Quarterly Report

For the quarter ended June 30, 2020

BNCCORP, INC.

(OTCQX: BNCC)

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BNCCORP, INC.
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Financial Statements

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Balance Sheets
(In thousands, except share data)

	June 30, 2020	December 31, 2019
ASSETS	(unaudited)	
CASH AND CASH EQUIVALENTS	$ 51,790	$ 10,523
DEBT SECURITIES AVAILABLE FOR SALE	189,703	265,278
FEDERAL RESERVE BANK AND FEDERAL HOME LOAN BANK STOCK	2,965	3,651
LOANS HELD FOR SALE-MORTGAGE BANKING	195,330	137,114
LOANS AND LEASES HELD FOR INVESTMENT	609,707	508,569
ALLOWANCE FOR CREDIT LOSSES	(9,680)	(8,141)
Net loans and leases held for investment	600,027	500,428
PREMISES AND EQUIPMENT, net	15,897	16,401
OPERATING LEASE RIGHT OF USE ASSETS	2,331	2,638
ACCRUED INTEREST RECEIVABLE	4,570	3,681
OTHER	41,340	27,036
Total assets	$ 1,103,953	$ 966,750
LIABILITIES AND STOCKHOLDERS' EQUITY		
DEPOSITS:		
Non-interest-bearing	$ 183,864	$ 136,313
Interest-bearing –		
Savings, interest checking and money market	607,937	514,869
Time deposits	145,898	169,365
Total deposits	937,699	820,547
SHORT-TERM BORROWINGS	7,167	4,565
FEDERAL HOME LOAN BANK ADVANCES	-	17,000
GUARANTEED PREFERRED BENEFICIAL INTERESTS IN COMPANY'S SUBORDINATED DEBENTURES	15,005	15,006
ACCRUED INTEREST PAYABLE	1,043	1,685
ACCRUED EXPENSES	10,659	7,580
OPERATING LEASE LIABILITIES	2,506	2,822
OTHER	9,849	1,267
Total liabilities	983,928	870,472
STOCKHOLDERS' EQUITY:		
Common stock, $.01 par value – Authorized 11,300,000 shares; 3,540,650 and 3,514,770 shares issued and outstanding	35	35
Capital surplus – common stock	25,812	25,831
Retained earnings	89,522	71,057
Treasury stock (128,003 and 153,883 shares, respectively)	(1,845)	(2,115)
Accumulated other comprehensive income, net	6,501	1,470
Total stockholders' equity	120,025	96,278
Total liabilities and stockholders' equity	$ 1,103,953	$ 966,750

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Income

(In thousands, except per share data, unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2020	2019	2020	2019
INTEREST INCOME:				
Interest and fees on loans	$ 8,257	$ 6,502	$ 15,521	$ 12,596
Interest and dividends on investments				
Taxable	1,220	2,574	2,861	5,167
Tax-exempt	58	278	117	683
Dividends	36	45	74	81
Total interest income	9,571	9,399	18,573	18,527
INTEREST EXPENSE:				
Deposits	1,008	1,972	2,447	3,812
Short-term borrowings	3	3	6	18
Federal Home Loan Bank advances	-	92	12	96
Long-term borrowings	-	158	-	317
Subordinated debentures	106	151	230	306
Total interest expense	1,117	2,376	2,695	4,549
Net interest income	8,454	7,023	15,878	13,978
PROVISION FOR CREDIT LOSSES:	1,500	200	2,050	200
Net interest income after provision for credit losses	6,954	6,823	13,828	13,778
NON-INTEREST INCOME:				
Bank charges and service fees	549	679	1,180	1,325
Wealth management revenues	414	432	855	875
Mortgage banking revenues, net	25,098	5,228	33,714	8,315
Gains on sales of loans, net	-	4	3	106
Gains on sales of debt securities, net	153	256	1,128	320
Other	119	458	247	618
Total non-interest income	26,333	7,057	37,127	11,559
NON-INTEREST EXPENSE:				
Salaries and employee benefits	7,961	5,375	14,272	10,493
Professional services	1,842	1,195	3,120	1,949
Data processing fees	1,199	1,061	2,323	2,100
Marketing and promotion	1,543	1,043	2,969	2,053
Occupancy	523	534	1,058	1,093
Regulatory costs	49	125	105	257
Depreciation and amortization	358	361	714	722
Office supplies and postage	116	128	250	264
Other	900	587	1,687	1,160
Total non-interest expense	14,491	10,409	26,498	20,091
Income before income taxes	18,796	3,471	24,457	5,246
Income tax expense	4,633	817	5,992	1,154
Net income	$ 14,163	$ 2,654	$ 18,465	$ 4,092
Basic earnings per common share	$ 3.97	$ 0.75	$ 5.18	$ 1.16
Diluted earnings per common share	$ 3.97	$ 0.75	$ 5.18	$ 1.15

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income
(In thousands, unaudited)

	For the Three Months Ended June 30,				For the Six Months Ended June 30,			
	2020		**2019**		**2020**		**2019**	
NET INCOME		$ 14,163		$ 2,654		$ 18,465		$ 4,092
Unrealized gain on securities available for sale	$ 3,318		$ 5,337		$ 7,801		$ 10,856	
Reclassification adjustment for gains included in net income	(153)		(256)		(1,128)		(320)	
Other comprehensive income before tax	3,165		5,081		6,673		10,536	
Income tax expense related to items of other comprehensive income	(778)		(1,249)		(1,642)		(2,591)	
Other comprehensive income	$ 2,387	2,387	$ 3,832	3,832	$ 5,031	5,031	$ 7,945	7,945
TOTAL COMPREHENSIVE INCOME		$ 16,550		$ 6,486		$ 23,496		$ 12,037

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity
For the Six Months Ended June 30,
(In thousands, except share data, unaudited)

	Common Stock		Capital Surplus				
	Shares	Amount	Capital Surplus Common Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
BALANCE, December 31, 2018	3,493,298	$ 35	$ 25,990	$ 61,042	$ (2,386)	$ (6,928)	$ 77,753
Net income	-	-	-	4,092	-	-	4,092
Other comprehensive income	-	-	-	-	-	7,945	7,945
Impact of share-based compensation	9,000	-	(78)	-	115	-	37
Cumulative effect adjustment for adoption of ASC 842 – *Leases*	-	-	-	(220)	-	-	(220)
BALANCE, June 30, 2019	3,502,298	$ 35	$ 25,912	$ 64,914	$ (2,271)	$ 1,017	$ 89,607
BALANCE, December 31, 2019	3,514,770	$ 35	$ 25,831	$ 71,057	$ (2,115)	$ 1,470	$ 96,278
Net income	-	-	-	18,465	-	-	18,465
Other comprehensive income	-	-	-	-	-	5,031	5,031
Impact of share-based compensation	25,880	-	(19)	-	270	-	251
BALANCE, June 30, 2020	3,540,650	$ 35	$ 25,812	$ 89,522	$ (1,845)	$ 6,501	$ 120,025

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
For the Six Months Ended June 30,
(In thousands, unaudited)

	2020	2019
OPERATING ACTIVITIES:		
Net income	$ 18,465	$ 4,092
Adjustments to reconcile net income to net cash (used in) provided by operating activities -		
Provision for credit losses	2,050	200
Depreciation and amortization	714	722
Net amortization of premiums on debt securities and subordinated debentures	1,709	3,910
Share-based compensation	251	37
Change in accrued interest receivable and other assets, net	985	(2,295)
Loss (gain) on sale of bank premises and equipment	7	(19)
Gains on sales of debt securities, net	(1,128)	(320)
Change in other liabilities, net	5,692	2,942
Originations of loans held for sale, mortgage banking	(1,249,046)	(391,265)
Proceeds from sales of loans held for sale, mortgage banking	1,195,822	358,636
Fair value adjustment for loans held for sale, mortgage banking	(5,058)	(929)
Fair value adjustment on mortgage banking derivatives	(10,795)	(2,201)
Proceeds from sales of loans	-	1,547
Gains on sales of loans, net	(3)	(106)
Net cash used in operating activities	(40,335)	(25,049)
INVESTING ACTIVITIES:		
Purchases of debt securities	(6,722)	(131,053)
Proceeds from sales of debt securities	72,108	119,036
Proceeds from maturities of debt securities	14,639	27,778
Purchases of Federal Reserve and Federal Home Loan Bank Stock	(4,272)	(6,830)
Sales of Federal Reserve and Federal Home Loan Bank Stock	4,958	6,620
Net increase in loans held for investment	(101,646)	(20,213)
Proceeds from sales of premises and equipment	1	22
Purchases of premises and equipment	(218)	(316)
Net cash used in investing activities	(21,152)	(4,956)

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows, continued

For the Six Months Ended June 30,

(In thousands, unaudited)

	2020	2019
FINANCING ACTIVITIES:		
Net increase in deposits	$ 117,152	$ 18,684
Net increase (decrease) in short-term borrowings	2,602	(7,598)
Repayments of Federal Home Loan Bank advances	(123,800)	(165,500)
Proceeds from Federal Home Loan Bank advances	106,800	170,000
Net cash provided by financing activities	102,754	15,586
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	41,267	(14,419)
CASH AND CASH EQUIVALENTS, beginning of period	10,523	25,185
CASH AND CASH EQUIVALENTS, end of period	$ 51,790	$ 10,766
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	$ 3,338	$ 4,230
Income taxes paid	$ 10	$ 942

See accompanying notes to consolidated financial statements.

NOTE 1 – Organization of Operations, BNCCORP, INC.

BNCCORP, INC. (BNCCORP or BNC) is a registered bank holding company incorporated under the laws of Delaware. It is the parent company of BNC National Bank (the Bank or BNC Bank). BNC operates community banking and wealth management businesses in North Dakota, Arizona and Minnesota from 13 locations. The Bank also conducts mortgage banking through a consumer-direct channel complemented by retail channels from 11 locations in Arizona, Minnesota, 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.

NOTE 2 – Basis of Presentation and Accounting Policies

The accounting and reporting policies of BNC and its subsidiaries (collectively, the Company) conform to accounting principles generally accepted in the United States of America and general practices within the financial services industry. The consolidated financial statements included herein are for BNC and its subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

The accompanying unaudited interim consolidated financial statements have been prepared under the presumption that users of the interim consolidated financial information have either read or have access to the audited consolidated financial statements of BNCCORP, INC. and subsidiaries for the year ended December 31, 2019. Accordingly, footnote disclosures which would substantially duplicate the disclosures contained in the December 31, 2019 audited consolidated financial statements have been omitted from these interim consolidated financial statements. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2019 and the notes thereto.

The accompanying interim consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America for interim financial information. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of income and expenses during the reporting period. These estimates are based on information available to management at the time the estimates are made.

The unaudited consolidated financial statements as of June 30, 2020, include, in the opinion of management, all adjustments, consisting primarily of normal recurring adjustments, necessary for a fair presentation of the financial results for the respective interim periods and are not necessarily indicative of results of operations to be expected for the entire fiscal year.

RECENTLY ISSUED OR ADOPTED ACCOUNTING PRONOUNCEMENTS & INTERPRETATIONS

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 6 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.

ASC 310-40, *Receivables – Troubled Debt Restructurings by Creditors.* In the first quarter of 2020, in response to economic conditions related to the COVID-19 pandemic, federal and state prudential banking regulators issued guidance on their approach for loan modifications. The guidance indicates that short-term modifications such as payment deferrals, made on a good faith basis in response to COVID-19, to borrowers who were current on contractually required payments as of December 31, 2019, are not considered Troubled Debt Restructurings (TDRs). The Financial Accounting Standards Board was consulted on and concurs with this guidance.

NOTE 3 – Debt Securities Available for Sale

Debt 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 June 30, 2020, or December 31, 2019. The carrying amount of available-for-sale debt securities and their estimated fair values were as follows (in thousands):

	As of June 30, 2020			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities	$ 4,994	$ 100	$ -	$ 5,094
U.S. government sponsored entity mortgage-backed securities issued by FNMA/FHLMC	4,829	62	-	4,891
U.S. government agency small business administration pools guaranteed by SBA	31,552	-	(1,387)	30,165
Collateralized mortgage obligations guaranteed by GNMA	19,909	1,358	-	21,267
Collateralized mortgage obligations issued by FNMA/FHLMC	72,038	3,087	-	75,125
Commercial mortgage-backed securities issued by FHLMC	13,174	1,978	-	15,152
Other commercial mortgage-backed securities	14,416	409	(103)	14,722
Asset-backed securities	7,932	76	-	8,008
State and municipal bonds	13,717	1,562	-	15,279
	$ 182,561	$ 8,632	$ (1,490)	$ 189,703

	As of December 31, 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/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
	$ 264,810	$ 4,095	$ (3,627)	$ 265,278

The amortized cost and estimated fair market value of available-for-sale debt securities classified according to their contractual maturities at June 30, 2020, were as follows (in thousands):

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ -	$ -
Due after one year through five years	4,993	5,094
Due after five years through ten years	41,987	44,178
Due after ten years	135,581	140,431
Total	$ 182,561	$ 189,703

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.

The following table shows the Company's debt securities fair value and gross unrealized losses; aggregated by debt security category and length of time that individual debt securities have been in a continuous unrealized loss position (dollars are in thousands):

	June 30, 2020								
	Less than 12 months			12 months or more			Total		
Description of Securities	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss
U.S. Treasury securities	-	$ -	$ -	-	$ -	$ -	-	$ -	$ -
U.S. government sponsored entity mortgage-backed securities issued by FNMA or FHLMC	-	-	-	-	-	-	-	-	-
U.S. government agency small business administration pools guaranteed by SBA	-	-	-	4	30,165	(1,387)	4	30,165	(1,387)
Collateralized mortgage obligations guaranteed by GNMA	-	-	-	-	-	-	-	-	-
Collateralized mortgage obligations issued by FNMA or FHLMC	-	-	-	-	-	-	-	-	-
Commercial mortgage-backed securities issued by FHLMC	-	-	-	-	-	-	-	-	-
Other commercial mortgage-backed securities	1	3,461	(103)	-	-	-	1	3,461	(103)
Asset-backed securities	-	-	-	-	-	-	-	-	-
State and municipal bonds	-	-	-	-	-	-	-	-	-
Total temporarily impaired securities	1	$ 3,461	$ (103)	4	$ 30,165	$ (1,387)	5	$ 33,626	$ (1,490)

Description of Securities	December 31, 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 or 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)
Commercial mortgage-backed securities issued by FHLMC	-	-	-	-	-	-	-	-	-
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	15	$ 94,009	$ (1,533)	5	$ 37,493	$ (2,094)	20	$ 131,502	$ (3,627)

Management regularly evaluates each debt security with unrealized losses to determine whether losses are other-than-temporary. When determining whether a debt 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 debt security, management considers several factors including, but not limited to, the amount of the unrealized loss, the length of time the debt security has been in a loss position, guarantees provided by third parties, ratings on the debt security, cash flow from the debt security, the level of credit support provided by subordinate tranches of the debt security, and the collateral underlying the debt security.

There were no debt securities that management concluded were other-than-temporarily impaired at June 30, 2020, or December 31, 2019.

NOTE 4 – Loans and Leases

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

	June 30, 2020	December 31, 2019
Loans held for sale-mortgage banking	$ 195,330	$ 137,114
Commercial and industrial	$ 160,671	$ 162,592
Commercial real estate	193,822	193,203
SBA	144,259	46,799
Consumer	84,288	82,498
Land and land development	10,344	10,449
Construction	18,009	12,656
Gross loans and leases held for investment	611,393	508,197
Unearned income and net unamortized deferred fees and costs	(1,686)	372
Loans, net of unearned income and unamortized fees and costs	609,707	508,569
Allowance for credit losses	(9,680)	(8,141)
Net loans and leases held for investment	$ 600,027	$ 500,428

NOTE 5 – Allowance for Credit Losses

Transactions in the allowance for credit losses were as follows (in thousands):

	Three Months Ended June 30, 2020						
	Commercial and industrial	Commercial real estate	SBA	Consumer	Land and land development	Construction	Total
Balance, beginning of period	$ 2,623	$ 3,659	$ 857	$ 918	$ 221	$ 136	$ 8,414
Provision (reduction)	521	350	474	130	(17)	42	1,500
Loans charged off	(36)	(187)	-	(13)	-	-	(236)
Loan recoveries	-	-	1	1	-	-	2
Balance, end of period	$ 3,108	$ 3,822	$ 1,332	$ 1,036	$ 204	$ 178	$ 9,680

	Three Months Ended June 30, 2019						
	Commercial and industrial	Commercial real estate	SBA	Consumer	Land and land development	Construction	Total
Balance, beginning of period	$ 1,916	$ 3,569	$ 858	$ 929	$ 228	$ 177	$ 7,677
Provision (reduction)	45	(57)	218	16	(16)	(6)	200
Loans charged off	-	-	-	(17)	-	-	(17)
Loan recoveries	-	3	9	19	-	-	31
Balance, end of period	$ 1,961	$ 3,515	$ 1,085	$ 947	$ 212	$ 171	$ 7,891

	Six Months Ended June 30, 2020						
	Commercial and industrial	**Commercial real estate**	**SBA**	**Consumer**	**Land and land development**	**Construction**	**Total**
Balance, beginning of period	$ 2,366	$ 3,502	$ 1,131	$ 853	$ 187	$ 102	$ 8,141
Provision (reduction)	804	756	198	205	11	76	2,050
Loans charged off	(62)	(437)	-	(25)	-	-	(524)
Loan recoveries	-	1	3	3	6	-	13
Balance, end of period	$ 3,108	$ 3,822	$ 1,332	$ 1,036	$ 204	$ 178	$ 9,680

	Six Months Ended June 30, 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)	27	(48)	230	32	(13)	(28)	200
Loans charged off	(3)	-	-	(36)	-	-	(39)
Loan recoveries	-	5	10	23	-	-	38
Balance, end of period	$ 1,961	$ 3,515	$ 1,085	$ 947	$ 212	$ 171	$ 7,891

The following table shows the balance in the allowance for credit losses at June 30, 2020, and December 31, 2019, 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**
June 30, 2020						
Commercial and industrial	$ 797	$ 2,311	$ 3,108	$ 1,840	$ 158,831	$ 160,671
Commercial real estate	-	3,822	3,822	935	192,887	193,822
SBA	373	959	1,332	1,008	143,251	144,259
Consumer	2	1,034	1,036	30	84,258	84,288
Land and land development	-	204	204	1	10,343	10,344
Construction	-	178	178	-	18,009	18,009
Total	$ 1,172	$ 8,508	$ 9,680	$ 3,814	$ 607,579	$ 611,393
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	$ 728	$ 7,413	$ 8,141	$ 3,480	$ 504,717	$ 508,197

Performing and non-accrual loans

The Bank's key credit quality indicator is the loan's performance status, defined as accrual or non-accrual. Performing loans are considered to have a lower risk of loss and are on accrual status. Non-accrual loans include loans on which the accrual of interest has been discontinued. Accrual of interest is discontinued when the Bank believes 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. 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 (in thousands):

	June 30, 2020					
	Current	31-89 Days Past Due	90 Days or More Past Due And Accruing	Total Performing	Non-accrual	Total
Commercial and industrial:						
Business loans	$ 70,025	$ 379	$ -	$ 70,404	$ 1,610	$ 72,014
Agriculture	29,418	644	-	30,062	-	30,062
Owner-occupied commercial real estate	58,365	-	-	58,365	230	58,595
Commercial real estate	192,887	-	-	192,887	935	193,822
SBA	143,250	-	-	143,250	1,009	144,259
Consumer:						
Automobile	22,926	-	-	22,926	12	22,938
Home equity	10,047	-	-	10,047	-	10,047
1st mortgage	12,041	-	-	12,041	-	12,041
Other	39,180	64	-	39,244	18	39,262
Land and land development	10,344	-	-	10,344	-	10,344
Construction	18,009	-	-	18,009	-	18,009
Total loans held for investment	606,492	1,087	-	607,579	3,814	611,393
Loans held for sale	194,979	2	349	195,330	-	195,330
Total gross loans	$ 801,471	$ 1,089	$ 349	$ 802,909	$ 3,814	$ 806,723

	December 31, 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	$ 642,860	$ 418	$ -	$ 643,278	$ 2,033	$ 645,311

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
Interest income that would have been recorded	$ 61	$ 30	$ 109	$ 60
Interest income recorded	-	-	-	-
Effect on interest income	$ 61	$ 30	$ 109	$ 60

Credit Risk by Internally Assigned Grade

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

At June 30, 2020, the Company had $593.2 million of loans held for investment categorized as pass rated loans compared to $489.8 million at December 31, 2019.

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 June 30, 2020, the Company had $7.4 million of loans categorized as watch list loans compared to $9.2 million at December 31, 2019.

Loans graded as substandard or doubtful are considered “Classified” loans for regulatory purposes. Loans classified as substandard are loans that are generally inadequately protected by the current net worth and paying capacity of the obligor, or by the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Substandard loans are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loans classified as doubtful have the weaknesses of those classified as substandard, with additional characteristics that make collection in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. At June 30, 2020, the Company had $8.6 million of substandard loans and $2.2 million of doubtful loans. At December 31, 2019, the Company had $7.8 million of substandard loans and $1.5 million of doubtful loans.

Impaired loans

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

The following tables summarize impaired loans and related allowances (in thousands):

	June 30, 2020				
	Unpaid Principal	**Recorded Investment**	**Related Allowance**	**Average Recorded Balance (6-months)**	**Interest Income Recognized (6-months)**
Impaired loans with an allowance recorded:					
Commercial and industrial:					
Business loans	$ 2,251	$ 1,610	$ 792	$ 1,610	$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	230	230	5	230	-
Commercial real estate	-	-	-	-	-
SBA	754	732	373	733	-
Consumer:					
Automobile	23	12	2	12	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans with an allowance recorded	$ 3,258	$ 2,584	$ 1,172	$ 2,585	$ -
Impaired loans without an allowance recorded:					
Commercial and industrial:					
Business loans	$ -	$ -	$ -	$ -	$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	1,718	935	-	1,208	6
SBA	338	276	-	278	-
Consumer:					
Automobile	-	-	-	-	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	39	18	-	20	-
Land and land development	136	1	-	2	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans without an allowance recorded	$ 2,231	$ 1,230	$ -	$ 1,508	$ 6
TOTAL IMPAIRED LOANS	$ 5,489	$ 3,814	$ 1,172	$ 4,093	$ 6

	December 31, 2019				
	Unpaid Principal	Recorded Investment	Related Allowance	Average Recorded Balance (12-months)	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

Troubled Debt Restructuring (TDRs)
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 the Bank would not otherwise consider, compared to the original terms and conditions of the loan, the modified loan is considered a troubled debt restructuring.

The tables below summarize the amounts of restructured loans (in thousands):

	June 30, 2020			
	Accrual	Non-accrual	Total	Allowance
Commercial and industrial:				
Business loans	$ -	$ 1,417	$ 1,417	$ 766
Agriculture	-	-	-	-
Owner-occupied commercial real estate	-	230	230	5
Commercial real estate	-	935	935	-
SBA	-	376	376	57
Consumer:				
Automobile	-	-	-	-
Home equity	-	-	-	-
1st mortgage	-	-	-	-
Other	-	-	-	-
Land and land development	-	-	-	-
Construction	-	-	-	-
Loans held for sale	-	-	-	-
	$ -	$ 2,958	$ 2,958	$ 828

	December 31, 2019			
	Accrual	Non-accrual	Total	Allowance
Commercial and industrial:				
Business loans	$ -	$ 1,417	$ 1,417	$ 497
Agriculture	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-
Commercial real estate	1,448	-	1,448	172
SBA	-	380	380	59
Consumer:				
Automobile	-	-	-	-
Home equity	-	-	-	-
1st mortgage	-	-	-	-
Other	-	-	-	-
Land and land development	-	-	-	-
Construction	-	-	-	-
Loans held for sale	-	-	-	-
	$ 1,448	$ 1,797	$ 3,245	$ 728

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

When a loan is modified as a TDR, there may be a direct, material impact on the loans within the consolidated balance sheets, as principal balances may be partially forgiven. There was one new TDR for the three- and six-month period ended June 30, 2020 with a pre-modification and post-modification balance of $230 thousand. There were no new TDRs for the three- or six-month period ended June 30, 2019. 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 period end had been recognized at original contractual rates (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
Interest income that would have been recorded	$ 54	$ 77	$ 106	$ 153
Interest income recorded	-	22	9	43
Effect on interest income	$ 54	$ 55	$ 97	$ 110

There were no additional funds committed to borrowers who are in TDR status at June 30, 2020, and December 31, 2019.

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

The Bank had no loans that were restructured within the 12 months preceding June 30, 2020, and June 30, 2019 and defaulted during the three and six months ended June 30, 2020, and June 30, 2019.

NOTE 6 – Leases

The Company has operating leases, primarily for office space, that expire over the next seven 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 three- and six-month period ended June 30, 2020, and June 30, 2019, were as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
Operating lease cost	$ 249	$ 237	$ 486	$ 483
Variable lease cost	12	17	23	26
Short-term lease cost	4	4	8	9
	$ 265	$ 258	$ 517	$ 518

Amounts reported in the consolidated balance sheet as of June 30, 2020, and December 31, 2019, are as follows (in thousands):

	As of June 30, 2020	As of December 31, 2019
Operating lease right of use asset	$ 2,331	$ 2,638
Operating lease liabilities	2,506	2,822

Other supplementary information related to leases is as follows (dollars are in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
Cash paid for amounts included in the measurement of lease liabilities	$ 248	$ 245	$ 493	$ 491
ROU assets obtained in exchange for lease obligations	47	111	63	111
Reductions to ROU assets resulting from reduction in lease obligations	192	646	370	826

	As of June 30, 2020	As of December 31, 2019
Weighted average remaining lease term	4.56 years	4.94 years
Weighted average discount rate	6.00%	6.00%

Maturities of lease liabilities under non-cancellable leases as of June 30, 2020, are as follows (in thousands):

	Operating Leases
2020	$ 340
2021	519
2022	495
2023	475
2024	357
Thereafter	320
Total lease liabilities	$ 2,506

NOTE 7 – Earnings Per Share

The following table shows the amounts used in computing per share results:

	Three Months Ended June 30, 2020		Six Months Ended June 30, 2020	
Denominator for basic earnings per share*:*				
Average common shares outstanding		3,567,980		3,562,072
Dilutive effect of stock compensation		2,676		5,249
Denominator for diluted earnings per share		3,570,656		3,567,321
Numerator (in thousands):				
Net income	$	14,163	$	18,465
Basic earnings per common share	$	3.97	$	5.18
Diluted earnings per common share	$	3.97	$	5.18

	Three Months Ended June 30, 2019		Six Months Ended June 30, 2019	
Denominator for basic earnings per share*:*				
Average common shares outstanding		3,519,478		3,518,937
Dilutive effect of stock compensation		37,364		37,443
Denominator for diluted earnings per share		3,556,842		3,556,380
Numerator (in thousands):				
Net income	$	2,654	$	4,092
Basic earnings per common share	$	0.75	$	1.16
Diluted earnings per common share	$	0.75	$	1.15

NOTE 8 – Share-Based Compensation

The Company may grant share-based compensation at prices equal to the fair value of the stock at the grant date. The Company has two share-based plans for certain key employees and directors whereby shares of common stock have been reserved for awards in the form of stock options or restricted stock awards. The plans are as follows:

	1995	2015	Total
Total Shares in Plan	45,951	36,339	82,290
Total Shares Available for Issuance	45,951	36,339	82,290

Following is a summary of stock option transactions for the six-month periods ending June 30:

	Six Months Ended June 30, 2020		Six Months Ended June 30, 2019	
	Options to Purchase Shares	Weighted Average Exercise Price	Options to Purchase Shares	Weighted Average Exercise Price
Outstanding, beginning of year	21,000	$ 3.00	42,600	$ 3.00
Granted	-	-	-	-
Exercised	(21,000)	3.00	(9,000)	3.00
Forfeited	-	-	-	-
Outstanding, end of period	-	-	33,600	3.00

The stock options expired on March 17, 2020. Option holders were able to pay the exercise price of a stock option in cash or through the surrender of shares of stock held by the option holder at the time of exercise. Executives selling shares into the market are encouraged, but not required, to do so under a passive trading plan that meets the requirements of the Securities and Exchange Commission's Rule 10b-5.

The Company recognized share-based compensation expense of $7,000 related to restricted stock for the three-month period ended June 30, 2020, and $14,000 for the six-month period ended June 30, 2020. The Company recognized share-based compensation expense of $5,000 related to restricted stock for the three-month period ended June 30, 2019, and $10,000 for the six-month period ended June 30, 2019.

At June 30, 2020, the Company had $61,000 of unamortized restricted stock compensation expense. The cost of a restricted stock grant is recognized over the vesting period, which is generally four years.

NOTE 9 – Revenue from Contracts with Customers

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
Service charges on deposits	$ 112	$ 195	$ 306	$ 377
Bankcard fees	235	271	462	518
Bank charges and service fees not within scope of ASC 606	202	213	412	430
Total bank charges and service fees	549	679	1,180	1,325
Wealth management revenue	414	432	855	848
Wealth management revenue not within the scope of ASC 606	-	-	-	27
Total wealth management revenues	414	432	855	875
Other	10	16	20	34
Other not within the scope of ASC 606 (a)	109	442	227	584
Total other	119	458	247	618
Other non-interest income not within the scope of ASC 606 (a)	25,251	5,488	34,845	8,741
Total non-interest income	$ 26,333	$ 7,057	$ 37,127	$ 11,559

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

The Company had no material contract assets or remaining performance obligations as of June 30, 2020. Total receivables from revenue recognized under the scope of ASC 606 were $398 thousand as of June 30, 2020, and $460 thousand as of December 31, 2019. These receivables are included as part of the Other assets line on the Company's Consolidated Balance Sheets.

NOTE 10 – Fair Value Measurements

FASB 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 not active and model-based valuation techniques for which significant assumptions are observable in the market.
>
> Level 3: Valuation is generated from model-based techniques that use significant assumptions not observable in the market and are used only to the extent that observable inputs are not available. These unobservable assumptions reflect the Company's own estimates of assumptions that market participants would use in pricing the asset or liability.

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

The following tables summarize the financial assets and liabilities of the Company for which fair values are determined on a recurring basis (in thousands):

	Carrying Value at June 30, 2020				Six Months Ended June 30, 2020
	Total	**Level 1**	**Level 2**	**Level 3**	**Total gains/(losses)**
ASSETS					
Debt securities available for sale	$ 189,703	$ 5,094	$ 184,609	$ -	$ 1,128
Loans held for sale	195,330	-	195,330	-	5,058
Commitments to originate mortgage loans	20,170	-	20,170	-	13,684
Commitments to sell mortgage loans	61	-	61	-	81
Total assets at fair value	$ 405,264	$ 5,094	$ 400,170	$ -	$ 19,951
LIABILITIES					
Mortgage banking short positions	$ 3,269	$ -	$ 3,269	$ -	$ (2,970)
Total liabilities at fair value	$ 3,269	$ -	$ 3,269	$ -	$ (2,970)

	Carrying Value at December 31, 2019				Twelve Months Ended December 31, 2019
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
ASSETS					
Debt 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	$ 406,750	$ 4,994	$ 401,756	$ -	$ 3,599
LIABILITIES					
Commitments to sell mortgage loans	$ 21	$ -	$ 21	$ -	$ 128
Mortgage banking short positions	299	-	299	-	(89)
Total liabilities at fair value	$ 320	$ -	$ 320	$ -	$ 39

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

The Company may also be required from time to time to measure certain other financial 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 the write-down of individual assets. For assets measured at fair value on a nonrecurring basis, the following tables provide the level of valuation assumptions used to determine the carrying value (in thousands):

	Carrying Value at June 30, 2020				Six Months Ended June 30, 2020
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
Impaired loans[(1)]	$ 2,642	$ -	$ -	$ 2,642	$ (937)
Other real estate[(2)]	-	-	-	-	-
Total	$ 2,642	$ -	$ -	$ 2,642	$ (937)

	Carrying Value at December 31, 2019				Twelve Months Ended December 31, 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	$ 2,752	$ -	$ -	$ 2,752	$ (438)

(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.

NOTE 11 – Fair Value of Financial Instruments

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

	Level in Fair Value Measurement Hierarchy	June 30, 2020		December 31, 2019	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:					
Cash and cash equivalents	Level 1	$ 51,790	$ 51,790	$ 10,523	$ 10,523
Debt securities available for sale	Level 1	5,094	5,094	4,994	4,994
Debt securities available for sale	Level 2	184,609	184,609	260,284	260,284
Federal Reserve Bank and Federal Home Loan Bank stock	Level 2	2,965	2,965	3,651	3,651
Loans held for sale-mortgage banking	Level 2	195,330	195,330	137,114	137,114
Commitments to originate mortgage loans	Level 2	20,170	20,170	4,358	4,358
Commitments to sell mortgage loans	Level 2	61	61	-	-
Gross loans and leases held for investment	Level 2	607,579	617,903	504,717	505,156
Gross loans and leases held for investment	Level 3	3,814	1,172	3,480	2,752
Accrued interest receivable	Level 2	4,570	4,570	3,681	3,681
		$ 1,075,982	$ 1,083,664	$ 932,802	$ 932,513
Liabilities and Stockholders' Equity:					
Deposits, noninterest-bearing	Level 2	$ 183,864	$ 183,864	$ 136,313	$ 136,313
Deposits, interest-bearing	Level 2	753,835	754,894	684,234	684,215
Borrowings and advances	Level 2	7,167	7,167	21,565	21,565
Accrued interest payable	Level 2	1,043	1,043	1,685	1,685
Accrued expenses	Level 2	10,659	10,659	7,580	7,580
Commitments to sell mortgage loans	Level 2	-	-	21	21
Mortgage banking short positions	Level 2	3,269	3,269	299	299
Guaranteed preferred beneficial interests in Company's subordinated debentures	Level 2	15,005	7,887	15,006	10,834
		$ 974,842	$ 968,783	$ 866,703	$ 862,512
Financial instruments with off-balance-sheet risk:					
Commitments to extend credit	Level 2	$ -	$ 181	$ -	$ 225
Standby and commercial letters of credit	Level 2	$ -	$ 9	$ -	$ 8

NOTE 12 – Federal Home Loan Bank Advances

As of June 30, 2020, the Bank had no Federal Home Loan Bank (FHLB) advances outstanding. At June 30, 2020, the Bank had loans with unamortized principal balances of approximately $176.1 million and debt securities with unamortized principal balances of approximately $20.5 million pledged as collateral to the FHLB.

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

As of June 30, 2020, the Bank has the ability to draw advances up to approximately $127.3 million based upon the aggregate collateral that is currently pledged, subject to a requirement to purchase additional FHLB stock, based upon collateral pledged.

NOTE 13 – Other Borrowings

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

June 30, 2020

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

Secured Borrowing Lines:	Collateral Pledged	Line	Outstanding	Available
BNC National Bank Line	$ 2,218	$ 2,105	$ -	$ 2,105
BNC Line	127,167	10,000	-	10,000
Total	$ 129,385	$ 12,105	$ -	$ 12,105

(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 June 30, 2020, 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 was the common stock of BNC National Bank.

December 31, 2019

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

Secured Borrowing Lines:	Collateral Pledged	Line	Outstanding	Available
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 was 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 June 30, 2020, and December 31, 2019, was 2.83% and 3.50%, respectively. The subordinated debentures mature on October 1, 2037. The subordinated debentures may be redeemed at par and the corresponding debentures may be prepaid at the option of BNCCORP, subject to approval by the Federal Reserve Board.

NOTE 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 BNC Bank to pay dividends to BNC in excess of the Bank's net profits from the current year plus retained net profits for the preceding two years.

While the Company has not historically paid a dividend or repurchased stock, if the Company elected to do so, the Company would be required to seek regulatory approval from the Federal Reserve Board.

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 June 30, 2020, the capital ratios exceeded all regulatory capital thresholds and maintained sufficient capital conservation buffers to avoid limitations on certain types of capital distributions.

At June 30, 2020, and December 31, 2019, the regulatory capital amounts and ratios were as follows (dollars in thousands):

	Actual		For Capital Adequacy Purposes		To be Well Capitalized		Amount in Excess of Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
June 30, 2020								
Total Risk-Based Capital:								
Consolidated	$ 137,701	18.51%	$ 59,514	≥8.00%	$ N/A	N/A%	$ N/A	N/A%
BNC National Bank	129,384	17.41	59,461	≥8.00	74,326	10.00	55,058	7.41
Tier 1 Risk-Based Capital:								
Consolidated	128,397	17.26	44,635	≥6.00	N/A	N/A	N/A	N/A
BNC National Bank	120,088	16.16	44,596	≥6.00	59,461	8.00	60,627	8.16
Common Equity Tier 1 Risk-Based Capital:								
Consolidated	113,392	15.24	33,476	≥4.50	N/A	N/A	N/A	N/A
BNC National Bank	120,088	16.16	33,447	≥4.50	48,312	6.50	71,776	9.66
Tier 1 Leverage Capital:								
Consolidated	128,397	11.55	44,461	≥4.00	N/A	N/A	N/A	N/A
BNC National Bank	120,088	10.81	44,422	≥4.00	55,527	5.00	64,561	5.81
Tangible Common Equity (to total assets): (a)								
Consolidated	119,914	10.86	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	127,055	11.52	N/A	N/A	N/A	N/A	N/A	N/A
December 31, 2019								
Total Risk-Based Capital:								
Consolidated	$ 117,817	17.13%	$ 55,023	≥8.00%	$ N/A	N/A%	$ N/A	N/A%
BNC National Bank	109,044	15.88	54,940	≥8.0	68,675	10.00	40,369	5.88
Tier 1 Risk-Based Capital:								
Consolidated	109,675	15.95	41,268	≥6.00	N/A	N/A	N/A	N/A
BNC National Bank	100,902	14.69	41,205	≥6.00	54,940	8.00	45,962	6.69
Common Equity Tier 1 Risk-Based Capital:								
Consolidated	94,669	13.76	30,951	≥4.50	N/A	N/A	N/A	N/A
BNC National Bank	100,902	14.69	30,904	≥4.50	44,639	6.50	56,263	8.19
Tier 1 Leverage Capital:								
Consolidated	109,675	10.65	41,205	≥4.00	N/A	N/A	N/A	N/A
BNC National Bank	100,902	9.81	41,142	≥4.00	51,427	5.00	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

(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.

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

We refer to "we", "our", "BNC", or "the Company" when such reference includes BNCCORP, INC. and its consolidated subsidiaries, collectively; "BNCCORP" when referring only to the holding company named BNCCORP, INC.; "the Bank", or "BNC Bank" when referring only to BNC National Bank. Where not otherwise indicated below, financial condition and results of operation discussed are of BNCCORP, INC.

Comparison of Results for the Three Months Ended June 30, 2020, and 2019

Summary for the Three Months Ended June 30, 2020, and 2019

Net income was $14.2 million, or $3.97 per diluted share, for the quarter ended June 30, 2020. This compared to net income of $2.7 million, or $0.75 per diluted share, in the same period of 2019.

Net interest income for the second quarter of 2020 was $8.5 million, an increase of $1.5 million, or 20.4%, from $7.0 million for the same period of 2019. The increase from the year-ago period primarily reflected the positive impact of SBA Paycheck Protection Program (PPP) loan funding, the redemption of subordinated debt in the fourth quarter of 2019 and reduced cost of deposits. The net interest margin for the current period increased to 3.30% from 2.96% a year ago.

Interest income increased to $9.6 million for the quarter ended June 30, 2020, compared to $9.4 million for the second quarter of 2019. The increase in interest income is due to impact of higher average loan balances that were offset by reduced interest income from debt securities sold to deleverage the balance sheet and fund elevated mortgage loan activity. The yield on average interest earning assets decreased to 3.72% from 3.94% in the same quarter of 2019. During the second quarter of 2020, the average balance of interest earning assets increased by $80.5 million when compared to the second quarter of 2019. Average loans held for investment increased $116.4 million, or 24.6%, and average loans held for sale increased by $82.2 million, or 170.1%, when comparing the second quarters of 2020 and 2019. The average balance of debt securities decreased by $213.8 million, or 51.0%, in the second quarter of 2020, compared to the same period a year ago. Yields on debt securities decreased to 2.45% in the second quarter of 2020 from 2.65% in the same period of 2019.

Interest expense in the second quarter of 2020 was $1.1 million, a decrease of $1.3 million, or 53.0%, from the same period in 2019. The cost of interest bearing liabilities decreased to 0.56% in the current quarter from 1.20% in the same period of 2019. Interest expense on deposits decreased due to ongoing pricing adjustments in response to reductions in Federal Reserve policy rates in the first quarter of 2020. The cost of core deposits was 0.42% in the second quarter of 2020 and 0.90% in the same period of 2019. Interest expense was also $158 thousand lower in the 2020 second quarter due to the redemption of $10.0 million of subordinated debt in the fourth quarter of 2019.

While credit risks have not yet manifested in significantly increased nonperforming loan levels, the Company recorded a provision for credit losses of $1.5 million in the second quarter of 2020, compared to $200 thousand in the same period of 2019. The increase was primarily attributed to qualitative risks identified in certain loan portfolio segments that were impacted more directly by the COVID-19 pandemic. Loan balances charged-off in the second quarter of 2020 were $236 thousand.

Non-interest income for the second quarter of 2020 was $26.3 million. This compares to non-interest income of $7.1 million for the same period in 2019, an increase of $19.2 million, or 273.1%. Mortgage banking revenues were $25.1 million in the current period compared to $5.2 million in the same period of 2019, as lower mortgage rates facilitated higher mortgage banking origination activity. Gains on sales of assets aggregated $153 thousand in the second quarter of 2020, compared to $260 thousand in the prior year second quarter. Gains on sales of assets and earnings from certain investments can vary significantly from period to period.

Non-interest expense for the second quarter of 2020 was $14.5 million compared to $10.4 million in the same period of 2019, an increase of $4.1 million. Salaries and benefits increased $2.6 million, or 48.1%, from the second quarter 2019. The increase in salaries and employee benefits relates to mortgage operations and is due to elevated levels of loan processing in the second quarter of 2020. Professional services in the second quarter of 2020 were up $647 thousand, or 54.1%, from the second quarter 2019, related exclusively to mortgage loan closing costs. Other expense increased by $313 thousand when compared to the same period of 2019 due to recording a provision for mortgage reimbursement obligations and mortgage related personnel recruiting costs.

In the second quarter of 2020, the Company recorded tax expense of $4.6 million, which resulted in an effective tax rate of 24.7% for the quarter. Tax expense of $817 thousand was recognized during the same period of 2019, which resulted in an effective tax rate of 23.5%. The increase in the effective tax rate in 2020 is due to higher pre-tax revenues and lower non-taxable interest income from municipal securities.

Summary for the Six Months Ended June 30, 2020 and 2019

Net income was $18.5 million, or $5.18 per diluted share, for the six months ended June 30, 2020. This compared to net income of $4.1 million, or $1.15 per diluted share, in the first six months of 2019.

Net interest income for the six months ended June 30, 2020, was $15.9 million, an increase of $1.9 million, or 13.6%, from $14.0 million for the same period of 2019. The increase primarily reflected the positive impact of the redemption of subordinated debt in the fourth quarter of 2019, as well as decreased cost of deposits following the reductions in Federal Reserve Board policy rates compared to the same period of 2019. The net interest margin for the current period increased to 3.29% from 2.98% a year ago.

Interest income increased to $18.6 million, compared to $18.5 million for the same period of 2019. The increase in interest income is due to higher average loan balances that were offset by reduced interest income from debt securities sold to deleverage the balance sheet and fund elevated loan activity. The yield on average interest-earning assets in the first half of 2020 decreased to 3.85% from 3.94% during the first half of 2019. During the first half of 2020, the average balance of interest-earning assets increased by $23.8 million when compared to the first half of 2019. Average loans held for investment increased $80.9 million, or 17.2%, and average loans held for sale increased by $90.9 million, or 255.0%, when comparing the first half of 2020 and 2019. The average balance of debt securities decreased by $194.3 million, or 46.0%, in the six-month period ended June 30, 2020, compared to the same period a year ago. Yields on debt securities decreased to 2.56% in the first six months of 2020 from 2.64% in the same period of 2019.

Interest expense in the first half of 2020 was $2.7 million, a decrease of $1.9 million, or 40.8%, from the same period in 2019. The cost of interest-bearing liabilities decreased to 0.72% in the first six months of 2020 from 1.16% in the first six months of 2019. Interest expense on deposits decreased as a result of lower balances as the Company deleveraged certain higher cost deposits. The cost of core deposits was 0.55% in the first half of 2020 and 0.87% in the first half of 2019. Interest expense was also $317 thousand lower in the 2020 first half due to the redemption of $10.0 million of subordinated debt in the fourth quarter of 2019.

Total loans held for investment increased by $122.5 million, or 25.1%, from June 30, 2019. The funding of $97.8 million of PPP loans drove a $101.1 million, or 19.9% increase in loans held for investment compared to December 31, 2019. Mortgage loans held for sale increased by $139.0 million, or 246.7%, from June 30, 2019, and $58.2 million from December 31, 2019 as lower mortgage rates continued to support higher mortgage banking origination activity in the first half of 2020.

Total deposits increased by $117.2 million to $937.7 million at June 30, 2020, from $820.5 million at December 31, 2019. In the first quarter 2020, we asserted our ability to bring back deposits previously moved off our balance sheet during the deleveraging activities of the fourth quarter of 2019. Deposit growth was supported during the second quarter of 2020 by PPP loan customers depositing loan proceeds with BNC prior to utilization.

Short-term borrowings increased $2.6 million at June 30, 2020 compared to December 31, 2019, while FHLB borrowings decreased by $17.0 million during the same period due to higher deposit balances.

While credit risks have not yet manifested in significantly increased nonperforming loan levels, the Company recorded a provision for credit losses of $2.1 million in the first six months of 2020 as compared to $200 thousand in the same period of 2019. The increase was primarily attributed to qualitative risks identified in certain loan portfolio segments that were impacted more directly by the COVID-19 pandemic. Loan balances charged-off in the first six months of 2020 were $524 thousand.

Non-interest income for the six months ended June 30, 2020, was $37.1 million. This compares to non-interest income of $11.6 million for the same period in 2019, an increase of $25.5 million, or 221.2%. Mortgage banking revenues aggregated $33.7 million in the current period compared to $8.3 million in the first six months of 2019, as lower mortgage rates induced higher mortgage banking origination activity. Gains on sales of assets aggregated $1.1 million in the first six months of 2020, compared to $426 thousand in the prior period. Gains on sales of assets and earnings from certain investments can vary significantly from period to period.

Non-interest expense for the six months ended June 30, 2020, was $26.5 million compared to $20.1 million in the same period of 2019, an increase of $6.4 million. Salaries and benefits increased $3.8 million, or 36.0%, from the first six months of 2019. The increase in salaries and employee benefits relates to mortgage operations and is due to elevated levels of loan processing in the second quarter of 2020. Professional services in the first half of 2020 were up $1.2 million, or 60.1%, from the first half of 2019, related exclusively to mortgage loan closing costs. Other expense increased by $527 thousand when compared to the same period of 2019 due to recording a provision for mortgage reimbursement obligations and mortgage related personnel recruiting costs.

During the six-month period ended June 30, 2020, income tax expense was $6.0 million, compared to $1.2 million in the first half of 2019. The effective tax rate was 24.5% in the first half of 2020, compared to 22.0% in the same period of 2019. The increase in the effective tax rate for the full year of 2020 is due to higher pre-tax revenues and lower non-taxable interest income from municipal securities.

Net Interest Income

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

	Three Months Ended June 30, 2020			2019			Change		
	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
Interest-earning assets									
Federal funds sold/cash equivalents	$ 112,287	$ 26	0.09%	$ 15,257	$ 80	2.10%	$ 97,030	$ (54)	-2.01% (a)
Debt securities – taxable	202,113	1,230	2.42%	379,467	2,539	2.68%	(177,354)	(1,309)	-0.26% (b)
Debt securities – tax exempt	6,520	58	3.59%	43,583	278	2.55%	(37,063)	(220)	1.04% (b)
Loans held for sale – mortgage banking	130,461	1,017	3.13%	48,295	451	3.75%	82,166	566	-0.62% (c)
Loans and leases held for investment	588,909	7,240	4.89%	472,511	6,051	5.14%	116,398	1,190	-0.25% (d)
Allowance for loan losses	(8,406)	-	0.00%	(7,696)	-	0.00%	(710)	-	0.00%
Total interest-earning assets	$ 1,031,884	$ 9,571	3.72%	$ 951,417	$ 9,399	3.94%	$ 80,467	$ 172	-0.22%
Interest-bearing liabilities									
Interest checking and money market	$ 584,695	$ 356	0.24%	$ 546,461	$ 1,163	0.85%	$ 38,234	$ (807)	-0.61% (e)
Savings	38,215	5	0.05%	34,001	5	0.06%	4,214	-	-0.01% (e)
Certificates of deposit	149,771	647	1.72%	168,622	804	1.91%	(18,851)	(157)	-0.19% (e)
Total interest-bearing deposits	772,681	1,008	0.52%	749,084	1,972	1.06%	23,597	(964)	-0.54%
Short-term borrowings	7,245	3	0.18%	3,905	2	0.23%	3,340	1	-0.05% (f)
Federal Home Loan Bank advances	-	-	0.00%	14,279	93	2.56%	(14,279)	(93)	-2.56% (g)
Long-term borrowings	-	-	0.00%	10,000	158	6.35%	(10,000)	(158)	-6.35%
Subordinated debentures	15,005	106	2.82%	15,008	151	3.97%	(3)	(45)	-1.15%
Total borrowings	22,250	109	1.95%	43,192	404	3.75%	(20,942)	(295)	-1.80%
Total interest-bearing liabilities	$ 794,931	1,117	0.56%	$ 792,276	2,376	1.20%	$ 2,655	(1,259)	-0.64%
Net interest income/spread		$ 8,454	3.16%		$ 7,023	2.74%		$ 1,431	0.42%
Net interest margin			3.30%			2.96%			0.34% (h)
Notation:									
Non-interest-bearing deposits	$ 178,264	-	0.00%	$ 124,838	-	0.00%	$ 53,426	-	0.00% (e)
Total deposits	$ 950,945	$ 1,008	0.42%	$ 873,922	$ 1,972	0.91%	$ 77,023	$ (964)	-0.49%
Taxable equivalents:									
Total interest-earning assets	$ 1,031,884	$ 9,611	3.71%	$ 951,417	$ 9,562	4.03%	$ 80,467	$ 49	-0.32%
Net interest income/spread	-	$ 8,493	3.15%	-	$ 7,187	2.83%	-	$ 1,306	0.32%
Net interest margin	-	-	3.27%	-	-	3.03%	-	-	0.24%

(a) Cash balances can fluctuate from period to period based on liquidity sources and uses of the business.
(b) Average debt securities portfolio balances have decreased as liquidity requirements for loan growth and deleveraging strategies resulted in the sale of debt securities.
(c) The average balance of loans held for sale increased in the second quarter of 2020 as the lower interest rate environment continued to support increased mortgage loan originations activity.
(d) The average balance of loans held for investment rose compared to the second quarter of 2019 due to steady loan activity in our core markets throughout 2019 and funding of PPP loans in the second quarter of 2020.
(e) Overall, average deposit balances have increased as we asserted our ability to bring back deposits previously moved off our balance sheet in the deleveraging activities of the fourth quarter of 2019 in addition to PPP loan customers depositing loan proceeds with BNC prior to utilization. Certificates of deposit decreased as BNC has lowered offered rates on new certificates of deposit.
(f) Short-term borrowings increased based increased customers use of repurchase agreements.
(g) FHLB short-term advances have been utilized to flexibly manage our balance sheet.
(h) Net interest margin has increased primarily due to higher loan balances, redemption of subordinated debt in December 2019 and lower cost of deposits.

	Six Months Ended June 30,								
	2020			2019			Change		
	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
Interest-earning assets									
Federal funds sold/cash equivalents	$ 70,772	$ 71	0.20%	$ 23,810	$ 311	2.65%	$ 46,962	$ (240)	-2.45% (a)
Debt securities – taxable	224,820	2,864	2.56%	373,171	4,937	2.67%	(148,351)	(2,073)	-0.11% (b)
Debt securities – tax exempt	6,571	117	3.57%	52,721	683	2.59%	(46,150)	(566)	0.98% (b)
Loans held for sale – mortgage banking	126,603	2,040	3.23%	35,664	685	3.87%	90,939	1,355	-0.64% (c)
Loans and leases held for investment	550,379	13,481	4.93%	469,461	11,911	5.12%	80,918	1,570	-0.19% (d)
Allowance for loan losses	(8,206)	-	0.00%	(7,691)	-	0.00%	(515)	-	0.00%
Total interest-earning assets	$ 970,939	$ 18,573	3.85%	$ 947,136	$ 18,527	3.94%	$ 23,803	$ 46	-0.09%
Interest-bearing liabilities									
Interest checking and money market	$ 541,555	$ 1,020	0.38%	$ 556,937	$ 2,362	0.86%	$ (15,382)	$ (1,342)	-0.48% (e)
Savings	37,014	12	0.06%	34,227	11	0.06%	2,787	1	0.00% (e)
Certificates of deposit	156,186	1,415	1.82%	160,818	1,439	1.80%	(4,632)	(24)	0.02% (e)
Total interest-bearing deposits	734,755	2,447	0.67%	751,982	3,812	1.02%	(17,227)	(1,365)	-0.35%
Short-term borrowings	6,204	6	0.20%	6,147	17	0.58%	57	(11)	-0.38%
Federal Home Loan Bank advances	1,343	12	1.79%	7,456	97	2.61%	(6,113)	(85)	-0.82% (f)
Long-term borrowings	-	-	0.00%	10,000	317	6.35%	(10,000)	(317)	-6.35%
Subordinated debentures	15,006	230	3.04%	15,008	306	4.05%	(2)	(76)	-1.01%
Total borrowings	22,553	248	2.21%	38,611	737	3.85%	(16,058)	(489)	-1.64%
Total interest-bearing liabilities	$ 757,308	2,695	0.72%	$ 790,593	4,553	1.16%	$ (33,285)	(1,854)	-0.44%
Net interest income/spread		$ 15,878	3.12%		$ 13,978	2.78%		$ 1,900	0.34%
Net interest margin			3.29%			2.98%			0.31% (g)
Notation:									
Non-interest-bearing deposits	$ 156,711	-	0.00%	$ 124,810	-	0.00%	$ 31,901	-	0.00% (e)
Total deposits	$ 891,466	$ 2,447	0.55%	$ 876,792	$ 3,812	0.88%	$ 14,674	$ (1,365)	-0.33%
Taxable equivalents:									
Total interest-earning assets	$ 970,939	$ 18,678	3.87%	$ 947,136	$ 18,919	4.03%	$ 23,803	$ (241)	-0.16%
Net interest income/spread	-	$ 15,982	3.15%	-	$ 14,369	2.87%	-	$ 1,613	0.28%
Net interest margin	-	-	3.32%	-	-	3.06%	-	-	0.26%

(a) Cash balances can fluctuate from period to period based on liquidity sources and uses of the business.
(b) Average debt securities portfolio balances have decreased as liquidity requirements for loan growth and deleveraging strategies resulted in the sale of debt securities.
(c) The average balance of loans held for sale increased in the second quarter of 2020 as the lower interest rate environment continued to support increased mortgage loan originations activity.
(d) The average balance of loans held for investment rose compared to the second quarter of 2019 due to steady loan activity in our core markets throughout 2019 and funding of PPP loans in the second quarter of 2020.
(e) Overall, average deposit balances have increased primarily due to PPP loan customers depositing loan proceeds with BNC prior to utilization partially offset by the impact of deleveraging activities in the fourth quarter of 2019.
(f) FHLB short-term advances have been utilized to flexibly manage our balance sheet.
(g) Net interest margin has increased primarily due to higher loan balances, redemption of subordinated debt in December 2019 and lower cost of deposits.

Non-interest Income

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

	Three Months Ended June 30,		Increase (Decrease)		Six Months Ended June 30,		Increase (Decrease)		
	2020	2019	$	%	2020	2019	$	%	
Bank charges and service fees	$ 549	$ 679	$ (130)	(19) %	$ 1,180	$ 1,325	$ (145)	(11) %	(a)
Wealth management revenues	414	432	(18)	(4) %	855	875	(20)	(2) %	
Mortgage banking revenues	25,098	5,228	19,870	380 %	33,714	8,315	25,399	305 %	(b)
Gains on sales of loans, net	-	4	(4)	(100) %	3	106	(103)	(97) %	(c)
Gains on sales of debt securities, net	153	256	(103)	(40) %	1,128	320	808	253 %	(d)
Other	119	458	(339)	(74) %	247	618	(371)	(60) %	(e)
Total non-interest income	$ 26,333	$ 7,057	$ 19,276	273 %	$ 37,127	$ 11,559	$ 25,568	221 %	

(a) Bank charges and service fees decreased due to lower ATM interchange income, deposit overdraft charges and non-use fees for lines of credit.
(b) Mortgage banking revenues increased due to higher mortgage origination activity in the current low interest rate environment.
(c) Gains on sale of loans can vary significantly from period to period.
(d) Gains and losses on sales of debt securities may vary significantly from period to period as the Company manages liquidity needs the risk and return profile of its debt securities portfolio through changing economic conditions.
(e) Other income decreased largely due to SBIC income received in the 2019 period that did not recur.

Non-interest Expense

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

	Three Months Ended June 30,		Increase (Decrease)		Six Months Ended June 30,		Increase (Decrease)		
	2020	2019	$	%	2020	2019	$	%	
Salaries and employee benefits	$ 7,961	$ 5,375	$ 2,586	48 %	$ 14,272	$ 10,493	$ 3,779	36 %	(a)
Professional services	1,842	1,195	647	54 %	3,120	1,949	1,171	60 %	(b)
Data processing fees	1,199	1,061	138	13 %	2,323	2,100	223	11 %	(c)
Marketing and promotion	1,543	1,043	500	48 %	2,969	2,053	916	45 %	(d)
Occupancy	523	534	(11)	(2) %	1,058	1,093	(35)	(3) %	
Regulatory costs	49	125	(76)	(61) %	105	257	(152)	(59) %	(e)
Depreciation and amortization	358	361	(3)	(1) %	714	722	(8)	(1) %	
Office supplies and postage	116	128	(12)	(9) %	250	264	(14)	(5) %	
Other	900	587	313	53 %	1,687	1,160	527	45 %	(f)
Total non-interest expense	$ 14,491	$ 10,409	$ 4,082	39 %	$ 26,498	$ 20,091	$ 6,407	32 %	
Efficiency ratio	41.7%	73.9%			50.0%	78.7%			

(a) Salaries and employee benefits increase relates to increased mortgage production in 2020.
(b) Professional service expense increase primarily relates to increased mortgage operating costs.
(c) Data processing fees increased due to increased network hardware and software expense.
(d) Marketing and promotion increased due to increased mortgage lead costs.
(e) Regulatory costs decrease relates to a decrease in the FDIC and OCC Assessments.
(f) Other expense increase includes increased mortgage warranty reserve expense and mortgage related recruiting costs.

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.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	**2019**	**2020**	**2019**
Number of funded mortgage loans held for sale	2,029	758	3,429	1,246
Mortgage loans held for sale funded	$ 743,965	$ 236,904	$ 1,249,046	$ 391,265
Year-to-date average loans held for sale-mortgage banking	$ 130,461	$ 48,295	$ 126,603	$ 35,664
Quarter-end loans held for sale-mortgage banking	$ 195,330	$ 56,346	$ 195,330	$ 56,346
Non-Interest Income				
Gains on sale of loans held for sale, net of commission expense	$ 10,386	$ 3,346	$ 17,861	$ 5,185
Unrealized gain on mortgage financial instruments (1)	$ 14,712	$ 1,882	$ 15,853	$ 3,130
Direct non-interest income	$ 25,098	$ 5,228	$ 33,714	$ 8,315
Direct non-interest expense	$ 7,046	$ 3,276	$ 12,244	$ 6,086

(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 predominantly relationship driven with originators capitalizing on local relationships to originate loans through four retail bank branches and seven midwest retail mortgage locations. The consumer direct channel uses a call-center with internet sales focused on both purchase and refinance transactions across the country from locations in Overland Park, Kansas, and Farmington Hills, Michigan.

The low interest rate environment that began late in 2019 has generated a significant increase in mortgage loan activity that continued through the first half of 2020. Non-interest income includes gains on the sale of loans, changes in the fair value of loans held for sale and mortgage banking derivatives, hedge instruments as well as commissions expense.

The increase in unemployment related to COVID-19 has put pressure on mortgage borrowers. In response, federal agencies such as Ginnie Mae and Fannie Mae have allowed borrowers to request loan payment deferrals for a period of time. While this program has not had a material impact on BNC in the first half of 2020, as we sell loans servicing released, it may impact the ability of mortgage loan servicers to purchase loans and will be monitored as conditions evolve.

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 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 Taxes

In the second quarter of 2020, the Company recorded income tax expense of $4.6 million, which resulted in an effective tax rate of 24.7% for the quarter. During the second quarter of 2020, the Company recorded higher income tax expense in order to increase the annual effective tax rate to 24.5%. Income tax expense of $817 thousand was recognized during the second quarter of 2019, which resulted in an effective tax rate of 23.5%. The resulting effective tax rate for the second quarter of 2020 is due to higher pre-tax revenues and lower non-taxable interest income from municipal securities.

During the six-month period ended June 30, 2020, income tax expense was $6.0 million, compared to $1.2 million in the first half of 2019. The effective tax rate was 24.5% in the first half of 2020, compared to 22.0% in the same period of 2019. The increase in the effective tax rate for the full year of 2020 is due to higher pre-tax revenues and lower non-taxable interest income from municipal securities.

Comparison of Financial Condition at June 30, 2020 and December 31, 2019

Assets

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

	June 30, 2020	December 31, 2019	Increase (Decrease) $	%	
Cash and cash equivalents	$ 51,790	$ 10,523	$ 41,267	392 %	(a)
Debt securities available for sale	189,703	265,278	(75,575)	(28) %	(b)
Federal Reserve Bank and Federal Home Loan Bank of Des Moines stock	2,965	3,651	(686)	(19) %	(c)
Loans held for sale-mortgage banking	195,330	137,114	58,216	42 %	(d)
Loans and leases held for investment, net	609,707	508,569	101,138	20 %	(e)
Allowance for credit losses	(9,680)	(8,141)	(1,539)	19 %	(f)
Premises and equipment, net	15,897	16,401	(504)	(3) %	
Operating lease right of use asset	2,331	2,638	(307)	(12) %	(g)
Accrued interest receivable	4,570	3,681	889	24 %	(h)
Other assets	41,340	27,036	14,304	53 %	(i)
Total assets	$ 1,103,953	$ 966,750	$ 137,203	14 %	

(a) Cash balances can fluctuate significantly from period to period based on liquidity sources and uses of the business.
(b) Investment balances have decreased to provide available liquidity for loan growth.
(c) Federal Reserve Bank and FHLB of Des Moines stock will vary based on the Company's utilization of FHLB advances.
(d) Loans held for sale increased as balances will fluctuate with the timing of loan funding and sales. During 2020, mortgage banking loan funding increased due to interest rates favorable to mortgage refinancing activity.
(e) The funding of $97.8 million of PPP loans drove an increase in loans and leases held for investment.
(f) The Company recorded a provision for credit losses primarily attributed to qualitative risks identified in certain loan portfolio segments that were impacted more directly by the COVID-19 pandemic.
(g) Operating lease right of use asset as required by ASC 842, *Leases* – See Note 6.
(h) Accrued interest receivable can fluctuate from period to period.
(i) Other assets increased primarily due to the increased value of commitments to fund mortgage loans, partially offset by a deferred tax asset decrease resulting from the increased value of available for sale debt securities in 2020.

Loan Participations

Pursuant to our lending policy, loans may not exceed 85 percent of the Bank's legal lending limit (except to the extent collateralized by U.S. Treasury securities or Bank deposits) unless the Bank's Chief Credit Officer or the Executive Credit Committee grant prior approval. To accommodate creditworthy customers whose financing needs exceed lending limits and internal restrictions, the Bank sells loan participations to outside participants without recourse. Loan participations sold on a nonrecourse basis to outside financial institutions were $151.9 million as of June 30, 2020, and $152.2 million as of December 31, 2019. The sales of participations are accounted for pursuant to FASB ASC 860, *Transfers and Servicing*.

Concentrations of Credit

The following table summarizes the locations and balances of the Company's borrowers (dollars are in thousands):

	June 30, 2020		December 31, 2019	
North Dakota	$ 391,962	64 %	$ 347,179	68 %
Arizona	135,018	22 %	101,244	20 %
Minnesota	46,857	8 %	33,594	7 %
Other	37,556	6 %	26,180	5 %
Total gross loans and leases held for investment	$ 611,393	100 %	$ 508,197	100 %

The Company's borrowers use loan proceeds for projects in various geographic areas. The following table summarizes the locations and balances where borrowers are using loan proceeds (dollars are in thousands):

	June 30, 2020		December 31, 2019	
North Dakota	$ 347,852	57 %	$ 306,609	60 %
Arizona	166,462	27 %	122,192	24 %
Minnesota	40,020	7 %	27,777	5 %
California	18,415	3 %	18,541	4 %
Colorado	16,252	3 %	15,297	3 %
Ohio	7,357	1 %	7,477	2 %
South Dakota	6,029	1 %	4,168	1 %
Other	9,006	1 %	6,136	1 %
Total gross loans and leases held for investment	$ 611,393	100 %	$ 508,197	100 %

BNC's loans and leases held for investment are concentrated geographically in North Dakota and Arizona. North Dakota and Arizona loans make up 57% and 27% of the total loan portfolio, respectively. The North Dakota economy is influenced by the energy and agriculture industries. Late in the first quarter, oil prices collapsed largely due to global over-supply and reduced demand due to the COVID-19 pandemic, which was further impacted by geo-political disagreements. An extended period of low energy prices may negatively impact credit quality in North Dakota. The Arizona economy is influenced by leisure and travel. Late in the first quarter, these activities diminished, primarily due to pandemic-related travel restrictions. An extended slowdown in these industries may negatively impact credit quality in Arizona. BNC's portfolio is constructed of various sized loans spread over a large number of industry sectors, although concentrations of loans in hospitality and real estate make up notable percentages of the portfolio.

The following table approximates the Company's significant concentrations by industry, excluding PPP loans (dollars are in thousands):

	June 30, 2020
Non-owner Occupied Commercial Real estate (not otherwise categorized)	$ 143,692
Hotels	77,604
Consumer, not otherwise categorized	73,846
Healthcare and Social Assistance	35,385
Agriculture, Forestry, Fishing and Hunting	31,359
Non-Hotel Accommodation and Food Service	22,587
Transportation and Warehousing	22,398
Retail Trade	24,567
Mining, Oil and Gas Extraction	17,161
Construction Contractors	13,732
Manufacturing	12,445
Other Service	8,437
Art, Entertainment and Recreation	7,516
All Other	22,831
Gross loans held for investment (excluding PPP loans)	$ 513,560

The COVID-19 pandemic has impacted all markets as the country continues to take measures to contain the spread of the virus. Business closures are negatively impacting the Company's commercial customers' ability to generate earnings while consumer customers are increasingly subject to employment uncertainty.

The hospitality industry is experiencing unprecedented low hotel occupancy and restaurant utilization. The hospitality industry began to rebound early in May, only to be impacted by the summer surge of COVID-19, especially in Arizona. The oil and gas industry is experiencing low oil prices due to COVID-19 related demand issues that are further impacted by geo-political disagreements. Oil prices have improved in the recent quarter, but not at a level to sustain and re-energize oil and gas activity in North Dakota. These COVID-19 influenced economic conditions are expected to negatively impact various industry sectors.

Loan Maturities(1)

The following table sets forth the maturities of loans in each major category of the Company's portfolio as of June 30, 2020 (in thousands):

		Over 1 year through 5 years		Over 5 years		Total Loans and Leases
	One year or less	Fixed Rate	Indexed Rate	Fixed Rate	Indexed rate	Held for Investment
Commercial and industrial	$ 20,962	$ 11,804	$ 9,237	$ 47,514	$ 71,154	$ 160,671
Commercial real estate	1,313	7,510	8,910	33,533	142,556	193,822
SBA	1,079	97,232	906	6,856	38,186	144,259
Consumer	1,023	3,767	4,588	65,872	9,038	84,288
Land and land development	1,833	2,807	2,214	2,703	787	10,344
Construction	1,446	1,797	14,766	-	-	18,009
Total principal amount of loans	$ 27,656	$ 124,917	$ 40,621	$ 156,478	$ 261,721	$ 611,393

(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 the same manner as new credit applications.

Allocation of the Allowance for Credit Losses

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

	June 30, 2020		December 31, 2019	
	Allocation of Allowance	Loans as a percent of Gross Loans Held for Investment	Allocation of Allowance	Loans as a percent of Gross Loans Held for Investment
Commercial and industrial	$ 3,108	33 %	$ 2,366	32 %
Commercial real estate	3,822	36 %	3,502	38 %
SBA	1,332	9 %	1,131	9 %
Consumer	1,036	16 %	853	16 %
Land and land development	204	3 %	187	2 %
Construction	178	3 %	102	3 %
Total	$ 9,680	100 %	$ 8,141	100 %

Nonperforming Loans

The following table sets forth information concerning the Company's nonperforming loans as of the dates indicated (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
Balance, beginning of period	$ 3,212	$ 2,155	$ 2,033	$ 1,686
Additions to nonperforming	1,297	226	2,528	763
Charge-offs	(225)	(9)	(235)	(21)
Reclassified back to performing	-	(242)	-	(242)
Principal payment received	(121)	(87)	(158)	(138)
Transferred to repossessed assets	-	-	(5)	(5)
Balance, end of period	$ 4,163	$ 2,043	$ 4,163	$ 2,043

Nonperforming Assets

The following table sets forth information concerning the Company's nonperforming assets as of the dates indicated (dollars are in thousands):

	June 30, 2020	December 31, 2019
Nonperforming loans:		
Loans 90 days or more delinquent and still accruing interest	$ 349	$ -
Non-accrual loans	3,814	2,033
Total nonperforming loans	$ 4,163	$ 2,033
Total nonperforming assets	$ 4,163	$ 2,033
Allowance for credit losses	$ 9,680	$ 8,141
Ratio of total nonperforming loans to total loans	0.52%	0.31%
Ratio of total nonperforming loans to loans and leases held for investment	0.68%	0.40%
Ratio of total nonperforming assets to total assets	0.38%	0.21%
Ratio of nonperforming loans to total assets	0.38%	0.21%
Ratio of allowance for credit losses to nonperforming loans	233%	400%

Problem Loans

Management attempts to quantify potential problem loans with more immediate credit risk. The table below summarizes the amounts of potential problem loans (in thousands):

	Watch List			Substandard		
	Impaired	**Other**	**Total**	**Impaired**	**Other**	**Total**
June 30, 2020	$ -	$ 7,406	$ 7,406	$ 1,665	$ 6,941	$ 8,606
December 31, 2019	$ 1,448	$ 7,713	$ 9,161	$ 514	$ 7,247	$ 7,761

At June 30, 2020, the Bank had $10.8 million of classified loans and $3.8 million of loans on non-accrual. This compares to $9.3 million of classified loans and $2.0 million of loans on non-accrual at December 31, 2019, and $10.3 million of classified loans and $2.0 million of loans on non-accrual at June 30, 2019.

A 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 the Company's position as creditor is protected to the fullest extent possible.

The COVID-19 pandemic has significantly increased credit risk. COVID-19 induced global reduction in the demand for oil, and geopolitical disagreements related to oil production are expected to adversely impact oil drilling, service, and employment metrics in North Dakota. It is expected that oil conditions when combined with the temporary closing of many businesses in all of BNC's markets has resulted in elevated credit stresses.

The extent and timing of the pandemic implications are not determinable at this point. Prolonged periods of COVID-19 pandemic disruption of business production, consumer goods and services consumption, and employment could have a material adverse impact on the Company's loan portfolio and operating results. The Company anticipates the provision for credit losses in future periods may be higher than in the recent past related to qualitative indicators in certain sub-segments of its loan portfolio more impacted by unemployment and business interruption.

In the first quarter of 2020, United States Congress enacted the Coronavirus Aid, Relief, and Economic Security (CARES) Act in response to economic conditions related to the COVID-19 pandemic. As a part of the CARES Act, Congress provided temporary relief from trouble debt restructurings under Section 4013. Specifically, financial institutions may elect to suspend US GAAP for loan modifications related to COVID-19 and suspend any loan modified as a result of the effects of COVID-19 as being a troubled debt restricting, including impairment so long as the subject loan was not more than 30 days past due as of December 31, 2019.

Subsequently, guidance was issued jointly by regulatory authorities related to troubled debt restructuring loan treatment that is consistent with the CARES Act. The guidance allows banks to prudently modify loans such as the temporary deferral of principal and interest. Financial institutions have been encouraged to provide modifications in situations where it will provide time to allow otherwise performing borrowers the opportunity to financially recover from potentially short-term COVID-19 related economic conditions.

To this end, BNC has modified approximately $200 million of loans consistent with the CARES Act and inter-agency guidance, allowing customers to defer payments or modify their loans. These loans were current as of December 31, 2019, and as a result, are not currently subject to troubled debt restructuring accounting standards.

Liabilities

The following table presents our liabilities (dollars are in thousands):

	June 30, 2020	December 31, 2019	Increase (Decrease) $	Increase (Decrease) %	
Deposits:					
Non-interest-bearing	$ 183,864	$ 136,313	$ 47,551	35 %	(a)
Interest-bearing-					
Savings, interest checking and money market	607,937	514,869	93,068	18 %	(a)
Time deposits	145,898	169,365	(23,467)	(14) %	(b)
Short-term borrowings	7,167	4,565	2,602	57 %	(c)
FHLB advances	-	17,000	(17,000)	(100) %	(d)
Guaranteed preferred beneficial interests in Company's subordinated debentures	15,005	15,006	(1)	- %	
Accrued interest payable	1,043	1,685	(642)	(38) %	(e)
Accrued expenses	10,659	7,580	3,079	41 %	
Operating lease liabilities	2,506	2,822	(316)	(11) %	(f)
Other liabilities	9,849	1,267	8,582	677 %	(g)
Total liabilities	$ 983,928	$ 870,472	$ 113,456	13 %	

(a) BNC exercised its ability to bring back deposits previously moved off-balance sheet. Additional increases are supported by PPP loan customers depositing loan proceeds with BNC prior to utilization.
(b) Time deposits have decreased as BNC has lowered rates on new certificates of deposit.
(c) 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 FHLB as an efficient source of liquidity.
(e) Accrued interest payable decreased primarily as a result of lower time deposit balances in the first quarter of 2020.
(f) Operating lease liabilities as required by ASC 842, *Leases* – See Note 6.
(g) The increase primarily relates to increased commitments to sell mortgage loans and increased taxes payable resulting from increased pre-tax income in 2020.

At June 30, 2020, and December 31, 2019, the Bank had $38.2 million and $45.7 million, respectively, in time deposits greater than $250 thousand.

Mortgage Banking Obligations

Included in accrued expenses is an estimate of mortgage banking reimbursement obligations, which aggregated $1.0 million at June 30, 2020, and $906 thousand at December 31, 2019. Although the Company sells mortgage banking loans without recourse, industry standards require standard representations and warranties, which can 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 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 record the estimated obligation. The following is a summary of activity related to mortgage banking obligations (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
Balance, beginning of period	$ 898	$ 921	$ 906	$ 982
Provision	300	-	400	-
Write offs, net	(181)	(28)	(289)	(89)
Balance, end of period	$ 1,017	$ 893	$ 1,017	$ 893

Stockholders' Equity

The Company's stockholders' equity increased $23.7 million from December 31, 2019 to June 30, 2020 primarily due to $18.5 million in additional retained earnings and an increase in accumulated other comprehensive income of $5.0 million. As presented in Note 16 – Regulatory Capital and Current Operating Environment, the Company maintains capital in excess of regulatory requirements.

The Company routinely evaluates the sufficiency of its capital in order to ensure compliance with regulatory capital standards and be a source of strength for the Bank. Capital is managed by assessing the composition of capital and amounts available for growth, risk or other purposes. Management regularly evaluates capital requirements and prudent capital management opportunities.

Liquidity Risk Management

Liquidity risk is the possibility of being unable to meet 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 the Company's 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, the Company utilizes 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 debt securities. The Bank has the ability to borrow from the Federal Reserve Bank through the Discount Window collateralized by mortgage loans and/or Paycheck Protection Program Lending Facility (PPPLF) collateralized by the PPP loans. As of June 30, 2020 the Company has not utilized the PPPLF. Funding through the issuance of subordinated notes, subordinated debentures, and long-term borrowings also has been obtained.

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

The Company's liquidity position is measured on an as needed basis, but no less frequently than monthly. Liquidity position is measured 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 ($170.9 million as of June 30, 2020);
2. Borrowing capacity from the FHLB ($127.3 million as of June 30, 2020); and
3. Capacity to issue brokered deposits with maturities of less than 12 months ($156.0 million as of June 30, 2020).

On an on-going basis, the Company uses 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.

BNC's liquidity assessment process segregates its 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. The Company has a targeted range for our liquidity position over this horizon and manage operations to achieve these targets.

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

Pursuant to the Company's contingency funding plan, it estimates cash flows over a 12-month horizon under a variety of stressed scenarios to identify potential funding needs and funding sources. The organizations contingency plan identifies actions that could be taken in response to adverse liquidity events.

The Company believes 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.

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 the Company's earnings or value. BNC's 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. The Company has risk management policies to monitor and limit exposure to interest rate risk. BNC's 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.

The Company's 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 it 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 2 of the Company's Consolidated Financial Statements for a summary of accounting policies pertaining to such instruments.

The Company's primary tool for measuring and managing interest rate risk is net interest income simulation. This exercise includes assumptions regarding the changes in interest rates and the impact on BNC's 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 June 30, 2020 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 June 30, 2020 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.

The Company monitors 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 June 30, 2020, the downward scenarios for interest rate movements is limited to -100bp. The parallel movement of interest rates means all projected market interest rates move up or down by the same amount. A ramp in interest rates means that the projected change in market interest rates occurs over the 12-month horizon on a pro-rata basis. For example, in the +100bp scenario, the projected Prime rate is projected to increase from 3.25% to 4.25% 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 results for the 12-month horizon are shown below (dollars are in thousands):

Net Interest Income Simulation

Movement in interest rates	-100bp	Unchanged	+100bp	+200bp	+300bp
Projected 12-month net interest income	$ 31,475	$ 32,132	$ 32,087	$ 31,973	$ 31,885
Dollar change from unchanged scenario	$ (657)	$ -	$ (45)	$ (159)	$ (247)
Percent change from unchanged scenario	(2.04)%	-	(0.14)%	(0.49)%	(0.77)%

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 assets and liabilities as of June 30, 2020 (without forward adjustments for planned growth and anticipated business activities) and do not contemplate any actions BNC 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 the Company’s rate sensitivity position as of June 30, 2020. 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 June 30, 2020				
	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	$ 51,790	$ -	$ -	$ -	$ 51,790
Debt securities (a)	34,867	20,723	57,464	57,442	170,496
FRB and FHLB stock	2,965	-	-	-	2,965
Loans held for sale-mortgage banking, fixed rate	195,330	-	-	-	195,330
Loans held for investment, fixed rate	22,411	74,496	170,513	19,793	287,213
Loans held for investment, indexed rate	98,236	50,868	168,113	5,277	322,494
Total interest-earning assets	$ 405,599	$ 146,087	$ 396,090	$ 82,512	$ 1,030,288
Interest-bearing liabilities:					
Interest checking and money market accounts	$ 568,398	$ -	$ -	$ -	$ 568,398
Savings	39,539	-	-	-	39,539
Time deposits	43,901	69,403	32,427	167	145,898
Short-term borrowings	7,167	-	-	-	7,167
Subordinated debentures	-	15,000	-	-	15,000
Total interest-bearing liabilities	$ 659,005	$ 84,403	$ 32,427	$ 167	$ 776,002
Interest rate gap	$ (253,406)	$ 61,684	$ 363,663	$ 82,345	$ 254,286
Cumulative interest rate gap at June 30, 2020	$ (253,406)	$ (191,722)	$ 171,941	$ 254,286	
Cumulative interest rate gap to total assets	(22.95%)	(17.37%)	15.58%	23.03%	

(a) Values for debt 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 debt securities.

The table assumes that all savings and interest-bearing demand deposits reprice in the earliest period presented, however, management believes a significant portion of these accounts constitute a core component and are generally not rate sensitive. The Company's 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 BNC's assets and liabilities as of June 30, 2020, and do not contemplate any actions the Company might undertake in response to changes in market interest rates.

Legal Proceedings

From time to time in the ordinary course of business, the Company and its subsidiaries may be a party to legal proceedings arising out of our lending, deposit operations, or other activities. The Company engages in foreclosure proceedings and other collection actions as part of its loan collection activities. From time to time, borrowers may also bring actions against BNC, in some cases claiming damages.

Submission of Matters to a Vote of Stockholders

The Annual Meeting of stockholders of the Company was held on June 18, 2020. Proxies for matters to be voted on at the Annual Meeting were solicited by the Board of Directors of the Company. Two proposals were voted upon at the Annual Meeting. The proposals were described in detail in the Company's Proxy Statement. Of the 3,540,650 shares of common stock outstanding on the record date of April 20, 2020, 3,224,156 shares were voted at the Annual Meeting. The final results for the votes regarding each proposal are set forth below.

1. The following nominees were elected as members of the Board of Directors of the Company for three-year terms ending in 2023:

Name	For	Withheld	Broker Non-Votes
Timothy Franz	1,214,083	1,389,640	620,433
Michael Vekich	2,546,819	56,904	620,433

   Since the Annual Meeting, Timothy Franz has resigned from all positions with the Company and BNC National Bank and the Board of Directors of the Company was reduced to six directors. The Board of Directors of the Company now consists of Nathan P. Brenna, Gaylen Ghylin, John W. Palmer, Tom Redmann, Tracy J. Scott and Michael M. Vekich.

2. The selection of CliftonLarsonAllen LLP as the Company's independent registered public accounting firm for fiscal 2020 was ratified:

For	Against	Abstain
3,144,205	2,522	77,429

Management is not aware of any material pending or threatening litigation as of June 30, 2020.

Signatures

This report is submitted on behalf of the Company by the duly authorized undersigned.

BNCCORP, INC.

Date:	August 13, 2020	By:	/s/ Daniel J. Collins
			Daniel J. Collins Interim President and Chief Executive Officer
		By:	/s/ Mark Peiler
			Mark Peiler Interim Chief Financial Officer