Quarterly Report

For the quarter ended September 30, 2019

BNCCORP, INC.

(OTCQX: BNCC)

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BNCCORP, INC.
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September 30, 2019

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BNCCORP, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(In thousands, except share data)

	September 30, 2019	December 31, 2018
ASSETS	(unaudited)	
CASH AND CASH EQUIVALENTS	$ 11,644	$ 25,185
INVESTMENT SECURITIES AVAILABLE FOR SALE	386,158	411,509
FEDERAL RESERVE BANK AND FEDERAL HOME LOAN BANK STOCK	5,447	2,941
LOANS HELD FOR SALE-MORTGAGE BANKING	147,107	22,788
LOANS AND LEASES HELD FOR INVESTMENT	490,150	468,468
ALLOWANCE FOR CREDIT LOSSES	(7,967)	(7,692)
Net loans and leases held for investment	482,183	460,776
REPOSSESSED ASSETS, net	41	-
PREMISES AND EQUIPMENT, net	16,621	16,761
OPERATING LEASE RIGHT OF USE ASSETS	2,790	-
ACCRUED INTEREST RECEIVABLE	4,383	5,079
OTHER	28,277	25,988
Total assets	$ 1,084,651	$ 971,027
LIABILITIES AND STOCKHOLDERS' EQUITY		
DEPOSITS:		
Non-interest-bearing	$ 140,331	$ 157,663
Interest-bearing –		
Savings, interest checking and money market	573,762	542,735
Time deposits	169,289	148,207
Total deposits	883,382	848,605
SHORT-TERM BORROWINGS	3,926	11,494
FEDERAL HOME LOAN BANK ADVANCES	61,900	-
LONG-TERM BORROWINGS	10,000	10,000
GUARANTEED PREFERRED BENEFICIAL INTERESTS IN COMPANY'S SUBORDINATED DEBENTURES	15,007	15,009
ACCRUED INTEREST PAYABLE	1,726	1,277
ACCRUED EXPENSES	8,479	5,700
OPERATING LEASE LIABILITIES	2,980	-
OTHER	2,692	1,189
Total liabilities	990,092	893,274
STOCKHOLDERS' EQUITY:		
Common stock, $.01 par value – Authorized 11,300,000 shares; 3,508,298 and 3,493,298 shares issued and outstanding	35	35
Capital surplus – common stock	25,880	25,990
Retained earnings	69,540	61,042
Treasury stock (160,355 and 175,355 shares, respectively)	(2,195)	(2,386)
Accumulated other comprehensive income (loss), net	1,299	(6,928)
Total stockholders' equity	94,559	77,753
Total liabilities and stockholders' equity	$ 1,084,651	$ 971,027

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 September 30,		For the Nine Months Ended September 30,	
	2019	**2018**	**2019**	**2018**
INTEREST INCOME:				
Interest and fees on loans	$ 7,062	$ 6,080	$ 19,658	$ 17,022
Interest and dividends on investments				
Taxable	2,462	2,326	7,629	6,919
Tax-exempt	127	386	810	1,315
Dividends	47	44	128	116
Total interest income	9,698	8,836	28,225	25,372
INTEREST EXPENSE:				
Deposits	1,981	1,284	5,793	3,256
Short-term borrowings	2	19	20	49
Federal Home Loan Bank advances	105	55	201	94
Long-term borrowings	159	158	476	476
Subordinated debentures	142	142	448	397
Total interest expense	2,389	1,658	6,938	4,272
Net interest income	7,309	7,178	21,287	21,100
PROVISION FOR CREDIT LOSSES:	300	-	500	-
Net interest income after provision for credit losses	7,009	7,178	20,787	21,100
NON-INTEREST INCOME:				
Bank charges and service fees	637	618	1,962	1,945
Wealth management revenues	431	462	1,306	1,398
Mortgage banking revenues, net	8,952	2,754	17,267	7,891
Gains on sales of loans, net	46	-	152	178
Gains on sales of securities, net	1,700	-	2,020	2,273
Other	172	145	790	1,902
Total non-interest income	11,938	3,979	23,497	15,587
NON-INTEREST EXPENSE:				
Salaries and employee benefits	6,402	4,903	16,895	15,503
Professional services	1,606	840	3,555	2,499
Data processing fees	1,094	1,043	3,194	2,977
Marketing and promotion	1,361	1,256	3,414	3,125
Occupancy	517	580	1,610	1,745
Regulatory costs	122	130	379	405
Depreciation and amortization	368	381	1,090	1,179
Office supplies and postage	141	128	405	436
Other	1,260	545	2,420	1,719
Total non-interest expense	12,871	9,806	32,962	29,588
Income before income taxes	6,076	1,351	11,322	7,099
Income tax expense	1,450	284	2,604	1,491
Net income	$ 4,626	$ 1,067	$ 8,718	$ 5,608
Basic earnings per common share	$ 1.31	$ 0.31	$ 2.47	$ 1.61
Diluted earnings per common share	$ 1.30	$ 0.30	$ 2.45	$ 1.58

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Loss)

(In thousands, unaudited)

	For the Three Months Ended September 30,				For the Nine Months Ended September 30,			
	2019		2018		2019		2018	
NET INCOME		$ 4,626		$ 1,067		$ 8,718		$ 5,608
Unrealized gain (loss) on securities available for sale	$ 2,074		$ (3,972)		$ 12,931		$ (9,858)	
Reclassification adjustment for gains included in net income	(1,700)		-		(2,020)		(2,273)	
Other comprehensive income (loss) before tax	375		(3,972)		10,911		(12,131)	
Income tax (expense) benefit related to items of other comprehensive income (loss)	(92)		977		(2,684)		2,984	
Other comprehensive income (loss)	$ 282	282	$ (2,995)	(2,995)	$ 8,227	8,227	$ (9,147)	(9,147)
TOTAL COMPREHENSIVE INCOME (LOSS)		$ 4,908		$ (1,928)		$ 16,945		$ (3,539)

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Stockholders' Equity
For the Nine Months Ended September 30,
(In thousands, except share data, unaudited)

	Common Stock		Capital Surplus Common	Retained	Treasury	Accumulated Other Comprehensive	
	Shares	**Amount**	**Stock**	**Earnings**	**Stock**	**Income (Loss)**	**Total**
BALANCE, December 31, 2017	3,465,992	$ 35	$ 26,072	$ 54,206	$ (2,741)	$ 54	$ 77,626
Net income	-	-	-	5,608	-	-	5,608
Other comprehensive loss	-	-	-	-	-	(9,147)	(9,147)
Impact of share-based compensation	11,434	-	(92)	-	196	-	104
BALANCE, September 30, 2018	3,477,426	$ 35	$ 25,980	$ 59,814	$ (2,545)	$ (9,093)	$ 74,191
BALANCE, December 31, 2018	3,493,298	$ 35	$ 25,990	$ 61,042	$ (2,386)	$ (6,928)	$ 77,753
Net income	-	-	-	8,718	-	-	8,718
Other comprehensive income	-	-	-	-	-	8,227	8,227
Impact of share-based compensation	15,000	-	(110)	-	191	-	81
Cumulative effect adjustment for adoption of ASC 842 – *Leases*	-	-	-	(220)	-	-	(220)
BALANCE, September 30, 2019	3,508,298	$ 35	$ 25,880	$ 69,540	$ (2,195)	$ 1,299	$ 94,559

See accompanying notes to consolidated financial statements.

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

	2019	2018
OPERATING ACTIVITIES:		
Net income	$ 8,718	$ 5,608
Adjustments to reconcile net income to net cash (used in) provided by operating activities -		
Provision for credit losses	500	-
Depreciation and amortization	1,090	1,179
Net amortization of premiums and (discounts) on investment securities and subordinated debentures	5,709	5,787
Share-based compensation	81	104
Change in accrued interest receivable and other assets, net	(2,868)	357
(Gain) loss on sale of bank premises and equipment	(16)	21
Gains on sales of securities, net	(2,020)	(2,273)
Increase in deferred taxes	-	(106)
Change in other liabilities, net	6,340	6
Originations of loans held for sale, mortgage banking	(842,424)	(472,263)
Proceeds from sales of loans held for sale, mortgage banking	721,232	477,985
Fair value adjustment for loans held for sale, mortgage banking	(3,128)	178
Fair value adjustment on mortgage banking derivatives	(3,088)	(327)
Proceeds from sales of loans	1,710	2,209
Gains on sales of loans, net	(152)	(178)
Net cash (used in) provided by operating activities	(108,316)	18,287
INVESTING ACTIVITIES:		
Purchases of investment securities	(159,209)	(129,930)
Proceeds from sales of investment securities	148,380	56,198
Proceeds from maturities of investment securities	43,400	37,711
Purchases of Federal Reserve and Federal Home Loan Bank Stock	(18,378)	(15,140)
Sales of Federal Reserve and Federal Home Loan Bank Stock	15,872	14,964
Net increase in loans held for investment	(23,465)	(48,491)
Proceeds from sales of premises and equipment	22	2,306
Purchases of premises and equipment	(956)	(557)
Net cash provided by (used in) investing activities	5,666	(82,939)

See accompanying notes to consolidated financial statements.

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

	2019	2018
FINANCING ACTIVITIES:		
Net increase in deposits	$ 34,777	$ 46,094
Net decrease in short-term borrowings	(7,568)	(1,650)
Repayments of Federal Home Loan Bank advances	(426,800)	(383,800)
Proceeds from Federal Home Loan Bank advances	488,700	387,100
Net cash provided by financing activities	89,109	47,744
NET DECREASE IN CASH AND CASH EQUIVALENTS	(13,541)	(16,908)
CASH AND CASH EQUIVALENTS, beginning of period	25,185	25,830
CASH AND CASH EQUIVALENTS, end of period	$ 11,644	$ 8,922
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	$ 6,489	$ 2,369
Income taxes paid	$ 1,666	$ 1,040

See accompanying notes to consolidated financial statements.

NOTE 1 – Organization of Operations, BNCCORP, INC.

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

NOTE 2 – Basis of Presentation and Accounting Policies

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

The accompanying unaudited interim consolidated financial statements have been prepared under the presumption that users of the interim consolidated financial information have either read or have access to the audited consolidated financial statements of BNCCORP, INC. and subsidiaries for the year ended December 31, 2018. Accordingly, footnote disclosures which would substantially duplicate the disclosures contained in the December 31, 2018 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, 2018 and the notes thereto.

The accompanying interim consolidated financial statements have been prepared by the Company, in accordance with accounting principles generally accepted in the United States of America for interim financial information. The preparation of financial statements in conformity with generally accepted accounting principles 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 September 30, 2019 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

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

The Company adopted ASC 842 using a modified retrospective transition approach as of January 1, 2019. As a result, the Company was not required to adjust its comparative period financial information for effects of the standard or make the new required lease disclosures for periods prior to January 1, 2019. The adoption of ASC 842 did not have a material impact to the Company's consolidated balance sheet or the consolidated statement of income. As a result of adopting ASC 842, the Company recognized operating lease liabilities of $4.0 million with corresponding ROU assets of $3.8 million and a cumulative effect adjustment to equity of $220 thousand as of January 1, 2019. See Note 6 to the consolidated financial statements.

ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*, replaces the current incurred loss methodology for recognizing credit losses with a current expected credit loss model, which requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. This amended guidance broadens the information that an entity must consider in developing its expected credit loss estimates. Additionally, this update amends the accounting for credit losses for available-for-sale debt securities and purchased financial assets with a more-than-insignificant amount of credit deterioration since origination. This update requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of a company's loan portfolio. This update is effective for fiscal years beginning after December 15, 2020. This update requires the use of the modified retrospective adoption approach and the Company is currently evaluating the impact that this amended guidance will have on its consolidated financial statements and disclosures.

NOTE 3 – Investment Securities Available for Sale

Investment securities have been classified in the consolidated balance sheets according to management's intent. The Company had no securities designated as trading or held-to-maturity in its portfolio at September 30, 2019 or December 31, 2018. The carrying amount of available-for-sale securities and their estimated fair values were as follows (in thousands):

	As of September 30, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities	$ 25,006	$ 339	$ -	$ 25,345
U.S. government sponsored entity mortgage-backed securities issued by FNMA or FHLMC	5,823	110	-	5,933
U.S. government agency small business administration pools guaranteed by SBA	143,042	-	(5,231)	137,811
Collateralized mortgage obligations guaranteed by GNMA	21,502	715	-	22,217
Collateralized mortgage obligations issued by FNMA or FHLMC	70,052	600	(63)	70,589
Commercial mortgage-backed securities issued by FHLMC	30,058	1,873	-	31,931
Other commercial mortgage-backed securities	58,225	1,383	(342)	59,266
Asset-backed securities	20,424	123	-	20,547
State and municipal bonds	11,783	965	(229)	12,519
	$ 385,915	$ 6,108	$ (5,865)	$ 386,158

	As of December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities	$ 59,710	$ -	$ (916)	$ 58,794
U.S. government sponsored entity mortgage-backed securities issued by FNMA or FHLMC	10,221	32	(121)	10,132
U.S. government agency small business administration pools guaranteed by SBA	158,430	-	(7,464)	150,966
Collateralized mortgage obligations guaranteed by GNMA	63,149	274	(1,166)	62,257
Collateralized mortgage obligations issued by FNMA or FHLMC	52,635	47	(903)	51,779
Asset-backed securities	24,170	-	(125)	24,045
State and municipal bonds	53,862	434	(760)	53,536
	$ 422,177	$ 787	$ (11,455)	$ 411,509

The amortized cost and estimated fair market value of available-for-sale securities classified according to their contractual maturities at September 30, 2019 were as follows (in thousands):

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 9,997	$ 10,003
Due after one year through five years	15,247	15,574
Due after five years through ten years	128,758	129,336
Due after ten years	231,913	231,245
Total	$ 385,915	$ 386,158

This disclosure is required pursuant to U.S. Generally Accepted Accounting Principles. This table 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 investments' fair value and gross unrealized losses; aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position (dollars are in thousands):

	September 30, 2019								
	Less than 12 months			12 months or more			Total		
Description of Securities	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss
U.S. Treasury securities	-	$ -	$ -	-	$ -	$ -	-	$ -	$ -
U.S. government sponsored entity mortgage-backed securities issued by FNMA or FHLMC	-	-	-	-	-	-	-	-	-
U.S. government agency small business administration pools guaranteed by SBA	2	14,669	(45)	45	123,142	(5,186)	47	137,811	(5,231)
Collateralized mortgage obligations guaranteed by GNMA	-	-	-	-	-	-	-	-	-
Collateralized mortgage obligations issued by FNMA or FHLMC	2	10,901	(63)	-	-	-	2	10,901	(63)
Commercial mortgage-backed securities issued by FHLMC	-	-	-	-	-	-	-	-	-
Other commercial mortgage-backed securities	2	21,663	(342)	-	-	-	2	21,663	(342)
Asset-backed securities	-	-	-	-	-	-	-	-	-
State and municipal bonds	1	5,898	(229)	-	-	-	1	5,898	(229)
Total temporarily impaired securities	7	$ 53,131	$ (679)	45	$ 123,142	$ (5,186)	52	$ 176,273	$ (5,865)

Description of Securities	December 31, 2018 Less than 12 months #	Fair Value	Unrealized Loss	12 months or more #	Fair Value	Unrealized Loss	Total #	Fair Value	Unrealized Loss
U.S. Treasury securities	2	$ 19,652	$ (55)	2	$ 39,142	$ (861)	4	$ 58,794	$ (916)
U.S. government sponsored entity mortgage-backed securities issued by FNMA or FHLMC	-	-	-	3	4,132	(121)	3	4,132	(121)
U.S. government agency small business administration pools guaranteed by SBA	5	28,836	(1,444)	40	122,130	(6,020)	45	150,966	(7,464)
Collateralized mortgage obligations guaranteed by GNMA	-	-	-	5	40,146	(1,166)	5	40,146	(1,166)
Collateralized mortgage obligations issued by FNMA or FHLMC	3	13,965	(88)	8	34,583	(815)	11	48,548	(903)
Asset-backed securities	4	14,752	(46)	4	9,293	(79)	8	24,045	(125)
State and municipal bonds	9	30,441	(402)	6	16,575	(358)	15	47,016	(760)
Total temporarily impaired securities	23	$ 107,646	$ (2,035)	68	$ 266,001	$ (9,420)	91	$ 373,647	$ (11,455)

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

There were no securities that management concluded were other-than-temporarily impaired at September 30, 2019 or December 31, 2018.

NOTE 4 – Loans and Leases

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

	September 30, 2019	December 31, 2018
Loans held for sale-mortgage banking	$ 147,107	$ 22,788
Commercial and industrial	$ 154,843	$ 149,886
Commercial real estate	180,125	174,868
SBA	48,921	32,505
Consumer	81,440	78,055
Land and land development	11,024	11,398
Construction	13,423	21,257
Gross loans and leases held for investment	489,776	467,969
Unearned income and net unamortized deferred fees and costs	374	499
Loans, net of unearned income and unamortized fees and costs	490,150	468,468
Allowance for credit losses	(7,967)	(7,692)
Net loans and leases held for investment	$ 482,183	$ 460,776

NOTE 5 – Allowance for Credit Losses

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

Three Months Ended September 30, 2019	Commercial and industrial	Commercial real estate	SBA	Consumer	Land and land development	Construction	Total
Balance, beginning of period	$ 1,961	$ 3,515	$ 1,085	$ 947	$ 212	$ 171	$ 7,891
Provision (reduction)	138	(49)	205	51	(1)	(44)	300
Loans charged off	(112)	-	(81)	(37)	-	-	(230)
Loan recoveries	-	4	-	2	-	-	6
Balance, end of period	$ 1,987	$ 3,470	$ 1,209	$ 963	$ 211	$ 127	$ 7,967

Three Months Ended September 30, 2018	Commercial and industrial	Commercial real estate	SBA	Consumer	Land and land development	Construction	Total
Balance, beginning of period	$ 2,049	$ 3,510	$ 827	$ 920	$ 320	$ 162	$ 7,788
Provision (reduction)	64	(20)	26	17	(84)	(3)	-
Loans charged off	(25)	-	(29)	(17)	-	-	(71)
Loan recoveries	4	2	-	5	-	-	11
Balance, end of period	$ 2,092	$ 3,492	$ 824	$ 925	$ 236	$ 159	$ 7,728

Nine Months Ended September 30, 2019	Commercial and industrial	Commercial real estate	SBA	Consumer	Land and land development	Construction	Total
Balance, beginning of period	$ 1,937	$ 3,558	$ 845	$ 928	$ 225	$ 199	$ 7,692
Provision (reduction)	165	(97)	435	83	(14)	(72)	500
Loans charged off	(115)	-	(81)	(73)	-	-	(269)
Loan recoveries	-	9	10	25	-	-	44
Balance, end of period	$ 1,987	$ 3,470	$ 1,209	$ 963	$ 211	$ 127	$ 7,967

Nine Months Ended September 30, 2018	Commercial and industrial	Commercial real estate	SBA	Consumer	Land and land development	Construction	Total
Balance, beginning of period	$ 2,158	$ 3,471	$ 834	$ 914	$ 358	$ 126	$ 7,861
Provision (reduction)	(34)	17	36	70	(122)	33	-
Loans charged off	(71)	(7)	(49)	(87)	-	-	(214)
Loan recoveries	39	11	3	28	-	-	81
Balance, end of period	$ 2,092	$ 3,492	$ 824	$ 925	$ 236	$ 159	$ 7,728

The following table shows the balance in the allowance for credit losses at September 30, 2019, and December 31, 2018, and the related loan balances, segregated on the basis of impairment methodology (in thousands). Impaired loans are loans on nonaccrual status and troubled debt restructurings, which are individually evaluated for impairment, and other loans deemed to have similar risk characteristics. All other loans are collectively evaluated for impairment.

	Allowance For Credit Losses			Gross Loans and Leases Held for Investment		
	Impaired	Other	Total	Impaired	Other	Total
September 30, 2019						
Commercial and industrial	$ 218	$ 1,769	$ 1,987	$ 1,898	$ 152,945	$ 154,843
Commercial real estate	111	3,359	3,470	1,462	178,663	180,125
SBA	60	1,149	1,209	383	48,538	48,921
Consumer	2	961	963	41	81,399	81,440
Land and land development	-	211	211	10	11,014	11,024
Construction	-	127	127	-	13,423	13,423
Total	$ 391	$ 7,576	$ 7,967	$ 3,794	$ 485,982	$ 489,776
December 31, 2018						
Commercial and industrial	$ 246	$ 1,691	$ 1,937	$ 1,758	$ 148,128	$ 149,886
Commercial real estate	73	3,485	3,558	1,496	173,372	174,868
SBA	62	783	845	104	32,401	32,505
Consumer	6	922	928	80	77,975	78,055
Land and land development	-	225	225	28	11,370	11,398
Construction	-	199	199	-	21,257	21,257
Total	$ 387	$ 7,305	$ 7,692	$ 3,466	$ 464,503	$ 467,969

Performing and non-accrual loans

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

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

	September 30, 2019					
	Current	31-89 Days Past Due	90 Days or More Past Due And Accruing	Total Performing	Non-accrual	Total
Commercial and industrial:						
Business loans	$ 71,471	$ -	$ -	$ 71,471	$ 1,620	$ 73,091
Agriculture	31,039	-	-	31,039	-	31,039
Owner-occupied commercial real estate	50,713	-	-	50,713	-	50,713
Commercial real estate	179,844	281	-	180,125	-	180,125
SBA	48,489	49	-	48,538	383	48,921
Consumer:						
Automobile	22,280	43	-	22,323	15	22,338
Home equity	9,816	-	-	9,816	-	9,816
1st mortgage	12,770	-	-	12,770	-	12,770
Other	36,489	1	-	36,490	26	36,516
Land and land development	11,014	-	-	11,014	10	11,024
Construction	13,336	87	-	13,423	-	13,423
Total loans held for investment	487,261	461	-	487,722	2,054	489,776
Loans held for sale	146,897	-	-	146,897	210	147,107
Total gross loans	$ 634,158	$ 461	$ -	$ 634,619	$ 2,264	$ 636,883

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Interest income that would have been recorded	$ 38	$ 35	$ 104	$ 99
Interest income recorded	-	-	-	-
Effect on interest income on loans	$ 38	$ 35	$ 104	$ 99

Credit Risk by Internally Assigned Grade

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

At September 30, 2019, the Company had $473.3 million of loans categorized as pass rated loans compared to $452.0 million at December 31, 2018.

Loans designated as watch list are loans that possess some credit deficiency that deserves close attention due to emerging problems. Such loans pose unwarranted financial risk that, if left uncorrected, may result in deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date. At September 30, 2019, the Company had $7.1 million of loans categorized as watch list loans compared to $5.2 million at December 31, 2018.

Loans graded as substandard or doubtful are considered "Classified" loans for regulatory purposes. Loans classified as substandard are loans that are generally inadequately protected by the current net worth and paying capacity of the obligor, or by the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Substandard loans are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loans classified as doubtful have the weaknesses of those classified as substandard, with additional characteristics that make collection in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. At September 30, 2019, the Company had $7.9 million of substandard loans and $1.5 million of doubtful loans. At December 31, 2018, the Company had $9.2 million of substandard loans and $1.6 million of doubtful loans.

Impaired loans

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

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

	September 30, 2019				
	Unpaid Principal	Recorded Investment	Related Allowance	Average Recorded Balance (9 months)	Interest Income Recognized (9 months)
Impaired loans with an allowance recorded:					
Commercial and industrial:					
Business loans	$ 2,245	$ 1,620	$ 218	$ 1,670	$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	1,762	1,462	111	1,484	57
SBA	121	102	60	103	-
Consumer:					
Automobile	19	15	2	16	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans with an allowance recorded	$ 4,147	$ 3,199	$ 391	$ 3,273	$ 57
Impaired loans without an allowance recorded:					
Commercial and industrial:					
Business loans	$ 1,878	$ 278	$ -	$ 281	$ 8
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	-	-	-	-	-
SBA	350	281	-	286	-
Consumer:					
Automobile	-	-	-	-	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	44	26	-	28	-
Land and land development	140	10	-	19	-
Construction	-	-	-	-	-
Loans held for sale	323	210	-	217	-
Total impaired loans without an allowance recorded	$ 2,735	$ 805	$ -	$ 831	$ 8
TOTAL IMPAIRED LOANS	$ 6,882	$ 4,004	$ 391	$ 4,104	$ 65

	December 31, 2018									
	Unpaid Principal		Recorded Investment		Related Allowance		Average Recorded Balance (12 months)		Interest Income Recognized (12 months)	
Impaired loans with an allowance recorded:										
Commercial and industrial:										
Business loans	$	1,996	$	1,454	$	246	$	1,484	$	-
Agriculture		-		-		-		-		-
Owner-occupied commercial real estate		-		-		-		-		-
Commercial real estate		1,795		1,496		73		1,497		76
SBA		143		115		62		117		-
Consumer:										
Automobile		16		12		6		15		-
Home equity		-		-		-		-		-
1st mortgage		-		-		-		-		-
Other		-		-		-		-		-
Land and land development		-		-		-		-		-
Construction		-		-		-		-		-
Loans held for sale		-		-		-		-		-
Total impaired loans with an allowance recorded	$	3,950	$	3,077	$	387	$	3,113	$	76
Impaired loans without an allowance recorded:										
Commercial and industrial:										
Business loans	$	1,915	$	294	$	-	$	305	$	12
Agriculture		-		-		-		-		-
Owner-occupied commercial real estate		-		-		-		-		-
Commercial real estate		-		-		-		-		-
SBA		-		-		-		-		-
Consumer:										
Automobile		62		43		-		44		-
Home equity		-		-		-		-		-
1st mortgage		-		-		-		-		-
Other		45		24		-		26		-
Land and land development		150		28		-		40		-
Construction		-		-		-		-		-
Loans held for sale		-		-		-		-		-
Total impaired loans without an allowance recorded	$	2,172	$	389	$	-	$	415	$	12
TOTAL IMPAIRED LOANS	$	6,122	$	3,466	$	387	$	3,528	$	88

Troubled Debt Restructuring (TDRs)
Included in net loans and leases held for investment, are certain loans that have been modified in order to maximize collection of loan balances. If the Company, for legal or economic reasons related to the borrower's financial difficulties, grants a concession that the Bank would not otherwise consider, compared to the original terms and conditions of the loan, the modified loan is considered a troubled debt restructuring.

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

	September 30, 2019			
	Accrual	Non-accrual	Total	Allowance
Commercial and industrial:				
Business loans	$ 278	$ 1,416	$ 1,694	$ 207
Agriculture	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-
Commercial real estate	1,462	-	1,462	111
SBA	-	102	102	60
Consumer:				
Automobile	-	-	-	-
Home equity	-	-	-	-
1st mortgage	-	-	-	-
Other	-	-	-	-
Land and land development	-	-	-	-
Construction	-	-	-	-
Loans held for sale	-	-	-	-
	$ 1,740	$ 1,518	$ 3,258	$ 378

	December 31, 2018			
	Accrual	Non-accrual	Total	Allowance
Commercial and industrial:				
Business loans	$ 284	$ 1,454	$ 1,738	$ 244
Agriculture	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-
Commercial real estate	1,496	-	1,496	73
SBA	-	115	115	63
Consumer:				
Automobile	-	-	-	-
Home equity	-	-	-	-
1st mortgage	-	-	-	-
Other	-	-	-	-
Land and land development	-	-	-	-
Construction	-	-	-	-
Loans held for sale	-	-	-	-
	$ 1,780	$ 1,569	$ 3,349	$ 380

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

When a loan is modified as a TDR, there may be a direct, material impact on the loans within the consolidated balance sheets, as principal balances may be partially forgiven. There were no new TDRs for the three or nine month period ended September 30, 2019. There were no new TDRs for the three-month period ended September 30, 2018. One new TDR was modified during the nine month period ended September 30, 2018 with a premodification and post-modification balance of $1.5 million.

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	**2018**	**2019**	**2018**
Interest income that would have been recorded	$ 77	$ 79	$ 230	$ 234
Interest income recorded	22	22	65	66
Effect on interest income on loans	$ 55	$ 57	$ 165	$ 168

There were no additional funds committed to borrowers who are in TDR status at September 30, 2019 and December 31, 2018.

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

The Bank had no loans that were restructured within the 12 months preceding September 30, 2019 and September 30, 2018 and defaulted during the three and nine months ended September 30, 2019 and September 30, 2018.

NOTE 6 – Leases

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

The components of lease cost for the three and nine month period ended September 30, 2019 were as follows (in thousands):

	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2019
Operating lease costs	$ 231	$ 714
Variable lease costs	6	32
Short-term lease costs	4	13
Total lease costs	$ 241	$ 759

Rental expense for operating leases for the three-month and nine-month period ending September 30, 2018 amounted to $285 thousand and $864 thousand, respectively.

Amounts reported in the consolidated balance sheet as of September 30, 2019 are as follows (in thousands):

	As of September 30, 2019
Operating lease right of use asset	$ 2,790
Operating lease liabilities	2,980

Other information related to leases as of September 30, 2019 was as follows (dollars are in thousands):

	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2019
Cash paid for amounts included in the measurement of lease liabilities	$ 245	$ 736
ROU Assets obtained in exchange for lease obligations	-	111
Reductions to ROU assets resulting from reduction in lease obligations	185	1,011

	As of September 30, 2019
Weighted Average remaining lease term	5.08 years
Weighted Average discount rate	6.00%

Maturities of lease liabilities under non-cancellable leases as of September 30, 2019 are as follows (in thousands):

	Operating Leases
2019	$ 2,335
2020	782
2021	589
2022	555
2023	501
Thereafter	626
Total lease liabilities	$ 5,388

NOTE 7 – Earnings Per Share

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

	Three Months Ended September 30, 2019		Nine Months Ended September 30, 2019	
Denominator for basic earnings per share*:*				
Average common shares outstanding		3,529,999		3,522,665
Dilutive effect of stock compensation		28,355		34,413
Denominator for diluted earnings per share		3,558,354		3,557,078
Numerator (in thousands):				
Net income	$	4,626	$	8,718
Basic earnings per common share	$	1.31	$	2.47
Diluted earnings per common share	$	1.30	$	2.45

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
Denominator for basic earnings per share*:*				
Average common shares outstanding		3,497,426		3,493,609
Dilutive effect of stock compensation		52,367		54,951
Denominator for diluted earnings per share		3,549,793		3,548,560
Numerator (in thousands):				
Net income	$	1,067	$	5,608
Basic earnings per common share	$	0.31	$	1.61
Diluted earnings per common share	$	0.30	$	1.58

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 four share-based plans for certain key employees and directors whereby shares of common stock have been reserved for awards in the form of stock options or restricted stock awards. The plans are as follows:

	1995	2002	2010	2015	Total
Total Shares in Plan	250,000	125,000	250,000	50,000	675,000
Total Shares Available for Issuance	45,951	-	250,000	39,415	335,366

Following is a summary of fully vested stock options and options expected to vest as of September 30, 2019:

	Stock Options Outstanding	Stock Options Currently Exercisable	Stock Options Vested and Expected to Vest
Number	27,600	27,600	27,600
Weighted-average exercise price	$3.00	$3.00	$3.00
Weighted-average remaining contractual term	0.45 years	0.45 years	0.45 years

The currently outstanding stock options may be exercised until expiration on March 17, 2020. The applicable stock option agreements do not permit the holders of stock options to elect to cause the Company to withhold shares of stock otherwise receivable upon exercise of an option in satisfaction on the exercise price. Option holders may pay the exercise price of a stock option in cash or through the surrender of shares of stock held by the option holder at the time of exercise. Executives selling share into the market are encouraged, but not required, to do so under a passive trading plan that meets the requirements of the Securities and Exchange Commission's Rule 10b-5.

The Company recognized share-based compensation expense of $5,000 related to restricted stock for the three month period ended September 30, 2019, and $15,000 for the nine month period ended September 30, 2019. The Company recognized share-based compensation expense of $5,000 related to restricted stock for the three month period ended September 30, 2018, and $15,000 for the nine month period ended September 30, 2018.

At September 30, 2019, the Company had $45,000 of unamortized restricted stock compensation expense. The cost of restricted stock granted is recognized over the vesting period, which is generally three or more years.

NOTE 9 – Revenue from Contracts with Customers

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

The following is a description of the principal activities from which the Company generates revenue that are within the scope of ASC 606, *Revenue from Contracts with Customers*:

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

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

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

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

The Company had no material contract assets or remaining performance obligations as of September 30, 2019. Total receivables from revenue recognized under the scope of ASC 606 were $453 thousand as of September 30, 2019 and $417 thousand as of December 31, 2018. These receivables are included as part of the Other assets line on the Company's Consolidated Balance Sheets.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	**2018**	**2019**	**2018**
Service charges on deposits	$ 189	$ 179	$ 566	$ 547
Bankcard fees	239	259	757	761
Bank charges and service fees not within scope of ASC 606	209	180	639	637
Total bank charges and service fees	637	618	1,962	1,945
Wealth management revenue	431	462	1,279	1,398
Wealth management revenue not within the scope of ASC 606	-	-	27	-
Total wealth management revenues	431	462	1,306	1,398
Other	7	13	41	38
Other not within the scope of ASC 606 (a)	165	132	749	1,864
Total other	172	145	790	1,902
Other non-interest income not within the scope of ASC 606 (a)	10,698	2,754	19,439	10,342
Total non-interest income	$ 11,938	$ 3,979	$ 23,497	$ 15,587

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

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 September 30, 2019				Nine Months Ended September 30, 2019
	Total	**Level 1**	**Level 2**	**Level 3**	**Total gains/(losses)**
ASSETS					
Securities available for sale	$ 386,158	$ 25,345	$ 360,813	$ -	$ 2,020
Loans held for sale	147,107	-	147,107	-	3,128
Commitments to originate mortgage loans	5,385	-	5,385	-	2,587
Commitments to sell mortgage loans	339	-	339	-	488
Total assets at fair value	$ 538,989	$ 25,345	$ 513,644	$ -	$ 8,223
LIABILITIES					
Mortgage banking short positions	$ 197	$ -	$ 197	$ -	$ 13
Total liabilities at fair value	$ 197	$ -	$ 197	$ -	$ 13

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

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.

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

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

	Carrying Value at September 30, 2019				Nine Months Ended September 30, 2019
	Total	**Level 1**	**Level 2**	**Level 3**	**Total gains/(losses)**
Impaired loans[1]	$ 3,613	$ -	$ -	$ 3,613	$ (125)

	Carrying Value at December 31, 2018				Twelve Months Ended December 31, 2018
	Total	**Level 1**	**Level 2**	**Level 3**	**Total gains/(losses)**
Impaired loans[1]	$ 3,079	$ -	$ 3,079	$ -	$ 36

(1) The carrying value represents the book value less allocated reserves. The gain or loss reported is the change in the reserve balances allocated on individual impaired loans in addition to the actual write-downs for the period presented.

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

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

NOTE 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	September 30, 2019		December 31, 2018	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:					
Cash and cash equivalents	Level 1	$ 11,644	$ 11,644	$ 25,185	$ 25,185
Investment securities available for sale	Level 1	25,345	25,345	58,794	58,794
Investment securities available for sale	Level 2	360,813	360,813	352,715	352,715
Federal Reserve Bank and Federal Home Loan Bank stock	Level 2	5,447	5,447	2,941	2,941
Loans held for sale-mortgage banking	Level 2	147,107	147,107	22,788	22,788
Commitments to originate mortgage loans	Level 2	5,385	5,385	1,479	1,479
Commitments to sell mortgage loans	Level 2	339	339	-	-
Loans and leases held for investment	Level 2	485,772	485,873	467,969	463,780
Loans and leases held for investment	Level 3	4,004	3,613	-	-
Accrued interest receivable	Level 2	4,383	4,383	5,079	5,079
		$ 1,050,239	$ 1,049,949	$ 936,950	$ 932,761
Liabilities and Stockholders' Equity:					
Deposits, noninterest-bearing	Level 2	$ 140,331	$ 140,331	$ 157,663	$ 157,663
Deposits, interest-bearing	Level 2	743,051	743,258	690,942	689,213
Borrowings and advances	Level 2	75,826	75,907	21,494	21,467
Accrued interest payable	Level 2	1,726	1,726	1,277	1,277
Accrued expenses	Level 2	8,479	8,479	5,700	5,700
Commitments to sell mortgage loans	Level 2	-	-	148	148
Mortgage banking short positions	Level 2	197	197	210	210
Guaranteed preferred beneficial interests in Company's subordinated debentures	Level 2	15,007	10,110	15,009	10,208
		$ 984,617	$ 980,008	$ 892,443	$ 885,886
Financial instruments with off-balance-sheet risk:					
Commitments to extend credit	Level 2	$ -	$ 241	$ -	$ 169
Standby and commercial letters of credit	Level 2	$ -	$ 8	$ -	$ 9

NOTE 12 – Federal Home Loan Bank Advances

As of September 30, 2019, the Bank had $61.9 million of FHLB advances outstanding. At September 30, 2019, the Bank had loans with unamortized principal balances of approximately $169.4 million and securities with unamortized principal balances of approximately $58.4 million pledged as collateral to the FHLB.

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

As of September 30, 2019, the Bank has the ability to draw advances up to approximately $108.1 million based upon the aggregate collateral that is currently pledged, subject to a requirement to purchase additional FHLB stock, based upon collateral pledged.

NOTE 13 – Long-Term Borrowings

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

	September 30, 2019	December 31, 2018
Note payable, interest due quarterly beginning on April 1, 2016 and ending October 19, 2025, interest payable at a fixed rate of 6.35%	$ 10,000	$ 10,000

The long-term borrowing is subordinated debt that qualifies as Tier 2 capital for the Company. The loan agreement includes various covenants that are primarily financial in nature. As of September 30, 2019, the Company was in compliance with these covenants. The note may be repaid, in whole or in part, by the Company at par beginning October 19, 2020.

NOTE 14 – Other Borrowings

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

September 30, 2019

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

Secured Borrowing Lines:	Collateral Pledged	Line	Outstanding	Available
BNC National Bank Line	$ 2,298	$ 2,160	$ -	$ 2,160
BNC Line	110,663	10,000	-	10,000
Total	$ 112,961	$ 12,160	$ -	$ 12,160

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

At September 30, 2019, the pledged collateral for the BNC National Bank line was comprised of collateralized mortgage obligations and the pledged collateral for the BNC Line is the common stock of BNC National Bank.

December 31, 2018

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

Secured Borrowing Lines:	Collateral Pledged	Line	Outstanding	Available
BNC National Bank Line	$ 2,377	$ 2,162	$ -	$ 2,162
BNC Line	92,633	10,000	-	10,000
Total	$ 95,010	$ 12,162	$ -	$ 12,162

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

At December 31, 2018, the pledged collateral for the BNC National Bank line was comprised of collateralized mortgage obligations and the pledged collateral for the BNC Line is the common stock of BNC National Bank.

NOTE 15 – Guaranteed Preferred Beneficial Interest's in Company's Subordinated Debentures

In July 2007, BNC issued $15.0 million of floating rate subordinated debentures. The interest rate paid on the securities is equal to the three month LIBOR plus 1.40%. The interest rate at September 30, 2019 and December 31, 2018 was 3.70% and 3.80%, respectively. The subordinated debentures mature on October 1, 2037. The subordinated debentures may be redeemed at par and the corresponding debentures may be prepaid at the option of BNCCORP, subject to approval by the Federal Reserve Board.

NOTE 16 – Stockholders' Equity

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

On May 30, 2001, BNCCORP's Board of Directors adopted a Rights Agreement intended to protect stockholder interests in the event BNCCORP becomes the subject of a takeover initiative. The Rights Agreement expired on April 15, 2019.

NOTE 17 – Regulatory Capital and Current Operating Environment

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

At September 30, 2019, the capital ratios exceeded all regulatory capital thresholds and maintained sufficient capital conservation buffers to avoid limitations on certain types of capital distributions.

At September 30, 2019 and December 31, 2018, 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
September 30, 2019								
Total Risk Based Capital:								
Consolidated	$ 126,092	18.46 %	$ 54,634	≥8.0 %	$ N/A	N/A %	$ N/A	N/A%
BNC National Bank	116,744	17.12	54,544	≥8.0	68,181	10.0	48,563	7.12
Tier 1 Risk Based Capital:								
Consolidated	108,125	15.83	40,975	≥6.0	N/A	N/A	N/A	N/A
BNC National Bank	108,777	15.95	40,908	≥6.0	54,544	8.0	54,233	7.95
Common Equity Tier 1 Risk Based Capital:								
Consolidated	93,119	13.64	30,731	≥4.5	N/A	N/A	N/A	N/A
BNC National Bank	108,777	15.95	30,681	≥4.5	44,317	6.5	64,460	9.45
Tier 1 Leverage Capital:								
Consolidated	108,125	10.44	41,432	≥4.0	N/A	N/A	N/A	N/A
BNC National Bank	108,777	10.51	41,397	≥4.0	51,747	5.0	57,030	5.51
Tangible Common Equity (to total assets): (a)								
Consolidated	94,438	8.71	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	110,542	10.21	N/A	N/A	N/A	N/A	N/A	N/A
December 31, 2018								
Total Risk Based Capital:								
Consolidated	$ 116,734	20.26 %	$ 46,091	≥8.00 %	$ N/A	N/A %	$ N/A	N/A%
BNC National Bank	106,154	18.44	46,053	≥8.00	57,566	10.00	48,588	8.44
Tier 1 Risk Based Capital:								
Consolidated	99,527	17.28	34,568	≥6.00	N/A	N/A	N/A	N/A
BNC National Bank	98,952	17.19	34,540	≥6.00	46,053	8.00	52,899	9.19
Common Equity Tier 1 Risk Based Capital:								
Consolidated	84,518	14.67	25,926	≥4.50	N/A	N/A	N/A	N/A
BNC National Bank	98,952	17.19	25,905	≥4.50	37,418	6.50	61,534	10.69
Tier 1 Leverage Capital:								
Consolidated	99,527	9.97	39,930	≥4.00	N/A	N/A	N/A	N/A
BNC National Bank	98,952	9.92	39,890	≥4.00	49,862	5.00	49,090	4.92
Tangible Common Equity (to total assets): (a)								
Consolidated	77,611	7.99	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	92,490	9.53	N/A	N/A	N/A	N/A	N/A	N/A

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

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

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

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

Comparison of Results for the Three and Nine Months Ended September 30, 2019 and 2018

Summary for the Three Months Ended September 30, 2019 and 2018

Net income was $4.626 million, or $1.30 per diluted share, for the quarter ended September 30, 2019. This compared to net income of $1.067 million, or $0.30 per diluted share, in the third quarter of 2018.

Net interest income for the third quarter of 2019 was $7.309 million, an increase of $131 thousand, or 1.8%, from $7.178 million for the same period of 2018. Interest rates have been declining in 2019. Falling interest rates generally result in lower net interest margin for the banking industry. The net interest margin for the current period decreased to 2.98% from 3.07% a year ago.

Interest income was $9.698 million for the quarter ended September 30, 2019, compared to $8.836 million for the third quarter of 2018. The increase reflects the benefit of higher average balances of loans and leases held for investment and loans held for sale, combined with higher yields on earning assets. The yield on average interest earning assets increased to 3.92% from 3.74% in the same quarter of 2018. During the third quarter of 2019, the average balance of interest earning assets increased by $44.9 million when compared to the third quarter of 2018. Average loans held for investment increased $18.0 million, or 3.8%, and average loans held for sale increased by $62.1 million, or 234.7%, when comparing the third quarters of 2019 and 2018. The average balance of investment securities decreased by $37.6 million, or 8.7%, in the third quarter of 2019, compared to the same period a year ago. Yields on investment securities increased to 2.54% in the third quarter of 2019 from 2.47% in the same period of 2018.

Interest expense in the third quarter of 2019 was $2.389 million, an increase of $731 thousand, or 44.1%, from the same period in 2018. The cost of interest bearing liabilities increased to 1.20% in the current quarter from 0.88% in the third quarter 2018. Interest expense increased on deposits as a result of higher balances and market driven cost increases for consumer certificates of deposit and money market accounts. The cost of core deposits was 0.89% in the third quarter of 2019 and 0.57% in the third quarter of 2018.

Total loans held for investment increased by $15.5 million, or 3.3%, from September 30, 2018 and increased by $21.7 million, or 4.6%, from December 31, 2018. Mortgage loans held for sale increased by $116.4 million, or 379.2%, from September 30, 2018 and $124.3 million from December 31, 2018 as lower interest rates induced higher mortgage banking origination activity in the third quarter of 2019.

Total deposits increased by $34.8 million to $883.4 million at September 30, 2019 from $848.6 million at December 31, 2018. Core deposits, which excludes certain brokered deposits, increased $27.2 million to $887.3 million at September 30, 2019 from December 31, 2018 and increased $27.0 million from September 30, 2018.

Short-term borrowings decreased $7.6 million at September 30, 2019 compared to December 31, 2018 while FHLB borrowings increased by $61.9 million during the same period due to higher mortgage funding, particularly in the third quarter of 2019.

Provision for credit losses was $300 thousand in the third quarter of 2019 and $0 in the third quarter of 2018.

Non-interest income for the third quarter of 2019 was $11.938 million. This compares to non-interest income of $3.979 million for the same period in 2018, an increase of $7.959 million, or 200.0%. Mortgage banking revenues aggregated $8.952 million in the current period compared to $2.754 million in the third quarter of 2018 due to higher loan origination activity and improved margins on mortgage loan production. Gains on sales assets aggregated $1.746 million in the third quarter 2019, compared to $0 in the prior year third quarter. Gains on sales of assets and earnings from certain investments can vary significantly from period to period.

Non-interest expense for the third quarter of 2019 was $12.871 million compared to $9.806 million in the same period of 2018, an increase of $3.065 million. Salaries and benefits increased $1.499 million, or 30.6%, from the third quarter 2018. The increase in salaries and employee benefits primarily relate to mortgage operations and higher accruals for incentive compensation. Professional services in the third quarter of 2019 were up $766 thousand, or 91.2%, from the third quarter 2018, including $311 thousand related to mortgage related closing costs. Professional service costs also included increased legal and consulting expense for various corporate purposes. Other expense increased by $715 thousand when compared to the same period of 2018 due to recording a mortgage warranty reserve provision and resolution of a litigation matter.

In the third quarter of 2019, we recorded tax expense of $1.450 million, which resulted in an effective tax rate of 23.9% for the quarter. Tax expense of $284 thousand was recognized during the third quarter of 2018, which resulted in an effective tax rate of 21.0%. The increase in the effective tax rate is due to increased pre-tax revenues and lower non-taxable pre-tax interest income from municipal securities.

Summary for the Nine Months Ended September 30, 2019 and 2018

Net income was $8.718 million, or $2.45 per diluted share, for the nine months ended September 30, 2019. This compared to net income of $5.608 million, or $1.58 per diluted share, in the first nine months of 2018.

Net interest income for the nine months ended September 30, 2019 was $21.287 million, an increase of $187 thousand, or 0.9%, from $21.100 million for the same period of 2018. The net interest margin for the current period decreased to 2.98% from 3.08% a year ago.

Interest income was $28.225 million for the first nine months of 2019 compared to $25.372 million for the first nine months of 2018. The increase reflects the benefit of higher average balances of cash and cash equivalents, loans and leases held for investment, mortgage loans held for sale, and taxable investments combined with higher overall yields on earning assets. The yield on loans and leases held for investment increased to 5.13% during the first nine months of 2019 compared to 4.84% in the same time period of 2018. The yield on average interest earning assets increased to 3.93% from 3.69% in the first nine months of 2018. During the first nine months of 2019, the average balance of interest earning assets increased by $40.7 million when compared to the first nine months of 2018. Average loans held for investment increased $25.6 million, or 5.7%, and average loans held for sale increased by $29.0 million, in first nine months of 2019 compared to the same period in 2018. The average balance of investment securities decreased by $20.6 million in the nine month period ended September 30, 2019, compared to the same period a year ago as tax-exempt securities decreased by $23.7 million. Yields on investment securities increased to 2.61% in the first nine months of 2019 from 2.49% in the same period of 2018.

Interest expense in the first nine months of 2019 was $6.938 million, an increase of $2.666 million from the same period in 2018. The cost of interest bearing liabilities increased to 1.17% in the first nine months of 2019 from 0.78% in the first nine months of 2018. Interest expense increased on deposits, driven largely by increased cost of consumer certificates of deposit and money market accounts. The cost of core deposits was 0.88% in the first nine months of 2019 and 0.48% in the first nine months of 2018.

Provision for credit losses was $500 thousand in the first nine months of 2019 and $0 in 2018.

Non-interest income for the nine months ended September 30, 2019 was $23.497 million. This compares to non-interest income of $15.587 million in the first nine months of 2018, an increase of $7.910 million, or 50.7%. Mortgage banking revenues aggregated $17.267 million in the current period compared to $7.891 million in the first nine months of 2018 as lower interest rates induced higher mortgage banking activity and the margin on mortgage loan sales has improved. Gains on sales of loans and investment securities aggregated $2.172 million in the first nine months of 2019, compared to $2.451 million in the prior year first nine months. Gains on sales of assets and earnings from certain investments can vary significantly from period to period. Other income was $1.204 million lower primarily due to revenues from a SBIC fund that sold portfolio companies in the prior year.

Non-interest expense for the nine months ended September 30, 2019 was $32.962 million compared to $29.588 million in the same period of 2018, an increase of $3.374 million. Salaries and benefits increased $1.392 million from the first nine months of 2018. The increase in salaries and employee benefits primarily relate to mortgage operations and higher accruals for incentive compensation. Professional services expense in the first nine months of 2019 were up $1.056 million, or 42.3% from the first nine months of 2018, primarily related to legal and consulting costs for various corporate purposes as well as mortgage operating costs. Other expense increased by $701 thousand when compared to the same period of 2018 due to recording a mortgage warranty reserve provision and resolution of a litigation matter.

During the nine month period ended September 30, 2019, we recorded tax expense of $2.604 million, which resulted in an effective tax rate of 23.0% for the first nine months. Tax expense of $1.491 million was recognized during the nine month period ended September 30, 2018, which resulted in an effective tax rate of 21.0%. The increase in the effective tax rate is due to increased pre-tax revenues and lower non-taxable interest income from municipal securities.

Net Interest Income

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

	Three Months Ended September 30,								
	2019			2018			Change		
	Average balance	Interest earned or owed	Average yield or cost	Average balance	Interest earned or owed	Average yield or cost	Average balance	Interest earned or owed	Average yield or cost
Interest-earning assets									
Federal funds sold/cash equivalents	$ 7,436	$ 52	2.75%	$ 5,281	$ 36	2.70%	$ 2,155	$ 16	0.05% (a)
Investments – taxable	380,930	2,457	2.56%	377,312	2,334	2.45%	3,618	123	0.10% (b)
Investments – tax exempt	18,160	127	2.79%	59,001	386	2.62%	(40,841)	(259)	0.17% (b)
Loans held for sale – mortgage banking	88,484	757	3.40%	26,433	286	4.29%	62,051	471	-0.89% (c)
Loans and leases held for investment	485,863	6,305	5.15%	467,900	5,794	4.91%	17,963	511	0.24% (d)
Allowance for loan losses	(7,823)	-	0.00%	(7,787)	-	0.00%	(36)	-	0.00%
Total interest-earning assets	$ 973,050	$ 9,698	3.92%	$ 928,140	$ 8,836	3.74%	$ 44,910	$ 862	0.18%
Interest-bearing liabilities									
Interest checking and money market	$ 541,587	$ 1,145	0.84%	$ 488,139	$ 659	0.54%	$ 53,448	$ 486	0.30% (e)
Savings	33,836	6	0.08%	35,150	4	0.05%	(1,314)	2	0.03% (e)
Certificates of deposit	168,837	830	1.95%	175,060	621	1.41%	(6,223)	209	0.54% (e)
Total interest-bearing deposits	744,260	1,981	1.06%	698,349	1,284	0.73%	45,911	697	0.33%
Short-term borrowings	4,129	2	0.26%	18,346	19	0.42%	(14,217)	(17)	-0.16% (f)
Federal Home Loan Bank advances	17,637	105	2.28%	9,809	55	1.36%	7,828	50	0.92% (g)
Long-term borrowings	10,000	159	6.35%	10,000	158	6.35%	-	1	0.00%
Subordinated debentures	15,007	142	3.70%	15,009	142	3.68%	(2)	-	0.02%
Total borrowings	46,773	408	3.46%	53,164	374	2.79%	(6,391)	34	0.67%
Total interest-bearing liabilities	$ 791,033	2,389	1.20%	$ 751,513	1,658	0.88%	$ 39,520	731	0.32%
Net interest income/spread		$ 7,309	2.72%		$ 7,178	2.85%		$ 131	-0.13%
Net interest margin			2.98%			3.07%			-0.09% (h)
Notation:									
Non-interest-bearing deposits	$ 134,794	-	0.00%	$ 150,787	-	0.00%	$ (15,993)	-	0.00% (e)
Total deposits	$ 879,054	$ 1,981	0.89%	$ 849,136	$ 1,284	0.60%	$ 29,918	$ 697	0.29%
Taxable equivalents:									
Total interest-earning assets	$ 973,050	$ 9,793	3.99%	$ 928,139	$ 9,053	3.87%	$ 44,911	$ 740	0.12%
Net interest income/spread	-	$ 7,405	2.79%	-	$ 7,395	2.98%	-	$ 10	-0.19%
Net interest margin	-	-	3.02%	-	-	3.16%	-	-	-0.14%

(a) Cash balances can fluctuate from period to period based on liquidity sources and uses of the business.
(b) Average investment portfolio balances have decreased as loan growth has utilized bank liquidity.
(c) The average balance of loans held for sale increased in the third quarter of 2019 as a declining interest rate environment induced increased mortgage loan originations activity in the third quarter of 2019.
(d) The average balance of loans held for investment rose in the third quarter of 2019 due to steady loan activity in our core market areas.
(e) Overall BNC has been successful in generating deposit growth in 2019. Non-interest bearing deposits have decreased primarily due customers shift to interest bearing deposits as rates increased in the third quarter of 2018 and through the first quarter of 2019.
(f) A significant portion of our customers transferred funds into traditional interest-bearing accounts.
(g) Federal Home Loan Bank short-term advances have been utilized to flexibly manage our balance sheet and increased in the third quarter of 2019 primarily to support higher mortgage banking loan funding levels.
(h) Interest rates have been declining in 2019. Falling interest rates generally result in lower net interest margin for the banking industry.

	Nine Months Ended September 30,								
	2019			2018			Change		
	Average balance	Interest earned or owed	Average yield or cost	Average balance	Interest earned or owed	Average yield or cost	Average balance	Interest earned or owed	Average yield or cost
Interest-earning assets									
Federal funds sold/cash equivalents	$ 18,292	$ 364	2.66%	$ 11,756	$ 155	1.77%	$ 6,536	$ 209	0.89% (a)
Investments – taxable	375,786	7,393	2.63%	372,515	6,880	2.47%	3,271	513	0.16% (b)
Investments – tax exempt	41,074	810	2.62%	64,765	1,315	2.71%	(23,691)	(505)	-0.09% (b)
Loans held for sale – mortgage banking	53,464	1,442	3.60%	24,498	748	4.08%	28,966	694	-0.48% (c)
Loans and leases held for investment	474,989	18,216	5.13%	449,420	16,274	4.84%	25,569	1,942	0.29% (d)
Allowance for loan losses	(7,736)	-	0.00%	(7,816)	-	0.00%	80	-	0.00%
Total interest-earning assets	$ 955,869	$ 28,225	3.93%	$ 915,138	$ 25,372	3.69%	$ 40,731	$ 2,853	0.24%
Interest-bearing liabilities									
Interest checking and money market	$ 551,764	$ 3,508	0.85%	$ 472,485	$ 1,541	0.44%	$ 79,279	$ 1,967	0.41% (e)
Savings	34,095	16	0.06%	35,467	13	0.05%	(1,372)	3	0.01% (e)
Certificates of deposit	163,521	2,269	1.86%	177,003	1,702	1.29%	(13,482)	567	0.57% (e)
Total interest-bearing deposits	749,380	5,793	1.03%	684,955	3,256	0.64%	64,425	2,537	0.40%
Short-term borrowings	5,467	20	0.50%	18,171	49	0.36%	(12,704)	(29)	0.14% (f)
Federal Home Loan Bank advances	10,887	201	2.46%	6,175	94	2.04%	4,712	107	0.42% (g)
Long-term borrowings	10,000	476	6.35%	10,000	476	6.35%	-	-	0.00%
Subordinated debentures	15,008	448	3.93%	15,010	397	3.48%	(2)	51	0.45%
Total borrowings	41,362	1,145	3.70%	49,356	1,016	2.75%	(7,994)	129	0.95%
Total interest-bearing liabilities	$ 790,742	6,938	1.17%	$ 734,311	4,272	0.78%	$ 56,431	2,666	0.40%
Net interest income/spread		$ 21,287	2.76%		$ 21,100	2.91%		$ 187	-0.15%
Net interest margin			2.98%			3.08%			-0.10% (h)
Notation:									
Non-interest-bearing deposits	$ 128,175	-	0.00%	$ 155,104	-	0.00%	$ (26,929)	-	0.00% (e)
Total deposits	$ 877,555	$ 5,793	0.88%	$ 840,059	$ 3,256	0.52%	$ 37,496	$ 2,537	0.36%
Taxable equivalents:									
Total interest-earning assets	$ 955,869	$ 28,712	4.02%	$ 915,139	$ 26,106	3.81%	$ 40,730	$ 2,606	0.21%
Net interest income/spread	-	$ 21,774	2.84%	-	$ 21,833	3.04%	-	$ (59)	-0.20%
Net interest margin	-	-	3.05%	-	-	3.19%	-	-	-0.14%

(a) Cash balances can fluctuate from period to period based on liquidity sources and uses of the business.
(b) Average investment portfolio balances have decreased as loan growth has utilized bank liquidity.
(c) The average balance of loans held for sale increased as the lower interest rate environment induced higher mortgage loan originations, particularly in the third quarter of 2019.
(d) The average balance of loans held for investment rose in 2019 due to steady loan activity in our core market areas.
(e) Overall BNC has been successful in generating deposit growth in 2019. Non-interest bearing deposits have decreased primarily due customers shift to interest bearing deposits as rates increased in the third quarter of 2018 and through the first quarter of 2019.
(f) Certain of our customers transferred funds from a short-term cash management product into traditional interest-bearing accounts with a cash sweep feature.
(g) Federal Home Loan Bank short-term advances have been utilized to flexibly manage our balance sheet.
(h) Interest rates have been declining in 2019. Falling interest rates generally result in lower net interest margin for the banking industry.

Non-interest Income

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

	Three Months Ended September 30,		Increase (Decrease)		Nine Months Ended September 30,		Increase (Decrease)		
	2019	2018	$	%	2019	2018	$	%	
Bank charges and service fees	$ 637	$ 618	$ 19	3 %	$ 1,962	$ 1,945	$ 17	1 %	
Wealth management revenues	431	462	(31)	(7) %	1,306	1,398	(92)	(7) %	(a)
Mortgage banking revenues	8,952	2,754	6,198	225 %	17,267	7,891	9,376	119 %	(b)
Gains on sales of loans, net	46	-	46	100 %	152	178	(26)	(15) %	(c)
Gains on sales of securities, net	1,700	-	1,700	100 %	2,020	2,273	(253)	(11) %	(d)
Other	172	145	27	19 %	790	1,902	(1,112)	(58) %	(e)
Total non-interest income	$ 11,938	$ 3,979	$ 7,959	200 %	$ 23,497	$ 15,587	$ 7,910	51 %	

(a) Wealth management revenues decreased as we sold our tax practice in the fourth quarter of 2018.
(b) Mortgage banking revenues increased due to higher mortgage origination activity as interest rates declined in 2019.
(c) Gains on sale of loans can vary significantly from period to period.
(d) Gains and losses on sales of securities may vary significantly from period to period as the company manages its risk and return profile through changing economic conditions.
(e) Other income decreased due to the timing of when a SBIC fund sells a portfolio company.

Non-interest Expense

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

	Three Months Ended September 30,		Increase (Decrease)		Nine Months Ended September 30,		Increase (Decrease)		
	2019	2018	$	%	2019	2018	$	%	
Salaries and employee benefits	$ 6,402	$ 4,903	$ 1,499	31 %	$ 16,895	$ 15,503	$ 1,392	9 %	(a)
Professional services	1,606	840	766	91 %	3,555	2,499	1,056	42 %	(b)
Data processing fees	1,094	1,043	51	5 %	3,194	2,977	217	7 %	(c)
Marketing and promotion	1,361	1,256	105	8 %	3,414	3,125	289	9 %	(d)
Occupancy	517	580	(63)	(11) %	1,610	1,745	(135)	(8) %	(e)
Regulatory costs	122	130	(8)	(6) %	379	405	(26)	(6) %	
Depreciation and amortization	368	381	(13)	(3) %	1,090	1,179	(89)	(8) %	(f)
Office supplies and postage	141	128	13	10 %	405	436	(31)	(7) %	(g)
Other	1,260	545	715	131 %	2,420	1,719	701	41 %	(h)
Total non-interest expense	$ 12,871	$ 9,806	$ 3,065	31 %	$ 32,962	$ 29,588	$ 3,374	11 %	
Efficiency ratio	66.9%	87.9%			73.6%	80.7%			

(a) Salaries and employee benefits increase primarily relates to increased mortgage production in 2019 and increased accruals for incentive compensation.
(b) Professional service expense increase primarily relates to increased mortgage operating costs and higher legal and consulting expenses for various corporate purposes.
(c) Data processing fees increased due to increased network hardware and software expense.
(d) Marketing and promotion increased primarily due to increased mortgage lead costs.
(e) Occupancy decreased due to lower rent expense from consolidating certain mortgage production offices.
(f) Depreciation and amortization decreased due to lower technology related capital expenditures.
(g) Office supplies and postage decreased due lower paper utilization as we continue to employ technological advances.
(h) Other expense increase includes a mortgage warranty reserve provision and the resolution of a litigation matter.

Income Taxes

In the third quarter of 2019, we recorded income tax expense of $1.450 million, which resulted in an effective tax rate of 23.9% for the quarter. Income tax expense of $284 thousand was recognized during the third quarter of 2018, which resulted in an effective tax rate of 21.0%.

During the nine month period ended September 30, 2019, we recorded a tax expense of $2.604 million, equating to an effective tax rate of 23.0%. We recorded tax expense of $1.491 million during the nine month period ended September 30, 2018, which resulted in an effective tax rate of 21.0%. The increase in the effective tax rate is due to increased pre-tax revenues and lower non-taxable pre-tax revenue from municipal securities.

Comparison of Financial Condition at September 30, 2019 and December 31, 2018

Assets

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

	September 30, 2019	December 31, 2018	Increase (Decrease) $	Increase (Decrease) %	
Cash and cash equivalents	$ 11,644	$ 25,185	$ (13,541)	(54) %	(a)
Investment securities available for sale	386,158	411,509	(25,351)	(6) %	(b)
Federal Reserve Bank and Federal Home Loan Bank of Des Moines stock	5,447	2,941	2,506	85 %	(c)
Loans held for sale-mortgage banking	147,107	22,788	124,319	546 %	(d)
Loans and leases held for investment, net	490,150	468,468	21,682	5 %	(e)
Allowance for credit losses	(7,967)	(7,692)	(275)	4 %	
Repossessed assets, net	41	-	41	100 %	
Premises and equipment, net	16,621	16,761	(140)	(1) %	
Operating lease right of use asset	2,790	-	2,790	100 %	(f)
Accrued interest receivable	4,383	5,079	(696)	(14) %	(g)
Other assets	28,277	25,988	2,289	9 %	(h)
Total assets	$ 1,084,651	$ 971,027	$ 113,624	12 %	

(a) Cash balances can fluctuate significantly from period to period based on liquidity sources and uses of the business.
(b) Investment balances have decreased as loan growth has utilized bank liquidity.
(c) Federal Reserve Bank and Federal Home loan Bank of Des Moines stock will vary based on the Company's utilization of Federal Home Loan Bank advances.
(d) Loans held for sale increased as balances will fluctuate with the timing of loan funding and sales. During 2019, mortgage banking loan funding increased due to more favorable interest rates, particularly in the third quarter of 2019.
(e) Loans held for investment increased as we continue to fund loans in our core markets.
(f) Operating lease right of use asset was established through adoption of ASC 842, *Leases* – See Note 6.
(g) Accrued interest receivable can fluctuate from period to period.
(h) Other assets increased primarily due to the increased value of commitments to fund mortgage loans, partially offset by a deferred tax asset decrease resulting from the increased value of available for sale investment securities in 2019.

Loan Participations

Pursuant to our lending policy, loans may not exceed 85 percent of the Bank's legal lending limit (except to the extent collateralized by U.S. Treasury securities or Bank deposits) unless the Bank's Chief Credit Officer or the Executive Credit Committee grant prior approval. To accommodate creditworthy customers whose financing needs exceed lending limits and internal restrictions, the Bank sells loan participations to outside participants without recourse. Loan participations sold on a nonrecourse basis to outside financial institutions were $153.3 million as of September 30, 2019 and $166.3 million as of December 31, 2018. 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 our borrowers (dollars are in thousands):

	September 30, 2019		December 31, 2018	
North Dakota	$ 333,601	68 %	$ 325,646	70 %
Arizona	99,032	20 %	80,896	17 %
Minnesota	33,863	7 %	32,215	7 %
Other	23,280	5 %	29,212	6 %
Total gross loans and leases held for investment	$ 489,776	100 %	$ 467,969	100 %

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

	September 30, 2019		December 31, 2018	
North Dakota	$ 307,759	63 %	$ 302,813	65 %
Arizona	117,285	24 %	99,394	21 %
Minnesota	18,981	4 %	25,870	5 %
Colorado	14,398	3 %	9,266	2 %
California	13,975	3 %	12,521	3 %
Ohio	7,563	1 %	7,814	2 %
Other	9,815	2 %	10,291	2 %
Total gross loans and leases held for investment	$ 489,776	100 %	$ 467,969	100 %

Loan Maturities[1]

The following table sets forth the remaining maturities of loans in each major category of our portfolio as of September 30, 2019 (in thousands):

		Over 1 year through 5 years		Over 5 years		Total Loans and Leases
	One year or less	Fixed Rate	Indexed Rate	Fixed Rate	Indexed rate	Held for Investment
Commercial and industrial	$ 24,436	$ 5,082	$ 7,856	$ 61,039	$ 56,430	$ 154,843
Commercial real estate	1,635	3,263	6,102	37,709	131,416	180,125
SBA	2,210	2,284	10,201	3,786	30,440	48,921
Consumer	1,171	381	4,122	66,059	9,707	81,440
Land and land development	1,982	388	116	6,072	2,466	11,024
Construction	151	399	12,873	-	-	13,423
Total principal amount of loans	$ 31,585	$ 11,797	$ 41,270	$ 174,665	$ 230,459	$ 489,776

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

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

Allocation of the Allowance for Credit Losses

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

	September 30, 2019		December 31, 2018	
	Allocation of Allowance	Loans as a percent of Gross Loans Held for Investment	Allocation of Allowance	Loans as a percent of Gross Loans Held for Investment
Commercial and industrial	$ 1,987	31 %	$ 1,937	32 %
Commercial real estate	3,470	37 %	3,558	37 %
SBA	1,209	10 %	845	7 %
Consumer	963	17 %	928	17 %
Land and land development	211	2 %	225	2 %
Construction	127	3 %	199	5 %
Total	$ 7,967	100 %	$ 7,692	100 %

Nonperforming Loans

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Balance, beginning of period	$ 2,043	$ 1,769	$ 1,686	$ 1,978
Additions to nonperforming	409	71	1,172	228
Charge-offs	(117)	(57)	(138)	(150)
Reclassified back to performing	-	-	(242)	(26)
Principal payment received	(30)	(47)	(168)	(294)
Transferred to repossessed assets	(41)	(12)	(46)	(12)
Balance, end of period	$ 2,264	$ 1,724	$ 2,264	$ 1,724

Nonperforming Assets

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

	September 30, 2019	December 31, 2018
Nonperforming loans:		
Loans 90 days or more delinquent and still accruing interest	$ -	$ -
Non-accrual loans	2,264	1,686
Total nonperforming loans	$ 2,264	$ 1,686
Repossessed assets, net	41	-
Total nonperforming assets	$ 2,305	$ 1,686
Allowance for credit losses	$ 7,967	$ 7,692
Ratio of total nonperforming loans to total loans	0.36%	0.34%
Ratio of total nonperforming loans to loans and leases held for investment	0.46%	0.36%
Ratio of total nonperforming assets to total assets	0.21%	0.17%
Ratio of nonperforming loans to total assets	0.21%	0.17%
Ratio of allowance for credit losses to nonperforming loans	352%	456%

Problem Loans

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

	Watch List			Substandard		
	Impaired	Other	Total	Impaired	Other	Total
September 30, 2019	$ 1,462	$ 5,630	$ 7,092	$ 535	$ 7,338	$ 7,873
December 31, 2018	$ -	$ 5,206	$ 5,206	$ 106	$ 9,069	$ 9,175

At September 30, 2019, the Bank had $9.4 million of classified loans and $2.3 million of loans on non-accrual. This compares to $10.7 million of classified loans and $1.7 million of loans on non-accrual at December 31, 2018 and $10.8 million of classified loans and $1.7 million of loans on non-accrual at September 30, 2018.

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

In recent periods, economic activity in western North Dakota, influenced by the energy sector, has improved. However, it will take time to absorb capacity built in earlier periods, particularly in the commercial real estate sector. The economy of this region is driven by the commodity-based industries of energy and agriculture, which can be volatile and impacted by a variety of influences including weather. Throughout the third quarter of 2019, North Dakota experienced an extreme amount of moisture. Early in the fourth quarter of 2019, North Dakota experienced a significant snowstorm that will negatively impact farming activity. It is too early to estimate the full impact of the recent excessive moisture and early season snowstorm will have. Previously, the impact of increases in global tariffs and lower commodity prices on North Dakota farmers added a measure of uncertainty about the strength of the region’s agriculture sector. Prolonged periods of lower commodity prices or market disruption could have an adverse impact on our loan portfolio and our operating results.

Liabilities

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

	September 30, 2019	December 31, 2018	Increase (Decrease) $	Increase (Decrease) %	
Deposits:					
Non-interest-bearing	$ 140,331	$ 157,663	$ (17,332)	(11) %	(a)
Interest-bearing-					
Savings, interest checking and money market	573,762	542,735	31,027	6 %	(a)
Time deposits	169,289	148,207	21,082	14 %	(b)
Short-term borrowings	3,926	11,494	(7,568)	(66) %	(c)
Federal Home Loan Bank advances	61,900	-	61,900	100 %	(d)
Long-term borrowings	10,000	10,000	-	- %	
Guaranteed preferred beneficial interests in Company's subordinated debentures	15,007	15,009	(2)	- %	
Accrued interest payable	1,726	1,277	449	35 %	(e)
Accrued expenses	8,479	5,700	2,779	49 %	(f)
Operating lease liabilities	2,980	-	2,980	100 %	(g)
Other liabilities	2,692	1,189	1,503	126 %	(h)
Total liabilities	$ 990,092	$ 893,274	$ 96,818	11 %	

(a) BNC markets have been successful in generating deposit growth in 2019. Demand deposits have declined as interest-bearing deposits have become more attractive due to higher market rates.
(b) Time deposits have increased as customers seek to increase account earnings as rates increased.
(c) During 2019, a significant portion of our customers transferred funds into traditional interest-bearing accounts. Short-term borrowings will vary depending on our customers need to use repurchase agreements.
(d) The Company has borrowed on a short-term basis from the Federal Home Loan Bank as an efficient source of liquidity.
(e) Accrued interest payable increased primarily due to increased time deposit balances and increased cost of deposits.
(f) The increase is primarily due to the increased accrued mortgage commissions and incentive compensation.
(g) Operating lease liabilities were established through adoption of ASC 842, *Leases* – See Note 6.
(h) The increase primarily relates to increased taxes payable resulting from increased pre-tax income in 2019.

At September 30, 2019 and December 31, 2018, the Bank had $42.4 million and $34.2 million, respectively, in time deposits greater than $250 thousand.

Mortgage Banking Obligations

Included in accrued expenses is an estimate of mortgage banking reimbursement obligations, which aggregated $1.1 million at September 30, 2019 and $982 thousand at December 31, 2018. Although the Company sells mortgage banking loans without recourse, industry standards require standard representations and warranties which require sellers to reimburse investors for economic losses if loans default or prepay after the sale. Repurchase risk is also evident within the mortgage banking industry as continued disputes arise between lenders and investors. Such requests for repurchase are commonly due to faulty representation and generally emerge at varied timeframes subsequent to the original sale of the loan. To estimate the contingent obligation, the Company tracks historical reimbursements and calculate 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 September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Balance, beginning of period	$ 893	$ 1,058	$ 982	$ 1,103
Provision	200	-	200	-
Write offs, net	(37)	(36)	(126)	(81)
Balance, end of period	$ 1,056	$ 1,022	$ 1,056	$ 1,022

Stockholders' Equity

Our stockholders' equity increased $16.8 million from December 31, 2018 to September 30, 2019 primarily due to $8.5 million in additional retained earnings and an increase in accumulated other comprehensive income of $8.2 million. As presented in Note 17 – Regulatory Capital and Current Operating Environment, the Company maintains capital in excess of regulatory requirements.

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

Liquidity Risk Management

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

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

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

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

1. Estimated liquid assets less estimated volatile liabilities using the aforementioned methodology ($153.5 million as of September 30, 2019);
2. Borrowing capacity from the FHLB ($108.1 million as of September 30, 2019); and
3. Capacity to issue brokered deposits with maturities of less than 12 months ($148.6 million as of September 30, 2019).

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

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

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

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

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

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

Quantitative and Qualitative Disclosures about Market Risk

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

Interest rate risk arises from changes in interest rates. Interest rate risk can result from: (1) Repricing risk – timing differences in the maturity/repricing of assets, liabilities, and off-balance-sheet contracts; (2) Options risk – the effect of embedded options, such as loan prepayments, interest rate caps/floors, and deposit withdrawals; (3) Basis risk – risk resulting from unexpected changes in the spread between two or more different rates of similar maturity, and the resulting impact on the behavior of lending and funding rates; and (4) Yield curve risk – risk resulting from unexpected changes in the spread between two or more rates of different maturities from the same type of instrument. We have risk management policies to monitor and limit exposure to interest rate risk. Our asset/liability management process is utilized to manage our interest rate risk. The measurement of interest rate risk associated with financial instruments is meaningful only when all related and offsetting on-and off-balance-sheet transactions are aggregated, and the resulting net positions are identified.

Our interest rate risk exposure is actively managed with the objective of managing the level and potential volatility of net interest income in addition to the long-term growth of equity, bearing in mind that we will always be in the business of taking on rate risk and that rate risk immunization is not entirely possible. Also, it is recognized that as exposure to interest rate risk is reduced, so too may the overall level of net interest income and equity. In general, the assets and liabilities generated through ordinary business activities do not naturally create offsetting positions with respect to repricing or maturity characteristics. Access to the derivatives market can be an important element in maintaining our interest rate risk position within policy guidelines. Using derivative instruments, principally interest rate floors, caps, and interest rate swaps, the interest rate sensitivity of specific transactions, as well as pools of assets or liabilities, can be adjusted to maintain the desired interest rate risk profile. See Note 2 of our Consolidated Financial Statements for a summary of our accounting policies pertaining to such instruments.

Our primary tool for measuring and managing interest rate risk is net interest income simulation. This exercise includes our assumptions regarding the changes in interest rates and the impact on our current balance sheet. Interest rate caps and floors are included to the extent that they are exercised in the 12-month simulation period. Additionally, changes in prepayment behavior of the residential mortgage, CMOs, and mortgage-backed securities portfolios in each rate environment are captured using industry estimates of prepayment speeds for various coupon segments of the portfolio. For purposes of this simulation, projected month end balances of the various balance sheet accounts are held constant at their September 30, 2019 levels. Cash flows from a given account are reinvested back into the same account so as to keep the month end balance constant at its September 30, 2019 level. The static balance sheet assumption is made so as to project the interest rate risk to net interest income embedded in the existing balance sheet. With knowledge of the balance sheet's existing net interest income profile, more informed strategies and tactics may be developed as it relates to the structure/mix of growth.

We monitor the results of net interest income simulation on a regular basis. Net interest income is generally simulated for the upcoming 12-month horizon in seven interest rate scenarios. The scenarios generally modeled are parallel interest rate ramps of +/- 100bp, 200bp, and 300bp along with a rates unchanged scenario. Given the current low absolute level of interest rates as of September 30, 2019, the downward scenarios for interest rate movements is limited to -200bp. The parallel movement of interest rates means all projected market interest rates move up or down by the same amount. A ramp in interest rates means that the projected change in market interest rates occurs over the 12-month horizon on a pro-rata basis. For example, in the +100bp scenario, the projected Prime rate is projected to increase from 5.00% to 6.00% 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	$ 29,326	$ 29,751	$ 29,924	$ 29,598	$ 29,279	$ 28,954
Dollar change from unchanged scenario	$ (598)	$ (173)	$ -	$ (326)	$ (645)	$ (970)
Percent change from unchanged scenario	(2.00)%	(0.58)%	-	(1.09)%	(2.16)%	(3.24)%

Since there are limitations inherent in any methodology used to estimate the exposure to changes in market interest rates, these analyses are not intended to be a forecast of the actual effect of changes in market interest rates, such as those indicated above on the Company. Further, these analyses are based on our assets and liabilities as of September 30, 2019 (without forward adjustments for planned growth and anticipated business activities) and do not contemplate any actions we might undertake in response to changes in market interest rates.

Static gap analysis is another tool that may be used for interest rate risk measurement. The net differences between the amount of assets, liabilities, equity and off-balance-sheet instruments repricing within a cumulative calendar period is typically referred to as the “rate sensitivity position” or “gap position.” The following table sets forth our rate sensitivity position as of September 30, 2019. Assets and liabilities are classified by the earliest possible repricing date or maturity, whichever occurs first.

Interest Sensitivity Gap Analysis

	Estimated Maturity or Repricing at September 30, 2019				
	0–3 Months	4–12 Months	1–5 Years	Over 5 years	Total
	(dollars are in thousands)				
Interest-earning assets:					
Interest-bearing deposits with banks	$ 11,644	$ -	$ -	$ -	$ 11,644
Investment securities (a)	129,925	31,014	78,535	115,256	354,730
FRB and FHLB stock	5,447	-	-	-	5,447
Loans held for sale-mortgage banking, fixed rate	147,107	-	-	-	147,107
Loans held for investment, fixed rate	12,299	48,897	104,883	28,631	194,710
Loans held for investment, indexed rate	104,131	40,159	145,432	5,718	295,440
Total interest-earning assets	$ 410,553	$ 120,070	$ 328,850	$ 149,605	$ 1,009,078
Interest-bearing liabilities:					
Interest checking and money market accounts	$ 539,954	$ -	$ -	$ -	$ 539,954
Savings	33,808	-	-	-	33,808
Time deposits	26,996	102,505	39,624	164	169,289
Short-term borrowings	3,926	-	-	-	3,926
FHLB advances	61,900	-	-	-	61,900
Long-term borrowings	-	-	10,000	-	10,000
Subordinated debentures	-	15,000	-	7	15,007
Total interest-bearing liabilities	$ 666,584	$ 117,505	$ 49,624	$ 171	$ 833,884
Interest rate gap	$ (256,031)	$ 2,565	$ 279,226	$ 149,434	$ 175,194
Cumulative interest rate gap at September 30, 2019	$ (256,031)	$ (253,466)	$ 25,760	$ 175,194	
Cumulative interest rate gap to total assets	(23.60%)	(23.37%)	2.37%	16.15%	

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

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

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

Since there are limitations inherent in any methodology used to estimate the exposure to changes in market interest rates, these analyses are not intended to be a forecast of the actual effect of changes in market interest rates such as those indicated above on the Company. Further, these analyses are based on our assets and liabilities as of September 30, 2019 and do not contemplate any actions we might undertake in response to changes in market interest rates.

Legal Proceedings

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

BNC was subject to an arbitration with former mortgage loan originators in which the claimants asserted overtime claims against BNC under the Fair Labor Standards Act and in which BNC asserted counterclaims against each claimant. The matter was confidentially resolved to the satisfaction of the parties in September of 2019 and reflected in the financial results for the quarter ended September 30, 2019.

Management is not aware of any material pending or threatening litigation as of September 30, 2019.

Signatures

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

BNCCORP, INC.

Date:	November 13, 2019	By:	/s/ Timothy J. Franz
			Timothy J. Franz President and Chief Executive Officer
		By:	/s/ Daniel J. Collins
			Daniel J. Collins Chief Financial Officer