Quarterly Report

For the quarter ended September 30, 2020

BNCCORP, INC.

(OTCQX: BNCC)

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BNCCORP, INC.
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September 30, 2020

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

	September 30, 2020	December 31, 2019
ASSETS	(unaudited)	
CASH AND CASH EQUIVALENTS	$ 9,421	$ 10,523
DEBT SECURITIES AVAILABLE FOR SALE	186,535	265,278
FEDERAL RESERVE BANK AND FEDERAL HOME LOAN BANK STOCK	4,749	3,651
LOANS HELD FOR SALE-MORTGAGE BANKING	239,033	137,114
LOANS AND LEASES HELD FOR INVESTMENT	606,429	508,569
ALLOWANCE FOR CREDIT LOSSES	(10,005)	(8,141)
Net loans and leases held for investment	596,424	500,428
PREMISES AND EQUIPMENT, net	14,843	16,401
OPERATING LEASE RIGHT OF USE ASSETS	2,452	2,638
ACCRUED INTEREST RECEIVABLE	6,050	3,681
OTHER	41,491	27,036
Total assets	$ 1,100,998	$ 966,750
LIABILITIES AND STOCKHOLDERS' EQUITY		
DEPOSITS:		
Non-interest-bearing	$ 171,875	$ 136,313
Interest-bearing –		
Savings, interest checking and money market	582,894	514,869
Time deposits	126,213	169,365
Total deposits	880,982	820,547
SHORT-TERM BORROWINGS	6,205	4,565
FEDERAL HOME LOAN BANK ADVANCES	44,600	17,000
GUARANTEED PREFERRED BENEFICIAL INTERESTS IN COMPANY'S SUBORDINATED DEBENTURES	15,004	15,006
ACCRUED INTEREST PAYABLE	736	1,685
ACCRUED EXPENSES	11,771	7,580
OPERATING LEASE LIABILITIES	2,623	2,822
OTHER	3,863	1,267
Total liabilities	965,784	870,472
STOCKHOLDERS' EQUITY:		
Common stock, $.01 par value – Authorized 11,300,000 shares; 3,540,650 and 3,514,770 shares issued and outstanding	35	35
Capital surplus – common stock	25,841	25,831
Retained earnings	103,222	71,057
Treasury stock (128,003 and 153,883 shares, respectively)	(1,845)	(2,115)
Accumulated other comprehensive income, net	7,961	1,470
Total stockholders' equity	135,214	96,278
Total liabilities and stockholders' equity	$ 1,100,998	$ 966,750

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Income
(In thousands, except per share data, unaudited)

	For the Three Months Ended September 30, 2020	For the Three Months Ended September 30, 2019	For the Nine Months Ended September 30, 2020	For the Nine Months Ended September 30, 2019
INTEREST INCOME:				
Interest and fees on loans	$ 7,585	$ 7,062	$ 23,106	$ 19,658
Interest and dividends on investments				
Taxable	1,056	2,462	3,917	7,629
Tax-exempt	58	127	175	810
Dividends	36	47	110	128
Total interest income	8,735	9,698	27,308	28,225
INTEREST EXPENSE:				
Deposits	758	1,981	3,205	5,793
Short-term borrowings	3	2	9	20
Federal Home Loan Bank advances	1	105	13	201
Long-term borrowings	-	159	-	476
Subordinated debentures	65	142	295	448
Total interest expense	827	2,389	3,522	6,938
Net interest income	7,908	7,309	23,786	21,287
PROVISION FOR CREDIT LOSSES:	350	300	2,400	500
Net interest income after provision for credit losses	7,558	7,009	21,386	20,787
NON-INTEREST INCOME:				
Bank charges and service fees	581	637	1,761	1,962
Wealth management revenues	464	431	1,319	1,306
Mortgage banking revenues, net	23,913	8,952	57,627	17,267
Gains on sales of loans, net	96	46	99	152
Gains on sales of debt securities, net	-	1,700	1,128	2,020
Other	137	172	384	790
Total non-interest income	25,191	11,938	62,318	23,497
NON-INTEREST EXPENSE:				
Salaries and employee benefits	7,228	6,402	21,500	16,895
Professional services	2,140	1,606	5,260	3,555
Data processing fees	1,200	1,094	3,523	3,194
Marketing and promotion	998	1,361	3,967	3,414
Occupancy	522	517	1,580	1,610
Regulatory costs	77	122	182	379
Depreciation and amortization	352	368	1,066	1,090
Office supplies and postage	111	141	361	405
Other	1,975	1,260	3,662	2,420
Total non-interest expense	14,603	12,871	41,101	32,962
Income before income taxes	18,146	6,076	42,603	11,322
Income tax expense	4,446	1,450	10,438	2,604
Net income	$ 13,700	$ 4,626	$ 32,165	$ 8,718
Basic earnings per common share	$ 3.84	$ 1.31	$ 9.03	$ 2.47
Diluted earnings per common share	$ 3.84	$ 1.30	$ 9.02	$ 2.45

See accompanying notes to consolidated financial statements.

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

	For the Three Months Ended September 30,				For the Nine Months Ended September 30,			
	2020		2019		2020		2019	
NET INCOME		$ 13,700		$ 4,626		$ 32,165		$ 8,718
Unrealized gain on debt securities available for sale	$ 1,936		$ 2,074		$ 9,737		$ 12,931	
Reclassification adjustment for gains included in net income	-		(1,700)		(1,128)		(2,020)	
Other comprehensive income before tax	1,936		374		8,609		10,911	
Income tax expense related to items of other comprehensive income	(476)		(92)		(2,118)		(2,684)	
Other comprehensive income	$ 1,460	1,460	$ 282	282	$ 6,491	6,491	$ 8,227	8,227
TOTAL COMPREHENSIVE INCOME		$ 15,160		$ 4,908		$ 38,656		$ 16,945

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 Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount					
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
BALANCE, December 31, 2019	3,514,770	$ 35	$ 25,831	$ 71,057	$ (2,115)	$ 1,470	$ 96,278
Net income	-	-	-	32,165	-	-	32,165
Other comprehensive income	-	-	-	-	-	6,491	6,491
Impact of share-based compensation	25,880	-	10	-	270	-	280
BALANCE, September 30, 2020	3,540,650	$ 35	$ 25,841	$ 103,222	$ (1,845)	$ 7,961	$ 135,214

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)

	2020	2019
OPERATING ACTIVITIES:		
Net income	$ 32,165	$ 8,718
Adjustments to reconcile net income to net cash provided by operating activities -		
Provision for credit losses	2,400	500
Depreciation and amortization	1,066	1,090
Net amortization of premiums on debt securities and subordinated debentures	2,458	5,709
Share-based compensation	280	81
Change in accrued interest receivable and other assets, net	504	(2,868)
Loss (gain) on sale of bank premises and equipment	8	(16)
Gains on sales of debt securities, net	(1,128)	(2,020)
Increase in deferred taxes	(900)	-
Change in other liabilities, net	2,733	6,340
Originations of loans held for sale, mortgage banking	(2,080,598)	(842,424)
Proceeds from sales of loans held for sale, mortgage banking	1,984,571	721,232
Fair value adjustment for loans held for sale, mortgage banking	(5,892)	(3,128)
Fair value adjustment on mortgage banking derivatives	(12,588)	(3,088)
Proceeds from sales of loans	12,625	1,710
Gains on sales of loans, net	(99)	(152)
Net cash used in operating activities	(62,395)	(108,316)
INVESTING ACTIVITIES:		
Purchases of debt securities	(10,796)	(159,209)
Proceeds from sales of debt securities	72,108	148,380
Proceeds from maturities of debt securities	22,592	43,400
Purchases of Federal Reserve and Federal Home Loan Bank Stock	(6,056)	(18,378)
Sales of Federal Reserve and Federal Home Loan Bank Stock	4,958	15,872
Net increase in loans held for investment	(110,922)	(23,465)
Proceeds from sales of premises and equipment	1	22
Purchases of premises and equipment	(267)	(956)
Net cash (used in) provided by investing activities	(28,382)	5,666

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)

	2020	2019
FINANCING ACTIVITIES:		
Net increase in deposits	$ 60,435	$ 34,777
Net increase (decrease) in short-term borrowings	1,640	(7,568)
Repayments of Federal Home Loan Bank advances	(123,800)	(426,800)
Proceeds from Federal Home Loan Bank advances	151,400	488,700
Net cash provided by financing activities	89,675	89,109
NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,102)	(13,541)
CASH AND CASH EQUIVALENTS, beginning of period	10,523	25,185
CASH AND CASH EQUIVALENTS, end of period	$ 9,421	$ 11,644
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	$ 4,472	$ 6,489
Income taxes paid	$ 10,065	$ 1,666

See accompanying notes to consolidated financial statements.

NOTE 1 – Organization of Operations, BNCCORP, INC.

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

NOTE 2 – Basis of Presentation and Accounting Policies

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

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

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

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

RECENTLY ISSUED OR ADOPTED ACCOUNTING PRONOUNCEMENTS & INTERPRETATIONS

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

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

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

NOTE 3 – Debt Securities Available for Sale

Debt securities have been classified in the consolidated balance sheets according to management's intent. The Company had no securities designated as trading or held-to-maturity in its portfolio at September 30, 2020, or December 31, 2019. The carrying amount of available-for-sale debt securities and their estimated fair values were as follows (in thousands):

	As of September 30, 2020			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities	$ 4,995	$ 84	$ -	$ 5,079
U.S. government sponsored entity mortgage-backed securities issued by FNMA/FHLMC	8,369	59	(107)	8,321
U.S. government agency small business administration pools guaranteed by SBA	30,210	-	(1,031)	29,179
Collateralized mortgage obligations guaranteed by GNMA	18,601	1,370	-	19,971
Collateralized mortgage obligations issued by FNMA/FHLMC	69,599	4,586	-	74,185
Commercial mortgage-backed securities issued by FHLMC	13,169	2,009	-	15,178
Other commercial mortgage-backed securities	13,628	413	(88)	13,953
Asset-backed securities	5,183	45	-	5,228
State and municipal bonds	13,703	1,738	-	15,441
	$ 177,457	$ 10,304	$ (1,226)	$ 186,535

	As of December 31, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities	$ 4,992	$ 2	$ -	$ 4,994
U.S. government sponsored entity mortgage-backed securities issued by FNMA/FHLMC	5,634	16	(7)	5,643
U.S. government agency small business administration pools guaranteed by SBA	53,873	-	(2,236)	51,637
Collateralized mortgage obligations guaranteed by GNMA	21,120	671	(1)	21,790
Collateralized mortgage obligations issued by FNMA/FHLMC	68,353	523	(261)	68,615
Commercial mortgage-backed securities issued by FHLMC	21,625	931	-	22,556
Other commercial mortgage-backed securities	56,530	921	(672)	56,779
Asset-backed securities	12,810	83	-	12,893
State and municipal bonds	19,873	948	(450)	20,371
	$ 264,810	$ 4,095	$ (3,627)	$ 265,278

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

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ -	$ -
Due after one year through five years	4,995	5,079
Due after five years through ten years	38,348	40,680
Due after ten years	134,114	140,776
Total	$ 177,457	$ 186,535

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

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

	September 30, 2020								
	Less than 12 months			12 months or more			Total		
Description of Securities	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss
U.S. Treasury securities	-	$ -	$ -	-	$ -	$ -	-	$ -	$ -
U.S. government sponsored entity mortgage-backed securities issued by FNMA/FHLMC	1	3,910	(107)	-	-	-	1	3,910	(107)
U.S. government agency small business administration pools guaranteed by SBA	-	-	-	4	29,179	(1,031)	4	29,179	(1,031)
Collateralized mortgage obligations guaranteed by GNMA	-	-	-	-	-	-	-	-	-
Collateralized mortgage obligations issued by FNMA/ FHLMC	-	-	-	-	-	-	-	-	-
Commercial mortgage-backed securities issued by FHLMC	-	-	-	-	-	-	-	-	-
Other commercial mortgage-backed securities	1	3,093	(88)	-	-	-	1	3,093	(88)
Asset-backed securities	1	163	-	-	-	-	1	163	-
State and municipal bonds	-	-	-	-	-	-	-	-	-
Total temporarily impaired securities	3	$ 7,166	$ (195)	4	$ 29,179	$ (1,031)	7	$ 36,345	$ (1,226)

Description of Securities	December 31, 2019								
	Less than 12 months			12 months or more			Total		
	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss
U.S. Treasury securities	-	$ -	$ -	-	$ -	$ -	-	$ -	$ -
U.S. government sponsored entity mortgage-backed securities issued by FNMA/FHLMC	1	4,779	(7)	-	-	-	1	4,779	(7)
U.S. government agency small business administration pools guaranteed by SBA	2	14,140	(142)	5	37,493	(2,094)	7	51,633	(2,236)
Collateralized mortgage obligations guaranteed by GNMA	1	507	(1)	-	-	-	1	507	(1)
Collateralized mortgage obligations issued by FNMA/ FHLMC	5	35,047	(261)	-	-	-	5	35,047	(261)
Commercial mortgage-backed securities issued by FHLMC	-	-	-	-	-	-	-	-	-
Other commercial mortgage-backed securities	3	25,756	(672)	-	-	-	3	25,756	(672)
Asset-backed securities	-	-	-	-	-	-	-	-	-
State and municipal bonds	3	13,780	(450)	-	-	-	3	13,780	(450)
Total temporarily impaired securities	15	$ 94,009	$ (1,533)	5	$ 37,493	$ (2,094)	20	$ 131,502	$ (3,627)

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

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

NOTE 4 – Loans and Leases

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

	September 30, 2020	December 31, 2019
Loans held for sale-mortgage banking	$ 239,033	$ 137,114
Commercial and industrial	$ 161,399	$ 162,592
Commercial real estate	196,646	193,203
SBA	135,306	46,799
Consumer	85,430	82,498
Land and land development	9,630	10,449
Construction	19,113	12,656
Gross loans and leases held for investment	607,524	508,197
Unearned income and net unamortized deferred fees and costs	(1,095)	372
Loans, net of unearned income and unamortized fees and costs	606,429	508,569
Allowance for credit losses	(10,005)	(8,141)
Net loans and leases held for investment	$ 596,424	$ 500,428

NOTE 5 – Allowance for Credit Losses

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

	Three Months Ended September 30, 2020						
	Commercial and industrial	Commercial real estate	SBA	Consumer	Land and land development	Construction	Total
Balance, beginning of period	$ 3,108	$ 3,822	$ 1,332	$ 1,036	$ 204	$ 178	$ 9,680
Provision (reduction)	196	45	68	34	(12)	19	350
Loans charged off	(26)	-	-	(6)	-	-	(32)
Loan recoveries	1	-	1	3	2	-	7
Balance, end of period	$ 3,279	$ 3,867	$ 1,401	$ 1,067	$ 194	$ 197	$ 10,005

	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

	Nine Months Ended September 30, 2020						
	Commercial and industrial	Commercial real estate	SBA	Consumer	Land and land development	Construction	Total
Balance, beginning of period	$ 2,366	$ 3,502	$ 1,131	$ 853	$ 187	$ 102	$ 8,141
Provision (reduction)	1,000	801	266	239	(1)	95	2,400
Loans charged off	(88)	(437)	-	(31)	-	-	(556)
Loan recoveries	1	1	4	6	8	-	20
Balance, end of period	$ 3,279	$ 3,867	$ 1,401	$ 1,067	$ 194	$ 197	$ 10,005

	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

The following table shows the balance in the allowance for credit losses at September 30, 2020, and December 31, 2019, and the related loan balances, segregated on the basis of impairment methodology (in thousands). Impaired loans are loans on nonaccrual status and troubled debt restructurings, which are individually evaluated for impairment, and other loans deemed to have similar risk characteristics. All other loans are collectively evaluated for impairment.

	Allowance For Credit Losses			Gross Loans and Leases Held for Investment		
	Impaired	Other	Total	Impaired	Other	Total
September 30, 2020						
Commercial and industrial	$ 766	$ 2,513	$ 3,279	$ 1,788	$ 159,611	$ 161,399
Commercial real estate	-	3,867	3,867	893	195,753	196,646
SBA	373	1,028	1,401	1,001	134,305	135,306
Consumer	-	1,067	1,067	26	85,404	85,430
Land and land development	-	194	194	-	9,630	9,630
Construction	-	197	197	-	19,113	19,113
Total	$ 1,139	$ 8,866	$ 10,005	$ 3,708	$ 603,816	$ 607,524
December 31, 2019						
Commercial and industrial	$ 497	$ 1,869	$ 2,366	$ 1,610	$ 160,982	$ 162,592
Commercial real estate	172	3,330	3,502	1,448	191,755	193,203
SBA	59	1,072	1,131	380	46,419	46,799
Consumer	-	853	853	37	82,461	82,498
Land and land development	-	187	187	5	10,444	10,449
Construction	-	102	102	-	12,656	12,656
Total	$ 728	$ 7,413	$ 8,141	$ 3,480	$ 504,717	$ 508,197

Performing and non-accrual loans

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

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

	September 30, 2020					
	Current	31-89 Days Past Due	90 Days or More Past Due And Accruing	Total Performing	Non-accrual	Total
Commercial and industrial:						
Business loans	$ 71,206	$ -	$ -	$ 71,206	$ 1,584	$ 72,790
Agriculture	29,634	-	-	29,634	-	29,634
Owner-occupied commercial real estate	58,771	-	-	58,771	204	58,975
Commercial real estate	195,753	-	-	195,753	893	196,646
SBA	134,306	-	-	134,306	1,000	135,306
Consumer:						
Automobile	22,142	11	-	22,153	11	22,164
Home equity	11,022	-	-	11,022	-	11,022
1st mortgage	10,246	-	-	10,246	-	10,246
Other	41,969	13	-	41,982	16	41,998
Land and land development	9,630	-	-	9,630	-	9,630
Construction	19,113	-	-	19,113	-	19,113
Total loans held for investment	603,792	24	-	603,816	3,708	607,524
Loans held for sale	239,030	3	-	239,033	-	239,033
Total gross loans	$ 842,822	$ 27	$ -	$ 842,849	$ 3,708	$ 846,557

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Interest income that would have been recorded	$ 67	$ 38	$ 176	$ 104
Interest income recorded	-	-	-	-
Effect on interest income on loans	$ 67	$ 38	$ 176	$ 104

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, 2020, the Company had $586.7 million of loans held for investment categorized as pass rated loans compared to $489.8 million at December 31, 2019.

Loans designated as watch list are loans that possess some credit deficiency that deserves close attention due to emerging problems. Such loans pose unwarranted financial risk that, if left uncorrected, may result in deterioration of the repayment prospects for the asset or in the Bank’s credit position at some future date. At September 30, 2020, the Company had $10.2 million of loans categorized as watch list loans compared to $9.2 million at December 31, 2019.

Loans graded as substandard or doubtful are considered “Classified” loans for regulatory purposes. Loans classified as substandard are loans that are generally inadequately protected by the current net worth and paying capacity of the obligor, or by the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Substandard loans are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loans classified as doubtful have the weaknesses of those classified as substandard, with additional characteristics that make collection in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. At September 30, 2020, the Company had $8.5 million of substandard loans and $2.1 million of doubtful loans. At December 31, 2019, the Company had $7.8 million of substandard loans and $1.5 million of doubtful loans.

Impaired loans

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

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

	September 30, 2020				
	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	$ 2,004	$ 1,417	$ 766	$ 1,417	$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	-	-	-	-	-
SBA	753	731	373	732	-
Consumer:					
Automobile	-	-	-	-	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans with an allowance recorded	$ 2,757	$ 2,148	$ 1,139	$ 2,149	$ -
Impaired loans without an allowance recorded:					
Commercial and industrial:					
Business loans	$ 248	$ 167	$ -	$ 185	$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	211	204	-	225	-
Commercial real estate	1,703	893	-	1,118	9
SBA	338	270	-	276	-
Consumer:					
Automobile	22	11	-	12	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	37	15	-	19	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans without an allowance recorded	$ 2,559	$ 1,560	$ -	$ 1,835	$ 9
TOTAL IMPAIRED LOANS	$ 5,316	$ 3,708	$ 1,139	$ 3,984	$ 9

	December 31, 2019				
	Unpaid Principal	**Recorded Investment**	**Related Allowance**	**Average Recorded Balance (12-months)**	**Interest Income Recognized (12-months)**
Impaired loans with an allowance recorded:					
Commercial and industrial:					
Business loans	$ 2,004	$ 1,417	$ 497	$ 1,429	$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	1,762	1,448	172	1,476	75
SBA	121	101	59	103	-
Consumer:					
Automobile	-	-	-	-	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans with an allowance recorded	$ 3,887	$ 2,966	$ 728	$ 3,008	$ 75
Impaired loans without an allowance recorded:					
Commercial and industrial:					
Business loans	$ 248	$ 193	$ -	$ 221	$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	-	-	-	-	-
SBA	338	279	-	280	-
Consumer:					
Automobile	18	15	-	16	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	42	22	-	27	-
Land and land development	137	5	-	16	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans without an allowance recorded	$ 783	$ 514	$ -	$ 560	$ -
TOTAL IMPAIRED LOANS	$ 4,670	$ 3,480	$ 728	$ 3,568	$ 75

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

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

	September 30, 2020			
	Accrual	Non-accrual	Total	Allowance
Commercial and industrial:				
Business loans	$ -	$ 1,417	$ 1,417	$ 766
Agriculture	-	-	-	-
Owner-occupied commercial real estate	-	204	204	-
Commercial real estate	-	893	893	-
SBA	-	368	368	56
Consumer:				
Automobile	-	-	-	-
Home equity	-	-	-	-
1st mortgage	-	-	-	-
Other	-	-	-	-
Land and land development	-	-	-	-
Construction	-	-	-	-
Loans held for sale	-	-	-	-
	$ -	$ 2,882	$ 2,882	$ 822

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

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

When a loan is modified as a TDR, there may be a direct, material impact on the loans within the consolidated balance sheets, as principal balances may be partially forgiven. There were no new TDR for the three-month period ended September 30, 2020 and one new TDR for the nine-month period ended September 30, 2020 with a premodification and post-modification balance of $230 thousand. There were no new TDRs for the three- or nine-month period ended September 30, 2019. Loans that were non-accrual prior to modification remain on non-accrual for at least six months following modification. Non-accrual TDR loans that have performed according to the modified terms for six months may be returned to accruing status. Loans that were accruing prior to modification remain on accrual status after the modification as long as the loan continues to perform under the new terms.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Interest income that would have been recorded	$ 55	$ 77	$ 161	$ 230
Interest income recorded	-	22	9	65
Effect on interest income on loans	$ 55	$ 55	$ 152	$ 165

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

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

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

NOTE 6 – Leases

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

The components of lease cost for the three- and nine-month period ended September 30, 2020, and September 30, 2019, were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Operating lease costs	$ 246	$ 231	$ 731	$ 714
Variable lease costs	1	6	25	32
Short-term lease costs	4	4	12	13
Total lease costs	$ 251	$ 241	$ 768	$ 759

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

	As of September 30, 2020		As of December 31, 2019	
Operating lease right of use asset	$	2,452	$	2,638
Operating lease liabilities		2,623		2,822

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2020		2019		2020		2019	
Cash paid for amounts included in the measurement of lease liabilities	$	253	$	245	$	745	$	736
ROU assets obtained in exchange for lease obligations		342		-		405		111
Reductions to ROU assets resulting from reduction in lease obligations		220		185		590		1,011

	As of September 30, 2020	As of December 31, 2019
Weighted average remaining lease term	4.20 years	4.94 years
Weighted average discount rate	6.00%	6.00%

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

	Operating Leases	
2020	$	187
2021		607
2022		614
2023		538
2024		357
Thereafter		320
Total lease liabilities	$	2,623

NOTE 7 – Earnings Per Share

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

	Three Months Ended September 30, 2020	Nine Months Ended September 30, 2020
Denominator for basic earnings per share:		
Average common shares outstanding	3,567,980	3,563,204
Dilutive effect of stock compensation	439	2,018
Denominator for diluted earnings per share	3,568,419	3,565,222
Numerator (in thousands):		
Net income	$ 13,700	$ 32,165
Basic earnings per common share	$ 3.84	$ 9.03
Diluted earnings per common share	$ 3.84	$ 9.02

	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

NOTE 8 – Share-Based Compensation

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

	1995	2015	Total
Total Shares in Plan	250,000	50,000	300,000
Total Shares Available for Issuance	45,951	35,625	81,576

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

	Nine Months Ended September 30, 2020		Nine Months Ended September 30, 2019	
	Options to Purchase Shares	Weighted Average Exercise Price	Options to Purchase Shares	Weighted Average Exercise Price
Outstanding, beginning of year	21,000	$ 3.00	42,600	$ 3.00
Granted	-	-	-	-
Exercised	(21,000)	3.00	(15,000)	3.00
Forfeited	-	-	-	-
Outstanding, end of period	-	-	27,600	3.00

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

The Company recognized share-based compensation expense of $7,000 related to restricted stock for the three-month period ended September 30, 2020, and $21,000 for the nine-month period ended September 30, 2020. 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.

At September 30, 2020, the Company had $54,000 of unamortized restricted stock compensation expense. The cost of a restricted stock grant is recognized over the vesting period, which is generally four years.

NOTE 9 – Revenue from Contracts with Customers

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Service charges on deposits	$ 133	$ 189	$ 439	$ 566
Bankcard fees	241	239	703	757
Bank charges and service fees not within scope of ASC 606	207	209	619	639
Total bank charges and service fees	581	637	1,761	1,962
Wealth management revenue	464	431	1,319	1,279
Wealth management revenue not within the scope of ASC 606	-	-	-	27
Total wealth management revenues	464	431	1,319	1,306
Other	10	7	30	41
Other not within the scope of ASC 606 (a)	127	165	354	749
Total other	137	172	384	790
Other non-interest income not within the scope of ASC 606 (a)	24,009	10,698	58,854	19,439
Total non-interest income	$ 25,191	$ 11,938	$ 62,318	$ 23,497

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

The Company had no material contract assets or remaining performance obligations as of September 30, 2020. Total receivables from revenue recognized under the scope of ASC 606 were $486 thousand as of September 30, 2020, and $460 thousand as of December 31, 2019. These receivables are included as part of the Other assets line on the Company's Consolidated Balance Sheets.

NOTE 10 – Fair Value Measurements

FASB ASC 820, *Fair Value Measurement,* defines fair value and establishes a framework for measuring fair value of assets and liabilities using a hierarchy system consisting of three levels based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets that the Company has the ability to access.

Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which significant assumptions are observable in the market.

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

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

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

	Carrying Value at September 30, 2020				Nine Months Ended September 30, 2020
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
ASSETS					
Debt securities available for sale	$ 186,535	$ 5,079	$ 181,456	$ -	$ 1,128
Loans held for sale	239,033	-	239,033	-	5,892
Commitments to originate mortgage loans	19,852	-	19,852	-	13,394
Total assets at fair value	$ 445,420	$ 5,079	$ 440,341	$ -	$ 20,414
LIABILITIES					
Commitments to sell mortgage loans	$ 107	$ -	$ 107	$ -	$ (719)
Mortgage banking short positions	1,018	-	1,018	-	(87)
Total liabilities at fair value	$ 1,125	$ -	$ 1,125	$ -	$ (806)

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

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

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

	Carrying Value at September 30, 2020				Nine Months Ended September 30, 2020
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
Impaired loans(1)	$ 2,569	$ -	$ -	$ 2,569	$ (929)
Other real estate(2)	-	-	-	-	-
Total	$ 2,569	$ -	$ -	$ 2,569	$ (929)

	Carrying Value at December 31, 2019				Twelve Months Ended December 31, 2019
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
Impaired loans(1)	$ 2,752	$ -	$ -	$ 2,752	$ (473)
Other real estate(2)	-	-	-	-	35
Total	$ 2,752	$ -	$ -	$ 2,752	$ (438)

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

(2) The carrying value represents the fair value of the collateral less estimated selling costs and is based upon appraised values. The gain or loss reported is a combination of gains and/or losses on sales of other real estate and provisions for other real estate losses.

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

NOTE 11 – Fair Value of Financial Instruments

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

	Level in Fair Value Measurement Hierarchy	September 30, 2020		December 31, 2019	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:					
Cash and cash equivalents	Level 1	$ 9,421	$ 9,421	$ 10,523	$ 10,523
Debt securities available for sale	Level 1	5,079	5,079	4,994	4,994
Debt securities available for sale	Level 2	181,456	181,456	260,284	260,284
Federal Reserve Bank and Federal Home Loan Bank stock	Level 2	4,749	4,749	3,651	3,651
Loans held for sale-mortgage banking	Level 2	239,033	239,033	137,114	137,114
Commitments to originate mortgage loans	Level 2	19,852	19,852	4,358	4,358
Gross loans and leases held for investment	Level 2	603,816	614,484	504,717	505,156
Gross loans and leases held for investment	Level 3	3,708	1,139	3,480	2,752
Accrued interest receivable	Level 2	6,050	6,050	3,681	3,681
		$ 1,073,164	$ 1,081,263	$ 932,802	$ 932,513
Liabilities and Stockholders' Equity:					
Deposits, noninterest-bearing	Level 2	$ 171,875	$ 171,875	$ 136,313	$ 136,313
Deposits, interest-bearing	Level 2	709,107	709,904	684,234	684,215
Borrowings and advances	Level 2	50,805	50,805	21,565	21,565
Accrued interest payable	Level 2	736	736	1,685	1,685
Accrued expenses	Level 2	11,771	11,771	7,580	7,580
Commitments to sell mortgage loans	Level 2	107	107	21	21
Mortgage banking short positions	Level 2	1,018	1,018	299	299
Guaranteed preferred beneficial interests in Company's subordinated debentures	Level 2	15,004	9,421	15,006	10,834
		$ 960,423	$ 955,637	$ 866,703	$ 862,512
Financial instruments with off-balance-sheet risk:					
Commitments to extend credit	Level 2	$ -	$ 154	$ -	$ 225
Standby and commercial letters of credit	Level 2	$ -	$ 9	$ -	$ 8

NOTE 12 – Federal Home Loan Bank Advances

As of September 30, 2020, the Bank had $44.6 million of Federal Home Loan Bank (FHLB) advances outstanding. At September 30, 2020, the Bank had loans with unamortized principal balances of approximately $168.8 million and debt securities with unamortized principal balances of approximately $19.9 million pledged as collateral to the FHLB.

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

As of September 30, 2020, the Bank has remaining collateral capacity to draw advances of approximately $73.7 million based upon the aggregate collateral that is currently pledged, subject to a requirement to purchase additional FHLB stock, based upon collateral pledged.

NOTE 13 – Other Borrowings

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

September 30, 2020

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

Secured Borrowing Lines:	**Collateral Pledged**	**Line**	**Outstanding**	**Available**
BNC National Bank Line	$ 2,188	$ 1,116	$ -	$ 1,116
BNC Line	127,862	10,000	-	10,000
Total	$ 130,050	$ 11,116	$ -	$ 11,116

(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, 2020, the pledged collateral for the secured BNC National Bank Line was comprised of commercial real estate loans and the pledged collateral for the secured BNC Line was the common stock of BNC National Bank.

December 31, 2019

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

Secured Borrowing Lines:	**Collateral Pledged**	**Line**	**Outstanding**	**Available**
BNC National Bank Line	$ 2,271	$ 2,157	$ -	$ 2,157
BNC Line	102,955	10,000	-	10,000
Total	$ 105,226	$ 12,157	$ -	$ 12,157

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

At December 31, 2019, the pledged collateral for the secured BNC National Bank Line was comprised of commercial real estate loans and the pledged collateral for the secured BNC Line was the common stock of BNC National Bank.

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

In July 2007, BNC issued $15.0 million of floating rate subordinated debentures. The interest rate paid on the securities is equal to the three month LIBOR plus 1.40%. The interest rate at September 30, 2020, and December 31, 2019, was 1.70% and 3.50%, respectively. The subordinated debentures mature on October 1, 2037. The subordinated debentures may be redeemed at par and the corresponding debentures may be prepaid at the option of BNCCORP, subject to approval by the Federal Reserve Board.

NOTE 15 – Stockholders' Equity

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

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

NOTE 16 – Regulatory Capital and Current Operating Environment

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

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

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

	Actual		For Capital Adequacy Purposes		To be Well Capitalized		Amount in Excess of Well Capitalized	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
September 30, 2020								
Total Risk-Based Capital:								
Consolidated	$ 151,561	20.30 %	$ 59,724	≥8.00 %	$ N/A	N/A %	$ N/A	N/A %
BNC National Bank	128,748	17.26	59,658	≥8.00	74,572	10.00	54,176	7.26
Tier 1 Risk-Based Capital:								
Consolidated	142,221	19.05	44,793	≥6.00	N/A	N/A	N/A	N/A
BNC National Bank	119,418	16.01	44,743	≥6.00	59,658	8.00	59,760	8.01
Common Equity Tier 1 Risk-Based Capital:								
Consolidated	127,216	17.04	33,595	≥4.50	N/A	N/A	N/A	N/A
BNC National Bank	119,418	16.01	33,557	≥4.50	48,472	6.50	70,946	9.51
Tier 1 Leverage Capital:								
Consolidated	142,221	12.94	43,959	≥4.00	N/A	N/A	N/A	N/A
BNC National Bank	119,418	10.88	43,913	≥4.00	54,891	5.00	64,527	5.88
Tangible Common Equity (to total assets): (a)								
Consolidated	135,198	12.28	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	127,845	11.62	N/A	N/A	N/A	N/A	N/A	N/A
December 31, 2019								
Total Risk-Based Capital:								
Consolidated	$ 117,817	17.13%	$ 55,023	≥8.00%	$ N/A	N/A%	$ N/A	N/A%
BNC National Bank	109,044	15.88	54,940	≥8.00	68,675	10.00	40,369	5.88
Tier 1 Risk-Based Capital:								
Consolidated	109,675	15.95	41,268	≥6.00	N/A	N/A	N/A	N/A
BNC National Bank	100,902	14.69	41,205	≥6.00	54,940	8.00	45,962	6.69
Common Equity Tier 1 Risk-Based Capital:								
Consolidated	94,669	13.76	30,951	≥4.50	N/A	N/A	N/A	N/A
BNC National Bank	100,902	14.69	30,904	≥4.50	44,639	6.50	56,263	8.19
Tier 1 Leverage Capital:								
Consolidated	109,675	10.65	41,205	≥4.00	N/A	N/A	N/A	N/A
BNC National Bank	100,902	9.81	41,142	≥4.00	51,427	5.00	49,475	4.81
Tangible Common Equity (to total assets): (a)								
Consolidated	96,159	9.95	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	102,837	10.65	N/A	N/A	N/A	N/A	N/A	N/A

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

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

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

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

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

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

Net income was $13.7 million, or $3.84 per diluted share, for the quarter ended September 30, 2020. This compared to net income of $4.6 million, or $1.30 per diluted share, in the same period of 2019.

Net interest income for the third quarter of 2020 was $7.9 million, an increase of $599 thousand, or 8.2%, from $7.3 million for the same period of 2019. The gain primarily reflected the impact of increases in loans held for sale and loans held for investment, including PPP loans, the reduction of debt securities to support increased loan activity, reduced cost of deposits, lower balances and costs of FHLB advances, and the redemption of $10.0 million of subordinated debt in the fourth quarter of 2019. The net interest margin for the current period increased to 3.09% from 2.98% a year ago.

Interest income decreased by $963 thousand for the quarter ended September 30, 2020, to $8.7 million in 2020, compared to $9.7 million for the third quarter of 2019. A portion of the decrease is a result of the impact of higher average loan balances and a reduction in loan yields due to growth in mortgage loans held for sale and PPP loans. Additionally, interest income from debt securities decreased as debt securities balances were liquidated to support the increase in loan activity. Yield on average interest-earning assets was 3.42% in the third quarter of 2020, compared to 3.92% in the 2019 third quarter.

During the third quarter of 2020, the average balance of interest earning assets increased by $43.6 million when compared to the third quarter of 2019. Average loans held for investment increased $118.7 million, or 24.4%, and average loans held for sale increased by $99.8 million, or 112.8%, when comparing the third quarters of 2020 and 2019. The average balance of debt securities decreased by $207.4 million, or 52.4%, in the third quarter of 2020, compared to the same period a year ago. Yields on debt securities decreased to 2.33% in the third quarter of 2020 from 2.54% in the same period of 2019.

Interest expense in the third quarter of 2020 was $827 thousand, a decrease of $1.6 million, or 65.4%, from the same period in 2019. The cost of interest bearing liabilities decreased to 0.43% in the current quarter from 1.20% in the same period of 2019. The cost of core deposits was 0.33% in the third quarter of 2020 and 0.89% in the same period of 2019. Interest expense was also $159 thousand lower in the 2020 third quarter due to the redemption of $10.0 million of subordinated debt in the fourth quarter of 2019.

While credit risks have not yet manifested in significantly increased nonperforming loan levels, the Company recorded a provision for credit losses of $350 thousand in the third quarter of 2020, due to the uncertain economic impact of COVID-19, compared to $300 thousand in the same period of 2019. Loan balances charged-off in the third quarter of 2020 were $32 thousand.

Non-interest income for the third quarter of 2020 was $25.2 million. This compares to non-interest income of $11.9 million for the same period in 2019, an increase of $13.3 million, or 111.0%. Mortgage banking revenues were $23.9 million in the current period compared to $9.0 million in the same period of 2019. The increase was driven by lower interest rates facilitating higher mortgage banking origination activity in addition to increased margins relative to the year-ago period. Gains on sales of assets aggregated $96 thousand in the third quarter of 2020, compared to $1.7 million 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 2020 was $14.6 million compared to $12.9 million in the same period of 2019, an increase of $1.7 million. Salaries and benefits increased $826 thousand, or 12.9%, from the third quarter 2019. The increase in salaries and employee benefits relates to mortgage operations due to elevated levels of loan production in the third quarter of 2020 compared to the same period in 2019. Professional services in the third quarter of 2020 were up $534 thousand, or 33.3%, from the third quarter 2019, due to increased mortgage loan closing costs partially offset by reductions in consulting, audit, and legal expenses. Other expense increased by $715 thousand when compared to the same period of 2019 due primarily to an impairment charge of a property to reflect the estimated fair value of a branch location.

In the third quarter of 2020, the Company recorded tax expense of $4.4 million, which resulted in an effective tax rate of 24.5% for the quarter. Tax expense of $1.5 million was recognized during the same period of 2019, which resulted in an effective tax rate of 23.9%. The increase in the effective tax rate in 2020 is due to higher pre-tax revenues and lower non-taxable interest income from municipal securities.

Summary for the Nine Months Ended September 30, 2020 and 2019

Net income was $32.2 million, or $9.02 per diluted share, for the nine months ended September 30, 2020. This compared to net income of $8.7 million, or $2.45 per diluted share, in the first nine months of 2019.

Net interest income for the nine months ended September 30, 2020, was $23.8 million, an increase of $2.5 million, or 11.7%, from $21.3 million for the same period of 2019. The increase primarily reflected the positive impact of the decreased cost of deposits and borrowings, and the redemption of $10.0 million of subordinated debt in the fourth quarter of 2019. The net interest margin for the current period increased to 3.22% from 2.98% a year ago.

Interest income decreased to $27.3 million, compared to $28.2 million for the same period of 2019. The decrease reflected the impact of higher average loan balances offset by lower loan yields due the growth in mortgage loans held for sale and PPP loans. In addition, interest income from debt securities decreased as reduced debt securities balances supported increased loan activity. The yield on average interest-earning assets in the first nine months of 2020 decreased to 3.70% from 3.93% during the first nine months of 2019. During the first nine months of 2020, the average balance of interest-earning assets increased by $30.4 million when compared to the first nine months of 2019. Average loans held for investment increased $93.6 million, or 19.7%, and average loans held for sale increased by $93.9 million, or 175.6%, when comparing the first nine months of 2020 and 2019. The average balance of debt securities decreased by $198.6 million, or 48.0%, in the nine-month period ended September 30, 2020, compared to the same period a year ago. Yields on debt securities decreased to 2.49% in the first nine months of 2020 from 2.61% in the same period of 2019.

Interest expense in the first nine months of 2020 was $3.5 million, a decrease of $3.4 million, or 49.2%, from the same period in 2019. The cost of interest-bearing liabilities decreased to 0.62% in the first nine months of 2020 from 1.17% in the first nine months of 2019. Interest expense on deposits decreased as a result of decreased cost of deposits. The cost of core deposits was 0.47% in the first nine months of 2020 and 0.88% in the first nine months of 2019. Interest expense also was $476 thousand lower in the 2020 first nine months due to the redemption of $10.0 million of subordinated debt in the fourth quarter of 2019, and $341 thousand lower due to lower cost of borrowings and lower volume and cost of FHLB advances.

Total loans held for investment increased by $116.3 million, or 23.7%, from September 30, 2019. PPP loan balances of $85.7 million drove a $97.9 million, or 19.2%, increase in loans held for investment compared to December 31, 2019. Mortgage loans held for sale increased by $91.9 million, or 62.5%, from September 30, 2019, and $101.9 million from December 31, 2019 due to higher mortgage origination activity in 2020.

Total deposits increased by $60.5 million to $881.0 million at September 30, 2020, from $820.5 million at December 31, 2019. In the first quarter of 2020, the Company exercised its ability to bring back deposits previously moved off its balance sheet in fourth quarter of 2019 deleveraging activities. Deposit growth during the 2020 period was also supported by PPP loan customers depositing loan proceeds with BNC prior to utilization offset by a reduction of certificates of deposit.

Short-term borrowings increased $1.6 million at September 30, 2020 compared to December 31, 2019 and FHLB borrowings increased by $27.6 million during the same period as the Company used FHLB advances as a flexible means of supporting the increase in mortgage loans held for sale at the end of the third quarter of 2020.

While credit risks have not yet manifested in significantly increased nonperforming loan levels, the Company recorded a provision for credit losses of $2.4 million in the first nine months of 2020 as compared to $500 thousand in the same period of 2019. The increase was primarily attributed to pandemic-related qualitative risks identified in certain loan portfolio segments, specifically hospitality, restaurants, fitness and retail sectors, as well as commercial real estate. Loan balances charged-off in the first nine months of 2020 were $556 thousand.

Non-interest income for the nine months ended September 30, 2020, was $62.3 million. This compares to non-interest income of $23.5 million for the same period in 2019, an increase of $38.8 million, or 165.2%. Mortgage banking revenues aggregated $57.6 million in the current period compared to $17.3 million in the first nine months of 2019, as lower interest rates continued to support higher mortgage banking origination activity and margins increased relative to the year-ago period. Gains on sales of assets aggregated $1.2 million in the first nine months of 2020, compared to $2.2 million in the prior period. Gains on sales of assets and earnings from certain investments can vary significantly from period to period.

Non-interest expense for the nine months ended September 30, 2020, was $41.1 million compared to $33.0 million in the same period of 2019, an increase of $8.1 million. Salaries and employee benefits increased $4.6 million, or 27.3%, from the first nine months of 2019. The increase in salaries and employee benefits is primarily attributed to mortgage operations and is directly attributed to elevated funding levels over the first nine-months of 2020. Professional services in the first nine months of 2020 were up $1.7 million, or 48.0%, from the first nine months of 2019, related exclusively to mortgage loan closing costs. Other expense increased by $1.2 million when compared to the same period of 2019 due to recording a provision for mortgage reimbursement obligations, mortgage related personnel recruiting costs, and the impairment charge of a property.

During the nine-month period ended September 30, 2020, income tax expense was $10.4 million, compared to $2.6 million in the first nine months of 2019. The effective tax rate was 24.5% in the first nine months of 2020, compared to 23.0% in the same period of 2019. The increase in the effective tax rate for the 2020 period is due to higher pre-tax revenues and lower non-taxable interest income from municipal securities.

Net Interest Income

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

	Three Months Ended September 30, 2020			2019			Change		
	Average balance	Interest earned or owed	Average yield or cost	Average balance	Interest earned or owed	Average yield or cost	Average balance	Interest earned or owed	Average yield or cost
Interest-earning assets									
Federal funds sold/cash equivalents	$ 42,413	$ 14	0.13%	$ 7,436	$ 52	2.75%	$ 34,977	$ (38)	-2.62% (a)
FHLB Stock	1,193	9	2.96%	1,870	20	4.21%	(677)	(11)	-1.25%
Federal Reserve Stock	1,807	27	6.02%	1,807	27	5.95%	-	-	0.07%
Debt securities – taxable	181,339	1,042	2.30%	377,253	2,410	2.56%	(195,914)	(1,368)	-0.26% (b)
Debt securities – tax exempt	6,687	58	3.49%	18,160	127	2.79%	(11,473)	(69)	0.70% (b)
Loans held for sale – mortgage banking	188,311	1,250	2.63%	88,484	757	3.40%	99,827	493	-0.77% (c)
Loans and leases held for investment	604,514	6,335	4.17%	485,863	6,305	5.15%	118,651	30	-0.98% (d)
Allowance for loan losses	(9,664)	-	0.00%	(7,823)	-	0.00%	(1,841)	-	0.00%
Total interest-earning assets	$ 1,016,600	$ 8,735	3.42%	$ 973,050	$ 9,698	3.92%	$ 43,550	$ (963)	-0.50%
Interest-bearing liabilities									
Interest checking and money market	$ 567,997	$ 304	0.21%	$ 541,587	$ 1,145	0.84%	$ 26,410	$ (841)	-0.63% (e)
Savings	39,840	4	0.04%	33,836	6	0.08%	6,004	(2)	-0.04% (e)
Certificates of deposit	133,173	450	1.35%	168,837	830	1.95%	(35,664)	(380)	-0.60% (e)
Total interest-bearing deposits	741,010	758	0.41%	744,260	1,981	1.06%	(3,250)	(1,223)	-0.65%
Short-term borrowings	6,964	3	0.16%	4,129	2	0.26%	2,835	1	-0.10% (f)
Federal Home Loan Bank advances	873	1	0.26%	17,637	105	2.28%	(16,764)	(104)	-2.02% (g)
Long-term borrowings	-	-	0.00%	10,000	159	6.35%	(10,000)	(159)	-6.35% (h)
Subordinated debentures	15,005	65	1.68%	15,007	142	3.70%	(2)	(77)	-2.02%
Total borrowings	22,842	69	1.20%	46,773	408	3.46%	(23,931)	(339)	-2.26%
Total interest-bearing liabilities	$ 763,852	827	0.43%	$ 791,033	2,389	1.20%	$ (27,181)	(1,562)	-0.77%
Net interest income/spread		$ 7,908	2.99%		$ 7,309	2.72%		$ 599	0.27%
Net interest margin			3.09%			2.98%			0.11%
Notation:									
Non-interest-bearing deposits	$ 177,204	-	0.00%	$ 134,794	-	0.00%	$ 42,410	-	0.00% (i)
Total deposits	$ 918,214	$ 758	0.33%	$ 879,054	$ 1,981	0.89%	$ 39,160	$ (1,223)	-0.56%
Taxable equivalents:									
Total interest-earning assets	$ 1,016,600	$ 8,786	3.44%	$ 973,050	$ 9,793	3.99%	$ 43,550	$ (1,007)	-0.55%
Net interest income/spread	-	$ 7,959	3.01%	-	$ 7,405	2.79%	-	$ 554	0.22%
Net interest margin	-	-	3.11%	-	-	3.02%	-	-	0.09%

(a) Cash balances can fluctuate from period to period based on liquidity sources and uses of the business.
(b) Average debt securities portfolio balances have decreased as debt securities were liquidated to provide liquidity to support the increase in loan activity.
(c) The average balance of loans held for sale increased in the third quarter of 2020 as the lower interest rate environment continued to support increased mortgage loan originations activity.
(d) The average balance of loans held for investment rose compared to the third quarter of 2019 due to steady loan activity in our core markets throughout 2019 and funding of PPP loans in the second quarter of 2020.
(e) Overall, average interest-bearing deposit balances have decreased due to a decrease in certificates of deposit as BNC has lowered offered rates on new certificates of deposit.
(f) Short-term borrowings increased based increased customers use of repurchase agreements.
(g) FHLB short-term advances have been utilized to flexibly manage our balance sheet.
(h) In the fourth quarter of 2019, the Company re-paid $10.0 million of subordinated debt as a part of implementing a deleveraging strategy.
(i) Non-interest-bearing deposits have increased as customers placed proceeds from PPP loans in deposit accounts prior to utilization.

	Nine Months Ended September 30,								
	2020			2019			Change		
	Average balance	Interest earned or owed	Average yield or cost	Average balance	Interest earned or owed	Average yield or cost	Average balance	Interest earned or owed	Average yield or cost
Interest-earning assets									
Federal funds sold/cash equivalents	$ 61,250	$ 85	0.19%	$ 18,292	$ 364	2.66%	$ 42,958	$ (279)	-2.47% (a)
FHLB Stock	1,208	28	3.14%	1,590	47	3.94%	(382)	(19)	-0.80%
Federal Reserve Stock	1,807	82	6.03%	1,807	81	6.02%	-	1	0.01%
Debt securities – taxable	208,214	3,832	2.45%	372,389	7,265	2.60%	(164,175)	(3,433)	-0.15% (b)
Debt securities – tax exempt	6,610	175	3.55%	41,074	810	2.62%	(34,464)	(635)	0.93% (b)
Loans held for sale – mortgage banking	147,323	3,291	2.98%	53,464	1,442	3.60%	93,859	1,849	-0.62% (c)
Loans and leases held for investment	568,555	19,815	4.64%	474,989	18,216	5.13%	93,566	1,599	-0.49% (d)
Allowance for loan losses	(8,696)	-	0.00%	(7,736)	-	0.00%	(960)	-	0.00%
Total interest-earning assets	$ 986,271	$ 27,308	3.70%	$ 955,869	$ 28,225	3.93%	$ 30,402	$ (917)	-0.23%
Interest-bearing liabilities									
Interest checking and money market	$ 550,433	$ 1,324	0.32%	$ 551,764	$ 3,508	0.85%	$ (1,331)	$ (2,184)	-0.53% (e)
Savings	37,963	16	0.06%	34,095	16	0.06%	3,868	-	0.00% (e)
Certificates of deposit	148,459	1,865	1.68%	163,521	2,269	1.86%	(15,062)	(404)	-0.18% (e)
Total interest-bearing deposits	736,855	3,205	0.58%	749,380	5,793	1.03%	(12,525)	(2,588)	-0.45%
Short-term borrowings	6,459	9	0.18%	5,467	20	0.50%	992	(11)	-0.32%
Federal Home Loan Bank advances	1,185	13	1.43%	10,887	201	2.46%	(9,702)	(188)	-1.03% (f)
Long-term borrowings	-	-	0.00%	10,000	476	6.35%	(10,000)	(476)	-6.35% (g)
Subordinated debentures	15,005	295	2.58%	15,008	448	3.93%	(3)	(153)	-1.35%
Total borrowings	22,649	317	1.86%	41,362	1,145	3.70%	(18,713)	(828)	-1.84%
Total interest-bearing liabilities	$ 759,504	3,522	0.62%	$ 790,742	6,938	1.17%	$ (31,238)	(3,416)	-0.55%
Net interest income/spread		$ 23,786	3.08%		$ 21,287	2.76%		$ 2,499	0.32%
Net interest margin			3.22%			2.98%			0.24%
Notation:									
Non-interest-bearing deposits	$ 163,592	-	0.00%	$ 128,175	-	0.00%	$ 35,417	-	0.00% (h)
Total deposits	$ 900,447	$ 3,205	0.47%	$ 877,555	$ 5,793	0.88%	$ 22,892	$ (2,588)	-0.41%
Taxable equivalents:									
Total interest-earning assets	$ 986,271	$ 27,464	3.72%	$ 955,869	$ 28,712	4.02%	$ 30,402	$ (1,248)	-0.30%
Net interest income/spread	-	$ 23,941	3.10%	-	$ 21,774	2.84%	-	$ 2,167	0.26%
Net interest margin	-	-	3.25%	-	-	3.05%	-	-	0.20%

(a) Cash balances can fluctuate from period to period based on liquidity sources and uses of the business.
(b) Average debt securities portfolio balances have decreased as debt securities were liquidated to provide liquidity to support the increase in loan activity.
(c) The average balance of loans held for sale increased in the third quarter of 2020 as the lower interest rate environment continued to support increased mortgage loan originations activity.
(d) The average balance of loans held for investment rose compared to the third quarter of 2019 due to steady loan activity in our core markets throughout 2019 and funding of PPP loans in the second quarter of 2020.
(e) Overall, average deposit balances have decreased primarily due to due to a decrease in certificates of deposit as BNC has lowered offered rates on new certificates of deposit.
(f) FHLB short-term advances have been utilized to flexibly manage our balance sheet.
(g) In the fourth quarter of 2019, the Company re-paid $10.0 million of subordinated debt as a part of implementing a deleveraging strategy.
(h) Non-interest-bearing deposits have increased as customers placed proceeds from PPP loans in deposit accounts prior to utilization.

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)		
	2020	2019	$	%	2020	2019	$	%	
Bank charges and service fees	$ 581	$ 637	$ (56)	(9) %	$ 1,761	$ 1,962	$ (201)	(10) %	(a)
Wealth management revenues	464	431	33	8 %	1,319	1,306	13	1 %	
Mortgage banking revenues	23,913	8,952	14,961	167 %	57,627	17,267	40,360	234 %	(b)
Gains on sales of loans, net	96	46	50	109 %	99	152	(53)	(35) %	(c)
Gains on sales of debt securities, net	-	1,700	(1,700)	(100) %	1,128	2,020	(892)	(44) %	(d)
Other	137	172	(35)	(20) %	384	790	(406)	(51) %	(e)
Total non-interest income	$ 25,191	$ 11,938	$ 13,253	111 %	$ 62,318	$ 23,497	$ 38,821	165 %	

(a) Bank charges and service fees decreased due to decreases in loan servicing income and non-use fees on lines of credit along with lower deposit charges and ATM interchange income.
(b) Mortgage banking revenues increased as lower interest rates are facilitating higher origination activity in addition to increased margins.
(c) Gains on sale of loans can vary significantly from period to period.
(d) Gains and losses on sales of debt securities may vary significantly from period to period as the Company manages liquidity needs and the risk and return profile of its debt securities portfolio.
(e) Other income decreased largely due to SBIC income received in the 2019 period that did not recur.

Non-interest Expense

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

	Three Months Ended September 30,		Increase (Decrease)		Nine Months Ended September 30,		Increase (Decrease)		
	2020	2019	$	%	2020	2019	$	%	
Salaries and employee benefits	$ 7,228	$ 6,402	$ 826	13 %	$ 21,500	$ 16,895	$ 4,605	27 %	(a)
Professional services	2,140	1,606	534	33 %	5,260	3,555	1,705	48 %	(b)
Data processing fees	1,200	1,094	106	10 %	3,523	3,194	329	10 %	(c)
Marketing and promotion	998	1,361	(363)	(27) %	3,967	3,414	553	16 %	(d)
Occupancy	522	517	5	1 %	1,580	1,610	(30)	(2) %	
Regulatory costs	77	122	(45)	(37) %	182	379	(197)	(52) %	(e)
Depreciation and amortization	352	368	(16)	(4) %	1,066	1,090	(24)	(2) %	
Office supplies and postage	111	141	(30)	(21) %	361	405	(44)	(11) %	(f)
Other	1,975	1,260	715	57 %	3,662	2,420	1,242	51 %	(g)
Total non-interest expense	$ 14,603	$ 12,871	$ 1,732	13 %	$ 41,101	$ 32,962	$ 8,139	25 %	
Efficiency ratio	44.1%	66.9%			47.7%	73.6%			

(a) Salaries and employee benefits increased due to increased mortgage production in 2020.
(b) Professional services expense increased primarily due to increased mortgage banking production costs partially offset by reductions in consulting, audit, and legal expenses.
(c) Data processing fees increased due to increased software maintenance, licensing fees and IT security costs.
(d) Marketing and promotion increased due to increased mortgage banking lead costs partially offset by reduced expenses in our banking markets.
(e) Regulatory costs decrease relates to a decrease in the FDIC and OCC Assessments.
(f) Office supplies and postage decreased due to a reduction in paper, office and data supplies, and customer checks.
(g) Other expenses increased due to recruitment cost for mortgage banking operations support staff in addition to an impairment charge of a property to reflect the estimated fair value of a branch location.

Mortgage Banking Division Selected Data

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Number of funded mortgage loans held for sale	2,345	1,298	5,774	2,544
Mortgage loans held for sale funded	$ 831,552	$ 451,159	$ 2,080,598	$ 842,424
Average loans held for sale-mortgage banking	$ 188,311	$ 88,484	$ 147,323	$ 53,464
Quarter-end loans held for sale-mortgage banking	$ 239,033	$ 147,107	$ 239,033	$ 147,107
Non-Interest Income:				
Gains on sale of loans held for sale, net of commission expense	$ 21,286	$ 5,866	$ 39,147	$ 11,051
Unrealized gain on mortgage financial instruments (1)	$ 2,627	$ 3,086	$ 18,480	$ 6,216
Direct non-interest income	$ 23,913	$ 8,952	$ 57,627	$ 17,267
Direct non-interest expense	$ 6,861	$ 5,418	$ 19,105	$ 11,504

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

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

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

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

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

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

Income Taxes

In the third quarter of 2020, the Company recorded income tax expense of $4.4 million, which resulted in an effective tax rate of 24.5% for the quarter. Income tax expense of $1.5 million was recognized during the third quarter of 2019, which resulted in an effective tax rate of 23.9%. The resulting effective tax rate for the third quarter of 2020 is due to higher pre-tax revenues and lower non-taxable interest income from municipal securities.

During the nine-month period ended September 30, 2020, income tax expense was $10.4 million, compared to $2.6 million in the first nine months of 2019. The effective tax rate was 24.5% in the first nine months of 2020, compared to 23.0% in the same period of 2019. The increase in the effective tax rate for the full year of 2020 is due to higher pre-tax revenues and lower non-taxable interest income from municipal securities.

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

Assets

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

	September 30, 2020	December 31, 2019	Increase (Decrease) $	Increase (Decrease) %	
Cash and cash equivalents	$ 9,421	$ 10,523	$ (1,102)	(10) %	(a)
Debt securities available for sale	186,535	265,278	(78,743)	(30) %	(b)
Federal Reserve Bank and Federal Home Loan Bank of Des Moines stock	4,749	3,651	1,098	30 %	(c)
Loans held for sale-mortgage banking	239,033	137,114	101,919	74 %	(d)
Loans and leases held for investment, net	606,429	508,569	97,860	19 %	(e)
Allowance for credit losses	(10,005)	(8,141)	(1,864)	23 %	(f)
Premises and equipment, net	14,843	16,401	(1,558)	(9) %	(g)
Operating lease right of use asset	2,452	2,638	(186)	(7) %	(h)
Accrued interest receivable	6,050	3,681	2,369	64 %	(i)
Other assets	41,491	27,036	14,455	53 %	(j)
Total assets	$ 1,100,998	$ 966,750	$ 134,248	14 %	

(a) Cash balances can fluctuate significantly from period to period based on liquidity sources and uses of the business.
(b) Investment balances have decreased to provide available liquidity for loan growth.
(c) Federal Reserve Bank and FHLB of Des Moines stock will vary based on the Company's utilization of FHLB advances.
(d) Loans held for sale increased as balances will fluctuate with the timing of loan funding and sales. During 2020, mortgage banking loan funding increased due to interest rates favorable to mortgage refinancing activity.
(e) PPP loans totaling $85.7 million drove an increase in loans and leases held for investment.
(f) The Company recorded a provision for credit losses primarily attributed to qualitative risks identified in certain loan portfolio segments that were impacted more directly by the COVID-19 pandemic.
(g) Premises and equipment decreased due to an impairment charge of a property to reflect the estimated fair value of a branch location.
(h) Operating lease right of use asset as required by ASC 842, *Leases* – See Note 6.
(i) Accrued interest receivable increased due to the impact of payment deferrals on loans modified to provide assistance to our borrowers under Section 4013 of the CARES Act.
(j) Other assets increased primarily due to the increase in fair value of mortgage banking commitments to originate.

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 $159.9 million as of September 30, 2020, and $152.2 million as of December 31, 2019. The sales of participations are accounted for pursuant to FASB ASC 860, *Transfers and Servicing*.

Concentrations of Credit

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

	September 30, 2020		December 31, 2019	
North Dakota	$ 397,857	66 %	$ 347,179	68 %
Arizona	134,664	22 %	101,244	20 %
Minnesota	32,069	5 %	33,594	7 %
Other	42,934	7 %	26,180	5 %
Total gross loans and leases held for investment	$ 607,524	100 %	$ 508,197	100 %

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

	September 30, 2020		December 31, 2019	
North Dakota	$ 352,691	58 %	$ 306,609	60 %
Arizona	167,952	28 %	122,192	24 %
Minnesota	27,198	5 %	27,777	5 %
California	18,406	3 %	18,541	4 %
Colorado	14,682	2 %	15,297	3 %
Ohio	7,357	1 %	7,477	2 %
South Dakota	6,341	1 %	4,168	1 %
Other	12,897	2 %	6,136	1 %
Total gross loans and leases held for investment	$ 607,524	100 %	$ 508,197	100 %

BNC's loans and leases held for investment are concentrated geographically in North Dakota and Arizona. North Dakota and Arizona loans make up 58% and 28% of the total loan portfolio, respectively. The North Dakota economy is influenced by the energy and agriculture industries. An extended period of low energy prices may negatively impact credit quality in North Dakota. The Arizona economy is influenced by leisure and travel. An extended slowdown in these industries may negatively impact credit quality in Arizona. BNC's portfolio is constructed of various sized loans spread over a large number of industry sectors, although concentrations of loans in hospitality and real estate make up notable percentages of the portfolio.

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

	September 30, 2020	
Non-owner Occupied Commercial Real estate (not otherwise categorized)	$ 141,294	27 %
Hotels	80,738	15
Consumer, not otherwise categorized	76,092	15
Healthcare and Social Assistance	35,568	7
Agriculture, Forestry, Fishing and Hunting	30,788	6
Non-Hotel Accommodation and Food Service	22,061	4
Transportation and Warehousing	23,300	4
Retail Trade	24,557	5
Mining, Oil and Gas Extraction	18,553	4
Construction Contractors	12,968	2
Manufacturing	11,444	2
Other Service	8,289	2
Real Estate and Rental and Leasing Support	8,588	2
Art, Entertainment and Recreation	7,401	1
All Other	20,201	4
Gross loans held for investment (excluding PPP loans)	$ 521,842	100 %

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

The hospitality industry is experiencing unprecedented low hotel occupancy and restaurant utilization. The hospitality industry began to rebound early in May 2020, only to be impacted by the summer surge of COVID-19, especially in Arizona. The oil and gas industry is experiencing low oil prices due to COVID-19 related demand issues that are further impacted by geo-political disagreements. Oil prices have improved but not at a level to sustain and re-energize oil and gas activity in North Dakota. These COVID-19 influenced economic conditions are expected to negatively impact various industry sectors.

Loan Maturities(1)

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

		Over 1 year through 5 years		Over 5 years		Total Loans and Leases
	One year or less	Fixed Rate	Indexed Rate	Fixed Rate	Indexed rate	Held for Investment
Commercial and industrial	$ 24,660	$ 9,300	$ 7,290	$ 48,047	$ 72,102	$ 161,399
Commercial real estate	1,310	7,792	9,115	32,137	146,292	196,646
SBA	1,470	84,628	1,986	7,025	40,197	135,306
Consumer	1,483	4,079	5,450	64,710	9,708	85,430
Land and land development	1,830	2,305	1,925	2,808	762	9,630
Construction	2,091	469	16,553	-	-	19,113
Total principal amount of loans	$ 32,844	$ 108,573	$ 42,319	$ 154,727	$ 269,061	$ 607,524

(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, 2020		December 31, 2019	
	Allocation of Allowance	Loans as a percent of Gross Loans Held for Investment	Allocation of Allowance	Loans as a percent of Gross Loans Held for Investment
Commercial and industrial	$ 3,279	27 %	$ 2,366	32 %
Commercial real estate	3,867	32 %	3,502	38 %
SBA	1,401	22 %	1,131	9 %
Consumer	1,067	14 %	853	16 %
Land and land development	194	2 %	187	2 %
Construction	197	3 %	102	3 %
Total	$ 10,005	100 %	$ 8,141	100 %

Nonperforming Loans

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Balance, beginning of period	$ 4,163	$ 2,043	$ 2,033	$ 1,686
Additions to nonperforming	-	409	2,528	1,172
Charge-offs	-	(117)	(235)	(138)
Reclassified back to performing	(349)	-	(349)	(242)
Principal payment received	(106)	(30)	(264)	(168)
Transferred to repossessed assets	-	(41)	(5)	(46)
Balance, end of period	$ 3,708	$ 2,264	$ 3,708	$ 2,264

Nonperforming Assets

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

	September 30, 2020	December 31, 2019
Nonperforming loans:		
Loans 90 days or more delinquent and still accruing interest	$ -	$ -
Non-accrual loans	3,708	2,033
Total nonperforming loans	$ 3,708	$ 2,033
Total nonperforming assets	$ 3,708	$ 2,033
Allowance for credit losses	$ 10,005	$ 8,141
Ratio of total nonperforming loans to total loans	0.44%	0.31%
Ratio of total nonperforming loans to loans and leases held for investment	0.61%	0.40%
Ratio of total nonperforming assets to total assets	0.34%	0.21%
Ratio of nonperforming loans to total assets	0.34%	0.21%
Ratio of allowance for credit losses to nonperforming loans	270%	400%

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

	Watch List			Substandard		
	Impaired	Other	Total	Impaired	Other	Total
September 30, 2020	$ -	$ 10,166	$ 10,166	$ 1,560	$ 6,920	$ 8,480
December 31, 2019	$ 1,448	$ 7,713	$ 9,161	$ 514	$ 7,247	$ 7,761

At September 30, 2020, the Bank had $10.6 million of classified loans and $3.7 million of loans on non-accrual. This compares to $9.3 million of classified loans and $2.0 million of loans on non-accrual at December 31, 2019, and $9.4 million of classified loans and $2.3 million of loans on non-accrual at September 30, 2019. As of September 30, 2020, classified and non-accrual loans include two commercial real estate loans with balances of $1.1 million where the underlying properties have subsequently been sold or are pending sale and the sales proceeds are anticipated to fully satisfy their existing loan balances without additional write-downs.

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

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

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

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

To this end, BNC has modified approximately $205 million of loans consistent with Section 4013 of the CARES Act and inter-agency guidance, allowing customers to defer payments or modify their loans. These loans were current as of December 31, 2019, and as a result, are not currently subject to troubled debt restructuring accounting standards. At September 30, 2020, approximately $158 million of these modified loans had reached expiration of their initial payment deferral period. As of September 30, 2020, borrowers have communicated that they will not be requesting additional assistance for loans aggregating $129 million. The remaining $47 million of CARES Act modified loans will reach the end of their initial payment deferral period by the end of 2020. Economic conditions, including pandemic-related challenges, may result in the Company agreeing to additional loan modifications to assist our borrowers.

Liabilities

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

	September 30, 2020	December 31, 2019	Increase (Decrease) $	%	
Deposits:					
Non-interest-bearing	$ 171,875	$ 136,313	$ 35,562	26 %	(a)
Interest-bearing-					
Savings, interest checking and money market	582,894	514,869	68,025	13 %	(a)
Time deposits	126,213	169,365	(43,152)	(25) %	(b)
Short-term borrowings	6,205	4,565	1,640	36 %	(c)
FHLB advances	44,600	17,000	27,600	162 %	(d)
Guaranteed preferred beneficial interests in Company's subordinated debentures	15,004	15,006	(2)	- %	
Accrued interest payable	736	1,685	(949)	(56) %	(e)
Accrued expenses	11,771	7,580	4,191	55 %	(f)
Operating lease liabilities	2,623	2,822	(199)	(7) %	(g)
Other liabilities	3,863	1,267	2,596	205 %	(h)
Total liabilities	$ 965,784	$ 870,472	$ 95,312	11 %	

(a) BNC exercised its ability to bring back deposits previously moved off-balance sheet. Additional increases are supported by PPP loan customers depositing loan proceeds with BNC prior to utilization.
(b) Time deposits have decreased as BNC has lowered rates on new certificates of deposit.
(c) Short-term borrowings will vary depending on our customers need to use repurchase agreements.
(d) The Company has borrowed on a short-term basis from the FHLB as an efficient source of liquidity.
(e) Accrued interest payable decreased primarily as a result of lower time deposit balances and lower cost of deposits.
(f) Accrued expenses increased due to increases in mortgage banking commissions and incentive accruals as well as an increase in the mortgage banking obligation reserve related to the increase in production.
(g) Operating lease liabilities as required by ASC 842, *Leases* – See Note 6.
(h) The increase primarily relates to increased mortgage banking commitments to sell mortgage loans and taxes payable, due to the increase in pre-tax income in 2020.

At September 30, 2020, and December 31, 2019, the Bank had $29.4 million and $45.7 million, respectively, in time deposits greater than $250 thousand.

Mortgage Banking Obligations

Included in accrued expenses is an estimate of mortgage banking reimbursement obligations, which aggregated $1.1 million at September 30, 2020, and $906 thousand at December 31, 2019. Although the Company sells mortgage banking loans without recourse, industry standards require standard representations and warranties, which can require sellers to reimburse investors for economic losses if loans default or prepay after the sale. Repurchase risk is also evident within the mortgage banking industry as disputes arise between lenders and investors. Such requests for repurchase are commonly due to faulty representation and generally emerge at varied timeframes subsequent to the original sale of the loan. To estimate the contingent obligation, the Company tracks historical reimbursements and calculates the ratio of reimbursement to loan production volumes. Using reimbursement ratios and recent production levels, the Company estimates the future reimbursement amounts and record the estimated obligation. The following is a summary of activity related to mortgage banking obligations (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	2020	2019
Balance, beginning of period	$ 1,017	$ 893	$ 906	$ 982
Provision	450	200	850	200
Write offs, net	(359)	(37)	(648)	(126)
Balance, end of period	$ 1,108	$ 1,056	$ 1,108	$ 1,056

Stockholders' Equity

The Company's stockholders' equity increased $38.9 million from December 31, 2019 to September 30, 2020 primarily due to $32.2 million in additional retained earnings and an increase in accumulated other comprehensive income of $6.5 million. As presented in Note 16 – Regulatory Capital and Current Operating Environment, the Company maintains capital in excess of regulatory requirements.

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

Liquidity Risk Management

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

The Consolidated Statements of Cash Flows in the Consolidated Financial Statements present data on cash and cash equivalents provided by and used in operating, investing, and financing activities. In addition to liquidity from core deposit growth, together with repayments and maturities of loans and investments, the Company utilizes brokered deposits, sell securities under agreements to repurchase and borrow overnight Federal funds. The Bank is a member of the FHLB of Des Moines. Advances from the FHLB are collateralized by the Bank's mortgage loans and various debt securities. The Bank has the ability to borrow from the Federal Reserve Bank through the Discount Window collateralized by mortgage loans and/or Paycheck Protection Program Liquidity Facility (PPPLF) collateralized by the PPP loans. As of September 30, 2020 the Company has not utilized the PPPLF. Funding through the issuance of subordinated notes, subordinated debentures, and long-term borrowings also has been obtained.

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

The Company's liquidity position is measured on an as needed basis, but no less frequently than monthly. Liquidity position is measured using the total of the following items:

1. Estimated liquid assets and certain off-balance sheet considerations less estimated volatile liabilities using the aforementioned methodology ($106.3 million as of September 30, 2020);
2. Borrowing capacity from the FHLB ($73.7 million as of September 30, 2020); and
3. Capacity to issue brokered deposits with maturities of less than 12 months ($149.9 million as of September 30, 2020).

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

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

BNC's liquidity assessment process segregates its balance sheet into liquid assets along with certain off-balance sheet considerations and short-term liabilities assumed to be vulnerable to non-replacement over a 30-day horizon in abnormally stringent conditions. Assumptions for the vulnerable short-term liabilities are based upon historical factors. The Company has a targeted range for our liquidity position over this horizon and manage operations to achieve these targets.

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

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

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

Quantitative and Qualitative Disclosures about Market Risk

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

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

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

The Company's primary tool for measuring and managing interest rate risk is net interest income simulation. This exercise includes assumptions regarding the changes in interest rates and the impact on BNC's current balance sheet. Interest rate caps and floors are included to the extent that they are exercised in the 12-month simulation period. Additionally, changes in prepayment behavior of the residential mortgage, CMOs, and mortgage-backed securities portfolios in each rate environment are captured using industry estimates of prepayment speeds for various coupon segments of the portfolio. For purposes of this simulation, projected month end balances of the various balance sheet accounts are held constant at their September 30, 2020 levels. Cash flows from a given account are reinvested back into the same account so as to keep the month end balance constant at its September 30, 2020 level. The static balance sheet assumption is made so as to project the interest rate risk to net interest income embedded in the existing balance sheet. With knowledge of the balance sheet's existing net interest income profile, more informed strategies and tactics may be developed as it relates to the structure/mix of growth.

The Company monitors the results of net interest income simulation on a regular basis. Net interest income is generally simulated for the upcoming 12-month horizon in seven interest rate scenarios. The scenarios generally modeled are parallel interest rate ramps of +/- 100bp, 200bp, and 300bp along with a rates unchanged scenario. Given the current low absolute level of interest rates as of September 30, 2020, the downward scenarios for interest rate movements is limited to -100bp. The parallel movement of interest rates means all projected market interest rates move up or down by the same amount. A ramp in interest rates means that the projected change in market interest rates occurs over the 12-month horizon on a pro-rata basis. For example, in the +100bp scenario, the projected Prime rate is projected to increase from 3.25% to 4.25% 12 months later. The Prime rate in this example will increase 1/12th of the overall increase of 100 basis points each month.

The net interest income simulation results for the 12-month horizon are shown below (dollars are in thousands):

Net Interest Income Simulation

Movement in interest rates	-100bp	Unchanged	+100bp	+200bp	+300bp
Projected 12-month net interest income	$ 31,739	$ 32,439	$ 32,278	$ 32,027	$ 31,791
Dollar change from unchanged scenario	$ (700)	$ -	$ (161)	$ (412)	$ (648)
Percent change from unchanged scenario	(2.16)%	-	(0.50)%	(1.27)%	(2.00)%

Since there are limitations inherent in any methodology used to estimate the exposure to changes in market interest rates, these analyses are not intended to be a forecast of the actual effect of changes in market interest rates, such as those indicated above on the Company. Further, these analyses are based on assets and liabilities as of September 30, 2020 (without forward adjustments for planned growth and anticipated business activities) and do not contemplate any actions BNC might undertake in response to changes in market interest rates.

Static gap analysis is another tool that may be used for interest rate risk measurement. The net differences between the amount of assets, liabilities, equity and off-balance-sheet instruments repricing within a cumulative calendar period is typically referred to as the “rate sensitivity position” or “gap position.” The following table sets forth the Company’s rate sensitivity position as of September 30, 2020. Assets and liabilities are classified by the earliest possible repricing date or maturity, whichever occurs first.

Interest Sensitivity Gap Analysis

	Estimated Maturity or Repricing at September 30, 2020				
	0–3 Months	4–12 Months	1–5 Years	Over 5 years	Total
	(dollars are in thousands)				
Interest-earning assets:					
Interest-bearing deposits with banks	$ 9,421	$ -	$ -	$ -	$ 9,421
Debt securities (a)	33,454	18,232	58,147	56,198	166,031
FRB and FHLB stock	4,749	-	-	-	4,749
Loans held for sale-mortgage banking, fixed rate	239,033	-	-	-	239,033
Loans held for investment, fixed rate	25,590	72,028	152,846	19,615	270,079
Loans held for investment, indexed rate	111,344	49,672	167,848	7,486	336,350
Total interest-earning assets	$ 423,591	$ 139,932	$ 378,841	$ 83,299	$ 1,025,663
Interest-bearing liabilities:					
Interest checking and money market accounts	$ 542,544	$ -	$ -	$ -	$ 542,544
Savings	40,350	-	-	-	40,350
Time deposits	31,122	60,992	33,985	114	126,213
Short-term borrowings	6,205	-	-	-	6,205
FHLB advances	44,600	-	-	-	44,600
Subordinated debentures	-	15,000	-	4	15,004
Total interest-bearing liabilities	$ 664,821	$ 75,992	$ 33,985	$ 118	$ 774,916
Interest rate gap	$ (241,230)	$ 63,940	$ 344,856	$ 83,181	$ 250,747
Cumulative interest rate gap at September 30, 2020	$ (241,230)	$ (177,290)	$ 167,566	$ 250,747	
Cumulative interest rate gap to total assets	(21.91%)	(16.10%)	15.22%	22.77%	

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

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

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

Since there are limitations inherent in any methodology used to estimate the exposure to changes in market interest rates, these analyses are not intended to be a forecast of the actual effect of changes in market interest rates such as those indicated above on the Company. Further, these analyses are based on BNC's assets and liabilities as of September 30, 2020, and do not contemplate any actions the Company might undertake in response to changes in market interest rates.

Legal Proceedings

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

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

Signatures

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

BNCCORP, INC.

Date:	November 12, 2020	By:	/s/ Daniel J. Collins
			Daniel J. Collins Interim President and Chief Executive Officer
		By:	/s/ Mark Peiler
			Mark Peiler Interim Chief Financial Officer