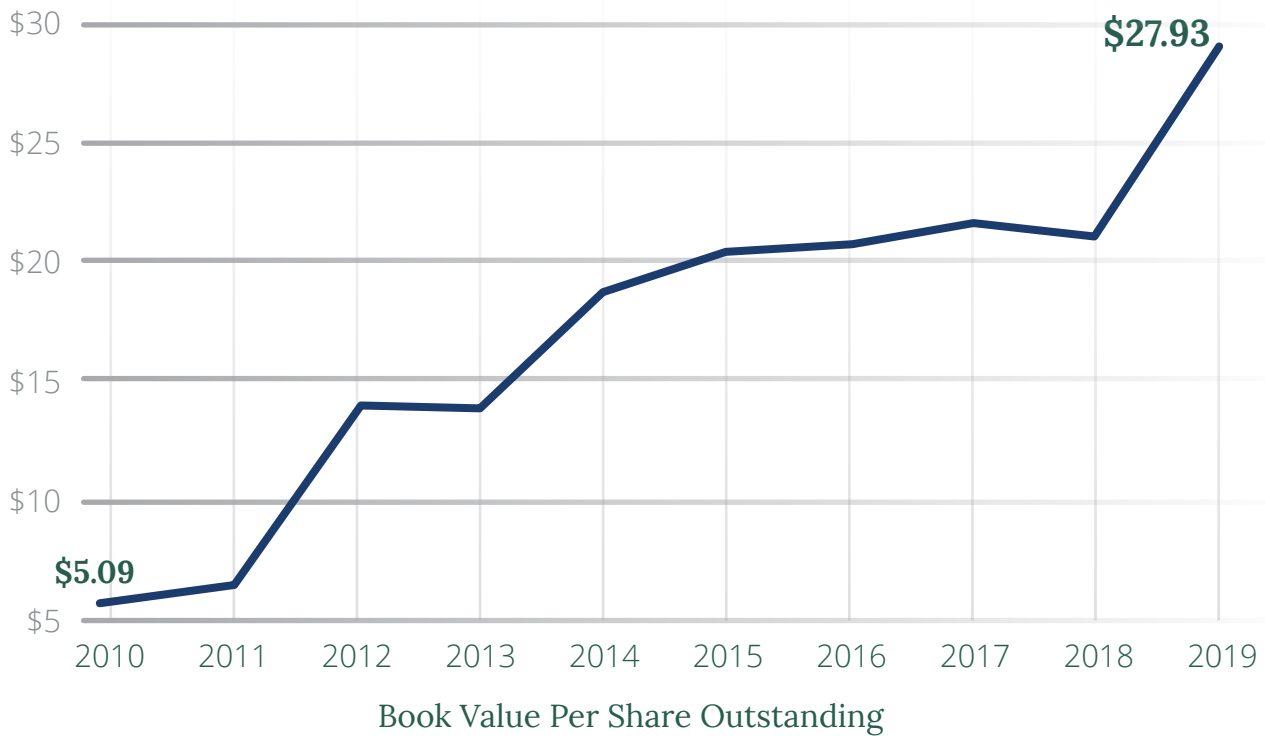


Performing & Transforming

2 0 1 9 A N N U A L R E P O R T



BNCCORP, INC.

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 13 locations. BNC also conducts mortgage banking from 11 locations in Arizona, North Dakota, Illinois, Kansas, Michigan, and Missouri.



CORPORATE PROFILE: THE BUSINESS OF BNC

BNC (or the Company) 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, we serve the agricultural communities of central North Dakota. In recent years, our banking presence in Phoenix, Arizona has grown significantly. By operating banking locations in Phoenix and Minnesota we 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, 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, Michigan and Missouri. The consumer direct channel emphasizes the use of technology, including internet-generated leads and a call center, to originate loans throughout the U.S. The retail channel 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, and personal wealth advisory services. 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.



Timothy J. Franz
*President and Chief Executive
Officer*

We are pleased to note that tangible book value per common share rose more than four-fold between year-end 2010 and 2019 - from **\$5.09 to \$27.39**.

TO OUR COMMUNITY, SHAREHOLDERS, CUSTOMERS AND EMPLOYEES:

As we begin a new decade, this is a good time to reflect on the value of a community bank like BNC and on how we have continually evolved over the years to deliver on our commitments to our customers, shareholders, employees and community.

Our progress during the last 10 years, and in fact since BNC's inception, reflects a dual focus on performing and transforming. We believe that vibrant, entrepreneurial banks like BNC must perform each and every day by building relationships, providing high quality service, working to deliver solid financial results, and meeting the needs of our customers. At the same time, we must constantly transform our business for a changing marketplace to meet new customer needs, remain competitive, maintain financial strength, develop our employees' talent, and promote sound corporate governance.

As this letter is being written, individuals, businesses and governments around the world are contending with the impact of the COVID-19 pandemic. While it is too soon to assess the impact of this crisis on the health of people and the economy alike, our own response at BNC has been guided by a deep concern for the safety and well-being of our customers, employees and community. We have taken actions to safeguard the health of our teammates and customers, to be flexible in assisting clients who may be affected by the economic burdens of the coronavirus, and to provide support to our community wherever possible. We are a resilient institution, comprised of resourceful and compassionate people. We will emerge from this challenge more united in our purpose.

A DECADE OF INCREASING VALUE

The actions of the past 10 years have resulted in a significant increase in value for our shareholders. As the chart on the cover of this annual report shows, BNC's tangible book value per common share rose more than four-fold between year-end 2010 and 2019 – from \$5.09 to \$27.39 – representing a 20.6% annual compounded growth rate. We are justifiably proud of this increase in a bedrock measure of shareholder value, and committed to maintaining the strategies that have led to these strong results.

Our track record of growing value has attracted recognition. BNC was recently honored by OTC Markets Group Inc. as one of its "2020 OTCQX® Best 50" companies, a ranking of the top-performing companies traded on the OTCQX Best Market in the prior calendar year. This selection was based on total return to shareholders and growth in average daily volume during 2019.

PERFORMING: IMPROVED 2019 EARNINGS

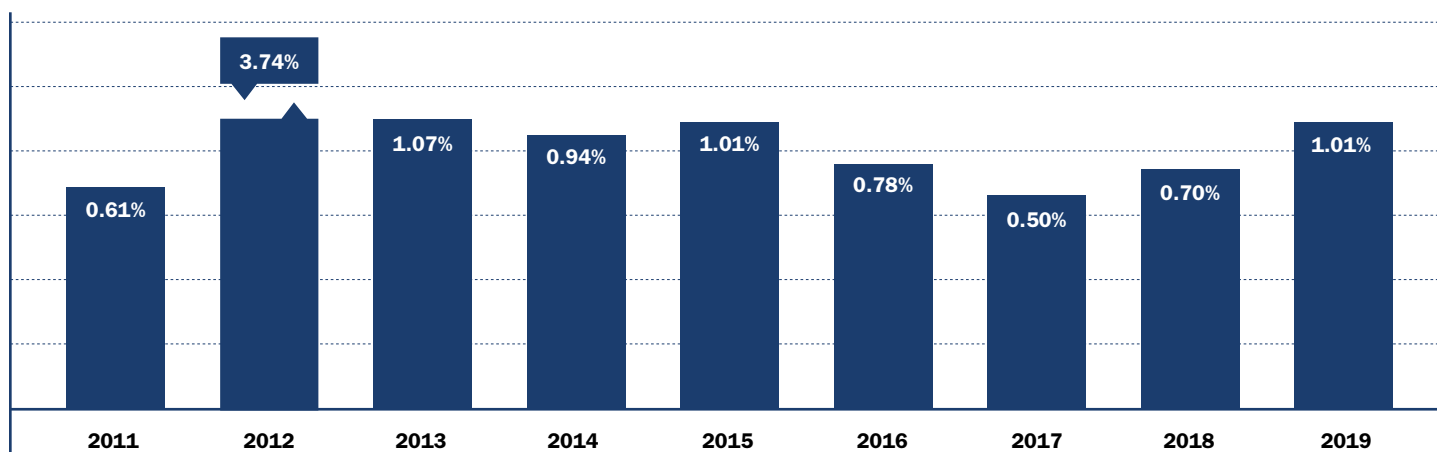
BNC's results in 2019 reflected notably improved financial performance and a commitment to embracing transformative change to drive value. Net income was \$10.2 million, or \$2.88 per diluted share, a sharp increase from \$6.8 million, or \$1.93 per diluted share, in 2018. This net income resulted in a return on average equity of 11.41% and a return on average assets of 1.01%. It is noteworthy that this level of net income has only been exceeded once in BNC's history, in 2012, when earnings included significant non-recurring gains from a tax recovery and an insurance settlement.

Earnings for 2019 reflected actions taken in the fourth quarter designed to enhance future performance. Specifically, we elected to sell securities at a loss in order to deleverage our balance sheet and redeem \$10 million of subordinated debt. While these actions reduced fourth quarter results, the transactions will have a positive impact on 2020 and future years by reducing debt and interest expense and should create value for our shareholders.

Excluding the transactions noted above, adjusted earnings (a non-GAAP measure) were \$11.2 million. The adjusted return on average equity and adjusted return on average assets for 2019 (non-GAAP) were 12.53% and 1.10%, respectively.

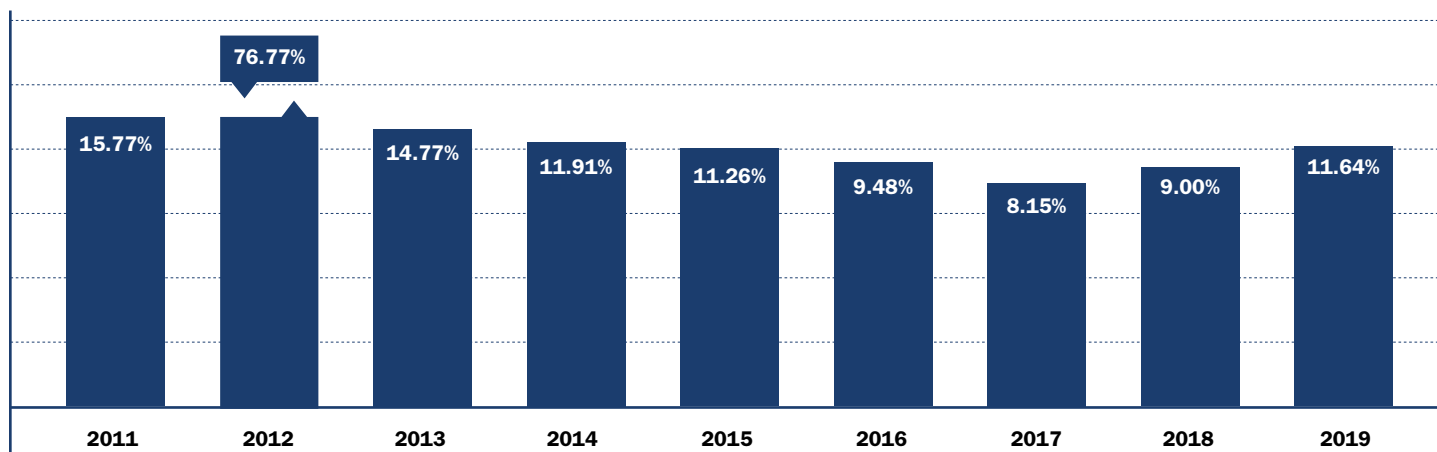
Asset quality and capital levels remained strong. Nonperforming assets were \$2.0 million, or 0.21% of total assets, at December 31, 2019, modestly higher than \$1.7 million, and 0.17% of total assets, at December 31, 2018. The Company's consolidated Tier 1 leverage ratio was 10.65% at year-end 2019, up from 9.97% a year ago, while the Tier 1 leverage ratio of BNC Bank was 9.81% and significantly above the "Well Capitalized" ratio threshold. BNC's tangible book value per common share rose sharply to \$27.39 as of December 31, 2019, compared to \$22.26 at year end 2018 and tangible common equity was 9.95% and 7.99% of total assets as of December 31, 2019 and 2018, respectively.

RETURN ON AVERAGE ASSETS



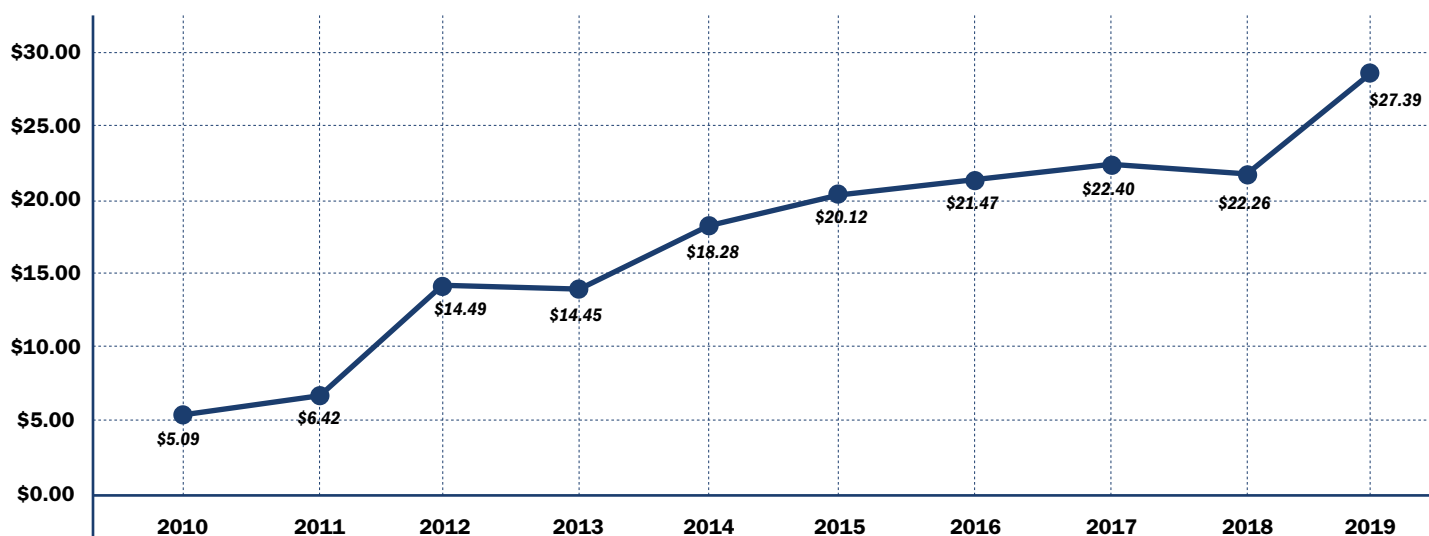
Note that this includes the \$1.5 mm impact of tax reform we changed for ROE chart

RETURN ON AVERAGE EQUITY



Note that the 2017 ROE excludes the \$1.5mm impact of the 2017 Tax Cut and Jobs Act

BOOK VALUE PER SHARE OUTSTANDING

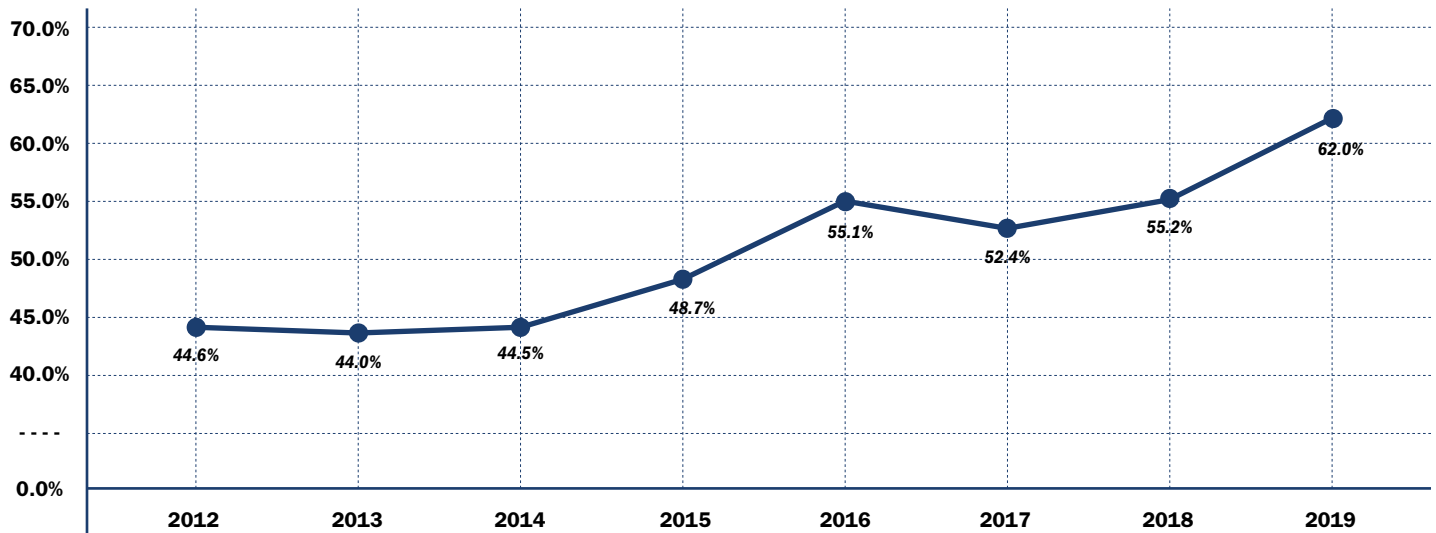


BNC's core banking business showed *steady progress* in 2019.

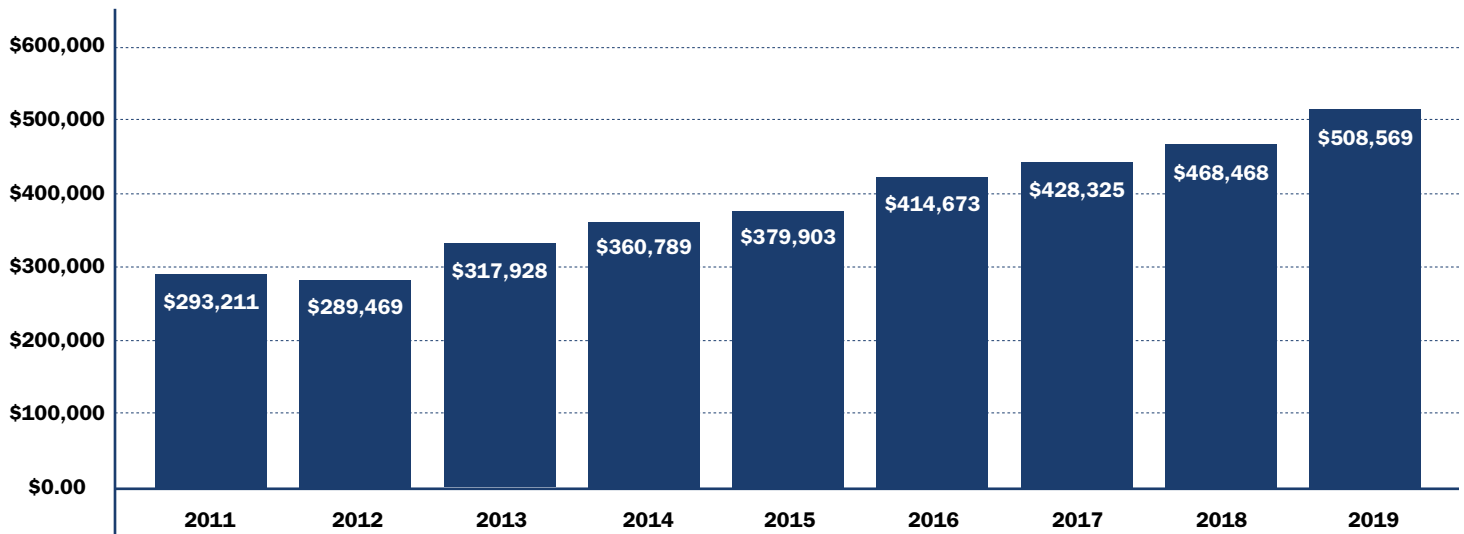
Effective Mortgage Banking Channels. During the Great Recession we added a modest mortgage banking business to BNC. Since then we have built a platform that is significantly scaled up and improved. In 2019, as interest rates moved downward, our mortgage banking team capitalized on these conditions and generated significantly higher revenues, having a positive impact on earnings. We funded \$1.3 billion of residential mortgage loans and generated \$24.9 million of revenue in 2019, versus loans funded of \$642.7 million and \$10.0 million in revenue in 2018. BNC's mortgage business benefits from our strategy of maintaining both a consumer direct channel and a more traditional retail channel. The consumer direct channel acquires leads and connects with customers to originate loans throughout the United States. When conditions are favorable, this channel can quickly monetize loan origination activity. The retail channel is relationship driven, with our originators capitalizing on local connections to originate loans. Cyclicity is inherent in mortgage banking, but housing finance is a durable industry. This division has been a significant contributor to shareholder value for most of the past decade, when interest rates were generally low or declining. As 2020 commences the housing market is strong and interest rates remain low, which gives us cause for optimism that our mortgage banking business will perform well in 2020.

Diverse Commercial Lending Platform. BNC's core banking business showed steady progress in 2019. We continue to benefit from our entrepreneurial approach and focus on serving the needs of small and medium-sized businesses in our communities. Loans and leases held for investment (LHFI) totaled \$508.6 million at December 31, 2019, a record high for BNC. Our growth rate for LHFI of 8.6% in 2019 was notably above the community banking industry. The strongest growth areas were commercial and industrial (C&I) lending, commercial real estate, Small Business Administration (SBA) and consumer loans, with our teams in North Dakota and Arizona each contributing to this growth.

LOAN TO DEPOSIT RATIO



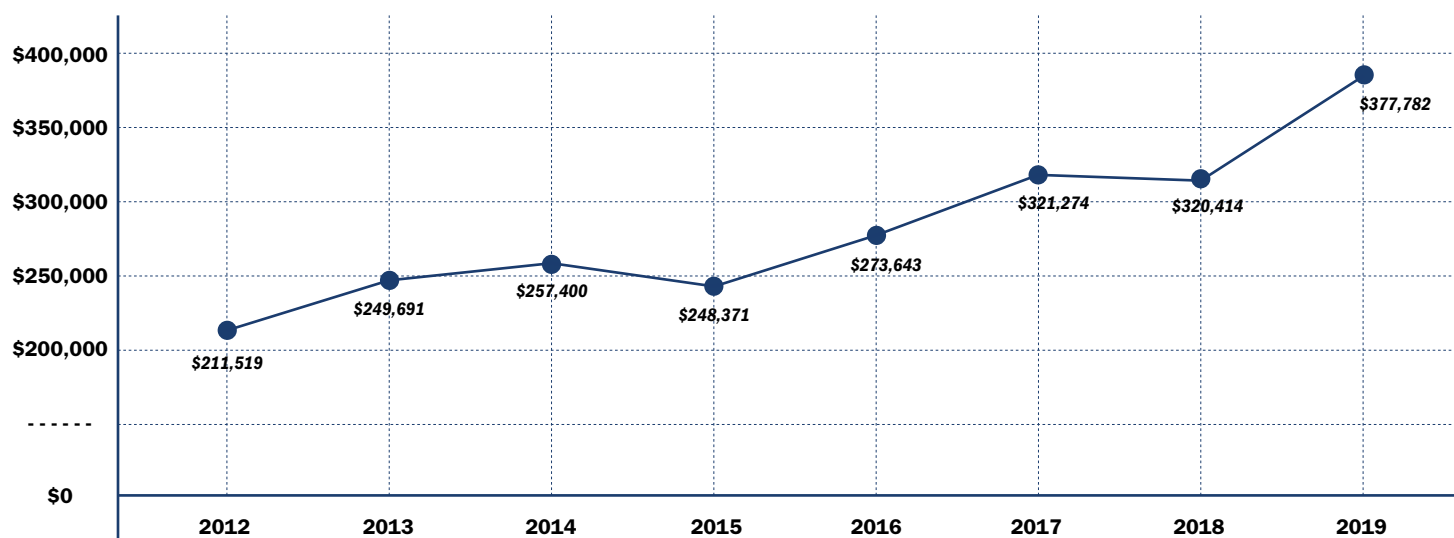
LOANS HELD FOR INVESTMENT



A Strong Deposit Franchise Complemented with Wealth Management. Building a deposit-rich franchise has been an important part of BNC’s value-creation strategy, as deposits contribute to our solid customer relationships and provide a stable source of cost-effective funding and build franchise value. Total deposits at December 31, 2019, totaled \$825.1 million, decreasing 4.1% from a year ago. This decrease was intentional and related to our efforts to deleverage our balance sheet while maintaining valuable customer relationships.

Our wealth management business has also contributed to our value. By offering such financial solutions as asset management, retirement plan administration, and trust services, we are able to strengthen the bonds between BNC and its customers as the vast majority of wealth management clients have multiple relationships with us. Trust assets under management or administration increased 17.9% during the past year, to \$377.8 million at December 31, 2019.

ASSETS UNDER ADMINISTRATION



TRANSFORMING TO IMPROVE

Throughout its existence, BNC has been entrepreneurial, flexible and resilient – able to transform our business to adapt, grow and thrive in a world of shifting customer demands, dynamic economic forces, changing regulations and new technologies. 2019 was no exception.

As noted earlier, we made the decision to deleverage the balance sheet late in 2019. Accordingly, we sold securities and reduced deposits via reversible one-way sell mechanisms that allow us to retain relationships with the depositors. We then used the cash proceeds generated from these actions to redeem subordinated debt with a coupon of 6.35%. These actions were intended to enhance our financial flexibility and improve net income in 2020 and beyond.

Over the years, BNC has demonstrated that, “the only constant is change.” We have consistently viewed change as a gateway to opportunity. Over the years, we have refined our branch network, exited asset-based lending and insurance businesses, expanded into Minnesota and Arizona, and created a home-grown direct mortgage platform, among many other initiatives. We have taken these actions with an eye toward remaining relevant to the needs of our customers, shareholders, employees and community. Look for us to continue transforming.

SUSTAINING: GREAT PEOPLE SERVING CUSTOMERS AND THE COMMUNITY

While we embrace transformation and continuous improvement, we remain committed to the timeless values that make community banks unique: the belief that talented people with a dedication to serving their neighbors help individuals, businesses and communities to prosper.

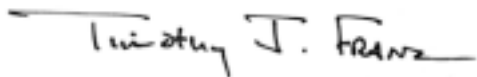
- We are only as strong as our people – our team of highly professional and motivated employees who are at the center of our customer relationships and our pursuit of excellence.

- We also see ourselves as partners with our customers, dedicated to helping them achieve their financial goals at every step in their development.
- And, we are active citizens of and contributors to the communities where our colleagues and customers live and work.

BNC actively supports organizations involved in community and youth services, education, the arts, and business development, while our team members devote their time and energy to numerous worthy causes. We are proud of our efforts to support many community organizations in the past year. In 2019, BNC was declared “Business of the Year” by the Mandan Progress Organization, which is a tribute to the spirit of service and community pride that is shared by all of our people across the Company.

I would like to take this opportunity to thank BNC’s customers for placing their trust in us, our employees for their hard work and dedication, our Board for their insight and guidance, and our shareholders for their confidence in our business and ability to create value. In 2020 and beyond, we will continue to focus on performing and transforming in order to deliver greater value for all of BNC’s stakeholders.

Sincerely,

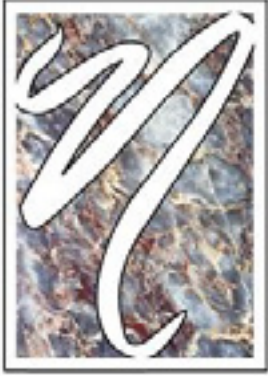


Timothy J. Franz

President and Chief Executive Officer

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, 2019

BNCCORP, INC.

(OTCQX: BNCC)

322 East Main Avenue
Bismarck, North Dakota 58501
(701) 250-3040

BNCCORP, INC.
INDEX TO YEAR END FINANCIAL REPORT
December 31, 2019
TABLE OF CONTENTS

	Page
Selected Financial Data	10
Operating Strategy	12
Management’s Discussion and Analysis of Financial Condition and Results of Operations	13
Quantitative and Qualitative Disclosures about Market Risk	33
Consolidated Financial Statements	36

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,				
	2019	2018	2017	2016	2015
Income Statement Data:					
Total interest income	\$ 37,817	\$ 34,478	\$ 31,443	\$ 29,346	\$ 27,915
Total interest expense	9,101	6,108	3,578	3,343	2,570
Net interest income	28,716	28,370	27,865	26,003	25,345
Provision (reduction) for credit losses	700	-	350	800	(400)
Non-interest income	29,131	19,017	19,499	25,777	24,950
Non-interest expense	43,991	39,013	39,116	41,193	37,544
Income tax expense (1)	2,921	1,538	3,020	2,631	3,945
Net income (1)	\$ 10,235	\$ 6,836	\$ 4,878	\$ 7,156	\$ 9,206
Preferred stock costs	-	-	-	-	1,656
Net income available to common shareholders	\$ 10,235	\$ 6,836	\$ 4,878	\$ 7,156	\$ 7,550
Balance Sheet Data: (at end of period)					
Total assets	\$ 966,750	\$ 971,027	\$ 946,150	\$ 910,400	\$ 904,246
Investments securities available for sale	265,278	411,509	411,917	400,136	419,346
Loans held for sale-mortgage banking	137,114	22,788	36,601	39,641	50,445
Loans and leases held for investment, net of unearned income	508,569	468,468	428,325	414,673	379,903
Allowance for credit losses	(8,141)	(7,692)	(7,861)	(8,285)	(8,611)
Total deposits	820,547	848,605	817,806	752,627	780,449
Short-term borrowings	4,565	11,494	18,043	12,510	13,851
Federal Home Loan Bank advances	17,000	-	-	38,000	7,300
Long-term borrowings	-	10,000	10,000	10,000	10,000
Guaranteed preferred beneficial interests in Company's subordinated debentures	15,006	15,009	15,011	15,013	15,015
Common stockholders' equity	96,278	77,753	77,626	74,195	68,988
Book value per common share outstanding	\$ 27.39	\$ 22.26	\$ 22.40	\$ 21.47	\$ 20.12
Tangible common equity ratio	9.95%	7.99%	8.18%	8.13%	7.62%
Earnings Performance / Share Data:					
Return on average total assets (1)	1.01%	0.70%	0.50%	0.78%	1.01%
Return on average common stockholders' equity, excluding accumulated other comprehensive income (1)	11.41%	8.33%	6.45%	10.35%	12.21%
Efficiency ratio	76.05%	82.33%	82.59%	79.55%	74.65%
Net interest margin	3.00%	3.08%	3.05%	3.03%	2.96%
Net interest spread	2.79%	2.90%	2.92%	2.93%	2.86%
Basic earnings per common share (1)	\$ 2.90	\$ 1.96	\$ 1.40	\$ 2.08	\$ 2.23
Diluted earnings per common share (1)	\$ 2.88	\$ 1.93	\$ 1.38	\$ 2.03	\$ 2.16
Average common shares outstanding	3,526,096	3,487,846	3,474,988	3,447,635	3,386,600
Average common and common equivalent shares	3,557,585	3,539,755	3,540,698	3,520,818	3,497,740
Shares outstanding at year end	3,514,770	3,493,298	3,465,992	3,456,008	3,428,416
Other Key Ratios					
Nonperforming assets to total assets	0.21%	0.17%	0.21%	0.29%	0.09%
Nonperforming loans to total assets	0.21%	0.17%	0.21%	0.27%	0.06%
Nonperforming loans to loans and leases held for investment	0.40%	0.36%	0.46%	0.59%	0.15%
Allowance for credit losses to loans and leases held for investment	1.60%	1.64%	1.84%	2.00%	2.27%

(1) The 2017 results include amounts linked to tax reform legislation aggregating \$1.515 billion. Excluding the impact of these amounts, the Company would have reported income tax expense of \$1.505 billion and net income of \$6.393 billion. Return on average total assets would have been 0.66% and Return on average common stockholder's equity would have been 8.46%. Basic and diluted earnings per share would be \$1.84 and \$1.81, respectively.

Quarterly Financial Data

	2019				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	YTD
Interest income	\$ 9,128	\$ 9,399	\$ 9,698	\$ 9,592	\$ 37,817
Interest expense	2,173	2,376	2,389	2,163	9,101
Net interest income	6,955	7,023	7,309	7,429	28,716
Provision for credit losses	-	200	300	200	700
Net interest income after provision for credit losses	6,955	6,823	7,009	7,229	28,016
Non-interest income	4,502	7,057	11,938	5,634	29,131
Non-interest expense	9,682	10,409	12,871	11,029	43,991
Income before income taxes	1,775	3,471	6,076	1,834	13,156
Income tax expense	337	817	1,450	317	2,921
Net income	<u>\$ 1,438</u>	<u>\$ 2,654</u>	<u>\$ 4,626</u>	<u>\$ 1,517</u>	<u>\$ 10,235</u>
Basic earnings per common share	<u>\$ 0.41</u>	<u>\$ 0.75</u>	<u>\$ 1.31</u>	<u>\$ 0.43</u>	<u>\$ 2.90</u>
Diluted earnings per common share	<u>\$ 0.40</u>	<u>\$ 0.75</u>	<u>\$ 1.30</u>	<u>\$ 0.43</u>	<u>\$ 2.88</u>
Average common shares:					
Basic	3,518,390	3,519,478	3,529,999	3,536,277	3,526,096
Diluted	3,555,845	3,556,842	3,558,354	3,558,994	3,557,585
	2018				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	YTD
Interest income	\$ 8,016	\$ 8,520	\$ 8,836	\$ 9,106	\$ 34,478
Interest expense	1,156	1,458	1,658	1,836	6,108
Net interest income	6,860	7,062	7,178	7,270	28,370
Provision for credit losses	-	-	-	-	-
Net interest income after provision for credit losses	6,860	7,062	7,178	7,270	28,370
Non-interest income	5,881	5,727	3,979	3,430	19,017
Non-interest expense	9,768	10,014	9,806	9,425	39,013
Income before income taxes	2,973	2,775	1,351	1,275	8,374
Income tax expense	577	630	284	47	1,538
Net income	<u>\$ 2,396</u>	<u>\$ 2,145</u>	<u>\$ 1,067</u>	<u>\$ 1,228</u>	<u>\$ 6,836</u>
Basic earnings per common share	<u>\$ 0.69</u>	<u>\$ 0.61</u>	<u>\$ 0.31</u>	<u>\$ 0.35</u>	<u>\$ 1.96</u>
Diluted earnings per common share	<u>\$ 0.68</u>	<u>\$ 0.60</u>	<u>\$ 0.30</u>	<u>\$ 0.35</u>	<u>\$ 1.93</u>
Average common shares:					
Basic	3,487,155	3,496,135	3,497,426	3,507,426	3,487,846
Diluted	3,547,427	3,548,350	3,549,793	3,550,207	3,539,755

Operating Strategy

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 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.
- *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 quality loan and deposit growth.* Providing loans and gathering deposits is a key strategy as our products are good for customers, communities, and shareholders. 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>2019</u>	<u>2018</u>
<u>Selected Income Statement Data</u>		
Interest income	\$ 37,817	\$ 34,478
Interest expense	9,101	6,108
Net interest income	28,716	28,370
Provision for credit losses	700	-
Non-interest income	29,131	19,017
Non-interest expense	43,991	39,013
Income before income taxes	13,156	8,374
Income tax expense	2,921	1,538
Net income	<u>\$ 10,235</u>	<u>\$ 6,836</u>
<u>Earnings Per Share Data</u>		
Basic earnings per common share	\$ 2.90	\$ 1.96
Diluted earnings per common share	\$ 2.88	\$ 1.93

The following is a brief comparison of 2019 to 2018 net income:

- In 2019, net interest income increased 1.2% from 2018 as a result of higher average balances of loans combined with higher yields on earning assets, partially offset by lower average balance of investment securities, higher use of FHLB advances and increased average deposit balances and costs.
- Provision for loan losses increased \$700 thousand in 2019 resulting in a 1.60% ratio of allowance for loan losses to loans held for investment. At December 31, 2019, non-performing assets were 0.21% of total assets, compared to 0.17% at December 31, 2018.
- Non-interest income increased \$10.114 million, or 53.2%, when comparing 2019 to 2018. The increase primarily relates to a \$14.870 million increase in mortgage banking revenue, net, partially offset by net losses on sales of securities in 2019 compared to net gains on sale of securities and SBIC income in 2018.
- Non-interest expense increased by \$4.978 million, or 12.8%, in 2019. Salaries and employee benefits increased \$2.385 million, or 11.9%, primarily driven by higher mortgage banking activity. Professional services expense increased \$1.595 million, or 47.2%, primarily due to mortgage operating costs as well as legal, consulting costs, and other corporate matters being partially offset by lower audit fees. Marketing and promotion expenses increased \$326 thousand, or 7.7%, largely attributed to increased purchase of mortgage leads.
- In 2019, the effective tax rate increased to 22.2% from 18.4% in 2018. The increase in the effective tax rate is due to increased pre-tax revenues and lower non-taxable interest income from municipal securities.

General

Net income in 2019 was \$10.235 million compared to net income of \$6.836 million in 2018. Earnings per diluted share was \$2.88 in 2019 and \$1.93 in 2018.

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,		
	2019			2018			2017		
	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									
Interest-bearing due from banks	\$ 15,980	\$ 401	2.51%	\$ 14,992	\$ 260	1.74%	\$ 38,367	\$ 416	1.08%
Taxable investments	362,093	9,347	2.58%	371,177	9,233	2.49%	345,621	7,546	2.18%
Tax-exempt investments	32,382	868	2.67%	63,049	1,699	2.69%	90,324	2,695	2.98%
Loans held for sale-mortgage banking	74,900	2,624	3.50%	25,772	1,069	4.15%	27,271	1,009	3.70%
Loans and leases held for investment	480,389	24,577	5.12%	454,215	22,217	4.89%	420,906	19,777	4.70%
Allowance for credit losses	(7,794)	-	0.00%	(7,792)	-	0.00%	(7,949)	-	0.00%
Total interest-earning assets	957,950	37,817	3.95%	921,413	34,478	3.72%	914,540	31,443	3.42%
Non-interest-earning assets:									
Cash and due from banks	8,903			8,961			8,901		
Other	50,626			48,972			47,591		
Total assets	<u>\$ 1,017,479</u>			<u>\$ 979,346</u>			<u>\$ 971,032</u>		
Liabilities and Stockholders' Equity									
Deposits:									
Interest checking and money market accounts	\$ 542,700	\$ 4,412	0.81%	\$ 486,754	\$ 2,439	0.50%	\$ 487,063	\$ 953	0.20%
Savings	34,177	24	0.07%	35,276	19	0.05%	35,067	11	0.03%
Certificates of deposit	164,898	3,104	1.88%	171,531	2,303	1.34%	158,266	1,545	0.98%
Total interest-bearing deposits	741,775	7,540	1.02%	693,561	4,761	0.69%	680,396	2,509	0.37%
Borrowings:									
Short-term borrowings	5,284	23	0.44%	17,944	74	0.41%	14,732	27	0.18%
FHLB advances	15,110	334	2.21%	4,662	95	2.04%	1,903	16	0.84%
Long-term borrowings	9,753	621	6.36%	10,000	635	6.35%	10,000	635	6.35%
Subordinated debentures	15,007	583	3.83%	15,010	543	3.62%	15,012	391	2.60%
Total interest-bearing liabilities	786,929	9,101	1.16%	741,177	6,108	0.82%	722,043	3,578	0.50%
Non-interest-bearing demand accounts	130,430			154,984			163,603		
Total deposits and interest-bearing liabilities	917,359			896,161			885,646		
Other non-interest-bearing liabilities	12,161			7,253			6,967		
Total liabilities	929,520			903,414			892,613		
Stockholders' equity	87,959			75,932			78,419		
Total liabilities and stockholders' equity	<u>\$ 1,017,479</u>			<u>\$ 979,346</u>			<u>\$ 971,032</u>		
Net interest income		<u>\$ 28,716</u>			<u>\$ 28,370</u>			<u>\$ 27,865</u>	
Net interest spread			<u>2.79%</u>			<u>2.90%</u>			<u>2.92%</u>
Net interest margin			<u>3.00%</u>			<u>3.08%</u>			<u>3.05%</u>
Ratio of average interest-earning assets to average interest-bearing liabilities	<u>121.73%</u>			<u>124.32%</u>			<u>126.66%</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>2019 Compared to 2018</u>			<u>2018 Compared to 2017</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						
Interest-bearing due from banks	\$ 18	\$ 123	\$ 141	\$ (330)	\$ 174	\$ (156)
Taxable investments	(215)	329	114	583	1,104	1,687
Tax-exempt investments	(822)	(9)	(831)	(754)	(242)	(996)
Loans held for sale- mortgage banking	1,744	(190)	1,554	(58)	117	59
Loans held for investment	1,464	897	2,361	1,657	784	2,441
Total increase in interest income	2,189	1,150	3,339	1,098	1,937	3,035
Interest Expense on Interest-Bearing Liabilities						
Interest checking and money market accounts	938	1,035	1,973	1	1,485	1,486
Savings	(1)	6	5	-	9	9
Certificates of Deposit	218	583	801	296	461	757
Short-term borrowings	(55)	4	(51)	7	40	47
FHLB advances	230	9	239	40	39	79
Long-term borrowings	(16)	2	(14)	-	-	-
Subordinated debentures	-	40	40	-	152	152
Total increase in interest expense	1,314	1,679	2,993	344	2,186	2,530
Increase (decrease) in net interest income	\$ 875	\$ (529)	\$ 346	\$ 754	\$ (249)	\$ 505

Net interest income was \$28.716 million in 2019 compared to \$28.370 million in 2018, an increase of \$346 thousand, or 1.2%. The net interest margin decreased to 3.00% for the year ended December 31, 2019 from 3.08% in 2018. Overall, yields on earning assets were 3.95% in 2019 and 3.74% in 2018. Average loans held for investment increased \$26.2 million in 2019, or 5.8%, compared to 2018, while loans held for sale significantly influenced income growth achieving an average balance increase of \$49.1 million during 2019. Average investments decreased \$40.2 million in 2019, providing liquidity to fund loan growth. The cost of interest bearing deposits was 1.02% in 2019 and 0.69% in 2018. The cost of interest bearing liabilities increased to 1.16% in 2019 from 0.82% in 2018. After successfully managing rising interest rates in recent years, the Company enacted certain adjustments to deposit rates in the fourth quarter of 2018 in response to rate increases. Certain deposit rates were adjusted down in 2019 following Federal Reserve actions to lower rates. Increased use of FHLB advances as a source of liquidity in 2019 also increased interest expense.

Net interest income was \$28.370 million in 2018 compared to \$27.865 million in 2017, an increase of \$505 thousand, or 1.8%. The net interest margin increased to 3.08% for the year ended December 31, 2018 from 3.05% in 2017. Overall, yields on earning assets were 3.72% in 2018 and 3.42% in 2017. Average loans held for investment increased \$33.3 million in 2018, or 7.9%, compared to 2017, while average loans held for sale decreased \$1.5 million and average investments decreased \$1.7 million. The cost of interest bearing deposits was 0.69% in 2018 and 0.37% in 2017. The cost of interest bearing liabilities increased to 0.82% in 2018 from 0.50% in 2017. After successfully managing rising interest rates in recent years, the Company enacted certain adjustments to deposit rates in the fourth quarter of 2018 in response to rate increases.

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,		\$	%
	2019	2018		
Bank charges and service fees	\$ 2,614	\$ 2,687	\$ (73)	(3) %
Wealth management revenues	1,735	1,810	(75)	(4) %
Mortgage banking revenues, net	24,902	10,032	14,870	148 % (a)
Gains on sales of loans, net	155	187	(32)	(17) % (b)
(Losses) gains on sales of securities, net	(1,296)	2,293	(3,589)	(157) % (c)
Other	1,021	2,008	(987)	(49) % (d)
Total non-interest income	<u>\$ 29,131</u>	<u>\$ 19,017</u>	<u>\$ 10,114</u>	53 %

- (a) Mortgage banking revenues were significantly higher in 2019, driven substantially by mortgage refinance activity in a declining rate environment.
- (b) Gains on sale of loans can vary significantly from period to period. Guaranteed portions of SBA loans have largely been retained in recent periods.
- (c) Net gains and losses on sales of securities may vary significantly from period to period. In 2019, the Company experienced net losses on sales of securities in order to generate liquidity that facilitated loan growth as well as executing deleveraging strategies.
- (d) Other income in 2019 was lower due to \$1.2 million lower SBIC Income.

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,		\$	%
	2019	2018		
Salaries and employee benefits	\$ 22,459	\$ 20,074	\$ 2,385	12 % (a)
Professional services	4,973	3,378	1,595	47 % (b)
Data processing fees	4,321	4,027	294	7 % (c)
Marketing and promotion	4,538	4,212	326	8 % (d)
Occupancy	2,218	2,408	(190)	(8) % (e)
Regulatory costs	435	540	(105)	(19) % (f)
Depreciation and amortization	1,452	1,545	(93)	(6) % (g)
Office supplies and postage	531	574	(43)	(7) % (h)
Other	3,064	2,255	809	36 % (i)
Total non-interest expense	<u>\$ 43,991</u>	<u>\$ 39,013</u>	<u>\$ 4,978</u>	13 %
Efficiency ratio	<u>76.05%</u>	<u>82.33%</u>	<u>(6.28)%</u>	

- (a) Salaries and employee benefits increased due to higher mortgage banking activity.
- (b) Professional service expense is higher primarily due to mortgage operating costs as well as legal, consulting costs, and other corporate matters being partially offset by lower audit fees.
- (c) Data processing fees increased as standard core processing costs continue to increase along with additional infrastructure expense to expand our current platform in response to continued customer growth.
- (d) Marketing and promotion increased primarily due increased purchase of mortgage banking leads.
- (e) Occupancy decreased due to rent expense from consolidating certain mortgage production offices.
- (f) Regulatory costs decreased due to fourth quarter 2019 utilization of Small Bank Assessment Credits.
- (g) Depreciation and amortization was lower primarily due to depreciated IT assets outlasting depreciable lives.
- (h) Office supplies and postage decreased as the Company continues to more efficiently distribute hardcopy data.
- (i) Other expense increases include a mortgage warranty reserve related to significantly increased mortgage loan production and resolution of a litigation matter.

Mortgage Banking Division Selected Data

The following table sets forth information related to mortgage banking products funded and sold with servicing released by the bank. The following selected data is not intended to be interpreted as a statement of profit and loss as it excludes interest income, interest expense, shared service expenses, and tax expense.

<u>(dollars in thousands)</u>	<u>2019</u>	<u>2018</u>
Number of funded mortgage loans held for sale	3,916	2,107
Mortgage loans held for sale funded	\$ 1,328,706	\$ 642,695
Year-to-date average loans held for sale-mortgage banking	\$ 74,900	\$ 25,772
Year-end loans held for sale-mortgage banking	\$ 137,114	\$ 22,788
Non-Interest Income:		
Gains on sale of loans held for sale, net of commission expense	\$ 19,959	\$ 10,760
Unrealized gain (loss) on mortgage financial instruments (1)	\$ 4,934	\$ (738)
Direct non-interest income	\$ 24,893	\$ 10,022
Direct non-interest expense	\$ 15,941	\$ 12,050

(1) Includes changes in fair value of mortgage commitments, hedge instruments, and loans held for sale

The Company's mortgage banking division originates and sells a variety of conventional and government sponsored mortgage loan products with servicing released through two primary channels. The retail channel is a predominantly relationship driven with originators capitalizing on local relationships to originate loans through four retail bank branches and seven mid-west retail mortgage locations. The Consumer Direct channel is located in Overland Park, KS and is a call-center with internet sales focused on both purchase and refinance transactions across the country.

The current low interest rate environment has generated a significant increase in mortgage loan activity in 2019 compared to 2018. Non-interest income includes gains on the sale of loans, changes in the fair value of loans held for sale, loans in the various stages of processing prior to funding, hedge instruments as well as commissions expense.

Direct non-interest expenses include direct costs necessary to underwrite, process, fund and sell mortgage loans as well as the costs of technology and operational costs specifically identified as serving the mortgage division.

Mortgage Banking Division Selected Data above excludes net-interest income earned on loans held-for-sale, tax expense and costs typically allocated to the mortgage division related to internal services shared with other divisions of the Bank.

Income Tax Expense

During 2019, we recorded tax expense of \$2.921 million, which resulted in an effective tax rate of 22.2%. The increase in the effective tax rate is due to increased pre-tax revenues and lower non-taxable interest income from municipal securities.

Subject to certain statutory limitations, the Company is able to carry forward state tax net operating losses aggregating \$389 thousand as of December 31, 2019. The state net operating losses expire between 2024 and 2031.

During 2018, we recorded tax expense of \$1.538 million, which resulted in an effective tax rate of 18.4%. It is lower than the federal statutory rate primarily due to a portion of the Company's pretax income being derived from tax-exempt securities in 2018.

Subject to certain statutory limitations, the Company is able to carry forward state tax net operating losses aggregating \$431 thousand as of December 31, 2018. The state net operating losses expire between 2024 and 2031.

Financial Condition and Fourth Quarter Deleveraging Activity

During 2019, assets generally increased due to growth in loans held for investment, mortgage loans held for sale, and deposit growth. In the fourth quarter of 2019, the Company sold investment securities at a pre-tax loss of \$3.316 million to provide liquidity to deleverage the balance sheet and redeem subordinated debt. The amount of investment securities sold in the fourth quarter 2019 was \$114.8 million. Proceeds from such sales were used to redeem \$10.0 million of subordinated debt, with a coupon rate of 6.35% per annum, and reduce deposit balances. The reduction in deposit balances primarily utilized one-way sell mechanisms allowing the Company to retain relationships with depositors.

Assets

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

	As of December 31,		Increase (Decrease)	
	2019	2018	\$	%
Cash and cash equivalents	\$ 10,523	\$ 25,185	\$ (14,662)	(58) % (a)
Investment securities available for sale	265,278	411,509	(146,231)	(36) % (b)
Federal Reserve Bank and Federal Home Loan Bank Stock	3,651	2,941	710	24 % (c)
Loans held for sale-mortgage banking	137,114	22,788	114,326	502 % (d)
Loans and leases held for investment, net	500,428	460,776	39,652	9 % (e)
Premises and equipment, net	16,401	16,761	(360)	(2) %
Operating lease right of use asset	2,638	-	2,638	100 % (f)
Accrued interest receivable	3,681	5,079	(1,398)	(28) % (g)
Other assets	27,036	25,988	1,048	4 %
Total assets	<u>\$ 966,750</u>	<u>\$ 971,027</u>	<u>\$ (4,277)</u>	(0) %

- (a) Cash balances can fluctuate significantly from period to period based on liquidity sources and uses of the business.
- (b) Investment balances have decreased as loan growth and deleveraging strategies have utilized bank liquidity.
- (c) Federal Reserve Bank and Federal Home Loan Bank of Des Moines stock will vary based on the Company's utilization of Federal Home Loan Bank advances.
- (d) Loans held for sale increased as balances will fluctuate with the timing of loan funding and sales. During 2019, mortgage banking loan funding increased due to more favorable interest rates, particularly in the second half of 2019.
- (e) Loans held for investment increased as we continue to fund loans in our core markets.
- (f) Operating lease right of use asset was established through adoption of ASC 842, *Leases* – See Note 8 of our Consolidated Financial Statements.
- (g) Accrued interest receivable can fluctuate from period to period. The reduction in interest receivable is influenced by the notable decrease in investment securities available for sale in 2019.

Investment Securities Available for Sale

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

	December 31,			
	2019		2018	
	Amortized cost	Estimated fair market value	Amortized cost	Estimated fair market value
U.S. Treasury securities	\$ 4,992	\$ 4,994	\$ 59,710	\$ 58,794
U.S. government agency mortgage-backed securities issued by FNMA or FHLMC	5,634	5,643	10,221	10,132
U.S. government agency small business administration pools guaranteed by SBA	53,873	51,637	158,430	150,966
Collateralized mortgage obligations guaranteed by GNMA	21,120	21,790	63,149	62,257
Collateralized mortgage obligations issued by FNMA or FHLMC	68,353	68,615	52,635	51,779
Commercial mortgage-backed securities issued by FHLMC	21,625	22,556	-	-
Other commercial mortgage-backed securities	56,530	56,779	-	-
Asset-backed securities	12,810	12,893	24,170	24,045
State and municipal bonds	19,873	20,371	53,862	53,536
Total investments	<u>\$ 264,810</u>	<u>\$ 265,278</u>	<u>\$ 422,177</u>	<u>\$ 411,509</u>

There were no securities that management concluded were other-than-temporarily impaired during 2019 or 2018. 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, 2019 (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%	\$ 4,992	1.59%	\$ -	0.00%	\$ -	0.00%	\$ 4,992	1.59%
U.S. government agency mortgage-backed securities issued by FNMA or FHLMC ⁽¹⁾⁽²⁾	-	0.00%	-	0.00%	-	0.00%	5,634	3.08%	5,634	3.08%
U.S. government agency small business administration pools guaranteed by SBA ⁽¹⁾⁽²⁾	-	0.00%	-	0.00%	20,226	2.33%	33,647	1.75%	53,873	1.97%
Collateralized mortgage obligations guaranteed by GNMA ⁽¹⁾⁽²⁾	-	0.00%	-	0.00%	-	0.00%	21,120	3.69%	21,120	3.69%
Collateralized mortgage obligations issued by FNMA or FHLMC ⁽¹⁾⁽²⁾	-	0.00%	-	0.00%	1,157	3.75%	67,196	3.13%	68,353	3.14%
Commercial mortgage-backed securities issued by FHLMC ⁽¹⁾⁽²⁾	-	0.00%	-	0.00%	21,625	3.05%	-	0.00%	21,625	3.05%
Other commercial mortgage-backed securities ⁽¹⁾⁽²⁾	-	0.00%	-	0.00%	19,371	2.56%	37,159	2.89%	56,530	2.77%
Asset-backed securities ⁽¹⁾⁽²⁾	-	0.00%	-	0.00%	12,810	3.21%	-	0.00%	12,810	3.21%
State and municipal bonds ⁽²⁾⁽³⁾	-	0.00%	-	0.00%	-	0.00%	19,873	3.51%	19,873	3.51%
Total book value of investment securities	<u>\$ -</u>	<u>0.00%</u>	<u>\$ 4,992</u>	<u>1.59%</u>	<u>\$ 75,189</u>	<u>2.77%</u>	<u>\$ 184,629</u>	<u>2.93%</u>	<u>264,810</u>	<u>2.86%</u>
Net unrealized gain on securities available for sale									<u>468</u>	
Total investment in securities available for sale									<u>\$ 265,278</u>	<u>2.86%</u>

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

(2) Maturities are based on contractual maturities. Actual cash flows from securities may vary from contractual maturities due to call options, cash flow structures of securitizations, and prepayments.

(3) Yields include adjustment for tax exempt income.

As of December 31, 2019, we had \$265.3 million of available-for-sale securities in the investment portfolio compared to \$411.5 million at December 31, 2018.

In 2019, available-for-sale investment securities decreased as compared to 2018. Investment securities were sold to generate liquidity to support increases in loans held for investment and loans held for sale and to provide liquidity to deleverage the balance sheet, including redemption of subordinated debt.

At December 31, 2019, all classifications of investment securities available for sale with the exception of U.S. Treasury securities and U.S. government agency mortgage-backed securities issued by FNMA/FHLMC 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

Our equity securities consisted of \$1.8 million of Federal Reserve Bank ("FRB") stock and \$1.9 million of Federal Home Loan Bank ("FHLB") stock as of December 31, 2019 and \$1.8 million of FRB stock and \$1.1 million of FHLB stock as of and December 31, 2018.

Loans

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

	2019		2018		2017		2016		2015	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Loans held for sale- mortgage banking	\$ 137,114	100.0	\$ 22,788	100.0	\$ 36,601	100.0	\$ 39,641	100.0	\$ 50,445	100.0
Loans Held for Investment:										
Commercial and industrial	\$ 162,592	32.0	149,886	32.0	\$ 126,169	29.4	\$ 123,604	29.8	\$ 125,009	32.9
Commercial real estate	193,203	38.0	174,868	37.3	177,429	41.4	171,972	41.5	149,099	39.3
SBA	46,799	9.2	32,505	6.9	25,064	5.9	31,518	7.6	25,860	6.8
Consumer	82,498	16.2	78,055	16.7	71,876	16.8	59,183	14.3	47,073	12.4
Land and land development	10,449	2.0	11,398	2.4	14,168	3.3	15,982	3.9	17,627	4.6
Construction	12,656	2.5	21,257	4.5	13,167	3.1	12,215	2.9	15,187	4.0
	508,197	99.9	467,969	99.9	427,873	99.9	414,474	100.0	379,855	100.0
Unearned income and net unamortized deferred fees and costs	372	0.1	499	0.1	452	0.1	199	-	48	-
Loans, net of unearned income and unamortized fees and costs	\$ 508,569	100.0	\$ 468,468	100.0	\$ 428,325	100.0	\$ 414,673	100.0	\$ 379,903	100.0

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

	December 31,		Increase (Decrease)	
	2019	2018	\$	%
Loans held for sale-mortgage banking	\$ 137,114	\$ 22,788	\$ 114,326	501.7 % (a)
Loans Held for Investment:				
Commercial and industrial	\$ 162,592	\$ 149,886	\$ 12,706	8.5 %
Commercial real estate	193,203	174,868	18,335	10.5 %
SBA	46,799	32,505	14,294	44.0 % (b)
Consumer	82,498	78,055	4,443	5.7 % (c)
Land and land development	10,449	11,398	(949)	(8.3) %
Construction	12,656	21,257	(8,601)	(40.5) %
	508,197	467,969	40,228	8.6 %
Unearned income and net unamortized deferred fees and costs	372	499	(127)	(25.5) %
Loans, net of unearned income and unamortized fees and costs	\$ 508,569	\$ 468,468	\$ 40,101	8.6 % (d)

- (a) Loans held for sale increased as balances will fluctuate with the timing of loan funding and sales. In 2019, balances grew due to more favorable interest rates, especially in the second half of 2019.
- (b) The Company, in recent periods, began retaining rather than selling the guaranteed portion of SBA loans as the premiums investors are willing to pay have compressed.
- (c) Consumer loans increased primarily due to indirect vehicle lending in the North Dakota market.
- (d) 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):

2019	\$	152,163
2018		166,291
2017		176,733
2016		182,224
2015		176,439

Concentrations of Credit

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

	<u>2019</u>		<u>2018</u>			
North Dakota	\$	347,179	68 %	\$	325,646	70 %
Arizona		101,244	20 %		80,896	17 %
Minnesota		33,594	7 %		32,215	7 %
Other		26,180	5 %		29,212	6 %
Total gross loans held for investment	\$	<u>508,197</u>	<u>100 %</u>	\$	<u>467,969</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>2019</u>		<u>2018</u>			
North Dakota	\$	306,609	60 %	\$	302,813	65 %
Arizona		122,192	24 %		99,394	21 %
Minnesota		27,777	5 %		25,870	5 %
California		18,541	4 %		12,521	3 %
Colorado		15,297	3 %		9,266	2 %
Ohio		7,477	2 %		7,814	2 %
Other		10,304	2 %		10,291	2 %
Total gross loans held for investment	\$	<u>508,197</u>	<u>100 %</u>	\$	<u>467,969</u>	<u>100 %</u>

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

	<u>2019</u>	<u>2018</u>
	<u>Total Loans and Leases Held for Investment</u>	<u>Total Loans and Leases Held for Investment</u>
North Dakota		
Commercial and industrial	\$ 51,483	\$ 45,241
Construction	897	4,439
Agricultural	29,909	25,525
Land and land development	6,373	7,932
Owner-occupied commercial real estate	38,127	42,591
Commercial real estate	106,835	109,829
Small business administration	4,737	5,044
Consumer	68,248	62,212
Subtotal	<u>\$ 306,609</u>	<u>\$ 302,813</u>
Consolidated		
Commercial and industrial	\$ 77,706	\$ 66,545
Construction	12,656	21,257
Agricultural	29,914	26,425
Land and land development	10,449	11,398
Owner-occupied commercial real estate	54,972	56,916
Commercial real estate	193,203	174,868
Small business administration	46,799	32,505
Consumer	82,498	78,055
Subtotal	<u>\$ 508,197</u>	<u>\$ 467,969</u>

Loan Maturities⁽¹⁾

The following table sets forth the remaining maturities of loans in our portfolio as of December 31, 2019 (in thousands):

	<u>One year or less</u>	<u>Over 1 year through 5 years</u>		<u>Over 5 years</u>		<u>Total Loans and Leases Held for Investment</u>
		<u>Fixed Rate</u>	<u>Indexed Rate</u>	<u>Fixed Rate</u>	<u>Indexed Rate</u>	
Commercial and industrial	\$ 23,893	\$ 6,466	\$ 10,842	\$ 56,760	\$ 64,631	\$ 162,592
Commercial real estate	1,763	2,912	5,084	32,415	151,029	193,203
SBA	2,471	2,606	7,611	4,029	30,082	46,799
Consumer	992	390	3,966	67,788	9,362	82,498
Land and land development	1,834	330	121	5,805	2,359	10,449
Construction	326	696	11,634	-	-	12,656
Total principal amount of loans	<u>\$ 31,279</u>	<u>\$ 13,400</u>	<u>\$ 39,258</u>	<u>\$ 166,797</u>	<u>\$ 257,463</u>	<u>\$ 508,197</u>

(1) Maturities are based on contractual maturities. Indexed 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 2019, a \$700 thousand provision for credit losses was recorded, compared to \$0 in 2018.

Allowance for Credit Losses

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

Analysis of Allowance for Credit Losses

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

	For the Years ended December 31,				
	2019	2018	2017	2016	2015
Balance of allowance for credit losses, beginning of period	\$ 7,692	\$ 7,861	\$ 8,285	\$ 8,611	\$ 8,601
Charge-offs:					
Commercial and industrial	(125)	(71)	(84)	(1,004)	(47)
Commercial real estate	-	(1)	-	-	-
SBA	(82)	(59)	(566)	(71)	(145)
Consumer	(97)	(129)	(123)	(99)	(43)
Land and land development	-	-	(103)	-	-
Construction	-	-	-	-	-
Total charge-offs	<u>(304)</u>	<u>(260)</u>	<u>(876)</u>	<u>(1,174)</u>	<u>(235)</u>
Recoveries:					
Commercial and industrial	-	40	-	-	7
Commercial real estate	13	16	12	13	551
SBA	11	4	48	15	68
Consumer	29	31	40	20	19
Land and land development	-	-	2	-	-
Construction	-	-	-	-	-
Total recoveries	<u>53</u>	<u>91</u>	<u>102</u>	<u>48</u>	<u>645</u>
Net (charge-offs) recoveries	(251)	(169)	(774)	(1,126)	410
Provision (reduction) for credit losses charged to operations	<u>700</u>	<u>-</u>	<u>350</u>	<u>800</u>	<u>(400)</u>
Balance of allowance for credit losses, end of period	<u>\$ 8,141</u>	<u>\$ 7,692</u>	<u>\$ 7,861</u>	<u>\$ 8,285</u>	<u>\$ 8,611</u>
Ratio of net (charge-offs) recoveries to average loans and leases held for investment	(0.052)%	(0.037)%	(0.184)%	(0.282)%	0.117%
Average gross loans and leases held for investment	\$ 480,389	\$ 454,215	\$ 420,906	\$ 399,669	\$ 350,840
Ratio of allowance for credit losses to loans and leases held for investment	1.60%	1.64%	1.84%	2.00%	2.27%
Ratio of nonperforming loans to total assets	0.21%	0.17%	0.21%	0.27%	0.06%

Allocation of the Allowance for Credit 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 as of December 31 (dollars are in thousands).

	2019		2018		2017		2016		2015	
	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	\$ 2,366	32%	\$ 1,937	32%	\$ 2,158	30%	\$ 2,323	30%	\$ 3,205	33%
Commercial real estate	3,502	38%	3,558	37%	3,471	41%	3,231	41%	1,999	39%
SBA	1,131	9%	845	7%	834	6%	1,433	8%	1,578	7%
Consumer	853	16%	928	17%	914	17%	772	14%	640	12%
Land and land development	187	2%	225	2%	358	3%	413	4%	1,041	5%
Construction	102	3%	199	5%	126	3%	113	3%	148	4%
Total	<u>\$ 8,141</u>	<u>100%</u>	<u>\$ 7,692</u>	<u>100%</u>	<u>\$ 7,861</u>	<u>100%</u>	<u>\$ 8,285</u>	<u>100%</u>	<u>\$ 8,611</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. The allocation of the allowance for credit losses as shown in the table above 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.

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 the balance sheet dates. 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,				
	2019	2018	2017	2016	2015
Nonperforming loans:					
Loans 90 days or more delinquent and still accruing interest	\$ -	\$ -	\$ 26	\$ 20	\$ 175
Non-accrual loans	2,033	1,686	1,952	2,425	390
Total nonperforming loans	2,033	1,686	1,978	2,445	565
Other real estate and repossessed assets, net	-	-	-	218	242
Total nonperforming assets	<u>\$ 2,033</u>	<u>\$ 1,686</u>	<u>\$ 1,978</u>	<u>\$ 2,663</u>	<u>\$ 807</u>
Allowance for credit losses	<u>\$ 8,141</u>	<u>\$ 7,692</u>	<u>\$ 7,861</u>	<u>\$ 8,285</u>	<u>\$ 8,611</u>
Ratio of total nonperforming loans to total loans	0.31%	0.34%	0.43%	0.54%	0.13%
Ratio of total nonperforming loans to loans and leases held for investment	0.40%	0.36%	0.46%	0.59%	0.15%
Ratio of total nonperforming assets to total assets	0.21%	0.17%	0.21%	0.29%	0.09%
Ratio of total nonperforming loans to total assets	0.21%	0.17%	0.21%	0.27%	0.06%
Ratio of allowance for credit losses to total nonperforming loans	400%	456%	397%	339%	1,524%

Nonperforming Loans

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

	2019	2018
Balance, beginning of period	\$ 1,686	\$ 1,978
Additions to nonperforming	1,179	349
Charge-offs	(148)	(194)
Reclassified back to performing	(242)	(26)
Principal payments received	(186)	(409)
Transferred to repossessed assets	(46)	(12)
Transferred to other real estate owned	(210)	-
Balance, end of period	<u>\$ 2,033</u>	<u>\$ 1,686</u>

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):

	2019	2018
Interest income that would have been recorded	\$ 327	\$ 436
Interest income recorded	75	88
Effect on interest income	<u>\$ 252</u>	<u>\$ 348</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):

	<u>Total</u>	<u>Accrual</u>	<u>Non-accrual</u>
2019	\$ 3,245	\$ 1,448	\$ 1,797
2018	3,348	1,779	1,569
2017	1,908	1,801	107
2016	2,153	1,845	308
2015	2,197	1,884	313

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):

	<u>Watch List</u>			<u>Substandard</u>		
	<u>Impaired</u>	<u>Other</u>	<u>Total</u>	<u>Impaired</u>	<u>Other</u>	<u>Total</u>
2019	\$ 1,448	\$ 7,713	\$ 9,161	\$ 514	\$ 7,247	\$ 7,761
2018	-	5,206	5,206	106	9,069	9,175
2017	-	1,730	1,730	52	9,062	9,114
2016	-	8,125	8,125	6	10,511	10,517
2015	-	7,945	7,945	11	9,398	9,409

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)		
	2019	2018	\$	%	
Deposits:					
Non-interest-bearing	\$ 136,313	\$ 157,663	\$ (21,350)	(14) %	(a)
Interest-bearing-					
Savings, interest checking and money market	514,869	542,735	(27,866)	(5) %	(a)
Time deposits	169,365	148,207	21,158	14 %	(b)
Short-term borrowings	4,565	11,494	(6,929)	(60) %	(c)
Federal Home Loan Bank advances	17,000	-	17,000	100 %	(d)
Long-term borrowings	-	10,000	(10,000)	(100) %	(e)
Guaranteed preferred beneficial interests in Company's subordinated debentures	15,006	15,009	(3)	(0) %	
Accrued interest payable	1,685	1,277	408	32 %	(f)
Accrued expenses	7,580	5,700	1,880	33 %	(g)
Operating lease liabilities	2,822	-	2,822	100 %	(h)
Other liabilities	1,267	1,189	78	7 %	(i)
Total liabilities	870,472	893,274	(22,802)	(3) %	
Stockholders' equity	96,278	77,753	18,525	24 %	(j)
Total liabilities and stockholders' equity	\$ 966,750	\$ 971,027	\$ (4,277)	(0) %	

- (a) Demand deposits have declined as interest-bearing deposits have become more attractive due to higher market rates.
- (b) Time deposits have increased as customers seek to increase account earnings as rates increased.
- (c) During 2019, a significant portion of our customers transferred funds into traditional interest-bearing accounts. Short-term borrowings will vary depending on our customers need to use repurchase agreements.
- (d) The Company has borrowed on a short-term basis from the Federal Home Loan Bank as an efficient source of liquidity.
- (e) Long-term borrowings decreased due to redemption of subordinated debt as part of the Company's deleveraging strategy.
- (f) Accrued interest payable increased primarily due to increased time deposit balances and increased cost of deposits.
- (g) The increase is primarily due to the increased accrued mortgage commissions and mortgage incentive compensation.
- (h) Operating lease liabilities were established through adoption of ASC 842, *Leases* – See Note 8 of our Consolidated Financial Statements.
- (i) The increase primarily relates to increased taxes payable resulting from increased pre-tax income in 2019.
- (j) Stockholders' equity increased due to \$10.235 million net income and \$8.398 increase in accumulated other comprehensive income, net.

Included in accrued expenses is an estimate of mortgage banking reimbursement obligations which aggregated \$906 thousand and \$982 thousand at December 31, 2019 and 2018, 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 20 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,								
	2019			2018			2017		
	Average balance	Percent of deposits	Wgtd. avg. rate	Average balance	Percent of deposits	Wgtd. avg. rate	Average balance	Percent of deposits	Wgtd. avg. rate
Interest checking and MMDAs	\$ 542,700	62.2%	0.81%	\$ 486,754	57.4%	0.50%	\$ 487,063	57.7%	0.20%
Savings deposits	34,177	3.9%	0.07%	35,276	4.2%	0.05%	35,067	4.1%	0.03%
Time deposits	164,898	18.9%	1.88%	171,531	20.2%	1.34%	158,266	18.8%	0.98%
Total interest-bearing deposits	741,775	85.0%	1.02%	693,561	81.7%	0.69%	680,396	80.6%	0.37%
Non-interest-bearing demand deposits	130,430	15.0%	0.00%	154,984	18.3%	0.00%	163,603	19.4%	0.00%
Total deposits (1)	\$ 872,205	100.0%	0.86%	\$ 848,545	100.0%	0.56%	\$ 843,999	100.0%	0.30%

(1) Included in average total deposits are \$0, \$18.2 million, and \$0 of average brokered deposits for the years ending 2019, 2018, and 2017, respectively.

During periods of higher energy prices our North Dakota deposits grew rapidly. In 2017, a ND Bakken branch with \$14.0 million of deposits was sold for a gain of \$864 thousand. Excluding the effect of the sold branch, ND Bakken deposits rose slightly compared to December 2016. In recent periods, deposits in North Dakota and Arizona have grown significantly. Deposit balances decreased in 2019 due to deleveraging activities. The table below shows total deposits since 2014 (in thousands):

	As of December 31,				
	2019	2018	2017	2016	2015
ND Bakken Branches	\$ 190,286	\$ 185,713	\$ 168,981	\$ 178,677	\$ 190,670
ND Non-Bakken Branches	403,337	431,246	435,255	384,476	388,630
Total ND Branches	593,623	616,959	604,236	563,153	579,300
Brokered Time Deposits	-	-	-	-	33,363
Other	226,924	231,646	213,570	189,474	167,786
Total Deposits	\$ 820,547	\$ 848,605	\$ 817,806	\$ 752,627	\$ 780,449

Time deposits, in denominations of \$250,000 and over, totaled \$45.7 million at December 31, 2019 as compared to \$34.2 million at December 31, 2018. The following table sets forth the amount and maturities of time deposits of \$250,000 and over as of December 31, 2019 (in thousands):

Maturing in:

3 months or less	\$ 7,237
Over 3 months through 6 months	6,818
Over 6 months through 12 months	20,809
Over 12 months	10,794
	<u>\$ 45,658</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>2019</u>	<u>2018</u>	<u>2017</u>
Short-term borrowings outstanding at period end	\$ 4,565	\$ 11,494	\$ 18,043
Weighted average interest rate at period end	0.21%	0.84%	0.25%
Maximum month end balance during the period	\$ 10,681	\$ 19,955	\$ 24,671
Average borrowings outstanding for the period	\$ 5,283	\$ 17,944	\$ 14,732
Weighted average interest rate for the period	0.44%	0.41%	0.18%

Note 10 of our Consolidated Financial Statements summarizes the general terms of our short-term borrowings outstanding at December 31, 2019 and 2018.

FHLB advances totaled \$17.0 million at December 31, 2019 and \$0 at December 31, 2018.

Notes 11, 12 and 13 of our Consolidated Financial Statements summarize the general terms of our FHLB advances, long-term borrowings, and other borrowings at December 31, 2019 and 2018.

Guaranteed Preferred Beneficial Interests in Company's Subordinated Debentures

See Note 14 of our Consolidated Financial Statements for a description of the subordinated debentures.

Capital Resources

	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Tier 1 leverage (Consolidated)	10.65%	9.97%	9.53%	9.47%	9.00%
Total risk based capital (Consolidated)	17.13%	20.26%	19.98%	19.96%	20.07%
Common equity tier 1 risk based capital (Consolidated)	13.76%	14.67%	14.15%	13.90%	13.57%
Tier 1 risk based capital (Consolidated)	15.95%	17.28%	16.90%	16.78%	16.72%
Tangible common equity (Consolidated)	9.95%	7.99%	8.18%	8.13%	7.62%
Tier 1 leverage (BNC Bank)	9.81%	9.92%	9.62%	9.67%	9.45%
Total risk based capital (BNC Bank)	15.88%	18.44%	18.31%	18.41%	18.71%
Common equity tier 1 risk based capital (BNC Bank)	14.69%	17.19%	17.06%	17.16%	17.45%
Tier 1 risk based capital (BNC Bank)	14.69%	17.19%	17.06%	17.16%	17.45%

See Note 15 and Note 16 of our Consolidated Financial Statements for a discussion of stockholders equity and regulatory capital and the current operating environment.

The 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. 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.

During the fourth quarter of 2019, as part of a deleveraging strategy, BNC National Bank paid a \$10.0 million dividend to BNCCORP, INC., which was used to redeem \$10.0 million of subordinated debt. The deleveraging strategy, along with earnings in 2019, impacted the capital ratios at BNC Bank and the Company.

The Company routinely evaluates the sufficiency of its 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. Management will continue to evaluate capital requirements

and prudent capital management opportunities. See Note 14 of our Consolidated Financial Statements for a detailed description of Subordinated Debentures.

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, standby and commercial letters of credit, and performance and financial standby letters of credit. 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 Note 20 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 three 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 20 of our Consolidated Financial Statements.

Investment-related financial instruments, characterized as an off-balance-sheet item, include potential funding for investments in Small Business Investment Companies (SBIC). See Note 21 of our Consolidated Financial Statements.

At December 31, 2019, 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	\$ 21,565	\$ -	\$ -	\$ 15,006	\$ 36,571
Commitments to sell loans	133,977	-	-	-	133,977
Lease liabilities under non-cancelable operating leases	670	1,001	831	320	2,822
Total	\$ 156,212	\$ 1,001	\$ 831	\$ 15,326	\$ 173,370

	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	\$ 269,274	\$ 24,988	\$ 5,216	\$ 1,255	\$ 300,733
Commitments to sell loans	342,034	-	-	-	342,034
Standby and commercial letters of credit	372	366	-	-	738
Commitments to fund SBIC	-	800	-	1,317	2,117
Total	\$ 611,680	\$ 26,154	\$ 5,216	\$ 2,572	\$ 645,622

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 and certain off-balance sheet considerations less estimated volatile liabilities using the aforementioned methodology (\$140.3 million as of December 31, 2019);
2. Borrowing capacity from the FHLB (\$131.0 million as of December 31, 2019); and
3. Capacity to issue brokered deposits with maturities of less than 12 months (\$138.2 million as of December 31, 2019).

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 along with certain off-balance sheet considerations 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, 2019 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, 2019 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, 2019, the downward scenarios for interest rate movements is limited to -200bp. 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 4.75% to 5.75% 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 2020 is shown below:

Net Interest Income Simulation

Movement in interest rates	<u>-200bp</u>	<u>-100bp</u>	<u>Unchanged</u>	<u>+100bp</u>	<u>+200bp</u>	<u>+300bp</u>
Projected 12-month net interest income	\$ 30,510	\$ 31,185	\$ 31,526	\$ 31,263	\$ 31,026	\$ 30,777
Dollar change from unchanged scenario	\$ (1,016)	\$ (341)	-	\$ (263)	\$ (500)	\$ (749)
Percentage change from unchanged scenario	(3.22)%	(1.08)%	-	(0.83)%	(1.59)%	(2.38)%

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, 2019 (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, 2019. 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, 2019				
	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	\$ 10,523	\$ -	\$ -	\$ -	\$ 10,523
Investment securities (a)	51,256	18,533	61,927	114,448	246,164
FRB and FHLB stock	3,651	-	-	-	3,651
Loans held for sale-mortgage banking, fixed rate	137,114	-	-	-	137,114
Loans held for investment, fixed rate	19,386	51,186	103,230	18,611	192,413
Loans held for investment, indexed rate	106,191	45,206	158,947	5,812	316,156
Total interest-earning assets	<u>\$ 328,121</u>	<u>\$ 114,925</u>	<u>\$ 324,104</u>	<u>\$ 138,871</u>	<u>\$ 906,021</u>
Interest-bearing liabilities:					
Interest checking and money market accounts	\$ 479,733	\$ -	\$ -	\$ -	\$ 479,733
Savings	35,136	-	-	-	35,136
Time deposits	36,574	93,683	38,943	165	169,365
Short-term borrowings	4,565	-	-	-	4,565
FHLB advances	17,000	-	-	-	17,000
Long-term borrowings	-	-	-	-	-
Subordinated debentures	-	15,000	-	6	15,006
Total interest-bearing liabilities	<u>\$ 573,008</u>	<u>\$ 108,683</u>	<u>\$ 38,943</u>	<u>\$ 171</u>	<u>\$ 720,805</u>
Interest rate gap	<u>\$ (244,887)</u>	<u>\$ 6,242</u>	<u>\$ 285,161</u>	<u>\$ 138,700</u>	<u>\$ 185,216</u>
Cumulative interest rate gap at December 31, 2019	<u>\$ (244,887)</u>	<u>\$ (238,645)</u>	<u>\$ 46,516</u>	<u>\$ 185,216</u>	
Cumulative interest rate gap to total assets	(25.33%)	(24.69%)	4.81%	19.16%	

(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, 2019 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, 2019 and 2018
(With Independent Auditors' Report Thereon)

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	Page
Independent Auditors' Report	38
Consolidated Balance Sheets as of December 31, 2019 and 2018	40
Consolidated Statements of Income for the Years Ended December 31, 2019 and 2018	41
Consolidated Statements of Comprehensive (Loss) Income for the Years Ended December 31, 2019 and 2018	42
Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2019 and 2018	43
Consolidated Statements of Cash Flows for the Years Ended December 31, 2019 and 2018	44
Notes to Consolidated Financial Statements	46



INDEPENDENT AUDITORS' REPORT

Audit Committee and Board of Directors
BNCCORP, Inc. and Subsidiaries
Bismarck, North Dakota

We have audited the accompanying consolidated financial statements of BNCCORP, Inc. and Subsidiaries, which comprise the consolidated balance sheet as of December 31, 2019, and the related consolidated statements of income, comprehensive income (loss), stockholders' equity, and cash flows for the year 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 accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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 of 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.

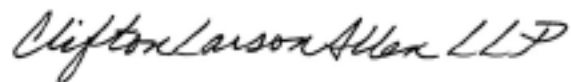
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of BNCCORP, Inc. and Subsidiaries as of December 31, 2019, and the results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

The 2018 financial statements of BNCCORP, Inc. and Subsidiaries were audited by other auditors whose report dated March 26, 2019, expressed an unmodified opinion on those statements.



CliftonLarsonAllen LLP

Minneapolis, Minnesota
March 20, 2020

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

As of December 31

(In thousands, except share data)

	<u>2019</u>	<u>2018</u>
ASSETS		
CASH AND CASH EQUIVALENTS	\$ 10,523	\$ 25,185
INVESTMENT SECURITIES AVAILABLE FOR SALE	265,278	411,509
FEDERAL RESERVE BANK AND FEDERAL HOME LOAN BANK STOCK	3,651	2,941
LOANS HELD FOR SALE-MORTGAGE BANKING	137,114	22,788
LOANS AND LEASES HELD FOR INVESTMENT	508,569	468,468
ALLOWANCE FOR CREDIT LOSSES	<u>(8,141)</u>	<u>(7,692)</u>
Net loans and leases held for investment	500,428	460,776
PREMISES AND EQUIPMENT, net	16,401	16,761
OPERATING LEASE RIGHT OF USE ASSET	2,638	-
ACCRUED INTEREST RECEIVABLE	3,681	5,079
OTHER	27,036	25,988
Total assets	<u>\$ 966,750</u>	<u>\$ 971,027</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
DEPOSITS:		
Non-interest-bearing	\$ 136,313	\$ 157,663
Interest-bearing –		
Savings, interest checking and money market	514,869	542,735
Time deposits	<u>169,365</u>	<u>148,207</u>
Total deposits	820,547	848,605
SHORT-TERM BORROWINGS	4,565	11,494
FEDERAL HOME LOAN BANK ADVANCES	17,000	-
LONG-TERM BORROWINGS	-	10,000
GUARANTEED PREFERRED BENEFICIAL INTERESTS IN COMPANY'S SUBORDINATED DEBENTURES	15,006	15,009
ACCRUED INTEREST PAYABLE	1,685	1,277
ACCRUED EXPENSES	7,580	5,700
OPERATING LEASE LIABILITIES	2,822	-
OTHER	<u>1,267</u>	<u>1,189</u>
Total liabilities	870,472	893,274
STOCKHOLDERS' EQUITY:		
Common stock, \$.01 par value – Authorized 11,300,000 shares; 3,514,770 and 3,493,298 shares issued and outstanding	35	35
Capital surplus – common stock	25,831	25,990
Retained earnings	71,057	61,042
Treasury stock (153,883 and 175,355 shares, respectively)	(2,115)	(2,386)
Accumulated other comprehensive income, net	<u>1,470</u>	<u>(6,928)</u>
Total stockholders' equity	<u>96,278</u>	<u>77,753</u>
Total liabilities and stockholders' equity	<u>\$ 966,750</u>	<u>\$ 971,027</u>

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>2019</u>	<u>2018</u>
INTEREST INCOME:		
Interest and fees on loans	\$ 27,201	\$ 23,286
Interest and dividends on investments		
Taxable	9,567	9,339
Tax-exempt	868	1,699
Dividends	181	154
Total interest income	<u>37,817</u>	<u>34,478</u>
INTEREST EXPENSE:		
Deposits	7,540	4,761
Short-term borrowings	23	74
Federal Home Loan Bank advances	334	95
Long-term borrowings	621	635
Subordinated debentures	583	543
Total interest expense	<u>9,101</u>	<u>6,108</u>
Net interest income	28,716	28,370
PROVISION FOR CREDIT LOSSES	700	-
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	<u>28,016</u>	<u>28,370</u>
NON-INTEREST INCOME:		
Bank charges and service fees	2,614	2,687
Wealth management revenues	1,735	1,810
Mortgage banking revenues, net	24,902	10,032
Gains on sales of loans, net	155	187
(Losses) gains on sales of securities, net	(1,296)	2,293
Other	1,021	2,008
Total non-interest income	<u>29,131</u>	<u>19,017</u>
NON-INTEREST EXPENSE:		
Salaries and employee benefits	22,459	20,074
Professional services	4,973	3,378
Data processing fees	4,321	4,027
Marketing and promotion	4,538	4,212
Occupancy	2,218	2,408
Regulatory costs	435	540
Depreciation and amortization	1,452	1,545
Office supplies and postage	531	574
Other	3,064	2,255
Total non-interest expense	<u>43,991</u>	<u>39,013</u>
Income before income taxes	13,156	8,374
Income tax expense	2,921	1,538
Net income	<u>\$ 10,235</u>	<u>\$ 6,836</u>
Basic earnings per common share	<u>\$ 2.90</u>	<u>\$ 1.96</u>
Diluted earnings per common share	<u>\$ 2.88</u>	<u>\$ 1.93</u>

See accompanying notes to consolidated financial statements.

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

	2019		2018	
NET INCOME	\$	10,235	\$	6,836
Unrealized gain (loss) on investment securities available for sale	\$	9,840	\$	(6,966)
Reclassification adjustment for losses (gains) on sales of securities, net, included in net income		1,296		(2,293)
Other comprehensive income (loss) before tax		11,136		(9,259)
Income tax (expense) benefit related to items of other comprehensive income (loss)		(2,738)		2,277
Other comprehensive income (loss)	\$	8,398	\$	(6,982)
TOTAL COMPREHENSIVE INCOME (LOSS)	\$	18,633	\$	(146)

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)

	Common Stock		Capital Surplus		Treasury	Accumulated Other Comprehensive	Total
	Shares	Amount	Common Stock	Retained Earnings	Stock	Income (Loss), net	
BALANCE, December 31, 2017	3,465,992	\$ 35	\$ 26,072	\$ 54,206	\$ (2,741)	\$ 54	\$ 77,626
Net income	-	-	-	6,836	-	-	6,836
Other comprehensive loss	-	-	-	-	-	(6,982)	(6,982)
Share-based compensation	27,306	-	(82)	-	355	-	273
BALANCE, December 31, 2018	3,493,298	\$ 35	\$ 25,990	\$ 61,042	\$ (2,386)	\$ (6,928)	\$ 77,753
Net income	-	-	-	10,235	-	-	10,235
Other comprehensive income	-	-	-	-	-	8,398	8,398
Share-based compensation	21,472	-	(159)	-	271	-	112
Cumulative effect adjust for adoption of ASC 842 - Leases	-	-	-	(220)	-	-	(220)
BALANCE, December 31, 2019	3,514,770	\$ 35	\$ 25,831	\$ 71,057	\$ (2,115)	\$ 1,470	\$ 96,278

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>2019</u>	<u>2018</u>
OPERATING ACTIVITIES:		
Net income	\$ 10,235	\$ 6,836
Adjustments to reconcile net income to net cash provided by operating activities -		
Provision for credit losses	700	-
Depreciation and amortization	1,452	1,545
Net amortization of premiums and (discounts) on investment securities and subordinated debentures	7,170	7,778
Share-based compensation	112	273
Change in accrued interest receivable and other assets, net	(1,903)	355
Gain on sale of other real estate	(35)	-
Gain on sale of bank premises and equipment	(10)	21
Net realized losses (gains) on sales of investment securities	1,296	(2,293)
Increase in deferred taxes	(96)	(88)
Change in other liabilities, net	4,185	248
Funding of loans held for sale, mortgage banking	(1,328,706)	(642,695)
Proceeds from sales of loans held for sale, mortgage banking	1,216,900	656,003
Fair value adjustment for loans held for sale, mortgage banking	(2,844)	505
Fair value adjustment on mortgage banking derivatives	(2,090)	233
Proceeds from sales of loans	1,710	2,209
Gains on sales of loans, net	(155)	(187)
Net cash (used in) provided by operating activities	<u>(92,079)</u>	<u>30,743</u>
INVESTING ACTIVITIES:		
Purchases of investment securities available for sale	(172,304)	(129,930)
Proceeds from sales of investment securities available for sale	263,218	62,516
Proceeds from maturities of investment securities available for sale	57,872	53,077
Purchases of Federal Reserve and Federal Home Loan Bank Stock	(30,430)	(15,456)
Sales of Federal Reserve and Federal Home Loan Bank Stock	29,720	15,412
Net increase in loans and leases held for investment	(41,907)	(42,334)
Proceeds from sales of other real estate	316	-
Proceeds from sales of premises and equipment	22	2,307
Purchases of premises and equipment	(1,103)	(1,230)
Net cash provided by (used in) investing activities	<u>105,404</u>	<u>(55,638)</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)

	2019	2018
FINANCING ACTIVITIES:		
Net (decrease) increase in deposits	\$ (28,058)	\$ 30,799
Net decrease in short-term borrowings	(6,929)	(6,549)
Decrease in long-term borrowings	(10,000)	-
Repayments of Federal Home Loan Bank advances	(804,400)	(395,000)
Proceeds from Federal Home Loan Bank advances	821,400	395,000
Net cash (used in) provided by financing activities	(27,987)	24,250
NET DECREASE IN CASH AND CASH EQUIVALENTS	(14,662)	(645)
CASH AND CASH EQUIVALENTS, beginning of period	25,185	25,830
CASH AND CASH EQUIVALENTS, end of period	\$ 10,523	\$ 25,185
 SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	\$ 8,693	\$ 3,945
Income taxes paid	\$ 3,527	\$ 1,102
 SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Additions to other real estate in the settlement of loans	\$ 281	\$ -

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, BNC, or Company) 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 Bank operates community banking and wealth management businesses in North Dakota, Arizona and Minnesota from 13 locations. The Bank also conducts mortgage banking through a consumer-direct channel complemented by retail channels from 11 locations in Arizona, North Dakota, Illinois, Kansas, Missouri, and Michigan. The consumer direct channel emphasizes technology (internet leads and call center) to originate mortgage loans throughout the United States. The retail channel is primarily relationship driven and originations are generally near mortgage banking locations.

With respect to group concentrations of credit risk, most of the Company's business activity is with customers in North Dakota. At December 31, 2019, the Company did not have any significant credit concentrations in any particular industry.

The consolidated financial statements included herein are for BNCCORP and subsidiaries. The accounting and reporting policies of BNCCORP and 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, reserves for mortgage banking reimbursement obligations, fair value measurements for financial instruments (including derivatives), impairment of long-lived assets, contingencies, and income taxes. Ultimate results could materially differ from those estimates.

SIGNIFICANT ACCOUNTING POLICIES

Cash and Cash Equivalents

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, liquidity needs, 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 (Loss)). All securities were classified as available for sale as of December 31, 2019 and 2018, except for Federal Reserve Bank (FRB) and Federal Home Loan Bank (FHLB) stocks, which have indeterminable maturities.

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, result in a charge to earnings and establishment of a new cost basis. The Company assesses available information about its 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;
- 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 Securities*. Any credit-related impairments are recognized through a charge to earnings. The amount of non-credit related impairments is recognized through comprehensive (loss) 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, 2019 and 2018.

Federal Reserve Bank and Federal Home Loan Bank

Investments in Federal Reserve Bank and Federal Home Loan Bank stock qualify as restricted stock, which is not subject to investment security accounting treatment, and are reported at cost, subject to impairment.

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 ASC 825, *Financial Instruments*. Gains and losses from the changes in fair value are included in mortgage banking revenues, net.

Loans and Leases Held For Investment

Loans and leases held for investment are stated at their outstanding principal amount net of unearned income, 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 and uncollected 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 collectable. 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 of the loan 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 or a valuation allowance is established for the difference.

Troubled debt 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.

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, the Company periodically reviews use of lines on a retrospective basis and recognizes 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 ASC 860, *Transfers and Servicing of Financial Assets*.

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 consolidated 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 the Bank's 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 the Bank's 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 the Bank estimates the allowance for credit losses.

The Bank's methodology has been consistently applied. However, the Bank enhances its methodology as circumstances dictate.

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 ASC 310, *Receivables*. 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 consolidated financial statements, generally at the time of initial charge-off of the loan balance.

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. This analysis 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 uncollectable are charged off against the allowance for credit 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. 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 for credit losses to the amount determined appropriate through application of the above processes. Actual credit losses may materially vary from the current estimated allowance for credit losses.

Other Real Estate Owned and Repossessed Assets, net

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. Net operating income from and gains on disposition of these assets are included in other non-interest income. Net operating expenses, losses on disposition, and subsequent declines in the estimated fair value of these assets are charged to other non-interest expense.

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 non-interest 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 capitalized and amortized over the shorter of the lease term or the estimated useful life of the improvement. 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. The impairment review includes a comparison of future cash flows (undiscounted and without interest charges) expected to be generated by the assets to their current carrying value. 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.

ASC 820, *Fair Value Measurement*, 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 less 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 the Company's own estimates of assumptions that market participants would use in pricing the asset or liability.

Management assigns levels to assets and liabilities accounted for at 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.

Investment Securities Available for Sale. The fair value of the Company's securities, other than U.S. Treasury securities, are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are less active, and model-based valuation techniques for which significant assumptions are observable in the market. U.S. Treasury securities are based upon quoted prices for identical instruments traded in active markets.

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 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.

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 less active, and model-based valuation techniques for which significant assumptions are observable in the market.

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

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 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 in other assets with changes in fair value recorded in mortgage banking revenues, net.

The Company also commits to originate and sell certain loans related to 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 in other liabilities with changes in fair value recorded in mortgage banking revenues, net.

Share-Based Compensation

ASC 718, *Compensation – Stock Compensation*, 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, 2019, the Company had four stock-based compensation plans, which are described more fully in Note 25 and Note 26 to these consolidated financial statements.

Revenue from Contracts with Customers

The majority of the Company's performance obligations for revenue from contracts with customers are satisfied at a point in time and are typically collected from customers at the time of the transaction or shortly thereafter.

The following is a description of the principal activities from which the Company generates revenue that are within the scope of ASC 606:

Service charges on deposits – Service charges on deposit accounts represent daily and monthly analysis fees recognized for the services related to customer deposit accounts, including account maintenance, overdraft fees, and depository transactions processing fees. Depository accounts charge fees in accordance with the customer's pricing schedule or may be assessed a flat service fee per month. The Company satisfies the performance obligation related to providing depository accounts daily as transactions are processed and deposit service charge revenue is recognized daily.

Bankcard fees – Bankcard fees primarily represent income earned from interchange revenue from Visa for the Company's processing of debit card transactions. The performance obligation for interchange revenue is the processing of each transaction through the Company's access to the banking system. This performance obligation is completed for each individual transaction and revenue is recognized per transaction in accordance with interchange rates established by Visa.

Wealth management revenue – Wealth management revenue consists of fees earned on personal trust accounts, retirement plan administration, and wealth management services. The performance obligations related to this revenue include items such as performing trustee service administration, investment management services, custody and record-keeping services, retirement plan administration, and tax services. These fees are part of contractual agreements and the performance obligations are satisfied upon completion of services. The fees are generally a fixed flat annual rate or based on a percentage of the account's market value per the contract with the customer and revenue is recognized over time as earned.

Other income – The Company recognizes other miscellaneous income through a variety of other revenue streams, the most material of which include revenue from investments in Small Business Investment Companies (SBIC), gains on sales of financial assets, and bank-owned life insurance income. These revenue streams are outside of the scope of ASC 606 and are recognized in accordance with the applicable U.S. generally accepted accounting principles. The remainder of Other income is primarily earned through transactions with personal banking customers, including stop payment charges and fees for cashier's checks. The performance obligations of these types of fees are satisfied as transactions are completed and revenue is recognized upon transaction execution according to established fee schedules with the customers.

Note 17 to these consolidated financial statements includes disclosure of revenue from contracts with customers.

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 effects of changes in tax rates on deferred tax assets and liabilities are recognized in income in the period of enactment regardless of the balance sheet classification of the underlying deferred tax asset or liability.

Management evaluates 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 23 to these consolidated financial statements includes disclosure of the Company's EPS calculations.

Comprehensive (Loss) Income

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

RECENTLY ISSUED OR ADOPTED ACCOUNTING PRONOUNCEMENTS

In February 2016, the FASB issued ASU 2016-02, *Leases – Accounting Standards Codification (ASC) Topic 842*. The amended guidance requires lessees to recognize leases on-balance sheet and disclose key information about leasing arrangements. ASC Topic 842 (ASC 842) establishes a right of use (ROU) model that requires a lessee to recognize a ROU asset and lease liability on the balance sheet for all leases with a term longer than 12 months. Leases are required to be classified as finance or operating, with classification affecting the pattern and classification of expense recognition in the income statement.

The Company adopted ASC 842 using a modified retrospective transition approach as of January 1, 2019. As a result, the Company was not required to adjust its comparative period financial information for effects of the standard or make the new required lease disclosures for periods prior to January 1, 2019. The adoption of ASC 842 did not have a material impact to the Company's consolidated balance sheet or the consolidated statement of income. As a result of adopting ASC 842, the Company recognized operating lease liabilities of \$4.0 million with corresponding ROU assets of \$3.8 million and a cumulative effect adjustment to equity of \$220 thousand as of January 1, 2019. See Note 8 to the consolidated financial statements.

ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*, replaces the current incurred loss methodology for recognizing credit losses with a current expected credit loss model, which requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. This amended guidance broadens the information that an entity must consider in developing its expected credit loss estimates. Additionally, this update amends the accounting for credit losses for available-for-sale debt securities and purchased financial assets with a more-than-insignificant amount of credit deterioration since origination. This update requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of a company's loan portfolio. This update is effective for fiscal years beginning after December 15, 2022. This update requires the use of the modified retrospective adoption approach and the Company is currently evaluating the impact that this amended guidance will have on its consolidated financial statements and 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, 2019 or 2018. The carrying amount of investment securities available for sale securities and their estimated fair values were as follows as of December 31 (in thousands):

	2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities	\$ 4,992	\$ 2	\$ -	\$ 4,994
U.S. government sponsored entity mortgage-backed securities issued by FNMA/FHLMC	5,634	16	(7)	5,643
U.S. government agency small business administration pools guaranteed by SBA	53,873	-	(2,236)	51,637
Collateralized mortgage obligations guaranteed by GNMA	21,120	671	(1)	21,790
Collateralized mortgage obligations issued by FNMA or FHLMC	68,353	523	(261)	68,615
Commercial mortgage-backed securities issued by FHLMC	21,625	931	-	22,556
Other commercial mortgage-backed securities	56,530	921	(672)	56,779
Asset-backed securities	12,810	83	-	12,893
State and municipal bonds	19,873	948	(450)	20,371
	<u>\$ 264,810</u>	<u>\$ 4,095</u>	<u>\$ (3,627)</u>	<u>\$ 265,278</u>
	2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities	\$ 59,710	\$ -	\$ (916)	\$ 58,794
U.S. government sponsored entity mortgage-backed securities issued by FNMA/FHLMC	10,221	32	(121)	10,132
U.S. government agency small business administration pools guaranteed by SBA	158,430	-	(7,464)	150,966
Collateralized mortgage obligations guaranteed by GNMA	63,149	274	(1,166)	62,257
Collateralized mortgage obligations issued by FNMA or FHLMC	52,635	47	(903)	51,779
Asset-backed securities	24,170	-	(125)	24,045
State and municipal bonds	53,862	434	(760)	53,536
	<u>\$ 422,177</u>	<u>\$ 787</u>	<u>\$ (11,455)</u>	<u>\$ 411,509</u>

The amortized cost and estimated fair value of investment securities available for sale classified according to their contractual maturities at December 31, 2019, were as follows (in thousands):

	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ -	\$ -
Due after one year through five years	4,992	4,994
Due after five years through ten years	75,189	75,733
Due after ten years	184,629	184,551
Total	<u>\$ 264,810</u>	<u>\$ 265,278</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.

Investment securities available for sale with estimated fair values of \$80.6 million and \$113.9 million at December 31, 2019 and 2018, 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):

	2019	2018
Sales proceeds	\$ 263,218	\$ 62,516
Gross realized gains	3,389	2,513
Gross realized losses	(4,685)	(220)
Net realized (losses) gains	<u>\$ (1,296)</u>	<u>\$ 2,293</u>

The following table shows the Company's gross unrealized losses and fair value of investment securities available for sale 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	2019								
	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	-	\$ -	\$ -	-	\$ -	\$ -	-	\$ -	\$ -
U.S. government sponsored entity mortgage-backed securities issued by FNMA/FHLMC	1	4,779	(7)	-	-	-	1	4,779	(7)
U.S. government agency small business administration pools guaranteed by SBA	2	14,140	(142)	5	37,493	(2,094)	7	51,633	(2,236)
Collateralized mortgage obligations guaranteed by GNMA	1	507	(1)	-	-	-	1	507	(1)
Collateralized mortgage obligations issued by FNMA or FHLMC	5	35,047	(261)	-	-	-	5	35,047	(261)
Other commercial mortgage-backed securities	3	25,756	(672)	-	-	-	3	25,756	(672)
Asset-backed securities	-	-	-	-	-	-	-	-	-
State and municipal bonds	3	13,780	(450)	-	-	-	3	13,780	(450)
Total temporarily impaired securities	<u>15</u>	<u>\$ 94,009</u>	<u>\$ (1,533)</u>	<u>5</u>	<u>\$ 37,493</u>	<u>\$ (2,094)</u>	<u>20</u>	<u>\$ 131,502</u>	<u>\$ (3,627)</u>
Description of Securities	2018								
	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	\$ 19,652	\$ (55)	2	\$ 39,142	\$ (861)	4	\$ 58,794	\$ (916)
U.S. government sponsored entity mortgage-backed securities issued by FNMA/FHLMC	-	-	-	3	4,132	(121)	3	4,132	(121)
U.S. government agency small business administration pools guaranteed by SBA	5	28,836	(1,444)	40	122,130	(6,020)	45	150,966	(7,464)
Collateralized mortgage obligations guaranteed by GNMA	-	-	-	5	40,146	(1,166)	5	40,146	(1,166)
Collateralized mortgage obligations issued by FNMA or FHLMC	3	13,965	(88)	8	34,583	(815)	11	48,548	(903)
Asset-backed securities	4	14,752	(46)	4	9,293	(79)	8	24,045	(125)
State and municipal bonds	9	30,441	(402)	6	16,575	(358)	15	47,016	(760)
Total temporarily impaired securities	<u>23</u>	<u>\$ 107,646</u>	<u>\$ (2,035)</u>	<u>68</u>	<u>\$ 266,001</u>	<u>\$ (9,420)</u>	<u>91</u>	<u>\$ 373,647</u>	<u>\$ (11,455)</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 before a recovery of amortized cost. 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 2019 or 2018.

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>2019</u>	<u>2018</u>
Federal Reserve Bank Stock, at cost	\$ 1,807	\$ 1,807
Federal Home Loan Bank, at cost	1,844	1,134
Total	<u>\$ 3,651</u>	<u>\$ 2,941</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>2019</u>	<u>2018</u>
Loans held for sale-mortgage banking	\$ 137,114	\$ 22,788
Commercial and industrial	\$ 162,592	\$ 149,886
Commercial real estate	193,203	174,868
SBA	46,799	32,505
Consumer	82,498	78,055
Land and land development	10,449	11,398
Construction	12,656	21,257
Gross loans and leases held for investment	508,197	467,969
Unearned income and net unamortized deferred fees and costs	372	499
Loans, net of unearned income and unamortized fees and costs	508,569	468,468
Allowance for credit losses	(8,141)	(7,692)
Net loans and leases held for investment	<u>\$ 500,428</u>	<u>\$ 460,776</u>

To accommodate customers whose financing needs exceed the Bank's lending limits, BNC sells loan participations on a nonrecourse basis to outside financial institutions and derecognizes the portion of the loan balance sold. At December 31, 2019 and 2018, loan participations sold on a nonrecourse basis to outside financial institutions totaled \$152.2 million and \$166.3 million, respectively.

Loans to Related Parties

Note 24 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 FHLB, FRB, and the Bank of North Dakota as of December 31 (in thousands):

	<u>2019</u>	<u>2018</u>
Commercial and industrial	\$ 51,641	\$ 43,130
Commercial real estate	110,597	97,788
Consumer	31,894	32,357
Total	<u>\$ 194,132</u>	<u>\$ 173,275</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):

	2019						
	Commercial and industrial	Commercial real estate	SBA	Consumer	Land and land development	Construction	Total
Balance, beginning of period	\$ 1,937	\$ 3,558	\$ 845	\$ 928	\$ 225	\$ 199	\$ 7,692
Provision (reduction)	554	(69)	357	(7)	(38)	(97)	700
Loans charged off	(125)	-	(82)	(97)	-	-	(304)
Loan recoveries	-	13	11	29	-	-	53
Balance, end of period	<u>\$ 2,366</u>	<u>\$ 3,502</u>	<u>\$ 1,131</u>	<u>\$ 853</u>	<u>\$ 187</u>	<u>\$ 102</u>	<u>\$ 8,141</u>

	2018						
	Commercial and industrial	Commercial real estate	SBA	Consumer	Land and land development	Construction	Total
Balance, beginning of period	\$ 2,158	\$ 3,471	\$ 834	\$ 914	\$ 358	\$ 126	\$ 7,861
Provision (reduction)	(190)	72	66	112	(133)	73	-
Loans charged off	(71)	(1)	(59)	(129)	-	-	(260)
Loan recoveries	40	16	4	31	-	-	91
Balance, end of period	<u>\$ 1,937</u>	<u>\$ 3,558</u>	<u>\$ 845</u>	<u>\$ 928</u>	<u>\$ 225</u>	<u>\$ 199</u>	<u>\$ 7,692</u>

The following table shows the balance in the allowance for credit losses at December 31, 2019, and December 31, 2018, 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, 2019						
Commercial and industrial	\$ 497	\$ 1,869	\$ 2,366	\$ 1,610	\$ 160,982	\$ 162,592
Commercial real estate	172	3,330	3,502	1,448	191,755	193,203
SBA	59	1,072	1,131	380	46,419	46,799
Consumer	-	853	853	37	82,461	82,498
Land and land development	-	187	187	5	10,444	10,449
Construction	-	102	102	-	12,656	12,656
Total	<u>\$ 728</u>	<u>\$ 7,413</u>	<u>\$ 8,141</u>	<u>\$ 3,480</u>	<u>\$ 504,717</u>	<u>\$ 508,197</u>
December 31, 2018						
Commercial and industrial	\$ 246	\$ 1,691	\$ 1,937	\$ 1,758	\$ 148,128	\$ 149,886
Commercial real estate	73	3,485	3,558	1,496	173,372	174,868
SBA	62	783	845	104	32,401	32,505
Consumer	6	922	928	80	77,975	78,055
Land and land development	-	225	225	28	11,370	11,398
Construction	-	199	199	-	21,257	21,257
Total	<u>\$ 387</u>	<u>\$ 7,305</u>	<u>\$ 7,692</u>	<u>\$ 3,466</u>	<u>\$ 464,503</u>	<u>\$ 467,969</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. Accrual of interest on loans is discontinued when the Bank believes 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):

	2019					
	Current	31-89 Days Past Due	90 Days or More Past Due And Accruing	Total Performing	Non-accrual	Total
Commercial and industrial:						
Business loans	\$ 75,907	\$ 189	\$ -	\$ 76,096	\$ 1,610	\$ 77,706
Agriculture	29,877	37	-	29,914	-	29,914
Owner-occupied commercial real estate	54,947	25	-	54,972	-	54,972
Commercial real estate	193,203	-	-	193,203	-	193,203
SBA	46,382	36	-	46,418	381	46,799
Consumer:						
Automobile	24,118	47	-	24,165	15	24,180
Home equity	9,650	-	-	9,650	-	9,650
1st mortgage	12,678	-	-	12,678	-	12,678
Other	35,884	84	-	35,968	22	35,990
Land and land development	10,444	-	-	10,444	5	10,449
Construction	12,656	-	-	12,656	-	12,656
Total loans held for investment	505,746	418	-	506,164	2,033	508,197
Loans held for sale	137,114	-	-	137,114	-	137,114
Total gross loans	<u>\$ 642,860</u>	<u>\$ 418</u>	<u>\$ -</u>	<u>\$ 643,278</u>	<u>\$ 2,033</u>	<u>\$ 645,311</u>

	2018					
	Current	31-89 Days Past Due	90 Days or More Past Due And Accruing	Total Performing	Non-accrual	Total
Commercial and industrial:						
Business loans	\$ 64,437	\$ 644	\$ -	\$ 65,081	\$ 1,464	\$ 66,545
Agriculture	26,425	-	-	26,425	-	26,425
Owner-occupied commercial real estate	56,916	-	-	56,916	-	56,916
Commercial real estate	174,868	-	-	174,868	-	174,868
SBA	32,343	47	-	32,390	115	32,505
Consumer:						
Automobile	22,377	10	-	22,387	55	22,442
Home equity	8,567	-	-	8,567	-	8,567
1st mortgage	12,505	229	-	12,734	-	12,734
Other	34,265	23	-	34,288	24	34,312
Land and land development	11,370	-	-	11,370	28	11,398
Construction	21,257	-	-	21,257	-	21,257
Total loans held for investment	465,330	953	-	466,283	1,686	467,969
Loans held for sale	22,788	-	-	22,788	-	22,788
Total gross loans	\$ 488,118	\$ 953	\$ -	\$ 489,071	\$ 1,686	\$ 490,757

The following table indicates the effect on interest income on loans 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):

	2019	2018
Interest income that would have been recorded	\$ 140	\$ 123
Interest income recorded	-	-
Effect on interest income on loans	\$ 140	\$ 123

Credit Risk by Internally Assigned Grade

The Company maintains an internal risk rating process in order to increase the precision and effectiveness of credit risk management. Loans are assigned one of the following four internally assigned grades: pass, watch list, substandard, and doubtful.

At December 31, 2019, the Company had \$489.8 million of loans categorized as pass rated loans. This compares to \$452.0 million at December 31, 2018.

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, 2019, the Company had \$9.2 million of loans categorized as watch list loans compared to \$5.2 million at December 31, 2018.

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 loan. 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, 2019, the Company had \$7.8 million of substandard loans and \$1.5 million of doubtful loans. This compares to \$9.2 million of substandard loans and \$1.6 million doubtful loans as of December 31, 2018.

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-accrual loans 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, 2019 and 2018 (in thousands):

	2019				
	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	\$ 2,004	\$ 1,417	\$ 497	\$ 1,429	\$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	1,762	1,448	172	1,476	75
SBA	121	101	59	103	-
Consumer:					
Automobile	-	-	-	-	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans with an allowance recorded	\$ 3,887	\$ 2,966	\$ 728	\$ 3,008	\$ 75
Impaired loans without an allowance recorded:					
Commercial and industrial:					
Business loans	\$ 248	\$ 193	\$ -	\$ 221	\$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	-	-	-	-	-
SBA	338	279	-	280	-
Consumer:					
Automobile	18	15	-	16	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	42	22	-	27	-
Land and land development	137	5	-	16	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans without an allowance recorded	\$ 783	\$ 514	\$ -	\$ 560	\$ -
TOTAL IMPAIRED LOANS	\$ 4,670	\$ 3,480	\$ 728	\$ 3,568	\$ 75

2018

	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	\$ 1,996	\$ 1,454	\$ 246	\$ 1,484	\$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	1,795	1,496	73	1,497	76
SBA	143	115	62	117	-
Consumer:					
Automobile	16	12	6	15	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans with an allowance recorded	\$ 3,950	\$ 3,077	\$ 387	\$ 3,113	\$ 76
Impaired loans without an allowance recorded:					
Commercial and industrial:					
Business loans	\$ 1,915	\$ 294	\$ -	\$ 305	\$ 12
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	-	-	-	-	-
SBA	-	-	-	-	-
Consumer:					
Automobile	62	43	-	44	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	45	24	-	26	-
Land and land development	150	28	-	40	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans without an allowance recorded	\$ 2,172	\$ 389	\$ -	\$ 415	\$ 12
TOTAL IMPAIRED LOANS	\$ 6,122	\$ 3,466	\$ 387	\$ 3,528	\$ 88

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 would not otherwise be considered, 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):

	2019			
	Accrual	Non-accrual	Total	Allowance
Commercial and industrial:				
Business loans	\$ -	\$ 1,417	\$ 1,417	\$ 172
Agriculture	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-
Commercial real estate	1,448	-	1,448	497
SBA	-	380	380	59
Consumer:				
Automobile	-	-	-	-
Home equity	-	-	-	-
1st mortgage	-	-	-	-
Other	-	-	-	-
Land and land development	-	-	-	-
Construction	-	-	-	-
Loans held for sale	-	-	-	-
	<u>\$ 1,448</u>	<u>\$ 1,797</u>	<u>\$ 3,245</u>	<u>\$ 728</u>
	2018			
	Accrual	Non-accrual	Total	Allowance
Commercial and industrial:				
Business loans	\$ 284	\$ 1,454	\$ 1,738	\$ 244
Agriculture	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-
Commercial real estate	1,496	-	1,496	73
SBA	-	115	115	63
Consumer:				
Automobile	-	-	-	-
Home equity	-	-	-	-
1st mortgage	-	-	-	-
Other	-	-	-	-
Land and land development	-	-	-	-
Construction	-	-	-	-
Loans held for sale	-	-	-	-
	<u>\$ 1,780</u>	<u>\$ 1,569</u>	<u>\$ 3,349</u>	<u>\$ 380</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, 2019, there was one new TDRs with a pre-modification

and post modification balance of \$279 thousand. For the year ended December 31, 2018, there were three new TDRs with a pre-modification and post modification balance of \$1.5 million.

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 on loans 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>2019</u>	<u>2018</u>
Interest income that would have been recorded	\$ 187	\$ 313
Interest income recorded	<u>75</u>	<u>88</u>
Effect on interest income on loans	<u>\$ 112</u>	<u>\$ 225</u>

There were no additional funds committed to borrowers who are in TDR status at December 31, 2019 and December 31, 2018.

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, 2019 and December 31, 2018, 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>2019</u>	<u>2018</u>
Balance, beginning of period	\$ -	\$ -
Transfers from nonperforming loans	281	-
Real estate sold	(316)	-
Net gains on sale of assets	35	-
(Provision) reduction	<u>-</u>	<u>-</u>
Balance, end of period	<u>\$ -</u>	<u>\$ -</u>

NOTE 7. Premises and Equipment, net

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

	<u>2019</u>	<u>2018</u>
Land and improvements	\$ 2,853	\$ 2,853
Buildings and improvements	17,735	17,534
Leasehold improvements	436	543
Furniture, fixtures, and equipment	<u>9,632</u>	<u>9,825</u>
Total cost	30,656	30,755
Less accumulated depreciation and amortization	<u>(14,255)</u>	<u>(13,994)</u>
Net premises and equipment	<u>\$ 16,401</u>	<u>\$ 16,761</u>

Depreciation and amortization expense totaled \$1.452 million and \$1.545 million for the years ended December 31, 2019 and 2018, respectively.

NOTE 8. Leases

The Company has operating leases, primarily for office space, that expire over the next eight years. These leases generally contain renewal options for periods ranging from one to five years. The Company has evaluated each individual lease to determine if exercising the renewal option was probable and considered the renewal into determining the lease term and associated payments. The Company's leases generally do not include termination options for either party to the lease or restrictive financial or other covenants. Payments due under the lease contracts include both fixed and variable payments. The variable payments are for the Company's proportionate share of the building's property taxes, insurance, and common area maintenance. As most of the Company's leases do not provide an implicit rate, the Company uses its incremental borrowing rate based on the information available at the lease commencement date in determining the present value of the lease payments.

The components of lease cost for the years ended December 31 were as follows (in thousands):

	<u>2019</u>
Operating lease costs	\$ 969
Variable lease costs	45
Short-term lease costs	17
Total lease costs	<u>\$ 1,031</u>

Rental expense for operating leases for the year ending December 31, 2018 amounted to \$1.3 million.

Amounts reported in the consolidated balance sheet as of December 31, 2019 are as follows (in thousands):

	<u>As of</u> <u>December 31, 2019</u>
Operating lease right of use asset	\$ 2,638
Operating lease liabilities	2,822

Other information related to leases as of December 31 was as follows (dollars are in thousands):

	<u>2019</u>
Cash paid for amounts included in the measurement of lease liabilities	\$ 987
ROU Assets obtained in exchange for lease obligations	175
Reductions to ROU assets resulting from reduction in lease obligations	1,034

	<u>As of</u> <u>December 31, 2019</u>
Weighted Average remaining lease term	4.94 years
Weighted Average discount rate	6.00%

Maturities of lease liabilities under non-cancellable leases as of December 31, 2019 are as follows (in thousands):

	Operating Leases
2020	\$ 670
2021	506
2022	495
2023	474
2024	357
Thereafter	320
Total lease liabilities	<u>\$ 2,822</u>

NOTE 9. Deposits

The scheduled maturities of time deposits as of December 31, 2019 are as follows (in thousands):

2020	\$ 130,236
2021	27,882
2022	5,242
2023	3,726
2024	2,090
Thereafter	189
	<u>\$ 169,365</u>

At December 31, 2019 and 2018, the Bank had no time deposits that had been acquired through a traditional broker channel. The Company had \$108.0 million and \$101.3 million of interest-bearing deposits that meet the regulatory definition of a brokered deposit as of December 31, 2019 and 2018, respectively.

At December 31, 2019 and 2018, the Bank had \$45.7 million and \$34.2 million, respectively, in time deposits greater than \$250 thousand.

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

	2019	2018
Savings	\$ 24	\$ 19
Interest checking	1,288	160
Money market	3,124	2,279
Time deposits	3,104	2,303
	<u>\$ 7,540</u>	<u>\$ 4,761</u>

Deposits Received from Related Parties

Note 24 to these consolidated financial statements includes information relating to deposits received from executive officers, directors, principal shareholders and associates of such persons.

NOTE 10. 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>2019</u>	<u>2018</u>
Federal reserve borrowings	\$ -	\$ -
Repurchase agreements with customers, renewable daily, interest payable monthly, rates ranging from 0.20% to 0.40% and 0.20% to 1.50%, respectively, secured by U.S. Treasury securities and general obligations of municipalities	4,565	11,494
	<u>\$ 4,565</u>	<u>\$ 11,494</u>

The weighted average interest rate on short-term borrowings outstanding as of December 31, 2019 and 2018 was 0.21% and 0.84%, 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 U.S. government, U.S. 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, 2019, the \$4.6 million of securities sold under repurchase agreements, with a weighted average interest rate of 0.21%, were collateralized by U.S. Treasury securities and collateralized mortgage obligations issued by FNMA having a fair value of \$7.9 million and unamortized principal balances of \$7.4 million. At December 31, 2018, the \$11.5 million of securities sold under repurchase agreements, with a weighted average interest rate of 0.84%, were collateralized by U.S. Treasury securities having a fair value of \$32.0 million and unamortized principal balances of \$32.7 million.

NOTE 11. Federal Home Loan Bank Advances

As of December 31, 2019, the Bank had \$17.0 million FHLB advances outstanding. At December 31, 2019, the Bank had loans with unamortized principal balances of approximately \$171.6 million and securities with unamortized principal balances of approximately \$46.8 million pledged as collateral to the FHLB.

As of December 31, 2018, the Bank had no FHLB advances outstanding. At December 31, 2018, the Bank had loans with unamortized principal balances of approximately \$170.3 million and securities with unamortized principal balances of approximately \$32.9 million pledged as collateral to the FHLB.

As of December 31, 2019, the Bank has the ability to draw advances up to approximately \$131.0 million based upon the aggregate collateral that is currently pledged, subject to a requirement to purchase additional FHLB stock, based upon collateral pledged.

NOTE 12. 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>2019</u>	<u>2018</u>
Note payable, interest due quarterly, beginning on April 1, 2016 ending October 19, 2025, interest payable at a fixed rate of 6.35%	\$ -	\$ 10,000

The Company redeemed the long-term borrowing of \$10.0 million in December of 2019. The long-term borrowing was subordinated debt that had qualified as Tier 2 capital for the Company.

NOTE 13. Other Borrowings

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

2019				
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	\$ 2,271	\$ 2,157	\$ -	\$ 2,157
BNC Line	102,955	10,000	-	10,000
Total	\$ 105,226	\$ 12,157	\$ -	\$ 12,157

(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, 2019, the pledged collateral for the secured BNC National Bank Line was comprised of commercial real estate loans and the pledged collateral for the secured BNC Line is the common stock of BNC National Bank.

2018				
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	\$ 2,377	\$ 2,162	\$ -	\$ 2,162
BNC Line	92,633	10,000	-	10,000
Total	\$ 95,010	\$ 12,162	\$ -	\$ 12,162

(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, 2018, the pledged collateral for the secured BNC National Bank Line was comprised of commercial real estate loans and the pledged collateral for the secured BNC Line is the common stock of BNC National Bank.

NOTE 14. Guaranteed Preferred Beneficial Interests 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, 2019 and 2018 was 3.50% and 3.80%, respectively. The subordinated debentures mature on October 1, 2037. The subordinated debentures may be redeemed at par and the corresponding debentures may be prepaid at the option of BNC, subject to approval by the Federal Reserve Board. The payment of interest and ultimate redemption of these debentures is primarily dependent upon the ability of the Bank to transfer funds to BNC in the form of cash dividends, which are subject to regulatory restrictions disclosed in Note 15 to these consolidated financial statements. Pursuant to the subordinated debentures agreement, BNC may defer the payment of interest on the subordinated debentures for up to 20 consecutive quarterly periods. BNC did not defer the payment of interest on the subordinated debentures during the years ended December 31, 2019 and 2018.

BNC fully and unconditionally guarantees the Company's subordinated debentures.

NOTE 15. Stockholders' Equity

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 Agreement intended to protect stockholder interests in the event BNCCORP becomes the subject of a takeover initiative. The Rights Agreement expired on April 15, 2019.

NOTE 16. 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. Regulators continue to impose capital requirements that are specific to individual institutions. The requirements are generally above the statutory ratios.

At December 31, 2019, the 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, 2019 and December 31, 2018 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>
2019								
Total Risk Based Capital:								
Consolidated	\$ 117,817	17.13 %	\$ 55,023	≥8.0 %	\$ N/A	N/A %	\$ N/A	N/A %
BNC National Bank	109,044	15.88	54,940	≥8.0	68,675	10.0	40,369	5.88
Tier 1 Risk Based Capital:								
Consolidated	109,675	15.95	41,268	≥6.0	N/A	N/A	N/A	N/A
BNC National Bank	100,902	14.69	41,205	≥6.0	54,940	8.0	45,962	6.69
Common Equity Tier 1 Risk Based Capital:								
Consolidated	84,669	13.76	30,951	≥4.5	N/A	N/A	N/A	N/A
BNC National Bank	100,902	14.69	30,904	≥4.5	44,639	6.5	56,263	8.19
Tier 1 Leverage Capital:								
Consolidated	109,675	10.65	41,205	≥4.0	N/A	N/A	N/A	N/A
BNC National Bank	100,902	9.81	41,142	≥4.0	51,427	5.0	49,475	4.81
Tangible Common Equity (to total assets): (a)								
Consolidated	96,159	9.95	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	102,837	10.65	N/A	N/A	N/A	N/A	N/A	N/A
2018								
Total Risk Based Capital:								
Consolidated	\$ 116,734	20.26 %	\$ 46,091	≥8.00 %	\$ N/A	N/A %	\$ N/A	N/A %
BNC National Bank	106,154	18.44	46,053	≥8.00	57,566	10.00	48,588	8.44
Tier 1 Risk Based Capital:								
Consolidated	99,527	17.28	34,568	≥6.00	N/A	N/A	N/A	N/A
BNC National Bank	98,952	17.19	34,540	≥6.00	46,053	8.00	52,899	9.19
Common Equity Tier 1 Risk Based Capital:								
Consolidated	84,518	14.67	25,926	≥4.50	N/A	N/A	N/A	N/A
BNC National Bank	98,952	17.19	25,905	≥4.50	37,418	6.50	61,534	10.69
Tier 1 Leverage Capital:								
Consolidated	99,527	9.97	39,930	≥4.00	N/A	N/A	N/A	N/A
BNC National Bank	98,952	9.92	39,890	≥4.00	49,862	5.00	49,090	4.92
Tangible Common Equity (to total assets): (a)								
Consolidated	77,611	7.99	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	92,490	9.53	N/A	N/A	N/A	N/A	N/A	N/A

(a) Tangible common equity is calculated by dividing common equity, less intangible assets, by total period end assets.

The most recent notifications from the 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 17. Revenue from Contracts with Customers

The following table disaggregates non-interest income subject to ASC 606 (in thousands):

	<u>2019</u>	<u>2018</u>
Service charges on deposits	\$ 760	\$ 727
Bankcard fees	998	1,031
Bank charges and service fees not within scope of ASC 606	856	929
Total bank charges and service fees	<u>2,614</u>	<u>2,687</u>
Wealth management revenue	1,708	1,810
Wealth management revenue not within the scope of ASC 606	27	-
Total wealth management revenues	<u>1,735</u>	<u>1,810</u>
Other	49	53
Other not within the scope of ASC 606 (a)	972	1,955
Total other	<u>1,021</u>	<u>2,008</u>
Other non-interest income not within the scope of ASC 606 (a)	23,761	12,512
Total non-interest income	<u>\$ 29,131</u>	<u>\$ 19,017</u>

(a) This revenue is not within the scope of ASC 606, and includes fees related to mortgage banking operations, gains on sale of loans, net gains (losses) on sale of securities, revenue from investments in SBIC, and various other transactions.

The Company had no material contract assets or remaining performance obligations as of December 31, 2019. Total receivables from revenue recognized under the scope of ASC 606 were \$460 thousand and \$417 thousand as of December 31, 2019 and December 31, 2018, respectively. These receivables are included as part of the Other assets line on the Company's Consolidated Balance Sheets.

NOTE 18. 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):

	<u>Carrying Value at December 31, 2019</u>				<u>Twelve Months Ended December 31, 2019</u>
	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total gains/(losses)</u>
ASSETS					
Investment securities available for sale	\$ 265,278	\$ 4,994	\$ 260,284	\$ -	\$ (1,296)
Loans held for sale	137,114	-	137,114	-	2,844
Commitments to originate mortgage loans	4,358	-	4,358	-	2,051
Total assets at fair value	<u>\$ 406,750</u>	<u>\$ 4,994</u>	<u>\$ 401,756</u>	<u>\$ -</u>	<u>\$ 3,599</u>
LIABILITIES					
Commitments to sell mortgage loans	\$ 21	\$ -	\$ 21	\$ -	\$ 128
Mortgage banking short positions	299	-	299	-	(89)
Total liabilities at fair value	<u>\$ 320</u>	<u>\$ -</u>	<u>\$ 320</u>	<u>\$ -</u>	<u>\$ 39</u>

	Carrying Value at December 31, 2018				Twelve Months Ended December 31, 2018
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
ASSETS					
Investment securities available for sale	\$ 411,509	\$ 58,794	\$ 352,715	\$ -	\$ 2,293
Loans held for sale	22,788	-	22,788	-	(505)
Commitments to originate mortgage loans	1,479	-	1,479	-	71
Total assets at fair value	<u>\$ 435,776</u>	<u>\$ 58,794</u>	<u>\$ 376,982</u>	<u>\$ -</u>	<u>\$ 1,859</u>
LIABILITIES					
Commitments to sell mortgage loans	\$ 148	\$ -	\$ 148	\$ -	\$ (198)
Mortgage banking short positions	210	-	210	-	(106)
Total liabilities at fair value	<u>\$ 358</u>	<u>\$ -</u>	<u>\$ 358</u>	<u>\$ -</u>	<u>\$ (304)</u>

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

For the periods presented, U.S. Treasury Securities were considered to be Level 1 while all other assets and liabilities recorded 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):

	2019				
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
Impaired loans ⁽¹⁾	\$ 2,752	\$ -	\$ -	\$ 2,752	\$ (473)
Other real estate ⁽²⁾	-	-	-	-	35
Total	<u>\$ 2,752</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,752</u>	<u>\$ (438)</u>
	2018				
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
Impaired loans ⁽¹⁾	\$ 3,079	\$ -	\$ 3,079	\$ -	\$ 36
Other real estate ⁽²⁾	-	-	-	-	-
Total	<u>\$ 3,079</u>	<u>\$ -</u>	<u>\$ 3,079</u>	<u>\$ -</u>	<u>\$ 36</u>

- (1) The carrying value represents the book value less allocated reserves. 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.

While the overall loan portfolio is not carried at fair value, reserves are allocated, on certain loans, to reflect fair value based on the external appraised value of the underlying collateral, less anticipated costs to sell, or through present value of future cash flow models for impaired loans that are not collateral dependent. The external appraisals are generally based on a sales, income, or cost approach, which are then adjusted for the unique characteristics of the property being valued. The valuation of impaired loans are reviewed on a quarterly basis. Because many of these inputs are not observable, the measurements are classified as Level 3.

As of December 31, 2018, impaired loans were considered to be Level 2. During the first quarter of 2019, the Company transferred impaired loans from Level 2 to Level 3.

NOTE 19. 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, 2019		December 31, 2018	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:					
Cash and cash equivalents	Level 1	\$ 10,523	\$ 10,523	\$ 25,185	\$ 25,185
Investment securities available for sale	Level 1	4,994	4,994	58,794	58,794
Investment securities available for sale	Level 2	260,284	260,284	352,715	352,715
Federal Reserve Bank and Federal Home Loan Bank stock	Level 2	3,651	3,651	2,941	2,941
Loans held for sale-mortgage banking	Level 2	137,114	137,114	22,788	22,788
Commitments to originate mortgage loans	Level 2	4,358	4,358	1,479	1,479
Gross Loans and leases held for investment	Level 2	504,717	505,156	467,969	463,780
Gross Loans and leases held for investment	Level 3	3,480	2,752	-	-
Accrued interest receivable	Level 2	3,681	3,681	5,079	5,079
		<u>\$ 932,802</u>	<u>\$ 932,513</u>	<u>\$ 936,950</u>	<u>\$ 932,761</u>
Liabilities and Stockholders' Equity:					
Deposits, noninterest-bearing	Level 2	\$ 136,313	\$ 136,313	\$ 157,663	\$ 157,663
Deposits, interest-bearing	Level 2	684,234	684,215	690,942	689,213
Borrowings and advances	Level 2	21,565	21,565	21,494	21,467
Accrued interest payable	Level 2	1,685	1,685	1,277	1,277
Accrued expenses	Level 2	7,580	7,580	5,700	5,700
Commitments to sell mortgage loans	Level 2	21	21	148	148
Mortgage banking short positions	Level 2	299	299	210	210
Guaranteed preferred beneficial interests in Company's subordinated debentures	Level 2	15,006	10,834	15,009	10,208
		<u>\$ 866,703</u>	<u>\$ 862,512</u>	<u>\$ 892,443</u>	<u>\$ 885,886</u>
Financial instruments with off-balance-sheet risk:					
Commitments to extend credit	Level 2	\$ -	\$ 225	\$ -	\$ 169
Standby and commercial letters of credit	Level 2	\$ -	\$ 8	\$ -	\$ 9

The Company discloses the estimated fair value of financial instruments as it is useful to the reader of financial statements. 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 20. 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 customers as well as to manage 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 losses in the event of default by the borrower. At December 31, 2019, 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 the mortgage banking operations, the Bank commits to extend credit for purposes of originating residential loans. The Bank underwrites these commitments to determine whether each loan meets criteria established by the secondary market for residential loans. See Note 1 and 18 to these consolidated financial statements for more information on financial instruments and derivatives related to 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, 2019, 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 the 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):

	2019		2018	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Commitments to extend credit	\$ 15,872	\$ 79,941	\$ 10,407	\$ 67,894
Standby and commercial letters of credit	85	653	18	877

In addition to the amounts in the table above, mortgage banking commitments to fund loans totaled \$204.9 million at December 31, 2019 and \$70.8 million at December 31, 2018. Mortgage banking commitments to sell loans totaled \$338.9 million at December 31, 2019 and \$93.3 million at December 31, 2018.

Performance and Financial Standby Letters of Credit

As of December 31, 2019 and 2018, the Bank had outstanding \$0 and \$13 thousand, respectively, of performance standby letters of credit and \$3.4 million and \$3.7 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.

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. Although the Company sells 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 continued disputes arise between lenders and investors. Such requests for repurchase are commonly due to faulty representation and generally emerge at varied timeframes subsequent to the original sale of the loan. To estimate the contingent obligation, the Company tracks historical reimbursements and calculates the ratio of reimbursement to loan production volumes. Using reimbursement ratios and recent production levels, the Company estimates the future reimbursement amounts and records the estimated obligation. The following is a summary of activity related to mortgage banking reimbursement obligations at December 31 (in thousands):

	<u>2019</u>	<u>2018</u>
Balance, beginning of period	\$ 982	\$ 1,103
Provision	200	-
Write offs, net	<u>(276)</u>	<u>(121)</u>
Balance, end of period	<u>\$ 906</u>	<u>\$ 982</u>

NOTE 21. Commitments and Contingencies

Small Business Investment Companies (SBIC)

The Bank has made investments in the Small Business Administration's SBIC program to enhance small business access to venture capital. At December 31, 2019, the Bank may be required to fund \$2.1 million of additional capital calls related to its SBIC investments.

Legal Proceedings

From time to time, the Company may be a party to legal proceedings arising from lending, deposit operations or other activities. While the Company is not aware of any such actions or allegations that should reasonably give rise to any material adverse effect, it is possible that the Company could be subject to such a claim in an amount that could be material. Based upon a review with legal counsel, the Company believes that the ultimate disposition of any such litigation will not have a material effect on the Company's financial condition, results of operations or cash flows.

NOTE 22. Income Taxes

Income tax expense (benefit) consists of the following for the years ended December 31 (in thousands):

	<u>2019</u>	<u>2018</u>
Current:		
Federal	\$ 2,398	\$ 1,281
State	619	345
	<u>3,017</u>	<u>1,626</u>
Deferred:		
Federal	(75)	(72)
State	(21)	(16)
	<u>(96)</u>	<u>(88)</u>
Total	<u>\$ 2,921</u>	<u>\$ 1,538</u>

The reconciliation between income tax expense computed by applying the statutory federal income tax rate of 21.0% are as follows for the years ended December 31 (in thousands):

	<u>2019</u>	<u>2018</u>
Statutory federal income tax expense	\$ 2,763	\$ 1,759
State income taxes, net of federal income tax benefit	460	260
Tax-exempt interest income	(170)	(325)
Tax-exempt life insurance	(92)	(91)
Other, net	(40)	(65)
Total	<u>\$ 2,921</u>	<u>\$ 1,538</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>2019</u>	<u>2018</u>
Deferred tax assets:		
Loans, primarily due to credit losses	\$ 2,137	\$ 1,975
Compensation	501	446
Unrealized loss on investment securities available for sale	-	2,624
Acquired intangibles	122	122
Net operating loss carryforwards	17	19
Other	318	174
Deferred tax assets	<u>3,095</u>	<u>5,360</u>
Deferred tax liabilities:		
Unrealized gain on investment securities available for sale	121	-
Discount accretion on securities	68	47
Premises and equipment	460	395
Other	312	134
Deferred tax liabilities	<u>961</u>	<u>576</u>
	2,134	4,784
Valuation allowance	<u>(14)</u>	<u>(14)</u>
Net deferred tax assets	<u>\$ 2,120</u>	<u>\$ 4,770</u>

Subject to certain limiting statutes, the Company is able to carry forward state tax net operating losses aggregating \$389 thousand as of December 31, 2019. The state net operating losses expire between 2024 and 2031.

Tax years ended December 31, 2016 through 2019 remain open to federal examination. Tax years ended December 31, 2015 through 2019 remain open to state examinations.

The Company recognizes the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by taxing authorities, based upon the technical merits of the position. The tax benefit recognized in the consolidated financial statements from such a position would be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. Also, interest and penalties expense would be recognized on the full amount of deferred benefits for uncertain tax positions. The Company's policy is to include interest and penalties related to unrecognized tax benefits in income tax expense within the consolidated statements of income. At December 31, 2019 and 2018, the Company did not have any uncertain tax positions.

NOTE 23. Earnings Per Share

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

	<u>2019</u>	<u>2018</u>
Denominator for basic earnings per share:		
Average common shares outstanding	3,526,096	3,487,846
Dilutive effect of share-based compensation	31,489	51,909
Denominator for diluted earnings per share	<u>3,557,585</u>	<u>3,539,755</u>
Numerator (in thousands):		
Net income	<u>\$ 10,235</u>	<u>\$ 6,836</u>
Basic earnings per common share	<u>\$ 2.90</u>	<u>\$ 1.96</u>
Diluted earnings per common share	<u>\$ 2.88</u>	<u>\$ 1.93</u>

NOTE 24. Related-Party 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 \$734 thousand and \$897 thousand at December 31, 2019 and 2018, respectively. Advances of loans to related parties in 2019 and 2018 totaled \$610 thousand and \$247 thousand, respectively. Loan pay downs and other reductions by related parties in 2019 and 2018 were \$773 thousand and \$475 thousand, respectively. Commitments to extend credit to related parties decreased to \$202 thousand at December 31, 2019 from \$289 thousand at December 31, 2018. The total amount of deposits received from these parties was \$1.1 million at December 31, 2019 and \$1.0 million at December 31, 2018. 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, 2019, BNCCORP and its affiliates were in compliance with these requirements.

NOTE 25. Benefit Plans

BNCCORP has a qualified 401(k) savings plan covering all employees of BNCCORP and 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 2019 and 2018, BNCCORP and 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 matching contribution. 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 \$779,000 and \$646,000 for 2019 and 2018, 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, 2019, the assets in the plan totaled \$32.6 million and included \$876,000 (25,000 shares) invested in BNCCORP common stock. At December 31, 2018, the assets in the plan totaled \$25.4 million and included \$544,000 (27,000 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 cash 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 ratably over 5 years. A participant's retirement account generally vests 50% upon an initial contribution and ratably 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 offset the change in value of this liability. Assets in the trust offsetting in-service liabilities are recorded in other assets. BNC common stock held in the trust related to the Company's retirement account obligation is recorded in treasury stock and equates to 27,192 shares as of December 31, 2019 and December 31, 2018. As of December 31, 2019, the plan obligation totaled \$1.0 million and \$985 thousand as of December 31, 2018.

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 BNC common stock at the time of separation from service with the Company. The deferred shares of BNC common stock were 9,289 shares and 8,298 shares as of December 31, 2019 and 2018, respectively.

NOTE 26. Share-Based Compensation

The Company has four share-based plans for certain key employees and directors whereby shares of BNC 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 BNC common stock at the grant date. The Company generally issues shares held in treasury when options are exercised and restricted stock is granted.

Total shares in plan and total shares available as of December 31, 2019 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	45,951	-	250,000	38,425	334,376

The Company recognized share-based compensation expense of \$20,000 and \$21,000 for the years ended December 31, 2019 and 2018, respectively, related to restricted stock.

The tax benefits associated with share-based compensation was approximately \$5,000 for the year ended December 31, 2019 and was approximately \$7,000 for the year ended December 31, 2018.

At December 31, 2019, the Company had \$40,000 of unamortized restricted stock compensation, which is expected to be recognized over a period of two years. Restricted shares of stock granted have vesting and amortization periods of four years.

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

	2019		2018	
	<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>
Non-vested, beginning of year	2,100	\$ 28.78	3,467	\$ 26.45
Granted	-	-	-	-
Vested	(700)	28.78	(1,367)	22.86
Forfeited	-	-	-	-
Non-vested, end of year	<u>1,400</u>	28.78	<u>2,100</u>	28.78

Following is a summary of vested stock options and options expected to vest as of December 31, 2019:

	<u>Stock Options Outstanding</u>	<u>Stock Options Currently Exercisable</u>	<u>Stock Options Vested and Expected to Vest</u>
Number	21,000	21,000	21,000
Weighted-average exercise price	\$3.00	\$3.00	\$3.00
Weighted-average remaining contractual term	0.20 years	0.20 years	0.20 years

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

	2019		2018	
	<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	42,600	\$ 3.00	68,600	\$ 3.00
Granted	-	-	-	-
Exercised	(21,600)	3.00	(26,000)	3.00
Forfeited	-	-	-	-
Outstanding, end of year	<u>21,000</u>	3.00	<u>42,600</u>	3.00
Exercisable, end of year	<u>21,000</u>	3.00	<u>42,600</u>	3.00

The total intrinsic value of options exercised during the years ended December 31, 2019 and 2018 was \$581 thousand and \$585 thousand, respectively. The aggregate intrinsic value of options exercisable as of December 31, 2019 was \$665 thousand.

NOTE 27. 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)

	<u>2019</u>	<u>2018</u>
Assets:		
Cash and cash equivalents	\$ 6,736	\$ 10,442
Investment in subsidiaries	103,421	93,098
Receivable from subsidiaries	1,674	481
Other	1,015	437
Total assets	<u>\$ 112,846</u>	<u>\$ 104,458</u>
Liabilities and stockholders' equity:		
Subordinated debentures	\$ 15,006	\$ 15,009
Long-term borrowings	-	10,000
Payable to subsidiaries	70	69
Accrued expenses and other liabilities	1,492	1,627
Total liabilities	<u>16,568</u>	<u>26,705</u>
Common stock, \$.01 par value – Authorized 11,300,000 shares; 3,514,770 and 3,493,298 shares issued and outstanding	35	35
Capital surplus – common stock	25,831	25,990
Retained earnings	71,057	61,042
Treasury stock (153,883 and 175,355 shares, respectively)	(2,115)	(2,386)
Accumulated other comprehensive (loss) income, net	1,470	(6,928)
Total stockholders' equity	<u>96,278</u>	<u>77,753</u>
Total liabilities and stockholders' equity	<u>\$ 112,846</u>	<u>\$ 104,458</u>

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

	<u>2019</u>	<u>2018</u>
Income:		
Management fee income	\$ 2,034	\$ 1,990
Interest	37	24
Other	18	4
Total income	<u>2,089</u>	<u>2,018</u>
Expenses:		
Interest	1,222	1,195
Salaries and benefits	1,453	1,345
Legal and other professional	1,157	678
Other	789	718
Total expenses	<u>4,621</u>	<u>3,936</u>
Loss before income tax benefit and equity in earnings of subsidiaries	(2,532)	(1,918)
Income tax benefit	621	476
Loss before equity in earnings of subsidiaries	(1,911)	(1,442)
Equity in earnings of subsidiaries	12,146	8,278
Net income	<u>\$ 10,235</u>	<u>\$ 6,836</u>

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

	<u>2019</u>	<u>2018</u>
Operating activities:		
Net income	\$ 10,235	\$ 6,836
Adjustments to reconcile net income to net cash provided by operating activities -		
Equity in earnings of subsidiaries	(12,146)	(8,278)
Dividend paid by subsidiaries	10,000	2,500
Share-based compensation	112	273
Change in other assets	(1,772)	2,325
Change in other liabilities	(135)	236
Net cash provided by operating activities	<u>6,294</u>	<u>3,892</u>
Financing activities:		
Decrease in long-term borrowings	(10,000)	-
Net cash used in financing activities	<u>(10,000)</u>	<u>-</u>
Net (decrease) increase in cash and cash equivalents	(3,706)	3,892
Cash and cash equivalents, beginning of year	10,442	6,550
Cash and cash equivalents, end of year	<u>\$ 6,736</u>	<u>\$ 10,442</u>
Supplemental cash flow information:		
Interest paid	<u>\$ 1,392</u>	<u>\$ 1,151</u>
Income taxes paid	<u>\$ 3,043</u>	<u>\$ 990</u>

NOTE 28. Subsequent Events

Subsequent to year-end, the World Health Organization declared the spread of Coronavirus Disease (COVID-19) a worldwide pandemic. The COVID-19 pandemic is having significant effects on global markets, supply chains, businesses, and communities. Specific to the Company, COVID-19 may impact various parts of its 2020 operations and financial results including, but not limited to, additional loan loss reserves, costs for emergency preparedness, or potential shortages of personnel. The Company is taking actions to mitigate the negative impact. However, the full impact of COVID-19 is unknown and cannot be reasonably estimated as these events occurred subsequent to year-end and are still developing as of the March 20, 2020 report date.

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CORPORATE DATA

Investor Relations

Email 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 J. Collins

Chief Financial Officer

(612)-305-2210

Timothy J. Franz

President/CEO

(612)-305-2213

Annual Meeting

The 2020 annual meeting of stockholders will be held on Thursday, June 18, 2020 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

CliftonLarsonAllen LLP

220 South Sixth Street, Suite 300

Minneapolis, MN 55402-1436

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,

	2019 ⁽¹⁾		2018 ⁽¹⁾	
	High	Low	High	Low
First Quarter	\$28.35	\$20.50	\$31.00	\$26.00
Second Quarter	\$30.25	\$26.90	\$27.25	\$25.41
Third Quarter	\$34.50	\$27.80	\$28.10	\$25.66
Fourth Quarter	\$35.20	\$31.50	\$27.90	\$19.20

⁽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.

Michael M. Vekich

*Chairman of the Board and
CEO, Vekich Chartered*

Timothy J. Franz

*President and
Chief Executive Officer of
BNCCORP, INC.*

Nathan P. Brenna

*Owner, Brenna Farm and Ranch
Former Attorney*

Gaylen Ghylin

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

John W. Palmer

*Principal and Managing Member,
PL Capital Advisors, LLC*

Tom Redmann

*Retired Loan Officer, Bank of North
Dakota*

Tracy J. Scott

Retired Co-Founder of BNCCORP, INC.

Directors, BNC National Bank

Nathan P. Brenna

Timothy J. Franz

Gaylen Ghylin

Dave Hoekstra

John W. Palmer

Tom Redmann

Tracy J. Scott

Michael M. Vekich

BNC National Bank

BANK BRANCHES – ND:

Bismarck Main⁽²⁾

322 East Main Avenue

Bismarck, ND 58501

Crosby

206 South Main Street

Crosby, ND 58730

Bismarck South

219 South 3rd Street

Bismarck, ND 58504

Garrison

92 North Main

Garrison, ND 58540

Bismarck North⁽²⁾

801 East Century Avenue

Bismarck, ND 58503

Linton

104 North Broadway

Linton, ND 58552

Bismarck Sunrise⁽²⁾

3000 Yorktown Drive

Bismarck, ND 58503

Stanley

210 South Main

Stanley, ND 58784

Primrose Assisted Living
Apartments

1144 College Drive

Bismarck, ND 58501

Watford City

205 North Main

Watford City, ND 58854

Mandan⁽²⁾

2711 Sunset Drive NW

Mandan, ND 58554

BANK BRANCHES - AZ

Glendale – Charter Address

20175 North 67th Ave

Glendale, AZ 85308

BANK BRANCHES - MN

Golden Valley

650 North Douglas Drive

Golden Valley, MN 55422

MORTGAGE BANKING OFFICES:

Glendale

6685 W. Beardsley

Glendale, AZ 85383

Moline

800 36th Avenue

Moline, IL 61265

Wichita

8558 W 21st Street N

Wichita, KS 67205

Lebanon

1403 West Elm Street

Lebanon, Missouri 65336

Wichita

12031 East 13th Street

Wichita, KS 67206

Farmington Hills

35055 West 12 Mile Road,

Suite 140

Farmington Hills, MI 48331

Overland Park

7007 College Boulevard

Overland Park, KS 66211

(2) Bank branches offering mortgage banking services.



BNCCORP, INC.



BNCCORP, INC.

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