



BNCCORP

Quarterly Report

For the quarter ended June 30, 2015

BNCCORP, INC.

(OTCQX: BNCC)

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BNCCORP, INC.
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June 30, 2015

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FINANCIAL INFORMATION

Financial Statements

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(In thousands, except share data)

	June 30, 2015	December 31, 2014
ASSETS		
	(unaudited)	
CASH AND CASH EQUIVALENTS	\$ 15,140	\$ 41,124
INVESTMENT SECURITIES AVAILABLE FOR SALE	437,036	449,333
FEDERAL RESERVE BANK AND FEDERAL HOME LOAN BANK STOCK	3,287	2,817
LOANS HELD FOR SALE-MORTGAGE BANKING	54,637	47,109
LOANS AND LEASES HELD FOR INVESTMENT	360,404	360,789
ALLOWANCE FOR CREDIT LOSSES	(8,591)	(8,601)
Net loans and leases held for investment	351,813	352,188
OTHER REAL ESTATE, net	242	256
PREMISES AND EQUIPMENT, net	16,410	16,228
ACCRUED INTEREST RECEIVABLE	4,096	3,931
OTHER	22,191	21,433
Total assets	\$ 904,852	\$ 934,419
LIABILITIES AND STOCKHOLDERS' EQUITY		
DEPOSITS:		
Non-interest-bearing	\$ 152,679	\$ 187,400
Interest-bearing –		
Savings, interest checking and money market	466,398	455,282
Time deposits under \$100,000	86,004	107,668
Time deposits \$100,000 and over	61,164	60,881
Total deposits	766,245	811,231
SHORT-TERM BORROWINGS	18,599	16,002
FHLB BORROWINGS	9,000	-
GUARANTEED PREFERRED BENEFICIAL INTERESTS IN COMPANY'S SUBORDINATED DEBENTURES	15,017	15,018
ACCRUED INTEREST PAYABLE	330	338
ACCRUED EXPENSES	8,036	7,279
OTHER	872	1,063
Total liabilities	818,099	850,931
STOCKHOLDERS' EQUITY:		
Preferred stock, \$.01 par value – Authorized 2,000,000 shares:		
Preferred stock - 9% Series A 20,093 shares outstanding;	20,093	20,093
Preferred stock - 9% Series B 1,005 shares outstanding;	1,005	1,005
Common stock, \$.01 par value – Authorized 35,000,000 shares; 3,414,052 and 3,413,854 shares issued and outstanding	34	34
Capital surplus – common stock	25,877	25,831
Retained earnings	39,174	34,622
Treasury stock (254,601 and 254,799 shares, respectively)	(3,423)	(3,421)
Accumulated other comprehensive income, net	3,993	5,324
Total stockholders' equity	86,753	83,488
Total liabilities and stockholders' equity	\$ 904,852	\$ 934,419

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		For the Six Months	
	Ended June 30,		Ended June 30,	
	2015	2014	2015	2014
INTEREST INCOME:				
Interest and fees on loans	\$ 4,781	\$ 4,279	\$ 9,367	\$ 8,360
Interest and dividends on investments				
Taxable	1,631	2,410	3,597	4,859
Tax-exempt	668	553	1,306	1,099
Dividends	32	29	60	57
Total interest income	<u>7,112</u>	<u>7,271</u>	<u>14,330</u>	<u>14,375</u>
INTEREST EXPENSE:				
Deposits	621	651	1,164	1,253
Short-term borrowings	14	9	21	18
Subordinated debentures	61	288	122	576
Total interest expense	<u>696</u>	<u>948</u>	<u>1,307</u>	<u>1,847</u>
Net interest income	6,416	6,323	13,023	12,528
PROVISION (REDUCTION) FOR CREDIT LOSSES	<u>-</u>	<u>(400)</u>	<u>-</u>	<u>(600)</u>
NET INTEREST INCOME AFTER PROVISION (REDUCTION) FOR CREDIT LOSSES	<u>6,416</u>	<u>6,723</u>	<u>13,023</u>	<u>13,128</u>
NON-INTEREST INCOME:				
Bank charges and service fees	732	667	1,424	1,371
Wealth management revenues	394	346	772	735
Mortgage banking revenues, net	4,015	3,391	9,484	5,673
Gains on sales of loans, net	257	760	572	1,000
Gains on sales of securities, net	964	5	1,560	528
Other	378	192	579	338
Total non-interest income	<u>6,740</u>	<u>5,361</u>	<u>14,391</u>	<u>9,645</u>
NON-INTEREST EXPENSE:				
Salaries and employee benefits	5,087	4,543	10,679	8,782
Professional services	1,058	714	1,852	1,389
Data processing fees	742	720	1,502	1,438
Marketing and promotion	895	654	1,556	1,308
Occupancy	443	491	950	973
Regulatory costs	178	157	347	308
Depreciation and amortization	355	302	704	607
Office supplies and postage	176	182	339	339
Other real estate costs	-	20	15	32
Other	724	1,104	1,380	1,801
Total non-interest expense	<u>9,658</u>	<u>8,887</u>	<u>19,324</u>	<u>16,977</u>
Income before income taxes	3,498	3,197	8,090	5,796
Income tax expense	1,211	990	2,589	1,797
Net income	2,287	2,207	5,501	3,999
Preferred stock costs	474	475	949	847
Net income available to common shareholders	<u>\$ 1,813</u>	<u>\$ 1,732</u>	<u>\$ 4,552</u>	<u>\$ 3,152</u>
Basic earnings per common share	<u>\$ 0.53</u>	<u>\$ 0.51</u>	<u>\$ 1.34</u>	<u>\$ 0.94</u>
Diluted earnings per common share	<u>\$ 0.52</u>	<u>\$ 0.50</u>	<u>\$ 1.30</u>	<u>\$ 0.91</u>

See accompanying notes to consolidated financial statements.

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

	For the Three Months				For the Six Months			
	Ended June 30,		Ended June 30,		Ended June 30,		Ended June 30,	
	2015		2014		2015		2014	
NET INCOME	\$ 2,287		\$ 2,207		\$ 5,501		\$ 3,999	
Unrealized gain (loss) on securities available for sale	\$ (4,143)		\$ 4,611		\$ (586)		\$ 8,137	
Reclassification adjustment for (gain) loss included in net income	(964)		(5)		(1,560)		(528)	
Other comprehensive income (loss) before tax	(5,107)		4,606		(2,146)		7,609	
Income tax benefit (expense) related to items of other comprehensive income (loss)	1,941		(1,750)		815		(2,831)	
Other comprehensive income (loss)	(3,166)		(3,166)		2,856		2,856	
TOTAL COMPREHENSIVE INCOME (LOSS)	\$ (879)		\$ 5,063		\$ 4,170		\$ 8,777	

See accompanying notes to consolidated financial statements.

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

	<u>Preferred Stock</u>		<u>Common Stock</u>		<u>Capital Surplus</u>		<u>Treasury Stock</u>	<u>Accumulated Other Comprehensive</u>		<u>Total</u>
					<u>Common Stock</u>	<u>Retained Earnings</u>		<u>Income (Loss)</u>		
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>	<u>Stock</u>	<u>Earnings</u>	<u>Stock</u>	<u>Income (Loss)</u>	<u>Total</u>	
BALANCE, December 31, 2013	21,098	\$ 21,098	3,374,601	\$ 34	\$ 26,133	\$ 27,962	\$ (3,894)	\$ (1,468)	\$ 69,865	
Net income	-	-	-	-	-	3,999	-	-	3,999	
Other comprehensive income	-	-	-	-	-	-	-	4,778	4,778	
Dividend on preferred stock	-	-	-	-	-	(847)	-	-	(847)	
Impact of share-based compensation	-	-	39,253	-	(367)	-	474	-	107	
BALANCE, June 30, 2014	21,098	\$ 21,098	3,413,854	\$ 34	\$ 25,766	\$ 31,114	\$ (3,420)	\$ 3,310	\$ 77,902	
BALANCE, December 31, 2014	21,098	\$ 21,098	3,413,854	\$ 34	\$ 25,831	\$ 34,622	\$ (3,421)	\$ 5,324	\$ 83,488	
Net income	-	-	-	-	-	5,501	-	-	5,501	
Other comprehensive income (loss)	-	-	-	-	-	-	-	(1,331)	(1,331)	
Dividend on preferred stock	-	-	-	-	-	(949)	-	-	(949)	
Impact of share-based compensation	-	-	198	-	46	-	(2)	-	44	
BALANCE, June 30, 2015	21,098	\$ 21,098	3,414,052	\$ 34	\$ 25,877	\$ 39,174	\$ (3,423)	\$ 3,993	\$ 86,753	

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

For the Six Months Ended June 30,

(In thousands, unaudited)

	<u>2015</u>	<u>2014</u>
OPERATING ACTIVITIES:		
Net income	\$ 5,501	\$ 3,999
Adjustments to reconcile net income to net cash provided by (used in) operating activities -		
Provision (reduction) for credit losses	-	(600)
Provision for other real estate losses	14	-
Depreciation and amortization	704	607
Net amortization of premiums and (discounts) on investment securities and subordinated debentures	3,960	2,844
Share-based compensation	44	107
Change in accrued interest receivable and other assets, net	(1,486)	1,377
Gain on sale of bank premises and equipment	(61)	(3)
Net realized gain on sales of investment securities	(1,560)	(528)
(Increase) decrease in deferred taxes	(173)	1,888
Change in other liabilities, net	1,685	(1,359)
Funding of loans held for sale, mortgage banking	(527,962)	(285,641)
Proceeds from sales of loans held for sale, mortgage banking	520,404	281,908
Fair value adjustment for loans held for sale, mortgage banking	98	(454)
Fair value adjustment on mortgage banking derivatives	(460)	(1,046)
Proceeds from sales of loans	5,370	8,719
Gains on sales of loans, net	(572)	(1,000)
Net cash provided by operating activities	<u>5,506</u>	<u>10,818</u>
INVESTING ACTIVITIES:		
Purchases of investment securities	(105,985)	(73,782)
Proceeds from sales of investment securities	91,836	34,033
Proceeds from maturities of investment securities	22,715	27,337
Purchases of Federal Reserve and Federal Home Loan Bank Stock	(5,152)	(1,280)
Sales of Federal Reserve and Federal Home Loan Bank Stock	4,682	1,192
Net increase in loans held for investment	(4,423)	(15,841)
Proceeds from sales of bank premises and equipment	162	778
Additions to bank premises and equipment	(987)	(1,629)
Net cash provided by (used in) investing activities	<u>2,848</u>	<u>(29,192)</u>

See accompanying notes to consolidated financial statements.

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

	2015	2014
FINANCING ACTIVITIES:		
Net (decrease) increase in deposits	\$ (44,986)	\$ 49,648
Net increase in short-term borrowings	2,597	1,881
Repayments of Federal Home Loan Bank advances	(118,750)	(29,800)
Proceeds from Federal Home Loan Bank advances	127,750	29,800
Dividends paid on preferred stock	(949)	(749)
Net cash (used in) provided by financing activities	(34,338)	50,780
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(25,984)	32,406
CASH AND CASH EQUIVALENTS, beginning of period	41,124	18,871
CASH AND CASH EQUIVALENTS, end of period	\$ 15,140	\$ 51,277
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	\$ 1,315	\$ 1,862
Income taxes paid	\$ 2,007	\$ 981
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Additions to other real estate in the settlement of loans	\$ -	\$ 697

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
June 30, 2015

NOTE 1 – Organization of Operations, BNCCORP, INC.

BNCCORP, INC. (BNCCORP) is a registered bank holding company incorporated under the laws of Delaware. It is the parent company of BNC National Bank (together with its wholly owned subsidiary, BNC Insurance Services, Inc., collectively, the Bank). BNCCORP operates community banking and wealth management businesses in North Dakota, Arizona, and Minnesota from 15 locations. The Bank also conducts mortgage banking from 14 locations in Arizona, Minnesota, North Dakota, Illinois, Kansas, Nebraska and Arkansas.

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

NOTE 2 – Basis of Presentation and Accounting Policies

The accompanying 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, 2014. Accordingly, footnote disclosures which would substantially duplicate the disclosures contained in the December 31, 2014 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, 2014 and the notes thereto.

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

The unaudited consolidated financial statements as of June 30, 2015 include, in the opinion of management, all adjustments, consisting solely 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.

The Company's critical accounting policies are unchanged since December 31, 2014.

RECENTLY ISSUED OR ADOPTED ACCOUNTING PRONOUNCEMENTS

ASU 2014-14, *Receivables - Troubled Debt Restructuring by Creditors (Subtopic 310-40)* – Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure, will require creditors to derecognize certain foreclosed government-guaranteed mortgage loans and to recognize a separate other receivable that is measured at the amount the creditor expects to recover from the guarantor, and to treat the guarantee and the receivable as a single unit of account. ASU 2014-14 is effective for entities other than public business entities, for annual periods ending after December 15, 2015, and interim periods beginning after December 15, 2015. An entity can elect a prospective or a modified retrospective transition method, but must use the same transition method that it elected under FASB ASU No. 2014-04, *Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*. Early adoption, including adoption in an interim period, is permitted if the entity already adopted ASU 2014-04. The Company does not expect the application of this guidance to have a material impact on the Company's consolidated financial statements.

ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in GAAP when it becomes effective. The new standard is effective for the Company for annual periods beginning after December 15, 2017 and interim periods within annual periods beginning after December 15, 2017. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures.

ASU No. 2014-04, *Receivables – Troubled Debt Restructuring by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure*, was issued to clarify that when an in substance repossession or foreclosure occurs, a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. ASU 2014-04 is effective for annual reporting periods beginning after December 15, 2014. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In December 2012, the FASB issued for public comment a draft proposal designed to improve financial reporting about expected credit losses on loans and other financial assets held by banks, financial institutions and other organizations. The proposed ASU, *Financial Instruments - Credit Losses*, proposes a new accounting model which would change the definition from inherent credit losses to expected credit losses, which could result in more timely recognition of credit losses, and also would provide additional transparency about credit risk. The FASB has not yet established a proposed effective date, but a final standard is expected to be issued in the second half of 2015.

In February 2013, the FASB issued ASU 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. This update requires entities to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, entities are required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. This ASU is effective for fiscal years and interim periods beginning after December 15, 2013 for non-public companies. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In July 2013, the FASB issued ASU No. 2013-10, *Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes* (a consensus of the FASB Emerging Issues Task Force), which permits the use of the Fed Funds Effective Swap Rate (also referred to as the Overnight Index Swap Rate), in addition to the U.S. government rate (UST) and London Interbank Offered Rate (LIBOR), as a U.S. benchmark interest rate for hedge accounting purposes under FASB ASC Topic 815, *Derivatives and Hedging*. Entities should apply the ASU prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In July 2013, the FASB issued ASU No. 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists* (a consensus of the FASB Emerging Issues Task Force), which requires an entity to present an unrecognized tax benefit as a reduction of a deferred tax asset for an net operating loss (NOL) carryforward, or similar tax loss or tax credit carryforward, rather than as a liability when (1) the uncertain tax position would reduce the NOL or other carryforward under the tax law of the applicable jurisdiction and (2) the entity intends to use the deferred tax asset for that purpose. The ASU does not require new recurring disclosures. It is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013 and December 15, 2014, for public and nonpublic entities, respectively. Early adoption and retrospective application are permitted. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

NOTE 3 – Capital and Current Operating Environment

In the first quarter of 2015 regulatory capital requirements for community banks changed to incorporate certain of the capital requirements addressed in the Basel III framework. These standards introduced a new requirement, Common Equity Tier 1 (“CET 1”), and increased certain previously existing capital requirements. At June 30, 2015 our capital ratios exceeded all regulatory capital thresholds.

The capital amounts and ratios presented below for June 30, 2015 conform to the current BASEL III risk based capital standards. The capital amounts and ratios presented for December 31, 2014 conform to the former general risk based capital standards (dollars in thousands):

	<u>Actual</u>		<u>For Capital Adequacy Purposes</u>		<u>To be Well Capitalized</u>		<u>Amount in Excess of Well Capitalized</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
June 30, 2015								
Total Risk Based Capital:								
Consolidated	\$ 103,630	21.84 %	\$ 37,953	≥8.0 %	\$ N/A	N/A %	\$ N/A	N/A%
BNC National Bank	97,856	20.67	37,873	≥8.0	47,341	10.0	50,515	10.67
Tier 1 Risk Based Capital:								
Consolidated	97,667	20.59	28,464	≥6.0	N/A	N/A	N/A	N/A
BNC National Bank	91,906	19.41	28,405	≥6.0	37,873	8.0	54,033	11.41
Common Equity Tier 1 Risk Based Capital								
Consolidated	61,552	12.97	21,348	≥4.5	N/A	N/A	N/A	N/A
BNC National Bank	91,906	19.41	21,303	≥4.5	30,722	6.5	61,134	12.91
Tier 1 Leverage Capital:								
Consolidated	97,667	10.52	37,147	≥4.0	N/A	N/A	N/A	N/A
BNC National Bank	91,906	9.94	36,969	≥4.0	46,212	5.0	45,694	4.94
Tangible Equity (to total assets):								
Consolidated	86,670	9.58	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	96,350	10.70	N/A	N/A	N/A	N/A	N/A	N/A
Tangible Common Equity (to total assets):								
Consolidated	65,655	7.26	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	96,350	10.70	N/A	N/A	N/A	N/A	N/A	N/A
December 31, 2014								
Total Risk Based Capital:								
Consolidated	\$ 99,085	21.10 %	\$ 37,562	≥8.0 %	\$ N/A	N/A %	\$ N/A	N/A%
BNC National Bank	91,967	19.73	37,285	≥8.0	46,606	10.0	45,361	9.73
Tier 1 Risk Based Capital :								
Consolidated	93,182	19.85	18,781	≥4.0	N/A	N/A	N/A	N/A
BNC National Bank	86,107	18.48	18,642	≥4.0	27,964	6.0	58,143	12.48
Tier 1 Leverage Capital:								
Consolidated	93,182	9.94	37,485	≥4.0	N/A	N/A	N/A	N/A
BNC National Bank	86,107	9.13	37,725	≥4.0	47,157	5.0	38,950	4.13
Tangible Equity (to total assets):								
Consolidated	83,412	8.93	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	91,806	9.83	N/A	N/A	N/A	N/A	N/A	N/A
Tangible Common Equity (to total assets):								
Consolidated	62,314	6.67	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	91,806	9.83	N/A	N/A	N/A	N/A	N/A	N/A

The new CET 1 ratio, which is generally a comparison of a bank's core equity capital with its total risk weighted assets, is a measure of the current risk profile of our asset base from a regulatory perspective. The Tier 1 leverage ratio, which is calculated by dividing Tier 1 capital by average total assets, does not consider the mix of risk weighted assets. In recent periods regulators have required Tier 1 leverage ratios that significantly exceed "Well Capitalized" ratio levels. As a result, management believes the Bank's Tier 1 leverage ratio is our most restrictive capital measurement and we are managing the Tier 1 leverage ratio to levels significantly above the "Well Capitalized" ratio threshold.

Although Tangible Common Equity (TCE) is not a regulatory capital measure, TCE is a ratio that is commonly used to assess the capital strength of banking entities. Accordingly, we have included the ratio in the preceding table.

NOTE 4 – Investment Securities Available for Sale

Investment securities have been classified in the consolidated balance sheets according to management's intent. The Company had no securities designated as trading or held-to-maturity in its portfolio at June 30, 2015 or December 31, 2014. The carrying amount of available-for-sale securities and their approximate fair values were as follows (in thousands):

	As of June 30, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities	\$ 19,876	\$ 179	\$ -	\$ 20,055
U.S. government agency mortgage-backed securities guaranteed by GNMA	88,445	846	(124)	89,167
U.S. government agency small business administration pools guaranteed by SBA	117,165	625	(175)	117,615
Collateralized mortgage obligations guaranteed by GNMA/VA	93,955	1,014	(379)	94,590
Collateralized mortgage obligations issued by FNMA or FHLMC	29,658	236	(254)	29,640
State and municipal bonds	83,018	3,690	(739)	85,969
	<u>\$ 432,117</u>	<u>\$ 6,590</u>	<u>\$ (1,671)</u>	<u>\$ 437,036</u>
	As of December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury securities	\$ 19,861	\$ 70	\$ (10)	\$ 19,921
U.S. government agency mortgage-backed securities guaranteed by GNMA	101,833	667	(863)	101,637
U.S. government agency small business administration pools guaranteed by SBA	83,990	687	(298)	84,379
Collateralized mortgage obligations guaranteed by GNMA/VA	96,988	1,500	(300)	98,188
Collateralized mortgage obligations issued by FNMA or FHLMC	62,638	923	(227)	63,334
State and municipal bonds	76,958	4,990	(74)	81,874
	<u>\$ 442,268</u>	<u>\$ 8,837</u>	<u>\$ (1,772)</u>	<u>\$ 449,333</u>

The amortized cost and estimated fair market value of available-for-sale securities classified according to their contractual maturities at June 30, 2015 were as follows (in thousands):

	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ -	\$ -
Due after one year through five years	19,876	20,055
Due after five years through ten years	23,344	23,317
Due after ten years	388,897	393,664
Total	<u>\$ 432,117</u>	<u>\$ 437,036</u>

Actual maturities may differ from the contractual maturities shown above as a result of prepayments.

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

Description of Securities	June 30, 2015								
	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 agency mortgage-backed securities guaranteed by GNMA	3	23,765	(124)	-	-	-	3	23,765	(124)
U.S. government agency small business administration pools guaranteed by SBA	9	36,806	(111)	3	5,377	(64)	12	42,183	(175)
Collateralized mortgage obligations guaranteed by GNMA/VA	9	22,229	(194)	2	13,747	(185)	11	35,976	(379)
Collateralized mortgage obligations issued by FNMA or FHLMC	1	4,930	(91)	3	9,753	(163)	4	14,683	(254)
State and municipal bonds	9	24,438	(739)	-	-	-	9	24,438	(739)
Total temporarily impaired securities	<u>31</u>	<u>\$ 112,168</u>	<u>\$ (1,259)</u>	<u>8</u>	<u>\$ 28,877</u>	<u>\$ (412)</u>	<u>39</u>	<u>\$ 141,045</u>	<u>\$ (1,671)</u>

Description of Securities	December 31, 2014								
	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	1	\$ 7,949	\$ (10)	-	\$ -	\$ -	1	\$ 7,949	\$ (10)
U.S. government agency mortgage-backed securities guaranteed by GNMA	7	47,031	(275)	2	16,853	(588)	9	63,884	(863)
U.S. government agency small business administration pools guaranteed by SBA	8	32,354	(241)	3	6,246	(57)	11	38,600	(298)
Collateralized mortgage obligations guaranteed by GNMA/VA	5	12,874	(99)	3	13,239	(201)	8	26,113	(300)
Collateralized mortgage obligations issued by FNMA or FHLMC	3	14,453	(149)	1	3,799	(78)	4	18,252	(227)
State and municipal bonds	4	10,430	(74)	-	-	-	4	10,430	(74)
Total temporarily impaired securities	<u>28</u>	<u>\$ 125,091</u>	<u>\$ (848)</u>	<u>9</u>	<u>\$ 40,137</u>	<u>\$ (924)</u>	<u>37</u>	<u>\$ 165,228</u>	<u>\$ (1,772)</u>

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

There were no securities that management concluded were other-than-temporarily impaired at June 30, 2015 or December 31, 2014.

NOTE 5 – Loans and Leases

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

	June 30, 2015	December 31, 2014
	<u> </u>	<u> </u>
Loans held for sale-mortgage banking	\$ 54,637	\$ 47,109
Commercial and industrial	\$ 121,951	\$ 132,229
Commercial real estate	134,545	108,122
SBA	21,309	26,972
Consumer	41,065	40,470
Land and land development	17,537	28,220
Construction	<u>23,980</u>	<u>24,916</u>
Gross loans and leases held for investment	360,387	360,929
Unearned income and net unamortized deferred fees and costs	<u>17</u>	<u>(140)</u>
Loans, net of unearned income and unamortized fees and costs	360,404	360,789
Allowance for credit losses	<u>(8,591)</u>	<u>(8,601)</u>
Net loans and leases held for investment	<u>\$ 351,813</u>	<u>\$ 352,188</u>

NOTE 6 – Allowance for Credit Losses

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

	Three Months Ended June 30, 2015						
	Commercial and industrial	Commercial real estate	SBA	Consumer	Land and land development	Construction	Total
Balance, beginning of period	\$ 3,276	\$ 2,168	\$ 1,156	\$ 653	\$ 1,192	\$ 291	\$ 8,736
Provision (reduction)	(295)	134	253	(35)	(63)	6	-
Loans charged off	(46)	-	(94)	(11)	-	-	(151)
Loan recoveries	-	4	-	2	-	-	6
Balance, end of period	<u>\$ 2,935</u>	<u>\$ 2,306</u>	<u>\$ 1,315</u>	<u>\$ 609</u>	<u>\$ 1,129</u>	<u>\$ 297</u>	<u>\$ 8,591</u>

	Three Months Ended June 30, 2014						
	Commercial and industrial	Commercial real estate	SBA	Consumer	Land and land development	Construction	Total
Balance, beginning of period	\$ 2,167	\$ 3,911	\$ 707	\$ 482	\$ 2,424	\$ 167	\$ 9,858
Provision (reduction)	159	(804)	210	19	(49)	65	(400)
Loans charged off	-	(408)	(43)	(17)	(179)	-	(647)
Loan recoveries	-	8	-	9	-	-	17
Balance, end of period	<u>\$ 2,326</u>	<u>\$ 2,707</u>	<u>\$ 874</u>	<u>\$ 493</u>	<u>\$ 2,196</u>	<u>\$ 232</u>	<u>\$ 8,828</u>

	Six Months Ended June 30, 2015						
	Commercial and industrial	Commercial real estate	SBA	Consumer	Land and land development	Construction	Total
Balance, beginning of period	\$ 2,686	\$ 2,496	\$ 1,190	\$ 516	\$ 1,436	\$ 277	\$ 8,601
Provision (reduction)	309	(308)	174	112	(307)	20	-
Loans charged off	(60)	-	(107)	(28)	-	-	(195)
Loan recoveries	-	118	58	9	-	-	185
Balance, end of period	<u>\$ 2,935</u>	<u>\$ 2,306</u>	<u>\$ 1,315</u>	<u>\$ 609</u>	<u>\$ 1,129</u>	<u>\$ 297</u>	<u>\$ 8,591</u>

	Six Months Ended June 30, 2014						
	Commercial and industrial	Commercial real estate	SBA	Consumer	Land and land development	Construction	Total
Balance, beginning of period	\$ 2,215	\$ 4,041	\$ 579	\$ 478	\$ 2,371	\$ 163	\$ 9,847
Provision (reduction)	111	(903)	338	20	(235)	69	(600)
Loans charged off	-	(439)	(43)	(22)	(190)	-	(694)
Loan recoveries	-	8	-	17	250	-	275
Balance, end of period	<u>\$ 2,326</u>	<u>\$ 2,707</u>	<u>\$ 874</u>	<u>\$ 493</u>	<u>\$ 2,196</u>	<u>\$ 232</u>	<u>\$ 8,828</u>

The following table shows the balance in the allowance for credit losses at June 30, 2015, and December 31, 2014, 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.

	<u>Allowance For Credit Losses</u>			<u>Gross Loans and Leases Held for Investment</u>		
	<u>Impaired</u>	<u>Other</u>	<u>Total</u>	<u>Impaired</u>	<u>Other</u>	<u>Total</u>
June 30, 2015						
Commercial and industrial	\$ 7	\$ 2,928	\$ 2,935	\$ 7	\$ 121,944	\$ 121,951
Commercial real estate	-	2,306	2,306	1,578	132,967	134,545
SBA	240	1,075	1,315	264	21,045	21,309
Consumer	-	609	609	323	40,742	41,065
Land and land development	-	1,129	1,129	-	17,537	17,537
Construction	-	297	297	-	23,980	23,980
Total	<u>\$ 247</u>	<u>\$ 8,344</u>	<u>\$ 8,591</u>	<u>\$ 2,172</u>	<u>\$ 358,215</u>	<u>\$ 360,387</u>
December 31, 2014						
Commercial and industrial	\$ 18	\$ 2,668	\$ 2,686	\$ 90	\$ 132,139	\$ 132,229
Commercial real estate	574	1,922	2,496	4,741	103,381	108,122
SBA	-	1,190	1,190	-	26,972	26,972
Consumer	-	516	516	330	40,140	40,470
Land and land development	-	1,436	1,436	-	28,220	28,220
Construction	-	277	277	-	24,916	24,916
Total	<u>\$ 592</u>	<u>\$ 8,009</u>	<u>\$ 8,601</u>	<u>\$ 5,161</u>	<u>\$ 355,768</u>	<u>\$ 360,929</u>

Performing and non-accrual loans

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

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

June 30, 2015						
	Current	31-89 Days Past Due	90 Days or More Past Due And Accruing	Total Performing	Non-accrual	Total
Commercial and industrial:						
Business loans	\$ 64,816	\$ -	\$ -	\$ 64,816	\$ 7	\$ 64,823
Agriculture	11,287	-	435	11,722	-	11,722
Owner-occupied commercial real estate	45,406	-	-	45,406	-	45,406
Commercial real estate	134,545	-	-	134,545	-	134,545
SBA	21,045	-	-	21,045	264	21,309
Consumer:						
Automobile	6,372	51	-	6,423	15	6,438
Home equity	6,581	-	-	6,581	-	6,581
1st mortgage	9,450	11	-	9,461	-	9,461
Other	18,572	13	-	18,585	-	18,585
Land and land development	17,537	-	-	17,537	-	17,537
Construction	23,980	-	-	23,980	-	23,980
Total loans held for investment	359,591	75	435	360,101	286	360,387
Loans held for sale	54,633	3	1	54,637	-	54,637
Total gross loans	<u>\$ 414,224</u>	<u>\$ 78</u>	<u>\$ 436</u>	<u>\$ 414,738</u>	<u>\$ 286</u>	<u>\$ 415,024</u>

December 31, 2014						
	Current	31-89 Days Past Due	90 Days or More Past Due And Accruing	Total Performing	Non-accrual	Total
Commercial and industrial:						
Business loans	\$ 67,335	\$ 161	\$ -	\$ 67,496	\$ 37	\$ 67,533
Agriculture	17,478	-	-	17,478	-	17,478
Owner-occupied commercial real estate	47,218	-	-	47,218	-	47,218
Commercial real estate	108,122	-	-	108,122	-	108,122
SBA	26,972	-	-	26,972	-	26,972
Consumer:						
Automobile	6,343	25	-	6,368	19	6,387
Home equity	9,798	-	-	9,798	-	9,798
1st mortgage	9,790	-	-	9,790	-	9,790
Other	14,470	20	5	14,495	-	14,495
Land and land development	28,220	-	-	28,220	-	28,220
Construction	24,916	-	-	24,916	-	24,916
Total loans held for investment	360,662	206	5	360,873	56	360,929
Loans held for sale	47,109	-	-	47,109	-	47,109
Total gross loans	<u>\$ 407,771</u>	<u>\$ 206</u>	<u>\$ 5</u>	<u>\$ 407,982</u>	<u>\$ 56</u>	<u>\$ 408,038</u>

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Interest income that would have been recorded	\$ 4	\$ 63	\$ 5	\$ 131
Interest income recorded	-	-	-	-
Effect on interest income	<u>\$ 4</u>	<u>\$ 63</u>	<u>\$ 5</u>	<u>\$ 131</u>

Impaired loans

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

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

	June 30, 2015				
	Unpaid Principal	Recorded Investment	Related Allowance	Average Recorded Balance	Interest Income Recognized (6 months)
Impaired loans with an allowance recorded:					
Commercial and industrial:					
Business loans	\$ 7	\$ 7	\$ 7	\$ 7	\$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	-	-	-	-	-
SBA	258	256	240	259	-
Consumer:					
Automobile	-	-	-	-	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans with an allowance recorded	\$ 265	\$ 263	\$ 247	\$ 266	\$ -
Impaired loans without an allowance recorded:					
Commercial and industrial:					
Business loans	\$ -	\$ -	\$ -	\$ -	\$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	1,876	1,578	-	1,580	41
SBA	16	8	-	8	-
Consumer:					
Automobile	32	16	-	18	-
Home equity	-	-	-	-	-
1st mortgage	1,878	307	-	309	6
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans without an allowance recorded	\$ 3,802	\$ 1,909	\$ -	\$ 1,915	\$ 47
TOTAL IMPAIRED LOANS	\$ 4,067	\$ 2,172	\$ 247	\$ 2,181	\$ 47

December 31, 2014

	<u>Unpaid Principal</u>	<u>Recorded Investment</u>	<u>Related Allowance</u>	<u>Average Recorded Balance</u>	<u>Interest Income Recognized (12 months)</u>
Impaired loans with an allowance recorded:					
Commercial and industrial:					
Business loans	\$ 90	\$ 90	\$ 18	\$ 93	\$ 4
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	8,642	4,741	574	5,077	136
SBA	-	-	-	-	-
Consumer:					
Automobile	-	-	-	-	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans with an allowance recorded	\$ 8,732	\$ 4,831	\$ 592	\$ 5,170	\$ 140
Impaired loans without an allowance recorded:					
Commercial and industrial:					
Business loans	\$ -	\$ -	\$ -	\$ -	\$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	-	-	-	-	-
SBA	-	-	-	-	-
Consumer:					
Automobile	35	19	-	23	-
Home equity	-	-	-	-	-
1st mortgage	1,878	311	-	395	16
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans without an allowance recorded	\$ 1,913	\$ 330	\$ -	\$ 418	\$ 16
TOTAL IMPAIRED LOANS	\$ 10,645	\$ 5,161	\$ 592	\$ 5,588	\$ 156

Troubled Debt Restructuring (TDRs)

Included in loans receivable, net, 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 compared to the original terms and conditions of the loan, the modified loan is considered a troubled debt restructuring.

The Company follows FASB ASU No. 2011-02, *Receivables (Topic 310), A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*, which modified guidance for identifying restructurings of receivables that constitute a TDR.

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

	June 30, 2015			
	Accrual	Non-accrual	Total	Allowance
Commercial and industrial:				
Business loans	\$ -	\$ -	\$ -	\$ -
Agriculture	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-
Commercial real estate	1,578	-	1,578	-
SBA	-	256	256	240
Consumer:				
Automobile	-	-	-	-
Home equity	-	-	-	-
1st mortgage	307	-	307	-
Other	-	-	-	-
Land and land development	-	-	-	-
Construction	-	-	-	-
Loans held for sale	-	-	-	-
	<u>\$ 1,885</u>	<u>\$ 256</u>	<u>\$ 2,141</u>	<u>\$ 240</u>

	December 31, 2014			
	Accrual	Non-accrual	Total	Allowance
Commercial and industrial:				
Business loans	\$ 53	\$ -	\$ 53	\$ 10
Agriculture	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-
Commercial real estate	4,741	-	4,741	574
SBA	-	-	-	-
Consumer:				
Automobile	-	-	-	-
Home equity	-	-	-	-
1st mortgage	311	-	311	-
Other	-	-	-	-
Land and land development	-	-	-	-
Construction	-	-	-	-
Loans held for sale	-	-	-	-
	<u>\$ 5,105</u>	<u>\$ -</u>	<u>\$ 5,105</u>	<u>\$ 584</u>

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

When a loan is modified as a TDR, there may be a direct, material impact on the loans within the Balance Sheet, as principal balances may be partially forgiven. There were two new TDR's for the three and six month periods ending June 30, 2015 and no new TDR's for the three or six months ended June 30, 2014. The pre-modification and post-modification balance of the two new TDR's equated to \$258 thousand.

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 income if interest on restructured loans outstanding at period end had been recognized at original contractual rates (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Interest income that would have been recorded	\$ 54	\$ 141	\$ 107	\$ 285
Interest income recorded	25	52	50	104
Effect on interest income	\$ 29	\$ 89	\$ 57	\$ 181

There were no additional funds committed to borrowers who are in TDR status at June 30, 2015 and December 31, 2014.

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

The Bank had no loans that were restructured within the 12 months preceding June 30, 2015 and June 30, 2014 and defaulted during the three and six months ended June 30, 2015 and June 30, 2014.

NOTE 7 – Other Real Estate

Other real estate (ORE) includes property acquired through foreclosure, property in judgment and in-substance foreclosures. ORE is carried at fair value less estimated selling costs. Each property is evaluated regularly and the amounts provided to decrease the carrying amount are included in non-interest expense. A summary of the activity related to ORE is presented below (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Balance, beginning of period	\$ 242	\$ 1,056	\$ 256	\$ 1,056
Transfers from nonperforming loans	-	697	-	697
Transfers from premises and equipment	-	-	-	-
Real estate sold	-	-	-	-
Net gains (losses) on sale of assets	-	-	-	-
Provision	-	-	(14)	-
Balance, end of period	<u>\$ 242</u>	<u>\$ 1,753</u>	<u>\$ 242</u>	<u>\$ 1,753</u>

	June 30,	December 31,	June 30,
	2015	2014	2014
Other real estate	\$ 954	\$ 954	\$ 2,451
Valuation allowance	(712)	(698)	(698)
Other real estate, net	<u>\$ 242</u>	<u>\$ 256</u>	<u>\$ 1,753</u>

NOTE 8 – Earnings Per Share

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

	Three months ended June 30, 2015	Six months ended June 30, 2015
Denominator for basic earnings per share:		
Average common shares outstanding	3,387,718	3,385,275
Dilutive effect of stock compensation	<u>112,371</u>	<u>113,235</u>
Denominator for diluted earnings per share	3,500,089	3,498,510
Numerator (in thousands):		
Net income	\$ 2,287	\$ 5,501
Preferred stock costs	<u>474</u>	<u>949</u>
Net income available to common shareholders	<u>\$ 1,813</u>	<u>\$ 4,552</u>
Basic earnings per common share	<u>\$ 0.53</u>	<u>\$ 1.34</u>
Diluted earnings per common share	<u>\$ 0.52</u>	<u>\$ 1.30</u>
	Three months ended June 30, 2014	Six months ended June 30, 2014
Denominator for basic earnings per share:		
Average common shares outstanding	3,364,235	3,355,276
Dilutive effect of stock compensation	<u>127,020</u>	<u>127,446</u>
Denominator for diluted earnings per share	3,491,255	3,482,722
Numerator (in thousands):		
Net income	\$ 2,207	\$ 3,999
Preferred stock costs	<u>475</u>	<u>847</u>
Net income available to common shareholders	<u>\$ 1,732</u>	<u>\$ 3,152</u>
Basic earnings per common share	<u>\$ 0.51</u>	<u>\$ 0.94</u>
Diluted earnings per common share	<u>\$ 0.50</u>	<u>\$ 0.91</u>

NOTE 9 – Share-Based Compensation

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

	<u>1995</u>	<u>2002</u>	<u>2006</u>	<u>2010</u>	<u>Total</u>
Total Shares in Plan	250,000	125,000	200,000	250,000	825,000
Total Shares Available	48,751	-	7,850	250,000	306,601

Following is a summary of fully vested stock options and options expected to vest as of June 30, 2015:

	<u>Stock Options Outstanding</u>	<u>Stock Options Currently Exercisable</u>	<u>Stock Options Vested and Expected to Vest</u>
Number	125,800	125,800	125,800
Weighted-average exercise price	\$3.00	\$3.00	\$3.00
Weighted-average remaining contractual term	4.71 years	4.71 years	4.71 years

The stock options currently outstanding can be exercised until they expire on March 17, 2020.

The Company recognized share-based compensation expense of \$34,000 related to restricted stock for the three month period ended June 30, 2015, and \$68,000 for the six month period ended June 30, 2015. The Company recognized share-based compensation expense of \$31,000 related to restricted stock for the three month period ended June 30, 2014, and \$56,000 for the six month period ended June 30, 2014.

At June 30, 2015, the Company had \$180,000 of unamortized restricted stock compensation expense. All of this expense will be amortized by December 31, 2017. The cost of restricted stock granted is recognized over the vesting period, which is generally three or more years.

NOTE 10 – Fair Value Measurements

FASB ASC 820, *Fair Value Measurements and Disclosures*, 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 our own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

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 period.

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

	Carrying Value at June 30, 2015				Six Months Ended June 30, 2015
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
ASSETS					
Securities available for sale	\$ 437,036	\$ 20,055	\$ 416,981	\$ -	\$ 572
Loans held for sale	54,637	-	54,637	-	(98)
Commitments to originate mortgage loans	1,658	-	1,658	-	(460)
Commitments to sell mortgage loans	328	-	328	-	297
Mortgage banking short positions	111	-	111	-	623
Total assets at fair value	<u>\$ 493,770</u>	<u>\$ 20,055</u>	<u>\$ 473,715</u>	<u>\$ -</u>	<u>\$ 934</u>

LIABILITIES					
Commitments to sell mortgage loans	\$ -	\$ -	\$ -	\$ -	\$ -
Mortgage banking short positions	-	-	-	-	-
Total liabilities at fair value	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

	Carrying Value at December 31, 2014				Twelve Months Ended December 31, 2014
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
ASSETS					
Securities available for sale	\$ 449,333	\$ 19,921	\$ 429,412	\$ -	\$ 53
Loans held for sale	47,109	-	47,109	-	622
Commitments to originate mortgage loans	2,015	-	2,015	-	1,122
Commitments to sell mortgage loans	-	-	-	-	-
Mortgage banking short positions	-	-	-	-	-
Total assets at fair value	<u>\$ 498,457</u>	<u>\$ 19,921</u>	<u>\$ 478,536</u>	<u>\$ -</u>	<u>\$ 1,797</u>

LIABILITIES					
Commitments to sell mortgage loans	\$ 295	\$ -	\$ 295	\$ -	\$ (403)
Mortgage banking short positions	185	-	185	-	(459)
Total liabilities at fair value	<u>\$ 480</u>	<u>\$ -</u>	<u>\$ 480</u>	<u>\$ -</u>	<u>\$ (862)</u>

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

	Carrying Value at June 30, 2015				Six Months Ended June 30, 2015
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
	Impaired loans ⁽¹⁾	\$ 1,925	\$ -	\$ 1,925	\$ -
Other real estate ⁽²⁾	242	-	242	-	(14)
Total	\$ 2,167	\$ -	\$ 2,167	\$ -	\$ 269

	Carrying Value at December 31, 2014				Twelve Months Ended December 31, 2014
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
	Impaired loans ⁽¹⁾	\$ 4,569	\$ -	\$ 4,569	\$ -
Other real estate ⁽²⁾	256	-	256	-	90
Total	\$ 4,825	\$ -	\$ 4,825	\$ -	\$ 15

(1) Represents the carrying value and related write-downs of loans based on the appraised value of the collateral.

(2) Represents the fair value of the collateral less estimated selling costs and is based upon appraised values.

At the beginning of the period, all assets and liabilities valued at fair value on a nonrecurring basis were considered to be Level 2. There were no transfers into or out of Level 2 during the period.

NOTE 11 – Fair Value of Financial Instruments

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

	Level in Fair Value Measurement Hierarchy	June 30, 2015		December 31, 2014	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:					
Cash and cash equivalents	Level 1	\$ 15,140	\$ 15,140	\$ 41,124	\$ 41,124
Investment securities available for sale	Level 1	20,055	20,055	19,921	19,921
Investment securities available for sale	Level 2	416,981	416,981	429,412	429,412
Federal Reserve Bank and Federal Home Loan Bank stock	Level 2	3,287	3,287	2,817	2,817
Loans held for sale-mortgage banking	Level 2	54,637	54,637	47,109	47,109
Commitments to originate mortgage loans	Level 2	1,658	1,658	2,015	2,015
Commitments to sell mortgage loans	Level 2	328	328	-	-
Mortgage banking short positions	Level 2	111	111	-	-
Loans and leases held for investment, net	Level 2	351,813	352,864	352,188	352,506
Accrued interest receivable	Level 2	4,096	4,096	3,931	3,931
		<u>\$ 868,106</u>	<u>\$ 869,157</u>	<u>\$ 898,517</u>	<u>\$ 898,835</u>
Liabilities and Stockholders' Equity:					
Deposits, noninterest-bearing	Level 2	\$ 152,679	\$ 152,679	\$ 187,400	\$ 187,400
Deposits, interest-bearing	Level 2	613,566	613,839	623,831	624,044
Borrowings and advances	Level 2	27,599	27,599	16,002	16,002
Accrued interest payable	Level 2	330	330	338	338
Accrued expenses	Level 2	8,036	8,036	7,279	7,279
Commitments to sell mortgage loans	Level 2	-	-	295	295
Mortgage banking short positions	Level 2	-	-	185	185
Guaranteed preferred beneficial interests in Company's subordinated debentures	Level 2	15,017	8,806	15,018	9,125
		<u>\$ 817,227</u>	<u>\$ 811,289</u>	<u>\$ 850,348</u>	<u>\$ 844,668</u>
Net Fair Value of Financial Instruments			<u>\$ 57,868</u>		<u>\$ 54,167</u>
Financial instruments with off-balance- sheet risk:					
Commitments to extend credit	Level 2	\$ -	\$ 194	\$ -	\$ 265
Standby and commercial letters of credit	Level 2	\$ -	\$ 30	\$ -	\$ 13

NOTE 12 – Other Borrowings

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

June 30, 2015

Unsecured Borrowing Line:

	<u>Line</u>	<u>Outstanding</u>	<u>Available</u>
Bank of North Dakota (1)	\$ 12,500	\$ -	\$ 12,500
US Bank (1)	10,000	-	10,000
Zions First National Bank (1)	12,000	-	12,000
Total	<u>\$ 34,500</u>	<u>\$ -</u>	<u>\$ 34,500</u>

Secured Borrowing Line:

	<u>Collateral Pledged</u>	<u>Line</u>	<u>Outstanding</u>	<u>Available</u>
Federal Borrower-In-Custody (1)	\$ 1,476	\$ 936	\$ -	\$ 936
Bank of North Dakota (1)	31	24	-	24
Bank of North Dakota (2)	96,434	10,000	-	10,000
Total	<u>\$ 97,941</u>	<u>\$ 10,960</u>	<u>\$ -</u>	<u>\$ 10,960</u>

- (1) BNC National Bank Line
(2) BNCCORP, INC. Line

At June 30, 2015, the pledged collateral for the BNC National Bank line with the Bank of North Dakota was comprised of collateralized mortgage obligations, the pledged collateral for the BNC National Bank line through the Federal Borrower-in-Custody line was comprised of commercial loans, and the pledged collateral for the BNCCORP, INC. line is the common stock of BNC National Bank.

December 31, 2014

Unsecured Borrowing Line:

	<u>Line</u>	<u>Outstanding</u>	<u>Available</u>
Bank of North Dakota (1)	\$ 10,000	\$ -	\$ 10,000
US Bank (1)	10,000	-	10,000
Zions First National Bank (1)	12,000	-	12,000
Total	<u>\$ 32,000</u>	<u>\$ -</u>	<u>\$ 32,000</u>

Secured Borrowing Line:

	<u>Collateral Pledged</u>	<u>Line</u>	<u>Outstanding</u>	<u>Available</u>
Federal Borrower-In-Custody (1)	\$ 2,113	\$ 1,241	\$ -	\$ 1,241
Bank of North Dakota (1)	311	249	-	249
Bank of North Dakota (2)	91,882	10,000	-	10,000
Total	<u>\$ 94,306</u>	<u>\$ 11,490</u>	<u>\$ -</u>	<u>\$ 11,490</u>

- (1) BNC National Bank Line
(2) BNCCORP, INC. Line

At December 31, 2014, the pledged collateral for the BNC National Bank line with the Bank of North Dakota was comprised of collateralized mortgage obligations, the pledged collateral for the BNC National Bank line through the Federal Borrower-in-Custody line was comprised of commercial loans, and the pledged collateral for the BNCCORP, INC. line is the common stock of BNC National Bank.

NOTE 13 – Guaranteed Preferred Beneficial Interest’s in Company’s Subordinated Debentures

In July 2000, BNCCORP issued \$7.5 million of subordinated debentures at a fixed rate of 12.05%. In the third quarter of 2014, these subordinated debentures were redeemed and the corresponding debentures were prepaid. Redemption costs totaling \$356 thousand were recorded in the second quarter of 2014.

In July 2007, BNCCORP issued \$15.0 million of floating rate subordinated debentures. The interest rate paid on the securities is equal to the three month LIBOR plus 1.40%. The interest rate at June 30, 2015 and December 31, 2014 was 1.67% and 1.64%, 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.

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

We refer to “we”, “our” 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” when referring only to BNC National Bank.

Comparison of Results for the Three and Six Months Ended June 30, 2015 and 2014

Summary for the Three Months Ended June 30, 2015 and 2014

Net income was \$2.287 million and the net income available to common shareholders was \$1.813 million, or \$0.52 per share on a diluted basis, for the quarter ended June 30, 2015. This compared to net income of \$2.207 million and net income available to common shareholders of \$1.732 million, or \$0.50 per diluted share, in the second quarter of 2014.

Net interest income for the second quarter of 2015 was \$6.416 million, an increase of \$93 thousand, or 1.5%, from \$6.323 million in the same period of 2014. The net interest margin for the current period decreased to 2.93% from 2.96% a year ago. Interest income declined slightly by \$159 thousand or 2.2% as the \$21.2 million increase in the average balance of interest earning assets was offset by decreased yields on investments when compared to the second quarter of 2014. Interest expense decreased by \$252 thousand despite an increase in average deposits of \$4.0 million, or 0.5% and incurring \$87 thousand of charges related to exercising our right to call \$20.0 million of brokered deposits in the second quarter of 2015. The Company’s redemption of \$7.5 million of subordinated debentures in the third quarter of 2014 reduced the second quarter of 2015 interest expense by approximately \$230 thousand. In addition, our call of \$10.0 million of brokered deposits in the second quarter 2014 contributed to reducing interest expense in the current quarter by \$27 thousand.

Total loans held for investment increased by \$35.5 million or 10.9% from June 30, 2014 and decreased by \$385 thousand or 0.1% from December 31, 2014. We continue to fund new loans held for investment but we have noticed some North Dakota clients are deferring investment decisions and repaying loans in response to softer economic conditions in the region. Year to date, significant loan pay-offs by North Dakota clients have exceeded \$20 million.

Total deposits decreased by \$45.0 million from December 31, 2014. In recent years we have experienced significant growth in deposits. We have been anticipating that some of our North Dakota customers would deploy funds previously deposited with us and some of this activity occurred this quarter. Also, during the second quarter of 2015 and 2014, recognizing favorable economic conditions, we exercised our redemption rights to call \$20.0 million and \$10.0 million of brokered certificates of deposit, respectively.

No provision for credit losses was recorded in the second quarter of 2015. The recent decreases in North Dakota commodity prices, while negatively affecting activity in certain sectors of the economy, have yet to have a significant negative impact on our credit quality. In the second quarter of 2014, a reversal of previous provisions for credit losses increased pre-tax earnings by \$400 thousand reflecting stable credit quality in 2014 and a successful restructuring of an impaired loan in the second quarter of 2014.

Non-interest income for the second quarter of 2015 was \$6.740 million. This compares to non-interest income of \$5.361 million for the same period in 2014, an increase of \$1.379 million, or 25.7%. The increase primarily relates to mortgage banking revenues, which aggregated \$4.015 million compared to \$3.391 million in the second quarter of 2014. Mortgage banking revenues benefited from lower rates in the second quarter of 2015 as we continue to sell residential mortgage loans with servicing released. We recorded a net gain on sales of investments of \$964 thousand, compared to a \$5 thousand net gain on sales of investments in the same period of 2014. Gains on sales of SBA loans decreased \$503 thousand or 66.2% to \$257 thousand in the second quarter of 2015 from \$760 thousand in the prior year second quarter.

Non-interest expense for the second quarter of 2015 was \$9.658 million compared to \$8.887 million in the same period of 2014, an increase of \$771 thousand, or 8.7%. This increase is primarily related to compensation for producers and costs related to higher mortgage banking activity.

In the second quarter of 2015, we recorded tax expense of \$1.211 million which resulted in an effective tax rate of 34.62% for the quarter. A tax expense of \$990 thousand was recognized during the second quarter of 2014, which resulted in an effective tax rate of 30.97%. The higher effective tax rate in the second quarter of 2015 is the result of an adjustment to the annual estimated effective tax rate to achieve a rate of 32.00% correlating to higher estimated full year taxable income.

Summary for the Six Months Ended June 30, 2015 and 2014

Net income was \$5.501 million, and the income available to common shareholders was \$4.552 million, or \$1.30 per share on a diluted basis, for the six months ended June 30, 2015. For the six months ended June 30, 2014, net income was \$3.999 million, and the income available to common shareholders was \$3.152 million, or \$0.91 per share on a diluted basis.

Net interest income for the six months ended June 30, 2015 was \$13.023 million, an increase of \$495 thousand, or 4.0%, from \$12.528 million in the same period of 2014. The year to date net interest margin decreased to 2.98% from 3.07% a year ago. Interest income decreased by \$45 thousand as the \$59.5 million increase in the average balance of interest earning assets was offset by lower investment portfolio yields, and a lower yielding mix of loans when compared to the first half of 2014. Interest expense decreased despite an increase in average deposits of \$46.2 million, or 6.1%, and incurring \$87 thousand of charges related to exercising our right to call \$20.0 million of brokered deposits in the second quarter of 2015. The Company's redemption of brokered deposits and subordinate debentures in 2014 enabled us to decrease interest expense by \$515 thousand during the six month period ending June 30, 2015 when compared to the same time period in 2014.

No provision for credit losses was taken in the first six months of 2015. A reversal of previous provisions for credit losses increased pre-tax earnings by \$600 thousand in the first six months of 2014.

Non-interest income for the six months ended June 30, 2015 was \$14.391 million. This compares to non-interest income of \$9.645 million for the same period in 2014, an increase of \$4.746 million, or 49.2%. The increase primarily relates to mortgage banking revenues, which aggregated \$9.484 million compared to \$5.673 million in the first half of 2014. Mortgage banking revenues benefited from lower rates in the first half of 2015 as we continue to sell residential mortgage loans with servicing released. During the first six months of 2015, we recorded a net gain on sales of investments of \$1.560 million, compared to a \$528 thousand net gain on sales of investments in the same period of 2014. The first half of 2015 included gains on sales of SBA loans of \$572 thousand, compared to \$1.000 million in the same period of 2014. Gains on sales of investments and SBA loans can vary significantly from period to period.

Non-interest expense for the six months ended June 30, 2015 was \$19.324 million compared to \$16.977 million, in the same period of 2014, an increase of \$2.347 million, or 13.8%. This increase is primarily related to compensation for producers and higher mortgage banking activity.

During the six month period ended June 30, 2015, we recorded tax expense of \$2.589 million which resulted in an effective tax rate of 32.00% on a year-to-date basis. A tax expense of \$1.797 million was recognized during the six month period ended June 30, 2014, which resulted in an effective tax rate of 31.00%. The higher effective tax rate is correlated to higher taxable income in the six month period ended June 30, 2015 and estimated full year taxable income.

Net Interest Income

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

	Three Months Ended June 30,								
	2015			2014			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	\$ 13,262	\$ 9	0.27%	\$ 54,095	\$ 29	0.22%	\$ (40,833)	\$ (20)	0.05% (a)
Investments - taxable	366,554	1,654	1.81%	385,088	2,410	2.51%	(18,534)	(756)	-0.70% (b)
Investments - tax exempt	85,348	668	3.14%	66,637	553	3.33%	18,711	115	-0.19% (b)
Loans held for sale – mortgage banking	65,499	536	3.28%	28,045	265	3.79%	37,454	271	-0.51% (c)
Loans and leases held for investment	355,545	4,245	4.79%	331,750	4,014	4.85%	23,795	231	-0.06% (d)
Allowance for loan losses	(8,722)	-	0.00%	(9,335)	-	0.00%	613	-	0.00%
Total interest-earning assets	<u>\$ 877,486</u>	<u>\$ 7,112</u>	3.25%	<u>\$ 856,280</u>	<u>\$ 7,271</u>	3.41%	<u>\$ 21,206</u>	<u>\$ (159)</u>	-0.16%
Interest-bearing liabilities									
Interest checking and money market	\$ 440,651	\$ 135	0.12%	\$ 426,146	\$ 143	0.13%	\$ 14,505	\$ (8)	-0.01% (e)
Savings	30,759	2	0.03%	24,663	2	0.03%	6,096	-	0.00% (e)
Certificates of deposit under \$100,000	97,545	407	1.67%	116,702	383	1.32%	(19,157)	24	0.35% (e)
Certificates of deposit \$100,000 and over	61,604	77	0.50%	82,483	123	0.60%	(20,879)	(46)	-0.10% (e)
Total interest-bearing deposits	630,559	621	0.40%	649,994	651	0.40%	(19,435)	(30)	0.00%
Short-term borrowings	16,740	7	0.17%	21,639	9	0.17%	(4,899)	(2)	0.00% (f)
Federal Home Loan Bank advances	9,590	7	0.29%	477	-	0.00%	9,113	7	0.29%
Subordinated debentures	15,017	61	1.63%	22,434	288	5.15%	(7,417)	(227)	-3.52% (g)
Total borrowings	41,347	75	0.73%	44,550	297	2.67%	(3,203)	(222)	-1.94%
Total interest-bearing liabilities	<u>\$ 671,906</u>	<u>696</u>	0.42%	<u>\$ 694,544</u>	<u>948</u>	0.55%	<u>\$ (22,638)</u>	<u>(252)</u>	-0.13%
Net interest income/spread		<u>\$ 6,416</u>	2.83%		<u>\$ 6,323</u>	2.86%		<u>\$ 93</u>	-0.03%
Net interest margin			2.93%			2.96%			-0.03% (h)
Notation:									
Non-interest-bearing deposits	\$ 158,012	-		\$ 134,620	-		\$ 23,392	-	
Total deposits	<u>\$ 788,571</u>	<u>\$ 621</u>	0.32%	<u>\$ 784,614</u>	<u>\$ 651</u>	0.33%	<u>\$ 3,957</u>	<u>\$ (30)</u>	-0.01%
Taxable equivalents:									
Total interest-earning assets	\$ 877,486	\$ 7,476	3.42%	\$ 856,280	\$ 7,558	3.54%	\$ 21,206	\$ (82)	-0.12%
Net interest income/spread	-	\$ 6,780	3.00%	-	\$ 6,610	2.99%	-	\$ 170	0.01%
Net interest margin	-	-	3.10%	-	-	3.10%	-	-	0.00%

- (a) Cash balances can fluctuate significantly, but we generally emphasize liquidity.
- (b) Investment portfolio allocation has changed to invest in more tax exempt securities.
- (c) Loans held for sale increased from the prior year due to interest rate driven refinance activity in the second quarter of 2015.
- (d) The balance of loans held for investment has risen due to increased activity in our core market areas. Loan balances, however, continue to be subject to unscheduled repayments in the North Dakota economic region.
- (e) Total deposits can vary depending on the cash needs of our customers; our balances in these accounts have decreased due to anticipated deployment of funds previously deposited with us, primarily in North Dakota. Additionally, the Company exercised our right to call \$20.0 million and \$10.0 million of brokered deposits in the second quarter of 2015 and 2014, respectively.
- (f) Short-term borrowings will vary depending on our customers need to use repurchase agreements and the Company's decision to utilize its lines of credit for various business purposes.
- (g) The Company redeemed \$7.5 million of subordinated debentures in 2014 significantly reducing interest expense from the prior period.
- (h) Net interest margin has decreased as yields on our loans held for sale and investment securities have generally declined period-over-period.

Six Months Ended June 30,

	2015			2014			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	\$ 27,201	\$ 33	0.24%	\$ 36,532	\$ 39	0.22%	\$ (9,331)	\$ (6)	0.02% (a)
Investments - taxable	369,910	3,624	1.98%	376,878	4,877	2.61%	(6,968)	(1,253)	-0.63% (b)
Investments - tax exempt	83,489	1,306	3.15%	65,031	1,099	3.41%	18,458	207	-0.26% (b)
Loans held for sale – mortgage banking	56,257	932	3.34%	26,074	494	3.82%	30,183	438	-0.48% (c)
Loans and leases held for investment	353,079	8,435	4.82%	326,920	7,866	4.85%	26,159	569	-0.03% (d)
Allowance for loan losses	(8,673)	-	0.00%	(9,642)	-	0.00%	969	-	0.00%
Total interest-earning assets	<u>\$ 881,263</u>	<u>\$ 14,330</u>	3.28%	<u>\$ 821,793</u>	<u>\$ 14,375</u>	3.53%	<u>\$ 59,470</u>	<u>\$ (45)</u>	-0.25%
Interest-bearing liabilities									
Interest checking and money market	\$ 440,202	\$ 264	0.12%	\$ 397,039	\$ 269	0.14%	\$ 43,163	\$ (5)	-0.02% (e)
Savings	28,799	4	0.03%	23,847	5	0.04%	4,952	(1)	-0.01% (e)
Certificates of deposit under \$100,000	101,978	742	1.47%	119,524	742	1.25%	(17,546)	-	0.22% (e)
Certificates of deposit \$100,000 and over	61,687	154	0.50%	81,305	237	0.59%	(19,618)	(83)	-0.09% (e)
Total interest-bearing deposits	632,666	1,164	0.37%	621,715	1,253	0.41%	10,951	(89)	-0.04%
Short-term borrowings	16,947	14	0.17%	19,821	17	0.18%	(2,874)	(3)	-0.01% (f)
Federal Home Loan Bank advances	4,795	7	0.29%	849	1	0.24%	3,946	6	0.05%
Subordinated debentures	15,017	122	1.64%	22,433	576	5.18%	(7,416)	(454)	-3.54% (g)
Total borrowings	36,759	143	0.78%	43,103	594	2.78%	(6,344)	(451)	-2.00%
Total interest-bearing liabilities	<u>\$ 669,425</u>	<u>1,307</u>	0.39%	<u>\$ 664,818</u>	<u>1,847</u>	0.56%	<u>\$ 4,607</u>	<u>(540)</u>	-0.17%
Net interest income/spread		<u>\$ 13,023</u>	2.89%		<u>\$ 12,528</u>	2.97%		<u>\$ 495</u>	-0.08%
Net interest margin			2.98%			3.07%			-0.09% (h)
Notation:									
Non-interest-bearing deposits	<u>\$ 167,121</u>	-		<u>\$ 131,828</u>	-		<u>\$ 35,293</u>	-	
Total deposits	<u>\$ 799,787</u>	<u>\$ 1,164</u>	0.29%	<u>\$ 753,543</u>	<u>\$ 1,252</u>	0.34%	<u>\$ 46,244</u>	<u>\$ (89)</u>	-0.05%
Taxable equivalents:									
Total interest-earning assets	\$ 881,263	\$ 15,044	3.44%	\$ 821,793	\$ 14,947	3.67%	\$ 59,470	\$ 97	-0.23%
Net interest income/spread	-	\$ 13,737	3.05%	-	\$ 13,100	3.11%	-	\$ 637	-0.06%
Net interest margin	-	-	3.14%	-	-	3.21%	-	-	-0.07% (h)

- (a) Cash balances can fluctuate significantly, but we generally emphasize liquidity.
- (b) Investment growth has been funded by an increase in deposits.
- (c) Loans held for sale increased from the prior year due to interest rate driven refinance activity in the first half of 2015.
- (d) The balance of loans held for investment has risen due to increased activity in our core market areas in 2013 and 2014. More recently, loan growth has been offset by an increased level of unscheduled loan repayments in the North Dakota economic region.
- (e) Total deposits can vary depending on the cash needs of our customers; our balances in these accounts have increased due to growth, primarily in North Dakota. Interest expense has declined despite significant balance growth as the Company has been able to lower the rates paid on deposits and exercised our right to call \$20.0 million and \$10.0 million of brokered deposits in the second quarters of 2015 and 2014, respectively, which carried a higher rate of interest than the Company's standard deposit products.
- (f) Short-term borrowings will vary depending on our customers need to use repurchase agreements and the Company's decision to utilize its lines of credit for various business purposes.
- (g) The Company redeemed \$7.5 million of subordinated debentures in 2014 significantly reducing interest expense from the prior period.
- (h) Net interest margin has decreased as yields on our loans held for sale and investment securities have generally declined period-over-period.

Non-interest Income

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

	Three Months Ended		Increase		Six Months Ended		Increase	
	June 30,		(Decrease)		June 30,		(Decrease)	
	2015	2014	\$	%	2015	2014	\$	%
Bank charges and service fees	\$ 732	\$ 667	\$ 65	10 %	\$ 1,424	\$ 1,371	\$ 53	4 %
Wealth management revenues	394	346	48	14 %	772	735	37	5 %
Mortgage banking revenues	4,015	3,391	624	18 %	9,484	5,673	3,811	67 % (a)
Gains on sales of loans, net	257	760	(503)	(66) %	572	1,000	(428)	(43) % (b)
Gains on sales of securities, net	964	5	959	19,180 %	1,560	528	1,032	195 % (c)
Other	378	192	186	97 %	579	338	241	71 % (d)
Total non-interest income	<u>\$ 6,740</u>	<u>\$ 5,361</u>	<u>\$ 1,379</u>	26 %	<u>\$ 14,391</u>	<u>\$ 9,645</u>	<u>\$ 4,746</u>	49 %

- (a) Mortgage banking revenues increased as origination volume continue to benefit from the lower interest rate environment.
- (b) Gains and losses on sales of loans may vary significantly from period to period. The secondary market for SBA loans currently remains acquisitive and loans can be sold at attractive prices.
- (c) Gains and losses on sales of securities may vary significantly from period to period.
- (d) Variance from prior year is due to timing of receipt of SBIC income and gain on sale of fixed assets.

Non-interest Expense

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

	Three Months Ended		Increase		Six Months Ended		Increase	
	June 30,		(Decrease)		June 30,		(Decrease)	
	2015	2014	\$	%	2015	2014	\$	%
Salaries and employee benefits	\$ 5,087	\$ 4,543	\$ 544	12 %	\$ 10,679	\$ 8,782	\$ 1,897	22 % (a)
Professional services	1,058	714	344	48 %	1,852	1,389	463	33 % (b)
Data processing fees	742	720	22	3 %	1,502	1,438	64	4 %
Marketing and promotion	895	654	241	37 %	1,556	1,308	248	19 % (c)
Occupancy	443	491	(48)	(10) %	950	973	(23)	(2) %
Regulatory costs	178	157	21	13 %	347	308	39	13 % (d)
Depreciation and amortization	355	302	53	18 %	704	607	97	16 % (e)
Office supplies and postage	176	182	(6)	(3) %	339	339	-	- %
Other real estate costs	-	20	(20)	(100) %	15	32	(17)	(53) %
Other	724	1,104	(380)	(34) %	1,380	1,801	(421)	(23) % (f)
Total non-interest expense	<u>\$ 9,658</u>	<u>\$ 8,887</u>	<u>\$ 771</u>	9 %	<u>\$ 19,324</u>	<u>\$ 16,977</u>	<u>\$ 2,347</u>	14 %
Efficiency ratio	<u>73.4%</u>	<u>76.1%</u>			<u>70.5%</u>	<u>76.6%</u>		

- (a) Increase primarily relates to higher mortgage banking activity and incentive compensation for producers.
- (b) Professional services increased in mortgage banking as our volumes increased.
- (c) Marketing efforts have increased in mortgage banking in order to capture refinance volume.
- (d) Increase is due to higher regulatory assessments as average assets increased relative to the prior periods.
- (e) Depreciation expense increase is primarily due to increased capital expenditures associated with our new Mandan, ND location.
- (f) Decrease is due to recognizing \$356 thousand of costs related to the planned redemption of \$7.5 million of subordinated debentures in the second quarter of 2014.

Income Taxes

In the second quarter of 2015, we recorded tax expense of \$1.211 million which resulted in an effective tax rate of 34.62% for the quarter. A tax expense of \$990 thousand was recognized during the second quarter of 2014, which resulted in an effective tax rate of 30.97%. The higher effective tax rate in the second quarter of 2015 is the result of an adjustment to the annual estimated effective tax rate to achieve a rate of 32.00% correlating to a higher level of taxable income.

Comparison of Financial Condition at June 30, 2015 and December 31, 2014

Assets

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

	June 30,	December 31,	Increase (Decrease)	
	2015	2014	\$	%
Cash and cash equivalents	\$ 15,140	\$ 41,124	\$ (25,984)	(63) % (a)
Investment securities available for sale	437,036	449,333	(12,297)	(3) %
Federal Reserve Bank and Federal Home Loan Bank of Des Moines stock	3,287	2,817	470	17 %
Loans held for sale-mortgage banking	54,637	47,109	7,528	16 % (b)
Loans and leases held for investment, net	360,404	360,789	(385)	(0) % (c)
Allowance for credit losses	(8,591)	(8,601)	10	(0) %
Other real estate, net	242	256	(14)	(5) %
Premises and equipment, net	16,410	16,228	182	1 %
Accrued interest receivable	4,096	3,931	165	4 %
Other assets	22,191	21,433	758	4 % (d)
Total assets	<u>\$ 904,852</u>	<u>\$ 934,419</u>	<u>\$ (29,567)</u>	(3) %

- (a) Cash balances can fluctuate from period-to-period. As anticipated, balances decreased from December 31, 2014 due to the deployment of funds previously deposited with us by our North Dakota customers.
- (b) Balances of loans held for sale have increased as mortgage loan volume has benefited from a lower interest rate environment.
- (c) The balance of loans held for investment has decreased slightly as we received unscheduled repayments, which offset new originations since December 31, 2014.
- (d) The increase relates primarily to higher net deferred tax assets as our unrealized gains on investment securities decreased.

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 \$199.8 million as of June 30, 2015 and \$180.2 million as of December 31, 2014. The sales of participations are accounted for pursuant to FASB ASC 860, *Transfers and Servicing*.

Concentrations of Credit

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

	<u>June 30, 2015</u>		<u>December 31, 2014</u>	
North Dakota	\$ 225,843	63 %	\$ 228,145	63 %
Minnesota	29,008	8 %	34,029	9 %
Arizona	63,496	17 %	52,679	15 %
Other	42,040	12 %	46,076	13 %
Total gross loans held for investment	<u>\$ 360,387</u>	<u>100 %</u>	<u>\$ 360,929</u>	<u>100 %</u>

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

	<u>June 30, 2015</u>		<u>December 31, 2014</u>	
North Dakota	\$ 236,329	66 %	\$ 232,533	64 %
Arizona	66,699	19 %	63,463	18 %
California	15,074	4 %	15,609	4 %
Minnesota	10,738	3 %	11,045	3 %
Ohio	8,873	3 %	9,000	3 %
Colorado	8,829	2 %	8,922	3 %
Idaho	5,206	1 %	5,391	2 %
Other	8,639	2 %	14,966	3 %
Total gross loans held for investment	<u>\$ 360,387</u>	<u>100 %</u>	<u>\$ 360,929</u>	<u>100 %</u>

Loan Maturities⁽¹⁾

The following table sets forth the remaining maturities of loans in each major category of our portfolio as of June 30, 2015 (in thousands):

	<u>One year or less</u>	<u>Over 1 year through 5 years</u>		<u>Over 5 years</u>		<u>Total Loans and Leases Held for Investment</u>
		<u>Fixed Rate</u>	<u>Floating Rate</u>	<u>Fixed Rate</u>	<u>Floating rate</u>	
Commercial and industrial	\$ 14,346	\$ 1,031	\$ 36,030	\$ 43,122	\$ 27,422	\$ 121,951
Commercial real estate	696	4,591	26,196	17,464	85,598	134,545
SBA	356	-	1,483	2,412	17,058	21,309
Consumer	1,327	18	3,618	32,546	3,556	41,065
Land and land development	70	1,151	2,948	7,172	6,196	17,537
Construction	2,226	225	21,529	-	-	23,980
Total principal amount of loans	<u>\$ 19,021</u>	<u>\$ 7,016</u>	<u>\$ 91,804</u>	<u>\$ 102,716</u>	<u>\$ 139,830</u>	<u>\$ 360,387</u>

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

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

Allocation of the Allowance for Credit Losses

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

	June 30, 2015		December 31, 2014	
	Total Loans and Leases Held for Investment Allowance	Loans in Category as a Percentage of Total Gross Loans and Leases Held for Investment	Total Loans and Leases Held for Investment Allowance	Loans in Category as a Percentage of Total Gross Loans and Leases Held for Investment
Commercial and industrial	\$ 2,935	34 %	\$ 2,686	37 %
Commercial real estate	2,306	37 %	2,496	30 %
SBA	1,315	6 %	1,190	7 %
Consumer	609	11 %	516	11 %
Land and land development	1,129	5 %	1,436	8 %
Construction	297	7 %	277	7 %
Total	\$ 8,591	100% %	\$ 8,601	100 %

Nonperforming Loans

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Balance, beginning of period	\$ 287	\$ 5,038	\$ 61	\$ 5,617
Additions to nonperforming	608	79	843	79
Charge-offs	(146)	(643)	(146)	(673)
Reclassified back to performing	(13)	-	(19)	-
Principal payment received	(14)	(526)	(17)	(1,075)
Transferred to repossessed assets	-	-	-	-
Transferred to other real estate owned	-	(697)	-	(697)
Balance, end of period	\$ 722	\$ 3,251	\$ 722	\$ 3,251

Nonperforming Assets

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

	June 30, 2015	December 31, 2014
Nonperforming loans:		
Loans 90 days or more delinquent and still accruing interest	\$ 436	\$ 5
Non-accrual loans	286	56
Total nonperforming loans	722	61
Other real estate, net	242	256
Total nonperforming assets	\$ 964	\$ 317
Allowance for credit losses	\$ 8,591	\$ 8,601
Ratio of total nonperforming loans to total loans	0.17%	0.01%
Ratio of total nonperforming loans to loans and leases held for investment	0.20%	0.02%
Ratio of total nonperforming assets to total assets	0.11%	0.03%
Ratio of nonperforming loans to total assets	0.08%	0.01%
Ratio of allowance for credit losses to nonperforming loans	1,190%	14,100%

Potential Problem Loans

We attempt to quantify potential problem loans with more immediate credit risk. At June 30, 2015, the Bank had \$7.3 million of classified loans and \$286 thousand of loans on non-accrual. This compares to \$9.1 million of classified loans and \$56 thousand of loans on non-accrual at December 31, 2014 and \$10.4 million of classified loans and \$3.3 million of loans on non-accrual at June 30, 2014. We estimate there are loans risk rated “watch list” which are not impaired aggregating \$2.8 million at June 30, 2015 and \$473 thousand at December 31, 2014. Also, we estimate there are loans risk rated “substandard” which are not impaired aggregating \$7.0 million at June 30, 2015 and \$9.1 million at December 31, 2014.

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

Other Real Estate

See Note 7 of our Financial Statements for information on other real estate owned.

Liabilities

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

	June 30,		December 31,		Increase (Decrease)	
	2015	2014	\$	%		
Deposits:						
Non-interest-bearing	\$ 152,679	\$ 187,400	\$ (34,721)	(19) %	(a)	
Interest-bearing-						
Savings, interest checking and money market	466,398	455,282	11,116	2 %	(a)	
Time deposits under \$100,000	86,004	107,668	(21,664)	(20) %	(a)	
Time deposits \$100,000 and over	61,164	60,881	283	0 %	(a)	
Short-term borrowings	18,599	16,002	2,597	16 %	(b)	
FHLB borrowings	9,000	-	9,000	100 %		
Guaranteed preferred beneficial interests in Company's subordinated debentures	15,017	15,018	(1)	- %		
Accrued interest payable	330	338	(8)	(2) %		
Accrued expenses	8,036	7,279	757	10 %	(c)	
Other liabilities	872	1,063	(191)	(18) %	(d)	
Total liabilities	\$ 818,099	\$ 850,931	\$ (32,832)	(4) %		

- (a) As anticipated, balances decreased from December 31, 2014 due to the deployment of funds previously deposited with us by our North Dakota customers and exercising our right to call \$20.0 million of brokered deposits in the second quarter of 2015.
- (b) Short-term borrowings will vary depending on our customers need to use repurchase agreements or the Company's decision to utilize its lines of credit for various business purposes.
- (c) Accrued expenses increased primarily due to incentive compensation related to increased mortgage banking activity and production staff.
- (d) Other liabilities decreased primarily due to a decrease in mortgage banking derivatives being offset by increased income taxes payable.

Mortgage Banking Obligations

Included in accrued expenses is an estimate of mortgage banking reimbursement obligations which aggregated \$2.1 million at June 30, 2015 and \$1.9 million at December 31, 2014. Although we sell mortgage banking loans without recourse, industry standards require standard representations and warranties which require sellers to reimburse investors for economic losses if loans default or prepay after the sale. Repurchase risk is also evident within the mortgage banking industry as continued disputes arise between lenders and investors. Such requests for repurchase are commonly requested due to faulty representation and generally emerge at varied timeframes subsequent to the original sale of the loan. To estimate the obligation, we track historical reimbursements and calculate the ratio of reimbursement to loan production volumes. Using reimbursement ratios and recent production levels, we estimate the future reimbursement amounts and record the estimated obligation. The following is a summary of activity related to mortgage banking obligations (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Balance, beginning of period	\$ 2,157	\$ 1,607	\$ 1,879	\$ 1,679
Provision	65	115	359	198
Write offs, net	(120)	(145)	(136)	(300)
Balance, end of period	\$ 2,102	\$ 1,577	\$ 2,102	\$ 1,577

Stockholders' Equity

Our stockholders' equity increased \$3.3 million between December 31, 2014 and June 30, 2015 primarily due to \$4.6 million in additional retained earnings and a decrease in unrealized gains and losses in our investment portfolio of \$1.3 million. As presented in Note 3 – Capital and Current Operating Environment, the Company maintains capital in excess of regulatory requirements. In addition to assessing capital adequacy, management periodically evaluates the components of our capital structure.

Liquidity Risk Management

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

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

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

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

1. Estimated liquid assets less estimated volatile liabilities using the aforementioned methodology (\$217.3 million as of June 30, 2015);
2. Borrowing capacity from the FHLB (\$75.3 million as of June 30, 2015); and
3. Capacity to issue brokered deposits with maturities of less than 12 months (\$126.6 million as of June 30, 2015).

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

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

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

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

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

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

Quantitative and Qualitative Disclosures about Market Risk

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

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

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

Our primary tool for measuring and managing interest rate risk is net interest income simulation. This exercise includes our assumptions regarding the changes in interest rates and the impact on our current balance sheet. Interest rate caps and floors are included to the extent that they are exercised in the 12-month simulation period. Additionally, changes in prepayment behavior of the residential mortgage, CMOs, and mortgage-backed securities portfolios in each rate environment are captured using industry estimates of prepayment speeds for various coupon segments of the portfolio. For purposes of this simulation, projected month end balances of the various balance sheet accounts are held constant at their June 30, 2015 levels. Cash flows from a given account are reinvested back into the same account so as to keep the month end balance constant at its June 30, 2015 level. The static balance sheet assumption is made so as to project the interest rate risk to net interest income embedded in the existing balance sheet. With knowledge of the balance sheet's existing net interest income profile, more informed strategies and tactics may be developed as it relates to the structure/mix of growth.

We monitor the results of net interest income simulation on a regular basis. Net interest income is generally simulated for the upcoming 12-month horizon in seven interest rate scenarios. The scenarios generally modeled are parallel interest rate ramps of +/- 100bp, 200bp, and 300bp along with a rates unchanged scenario. Given the current low absolute level of interest rates as of June 30, 2015, the downward scenarios for interest rate movements is limited to -100bp but a +400bp scenario has been added. 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	+400bp
Projected 12-month net interest income	\$ 25,607	\$ 26,566	\$ 26,420	\$ 26,168	\$ 25,841	\$ 25,474
Dollar change from unchanged scenario	\$ (959)	\$ -	\$ (146)	\$ (398)	\$ (725)	\$ (1,092)
Percentage change from unchanged scenario	(3.61)%	-	(0.55)%	(1.50)%	(2.73)%	(4.11)%

Since there are limitations inherent in any methodology used to estimate the exposure to changes in market interest rates, these analyses are not intended to be a forecast of the actual effect of changes in market interest rates, such as those indicated above on the Company. Further, these analyses are based on our assets and liabilities as of June 30, 2015 (without forward adjustments for planned growth and anticipated business activities) and do not contemplate any actions we might undertake in response to changes in market interest rates.

Static gap analysis is another tool that may be used for interest rate risk measurement. The net differences between the amount of assets, liabilities, equity and off-balance-sheet instruments repricing within a cumulative calendar period is typically referred to as the “rate sensitivity position” or “gap position.” The following table sets forth our rate sensitivity position as of June 30, 2015. Assets and liabilities are classified by the earliest possible repricing date or maturity, whichever occurs first.

Interest Sensitivity Gap Analysis

	Estimated maturity or repricing at June 30, 2015				
	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	\$ 15,140	\$ -	\$ -	\$ -	\$ 15,140
Investment securities (a)	92,594	24,248	151,742	134,207	402,791
FRB and FHLB stock	3,287	-	-	-	3,287
Fed funds sold	-	-	-	-	-
Loans held for sale-mortgage banking, fixed rate	-	54,637	-	-	54,637
Loans held for sale-mortgage banking, floating rate	-	-	-	-	-
Loans held for investment, fixed rate	12,092	24,208	55,254	25,952	117,506
Loans held for investment, floating rate	97,851	14,712	122,234	8,101	242,898
Total interest-earning assets	<u>\$ 220,964</u>	<u>\$ 117,805</u>	<u>\$ 329,230</u>	<u>\$ 168,260</u>	<u>\$ 836,259</u>
Interest-bearing liabilities:					
Interest checking and money market accounts	\$ 435,551	\$ -	\$ -	\$ -	\$ 435,551
Savings	30,847	-	-	-	30,847
Time deposits under \$100,000	9,278	24,133	16,832	35,761	86,004
Time deposits \$100,000 and over	15,489	32,659	6,474	6,542	61,164
Short-term borrowings	18,599	-	-	-	18,599
FHLB advances	9,000	-	-	-	9,000
Long-term borrowings	-	-	-	-	-
Subordinated debentures	15,000	-	-	17	15,017
Total interest-bearing liabilities	<u>\$ 533,764</u>	<u>\$ 56,792</u>	<u>\$ 23,306</u>	<u>\$ 42,320</u>	<u>\$ 656,182</u>
Interest rate gap	<u>\$ (312,800)</u>	<u>\$ 61,013</u>	<u>\$ 305,924</u>	<u>\$ 125,940</u>	<u>\$ 180,077</u>
Cumulative interest rate gap at June 30, 2015	<u>\$ (312,800)</u>	<u>\$ (251,787)</u>	<u>\$ 54,137</u>	<u>\$ 180,077</u>	
Cumulative interest rate gap to total assets	(34.57)%	(27.83)%	5.98%	19.90%	

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

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

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

Since there are limitations inherent in any methodology used to estimate the exposure to changes in market interest rates, these analyses are not intended to be a forecast of the actual effect of changes in market interest rates such as those indicated above on the Company. Further, these analyses are based on our assets and liabilities as of June 30, 2015 and do not contemplate any actions we might undertake in response to changes in market interest rates.

OTHER INFORMATION

Legal Proceedings

From time to time, we may be a party to legal proceedings arising out of our lending, deposit operations or other activities. We engage in foreclosure proceedings and other collection actions as part of our loan collection activities. From time to time, borrowers may also bring actions against us, in some cases claiming damages. Some financial services companies have been subjected to significant exposure in connection with litigation, including class action litigation and punitive damage claims. While we are not aware of any such actions or allegations that should reasonably give rise to any material adverse effect, it is possible that we could be subjected to such a claim in an amount that could be material. Based upon a review with our legal counsel, we believe that the ultimate disposition of such pending litigation will not have a material effect on our financial condition, results of operations or cash flows.

Signatures

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

BNCCORP, INC.

Date: August 12, 2015

By: /s/ Timothy J. Franz
Timothy J. Franz
President and Chief Executive Officer

By: /s/ Daniel J. Collins
Daniel J. Collins
Chief Financial Officer