Quarterly Report

For the quarter ended June 30, 2023

BNCCORP, INC.

(OTCQX: BNCC)

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Financial Statements

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(In thousands, except share data)

	June 30, 2023	December 31, 2022
ASSETS	(unaudited)	
Cash and cash equivalents	$ 16,640	$ 73,968
Debt securities available for sale	165,745	174,876
Federal Reserve Bank and Federal Home Loan Bank stock	2,938	3,063
Loans held for sale-mortgage banking	67,228	37,764
Loans held for investment	640,989	616,645
Allowance for credit losses (1)	(9,000)	(8,831)
Net loans held for investment	631,989	607,814
Premises and equipment, net	11,247	11,764
Operating lease right of use asset	867	1,521
Accrued interest receivable	3,458	3,312
Other	29,661	29,239
Total assets	$ 929,773	$ 943,321
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Deposits:		
Non-interest-bearing	$ 181,508	$ 207,232
Interest-bearing –		
Savings, interest checking and money market	563,878	554,577
Time deposits	59,111	57,775
Total deposits	804,497	819,584
Guaranteed preferred beneficial interest in Company's subordinated debentures	15,000	15,000
Accrued interest payable	451	312
Accrued expenses	4,987	5,482
Operating lease liabilities	986	1,660
Other	1,026	937
Total liabilities	826,947	842,975
STOCKHOLDERS' EQUITY:		
Common stock, $.01 par value – Authorized 11,300,000 shares; 3,561,334 and 3,559,334 shares issued and outstanding	36	36
Capital surplus – common stock	26,634	26,399
Retained earnings	89,528	87,575
Treasury stock (107,319 and 109,319 shares, respectively)	(1,664)	(1,622)
Accumulated other comprehensive loss	(11,708)	(12,042)
Total stockholders' equity	102,826	100,346
Total liabilities and stockholders' equity	$ 929,773	$ 943,321

(1) The Company adopted ASU 2016-13 as of January 1, 2023. The prior year amounts presented are calculated under the prior accounting standard.

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,	
	2023	**2022**	**2023**	**2022**
INTEREST INCOME:				
Interest and fees on loans	$ 8,942	$ 6,504	$ 17,101	$ 12,671
Interest and dividends on investments				
Taxable	1,719	1,195	3,511	2,235
Tax-exempt	-	57	19	115
Dividends	36	37	72	73
Total interest income	10,697	7,793	20,703	15,094
INTEREST EXPENSE:				
Deposits	2,405	325	3,733	658
Federal Home Loan Bank advances	-	1	6	1
Subordinated debentures	249	89	480	148
Total interest expense	2,654	415	4,219	807
Net interest income	8,043	7,378	16,484	14,287
PROVISION (CREDIT) FOR CREDIT LOSSES:	165	-	405	(550)
Net interest income after provision for credit losses	7,878	7,378	16,079	14,837
NON-INTEREST INCOME:				
Bank charges and service fees	885	753	1,977	1,353
Wealth management revenues	483	492	970	1,028
Mortgage banking revenues, net	2,292	3,782	4,148	7,924
Gains on sales of loans, net	2	219	10	239
Gains on sales of debt securities, net	-	-	12	-
Other	50	532	226	746
Total non-interest income	3,712	5,778	7,343	11,290
NON-INTEREST EXPENSE:				
Salaries and employee benefits	5,061	5,219	10,004	11,160
Professional services	1,689	966	2,586	1,916
Data processing fees	1,064	998	2,053	1,971
Marketing and promotion	1,360	1,437	2,729	2,792
Occupancy	482	527	994	1,110
Regulatory costs	94	121	200	240
Depreciation and amortization	284	306	577	617
Office supplies and postage	132	107	228	217
Other	674	849	1,375	1,552
Total non-interest expense	10,840	10,530	20,746	21,575
Income before income taxes	750	2,626	2,676	4,552
Income tax expense	176	617	629	1,070
NET INCOME	$ 574	$ 2,009	$ 2,047	$ 3,482
Basic earnings per common share	$ 0.16	$ 0.56	$ 0.57	$ 0.97
Diluted earnings per common share	$ 0.16	$ 0.56	$ 0.57	$ 0.97

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive (Loss) Income

(In thousands, unaudited)

	For the Three Months Ended June 30,				For the Six Months Ended June 30,			
	2023		2022		2023		2022	
NET INCOME		$ 574		$ 2,009		$ 2,047		$ 3,482
Unrealized (loss) gain on debt securities available for sale	$ (2,060)		$ (5,518)		$ 455		$ (14,498)	
Reclassification adjustment for gains included in net income	-		-		(12)		-	
Other comprehensive (loss) income before tax	(2,060)		(5,518)		443		(14,498)	
Income tax benefit (expense) related to items of other comprehensive (loss) income	507		1,160		(109)		3,567	
Other comprehensive (loss) income	$ (1,553)	(1,553)	$ (4,358)	(4,358)	$ 334	334	$ (10,931)	(10,931)
TOTAL COMPREHENSIVE (LOSS) INCOME		$ (979)		$ (2,349)		$ 2,381		$ (7,449)

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 Shares	Common Stock Amount	Capital Surplus Common Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
BALANCE, December 31, 2021	3,554,983	$ 36	$ 26,068	$ 87,378	$ (1,650)	$ 3,154	$ 114,986
Net income	-	-	-	3,482	-	-	3,482
Other comprehensive loss	-	-	-	-	-	(10,931)	(10,931)
Impact of share-based compensation	2,400	-	284	-	(16)	-	268
Dividends declared on common stock ($1.75)	-	-	-	(6,303)	-	-	(6,303)
BALANCE, June 30, 2022	3,557,383	$ 36	$ 26,352	$ 84,557	$ (1,666)	$ (7,777)	$ 101,502
BALANCE, December 31, 2022	3,559,334	$ 36	$ 26,399	$ 87,575	$ (1,622)	$ (12,042)	$ 100,346
Cumulative effect adjustment for adoption of ASU 2016-13, Measurement of Credit Losses on Financial Instruments	-	-	-	(94)	-	-	(94)
Net income	-	-	-	2,047	-	-	2,047
Other comprehensive income	-	-	-	-	-	334	334
Impact of share-based compensation	2,000	-	235	-	(42)	-	193
BALANCE, June 30, 2023	3,561,334	$ 36	$ 26,634	$ 89,528	$ (1,664)	$ (11,708)	$ 102,826

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)

	2023	2022
OPERATING ACTIVITIES:		
Net income	$ 2,047	$ 3,482
Adjustments to reconcile net income to net cash provided by operating activities -		
Provision (credit) for credit losses	405	(550)
Depreciation	577	617
Amortization of right of use asset	397	377
Net amortization of premiums on debt securities and subordinated debentures	860	1,774
Share-based compensation	193	268
Change in accrued interest receivable and other assets, net	70	2,950
Loss on sale of bank premises and equipment	142	2
Net realized gain on sales of debt securities	(12)	-
Increase in deferred taxes	(31)	-
Change in other liabilities, net	(998)	(2,671)
Originations of loans held for sale, mortgage banking	(395,048)	(594,307)
Proceeds from sales of loans held for sale, mortgage banking	366,046	608,696
Fair value adjustment for loans held for sale, mortgage banking	(497)	901
Fair value adjustment on mortgage banking derivatives	(462)	(258)
Proceeds from sales of loans	-	1,096
Gains on sales of loans, net	(10)	(239)
Gain on sale of assets held for sale	-	(532)
Net cash (used in) provided by operating activities	(26,321)	21,606
INVESTING ACTIVITIES:		
Purchases of debt securities	(9,555)	(17,566)
Proceed from sales of debt securities	9,483	-
Proceeds from maturities of debt securities	8,797	17,529
Purchases of Federal Reserve and Federal Home Loan Bank Stock	(1,640)	(717)
Sales of Federal Reserve and Federal Home Loan Bank Stock	1,765	750
Net increase in loans held for investment	(24,569)	(29,388)
Proceeds from sales of premises and equipment	60	4
Purchases of premises and equipment	(261)	(282)
Net cash used in investing activities	(15,920)	(29,670)

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)

	2023	2022
FINANCING ACTIVITIES:		
Net decrease in deposits	$ (15,087)	$ (112,621)
Repayments of Federal Home Loan Bank advances	(41,000)	(17,910)
Proceeds from Federal Home Loan Bank advances	41,000	17,910
Dividends paid on common stock	-	(6,303)
Net cash used in financing activities	(15,087)	(118,924)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(57,328)	(126,988)
CASH AND CASH EQUIVALENTS, beginning of period	73,968	188,060
CASH AND CASH EQUIVALENTS, end of period	$ 16,640	$ 61,072
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	$ 4,080	$ 849
Income taxes paid	$ 1,147	$ 563
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Additions to repossessed assets in the settlement of loans	$ 47	$ 15
Right of use assets obtained in exchange for lease obligations	$ 100	$ 93

See accompanying notes to consolidated financial statements.

NOTE 1 – Organization of Operations, BNCCORP, INC.

BNCCORP, INC. ("BNCCORP") is a registered bank holding company incorporated under the laws of Delaware. It is the parent company of BNC National Bank (the "Bank"). BNC National Bank operates community banking and wealth management businesses through 11 locations in North Dakota and Arizona.

NOTE 2 – Basis of Presentation and Accounting Policies

The accounting and reporting policies of BNCCORP 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 BNCCORP 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, 2022. Accordingly, footnote disclosures which would substantially duplicate the disclosures contained in the December 31, 2022 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, 2022, and the notes thereto.

The accompanying interim consolidated financial statements have been prepared by the Company in accordance with generally accepted accounting principles (GAAP) 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, 2023, 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

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.

The Company adopted the standard on January 1, 2023, and applied the standard as a cumulative effect adjustment to retained earnings. At adoption, the Company recorded a $125 thousand increase to the allowance for credit losses, which was comprised of a $64 thousand decrease in the allowance for loan losses and a $189 thousand increase to the allowance for unfunded commitments. The after-tax impact resulted in a $94 thousand decrease to retained earnings. The tax effect resulted in an increase to deferred tax assets.

ASU No. 2022-02, *Financial Instruments – Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures*, eliminates the accounting guidance for TDRs by creditors in ASC 310-40, *Receivables – Troubled Debt Restructurings by Creditors*, in its entirety and requires entities to evaluate all receivable modifications under ASC 310-20-35-9 through 35-11 to determine whether a modification made to a borrower results in a new loan or a continuation of the existing loan. For entities that have already adopted ASU 2016-13, the amendments in ASU 2022-02 are effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. For entities that have not yet adopted ASU 2016-13, the amendments in ASU 2022-02 are effective upon adoption of ASU 2016-13. The Company adopted the standard on January 1, 2023 and the adoption did not have a material impact on the Company's consolidated financials.

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, 2023, or December 31, 2022. The carrying amount of available-for-sale debt securities and their estimated fair values were as follows (in thousands):

	As of June 30, 2023			
	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
U.S. treasury securities	$ 25,630	$ -	$ (1,362)	$ 24,268
U.S. government sponsored entity mortgage-backed securities issued by FNMA/FHLMC	22,383	-	(3,369)	19,014
U.S. government agency small business administration pools guaranteed by SBA	13,738	-	(874)	12,864
Collateralized mortgage obligations guaranteed by GNMA	9,027	-	(424)	8,603
Collateralized mortgage obligations issued by FNMA/FHLMC	59,628	-	(5,569)	54,059
Commercial mortgage-backed securities issued by FHLMC	17,227	-	(1,490)	15,737
Other commercial mortgage-backed securities	27,053	-	(2,700)	24,353
State and municipal bonds	8,067	-	(1,220)	6,847
	$ 182,753	$ -	$ (17,008)	$ 165,745

	As of December 31, 2022			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. treasury securities	$ 19,864	$ -	$ (1,828)	$ 18,036
U.S. government sponsored entity mortgage-backed securities issued by FNMA/FHLMC	23,485	-	(3,338)	20,147
U.S. government agency small business administration pools guaranteed by SBA	15,572	-	(1,191)	14,381
Collateralized mortgage obligations guaranteed by GNMA	10,096	-	(338)	9,758
Collateralized mortgage obligations issued by FNMA/FHLMC	64,285	-	(5,533)	58,752
Commercial mortgage-backed securities issued by FHLMC	17,557	-	(1,476)	16,081
Other commercial mortgage-backed securities	27,906	-	(2,617)	25,289
State and municipal bonds	13,562	341	(1,471)	12,432
	$ 192,327	$ 341	$ (17,792)	$ 174,876

The amortized cost and estimated fair market value of available-for-sale debt securities classified according to their contractual maturities at June 30, 2023, were as follows (in thousands):

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 14,740	$ 14,578
Due after one year through five years	16,488	15,189
Due after five years through 10 years	22,922	20,866
Due after 10 years	128,603	115,112
Total	$ 182,753	$ 165,745

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, 2023								
	Less Than 12 Months			12 Months or More			Total		
Description of Securities	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss
U.S. treasury securities	1	$ 9,707	$ (32)	4	$ 14,561	$ (1,330)	5	$ 24,268	$ (1,362)
U.S. government sponsored entity mortgage-backed securities issued by FNMA/FHLMC	-	-	-	8	19,014	(3,369)	8	19,014	(3,369)
U.S. government agency small business administration pools guaranteed by SBA	-	-	-	4	12,864	(874)	4	12,864	(874)
Collateralized mortgage obligations guaranteed by GNMA	2	2,281	(89)	6	6,322	(335)	8	8,603	(424)
Collateralized mortgage obligations issued by FNMA/ FHLMC	6	7,235	(350)	13	46,824	(5,219)	19	54,059	(5,569)
Commercial mortgage-backed securities issued by FHLMC	1	5,687	(295)	2	10,050	(1,195)	3	15,737	(1,490)
Other commercial mortgage-backed securities	-	-	-	11	24,353	(2,700)	11	24,353	(2,700)
State and municipal bonds	-	-	-	2	6,847	(1,220)	2	6,847	(1,220)
Total temporarily impaired securities	10	$ 24,910	$ (766)	50	$ 140,835	$ (16,242)	60	$ 165,745	$ (17,008)

	December 31, 2022								
	Less Than 12 Months			12 Months or More			Total		
Description of Securities	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss
U.S. treasury securities	1	$ 4,817	$ (185)	3	$ 13,219	$ (1,643)	4	$ 18,036	$ (1,828)
U.S. government sponsored entity mortgage-backed securities issued by FNMA/FHLMC	2	2,092	(109)	6	18,055	(3,229)	8	20,147	(3,338)
U.S. government agency small business administration pools guaranteed by SBA	-	-	-	4	14,381	(1,191)	4	14,381	(1,191)
Collateralized mortgage obligations guaranteed by GNMA	8	9,758	(338)	-	-	-	8	9,758	(338)
Collateralized mortgage obligations issued by FNMA/FHLMC	14	34,501	(1,186)	5	24,251	(4,347)	19	58,752	(5,533)
Commercial mortgage-backed securities issued by FHLMC	2	12,312	(816)	1	3,769	(660)	3	16,081	(1,476)
Other commercial mortgage-backed securities	7	18,458	(1,157)	4	6,831	(1,460)	11	25,289	(2,617)
State and municipal bonds	3	9,550	(1,471)	-	-	-	3	9,550	(1,471)
Total temporarily impaired securities	37	$ 91,488	$ (5,262)	23	$ 80,506	$ (12,530)	60	$ 171,994	$ (17,792)

As identified in the recently issued or adopted accounting pronouncements and interpretations section, the Company's January 1, 2023, adoption of ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*, requires an evaluation of debt securities available for sale to determine if a credit loss exists.

The Company's evaluation first assesses whether it intends to sell, or it is more likely than not that it will be required to sell the security before recovery of its amortized cost basis. If either criteria is met, the security's amortized cost basis is written down to fair value through income. For AFS debt securities that do not meet the aforementioned criteria, the Company evaluates whether the decline in fair value has resulted from credit losses or other factors. In making this assessment, management considers the extent to which fair value is less than amortized cost, any changes to the rating of the security by a rating agency, and adverse conditions specifically related to the security, among other factors. If this assessment indicates that a credit loss exists, the present value of cash flows expected to be collected from the security are compared to the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis, a credit loss exists and an allowance for credit losses is recorded for the credit loss, limited by the amount that the fair value is less than the amortized cost basis. Changes in the allowance for credit losses are recorded as a provision for (or reversal of) credit losses and can change over time.

The Company does not believe that the debt securities available for sale that were in an unrealized loss position as of June 30, 2023 represent a credit loss impairment. As of June 30, 2023, the gross unrealized loss positions were primarily related to mortgage-backed securities issued by U.S. government agencies or U.S. government-sponsored enterprises. These securities carry the explicit and/or implicit guarantee of the U.S. government and have a history of zero credit loss. Total gross unrealized losses were attributable to changes in interest rates, relative to when the investment securities were purchased, and not due to the credit quality of the debt securities. The Company does not intend to sell the debt securities that were in an unrealized loss position and it is unlikely that the Company will be required to sell the debt securities before recovery of their amortized cost basis, which may be at maturity.

At December 31, 2022, management evaluated 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 debt security or whether it is more likely than not that it will be required to sell the debt security before a recovery of amortized cost.

There were no debt securities that management concluded were other-than-temporarily impaired at December 31, 2022.

NOTE 4 – Loans

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

	June 30, 2023	December 31, 2022
Loans held for sale-mortgage banking	$ 67,228	$ 37,764
Commercial and industrial	$ 206,668	$ 205,429
Commercial real estate	232,222	230,243
SBA	55,862	48,638
Consumer	102,476	95,891
Land and land development	7,862	10,758
Construction	34,821	24,690
Gross loans held for investment	639,911	615,649
Unearned income and net unamortized deferred fees and costs	1,078	996
Loans, net of unearned income and unamortized fees and costs	640,989	616,645
Allowance for credit losses	(9,000)	(8,831)
Net loans held for investment	$ 631,989	$ 607,814

NOTE 5 – Allowance for Credit Losses

As identified in the recently issued or adopted accounting pronouncements and interpretations section, the Company's January 1, 2023 adoption of ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*, resulted in changes to the methodology for estimating the allowance for credit losses. As a result of this adoption, the Company recorded a $125 thousand increase to the allowance for credit losses as a cumulative-effect adjustment on January 1, 2023.

The Company is required to estimate the credit losses expected over the life of the loan. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the estimated collectability of the loan portfolio.

The Company's methodology for estimating the allowance for credit losses is applied consistently to the loan portfolio. The following identifies the methodology by which the Company estimates the allowance for credit losses:

Collective Pools. The Company makes a significant number of loans that, due to their underlying similar characteristics, are assessed for loss as "collective" pools. The Bank segments the pools by type of loan and using historical loss and peer group loss information estimates an expected credit loss for each individual loan or lease within the pool. Loans of this nature are generally internally designated as a "pass" rated credit.

Collective Risk Grade. The Company has loans where the risk grade classification deteriorates below an internally assigned grade of "pass". In these cases, the Company generally experiences higher historical loss rates and expects the credit losses on the contractual balance to increase. Loans in this category are pooled by risk grade and historic loss rates are applied to the contractual balances of each individual loan or lease.

Individual Reserves. The Company estimates specific reserves for individually evaluated loans through a loan-by-loan analysis of problem loans that considers expected future cash flows, the value of collateral and other factors that may impact the borrower's ability to make payments when due. Included in this group are loans in nonaccrual status or modified loans.

Qualitative / Forecast Reserve. The Company also considers qualitative adjustments to the quantitative baseline. Utilizing a framework based on the Interagency Policy Statement on Allowance for Credit Losses, the Company considers prevailing and anticipated economic trends, such as current and forecasted economic conditions, economic trends, an assessment of credit risk inherent in the loan portfolio, and delinquency trends. The Company also considers information to the extent the Company expects current conditions and reasonable and supportable forecasts to differ from the conditions that existed for the period over which historical information was evaluated. The Company's forecast period is generally 1 to 2 years.

The following table presents transactions in the allowance for credit losses by portfolio segment (in thousands):

	Three Months Ended June 30, 2023						
	Commercial and Industrial	**Commercial Real Estate**	**SBA**	**Consumer**	**Land and Land Development**	**Construction**	**Total**
Balance, beginning of period	$ 2,958	$ 3,544	$ 963	$ 975	$ 129	$ 367	$ 8,936
Provision (credit)	335	(268)	(20)	49	(3)	69	162
Loans charged off	(29)	-	(51)	(28)	-	-	(108)
Loan recoveries	-	-	-	10	-	-	10
Balance, end of period	$ 3,264	$ 3,276	$ 892	$ 1,006	$ 126	$ 436	$ 9,000

	Three Months Ended June 30, 2022						
	Commercial and Industrial	Commercial Real Estate	SBA	Consumer	Land and Land Development	Construction	Total
Balance, beginning of period	$ 2,168	$ 3,852	$ 1,357	$ 784	$ 134	$ 180	$ 8,475
Provision (credit)	261	(383)	76	119	(45)	(28)	-
Loans charged off	-	-	-	(5)	-	-	(5)
Loan recoveries	-	-	2	5	10	-	17
Balance, end of period	$ 2,429	$ 3,469	$ 1,435	$ 903	$ 99	$ 152	$ 8,487

The Company recorded a $165 thousand provision for credit losses in the second quarter of 2023. A provision of $162 thousand was recorded as an allowance for loan losses and $3 thousand was recorded as an allowance for unfunded commitments. At June 30, 2023, the Company maintained an allowance for unfunded commitments of $212 thousand. The allowance for unfunded commitments are included as part of the Other Liabilities line on the Company's Consolidated Balance Sheets.

	Six Months Ended June 30, 2023						
	Commercial and Industrial	Commercial Real Estate	SBA	Consumer	Land and Land Development	Construction	Total
Balance, beginning of period	$ 2,519	$ 3,621	$ 1,396	$ 982	$ 87	$ 226	$ 8,831
Cumulative effect-CECL adoption	511	(300)	(467)	(13)	66	139	(64)
Provision (credit)	306	(45)	14	63	(27)	71	382
Loans charged off	(72)	-	(51)	(42)	-	-	(165)
Loan recoveries	-	-	-	16	-	-	16
Balance, end of period	$ 3,264	$ 3,276	$ 892	$ 1,006	$ 126	$ 436	$ 9,000

	Six Months Ended June 30, 2022						
	Commercial and Industrial	Commercial Real Estate	SBA	Consumer	Land and Land Development	Construction	Total
Balance, beginning of period	$ 2,173	$ 4,129	$ 1,641	$ 836	$ 148	$ 153	$ 9,080
Provision (credit)	256	(660)	(209)	133	(69)	(1)	(550)
Loans charged off	-	-	-	(74)	-	-	(74)
Loan recoveries	-	-	3	8	20	-	31
Balance, end of period	$ 2,429	$ 3,469	$ 1,435	$ 903	$ 99	$ 152	$ 8,487

The Company recorded a $405 thousand provision for credit losses in the six months ended June 30, 2023. A provision of $382 thousand was recorded as an allowance for loan losses and $23 thousand was recorded as an allowance for unfunded commitments. At June 30, 2023, the Company maintained an allowance for unfunded commitments of $212 thousand. The allowance for unfunded commitments are included as part of the Other liabilities line on the Company's Consolidated Balance Sheets.

Impaired loans are loans on non-accrual status and troubled debt restructurings, which are individually evaluated for impairment, and other loans deemed to have similar risk characteristics. With the adoption of ASU 2016-13, *Measurement of Credit Losses on Financial Instruments*, this disclosure is no longer a required disclosure after December 31, 2022.

The following table shows the balance in the allowance for credit losses at December 31, 2022, and the related loan balances, segregated on the basis of impairment methodology (in thousands).

	Allowance For Credit Losses			Gross Loans Held for Investment		
	Impaired	Other	Total	Impaired	Other	Total
December 31, 2022						
Commercial and industrial	$ -	$ 2,519	$ 2,519	$ 644	$ 204,785	$ 205,429
Commercial real estate	-	3,621	3,621	-	230,243	230,243
SBA	457	939	1,396	830	47,808	48,638
Consumer	-	982	982	34	95,857	95,891
Land and land development	-	87	87	-	10,758	10,758
Construction	-	226	226	-	24,690	24,690
Total	$ 457	$ 8,374	$ 8,831	$ 1,508	$ 614,141	$ 615,649

Credit Quality Indicators

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

Pass. Loans designated as pass are not adversely rated, are contractually current as to principal and interest, and are otherwise in compliance with the contractual terms of the loan or lease agreement. Management believes that there is a low likelihood of loss related to those loans and leases that are considered Pass.

Watch list. 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.

Substandard. Loans graded as substandard or doubtful are considered "Classified" loans for regulatory purposes. Loans classified as substandard are loans that are generally inadequately protected by the current net worth and paying capacity of the obligor, or by the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the loan. Substandard loans are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have the weaknesses of those classified as substandard, with additional characteristics that make collection in full on the basis of currently existing facts, conditions and values questionable, and there is a higher probability of loss.

The following presents by credit quality indicator, loan class, and year of origination, the amortized cost basis of the Company's loans as of June 30, 2023 (in thousands):

	Term Loans by Origination Year							
June 30, 2023	**2023**	**2022**	**2021**	**2020**	**2019**	**Prior**	**Revolving Loans**	**Total**
Commercial and industrial								
Pass	$ 15,232	$ 71,817	$ 29,688	$ 20,540	$ 8,883	$ 28,722	$ 27,541	$ 202,423
Watch List	-	20	-	114	-	-	3	137
Substandard	30	143	126	337	1,161	1,826	-	3,623
Doubtful	-	485	-	-	-	-	-	485
Total commercial and industrial	$ 15,262	$ 72,465	$ 29,814	$ 20,991	$ 10,044	$ 30,548	$ 27,544	$ 206,668
Commercial and industrial loans:								
Current period gross write-offs:	$ 29	$ -	$ 43	$ 50	$ -	$ -	$ -	$ 122
Commercial Real Estate								
Pass	$ 12,642	$ 48,599	$ 35,747	$ 19,202	$ 10,143	$ 97,222	$ 6,758	$ 230,313
Watch List	-	-	1,909	-	-	-	-	1,909
Substandard	-	-	-	-	-	-	-	-
Doubtful	-	-	-		-	-	-	-
Total commercial real estate	$ 12,642	$ 48,599	$ 37,656	$ 19,202	$ 10,143	$ 97,222	$ 6,758	$ 232,222
Commercial real estate:								
Current period gross write-offs:	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Small Business Administration								
Pass	$ 5,822	$ 12,177	$ 9,462	$ 1,922	$ 10,925	$ 9,875	$ 583	$ 50,766
Watch List	-	3,103	-	195	-	-	-	3,298
Substandard	-	-	32	-	841	336	110	1,319
Doubtful	-	-	-	-	-	479	-	479
Total small business administration	$ 5,822	$ 15,280	$ 9,494	$ 2,117	$ 11,766	$ 10,690	$ 693	$ 55,862
Small business administration loans:								
Current period gross write-offs:	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Consumer								
Pass	$ 16,651	$ 34,493	$ 14,313	$ 10,949	$ 4,768	$ 7,327	$ 13,894	$ 102,395
Watch List	-	-	-	-	-	-	-	-
Substandard	-	-	-	11	22	48	-	81
Doubtful	-	-	-	-	-	-	-	-
Total consumer	$ 16,651	$ 34,493	$ 14,313	$ 10,960	$ 4,790	$ 7,375	$ 13,894	$ 102,476
Consumer loans:								
Current period gross write-offs:	$ 15	$ -	$ 20	$ 1	$ -	$ 7	$ -	$ 43
Land and Land Development								
Pass	$ 1,618	$ 1,730	$ 1,884	$ 283	$ -	$ 237	$ 2,110	$ 7,862
Watch List	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-	-	-
Total land and land development	$ 1,618	$ 1,730	$ 1,884	$ 283	$ -	$ 237	$ 2,110	$ 7,862
Land and land development loans:								
Current period gross write-offs:	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Construction								
Pass	$ 932	$ 413	$ -	$ -	$ -	$ -	$ 33,476	$ 34,821
Watch List	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-	-	-
Total Construction	$ 932	$ 413	$ -	$ -	$ -	$ -	$ 33,476	$ 34,821
Construction loans:								
Current period gross write-offs:	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total gross loans	$ 52,927	$ 172,980	$ 93,161	$ 53,553	$ 36,743	$ 146,072	$ 84,475	$ 639,911

The following presents by credit quality indicator and the amortized cost basis of the Company's loans as of December 31, 2022 (in thousands):

	December 31, 2022				
	Pass	**Watch List**	**Substandard**	**Doubtful**	**Total Loans Held for Investment**
Commercial and industrial	$ 203,059	$ 238	$ 1,641	$ 491	$ 205,429
Commercial real estate	228,309	1,934	-	-	230,243
SBA	46,936	300	876	526	48,638
Consumer	95,810	-	81	-	95,891
Land and land development	10,758	-	-	-	10,758
Construction	24,690	-	-	-	24,690
Total gross loans	$ 609,562	$ 2,472	$ 2,598	$ 1,017	$ 615,649

Performing and Non-Accrual Loans

The Bank's key credit quality indicator is a 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, 2023					
	Current	**31-89 Days Past Due**	**90 Days or More Past Due And Accruing**	**Total Performing**	**Non-accrual**	**Total**
Commercial and industrial:						
Business loans	$ 97,178	$ -	$ -	$ 97,178	$ 678	$ 97,856
Agriculture	33,587	-	-	33,587	-	33,587
Owner-occupied commercial real estate	75,225	-	-	75,225	-	75,225
Commercial real estate	232,222	-	-	232,222	-	232,222
SBA	55,138	-	-	55,138	724	55,862
Consumer:						
Automobile	11,616	-	-	11,616	-	11,616
Home equity	12,752	-	-	12,752	-	12,752
1st mortgage	21,730	-	-	21,730	-	21,730
Other	56,190	156	-	56,346	32	56,378
Land and land development	7,862	-	-	7,862	-	7,862
Construction	34,821	-	-	34,821	-	34,821
Total loans held for investment	638,321	156	-	638,477	1,434	639,911
Loans held for sale	67,228	-	-	67,228	-	67,228
Total gross loans	$ 705,549	$ 156	$ -	$ 705,705	$ 1,434	$ 707,139

	December 31, 2022					
	Current	31-89 Days Past Due	90 Days or More Past Due And Accruing	Total Performing	Non-accrual	Total
Commercial and industrial:						
Business loans	$ 95,844	$ 54	$ -	$ 95,898	$ 491	$ 96,389
Agriculture	30,850	-	-	30,850	-	30,850
Owner-occupied commercial real estate	78,190	-	-	78,190	-	78,190
Commercial real estate	230,243	-	-	230,243	-	230,243
SBA	47,757	52	-	47,809	829	48,638
Consumer:						
Automobile	13,879	81	-	13,960	-	13,960
Home equity	13,555	-	-	13,555	-	13,555
1st mortgage	18,862	-	-	18,862	-	18,862
Other	49,434	45	1	49,480	34	49,514
Land and land development	10,758	-	-	10,758	-	10,758
Construction	24,690	-	-	24,690	-	24,690
Total loans held for investment	614,062	232	1	614,295	1,354	615,649
Loans held for sale	37,704	60	-	37,764	-	37,764
Total gross loans	$ 651,766	$ 292	$ 1	$ 652,059	$ 1,354	$ 653,413

The following table sets forth information on non-accrual loans as of June 30, 2023, and December 31, 2022 (in thousands):

	June 30, 2023			December 31, 2022
	Non-accrual loans with a related ACL	Non-accrual loans without a related ACL	Total Non-Accrual Loans	Total Non-Accrual Loans
Commercial and industrial: Business loans	$ 678	$ -	$ 678	$ 491
SBA	724	-	724	829
Consumer: Other	32	-	32	34
Total	$ 1,434	$ -	1,434	$ 1,354

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,	
	2023	2022	2023	2022
Interest income that would have been recorded	$ 41	$ 40	$ 80	$ 79
Interest income recorded	-	-	-	-
Effect on interest income on loans	$ 41	$ 40	$ 80	$ 79

Impaired loans

As identified in the recently issued or adopted accounting pronouncements and interpretations section, the Company adopted ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*, on January 1, 2023. As a result of adoption, the Company is no longer required to provide information on impaired loans. Information on impaired loans as of December 31, 2022 is being provided for comparative purposes.

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

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

	December 31, 2022				
	Unpaid Principal	Recorded Investment	Related Allowance	Average Recorded Balance (12-months)	Interest Income Recognized (12-months)
Impaired loans with an allowance recorded:					
SBA	$ 661	$ 527	$ 457	$ 578	$ -
Total impaired loans with an allowance recorded	$ 661	$ 527	$ 457	$ 578	$ -
Impaired loans without an allowance recorded:					
Commercial and industrial:					
Business loans	$ 2,004	$ 491	$ -	$ 519	$ -
Owner-occupied commercial real estate	175	153	-	160	7
SBA	450	303	-	324	-
Consumer: Other	57	34	-	37	-
Total impaired loans without an allowance recorded	$ 2,686	$ 981	$ -	$ 1,040	$ 7
Total impaired loans	$ 3,347	$ 1,508	$ 457	$ 1,618	$ 7

Loan Modifications

The Company adopted ASU No. 2022-02, *Financial Instruments – Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures*, on January 1, 2023. ASU 2022-02 requires the Company to evaluate all loan modifications under ASC 310-20-35-9 through 35-11 to determine whether a modification made to a borrower results in a new loan or a continuation of the existing loan.

The Company individually evaluates all modification to loans where the borrower is experiencing financial difficulty. In cases where the modification is determined to be at least as favorable to the Company as the terms for comparable loans to other borrowers with similar risk characteristics the loan is considered a new origination. In the event the evaluation determines that the modification is not in-line with terms for comparable loans, the Company considers these loans to be a modified loan. These types of modifications generally take the form of principal forgiveness, interest rate reduction, other-than-insignificant payment delay, or a term extension.

The following presents the amortized cost of loans to borrowers experiencing financial difficulty that were modified during the period by loan segment and modification type (in thousands):

	June 30, 2023			
	Term Extension and Payment Deferment (1)	Term Extension, Payment Modification, Interest Rate Reduction (2)	Total	Percentage of Total Loans
Commercial and industrial	$ 133	$ 60	$ 193	- %
SBA	963	-	963	0.2
	$ 1,096	$ 60	$ 1,156	0.2 %

(1) Modifications extended term by seven months and deferred payments by four months.
(2) Modifications extended term by twelve months and reduced interest rate by 8.75%.

Loan modifications to borrowers experiencing financial difficulty during first six months of 2023 did not result in principal forgiveness.

All loans modified during the first six months of 2023 were current as of June 30, 2023.

Troubled Debt Restructuring (TDRs)
As identified in the recently issued or adopted accounting pronouncements and interpretations section, the Company adopted ASU No. 2022-02, *Financial Instruments – Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures,* on January 1, 2023. As a result of adoption, the Company is no longer required to provide information on troubled debt restructuring. Information on troubled debt restructuring as of December 31, 2022 is being provided for comparative purposes.

TDRs are certain loans that have been modified in order to maximize collection of loan balances. If the Company, for legal or economic reasons related to the borrower's financial difficulties, grants a concession that would not otherwise be considered, compared to the original terms and conditions of the loan, the modified loan is considered a troubled debt restructuring.

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

	December 31, 2022			
	Accrual	Non-accrual	Total	Allowance
Commercial and industrial:				
Business loans	$ -	$ 491	$ 491	$ -
Owner-occupied commercial real estate	153	-	153	-
SBA	-	282	282	48
	$ 153	$ 773	$ 926	$ 48

NOTE 6 – Leases

The Company has operating leases, primarily for office space, which expire over the next six 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, 2023, and June 30, 2022, were as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
Operating lease costs	$ 173	$ 235	$ 376	$ 470
Variable lease costs	14	5	36	12
Short-term lease costs	7	26	11	52
Total lease costs	$ 194	$ 266	$ 423	$ 534

Amounts reported in the consolidated balance sheet as of June 30, 2023, and December 31, 2022, are as follows (in thousands):

	As of June 30, 2023	As of December 31, 2022
Operating lease right of use (ROU) asset	$ 867	$ 1,521
Operating lease liabilities	986	1,660

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
Cash paid for lease liabilities	$ 213	$ 270	$ 438	$ 541
Amortization of ROU assets	168	191	397	377

	As of June 30, 2023	As of December 31, 2022
Weighted average remaining lease term	4.52 years	3.64 years
Weighted average discount rate	5.24%	5.55%

Maturities of lease liabilities under non-cancellable leases as of June 30, 2023, are as follows (in thousands):

	Operating Leases
2023	$ 147
2024	288
2025	275
2026	193
2027	40
Thereafter	167
Total future minimum lease payments	1,110
Amounts representing interest	(124)
Total lease liabilities	$ 986

NOTE 7 – Earnings Per Share

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

	Three Months Ended June 30, 2023	Six Months Ended June 30, 2023
Denominator for basic earnings per share*:*		
Average common shares outstanding	3,578,029	3,576,803
Dilutive effect of stock compensation	2,244	2,281
Denominator for diluted earnings per share	3,580,273	3,579,084
Numerator (in thousands):		
Net income	$ 574	$ 2,047
Basic earnings per common share	$ 0.16	$ 0.57
Diluted earnings per common share	$ 0.16	$ 0.57

	Three Months Ended June 30, 2022	Six Months Ended June 30, 2022
Denominator for basic earnings per share*:*		
Average common shares outstanding	3,574,783	3,573,600
Dilutive effect of stock compensation	846	903
Denominator for diluted earnings per share	3,575,629	3,574,503
Numerator (in thousands):		
Net income	$ 2,009	$ 3,482
Basic earnings per common share	$ 0.56	$ 0.97
Diluted earnings per common share	$ 0.56	$ 0.97

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	250,000	50,000	300,000
Total Shares Available for Issuance	45,951	26,933	72,884

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

	Six Months Ended June 30, 2023		Six Months Ended June 30, 2022	
	Number Restricted Stock Shares	Weighted Average Grant Date Fair Value	Number Restricted Stock Shares	Weighted Average Grand Date Fair Value
Outstanding, beginning of period	5,500	$ 39.91	5,750	$ 39.68
Granted	-	-	-	-
Vested	(250)	34.77	(250)	34.77
Forfeited	-	-	-	-
Outstanding, end of period	5,250	40.15	5,500	39.68

The Company recognized share-based compensation expense of $19 thousand related to restricted stock for the three-month period ended June 30, 2023, and $38 thousand for the six-month period ended June 30, 2023. The Company recognized share-based compensation expense of $19 thousand related to restricted stock for the three-month period ended June 30, 2022, and $38 thousand for the six-month period ended June 30, 2022.

At June 30, 2023, the Company had $89 thousand of unamortized restricted stock compensation expense. The cost of a restricted stock grant is recognized over the vesting period, which is generally three to 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,	
	2023	2022	2023	2022
Service charges on deposits	$ 160	$ 164	$ 326	$ 330
Bankcard fees	298	278	578	541
Bank charges and service fees not within scope of ASC 606	427	311	1,073	482
Total bank charges and service fees	885	753	1,977	1,353
Wealth management revenue	483	492	970	1,028
Wealth management revenue not within the scope of ASC 606	-	-	-	-
Total wealth management revenues	483	492	970	1,028
Other	9	13	20	24
Other not within the scope of ASC 606 (a)	41	519	206	722
Total other	50	532	226	746
Other non-interest income not within the scope of ASC 606 (a)	2,294	4,001	4,170	8,163
Total non-interest income	$ 3,712	$ 5,778	$ 7,343	$ 11,290

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

The Company had no material contract assets or remaining performance obligations as of June 30, 2023. Total receivables from revenue recognized under the scope of ASC 606 were $491 thousand as of June 30, 2023, and $478 thousand as of December 31, 2022. 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, 2023				Six Months Ended June 30, 2023
	Total	Level 1	Level 2	Level 3	Total Gains/(Losses)
ASSETS					
Debt securities available for sale	$ 165,745	$ 24,268	$ 141,477	$ -	$ 12
Loans held for sale	67,228	-	67,228	-	497
Commitments to originate mortgage loans	528	-	528	-	326
Commitments to sell mortgage loans	58	-	58	-	26
Mortgage banking short positions	544	-	544	-	110
Total assets at fair value	$ 234,103	$ 24,268	$ 209,835	$ -	$ 971

	Carrying Value at December 31, 2022				Twelve Months Ended December 31, 2022
	Total	Level 1	Level 2	Level 3	Total Gains/(Losses)
ASSETS					
Debt securities available for sale	$ 174,876	$ 18,036	$ 156,840	$ -	$ -
Loans held for sale	37,764	-	37,764	-	(1,592)
Commitments to originate mortgage loans	205	-	205	-	(1,534)
Commitments to sell mortgage loans	32	-	32	-	20
Mortgage banking short positions	434	-	434	-	437
Total assets at fair value	$ 213,311	$ 18,036	$ 195,275	$ -	$ (2,669)

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.

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, 2023		December 31, 2022	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:					
Cash and cash equivalents	Level 1	$ 16,640	$ 16,640	$ 73,968	$ 73,968
Federal Reserve Bank and Federal Home Loan Bank stock	Level 2	2,938	2,938	3,063	3,063
Gross loans held for investment	Level 2	639,911	621,017	614,668	597,644
Gross loans held for investment (a)	Level 3	-	-	981	674
Accrued interest receivable	Level 2	3,458	3,458	3,312	3,312
		$ 662,947	$ 644,053	$ 695,992	$ 678,661
Liabilities and Stockholders' Equity:					
Deposits, noninterest-bearing	Level 2	$ 181,508	$ 181,508	$ 207,232	$ 207,232
Deposits, interest-bearing	Level 2	622,989	620,972	612,352	610,000
Accrued interest payable	Level 2	451	451	312	312
Guaranteed preferred beneficial interests in Company's subordinated debentures	Level 2	15,000	11,817	15,000	12,760
		$ 819,948	$ 814,748	$ 834,896	$ 830,304
Financial instruments with off-balance-sheet risk:					
Commitments to extend credit	Level 2	$ -	$ 310	$ -	$ 339
Standby and commercial letters of credit	Level 2	$ -	$ 42	$ -	$ 25

(a) Company adopted ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*, on January 1, 2023. As a result of adoption, the Company no longer reports impaired loans. Information on impaired loans as of December 31, 2022 is being provided for comparative purposes.

NOTE 12 – Federal Home Loan Bank Advances

As of June 30, 2023, the Bank had no Federal Home Loan Bank (FHLB) advances outstanding. At June 30, 2023, the Bank had loans with unamortized principal balances of approximately $241.6 million pledged as collateral to the FHLB.

As of December 31, 2022, the Bank had no FHLB advances outstanding. At December 31, 2022, the Bank had loans with unamortized principal balances of approximately $211.0 million pledged as collateral to the FHLB.

As of June 30, 2023, the Bank has the ability to draw advances up to approximately $165.0 million based upon the aggregate collateral that is currently pledged, subject to additional FHLB stock purchase requirements.

NOTE 13 – Other Borrowings

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

June 30, 2023

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	$ 3,300	$ 1,587	$ -	$ 1,587
BNCCORP line	99,919	10,000	-	10,000
Total	$ 103,219	$ 11,587	$ -	$ 11,587

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

At June 30, 2023, the pledged collateral for the secured BNC National Bank line was comprised of commercial real estate loans and the pledged collateral for the secured BNCCORP line is the common stock of BNC National Bank.

December 31, 2022

Unsecured Borrowing Lines:	Line	Outstanding	Available
BNC National Bank lines (1)	$ 39,500	$ -	$ 39,500

Secured Borrowing Lines:	Collateral Pledged	Line	Outstanding	Available
BNC National Bank line	$ 2,050	$ 1,086	$ -	$ 1,086
BNCCORP line	96,959	10,000	-	10,000
Total	$ 99,009	$ 11,086	$ -	$ 11,086

(1) The unsecured BNC National Bank Lines consists of four separate lines with three institutions in individual amounts of $12.5 million, $10 million, $12 million, and $5 million.

At December 31, 2022, the pledged collateral for the secured BNC National Bank line was comprised of commercial real estate loans and the pledged collateral for the secured BNCCORP line is the common stock of BNC National Bank.

NOTE 14 – Guaranteed Preferred Beneficial Interests in Company's Subordinated Debentures

In July 2007, BNCCORP 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, 2023, and December 31, 2022, was 6.58% and 5.14%, 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 National Bank to pay dividends to BNCCORP in excess of the Bank’s net profits from the current year plus retained net profits for the preceding two years.

BNCCORP is required to consult with the Federal Reserve Board prior to declaring a cash dividend to stockholders. On May 3, 2022, BNCCORP’s Board of Directors declared a $1.75 per share special cash dividend that was paid on June 21, 2022. In October of 2021, BNCCORP’s Board of Directors declared a $6.00 per share special cash dividend that was paid on December 15, 2021. In December 2020, BNCCORP’s Board of Directors declared an $8.00 per share special cash dividend that was paid on February 1, 2021.

The Company currently has an outstanding 175,000 share repurchase authorization with no expiration date set on the authorization. No share repurchases have been made under the authorization as of June 30, 2023.Share repurchases can be made through open market purchases, unsolicited and solicited privately negotiated transactions, or in accordance with terms of Rule 10b-18 promulgated under the Securities Exchange Act of 1934. The Company will not repurchase shares from directors or officers of the Company under the authorization. The Company will contemplate share repurchases subject to market conditions and other factors, including legal and regulatory restrictions and required approvals.

NOTE 16 – Regulatory Capital and Current Operating Environment

BNCCORP and BNC National Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet capital requirements mandated by regulators can trigger certain mandatory and discretionary actions by regulators. Such actions, if undertaken, could have a direct material adverse effect on the Company’s financial condition and results of operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, BNCCORP and BNC National 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 may also impose capital requirements that are specific to individual institutions. The requirements are generally above the statutory ratios.

At June 30, 2023, the Company’s 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, 2023, and December 31, 2022, 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, 2023								
Total Risk-Based Capital:								
Consolidated	$ 138,078	16.96 %	$ 65,139	≥8.00 %	$ N/A	N/A %	$ N/A	N/A %
BNC National Bank	120,082	14.76	65,088	≥8.00	81,360	10.00	38,722	4.76
Tier 1 Risk-Based Capital:								
Consolidated	129,078	15.85	48,855	≥6.00	N/A	N/A	N/A	N/A
BNC National Bank	111,081	13.65	48,816	≥6.00	65,088	8.00	45,993	5.65
Common Equity Tier 1 Risk-Based Capital:								
Consolidated	114,078	14.01	36,641	≥4.50	N/A	N/A	N/A	N/A
BNC National Bank	111,081	13.65	36,612	≥4.50	52,884	6.50	58,197	7.15
Tier 1 Leverage Capital:								
Consolidated	129,078	14.03	36,806	≥4.00	N/A	N/A	N/A	N/A
BNC National Bank	111,081	12.08	36,769	≥4.00	45,961	5.00	65,120	7.08
Tangible Common Equity (to total assets): (a)								
Consolidated	102,746	11.05	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	99,839	10.75	N/A	N/A	N/A	N/A	N/A	N/A
December 31, 2022								
Total Risk-Based Capital:								
Consolidated	$ 135,744	17.57%	$ 61,814	≥8.00%	$ N/A	N/A%	$ N/A	N/A%
BNC National Bank	117,267	15.19	61,776	≥8.00	77,219	10.00	40,048	5.19
Tier 1 Risk-Based Capital:								
Consolidated	126,913	16.43	46,360	≥6.00	N/A	N/A	N/A	N/A
BNC National Bank	108,436	14.04	46,332	≥6.00	61,776	8.00	46,660	6.04
Common Equity Tier 1 Risk-Based Capital:								
Consolidated	111,913	14.48	34,770	≥4.50	N/A	N/A	N/A	N/A
BNC National Bank	108,436	14.04	34,749	≥4.50	50,193	6.50	58,243	7.54
Tier 1 Leverage Capital:								
Consolidated	126,913	13.99	36,279	≥4.00	N/A	N/A	N/A	N/A
BNC National Bank	108,436	11.97	36,237	≥4.00	45,297	5.00	63,139	6.97
Tangible Common Equity (to total assets): (a)								
Consolidated	100,246	10.63	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	96,860	10.28	N/A	N/A	N/A	N/A	N/A	N/A

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

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

NOTE 17 – Segment Reporting

The Company determines reportable segments based on the way that management organizes the segments within the Company for making operating decisions, allocating resources, and assessing performance. The Company has determined that it has three reportable segments: Community Banking, Mortgage Banking and Holding Company.

Community Banking
The Community Banking segment serves the needs of businesses and consumers through 11 locations in North Dakota and Arizona. Within this segment, the following products and services are provided: business and personal loans, commercial real estate loans, SBA loans, business and personal checking, savings products, and cash management, as well as trust and wealth management services and retirement plan administration. These products and services are supported through web and mobile based applications. Revenues for community banking consist primarily of interest earned on loans and debt securities, bankcard fees, loan fees, services charges on deposits and fees for wealth management services.

Mortgage Banking
The Mortgage Banking segment originates residential mortgage loans for the primary purpose of sale on the secondary market. The segment consists of both a consumer direct channel located in Kansas utilizing internet leads and a call center to originate residential mortgage loans throughout the United States complemented by a relationship based retail channels. Revenues for mortgage banking consist primarily of interest earned on mortgage loans held for sale, gains on sales of loans, unrealized gains or losses on mortgage financial instruments, and loan origination fees. On June 16, 2023, the Company sold certain operating assets and released certain liabilities to First Federal Bank. As of June 30, 2023, the Company maintained $67.2 million of mortgage loans held for sale and commitments to fund mortgage loans of $56.6 million along with the corresponding hedge positions. The Company anticipates final settlement of the loans and hedge positions will occur during the third quarter of 2023.

Holding Company
The Holding Company segment represents BNCCORP, the parent company of BNC National Bank. Revenue for the Holding Company segment primarily consists of interest earned on cash and cash equivalents and management fees charged to the Community Banking and Mortgage Banking segments for management services. Interest expense for the Holding Company segment consists of interest expense on the Company's subordinated debentures. Non-interest expense for the segment includes parent company costs for certain centralized functions such as corporate administration, accounting, audit, consulting, and governance.

The Company's operating segments are presented based on its management structure and management accounting practices. The structure and practices are specific to the Company and therefore, the financial results of the Company's business segments are not necessarily comparable with similar information for other financial institutions.

	Three Months Ended June 30, 2023				
	Community Banking	**Mortgage Banking**	**Holding Company**	**Intercompany Eliminations (1)**	**BNCCORP Consolidated**
Interest income	$ 10,549	$ 732	$ 31	$ (615)	$ 10,697
Interest expense	2,435	585	249	(615)	2,654
Net interest income (expense)	8,114	147	(218)	-	8,043
Provision for credit losses	165	-	-	-	165
Net interest income after provision for credit losses	7,949	147	(218)	-	7,878
Non-interest Income	1,950	2,172	521	(931)	3,712
Non-interest Expense	6,178	4,845	748	(931)	10,840
Income (loss) before income taxes	3,721	(2,526)	(445)	-	750
Income tax expense (benefit)	907	(626)	(105)	-	176
Net income (loss)	$ 2,814	$ (1,900)	$ (340)	$ -	$ 574
Total Assets at June 30, 2023	$ 860,209	$ 68,521	$ 18,928	$ (17,885)	$ 929,773

	Three Months Ended June 30, 2022				
	Community Banking	**Mortgage Banking**	**Holding Company**	**Intercompany Eliminations (1)**	**BNCCORP Consolidated**
Interest income	$ 7,351	$ 484	$ 4	$ (46)	$ 7,793
Interest expense	330	42	89	(46)	415
Net interest income (expense)	7,021	442	(85)	-	7,378
Credit for credit losses	-	-	-	-	-
Net interest income after credit for credit losses	7,021	442	(85)	-	7,378
Non-interest Income	2,579	3,781	537	(1,119)	5,778
Non-interest Expense	5,905	4,994	750	(1,119)	10,530
Income (loss) before income taxes	3,695	(771)	(298)	-	2,626
Income tax expense (benefit)	878	(191)	(70)	-	617
Net income (loss)	$ 2,817	$ (580)	$ (228)	$ -	$ 2,009
Total Assets at June 30, 2022	$ 848,102	$ 69,614	$ 6,040	$ (5,097)	$ 918,659

(1) Intercompany eliminations remove internal shared service costs for intercompany use of funds to originate mortgage loans held for sale and costs related to internal services rendered to segments by centralized function of the Company such as administration, audit, accounting, compliance, governance, consulting and technology expense.

	Six Months Ended June 30, 2023				
	Community Banking	Mortgage Banking	Holding Company	Intercompany Eliminations (1)	BNCCORP Consolidated
Interest income	$ 20,400	$ 1,130	$ 51	$ (878)	$ 20,703
Interest expense	3,789	828	480	(878)	4,219
Net interest income (expense)	16,611	302	(429)	-	16,484
Provision for credit losses	405	-	-	-	405
Net interest income after provision for credit losses	16,206	302	(429)	-	16,079
Non-interest Income	4,177	4,019	1,071	(1,924)	7,343
Non-interest Expense	12,689	8,459	1,522	(1,924)	20,746
Income (loss) before income taxes	7,694	(4,138)	(880)	-	2,676
Income tax expense (benefit)	1,862	(1,026)	(207)	-	629
Net income (loss)	$ 5,832	$ (3,112)	$ (673)	$ -	$ 2,047
Total Assets at June 30, 2022	$ 860,209	$ 68,521	$ 18,928	$ (17,885)	$ 929,773

	Six Months Ended June 30, 2022				
	Community Banking	Mortgage Banking	Holding Company	Intercompany Eliminations (1)	BNCCORP Consolidated
Interest income	$ 14,203	$ 933	$ 8	$ (50)	$ 15,094
Interest expense	667	42	148	(50)	807
Net interest income (expense)	13,536	891	(140)	-	14,287
Credit for credit losses	(550)	-	-	-	(550)
Net interest income after credit for credit losses	14,086	891	(140)	-	14,837
Non-interest Income	4,493	7,921	1,048	(2,172)	11,290
Non-interest Expense	12,022	10,262	1,463	(2,172)	21,575
Income (loss) before income taxes	6,557	(1,450)	(555)	-	4,552
Income tax expense (benefit)	1,559	(359)	(130)	-	1,070
Net income (loss)	$ 4,998	$ (1,091)	$ (425)	$ -	$ 3,482
Total Assets at June 30, 2021	$ 848,102	$ 69,614	$ 6,040	$ (5,097)	$ 918,659

(1) Intercompany eliminations remove internal shared service costs for intercompany use of funds to originate mortgage loans held for sale and costs related to internal services rendered to segments by centralized function of the Company such as administration, audit, accounting, compliance, governance, consulting and technology expense.

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

References to "BNCCORP" or "the Company" refer to BNCCORP, INC. and its consolidated subsidiaries, collectively; references to "the Bank" only refer to BNC National Bank. Where not otherwise indicated below, financial condition and results of operations discussed are of BNCCORP, INC.

Comparison of Results for the Three Months Ended June 30, 2023, and 2022

The Community Banking Segment reported net income of $2.8 million, or 0.79 per diluted share, unchanged from the second quarter of 2022. The second quarter of 2023 produced higher net interest income and bank charges and service fees that were offset by lower gains on sales of loans, other income and higher provision for credit losses and non-interest expense compared to the same period of 2022.

The Mortgage Banking Segment reported a net loss of $1.9 million in the second quarter of 2023 compared to a net loss of $580 thousand in the 2022 period. The decrease was driven by a reduction in the mortgage segment revenues to $2.3 million in the second quarter of 2023 versus $4.2 million in the same prior-year period. Non-interest expenses related to mortgage operations decreased by $149 thousand year-over-year, as the Company recorded $1.4 million of expenses associated with the sale of certain assets to and assumption of certain operating liabilities by First Federal Bank on June 16, 2023. The $1.4 million charge was comprised of a $570 thousand accrual for costs to originate and sell the remaining commitments to fund loans, $360 thousand for employee severance costs, $238 thousand for write-downs of fixed asset and contract costs, and $270 thousand for other professional services related to the transaction close. As of June 30, 2023, the Company maintained $67.2 million of mortgage loans held for sale and future commitments to fund mortgage loans of $56.6 million along with the corresponding hedge positions. The Company anticipates final settlement of the loans and hedge positions will occur during the third quarter of 2023.

Consolidated net interest income for the second quarter of 2023 was $8.0 million, an increase of $665 thousand, or 9.0%, up from $7.4 million in the second quarter of 2022. Net interest margin increased to 3.68% in the 2023 second quarter from 3.31% in the year-earlier period. The Community Banking Segment reported a year-over-year increase of $1.1 million, or 15.5%, from $7.0 million in 2022 to $8.1 million in 2023. The increase was primarily driven by growth in loans held for investment and overall higher yields that were partially offset by an increase in the cost of deposits.

On a consolidated basis, second quarter interest income increased 37.3%, from $7.8 million to $10.7 million. This increase improved the yield on average interest-earning assets substantially in the second quarter of 2023, growing to 4.90% compared to 3.50% in the 2022 second quarter. The Community Banking Segment reported interest income of $10.5 million in the second quarter of 2023 compared to $7.4 million for the 2022 quarter. The increase was the result of higher yields on interest-earning assets and an $83.8 million quarter-over-quarter increase in the average balance of loans held for investment and higher yields on cash and debt securities. It is noteworthy that the Company's variable rate assets have continued to re-price in step with interest rate movements by the Federal Reserve. Furthermore, the Company is receiving higher yields on new loan originations.

Consolidated interest expense in the second quarter of 2023 was $2.7 million, an increase of $2.2 million from the 2022 period. The cost of core deposits in the second quarters of 2023 and 2022 was 1.20% and 0.16%, respectively. Within the Community Banking Segment, the 2023 second quarter average balance of deposits decreased by $4.7 million when compared to second quarter of 2022. The cost of interest-bearing liabilities was 1.54% during the second quarter of 2023, compared to 0.21% in the same period of 2022. The Company continues to actively manage its overall cost of deposits well below the prevailing brokered deposit rates offered by national brokerage firms while staying focused on maintaining strong liquidity levels.

As of June 30, 2023, credit metrics remained stable with $1.5 million of nonperforming assets, representing a 0.16% nonperforming assets-to-total-assets ratio. These results are comparable to the $1.4 million in nonperforming assets, a 0.15% ratio of nonperforming assets-to-total-assets held on December 31, 2022. The Company recorded a $165 thousand provision for credit losses in the second quarter of 2023 compared to no provision in the second quarter of 2022. The allowance for credit losses decreased slightly to 1.40% of loans held for investment on June 30, 2023, from 1.43% on December 31, 2022.

Non-interest income for the Community Banking Segment during the second quarter of 2023 was $2.0 million, compared to $2.6 million in the 2022 second quarter. Bank charges and service fees were $132 thousand higher quarter-over-quarter due to higher letter of credit fees and from the movement of deposits to one-way sell positions. Fees derived from the movement of deposits off the balance sheet began late in the first quarter of 2022 and can fluctuate significantly based on our customer's use of their excess funding. The Company experienced a significant decrease in the level of off-balance sheet deposits during the second quarter of 2023. As of June 30, 2023, off-balance sheet deposits amounted to $4.8 million compared to $187.5 million as of June 30, 2022. Through the use of an associated banking network, the Company is able to generate fee income on deposits that are not otherwise deployed. The deposits are placed with another financial institution by the associated banking network to meet their liquidity needs, but can be reclaimed for future liquidity use by the Company at any time. Gains on sales of loans decreased period-over-period by $217 thousand as the premiums available on sale of the guaranteed portion of SBA loans has become less attractive in recent quarters. Other income decreased by $528 thousand when comparing the second quarter of 2023 to 2022 as the Company recorded gains on the sale of the Golden Valley, MN location in the second quarter of 2022.

Non-interest expense for the Community Banking Segment during the second quarter of 2023 increased $273 thousand, or 4.6%, to $6.2 million from $5.9 million in the second quarter of 2022. The increase is primarily due to higher salary, data processing, and occupancy expenses. These higher costs reflect normal inflationary increases as well as assuming a greater percentage of shared service costs because of significantly reduced mortgage banking operations compared to the prior year period. Shared service costs will continue to increase in the Community Banking Segment as the Mortgage Banking Segment winds-down.

In the second quarter of 2023, income tax expense on a consolidated basis was $176 thousand, compared to $617 thousand in the second quarter of 2022. The effective tax rate was 23.5% in the second quarter of 2023, unchanged from the same period of 2022.

Tangible book value per common share on June 30, 2023, was $28.87, compared to $28.19 at December 31, 2022. The increase in tangible book value per common share was driven by increased retained earnings and positive adjustments to the tax-effected fair value of debt securities available for sale as evidenced in the reduction of accumulated other comprehensive losses. The Company's tangible common equity capital ratio was 11.05% on June 30, 2023, compared to 10.63% on December 31, 2022.

Comparison of Results for the Six Months Ended June 30, 2023, and 2022

The Community Banking Segment reported net income of $5.8 million in the first six months of 2023, compared to $5.0 million in the same period of 2022. In the first six months, earnings per diluted share was $1.63 versus $1.40 in the first six months of 2022. The first half of 2023 produced higher net interest income and higher bank charges and service fees compared to the same period of 2022. These results were offset by lower wealth management revenue, gains on sale of loans, other income and an increased provision for credit losses and higher non-interest expense when compared to the 2022 period.

The Mortgage Banking Segment reported a net loss of $3.1 million in the first six months of 2023 compared to a net loss of $1.1 million in the same period of 2022. The decrease was driven by a reduction in mortgage segment revenues to $4.3 million in the first half of 2023 versus $8.8 million in the prior-year period. Non-interest expenses related to mortgage operations decreased by $1.8 million year-over-year, which included $1.4 million of expenses associated with the sale of certain assets to and assumption of certain operating liabilities by First Federal Bank on June 16, 2023.

Consolidated net interest income in the first half of 2023 was $16.5 million, an increase of $2.2 million, or 15.4%, from $14.3 million in the first half of 2022. Net interest margin increased to 3.83% in the 2023 six-month period from 3.05% in the year-earlier period. The Community Banking Segment reported a year-over-year increase of $3.1 million, or 22.7%, from $13.5 million in first half of 2022 to $16.6 million in the comparable 2023 period. The increase was primarily driven by growth in loans held for investment and overall higher yields that were partially offset by an increase in the cost of deposits.

On a consolidated basis, interest income increased by $5.6 million, or 37.2%, to $20.7 million for the six-month period of 2023, compared to $15.1 million in the six-month period of 2022. For the same periods, the yield on average interest-earning assets improved significantly to 4.81% in the first half of 2023, compared to 3.22% in the 2022 first half. The Community Banking Segment reported interest income of $20.4 million in the 2023 first half compared to $14.2 million in the 2022 first half, an increase of $6.2 million, or 43.6%. The increase is the result of higher yields on interest-earning assets and an $88.9 million increase in average balances of loans held for investment. It is noteworthy that the Company's variable rate assets have continued to re-price in step with interest rate movements by the Federal Reserve and the Company is receiving higher yields on new loan originations.

Consolidated interest expense in the first half of 2023 was $4.2 million, an increase of $3.4 million from the 2022 period. The cost of core deposits in the first six months of 2023 and 2022 was 0.94% and 0.15%, respectively. Within the Community Banking Segment, the average balance of deposits decreased by $60.5 million when compared to the first half of 2022. The primary driver of the decrease in average balances was the movement of deposits off the balance sheet at the end of the first quarter of 2022 through the use of an associated banking network. The cost of interest-bearing liabilities was 1.22% during the first six months of 2023, compared to 0.20% in the same period of 2022. The Company continues to actively manage its overall cost of deposits well below the prevailing brokered deposit rates offered by national brokerage firms while staying focused on maintaining liquidity.

The Company recorded a $405 thousand provision for credit losses in the first six months of 2023. By comparison, the Company credited provision expense to release $550 thousand of its allowance for credit losses in the first six months of 2022 as pandemic risks subsided. The allowance for credit losses decreased slightly to 1.40% of loans held for investment on June 30, 2023, compared to 1.43% on December 31, 2022.

The Company adopted ASU 2016-13, *Measurement of Credit Losses on Financial Instruments*, on January 1, 2023, and applied the standard as a cumulative effect adjustment to retained earnings. At adoption, the Company recorded a $125 thousand increase to the allowance for credit losses, which was comprised of a $64 thousand decrease in the allowance for loan losses and a $189 thousand increase to the allowance for unfunded commitments. The after-tax impact resulted in a $94 thousand decrease to retained earnings. The tax effect resulted in an increase to deferred tax assets.

Non-interest income for the Community Banking Segment in first six months of 2023 was $4.2 million, compared to $4.5 million in the first six months of 2022. The decrease was driven by a reduction in wealth management revenues, gains on sale of loans, and other income that were partially offset by increased bank charges and services fees. Wealth management revenues decreased $81 thousand, or 7.0%, largely due to the mix of fees associated with more conservative investment vehicles. During 2023, the Company has seen increases in assets under administration from new investments in U.S. Treasury securities. Assets under administration were $380.4 million at June 30, 2023 compared to $346.4 million at June 30, 2022. Gains on sales of loans decreased period-over-period by $229 thousand as the premiums earned on sale of the guaranteed portion of SBA loans has become less attractive in recent quarter. Other income decreased by $638 thousand when comparing the second quarter of 2023 to 2022 as the Company recorded gains on the sale of the Golden Valley, MN location in the second quarter of 2022. Bank charges and service fees were $624 thousand higher in the first six months of 2023 due to higher letter of credit fees and from the movement of deposits to one-way sell positions.

Non-interest expense for the Community Banking Segment increased $667 thousand, or 5.5%, to $12.7 million from $12.0 million in the first half of 2022. The increase is primarily due to higher salary, marketing, and other expenses being partially offset by lower regulatory costs and depreciation expense. These higher costs reflect normal inflationary increases as well as assuming a greater percentage of shared service costs because of significantly reduced mortgage banking operations compared to the prior year period. Shared service costs will continue to increase in the Community Banking Segment as the Mortgage Banking Segment winds-down.

During the six-month period ended June 30, 2023, income tax expense on a consolidated basis was $629 thousand, compared to $1.1 million in the first half of 2022. The effective tax rate was 23.5% in the first half of 2023 unchanged from the same period of 2022.

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,								
	2023			2022			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									
Cash and cash equivalents	$ 27,829	$ 358	5.15%	$ 105,465	$ 215	0.82%	$ (77,636)	$ 143	4.33% (a)
FHLB Stock	1,131	8	3.01%	1,264	10	3.02%	(133)	(2)	-0.01%
Federal Reserve Stock	1,807	28	6.10%	1,807	27	6.10%	-	1	0.00%
Debt securities – taxable	170,176	1,361	3.21%	191,043	980	2.06%	(20,867)	381	1.15% (b)
Debt securities – tax exempt	-	-	0.00%	5,904	57	3.92%	(5,904)	(57)	-3.92% (b)
Loans held for sale – mortgage banking	53,857	732	5.45%	50,196	480	3.84%	3,661	252	1.61%
Loans held for investment	629,712	8,210	5.23%	545,953	6,024	4.43%	83,759	2,186	0.80% (c)
Allowance for loan losses	(8,922)	-	0.00%	(8,484)	-	0.00%	(438)	-	0.00%
Total interest-earning assets	$ 875,590	$ 10,697	4.90%	$ 893,148	$ 7,793	3.50%	$ (17,558)	$ 2,904	1.40%
Interest-bearing liabilities									
Interest checking and money market	$ 516,489	$ 2,238	1.74%	$ 506,920	$ 251	0.20%	$ 9,569	$ 1,987	1.54% (d)
Savings	48,099	13	0.11%	51,396	5	0.04%	(3,297)	8	0.07% (d)
Certificates of deposit	54,150	154	1.14%	66,549	69	0.42%	(12,399)	85	0.72% (e)
Total interest-bearing deposits	618,738	2,405	1.56%	624,865	325	0.21%	(6,127)	2,080	1.35%
Short-term borrowings	211	-	5.64%	269	-	0.30%	(58)	-	5.34%
Federal Home Loan Bank advances	1	-	5.32%	197	1	1.24%	(196)	(1)	4.08%
Subordinated debentures	15,000	249	6.67%	15,001	89	2.38%	(1)	160	4.29%
Total borrowings	15,212	249	6.57%	15,467	90	2.33%	(255)	159	4.23%
Total interest-bearing liabilities	$ 633,950	2,654	1.68%	$ 640,332	415	0.26%	$ (6,382)	2,239	1.42%
Net interest income/spread		$ 8,043	3.22%		$ 7,378	3.24%		$ 665	-0.02%
Net interest margin			3.68%			3.31%			0.37% (f)
Notation:									
Non-interest-bearing deposits	$ 185,973	-	0.00%	$ 192,026	-	0.00%	$ (6,053)	-	0.00% (d)
Total deposits	$ 804,711	$ 2,405	1.20%	$ 816,891	$ 325	0.16%	$ (12,180)	$ 2,080	1.04%
Taxable equivalents:									
Total interest-earning assets	$ 875,588	$ 10,732	4.92%	$ 893,147	$ 7,843	3.52%	$ (17,559)	$ 2,889	1.40%
Net interest income/spread	-	$ 8,078	3.24%	-	$ 7,428	3.26%	-	$ 650	-0.02%
Net interest margin	-	-	3.70%	-	-	3.34%	-	-	0.36%

(a) Cash balances decreased as the Company was able to move deposit balances off the balance sheet at the end of the first quarter of 2022 through the use of an associated banking network and utilized cash for loan growth. Yields on cash have increased due to rate increases by the Federal Reserve.

(b) The average balance of debt securities decreased as the Company is utilizing the cash flow from the portfolio to provide liquidity for loan growth.

(c) The increase in average loans held for investment is due to the significant loan growth produced by the Company during 2022 that continued through the first half of 2023.

(d) Overall, average deposit balances decreased as the Company began moving deposits off the balance sheet at the end of the first quarter of 2022 through the use of an associated banking network.

(e) The Company continues to actively manage a reduction in certificates of deposit.

(f) Yields on interest earning assets have increased as the Federal Reserve continues to drive rates higher. Cost of liabilities has increased from market competition for deposits along with higher variable rate subordinate debentures.

	Six Months Ended June 30,								
	2023			2022			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									
Cash and cash equivalents	$ 33,998	$ 793	4.70%	$ 158,281	$ 302	0.38%	$ (124,283)	$ 491	4.32% (a)
FHLB Stock	1,201	18	3.04%	1,276	19	3.01%	(75)	(1)	0.03%
Federal Reserve Stock	1,807	54	6.05%	1,807	54	6.05%	-	-	0.00%
Debt securities – taxable	171,303	2,718	3.20%	194,514	1,933	2.00%	(23,211)	785	1.20% (b)
Debt securities – tax exempt	1,568	19	3.71%	6,120	115	3.80%	(4,552)	(96)	-0.09% (b)
Loans held for sale – mortgage banking	41,492	1,130	5.49%	55,072	905	3.31%	(13,580)	225	2.18% (c)
Loans held for investment	626,507	15,971	5.14%	537,622	11,766	4.41%	88,885	4,205	0.73% (d)
Allowance for loan losses	(8,844)	-	0.00%	(8,762)	-	0.00%	(82)	-	0.00%
Total interest-earning assets	$ 869,032	$ 20,703	4.81%	$ 945,930	$ 15,094	3.22%	$ (76,898)	$ 5,609	1.59%
Interest-bearing liabilities									
Interest checking and money market	$ 502,764	$ 3,478	1.40%	$ 555,069	$ 493	0.18%	$ (52,305)	$ 2,985	1.22% (e)
Savings	50,517	24	0.09%	51,088	10	0.04%	(571)	14	0.05% (e)
Certificates of deposit	53,933	231	0.86%	69,554	155	0.45%	(15,621)	76	0.41% (f)
Total interest-bearing deposits	607,214	3,733	1.24%	675,711	658	0.20%	(68,497)	3,075	1.04%
Short-term borrowings	274	-	3.74%	253	-	0.30%	21	-	3.44%
Federal Home Loan Bank advances	227	6	4.87%	198	1	0.62%	29	5	4.25%
Subordinated debentures	15,000	480	6.45%	15,001	148	1.99%	(1)	332	4.46%
Total borrowings	15,501	486	6.32%	15,452	149	1.94%	49	337	4.38%
Total interest-bearing liabilities	$ 622,715	4,219	1.37%	$ 691,163	807	0.24%	$ (68,448)	3,412	1.13%
Net interest income/spread		$ 16,484	3.44%		$ 14,287	2.98%		$ 2,197	0.46%
Net interest margin			3.83%			3.05%			0.78% (g)
Notation:									
Non-interest-bearing deposits	$ 190,994	-	0.00%	$ 190,183	-	0.00%	$ 811	-	0.00% (e)
Total deposits	$ 798,208	$ 3,733	0.94%	$ 865,894	$ 658	0.15%	$ (67,686)	$ 3,075	0.79%
Taxable equivalents:									
Total interest-earning assets	$ 868,502	$ 20,782	4.83%	$ 945,929	$ 15,195	3.24%	$ (77,427)	$ 5,587	1.59%
Net interest income/spread	-	$ 16,563	3.46%	-	$ 14,389	3.00%	-	$ 2,174	0.46%
Net interest margin	-	-	3.85%	-	-	3.07%	-	-	0.78%

(a) Cash balances decreased as the Company was able to move deposit balances off the balance sheet at the end of the first quarter of 2022 through the use of an associated banking network and the utilization of cash for loan growth. Yields on cash increased with rate increases by the Federal Reserve.

(b) The average balance of debt securities decreased as the Company is utilizing the cash flow from the portfolio to provide liquidity for loan growth.

(c) The average balance of loans held for sale decreased as mortgage origination activity during the first six months of 2023 was significantly lower when compared to first six months of 2022 due to significant rate increases that continued during 2022.

(d) The increase in average loans held for investment is due to the significant loan growth produced by the Company during 2022 and continuing through the second quarter of 2023.

(e) Overall, average deposit balances decreased as the Company continued moving deposits off the balance sheet beginning at the end of the first quarter of 2022 through the use of an associated banking network.

(f) The Company continues to actively manage a reduction in certificates of deposit.

(g) Yields on interest earning assets have increased as the Federal Reserve continues to drive rates higher. Cost of liabilities has increased from market competition for deposits along with higher variable rate subordinate debentures.

Non-interest Income

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

	Three Months Ended June 30,		Increase (Decrease)		Six Months Ended June 30,		Increase (Decrease)		
	2023	2022	$	%	2023	2022	$	%	
Bank charges and service fees	$ 885	$ 753	$ 132	18 %	$ 1,977	$ 1,353	$ 624	46 %	(a)
Wealth management revenues	483	492	(9)	(2)	970	1,028	(58)	(6)	(b)
Mortgage banking revenues	2,292	3,782	(1,490)	(39)	4,148	7,924	(3,776)	(48)	(c)
Gains on sales of loans, net	2	219	(217)	(99)	10	239	(229)	(96)	(d)
Gains on sales of debt securities, net	-	-	-	-	12	-	12	100	(e)
Other	50	532	(482)	(91)	226	746	(520)	(70)	(f)
Total non-interest income	$ 3,712	$ 5,778	$ (2,066)	(36) %	$ 7,343	$ 11,290	$ (3,947)	(35) %	

(a) Bank charges and services fees increased due to increased fees associated with issuances of letters of credit and fees earned from the movement of deposits to a one-way sell position.
(b) Wealth management revenues decreased despite healthy growth in new assets largely due to the mix of fees associated with more conservative investment vehicles.
(c) Mortgage banking revenues decreased as the industry has been negatively impacted by higher interest rates and higher home values.
(d) Gains on sales of loans decreased as the premiums earned on the sale of the guaranteed portion of SBA loans has become less attractive in recent quarter.
(e) Gains on sales of debt securities may vary significantly from period to period as the Company manages its risk and return profile through changing economic conditions.
(f) The decrease in other income is primarily due to the company recording a gain on the sale of the Golden Valley, MN location in the second quarter of 2022.

Non-interest Expense

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

	Three Months Ended June 30,		Increase (Decrease)		Six Months Ended June 30,		Increase (Decrease)		
	2023	2022	$	%	2023	2022	$	%	
Salaries and employee benefits	$ 5,061	$ 5,219	$ (158)	(3) %	$ 10,004	$ 11,160	$ (1,156)	(10) %	(a)
Professional services	1,689	966	723	75	2,586	1,916	670	35	(b)
Data processing fees	1,064	998	66	7	2,053	1,971	82	4	
Marketing and promotion	1,360	1,437	(77)	(5)	2,729	2,792	(63)	(2)	
Occupancy	482	527	(45)	(9)	994	1,110	(116)	(10)	(c)
Regulatory costs	94	121	(27)	(22)	200	240	(40)	(17)	(d)
Depreciation and amortization	284	306	(22)	(7)	577	617	(40)	(6)	(e)
Office supplies and postage	132	107	25	23	228	217	11	5	
Other	674	849	(175)	(21)	1,375	1,552	(177)	(11)	(f)
Total non-interest expense	$ 10,840	$ 10,530	$ 310	3 %	$ 20,746	$ 21,575	$ (829)	(4) %	
Efficiency ratio	92.2%	80.0%			87.1%	84.4%			

(a) Salaries and employee benefits expense decreased primarily due to a reduction of staff within the mortgage banking segment.
(b) Professional services expense increased due to recording $840 thousand of one-time expenses related to the Company's exit from the mortgage business, which was partially offset by lower mortgage operating costs.
(c) Occupancy expense decreased due to fewer locations within the mortgage banking segment.
(d) Regulatory costs decreased primarily due to lower average asset balances.
(e) Depreciation and amortization expense decreased as groups of depreciable assets completed their estimated useful life.
(f) Other expense decreased primarily due decreased travel expense, insurance costs, and director's fees.

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 (dollars in thousands).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2023	2022	2023	2022
Number of funded mortgage loans held for sale	584	718	922	1,478
Mortgage loans held for sale funded	$ 257,421	$ 294,064	$ 395,048	$ 594,307
Average loans held for sale-mortgage banking	$ 53,857	$ 50,196	$ 41,492	$ 55,072
Loans held for sale-mortgage banking	$ 67,228	$ 65,616	$ 67,228	$ 65,616
Non-Interest Income:				
Gains on sale of loans held for sale, net of commission expense	$ 2,052	$ 4,169	$ 3,189	$ 8,567
Change in fair value of mortgage banking instruments (1)	$ 240	$ (387)	$ 959	$ (643)

(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 retail bank branches and retail mortgage locations. The consumer direct channel is a nationwide mortgage platform operating from Overland Park, Kansas, which uses a call center with internet sales focused on both purchase and refinance transactions.

Beginning in 2022 and continuing through the first quarter of 2023, the Company's mortgage business was negatively affected by higher interest rates and higher home values which negatively impacted both purchase and refinance originations. This trend witnessed by the Company is consistent with overall performance of the industry.

On June 16, 2023 BNCCORP, INC. executed on the previously announced transaction with First Federal Bank (First Federal) under which First Federal purchased certain operating assets and assumed certain liabilities of BNC National Bank's mortgage division as part of the Company's strategic decision to exit the residential mortgage origination business. As of June 30, 2023, the Company maintained $67.2 million of mortgage loans held for sale and future commitments to fund mortgage loans of $56.6 million along with the corresponding hedge positions. The Company anticipates final settlement of the loans and hedge positions will occur during the third quarter of 2023.

Income Taxes

In the second quarter of 2023, income tax expense on a consolidated basis was $176 thousand, compared to $617 thousand in the second quarter of 2022. The effective tax rate was 23.5% in the second quarter of 2023, unchanged from the same period of 2022.

During the six-month period ended June 30, 2023, income tax expense on a consolidated basis was $629 thousand, compared to $1.1 million in the first half of 2022. The effective tax rate was 23.5% in the first half of 2023 unchanged from the same period of 2022.

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Comparison of Financial Condition at June 30, 2023 and December 31, 2022

Assets

The following table presents the Company's assets by category (dollars are in thousands):

	June 30, 2023	December 31, 2022	Increase (Decrease) $	Increase (Decrease) %	
Cash and cash equivalents	$ 16,640	$ 73,968	$ (57,328)	(78) %	(a)
Debt securities available for sale	165,745	174,876	(9,131)	(5)	(b)
Federal Reserve Bank and Federal Home Loan Bank stock	2,938	3,063	(125)	(4)	
Loans held for sale-mortgage banking	67,228	37,764	29,464	78	(c)
Loans held for investment, net	640,989	616,645	24,344	4	(d)
Allowance for credit losses	(9,000)	(8,831)	(169)	2	
Premises and equipment, net	11,247	11,764	(517)	(4)	
Operating lease right of use asset	867	1,521	(654)	(43)	(e)
Accrued interest receivable	3,458	3,312	146	4	
Other assets	29,661	29,239	422	1	
Total assets	$ 929,773	$ 943,321	$ (13,548)	(1) %	

(a) Cash balances decreased as the Company experienced normal seasonal reductions in deposits and utilized cash to fund loans.
(b) Debt securities available for sale decreased as the Company is utilizing the cash flow from the portfolio to provide liquidity for loan growth.
(c) Loans held for sale increased as mortgage origination activity continued to fluctuate with rate movements during the first half of 2023.
(d) Loans held for investment increased as the Company continues to experience organic growth in core markets.
(e) Decrease is primarily due to the assumption of the Company's Overland Park lease by First Federal Bank as a part of the mortgage transaction on June 16, 2023.

Loan Participations

Pursuant to the Company's 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 $121.3 million as of June 30, 2023, and $123.7 million as of December 31, 2022. 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, 2023		December 31, 2022	
North Dakota	$ 402,683	63 %	$ 390,006	63 %
Arizona	125,362	20	115,767	19
Minnesota	29,890	5	29,676	5
Other	81,976	12	80,200	13
Total gross loans held for investment	$ 639,911	100 %	$ 615,649	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, 2023			December 31, 2022		
North Dakota	$	375,819	59 %	$	362,354	59 %
Arizona		150,697	23		149,973	24
South Dakota		23,843	4		16,088	3
California		23,738	4		22,154	4
Minnesota		16,368	2		15,248	2
Colorado		10,598	2		13,245	2
Montana		9,317	1		4,521	1
Ohio		6,529	1		6,725	1
Texas		6,214	1		7,086	1
Other		16,788	3		18,255	3
Total gross loans held for investment	$	636,911	100 %	$	615,649	100 %

BNC's loans held for investment are concentrated geographically in North Dakota and Arizona which comprise 59% and 23% of the Company's total loan portfolio, respectively. The North Dakota economy is influenced by the energy and agriculture industries. Energy supply and demand factors have recently increased oil prices, benefiting the oil industry and ancillary services. Legislation and economic conditions remain potential risks to energy markets and production activity and could present potential challenges to credit quality in North Dakota. The Arizona economy is influenced by the leisure and travel industries. Positive trends in both industries have been noted, but 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 the Company manages meaningful concentrations of loans in hospitality and commercial real estate.

The following table approximately describes the Company's concentrations by industry as of June 30, 2023 and December 31, 2022, respectively (dollars are in thousands):

	June 30, 2023			December 31, 2022		
Non-owner occupied commercial real estate – not otherwise categorized	$	197,700	31 %	$	177,674	29 %
Hotels		78,509	12		91,388	15
Consumer, not otherwise categorized		91,507	14		85,648	14
Retail trade		35,597	6		36,607	6
Healthcare and social assistance		32,741	5		33,327	5
Agriculture, forestry, fishing and hunting		31,003	5		30,641	5
Transportation and warehousing		25,158	4		23,951	4
Non-hotel accommodation and food service		23,903	4		21,538	4
Mining, oil and gas extraction		23,152	4		22,480	4
Art, entertainment and recreation		19,352	3		19,024	3
Construction contractors		15,301	2		11,124	2
Other service		12,699	2		11,810	2
Professional, scientific, and technical services		9,447	2		8,209	1
Real estate and rental and leasing support services		8,449	1		9,233	1
Public administration		8,137	1		8,316	1
Manufacturing		8,182	1		7,572	1
Finance and insurance		6,611	1		5,022	1
Educational services		4,334	1		4,435	1
All other		8,129	1		7,650	1
Gross loans held for investment	$	639,911	100 %	$	615,649	100 %

The Company's loans within the hospitality industry have shown signs of improved credit quality that are reflected by hotel occupancy and restaurant utilization trends. Hotel operators in the Company's loan portfolio are reporting positive trends, and in some cases stronger balance sheets. Despite these positive indications, labor shortages limit the ability of the industry to fully capitalize on these trends and the potential for inflationary impacts on travel and leisure activities continue to be closely monitored.

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, 2023 (in thousands):

		Over 1 Year Through 5 Years		Over 5 Years		
	One Year or Less	**Fixed Rate**	**Indexed Rate**	**Fixed Rate**	**Indexed Rate**	**Total Loans Held for Investment**
Commercial and industrial	$ 23,738	$ 23,038	$ 2,188	$ 62,421	$ 95,283	$ 206,668
Commercial real estate	1,304	21,478	9,416	27,645	172,379	232,222
SBA	953	166	107	3,624	51,012	55,862
Consumer	395	5,251	4,730	73,690	18,410	102,476
Land and land development	1,423	2,812	105	205	3,317	7,862
Construction	2,499	211	12,410	5,828	13,873	34,821
Total principal amount of loans	$ 30,312	$ 52,956	$ 28,956	$ 173,413	$ 354,274	$ 639,911

(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 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, 2023		December 31, 2022	
	Allocation of Allowance	**Loans as a % of Gross Loans Held for Investment**	**Allocation of Allowance**	**Loans as a % of Gross Loans Held for Investment**
Commercial and industrial	$ 3,264	32 %	$ 2,519	33 %
Commercial real estate	3,276	36	3,621	37
SBA	892	9	1,396	8
Consumer	1,006	16	982	16
Land and land development	126	1	87	2
Construction	436	6	226	4
Total	$ 9,000	100 %	$ 8,831	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,	
	2023	2022	2023	2022
Balance, beginning of period	$ 1,469	$ 1,466	$ 1,355	$ 1,673
Additions to nonperforming	121	-	332	73
Charge-offs	(80)	-	(87)	(47)
Reclassified back to performing	-	-	(1)	(165)
Principal payment received	(45)	(45)	(119)	(113)
Transferred to repossessed assets	(31)	(15)	(46)	(15)
Balance, end of period	$ 1,434	$ 1,406	$ 1,434	$ 1,406

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, 2023	December 31, 2022
Nonperforming loans:		
Loans 90 days or more delinquent and still accruing interest	$ -	$ 1
Non-accrual loans	1,434	1,354
Total nonperforming loans	$ 1,434	$ 1,355
Repossessed assets, net	42	64
Total nonperforming assets	$ 1,476	$ 1,419
Allowance for credit losses	$ 9,000	$ 8,831
Ratio of total nonperforming loans to total loans	0.20%	0.21%
Ratio of total nonperforming loans to loans held for investment	0.22%	0.22%
Ratio of total nonperforming assets to total assets	0.16%	0.15%
Ratio of nonperforming loans to total assets	0.15%	0.14%
Ratio of allowance for credit losses to nonperforming loans	628%	652%

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			Doubtful
	Impaired(1)	Other	Total	Impaired(1)	Other	Total	Impaired(1)
June 30, 2023	$ -	$ 2,552	$ 2,552	$ -	$ 4,013	$ 4,013	$ 963
December 31, 2022	-	2,472	2,472	336	2,262	2,598	1,018

(1) The Company adopted ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*, on January 1, 2023. As a result of adoption, the Company is no longer required to provide information on impaired loans. Information on impaired loans as of December 31, 2022 is being provided for comparative purposes.

At June 30, 2023, the Bank had $5.0 million of classified loans and $1.4 million of loans on non-accrual. This compares to $3.6 million of classified loans and $1.4 million of loans on non-accrual at December 31, 2022, and $3.7 million of classified loans and $1.4 million of loans on non-accrual at June 30, 2022.

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

Liabilities

The following table presents the Company's liabilities (dollars are in thousands):

	June 30, 2023	December 31, 2022	Increase (Decrease) $	Increase (Decrease) %	
Deposits:					
Non-interest-bearing	$ 181,508	$ 207,232	$ (25,724)	(12) %	(a)
Interest-bearing-					
Savings, interest checking and money market	563,878	554,577	9,301	2	(a)
Time deposits	59,111	57,775	1,336	2	
Guaranteed preferred beneficial interests in Company's subordinated debentures	15,000	15,000	-	-	
Accrued interest payable	451	312	139	45	(b)
Accrued expenses	4,987	5,482	(495)	(9)	(c)
Operating lease liabilities	986	1,660	(674)	(41)	(d)
Other liabilities	1,026	937	89	9	(e)
Total liabilities	$ 826,947	$ 842,975	$ (16,028)	(2) %	

(a) Deposits decreased as the Company witnessed normal levels of seasonal deposit fluctuations during the second quarter of 2023.
(b) Accrued interest payable increased primarily due to increased cost of deposits and subordinate debentures.
(c) Accrued expenses decreased due to the payout of incentive accruals, reduction in 401k matching contributions, and vacation accruals, partially offset by increased accruals for servicing of the remaining pipeline of mortgage loans and mortgage banking commissions.
(d) Decrease is primarily due to the assumption of the Company's Overland Park lease by First Federal Bank as a part of the mortgage transaction on June 16, 2023.
(e) Increase primarily relates to recording an allowance for unfunded commitments.

Deposits

Total deposits decreased $15.1 million to $804.5 million on June 30, 2023, from $819.6 million on December 31, 2022. The Company continues to focus on new deposit relationships and is keenly focused on the importance of liquidity.

The following table provides additional detail to the Company's total deposit relationships:

	As of		
(In thousands)	June 30, 2023	December 31, 2022	June 30, 2022
Deposits:			
Non-interest-bearing	$ 181,508	$ 207,232	$ 192,640
Interest-bearing –			
Savings, interest checking and money market	563,878	554,577	538,176
Time deposits	59,111	57,775	63,231
Total on balance sheet deposits	804,497	819,584	794,047
Off-balance sheet deposits (1)	4,808	187,407	187,475
Total available deposits	$ 809,305	$ 1,006,991	$ 981,522

(1) The off-balance sheet deposits above do not include off-balance sheet time deposit that can be brought back on the balance sheet at various future maturity dates. As of June 30, 2023, the Company managed off-balance sheet time deposit balances of $34.7 million, compared to no time deposit balances as of December 31, 2022 and June 30, 2022.

The Company remains highly focused on meeting the needs of its customers and ensuring deposit rates reflect changing market conditions. The Company estimates that deposit insurance and other deposit protection programs secure greater than 70% of its customer's deposit balances. This fact, combined with our strong balance sheet and relationship-focused culture has allowed the Company to maintain a significant deposit base.

Off-balance sheet accounts are primarily utilized to custody larger business customer deposits that require daily access to funds and provide for FDIC insurance coverage. The Company maintained $62.8 million of off balance sheet deposits late in the first quarter of 2022 and proceeded to further expand its use throughout 2022. These off-balance sheet deposits grew to $187.4 million at year-end 2022 and were $4.8 million at June 30, 2023. Off-balance sheet deposits can fluctuate greatly as customers balance utilization demands evolve. Competition for deposits increased significantly in the second quarter as national news prompted greater focus on deposit rates. Customers with deposit balances beyond their near-term needs redeployed portions of their cash to high-yielding instruments. The Company earns non-interest income through the associated banking network for the utilization of these funds.

At June 30, 2023, and December 31, 2022, the Bank had $13.8 million and $14.9 million, respectively, in time deposits greater than $250 thousand.

Mortgage Banking Obligations

Included in accrued expenses is an estimate of mortgage banking reimbursement obligations. 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,	
	2023	2022	2023	2022
Balance, beginning of period	$ 581	$ 804	$ 656	$ 820
Provision	51	30	81	60
Write offs, net	(95)	(188)	(200)	(234)
Balance, end of period	$ 537	$ 646	$ 537	$ 646

Stockholders' Equity

The Company's stockholders' equity increased $2.5 million from December 31, 2022, to June 30, 2023, primarily driven by increased retained earnings and a positive adjustment to the tax-effected fair value of debt securities available for sale as evidenced in the reduction of accumulated other comprehensive losses. 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 to provide a source of strength for the Bank. The Company manages capital by assessing the composition of capital and the amounts available for growth, risk, or other purposes. On May 3, 2022, BNCCORP's Board of Directors declared a $1.75 per share special cash dividend that was paid on June 21, 2022. In October of 2021, BNCCORP's Board of Directors declared a $6.00 per share special cash dividend that was paid on December 15, 2021. In December 2020, BNCCORP's Board of Directors declared an $8.00 per share special cash dividend that was paid on February 1, 2021.

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 the Company's 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 debt securities, the Company may utilize brokered deposits, sell debt 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. Funding through the issuance of subordinated notes, subordinated debentures, and long-term borrowings also has been utilized.

The Company's liquidity is defined by its ability to meet 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 the Company'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 using each of the following items:

1. Estimated liquid assets and certain off-balance sheet considerations less estimated volatile liabilities using the aforementioned methodology ($164.4 million as of June 30, 2023);
2. Borrowing capacity from the FHLB ($165.0 million as of June 30, 2023); and
3. Capacity to issue brokered deposits with maturities of less than 12 months ($131.8 million as of June 30, 2023).

On an ongoing basis, the Company uses a variety of factors to assess the Company's liquidity position including, but not limited to, the following:

- Stability of its deposit base;
- Amount of unpledged debt securities;
- Liquidity of its loan portfolio; and
- Potential loan demand.

The Company'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 its liquidity position over this horizon and manage operations to achieve these targets.

The Company further projects cash flows over a 12-month horizon based on its 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 Company's contingency plan identifies actions that could be taken in response to adverse liquidity events.

The Company believes this process, combined with its 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 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. The Company'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. The Company's asset/liability management process is utilized to manage its 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.

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 the Company'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, 2023 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, 2023, 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 level of interest rates as of June 30, 2023, the downward scenarios for interest rate movements is limited to -200bp. The parallel movement of interest rates means all projected market interest rates move up or down by the same amount. A ramp in interest rates means that the projected change in market interest rates occurs over the 12-month horizon on a pro-rata basis. For example, in the +100bp scenario, the projected Prime rate is projected to increase from 8.25% to 9.25% 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	-200bp	-100bp	Unchanged	+100bp	+200bp	+300bp
Projected 12-month net interest income	$ 36,374	$ 36,913	$ 37,476	$ 36,630	$ 36,295	$ 35,951
Dollar change from unchanged scenario	$ (1,102)	$ (563)	$ -	$ (846)	$ (1,181)	$ (1,525)
Percentage change from unchanged scenario	(2.94)%	(1.50)%	-	(2.26)%	(3.15)%	(4.07)%

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, 2023 (without forward adjustments for planned growth and anticipated business activities) and do not reflect any actions the Company 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, 2023. 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, 2023				
	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	$ 6,568	$ -	$ -	$ -	$ 6,568
Debt securities (a)	15,229	25,028	65,928	66,778	172,963
FRB and FHLB stock	2,938	-	-	-	2,938
Loans held for sale-mortgage banking, fixed rate	67,228	-	-	-	67,228
Loans held for investment, fixed rate	17,793	47,642	143,257	27,852	236,544
Loans held for investment, indexed rate	104,195	46,154	243,968	10,128	404,445
Total interest-earning assets	$ 213,951	$ 118,824	$ 453,153	$ 104,758	$ 890,686
Interest-bearing liabilities:					
Interest checking and money market accounts	$ 517,947	$ -	$ -	$ -	$ 517,947
Savings	45,931	-	-	-	45,931
Time deposits	10,378	36,256	12,384	93	59,111
Subordinated debentures	-	15,000	-	-	15,000
Total interest-bearing liabilities	$ 574,256	$ 51,256	$ 12,384	$ 93	$ 637,989
Interest rate gap	$ (360,305)	$ 67,568	$ 440,769	$ 104,665	$ 252,697
Cumulative interest rate gap at June 30, 2023	$ (360,305)	$ (292,737)	$ 148,032	$ 252,697	
Cumulative interest rate gap to total assets	(38.75%)	(31.48)%	15.92%	27.18%	

(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 the debt securities.

The table assumes that all savings and interest-bearing demand deposits reprice in the earliest period presented, however, management believes that a significant portion of these accounts are generally not rate sensitive. Management's view is supported by historical non-maturity deposit studies, which indicate that the Company's deposit rates have largely lagged broader market rate changes and the fact that changes in interest rates paid on these deposits historically have not caused notable reductions in balances or 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 the Company's assets and liabilities as of June 30, 2023, 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 the Company's 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 the Company, in some cases claiming damages.

Management is not aware of any material pending or threatening litigation as of June 30, 2023.

Submission of Matters to a Vote of Stockholders

The Annual Meeting of Stockholders (the "Annual Meeting") of the Company was held on June 22, 2023. 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 3,561,334 shares of common stock outstanding on the record date of April 24, 2023, 2,720,331 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 member of the Board of Directors of the Company for a three-year term ending in 2026:

Name	For	Withheld	Broker Non-Votes
Thomas Redmann	1,395,257	981,171	343,903
Michael M. Vekich	2,017,094	359,334	343,903

   The Board of Directors of the Company now consists of Michael M. Vekich, Nathan P. Brenna, Gaylen Ghylin, John W. Palmer, and Tom Redmann.

2. The selection of CliftonLarsonAllen LLP as the Company's independent registered public accounting firm for fiscal 2023 was ratified:

For	Against	Abstain
2,715,255	4,714	362

Signatures

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

BNCCORP, INC.

Date:	August 10, 2023	By:	/s/ Daniel J. Collins
			Daniel J. Collins President and Chief Executive Officer
		By:	/s/ Justin C. Currie
			Justin C. Currie Chief Financial Officer