ (148)</u>	<u>41</u>	<u>\$ 199,508</u>	<u>\$ (2,029)</u>

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 management concluded were other-than-temporarily impaired during 2016 or 2015.

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):

	<u>2016</u>	<u>2015</u>
Federal Reserve Bank Stock, at cost	\$ 1,807	\$ 1,807
Federal Home Loan Bank of Des Moines Stock, at cost	2,604	1,412
Total	<u>\$ 4,411</u>	<u>\$ 3,219</u>

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):

	<u>2016</u>	<u>2015</u>
Loans held for sale-mortgage banking	\$ 39,641	\$ 50,445
Commercial and industrial	\$ 123,604	\$ 125,009
Commercial real estate	171,972	149,099
SBA	31,518	25,860
Consumer	59,183	47,073
Land and land development	15,982	17,627
Construction	<u>12,215</u>	<u>15,187</u>
Gross loans and leases held for investment	414,474	379,855
Unearned income and net unamortized deferred fees and costs	<u>199</u>	<u>48</u>
Loans, net of unearned income and unamortized fees and costs	414,673	379,903
Allowance for credit losses	<u>(8,285)</u>	<u>(8,611)</u>
Net loans and leases held for investment	<u>\$ 406,388</u>	<u>\$ 371,292</u>

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):

	<u>2016</u>	<u>2015</u>
Commercial and industrial	\$ 38,747	\$ 37,130
Commercial real estate	90,798	88,948
Consumer	30,943	22,487
Construction	<u>575</u>	<u>644</u>
	<u>\$ 161,063</u>	<u>\$ 149,209</u>

NOTE 5. Allowance for Credit Losses

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

	2016						
	Commercial and industrial	Commercial real estate	SBA	Consumer	Land and land development	Construction	Total
Balance, beginning of period	\$ 3,205	\$ 1,999	\$ 1,578	\$ 640	\$ 1,041	\$ 148	\$ 8,611
Provision (reduction)	122	1,219	(89)	211	(628)	(35)	800
Loans charged off	(1,004)	-	(71)	(99)	-	-	(1,174)
Loan recoveries	-	13	15	20	-	-	48
Balance, end of period	<u>\$ 2,323</u>	<u>\$ 3,231</u>	<u>\$ 1,433</u>	<u>\$ 772</u>	<u>\$ 413</u>	<u>\$ 113</u>	<u>\$ 8,285</u>

	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	<u>\$ 3,205</u>	<u>\$ 1,999</u>	<u>\$ 1,578</u>	<u>\$ 640</u>	<u>\$ 1,041</u>	<u>\$ 148</u>	<u>\$ 8,611</u>

The following table shows the balance in the allowance for credit losses at December 31, 2016, and December 31, 2015, 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, 2016						
Commercial and industrial	\$ 514	\$ 1,809	\$ 2,323	\$ 1,909	\$ 121,695	\$ 123,604
Commercial real estate	286	2,945	3,231	1,547	170,425	171,972
SBA	376	1,057	1,433	481	31,037	31,518
Consumer	14	758	772	333	58,850	59,183
Land and land development	-	413	413	-	15,982	15,982
Construction	-	113	113	-	12,215	12,215
Total	<u>\$ 1,190</u>	<u>\$ 7,095</u>	<u>\$ 8,285</u>	<u>\$ 4,270</u>	<u>\$ 410,204</u>	<u>\$ 414,474</u>
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	<u>\$ 346</u>	<u>\$ 8,265</u>	<u>\$ 8,611</u>	<u>\$ 2,274</u>	<u>\$ 377,581</u>	<u>\$ 379,855</u>

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):

	2016					
	Current	31-89 Days Past Due	90 Days or More Past Due And Accruing	Total Performing	Non-accrual	Total
Commercial and industrial:						
Business loans	\$ 52,107	\$ -	\$ 20	\$ 52,127	\$ 1,909	\$ 54,036
Agriculture	20,206	67	-	20,273	-	20,273
Owner-occupied commercial real estate	49,295	-	-	49,295	-	49,295
Commercial real estate	171,972	-	-	171,972	-	171,972
SBA	31,037	-	-	31,037	481	31,518
Consumer:						
Automobile	7,098	15	-	7,113	35	7,148
Home equity	8,787	-	-	8,787	-	8,787
1st mortgage	13,472	-	-	13,472	-	13,472
Other	29,722	54	-	29,776	-	29,776
Land and land development	15,827	155	-	15,982	-	15,982
Construction	12,215	-	-	12,215	-	12,215
Total loans held for investment	411,738	291	20	412,049	2,425	414,474
Loans held for sale	39,637	4	-	39,641	-	39,641
Total gross loans	\$ 451,375	\$ 295	\$ 20	\$ 451,690	\$ 2,425	\$ 454,115

2015

	<u>Current</u>	<u>31-89 Days Past Due</u>	<u>90 Days or More Past Due And Accruing</u>	<u>Total Performing</u>	<u>Non-accrual</u>	<u>Total</u>
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	<u>377,918</u>	<u>1,372</u>	<u>175</u>	<u>379,465</u>	<u>390</u>	<u>379,855</u>
Loans held for sale	<u>50,444</u>	<u>1</u>	<u>-</u>	<u>50,445</u>	<u>-</u>	<u>50,445</u>
Total gross loans	<u>\$ 428,362</u>	<u>\$ 1,373</u>	<u>\$ 175</u>	<u>\$ 429,910</u>	<u>\$ 390</u>	<u>\$ 430,300</u>

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):

	<u>2016</u>	<u>2015</u>
Interest income that would have been recorded	\$ 104	\$ 14
Interest income recorded	-	-
Effect on interest income	<u>\$ 104</u>	<u>\$ 14</u>

Credit Risk by Internally Assigned Grade

The Company maintains an internal risk rating process in order to manage credit risk. Internal grade is generally categorized into the following four categories: pass, watch list, substandard, and doubtful.

At December 31, 2016, the Company had \$393.4 million of loans categorized as pass rated loans. This compares to \$362.1 million at December 31, 2015.

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, 2016 the Company had \$8.1 million of loans categorized as watch list loans compared to \$7.9 million at December 31, 2015.

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 higher probability of loss. At December 31, 2016, the Company had \$10.5 million of substandard loans and \$2.4 million of doubtful loans. This compares to \$9.4 million of substandard loans and \$379 thousand doubtful loans as of December 31, 2015.

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, 2016 and 2015 (in thousands):

	2016				
	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	\$ 2,714	\$ 1,909	\$ 514	\$ 2,128	\$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	1,846	1,547	286	1,569	80
SBA	510	481	376	489	-
Consumer:					
Automobile	30	28	14	33	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans with an allowance recorded	\$ 5,100	\$ 3,965	\$ 1,190	\$ 4,219	\$ 80
Impaired loans without an allowance recorded:					
Commercial and industrial:					
Business loans	\$ -	\$ -	\$ -	\$ -	\$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	-	-	-	-	-
SBA	-	-	-	-	-
Consumer:					
Automobile	10	7	-	7	-
Home equity	-	-	-	-	-
1st mortgage	1,878	298	-	302	12
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans without an allowance recorded	\$ 1,888	\$ 305	\$ -	\$ 309	\$ 12
TOTAL IMPAIRED LOANS	\$ 6,988	\$ 4,270	\$ 1,190	\$ 4,528	\$ 92

2015

	<u>Unpaid Principal</u>	<u>Recorded Investment</u>	<u>Related Allowance</u>	<u>Average Recorded Balance</u>	<u>Interest Income Recognized (12 months)</u>
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

Troubled Debt Restructuring (TDR)

Included in net loans and leases held for investment, 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 that we would not otherwise consider, compared to the original terms and conditions of the loan, the modified loan is considered a troubled debt restructuring.

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

	2016			
	Accrual	Non-accrual	Total	Allowance
Commercial and industrial:				
Business loans	\$ -	\$ -	\$ -	\$ -
Agriculture	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-
Commercial real estate	1,547	-	1,547	286
SBA	-	308	308	308
Consumer:				
Automobile	-	-	-	-
Home equity	-	-	-	-
1st mortgage	298	-	298	-
Other	-	-	-	-
Land and land development	-	-	-	-
Construction	-	-	-	-
Loans held for sale	-	-	-	-
	<u>\$ 1,845</u>	<u>\$ 308</u>	<u>\$ 2,153</u>	<u>\$ 594</u>
	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	-	-	-	-
	<u>\$ 1,884</u>	<u>\$ 313</u>	<u>\$ 2,197</u>	<u>\$ 313</u>

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 loan balances, as principal balances may be partially forgiven. For the year ended December 31, 2016 there was one new TDR with a pre-modification balance of \$119 thousand and a post-modification balance of \$119 thousand. For the year ended December 31, 2015 there were three new TDR with a pre-modification balance of \$329 thousand and a post-modification balance of \$313 thousand.

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 interest 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):

	<u>2016</u>	<u>2015</u>
Interest income that would have been recorded	\$ 229	\$ 222
Interest income recorded	<u>92</u>	<u>93</u>
Effect on interest income	<u>\$ 137</u>	<u>\$ 129</u>

There were no additional funds committed to borrowers who are in TDR status at December 31, 2016 and December 31, 2015.

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, 2016 and December 31, 2015, 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. 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):

	<u>2016</u>	<u>2015</u>
Balance, beginning of period	\$ 242	\$ 256
Real estate sold	(4)	(7)
Net gains on sale of assets	4	7
Provision	(28)	(14)
Balance, end of period	<u>\$ 214</u>	<u>\$ 242</u>

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

	<u>2016</u>	<u>2015</u>
Other real estate	\$ 954	\$ 954
Valuation allowance	(740)	(712)
Other real estate, net	<u>\$ 214</u>	<u>\$ 242</u>

NOTE 7. Premises and Equipment, net

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

	<u>2016</u>	<u>2015</u>
Land and improvements	\$ 4,469	\$ 4,326
Buildings and improvements	16,436	14,499
Leasehold improvements	549	545
Furniture, fixtures and equipment	10,409	10,103
Total cost	31,863	29,473
Less accumulated depreciation and amortization	(12,482)	(11,899)
Net premises and equipment	<u>\$ 19,381</u>	<u>\$ 17,574</u>

Depreciation and amortization expense totaled approximately \$1.5 million and \$1.4 million for the years ended December 31, 2016 and 2015, respectively.

NOTE 8. Deposits

The scheduled maturities of time deposits as of December 31, 2016 are as follows (in thousands):

2017	\$	79,070
2018		51,346
2019		11,451
2020		5,430
2021		3,736
Thereafter		670
	\$	<u>151,703</u>

At December 31, 2016 and 2015, the Bank had \$0 and \$33.4 million, respectively, of time deposits that had been acquired through a traditional broker channel. In addition, the Company had \$126.9 million and \$144.7 million of interest-bearing deposits that meet the regulatory definition of a brokered deposit as of December 31, 2016 and 2015, respectively.

At December 31, 2016 and 2015, the Bank had \$22.3 million and \$11.6 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):

	<u>2016</u>	<u>2015</u>
Savings	\$ 9	\$ 9
Interest checking	60	64
Money market	512	466
Time deposits	<u>1,593</u>	<u>1,609</u>
	<u>\$ 2,174</u>	<u>\$ 2,148</u>

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):

	<u>2016</u>	<u>2015</u>
Federal reserve borrowings	\$ -	\$ -
Repurchase agreements with customers, renewable daily, interest payable monthly, rates ranging from 0.05% to 0.40% in 2016 and 2015, secured by U.S. Treasury securities and general obligations of municipalities	<u>12,510</u>	<u>13,851</u>
	<u>\$ 12,510</u>	<u>\$ 13,851</u>

The weighted average interest rate on short-term borrowings outstanding as of December 31, 2016 and 2015 was 0.15% and 0.14%, 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, 2016, \$12.5 million of securities sold under repurchase agreements, with a weighted average interest rate of 0.15%, were collateralized by U.S. Treasury securities and general obligations of municipalities having a market value of \$25.8 million and unamortized principal balances of \$24.5 million. 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 U.S. Treasury securities and general obligations of municipalities having a market value of \$34.5 million and unamortized principal balances of \$32.0 million.

NOTE 10. Federal Home Loan Bank Advances

As of December 31, 2016, the Bank had \$38 million of FHLB advances outstanding. At December 31, 2016, the Bank has mortgage loans with unamortized principal balances of approximately \$158.2 million and securities with unamortized principal balances of approximately \$49.2 million pledged as collateral to the FHLB. The Bank has the ability to draw advances up to approximately \$122.6 million based upon the aggregate collateral that is currently pledged, subject to a requirement to purchase additional FHLB stock.

As of December 31, 2015, the Bank had \$7.3 million of FHLB advances outstanding. At December 31, 2015, the Bank had 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.

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):

	<u>2016</u>	<u>2015</u>
Note payable, interest due quarterly, beginning on April 1, 2016 ending October 19, 2025, interest payable at a fixed rate of 6.35%	<u>\$ 10,000</u>	<u>\$ 10,000</u>

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 agreement includes various covenants that are primarily operational rather than financial in nature. As of December 31, 2016, 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):

2016				
Unsecured Borrowing Lines:				
		<u>Line</u>	<u>Outstanding</u>	<u>Available</u>
BNC National Bank Lines (1)		\$ 34,500	\$ -	\$ 34,500
Secured Borrowing Lines:				
	<u>Collateral Pledged</u>	<u>Line</u>	<u>Outstanding</u>	<u>Available</u>
BNC National Bank Line	\$ 575	\$ 406	\$ -	\$ 406
BNC Line	91,435	10,000	-	10,000
Total	\$ 92,010	\$ 10,406	\$ -	\$ 10,406

(1) The unsecured BNC National 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, 2016, the pledged collateral for the BNC National Bank Line was comprised of collateralized mortgage obligations and the pledged collateral for the BNC Line is the common stock of BNC National Bank.

2015				
Unsecured Borrowing Line:				
		<u>Line</u>	<u>Outstanding</u>	<u>Available</u>
BNC National Bank Lines (1)		\$ 34,500	\$ -	\$ 34,500
Secured Borrowing Line:				
	<u>Collateral Pledged</u>	<u>Line</u>	<u>Outstanding</u>	<u>Available</u>
BNC National Bank Line	\$ 650	\$ 387	\$ -	\$ 387
BNC Line	87,862	10,000	-	10,000
Total	\$ 88,512	\$ 10,387	\$ -	\$ 10,387

(1) The unsecured BNC National 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 National Bank Line was comprised of collateralized mortgage obligations and the pledged collateral for the BNC Line is the common stock of BNC National Bank.

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

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, 2016 and December 31, 2015 was 2.05% and 1.73%, 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 BNCCORP, subject to approval by the Federal Reserve Board.

NOTE 14. Stockholders' Equity

On January 16, 2009, BNC 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.

Pursuant to the rights plan, the rights are issued to each common stockholder of record, and are 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

BNC and BNC 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, BNC and BNC 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.

At December 31, 2016, our capital ratios exceeded all regulatory capital thresholds and maintained sufficient capital conservation buffers to avoid limitations on certain types of capital distributions.

The capital amounts and ratios presented below for December 31, 2016 and December 31, 2015 were as follows (dollars in thousands):

	<u>Actual</u>		<u>For Capital Adequacy Purposes</u>		<u>To be Well Capitalized</u>		<u>Amount in Excess of Well Capitalized</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
2016								
Total Risk Based Capital:								
Consolidated	\$ 103,887	19.96%	\$ 41,646	≥8.0%	\$ N/A	N/A%	\$ N/A	N/A%
BNC National Bank	95,655	18.41	41,558	≥8.0	51,947	10.0	43,708	8.41
Tier 1 Risk Based Capital:								
Consolidated	87,358	16.78	31,235	≥6.0	N/A	N/A	N/A	N/A
BNC National Bank	89,139	17.16	31,168	≥6.0	41,558	8.0	47,581	9.16
Common Equity Tier 1 Risk Based Capital:								
Consolidated	72,345	13.90	23,426	≥4.5	N/A	N/A	N/A	N/A
BNC National Bank	89,139	17.16	23,376	≥4.5	33,766	6.5	55,373	10.66
Tier 1 Leverage Capital:								
Consolidated	87,358	9.47	36,902	≥4.0	N/A	N/A	N/A	N/A
BNC National Bank	89,139	9.67	36,873	≥4.0	46,092	5.0	43,048	4.67
Tangible Common Equity (to total assets):								
Consolidated	74,048	8.13	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	91,288	9.71	N/A	N/A	N/A	N/A	N/A	N/A
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 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

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, 2016				Twelve Months Ended December 31, 2016
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
ASSETS					
Securities available for sale	\$ 400,136	\$ 24,715	\$ 375,421	\$ -	\$ 729
Loans held for sale	39,641	-	39,641	-	(23)
Commitments to originate mortgage loans	1,414	-	1,414	-	(379)
Commitments to sell mortgage loans	259	-	259	-	342
Total assets at fair value	<u>\$ 441,450</u>	<u>\$ 24,715</u>	<u>\$ 416,735</u>	<u>\$ -</u>	<u>\$ 669</u>
LIABILITIES					
Mortgage banking short positions	\$ 53	\$ -	\$ 53	\$ -	\$ (30)
Total liabilities at fair value	<u>\$ 53</u>	<u>\$ -</u>	<u>\$ 53</u>	<u>\$ -</u>	<u>\$ (30)</u>
	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	<u>\$ 471,650</u>	<u>\$ 32,649</u>	<u>\$ 439,001</u>	<u>\$ -</u>	<u>\$ 1,319</u>
LIABILITIES					
Commitments to sell mortgage loans	\$ 83	\$ -	\$ 83	\$ -	\$ 162
Mortgage banking short positions	23	-	23	-	212
Total liabilities at fair value	<u>\$ 106</u>	<u>\$ -</u>	<u>\$ 106</u>	<u>\$ -</u>	<u>\$ 374</u>

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.

For the periods presented, Treasury Securities were considered to be Level 1 while all other assets and liabilities valued at fair value were considered to be Level 2. There were no transfers into or out of the respective levels during the periods presented.

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):

	2016				
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
Impaired loans ⁽¹⁾	\$ 3,080	\$ -	\$ 3,080	\$ -	\$ (1,714)
Other real estate ⁽²⁾	214	-	214	-	4
Total	\$ 3,294	\$ -	\$ 3,294	\$ -	\$ (1,710)

	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

- (1) The carrying value represents the book value less allocated reserves based on the appraised value of the collateral. The gain or loss reported is the change in the reserve balances allocated on individual impaired loans in addition to the actual write-downs for the period presented.
- (2) The carrying value represents the fair value of the collateral less estimated selling costs and is based upon appraised values. The gain or loss reported is a combination of gains and/or losses on sales of other real estate and provisions for other real estate losses.

At the beginning of the period, all assets and liabilities valued at fair value on a nonrecurring basis were considered to be Level 2. There were no transfers into or out of Level 2 during the periods presented.

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, 2016		December 31, 2015	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:					
Cash and cash equivalents	Level 1	\$ 11,113	\$ 11,113	\$ 15,189	\$ 15,189
Investment securities available for sale	Level 1	24,715	24,715	32,649	32,649
Investment securities available for sale	Level 2	375,421	375,421	386,697	386,697
Federal Reserve Bank and Federal Home Loan Bank stock	Level 2	4,411	4,411	3,219	3,219
Loans held for sale-mortgage banking	Level 2	39,641	39,641	50,445	50,445
Commitments to originate mortgage loans	Level 2	1,414	1,414	1,859	1,859
Commitments to sell mortgage loans	Level 2	259	259	-	-
Loans and leases held for investment, net	Level 2	406,388	405,302	371,292	370,243
Accrued interest receivable	Level 2	4,444	4,444	4,027	4,027
		<u>\$ 867,806</u>	<u>\$ 866,720</u>	<u>\$ 865,377</u>	<u>\$ 864,328</u>
Liabilities and Stockholders' Equity:					
Deposits, noninterest-bearing	Level 2	\$ 147,027	\$ 147,027	\$ 168,259	\$ 168,259
Deposits, interest-bearing	Level 2	605,600	604,823	612,190	612,449
Borrowings and advances	Level 2	60,510	60,748	31,151	31,204
Accrued interest payable	Level 2	777	777	487	487
Accrued expenses	Level 2	6,685	6,685	7,398	7,398
Commitments to sell mortgage loans	Level 2	-	-	83	83
Mortgage banking short positions	Level 2	53	53	23	23
Guaranteed preferred beneficial interests in Company's subordinated debentures	Level 2	15,013	10,292	15,015	9,426
		<u>\$ 835,665</u>	<u>\$ 830,405</u>	<u>\$ 834,606</u>	<u>\$ 829,329</u>
Financial instruments with off-balance-sheet risk:					
Commitments to extend credit	Level 2	\$ -	\$ 132	\$ -	\$ 203
Standby and commercial letters of credit	Level 2	\$ -	\$ 10	\$ -	\$ 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, 2016, 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, 2016, based on current information, no losses were anticipated as a result of these commitments. Management assesses the borrower's creditworthiness 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):

	2016		2015	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Commitments to extend credit	\$ 10,576	\$ 57,039	\$ 14,747	\$ 51,298
Standby and commercial letters of credit	561	421	585	709

In addition to the amounts in the table above, our mortgage banking commitments to fund loans totaled \$84.6 million at December 31, 2016 and \$94.3 million at December 31, 2015. Also, our mortgage banking commitments to sell loans totaled \$123.1 million at December 31, 2016 and \$143.6 million at December 31, 2015.

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):

	<u>2016</u>	<u>2015</u>
Balance, beginning of period	\$ 1,781	\$ 1,879
Provision	90	145
Write offs, net	(532)	(243)
Balance, end of period	<u>\$ 1,339</u>	<u>\$ 1,781</u>

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, 2016 and 2015, the Bank had outstanding \$172 thousand and \$131 thousand, respectively, of performance standby letters of credit and \$3.2 million and \$5.5 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 \$1.5 million and \$2.3 million at December 31, 2016 and 2015, respectively. Advances of loans to related parties in 2016 and 2015 totaled \$74 thousand and \$486 thousand, respectively. Loan pay downs and other reductions by related parties in 2016 and 2015 were \$821 thousand and \$1.5 million, respectively. Commitments to extend credit to related parties increased to \$278 thousand at December 31, 2016 from \$179 thousand at December 31, 2015. The total amount of deposits received from these parties was \$764 thousand at December 31, 2016 and \$2.7 million at December 31, 2015. 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, 2016, 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):

	<u>2016</u>	<u>2015</u>
Current:		
Federal	\$ 1,968	\$ 3,528
State	363	565
	<u>2,331</u>	<u>4,093</u>
Deferred:		
Federal	215	(182)
State	85	34
	<u>300</u>	<u>(148)</u>
Total	<u>\$ 2,631</u>	<u>\$ 3,945</u>

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):

	<u>2016</u>	<u>2015</u>
Tax expense at 34% statutory rate	\$ 3,328	\$ 4,471
State taxes (net of Federal benefit)	296	395
Tax-exempt interest	(901)	(910)
Bank-owned life insurance	(150)	(148)
Other, net	58	137
Total	<u>\$ 2,631</u>	<u>\$ 3,945</u>

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):

	<u>2016</u>	<u>2015</u>
Deferred tax asset:		
Loans, primarily due to credit losses	\$ 3,413	\$ 3,808
Compensation	560	562
Acquired intangibles	193	199
Net operating loss carryforwards	20	21
Other real estate owned	74	65
Other	<u>316</u>	<u>204</u>
Deferred tax asset	<u>4,576</u>	<u>4,859</u>
Deferred tax liability:		
Unrealized gain on securities available for sale	459	1,929
Discount accretion on securities	16	13
Premises and equipment	721	727
Other	<u>250</u>	<u>229</u>
Deferred tax liability	<u>1,446</u>	<u>2,898</u>
	3,130	1,961
Valuation allowance	<u>(14)</u>	<u>(14)</u>
Net deferred tax asset	<u>\$ 3,116</u>	<u>\$ 1,947</u>

Subject to certain limiting statutes, the Company is able to carry forward state tax net operating losses aggregating \$483 thousand as of December 31, 2016. 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, 2013 through 2016 remain open to federal examination. Tax years ended December 31, 2012 through 2016 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):

	<u>2016</u>	<u>2015</u>
Denominator for basic earnings per share:		
Average common shares outstanding	3,447,635	3,386,600
Dilutive effect of stock compensation	<u>73,183</u>	<u>111,140</u>
Denominator for diluted earnings per share	3,520,818	3,497,740
Numerator (in thousands):		
Net income	\$ 7,156	\$ 9,206
Preferred stock costs	<u>-</u>	<u>1,656</u>
Net income available to common shareholders	<u>\$ 7,156</u>	<u>\$ 7,550</u>
Basic earnings per common share	<u>\$ 2.08</u>	<u>\$ 2.23</u>
Diluted earnings per common share	<u>\$ 2.03</u>	<u>\$ 2.16</u>

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 2016 and 2015, 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 \$599,000 and \$559,000 for 2016 and 2015, 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, 2016, the assets in the plan totaled \$21.9 million and included \$789,000 (30,000 shares) invested 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. 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 19,500 shares as of December 31, 2016 and 11,000 shares as of December 31, 2015. As of December 31, 2016, the plan obligation totaled \$665 thousand and \$330 thousand as of December 31, 2015.

In December of 2015, the Company adopted a non-qualified deferred compensation plan for directors of BNCCORP. Effective with 2016 service, a director may voluntarily make contributions of earned director compensation to a deferred account that is ultimately payable with BNCCORP, INC. common stock at the time of separation from service with the Company.

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, 2016 and 2015 was \$1.1 million and \$975,000, respectively, for facilities, and \$8,000 and \$20,000, respectively, for equipment and other items. At December 31, 2016, the total minimum annual base lease payments for operating leases were as follows (in thousands):

2017	\$	956
2018		531
2019		519
2020		407
2021		296
Thereafter		938

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, restricted stock, or common stock equivalent 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, 2016 are as follows:

	<u>1995</u>	<u>2002</u>	<u>2010</u>	<u>2015</u>	<u>Total</u>
Total Shares in Plan	250,000	125,000	250,000	50,000	675,000
Total Shares Available	48,751	-	250,000	44,629	343,380

The Company recognized share-based compensation expense of \$94,000 and \$136,000 for the years ended December 31, 2016 and 2015, respectively, related to restricted stock.

The tax benefits associated with share-based compensation was approximately \$74,000 for the year ended December 31, 2016 and was approximately \$59,000 for the year ended December 31, 2015.

At December 31, 2016, the Company had \$18,000 of unamortized restricted stock compensation. At December 31, 2015, the Company had \$111,000 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:

	<u>2016</u>		<u>2015</u>	
	<u>Number Restricted Stock Shares</u>	<u>Weighted Average Grant Date Fair Value</u>	<u>Number Restricted Stock Shares</u>	<u>Weighted Average Grant Date Fair Value</u>
Nonvested, beginning of year	14,334	\$ 12.91	27,667	\$ 12.29
Granted	-	-	2,000	16.65
Vested	(11,000)	12.41	(15,333)	12.28
Forfeited	-	-	-	-
Nonvested, end of year	<u>3,334</u>	14.06	<u>14,334</u>	12.91

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, 2016 and 2015, respectively, related to stock options. At December 31, 2016, 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, 2016:

	<u>Stock Options Outstanding</u>	<u>Stock Options Currently Exercisable</u>	<u>Stock Options Vested and Expected to Vest</u>
Number	75,600	75,600	75,600
Weighted-average exercise price	\$3.00	\$3.00	\$3.00
Weighted-average remaining contractual term	3.20 years	3.20 years	3.20 years

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

	<u>2016</u>		<u>2015</u>	
	<u>Options to Purchase Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Options to Purchase Shares</u>	<u>Weighted Average Exercise Price</u>
Outstanding, beginning of year	107,200	\$ 3.00	125,800	\$ 3.00
Granted	-	-	-	-
Exercised	(31,600)	3.00	(18,600)	3.00
Forfeited	-	-	-	-
Outstanding, end of year	<u>75,600</u>	3.00	<u>107,200</u>	3.00
Exercisable, end of year	<u>75,600</u>	3.00	<u>107,200</u>	3.00
Weighted average fair value of options:				
Granted	<u>\$ -</u>		<u>\$ -</u>	
Exercised	<u>\$ 1.47</u>		<u>\$ 1.47</u>	
Forfeited	<u>\$ -</u>		<u>\$ -</u>	

Following is a summary of the status of options outstanding at December 31, 2016:

	<u>Outstanding Options</u>			<u>Exercisable Options</u>		
	<u>Number</u>	<u>Weighted Average Remaining Contractual Life</u>	<u>Weighted Average Exercise Price</u>	<u>Number</u>	<u>Weighted Average Exercise Price</u>	
Options with exercise prices of:						
	\$ 3.00	75,600	3.20 years	\$ 3.00	75,600	\$ 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)

	2016	2015
Assets:		
Cash and cash equivalents	\$ 4,165	\$ 5,351
Investment in subsidiaries	89,304	83,332
Receivable from subsidiaries	3,333	964
Other	1,108	482
Total assets	\$ 97,910	\$ 90,129
Liabilities and stockholders' equity:		
Subordinated debentures	\$ 15,013	\$ 15,015
Long-term borrowings	10,000	10,000
Payable to subsidiaries	119	54
Accrued expenses and other liabilities	717	604
Total liabilities	25,849	25,673
Common stock, \$.01 par value – Authorized 35,000,000 shares; 3,456,008 and 3,428,416 shares issued and outstanding	35	34
Capital surplus – common stock	25,996	25,979
Retained earnings	49,328	42,172
Treasury stock (212,645 and 240,237 shares, respectively)	(2,847)	(3,278)
Accumulated other comprehensive loss, net of income taxes	(451)	(451)
Total stockholders' equity	72,061	64,456
Total liabilities and stockholders' equity	\$ 97,910	\$ 90,129

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

	<u>2016</u>	<u>2015</u>
Income:		
Management fee income	\$ 1,875	\$ 1,820
Interest	6	4
Other	12	9
Total income	<u>1,893</u>	<u>1,833</u>
Expenses:		
Interest	958	394
Salaries and benefits	1,593	1,404
Legal and other professional	571	603
Other	769	779
Total expenses	<u>3,891</u>	<u>3,180</u>
Loss before income tax benefit and equity in earnings of subsidiaries	(1,998)	(1,347)
Income tax benefit	684	330
Loss before equity in earnings of subsidiaries	(1,314)	(1,017)
Equity in earnings of subsidiaries	8,470	10,223
Net income	<u>\$ 7,156</u>	<u>\$ 9,206</u>

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

	<u>2016</u>	<u>2015</u>
Operating activities:		
Net income	\$ 7,156	\$ 9,206
Adjustments to reconcile net income to net cash used in operating activities -		
Equity in earnings of subsidiaries	(8,470)	(10,223)
Share-based compensation	449	291
Change in prepaid expenses and other receivables	(2,996)	(57)
Change in accrued expenses and other liabilities	175	(54)
Net cash used in operating activities	<u>(3,686)</u>	<u>(837)</u>
Investing activities:		
Dividend paid by subsidiaries	2,500	13,000
Net cash provided by investing activities	<u>2,500</u>	<u>13,000</u>
Financing activities:		
Redemption of preferred stock	-	(21,098)
Dividends paid on preferred stock	-	(1,908)
Increase in long-term borrowings	-	10,000
Net cash used in financing activities	<u>-</u>	<u>(13,006)</u>
Net decrease in cash and cash equivalents	(1,186)	(843)
Cash and cash equivalents, beginning of year	5,351	6,194
Cash and cash equivalents, end of year	<u>\$ 4,165</u>	<u>\$ 5,351</u>
Supplemental cash flow information:		
Interest paid	<u>\$ 1,007</u>	<u>\$ 527</u>
Income taxes paid	<u>\$ 2,935</u>	<u>\$ 3,463</u>

NOTE 27. Subsequent Events

The Company has evaluated subsequent events from the balance sheet date through March 23, 2017, the date at which the consolidated financial statements were available to be issued, and determined there are no other items to record or disclose related to subsequent events.

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CORPORATE DATA

Investor Relations

E-mail Inquiries:
corp@bncbank.com

General Inquiries:
BNCCORP, INC.
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 2017 annual meeting of stockholders will be held on Wednesday, June 21, 2017 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,

	2016(1)		2015(1)	
	High	Low	High	Low
First Quarter	\$16.40	\$14.26	\$17.10	\$15.30
Second Quarter	\$15.50	\$14.80	\$17.20	\$15.09
Third Quarter	\$21.00	\$15.25	\$17.35	\$16.00
Fourth Quarter	\$26.35	\$20.10	\$16.85	\$15.95

⁽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, LLC
6201 15th Avenue
Brooklyn, NY 11219
(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.
Michael O'Rourke
Attorney / Auditor

Directors, BNC National Bank

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

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
206 South 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 Avenue
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

Bloomington
7201 West 78th Street
Bloomington, MN 55439

Wichita
2868 North Ridge Road
Wichita, KS 67205

Wichita
12031 East 13th Street
Wichita, KS 67206

McPherson
1345 N Main Street
McPherson, KS 67460

Overland Park
7007 College Boulevard
Overland Park, KS 66211

Moline
800 36th Avenue
Moline, IL 61265

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

Lebanon
1403 West Elm Street
Lebanon, Missouri 65336

(2) Bank branches offering mortgage banking services.



BNCCORP

BNCCORP, INC.
322 East Main Avenue
Bismarck, ND 58501
(701) 250-3040
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OTC QX