Quarterly Report

For the quarter ended June 30, 2014

BNCCORP, INC.

(OTCQB: BNCC)

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BNCCORP, INC.
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June 30, 2014

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BNCCORP, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(In thousands, except share data)

ASSETS	**June 30, 2014** (unaudited)	**December 31, 2013**
CASH AND CASH EQUIVALENTS	$ 51,277	$ 18,871
INVESTMENT SECURITIES AVAILABLE FOR SALE	451,974	435,719
FEDERAL RESERVE BANK AND FEDERAL HOME LOAN BANK STOCK	2,817	2,729
LOANS HELD FOR SALE-MORTGAGE BANKING	37,057	32,870
LOANS AND LEASES HELD FOR INVESTMENT	324,934	317,928
ALLOWANCE FOR CREDIT LOSSES	(8,828)	(9,847)
Net loans and leases held for investment	316,106	308,081
OTHER REAL ESTATE, net	1,753	1,056
PREMISES AND EQUIPMENT, net	15,118	14,870
ACCRUED INTEREST RECEIVABLE	3,757	3,554
OTHER	23,107	25,373
Total assets	$ 902,966	$ 843,123
LIABILITIES AND STOCKHOLDERS' EQUITY		
DEPOSITS:		
Non-interest-bearing	$ 129,114	$ 141,788
Interest-bearing –		
Savings, interest checking and money market	430,145	378,355
Time deposits under $100,000	112,155	123,058
Time deposits $100,000 and over	101,463	80,028
Total deposits	772,877	723,229
SHORT-TERM BORROWINGS	21,848	19,967
GUARANTEED PREFERRED BENEFICIAL INTERESTS IN COMPANY'S SUBORDINATED DEBENTURES	22,519	22,432
ACCRUED INTEREST PAYABLE	756	771
ACCRUED EXPENSES	6,095	6,307
OTHER	969	552
Total liabilities	825,064	773,258
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; 3,413,854 and 3,374,601 shares issued and outstanding	34	34
Capital surplus – common stock	25,766	26,133
Retained earnings	31,114	27,962
Treasury stock (254,799 and 294,052 shares, respectively)	(3,420)	(3,894)
Accumulated other comprehensive income (loss), net	3,310	(1,468)
Total stockholders' equity	77,902	69,865
Total liabilities and stockholders' equity	$ 902,966	$ 843,123

See accompanying notes to consolidated financial statements

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Income

(In thousands, except per share data, unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2014	**2013**	**2014**	**2013**
INTEREST INCOME:				
Interest and fees on loans	$ 4,279	$ 3,915	$ 8,360	$ 7,915
Interest and dividends on investments				
Taxable	2,410	1,322	4,859	2,661
Tax-exempt	553	295	1,099	577
Dividends	29	28	57	56
Total interest income	7,271	5,560	14,375	11,209
INTEREST EXPENSE:				
Deposits	651	677	1,253	1,393
Short-term borrowings	9	10	18	20
Subordinated debentures	288	290	576	580
Total interest expense	948	977	1,847	1,993
Net interest income	6,323	4,583	12,528	9,216
PROVISION (REDUCTION) FOR CREDIT LOSSES	(400)	-	(600)	700
NET INTEREST INCOME AFTER PROVISION (REDUCTION) FOR CREDIT LOSSES	6,723	4,583	13,128	8,516
NON-INTEREST INCOME:				
Bank charges and service fees	667	674	1,371	1,291
Wealth management revenues	346	313	735	633
Mortgage banking revenues, net	3,391	6,744	5,673	14,991
Gains on sales of loans, net	760	352	1,000	1,107
Gains on sales of securities, net	5	-	528	1,210
Other	192	269	338	444
Total non-interest income	5,361	8,352	9,645	19,676
NON-INTEREST EXPENSE:				
Salaries and employee benefits	4,543	4,319	8,782	9,354
Professional services	714	1,053	1,389	2,022
Data processing fees	720	781	1,438	1,501
Marketing and promotion	654	700	1,308	1,209
Occupancy	491	650	973	1,168
Regulatory costs	157	210	308	534
Depreciation and amortization	302	312	607	617
Office supplies and postage	182	167	339	322
Other real estate costs	20	49	32	126
Other	1,104	818	1,801	1,603
Total non-interest expense	8,887	9,059	16,977	18,456
Income before income taxes	3,197	3,876	5,796	9,736
Income tax expense	990	1,400	1,797	3,475
Net income	2,207	2,476	3,999	6,261
Preferred stock costs	475	327	847	651
Net income available to common shareholders	$ 1,732	$ 2,149	$ 3,152	$ 5,610
Basic earnings per common share	$ 0.51	$ 0.65	$ 0.94	$ 1.70
Diluted earnings per common share	$ 0.50	$ 0.62	$ 0.91	$ 1.62

See accompanying notes to consolidated financial statements.

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

	For the Three Months Ended June 30,				For the Six Months Ended June 30,			
	2014		2013		2014		2013	
NET INCOME		$ 2,207		$ 2,476		$ 3,999		$ 6,261
Unrealized gain (loss) on securities available for sale	$ 4,611		$ (8,219)		$ 8,137		$ (8,592)	
Reclassification adjustment for (gain) loss included in net income	(5)		-		(528)		(1,210)	
Other comprehensive income (loss) before tax	4,606		(8,219)		7,609		(9,802)	
Income tax benefit (expense) related to items of other comprehensive income (loss)	(1,750)		3,123		(2,831)		3,725	
Other comprehensive income (loss)	2,856	2,856	(5,096)	(5,096)	4,778	4,778	(6,077)	(6,077)
TOTAL COMPREHENSIVE INCOME (LOSS)		$ 5,063		$ (2,620)		$ 8,777		$ 184

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)

	Preferred Stock		Common Stock		Capital Surplus Common	Retained Earnings	Treasury	Accumulated Other Comprehensive	
	Shares	**Amount**	**Shares**	**Amount**	**Stock**	**(Deficit)**	**Stock**	**Income (Loss)**	**Total**
BALANCE, December 31, 2012	21,098	$ 20,888	3,300,652	$ 33	$ 27,257	$ 20,655	$ (5,064)	$ 4,961	$ 68,730
Net income	-	-	-	-	-	6,261	-	-	6,261
Other comprehensive loss	-	-	-	-	-	-	-	(6,077)	(6,077)
Preferred stock amortization, net	-	101	-	-	-	(101)	-	-	-
Dividend on preferred stock	-	-	-	-	-	(551)	-	-	(551)
Impact of share-based compensation	-	-	-	-	2	-	-	-	2
BALANCE, June 30, 2013	21,098	$ 20,989	3,300,652	$ 33	$ 27,259	$ 26,264	$ (5,064)	$ (1,116)	$ 68,365
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
Preferred stock amortization, net	-	-	-	-	-	-	-	-	-
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

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)

	2014	2013
OPERATING ACTIVITIES:		
Net income	$ 3,999	$ 6,261
Adjustments to reconcile net income to net cash provided by operating activities -		
Provision (reduction) for credit losses	(600)	700
Depreciation and amortization	607	617
Net amortization of premiums and (discounts)	2,844	3,963
Share-based compensation	107	2
Change in interest receivable and other assets, net	1,377	(894)
(Gain) loss on sale of bank premises and equipment	(3)	9
Net realized gain on sales of investment securities	(528)	(1,210)
Provision for deferred income taxes	1,888	(384)
Change in other liabilities, net	(1,359)	(3,848)
Funding of originations of loans held for sale	(285,641)	(625,668)
Proceeds from sales of loans held for sale	281,908	636,306
Fair value adjustment for loans held for sale	(454)	424
Change in fair value on mortgage banking derivatives	(1,046)	(46)
Proceeds from sales of loans	8,719	10,578
Gains on sales of loans, net	(1,000)	(1,107)
Net cash provided by (used in) operating activities	10,818	25,703
INVESTING ACTIVITIES:		
Purchases of investment securities	(73,782)	(120,043)
Proceeds from sales of investment securities	34,033	39,147
Proceeds from maturities of investment securities	27,337	28,629
Purchases of Federal Reserve and Federal Home Loan Bank Stock	(1,280)	(129)
Sales of Federal Reserve and Federal Home Loan Bank Stock	1,192	-
Net (increase) decrease in loans held for investment	(15,841)	(2,374)
Proceeds from sales of other real estate	-	2,165
Proceeds from sales of bank premises and equipment	778	-
Additions to bank premises and equipment	(1,629)	(919)
Net cash provided by (used in) investing activities	(29,192)	(53,524)

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)

	2014	2013
FINANCING ACTIVITIES:		
Net increase (decrease) in deposits	$ 49,648	$ 29,479
Net increase (decrease) in short-term borrowings	1,881	8,207
Repayments of Federal Home Loan Bank advances	(29,800)	(10)
Proceeds from Federal Home Loan Bank advances	29,800	10
Dividends paid on preferred stock	(749)	(4,132)
Net cash provided by (used in) financing activities	50,780	33,554
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	32,406	5,733
CASH AND CASH EQUIVALENTS, beginning of period	18,871	40,790
CASH AND CASH EQUIVALENTS, end of period	$ 51,277	$ 46,523
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	$ 1,862	$ 6,292
Income taxes paid	$ 981	$ 699
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Additions to other real estate in settlement of loans	$ 697	$ -

See accompanying notes to consolidated financial statements.

NOTE 1 – Organization of Operations, BNCCORP, INC.

BNCCORP, INC. (BNCCORP) is a registered bank holding company incorporated under the laws of Delaware. It is the parent company of BNC National Bank (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 14 locations. The Bank also conducts mortgage banking from 13 locations in Arizona, Minnesota, North Dakota, Illinois, Kansas, and Nebraska.

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, 2013. Accordingly, footnote disclosures which would substantially duplicate the disclosures contained in the December 31, 2013 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, 2013 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, 2014 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, 2013.

RECENTLY ISSUED OR ADOPTED ACCOUNTING PRONOUNCEMENTS

FASB ASU 2011-02, *Receivables (Topic 310), A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring,* clarifies when the restructuring of a receivable should be considered a troubled debt restructuring (TDR). FASB issued the guidance in response to constituents' concerns that creditors were inconsistently applying the guidance for identifying TDRs. The ASU provides additional guidance for determining whether the creditor has granted a concession and whether the debtor is experiencing financial difficulty. For nonpublic companies, this ASU is effective for annual periods ending after December 15, 2012, including interim periods within those annual periods. Information related to this ASU and the related disclosures are included in Note 6 in the Company's notes to the consolidated financial statements.

In June 2011, the FASB issued ASU 2011-05, *Presentation of Comprehensive Income* (*Topic 220*), which requires companies to report total net income, each component of comprehensive income, and total comprehensive income on the face of the income statement, or as two consecutive statements. The components of comprehensive income are not changed, nor does the ASU affect how earnings per share is calculated or reported. The adoption of this ASU in 2013 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. Stakeholders were asked to review and provide comments to the FASB on the proposal by May 31, 2013.

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 in 2015 is not expected to have a material impact on the Company's consolidated financial statements.

In December 2011, the FASB issued ASU 2011-11, *Disclosures about Offsetting Assets and Liabilities.* The ASU is a joint requirement by the FASB and International Accounting Standards Board to enhance current disclosures and increase comparability of GAAP and International Financial Reporting Standards financial statements. Under the ASU, an entity will be required to disclose both gross and net information about instruments and transactions eligible for offset in the balance sheet, as well as instruments and transactions subject to an agreement similar to a master netting agreement. The scope of the ASU includes derivatives, sale and repurchase agreements, reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. The ASU was effective for annual and interim periods beginning January 1, 2013. Adoption of the ASU did not have a material effect on the Company's consolidated financial statements.

NOTE 3 – Capital and Current Operating Environment

Capital amounts and ratios of BNCCORP and the Bank are presented in the tables below (dollars in thousands):

	Actual		For Capital Adequacy Purposes		To be Well Capitalized		Amount in Excess of Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
June 30, 2014								
Total Risk Based Capital:								
Consolidated	$ 102,611	23.49 %	$ 34,942	≥8.0 %	$ N/A	N/A %	$ N/A	N/A %
BNC National Bank	94,203	21.77	34,610	≥8.0	43,263	10.0	50,940	11.77
Tier 1 Risk Based Capital :								
Consolidated	97,110	22.23	17,471	≥4.0	N/A	N/A	N/A	N/A
BNC National Bank	88,753	20.51	17,305	≥4.0	25,958	6.0	62,795	14.51
Tier 1 Leverage Capital:								
Consolidated	97,110	10.66	36,456	≥4.0	N/A	N/A	N/A	N/A
BNC National Bank	88,753	9.75	36,400	≥4.0	45,500	5.0	43,253	4.75
Tangible Equity (to total assets):								
Consolidated tangible equity	77,816	8.62	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	92,429	10.24	N/A	N/A	N/A	N/A	N/A	N/A
Tangible Common Equity (to total assets):								
Consolidated tangible common equity	56,718	6.28	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	92,429	10.24	N/A	N/A	N/A	N/A	N/A	N/A
December 31, 2013								
Total Risk Based Capital:								
Consolidated	$ 97,354	23.15 %	$ 33,644	≥8.0 %	$ N/A	N/A %	$ N/A	N/A %
BNC National Bank	88,922	21.40	33,245	≥8.0	41,556	10.0	47,366	11.40
Tier 1 Risk Based Capital :								
Consolidated	91,150	21.67	16,822	≥4.0	N/A	N/A	N/A	N/A
BNC National Bank	83,670	20.13	16,622	≥4.0	24,934	6.0	58,736	14.13
Tier 1 Leverage Capital:								
Consolidated	91,150	10.94	33,316	≥4.0	N/A	N/A	N/A	N/A
BNC National Bank	83,670	10.06	33,271	≥4.0	41,589	5.0	42,081	5.06
Tangible Equity (to total assets):								
Consolidated tangible equity	69,800	8.30	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	82,592	9.82	N/A	N/A	N/A	N/A	N/A	N/A
Tangible Common Equity (to total assets):								
Consolidated tangible common equity	48,702	5.79	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	82,592	9.82	N/A	N/A	N/A	N/A	N/A	N/A

In the current operating environment, management believes banking entities are regularly required to maintain capital ratios in excess of the statutory amounts required to be considered well capitalized. We are managing capital accordingly. The most recent notifications from the Office of the Comptroller of the Currency (OCC) categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. Management believes the Bank remains well capitalized through the date for which subsequent events have been evaluated.

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.

In July of 2013, the Federal Reserve issued new regulatory capital standards for community banks which incorporate some of the capital requirements addressed in the Basel III framework and begin to be effective January 1, 2015. We have reviewed estimates of our regulatory capital ratios under the new Basel III framework and expect to be in compliance with these standards.

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, 2014 or December 31, 2013. The carrying amount of available-for-sale securities and their approximate fair values were as follows (in thousands):

	As of June 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. treasury securities	$ 11,891	$ 43	$ -	$ 11,934
U.S. government agency mortgage-backed securities guaranteed by GNMA	68,296	993	(446)	68,843
U.S. government agency mortgage-backed securities issued by FNMA or FHLMC	16,065	-	(275)	15,790
U.S. government agency small business administration pools guaranteed by SBA	68,010	297	(162)	68,145
Collateralized mortgage obligations guaranteed by GNMA/VA	134,627	1,265	(975)	134,917
Collateralized mortgage obligations issued by FNMA or FHLMC	83,814	909	(767)	83,956
Other collateralized mortgage obligations	-	-	-	-
State and municipal bonds	65,453	3,042	(106)	68,389
	$ 448,156	$ 6,549	$ (2,731)	$ 451,974

	As of December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. treasury securities	$ -	$ -	$ -	$ -
U.S. government agency mortgage-backed securities guaranteed by GNMA	74,247	591	(1,372)	73,466
U.S. government agency mortgage-backed securities issued by FNMA or FHLMC	32,065	210	(597)	31,678
U.S. government agency small business administration pools guaranteed by SBA	47,882	111	(169)	47,824
Collateralized mortgage obligations guaranteed by GNMA/VA	141,552	968	(1,963)	140,557
Collateralized mortgage obligations issued by FNMA or FHLMC	77,286	514	(1,171)	76,629
Other collateralized mortgage obligations	1,746	48	-	1,794
State and municipal bonds	64,733	521	(1,483)	63,771
	$ 439,511	$ 2,963	$ (6,755)	$ 435,719

The amortized cost and estimated fair market value of available-for-sale securities classified according to their contractual maturities at June 30, 2014 were as follows (in thousands):

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ -	$ -
Due after one year through five years	11,891	11,934
Due after five years through ten years	29,721	29,680
Due after ten years	406,544	410,360
Total	$ 448,156	$ 451,974

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, 2014 Less than 12 months #	Fair Value	Unrealized Loss	12 months or more #	Fair Value	Unrealized Loss	Total #	Fair Value	Unrealized Loss
U.S. treasury securities	-	$ -	$ -	-	$ -	$ -	-	$ -	$ -
U.S. government agency mortgage-backed securities guaranteed by GNMA	1	6,773	(18)	2	17,778	(428)	3	24,551	(446)
U.S. government agency mortgage-backed securities issued by FNMA or FHLMC	-	-	-	4	15,790	(275)	4	15,790	(275)
U.S. government agency small business administration pools guaranteed by SBA	2	15,606	(39)	5	9,441	(123)	7	25,047	(162)
Collateralized mortgage obligations guaranteed by GNMA/VA	5	16,544	(176)	10	41,597	(799)	15	58,141	(975)
Collateralized mortgage obligations issued by FNMA or FHLMC	4	15,284	(212)	3	15,332	(555)	7	30,616	(767)
Other collateralized mortgage obligations	-	-	-	-	-	-	-	-	-
State and municipal bonds	2	4,332	(78)	2	5,870	(28)	4	10,202	(106)
Total temporarily impaired securities	14	$ 58,539	$ (523)	26	$ 105,808	$ (2,208)	40	$ 164,347	$ (2,731)

Description of Securities	December 31, 2013 Less than 12 months #	Fair Value	Unrealized Loss	12 months or more #	Fair Value	Unrealized Loss	Total #	Fair Value	Unrealized Loss
U.S. treasury securities	-	$ -	$ -	-	$ -	$ -	-	$ -	$ -
U.S. government agency mortgage-backed securities guaranteed by GNMA	7	34,534	(889)	1	8,891	(483)	8	43,425	(1,372)
U.S. government agency mortgage-backed securities issued by FNMA or FHLMC	6	27,265	(597)	-	-	-	6	27,265	(597)
U.S. government agency small business administration pools guaranteed by SBA	7	17,741	(169)	-	-	-	7	17,741	(169)
Collateralized mortgage obligations guaranteed by GNMA/VA	13	49,531	(1,478)	4	16,373	(485)	17	65,904	(1,963)
Collateralized mortgage obligations issued by FNMA or FHLMC	6	24,740	(529)	3	14,452	(642)	9	39,192	(1,171)
Other collateralized mortgage obligations	-	-	-	-	-	-	-	-	-
State and municipal bonds	24	46,609	(1,483)	-	-	-	24	46,609	(1,483)
Total temporarily impaired securities	63	$ 200,420	$ (5,145)	8	$ 39,716	$ (1,610)	71	$ 240,136	$ (6,755)

Management regularly evaluates each security with unrealized losses to determine whether losses are other–than-temporary. 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, cash flow from the security, the level of credit support provided by subordinate tranches, and the collateral underlying the security.

There were no securities that management concluded were other-than-temporarily impaired at June 30, 2014 or December 31, 2013.

NOTE 5 – Loans and Leases

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

	June 30, 2014	December 31, 2013
Loans held for sale-mortgage banking	$ 37,057	$ 32,870
Commercial and industrial	$ 120,552	$ 132,983
Commercial real estate	100,869	93,330
SBA	24,312	18,215
Consumer	34,648	32,612
Land and land development	25,605	27,582
Construction	18,951	13,286
	324,937	318,008
Unearned income and net unamortized deferred fees and costs	(3)	(80)
Loans, net of unearned income and unamortized fees and costs	324,934	317,928
Allowance for credit losses	(8,828)	(9,847)
Net loans and leases held for investment	$ 316,106	$ 308,081

NOTE 6 – Allowance for Credit Losses

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

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	$ 2,326	$ 2,707	$ 874	$ 493	$ 2,196	$ 232	$ 8,828

Three Months Ended June 30, 2013	Commercial and industrial	Commercial real estate	SBA	Consumer	Land and land development	Construction	Total
Balance, beginning of period	$ 2,072	$ 4,507	$ 712	$ 448	$ 1,926	$ 208	$ 9,873
Provision	84	(94)	22	42	53	(107)	-
Loans charged off	-	-	-	(23)	-	-	(23)
Loan recoveries	-	-	-	2	46	-	48
Balance, end of period	$ 2,156	$ 4,413	$ 734	$ 469	$ 2,025	$ 101	$ 9,898

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	$ 2,326	$ 2,707	$ 874	$ 493	$ 2,196	$ 232	$ 8,828

Six Months Ended June 30, 2013	Commercial and industrial	Commercial real estate	SBA	Consumer	Land and land development	Construction	Total
Balance, beginning of period	$ 2,546	$ 4,790	$ 616	$ 382	$ 1,609	$ 148	$ 10,091
Provision	526	(382)	118	127	358	(47)	700
Loans charged off	(916)	(3)	-	(48)	-	-	(967)
Loan recoveries	-	8	-	8	58	-	74
Balance, end of period	$ 2,156	$ 4,413	$ 734	$ 469	$ 2,025	$ 101	$ 9,898

The following table shows the balance in the allowance for credit losses at June 30, 2014, and December 31, 2013, and the related loan balances, segregated on the basis of impairment methodology (in thousands). Loans evaluated under ASC 310-10-35 include loans on nonaccrual status and troubled debt restructurings, which are individually evaluated for impairment, and other impaired loans deemed to have similar risk characteristics. All other loans are collectively evaluated for impairment under ASC 450-20.

	Allowance For Credit Losses			Gross Loans and Leases Held for Investment		
	Under ASC 310-10-35	Under ASC 450-20	Total	Evaluated for Impairment Under ASC 310-10-35	Evaluated for Impairment Under ASC 450-20	Total
June 30, 2014						
Commercial and industrial	$ 8	$ 2,318	$ 2,326	$ 53	$ 120,499	$ 120,552
Commercial real estate	223	2,484	2,707	6,945	93,924	100,869
SBA	-	874	874	50	24,262	24,312
Consumer	8	485	493	343	34,305	34,648
Land and land development	-	2,196	2,196	-	25,605	25,605
Construction	-	232	232	-	18,951	18,951
Total	$ 239	$ 8,589	$ 8,828	$ 7,391	$ 317,546	$ 324,937
December 31, 2013						
Commercial and industrial	$ 30	$ 2,185	$ 2,215	$ 430	$ 132,553	$ 132,983
Commercial real estate	1,030	3,011	4,041	4,188	89,142	93,330
SBA	-	579	579	-	18,215	18,215
Consumer	-	478	478	38	32,574	32,612
Land and land development	-	2,371	2,371	-	27,582	27,582
Construction	-	163	163	-	13,286	13,286
Total	$ 1,060	$ 8,787	$ 9,847	$ 4,656	$ 313,352	$ 318,008

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, 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	$ 64,801	$ 41	$ -	$ 64,842	$ 18	$ 64,860
Agriculture	18,628	-	-	18,628	-	18,628
Owner-occupied commercial real estate	37,064	-	-	37,064	-	37,064
Commercial real estate	97,656	-	-	97,656	3,213	100,869
SBA	24,312	-	-	24,312	-	24,312
Consumer:						
Automobile	6,636	-	-	6,636	19	6,655
Home equity	5,414	-	-	5,414	-	5,414
1st mortgage	9,970	-	-	9,970	-	9,970
Other	12,597	11	1	12,609	-	12,609
Land and land development	25,605	-	-	25,605	-	25,605
Construction	18,951	-	-	18,951	-	18,951
Total loans held for investment	321,634	52	1	321,687	3,250	324,937
Loans held for sale	37,057	-	-	37,057	-	37,057
Total gross loans	$ 358,691	$ 52	$ 1	$ 358,744	$ 3,250	$ 361,994

	December 31, 2013					
	Current	31-89 Days Past Due	90 Days or More Past Due and Accruing	Total Performing	Non-accrual	Total
Commercial and industrial:						
Business loans	$ 78,137	$ 88	$ -	$ 78,225	$ -	$ 78,225
Agriculture	17,499	-	-	17,499	-	17,499
Owner-occupied commercial real estate	36,829	-	-	36,829	430	37,259
Commercial real estate	89,142	-	-	89,142	4,188	93,330
SBA	18,215	-	-	18,215	-	18,215
Consumer:						
Automobile	6,634	17	-	6,651	38	6,689
Home equity	4,292	-	-	4,292	-	4,292
1st mortgage	11,612	-	-	11,612	-	11,612
Other	10,012	7	-	10,019	-	10,019
Land and land development	26,621	-	961	27,582	-	27,582
Construction	13,286	-	-	13,286	-	13,286
Total loans held for investment	312,279	112	961	313,352	4,656	318,008
Loans held for sale	32,870	-	-	32,870	-	32,870
Total gross loans	$ 345,149	$ 112	$ 961	$ 346,222	$ 4,656	$ 350,878

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 June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Interest income that would have been recorded	$ 63	$ 121	$ 131	$ 242
Interest income recorded	-	-	-	-
Effect on interest income	$ 63	$ 121	$ 131	$ 242

Impaired loans

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

The following table summarizes impaired loans and related allowances (in thousands):

	June 30, 2014				
	Unpaid Principal	**Recorded Investment**	**Related Allowance**	**Average Recorded Balance**	**Interest Income Recognized**
Impaired loans with an allowance recorded:					
Commercial and industrial:					
Business loans	$ 53	$ 53	$ 8	$ 63	$ 2
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	11,388	6,945	223	7,511	98
SBA	-	-	-	-	-
Consumer:					
Automobile	-	-	-	-	-
Home equity	-	-	-	-	-
1st mortgage	1,878	314	8	466	10
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans with an allowance recorded	$ 13,319	$ 7,312	$ 239	$ 8,040	$ 110
Impaired loans without an allowance recorded:					
Commercial and industrial:					
Business loans	$ -	$ -	$ -	$ -	$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	-	-	-	-	-
SBA	61	50	-	50	-
Consumer:					
Automobile	39	29	-	31	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans without an allowance recorded	$ 100	$ 79	$ -	$ 81	$ -
TOTAL IMPAIRED LOANS	$ 13,419	$ 7,391	$ 239	$ 8,121	$ 110

	December 31, 2013				
	Unpaid Principal	Recorded Investment	Related Allowance	Average Recorded Balance	Interest Income Recognized
Impaired loans with an allowance recorded:					
Commercial and industrial:					
Business loans	$ -	$ -	$ -	$ -	$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	514	430	30	430	-
Commercial real estate	6,857	4,188	1,030	4,347	-
SBA	-	-	-	-	-
Consumer:					
Automobile	-	-	-	-	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans with an allowance recorded	$ 7,371	$ 4,618	$ 1,060	$ 4,777	$ -
Impaired loans without an allowance recorded:					
Commercial and industrial:					
Business loans	$ -	$ -	$ -	$ -	$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	-	-	-	-	-
SBA	-	-	-	-	-
Consumer:					
Automobile	64	38	-	44	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans without an allowance recorded	$ 64	$ 38	$ -	$ 44	$ -
TOTAL IMPAIRED LOANS	$ 7,435	$ 4,656	$ 1,060	$ 4,821	$ -

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.

During 2012, the Company adopted 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, 2014			
	Accrual	Non-accrual	Total	Allowance
Commercial and industrial:				
Business loans	$ 53	$ -	$ 53	$ 8
Agriculture	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-
Commercial real estate	3,719	3,213	6,932	223
SBA	-	-	-	-
Consumer:				
Automobile	-	-	-	-
Home equity	-	-	-	-
1st mortgage	314	-	314	8
Other	-	-	-	-
Land and land development	-	-	-	-
Construction	-	-	-	-
Loans held for sale	-	-	-	-
	$ 4,086	$ 3,213	$ 7,299	$ 239

	December 31, 2013			
	Accrual	Non-accrual	Total	Allowance
Commercial and industrial:				
Business loans	$ 93	$ -	$ 93	$ 14
Agriculture	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-
Commercial real estate	3,770	4,188	7,958	1,124
SBA	-	-	-	-
Consumer:				
Automobile	-	-	-	-
Home equity	-	-	-	-
1st mortgage	493	-	493	12
Other	-	-	-	-
Land and land development	-	-	-	-
Construction	-	-	-	-
Loans held for sale	-	-	-	-
	$ 4,356	$ 4,188	$ 8,544	$ 1,150

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 no new TDR's for the three and six month periods ending June 30, 2014 and June 30, 2013.

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 June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Interest income that would have been recorded	$ 141	$ 138	$ 285	$ 276
Interest income recorded	52	55	104	110
Effect on interest income	$ 89	$ 83	$ 181	$ 166

The amount of additional funds committed to borrowers who are in TDR status was $232 thousand at June 30, 2014 and $232 thousand at December 31, 2013.

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, 2014 and June 30, 2013 and defaulted during the three and six months ended June 30, 2014 and June 30, 2013.

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 June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Balance, beginning of period	$ 1,056	$ 3,336	$ 1,056	$ 5,131
Transfers from nonperforming loans	697	-	697	-
Real estate sold	-	(370)	-	(2,165)
Net gains (losses) on sale of assets	-	-	-	-
Provision	-	-	-	-
Balance, end of period	$ 1,753	$ 2,966	$ 1,753	$ 2,966

	June 30, 2014	December 31, 2013	June 30, 2013
Other real estate	$ 2,451	$ 3,250	$ 4,561
Valuation allowance	(698)	(2,194)	(1,595)
Other real estate, net	$ 1,753	$ 1,056	$ 2,966

NOTE 8 – Earnings Per Share

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

	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		127,020		127,446
Denominator for diluted earnings per share		3,491,255		3,482,722
Numerator (in thousands):				
Net income	$	2,207	$	3,999
Preferred stock costs		(475)		(847)
Net income available to common shareholders	$	1,732	$	3,152
Basic earnings per common share	$	0.51		0.94
Diluted earnings per common share	$	0.50	$	0.91

	Three months ended June 30, 2013		Six months ended June 30, 2013	
Denominator for basic earnings per share*:*				
Average common shares outstanding		3,297,352		3,297,352
Dilutive effect of stock compensation		170,397		169,964
Denominator for diluted earnings per share		3,467,749		3,467,316
Numerator (in thousands):				
Net income	$	2,476	$	6,261
Preferred stock costs		(327)		(651)
Net income available to common shareholders	$	2,149	$	5,610
Basic earnings per common share	$	0.65	$	1.70
Diluted earnings per common share	$	0.62	$	1.62

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:

	1995	2002	2006	2010	Total
Total Shares in Plan	250,000	125,000	200,000	250,000	825,000
Total Shares Available	48,751	-	9,850	250,000	308,601

Following is a summary of fully vested stock options and options expected to vest as of June 30, 2014:

	Stock Options Outstanding	Stock Options Currently Exercisable	Stock Options Vested and Expected to Vest
Number	125,800	125,800	125,800
Weighted-average exercise price	$3.00	$3.00	$3.00
Weighted-average remaining contractual term	5.71 years	5.71 years	5.71 years

The stock options currently outstanding can be exercised until the expiration date of March 17, 2020.

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. The Company recognized share-based compensation expense of $1,000 related to restricted stock for the three month period ended June 30, 2013, and $2,000 for the six month period ended June 30, 2013.

At June 30, 2014, the Company had $277,000 of unamortized restricted stock compensation expense. All of this expense will be amortized by March 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.

At the beginning of the period, all assets and liabilities valued at fair value on a recurring basis were considered to be Level 2. There were no transfers into or out of Level 2 during the period; however, the Company purchased US Treasury Securities during the second quarter of 2014, which are considered Level 1.

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, 2014				Six Months Ended June 30, 2014
	Total	**Level 1**	**Level 2**	**Level 3**	**Total gains/(losses)**
ASSETS					
Securities available for sale	$ 451,974	$ 11,934	$ 440,040	$ -	$ 528
Loans held for sale	37,057	-	37,057	-	477
Commitments to originate mortgage loans	2,265	-	2,265	-	1,366
Commitments to sell mortgage loans	-	-	-	-	-
Mortgage banking short positions	-	-	-	-	-
Total assets at fair value	$ 491,296	$ 11,934	$ 479,362	$ -	$ 2,371
LIABILITIES					
Commitments to sell mortgage loans	$ 157	$ -	$ 157	$ -	$ (265)
Mortgage banking short positions	259	-	259	-	(532)
Total liabilities at fair value	$ 416	$ -	$ 416	$ -	$ (797)

	Carrying Value at December 31, 2013				Twelve Months Ended December 31, 2013
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
ASSETS					
Securities available for sale	$ 435,719	$ -	$ 435,719	$ -	$ 1,247
Loans held for sale	32,870	-	32,870	-	(2,032)
Commitments to originate mortgage loans	706	-	706	-	(4,153)
Commitments to sell mortgage loans	107	-	107	-	2,341
Mortgage banking short positions	274	-	274	-	326
Total assets at fair value	$ 469,676	$ -	$ 469,676	$ -	$ (2,271)
LIABILITIES					
Commitments to sell mortgage loans	$ -	$ -	$ -	$ -	$ -
Mortgage banking short positions	-	-	-	-	-
Total liabilities at fair value	$ -	$ -	$ -	$ -	$ -

The Company may also be required from time to time to measure certain other financial assets at fair value on a nonrecurring basis in accordance with U.S. generally accepted accounting principles. These adjustments to fair value usually result from the application of the lower-of-cost-or-market accounting or 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, 2014				Six Months Ended June 30, 2014
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
Impaired loans(1)	$ 7,098	$ -	$ 7,098	$ -	$ 468
Other real estate(2)	1,753	-	1,753	-	-
Total	$ 8,851	$ -	$ 8,851	$ -	$ 468

	Carrying Value at December 31, 2013				Twelve Months Ended December 31, 2013
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
Impaired loans(1)	$ 3,596	$ -	$ 3,596	$ -	$ 140
Other real estate(2)	1,056	-	1,056	-	22
Total	$ 4,652	$ -	$ 4,652	$ -	$ 162

(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, 2014 Carrying Amount	June 30, 2014 Fair Value	December 31, 2013 Carrying Amount	December 31, 2013 Fair Value
Assets:					
Cash and cash equivalents	Level 1	$ 51,277	$ 51,277	$ 18,871	$ 18,871
Investment securities available for sale	Level 1	11,934	11,934	-	-
Investment securities available for sale	Level 2	440,040	440,040	435,719	435,719
Federal Reserve Bank and Federal Home Loan Bank stock	Level 2	2,817	2,817	2,729	2,729
Loans held for sale-mortgage banking	Level 2	37,057	37,057	32,870	32,870
Commitments to originate mortgage loans	Level 2	2,265	2,265	706	706
Commitments to sell mortgage loans	Level 2	-	-	107	107
Mortgage banking short positions	Level 2	-	-	274	274
Loans and leases held for investment, net	Level 2	316,106	317,204	308,081	308,932
Accrued interest receivable	Level 2	3,757	3,757	3,554	3,554
		$ 865,253	$ 866,351	$ 802,911	$ 803,762
Liabilities and Stockholders' Equity:					
Deposits, noninterest-bearing	Level 2	$ 129,114	$ 129,114	$ 141,788	$ 141,788
Deposits, interest-bearing	Level 2	643,763	643,555	581,441	583,626
Borrowings and advances	Level 2	21,848	21,848	19,967	19,967
Accrued interest payable	Level 2	756	756	771	771
Accrued expenses	Level 2	6,095	6,095	6,307	6,307
Commitments to sell mortgage loans	Level 2	157	157	-	-
Mortgage banking short positions	Level 2	259	259	-	-
Guaranteed preferred beneficial interests in Company's subordinated debentures	Level 2	22,519	16,836	22,432	16,908
		$ 824,511	$ 818,620	$ 772,706	$ 769,367
Net Fair Value of Financial Instruments			$ 47,731		$ 34,395
Financial instruments with off-balance-sheet risk:					
Commitments to extend credit	Level 2	$ -	$ 293	$ -	$ 254
Standby and commercial letters of credit	Level 2	$ -	$ 16	$ -	$ 14

NOTE 12 – Other Borrowings

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

June 30, 2014

Unsecured Borrowing Line:	**Line**	**Outstanding**	**Available**
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	$ 32,000	$ -	$ 32,000

Secured Borrowing Line:	**Collateral Pledged**	**Line**	**Outstanding**	**Available**
Bank of North Dakota (1)	$ 790	$ 632	$ -	$ 632
Bank of North Dakota (2)	92,515	10,000	-	10,000
Total	$ 93,305	$ 10,632	$ -	$ 10,632

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

At June 30, 2014, the pledged collateral for the BNC National Bank line was comprised of collateralized mortgage obligations and the pledged collateral for the BNCCORP, INC. line is the common stock of BNC National Bank.

December 31, 2013

Unsecured Borrowing Line:	**Line**	**Outstanding**	**Available**
Bank of North Dakota (1)	$ 5,000	$ -	$ 5,000
US Bank (1)	10,000	-	10,000
Zions First National Bank (1)	12,000	-	12,000
Total	$ 27,000	$ -	$ 27,000

Secured Borrowing Line:	**Collateral Pledged**	**Line**	**Outstanding**	**Available**
Bank of North Dakota (1)	$ 1,397	$ 1,118	$ -	$ 1,118
Total	$ 1,397	$ 1,118	$ -	$ 1,118

(1) BNC National Bank Line

At December 31, 2013, the pledged collateral was comprised of collateralized mortgage obligations.

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%. The subordinated debentures are subject to mandatory redemption on July 19, 2030. On or after July 19, 2010, the subordinated debentures may be redeemed and the corresponding debentures may be prepaid at the option of BNCCORP at declining redemption prices.

In the third quarter of 2014, the Company plans to redeem the $7.5 million of subordinated debentures issued in July of 2000 accruing at a rate of 12.05%. In the preceding twelve month period, the interest expense associated with these subordinated debentures was approximately $900 thousand.

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, 2014 and December 31, 2013 was 1.63% and 1.65%, 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 FRB.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

For purposes of Items 2 and 3 of this report, 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, 2014 and 2013

Summary for the Three Months Ended June 30, 2014 and 2013

Net income was $2.207 million and the net income available to common shareholders was $1.732 million, or $0.50 per share on a diluted basis, for the quarter ended June 30, 2014. This compared to net income of $2.476 million and net income available to common shareholders of $2.149 million, or $0.62 per diluted share, in the second quarter of 2013.

Net interest income for the second quarter of 2014 was $6.323 million, an increase of $1.740 million, or 38%, from $4.583 million in the same period of 2013. The net interest margin for the current period increased to 2.96% from 2.47% as yields on our investment securities and mortgage loans held for sale increased. Net interest income growth was fueled by increased deposits invested in loans held for investment and investment securities available for sale. Interest expense decreased, despite substantial deposit growth, as the Company was able to lower interest rates paid on deposits.

Total loans held for investment increased by $43.4 million or 15.4% from June 30, 2013 and $7.0 million or 2% from December 31, 2013. This growth resulted from strategies to increase loans held for investment that were instituted in early 2013. Favorable economic conditions in North Dakota continue to provide robust loan growth opportunities. However, these conditions also result in exceptional liquidity and our clients in North Dakota may be predisposed to repay loans on an accelerated basis.

Deposits continue to grow, primarily, though not exclusively, in North Dakota. Total deposits increased by $49.6 million from December 31, 2013. We experienced a surge in growth in the first quarter of 2014 when deposits grew $80 million and, as anticipated, our clients redeployed portions of these funds in the second quarter of 2014. Also during the second quarter of 2014, recognizing favorable economic conditions, we exercised our redemption rights to call a $10 million brokered certificate of deposit. These reductions were partially offset by other depository growth in the quarter.

A reversal of previous provisions for credit losses increased pre-tax earnings by $400 thousand in the second quarter of 2014. In the second quarter of 2013, the Company's provision for credit losses was $0. This reflects the continued improvement of our credit quality and a successful restructuring of an impaired loan in the second quarter of 2014, which consequently used less of the allowance for loan losses than previously anticipated and led to recognition of the reversal.

Non-interest income for the second quarter of 2014 was $5.361 million. This compares to non-interest income of $8.352 million for the same period in 2013, a decrease of $2.991 million, or 35.8%. The decrease relates to a decline in mortgage banking revenues, which aggregated $3.391 million compared to $6.744 million in the second quarter of 2013. Although mortgage revenues continue to be significantly impacted in 2014 by interest rates that are higher than in 2013, we have successfully transformed this business as purchase originations now exceed refinance originations by almost two to one. The focus on purchase originations may result in a more seasonal business, particularly in our more northern locations. Gains on sales of SBA loans increased $398 thousand or 113.0% to $760 thousand in the second quarter of 2014 from $352 thousand in the prior year second quarter, overcoming processing delays experienced in the first quarter of 2014.

Non-interest expense for the second quarter of 2014 was $8.887 million compared to $9.059 million in the same period of 2013, a decrease of $172 thousand, or 1.9%. Non-interest expense includes $356 thousand of costs related to the planned redemption of $7.5 million of subordinated debentures accruing interest at 12.05%. As a result of the redemption, we expect the full year reduction of interest expense to be approximately $900 thousand in 2015. After the redemption, we will continue to remain in excess of well capitalized levels. Furthermore, the significant reduction in interest expense will have a positive impact on future earnings and capital. The redemption is scheduled to be completed in the third quarter of 2014.

In the second quarter of 2014, we recorded tax expense of $990 thousand which resulted in an effective tax rate of 30.97% for the quarter. A tax expense of $1.400 million was recognized during the second quarter of 2013, which resulted in an effective tax rate of 36.12%. The effective tax rate reduction in 2014 was primarily due to the impact of increased tax exempt investments made in the second half of 2013.

Summary for the Six Months Ended June 30, 2014 and 2013

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, for the six months ended June 30, 2014. For the six months ended June 30, 2013, net income was $6.261 million, and the income available to common shareholders was $5.610 million, or $1.62 per share on a diluted basis.

Net interest income for the six months ended June 30, 2014 was $12.528 million, an increase of $3.312 million, or 35.9%, from $9.216 million in the same period of 2013. The year to date net interest margin increased to 3.07% from 2.54% as yields on our investment securities and mortgage loans held for sale increased. Net interest income growth was fueled by increased deposits invested in loans held for investment and investment securities available for sale. Interest expense decreased, despite substantial deposit growth, as the Company was able to lower interest rates paid on deposits.

A reversal of previous provisions for credit losses increased pre-tax earnings by $600 thousand in the first six months of 2014. In the first six months of 2013, the Company's provision for credit losses was $700 thousand. The reversal in 2014 was recorded based on the Company's continued improvement in credit quality during the period as nonperforming assets decreased by $1.7 million from year-end 2013 from $6.7 million to $5.0 million at June 30, 2014. The ratio of allowance for credit losses to nonperforming loans increased to 272% at June 30, 2014 from 175% at year end 2013.

Non-interest income for the six months ended June 30, 2014 was $9.645 million. This compares to non-interest income of $19.676 million for the same period in 2013, a decrease of $10.031 million, or 51.0%. As noted above, while interest rate changes in 2013 have adversely impacted our year-to-date originations, our transformation from refinance originations to purchase originations has been successful. Gains on sales of SBA loans of $1.0 million for the six month period in 2014 was only $100 thousand less than the prior year.

Non-interest expense for the six months ended June 30, 2014 was $16.977 million compared to $18.456 million, in the same period of 2013, a decrease of $1.479 million, or 8.0%. A noted above, non-interest expense in 2014 includes $356 thousand of costs related to the planned redemption of $7.5 million of 12.05% subordinated debentures.

During the six month period ended June 30, 2014, we recorded tax expense of $1.797 million which resulted in an effective tax rate of 31.00% on a year-to-date basis. A tax expense of $3.475 million was recognized during the six month period ended June 30, 2013, which resulted in an effective tax rate of 35.69%. The effective tax rate reduction in 2014 was primarily due to the impact of increased tax exempt investments made in the second half of 2013.

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,								
	2014			2013			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	$ 54,095	$ 29	0.22%	$ 68,122	$ 54	0.32%	$ (14,027)	$ (25)	-0.10%(a)
Investments - taxable	385,088	2,410	2.51%	298,108	1,296	1.74%	86,980	1,114	0.77%(b)
Investments - tax exempt	66,637	553	3.33%	39,650	295	2.98%	26,987	258	0.35%(b)
Loans held for sale – mortgage banking	28,045	265	3.79%	73,790	580	3.15%	(45,745)	(315)	0.64%(c)
Loans and leases held for investment	331,750	4,014	4.85%	274,283	3,335	4.88%	57,467	679	-0.03%(d)
Allowance for loan losses	(9,335)	-	0.00%	(9,893)	-	0.00%	558	-	0.00%
Total interest-earning assets	$ 856,280	$ 7,271	3.41%	$ 744,060	$ 5,560	3.00%	$ 112,220	$ 1,711	0.41%
Interest-bearing liabilities									
Interest checking and money market	$ 426,146	$ 143	0.13%	$ 343,148	$ 154	0.18%	$ 82,998	$ (11)	-0.05%(e)
Savings	24,663	2	0.03%	20,100	5	0.10%	4,563	(3)	-0.07%(e)
Certificates of deposit under $100,000	116,702	383	1.32%	126,042	387	1.23%	(9,340)	(4)	0.09%(e)
Certificates of deposit $100,000 and over	82,483	123	0.60%	79,970	131	0.66%	2,513	(8)	-0.06%(e)
Total interest-bearing deposits	649,994	651	0.40%	569,260	677	0.48%	80,734	(26)	-0.08%
Short-term borrowings	21,639	9	0.17%	17,112	10	0.23%	4,527	(1)	-0.06%(f)
Federal Home Loan Bank advances	477	-	0.00%	-	-	0.00%	477	-	0.00%
Subordinated debentures	22,434	288	5.15%	22,431	290	5.19%	3	(2)	-0.04% (g)
Total borrowings	44,550	297	2.67%	39,543	300	3.04%	5,007	(3)	-0.37%
Total interest-bearing liabilities	$ 694,544	948	0.55%	$ 608,803	977	0.64%	$ 85,741	(29)	-0.09%
Net interest income/spread		$ 6,323	2.86%		$ 4,583	2.36%		$ 1,740	0.50%
Net interest margin			2.96%			2.47%			0.49%(h)
Notation:									
Non-interest-bearing deposits	$ 134,620	-		$ 114,537	-		$ 20,083	-	
Total deposits	$ 784,614	$ 651	0.33%	$ 683,797	$ 677	0.40%	$ 100,817	$ (26)	-0.07%
Taxable equivalents:									
Total interest-earning assets	$ 856,280	$ 7,558	3.54%	$ 744,060	$ 5,715	3.08%	$ 112,220	$ 1,843	0.46%
Net interest income/spread	-	$ 6,610	2.99%	-	$ 4,738	2.44%	-	$ 1,872	0.55%
Net interest margin	-	-	3.10%	-	-	2.55%	-	-	0.55%(h)

(a) Cash balances can fluctuate significantly, but we generally emphasize liquidity.

(b) Investment growth has been funded by an increase in deposits and redeployment of capital from reduced mortgage loans held for sale.

(c) Loans held for sale declined as production was reduced due to an increase in interest rates in 2013.

(d) The balance of loans held for investment has risen due to increased activity in our core market areas. Early in 2013, we implemented measures to increase our loans held for investment and continue to gain traction considering the liquidity in the market place. Loan balances, however, are subject to unscheduled repayments due to the present excess liquidity 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. Deposit balances surged upward on March 31, 2014 by $80 million. Customers redeployed a portion of those balances in the second quarter of 2014. Interest expense has declined despite significant balance growth as the Company has been able to lower the rates paid on deposits.

(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 plans to redeem $7.5 million of subordinated debentures in the third quarter of 2014.

(h) Net interest margin has increased as rising low cost deposit balances are deployed in investment securities and loans. Loans held for investment yields have remained steady while investment and mortgage loan yields have increased in 2014 compared to 2013.

	Six Months Ended June 30,								
	2014			2013			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	$ 36,532	$ 39	0.22%	$ 64,474	$ 80	0.25%	$ (27,942)	$ (41)	-0.03%(a)
Investments - taxable	376,878	4,877	2.61%	282,909	2,637	1.88%	93,969	2,240	0.73%(b)
Investments - tax exempt	65,031	1,099	3.41%	38,944	577	2.99%	26,087	522	0.42%(b)
Loans held for sale – mortgage banking	26,074	494	3.82%	76,181	1,175	3.11%	(50,107)	(681)	0.71%(c)
Loans and leases held for investment	326,920	7,866	4.85%	279,696	6,740	4.86%	47,224	1,126	-0.01%(d)
Allowance for loan losses	(9,642)	-	0.00%	(9,979)	-	0.00%	337	-	0.00%
Total interest-earning assets	$ 821,793	$ 14,375	3.53%	$ 732,225	$ 11,209	3.09%	$ 89,568	$ 3,166	0.44%
Interest-bearing liabilities									
Interest checking and money market	$ 397,039	$ 269	0.14%	$ 334,705	$ 323	0.19%	$ 62,334	$ (54)	-0.05%(e)
Savings	23,847	5	0.04%	19,211	9	0.09%	4,636	(4)	-0.05%(e)
Certificates of deposit under $100,000	119,524	742	1.25%	126,823	780	1.24%	(7,299)	(38)	0.01%(e)
Certificates of deposit $100,000 and over	81,305	237	0.59%	79,635	281	0.71%	1,670	(44)	-0.12%(e)
Total interest-bearing deposits	621,715	1,253	0.41%	560,374	1,393	0.50%	61,341	(140)	-0.09%
Short-term borrowings	19,821	17	0.18%	15,969	20	0.25%	3,852	(3)	-0.07%(f)
Federal Home Loan Bank advances	849	1	0.24%	-	-	0.00%	849	1	0.24%
Subordinated debentures	22,433	576	5.18%	22,430	580	5.21%	3	(4)	-0.03%(g)
Total borrowings	43,103	594	2.78%	38,399	600	3.15%	4,704	(6)	-0.37%
Total interest-bearing liabilities	$ 664,818	1,847	0.56%	$ 598,773	1,993	0.67%	$ 66,045	(146)	-0.11%
Net interest income/spread		$ 12,528	2.97%		$ 9,216	2.42%		$ 3,312	0.55%
Net interest margin			3.07%			2.54%			0.53%(h)
Notation:									
Non-interest-bearing deposits	$ 131,828	-		$ 113,334	-		$ 18,494	-	
Total deposits	$ 753,543	$ 1,252	0.34%	$ 673,708	$ 1,393	0.42%	$ 79,835	$ (141)	-0.08%
Taxable equivalents:									
Total interest-earning assets	$ 821,793	$ 14,947	3.67%	$ 732,225	$ 11,512	3.17%	$ 89,568	$ 3,435	0.50%
Net interest income/spread	-	$ 13,100	3.11%	-	$ 9,519	2.50%	-	$ 3,581	0.61%
Net interest margin	-	-	3.21%	-	-	2.62%	-	-	0.59%(h)

(a) Cash balances can fluctuate significantly, but we generally emphasize liquidity.
(b) Investment growth has been funded by an increase in deposits and redeployment of capital from reduced mortgage loans held for sale.
(c) Loans held for sale declined as production was reduced due to an increase in interest rates in 2013.
(d) The balance of loans held for investment has risen due to increased activity in our core market areas. Early in 2013, we implemented measures to increase our loans held for investment and continue to gain traction considering the liquidity in the market place. Loan balances, however, are subject to unscheduled repayments due to the present excess liquidity 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. Deposit balances surged upward on March 31, 2014 by $80 million. Customers redeployed a portion of those balances in the second quarter of 2014. Interest expense has declined despite significant balance growth as the Company has been able to lower the rates paid on deposits.
(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 plans to redeem $7.5 million of subordinated debentures in the third quarter of 2014.
(h) Net interest margin has increased as rising low cost deposit balances are deployed in investment securities and loans. Loans held for investment yields have remained steady while investment and mortgage loan yields have increased in 2014 compared to 2013.

Non-interest Income

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

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Increase (Decrease) $	Increase (Decrease) %	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013	Increase (Decrease) $	Increase (Decrease) %	
Bank charges and service fees	$ 667	$ 674	$ (7)	(1) %	$ 1,371	$ 1,291	$ 80	6 %	(a)
Wealth management revenues	346	313	33	11 %	735	633	102	16 %	(b)
Mortgage banking revenues	3,391	6,744	(3,353)	(50) %	5,673	14,991	(9,318)	(62) %	(c)
Gains on sales of loans, net	760	352	408	116 %	1,000	1,107	(107)	(10) %	(d)
Gains on sales of securities, net	5	-	5	100 %	528	1,210	(682)	(56) %	(e)
Other	192	269	(77)	(29) %	338	444	(106)	(24) %	
Total non-interest income	$ 5,361	$ 8,352	$ (2,991)	(36) %	$ 9,645	$ 19,676	$ (10,031)	(51) %	

(a) These fees are growing over the six month period ended June 30, 2014 as we continue to grow deposits and open new accounts.
(b) Wealth management revenues continue to grow as our North Dakota customers increase utilization of our wealth management services.
(c) Mortgage banking revenues have been significantly impacted by the increase in interest rates in 2013, but have benefited from the successful transition to purchase originations from refinance originations.
(d) Gains and losses on sales of loans will vary significantly from period to period. The secondary market for SBA loans is currently acquisitive and loans can be sold at attractive prices. The significant increase in the second quarter of 2014 reflects a clearing of the pipeline delays reflected in the first quarter of 2014 earnings results.
(e) Gains and losses on sales of securities will vary significantly from period to period.

Non-interest Expense

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

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Increase (Decrease) $	Increase (Decrease) %	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013	Increase (Decrease) $	Increase (Decrease) %	
Salaries and employee benefits	$ 4,543	$ 4,319	$ 224	5 %	$ 8,782	$ 9,354	$ (572)	(6) %	(a)
Professional services	714	1,053	(339)	(32) %	1,389	2,022	(633)	(31) %	(b)
Data processing fees	720	781	(61)	(8) %	1,438	1,501	(63)	(4) %	
Marketing and promotion	654	700	(46)	(7) %	1,308	1,209	99	8 %	(c)
Occupancy	491	650	(159)	(24) %	973	1,168	(195)	(17) %	
Regulatory costs	157	210	(53)	(25) %	308	534	(226)	(42) %	(d)
Depreciation and amortization	302	312	(10)	(3) %	607	617	(10)	(2) %	
Office supplies and postage	182	167	15	9 %	339	322	17	5 %	
Other real estate costs	20	49	(29)	(59) %	32	126	(94)	(75) %	(e)
Other	1,104	818	286	35 %	1,801	1,603	198	12 %	(f)
Total non-interest expense	$ 8,887	$ 9,059	$ (172)	(2) %	$ 16,977	$ 18,456	$ (1,479)	(8) %	
Efficiency ratio	76.1%	70.0%			76.6%	63.9%			

(a) Incentive accruals were increased in the second quarter of 2014 in consideration of indications of strong loan and deposit growth. On a year-to-date basis, the Company's lower compensation cost reflects the lower mortgage originations in the period.
(b) Professional services decreased in mortgage banking as our volumes decreased.
(c) Marketing costs have increased for the banking and mortgage banking operations to drive volume.
(d) The decrease is due to lower regulatory assessments.
(e) Other real estate costs will vary from period to period depending on valuation adjustments and maintenance costs on our foreclosed properties– see Note 7.
(f) Other expense in the second quarter of 2014 includes $356 thousand of costs related to the planned redemption of $7.5 million of subordinated debentures.

Income Taxes

In the second quarter of 2014, we recorded tax expense of $990 thousand which resulted in an effective tax rate of 30.97% for the quarter. A tax expense of $1.400 million was recognized during the second quarter of 2013, which resulted in an effective tax rate of 36.12%. The effective tax rate reduction in 2014 was primarily due to the impact of increased tax exempt investments made in the second half of 2013.

Comparison of Financial Condition at June 30, 2014 and December 31, 2013

Assets

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

	June 30, 2014	December 31, 2013	Increase (Decrease) $	Increase (Decrease) %	
Cash and cash equivalents	$ 51,277	$ 18,871	$ 32,406	172 %	(a)
Investment securities available for sale	451,974	435,719	16,255	4 %	
Federal Reserve Bank and Federal Home Loan Bank of Des Moines stock	2,817	2,729	88	3 %	
Loans held for sale-mortgage banking	37,057	32,870	4,187	13 %	(b)
Loans and leases held for investment, net	324,934	317,928	7,006	2 %	(c)
Allowance for credit losses	(8,828)	(9,847)	1,019	(10) %	(d)
Other real estate, net	1,753	1,056	697	66 %	(e)
Premises and equipment, net	15,118	14,870	248	2 %	
Accrued interest receivable	3,757	3,554	203	6 %	
Other assets	23,107	25,373	(2,266)	(9) %	(f)
Total assets	$ 902,966	$ 843,123	$ 59,843	7 %	

(a) Cash balances can fluctuate significantly, but we generally emphasize liquidity. Balances were elevated at June 30, 2014 due to an increase in customer deposits and loan payoffs.

(b) Loans held for sale increased from year end 2013 due to the successful transition to a purchase origination business model as well as seasonality associated with this model.

(c) The balance of loans held for investment has increased due to increased activity in our core market areas. Early in 2013, we implemented measures to increase our loans held for investment and continue to gain traction considering the liquidity in the market place. This portfolio has experienced unscheduled pay-downs in the second quarter of 2014, including $14 million in June 2014, owing to higher levels of liquidity in the North Dakota economic region.

(d) The allowance for credit losses decreased primarily due to a $600 thousand reversal of previous provisions and $673 thousand of loan balances charged off as the Company continued to manage non-accrual loans.

(e) See Note 7 for further detail on changes in other real estate.

(f) The decrease relates primarily due to the reduction in deferred tax assets.

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 $173.0 million as of June 30, 2014 and $222.8 million as of December 31, 2013. 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):

	June 30, 2014		December 31, 2013	
North Dakota	$ 204,340	63 %	$ 206,315	65 %
Minnesota	29,924	9	32,198	10
Arizona	43,125	13	34,043	11
Other	47,548	15	45,452	14
Total gross loans held for investment	$ 324,937	100 %	$ 318,008	100 %

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

	June 30, 2014		December 31, 2013	
North Dakota	$ 211,563	65 %	$ 211,789	67 %
Arizona	55,464	17	43,750	14
California	16,252	5	18,314	6
Minnesota	15,204	5	16,372	5
Colorado	8,988	3	9,164	3
Wisconsin	5,609	2	5,787	2
Other	11,857	3	12,832	3
Total gross loans held for investment	$ 324,937	100 %	$ 318,008	100 %

Loan Maturities[1]

The following table sets forth the remaining maturities of loans in each major category of our portfolio as of June 30, 2014 (in thousands):

	One year or less	Over 1 year through 5 years: Fixed Rate	Over 1 year through 5 years: Floating Rate	Over 5 years: Fixed Rate	Over 5 years: Floating rate	Total Loans and Leases Held for Investment
Commercial and industrial	$ 51,326	$ 26,942	$ 6,495	$ 16,238	$ 19,551	$ 120,552
Commercial real estate	4,995	18,634	14,628	14,957	47,655	100,869
SBA	1,232	161	324	1,226	21,369	24,312
Consumer	3,045	16,734	4,832	9,389	648	34,648
Land and land development	8,764	3,422	9,607	3,812	-	25,605
Construction	3,292	2,721	391	2,622	9,925	18,951
Total principal amount of loans	$ 72,654	$ 68,614	$ 36,277	$ 48,244	$ 99,148	$ 324,937

(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, 2014: Total Loans and Leases Held for Investment Allowance	June 30, 2014: Loans in Category as a Percentage of Total Gross Loans and Leases Held for Investment	December 31, 2013: Total Loans and Leases Held for Investment Allowance	December 31, 2013: Loans in Category as a Percentage of Total Gross Loans and Leases Held for Investment
Commercial and industrial	$ 2,326	37%	$ 2,215	42%
Commercial real estate	2,707	31%	4,041	29%
SBA	874	7%	579	6%
Consumer	493	11%	478	10%
Land and land development	2,196	8%	2,371	9%
Construction	232	6%	163	4%
Total	$ 8,828	100%	$ 9,847	100%

We do not originate sub-prime single family loans. We do have land, construction, and commercial real estate loans in our portfolio. We continue to closely monitor all loans, but particularly those in deteriorating industries.

Nonperforming Loans

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Balance, beginning of period	$ 5,038	$ 10,270	$ 5,617	$ 10,512
Additions to nonperforming	79	12	78	737
Charge-offs	(643)	(10)	(673)	(904)
Reclassified back to performing	-	(7)	-	(7)
Principal payment received	(526)	(58)	(1,075)	(131)
Transferred to repossessed assets	-	(24)	-	(24)
Transferred to other real estate owned	(697)	-	(697)	-
Balance, end of period	$ 3,251	$ 10,183	$ 3,250	$ 10,183

Nonperforming Assets

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

	June 30, 2014	December 31, 2013
Nonperforming loans:		
Loans 90 days or more delinquent and still accruing interest	$ 1	$ 961
Non-accrual loans	3,250	4,656
Total nonperforming loans	3,251	5,617
Other real estate, net	1,753	1,056
Total nonperforming assets	$ 5,004	$ 6,673
Allowance for credit losses	$ 8,828	$ 9,847
Ratio of total nonperforming loans to total loans	0.90%	1.60%
Ratio of total nonperforming loans to loans and leases held for investment	1.00%	1.77%
Ratio of total nonperforming assets to total assets	0.55%	0.79%
Ratio of nonperforming loans to total assets	0.36%	0.67%
Ratio of allowance for credit losses to nonperforming loans	272%	175%

Potential Problem Loans

We attempt to quantify potential problem loans with more immediate credit risk. At June 30, 2014, the Bank had $10.4 million of classified loans and $3.3 million of loans on non-accrual. This compares to $13.5 million of classified loans and $4.7 million of loans on non-accrual at December 31, 2013 and $13.1 million of classified loans and $10.2 million of loans on non-accrual at June 30, 2013. We estimate there are loans risk rated “watch list” which are not impaired aggregating $397 thousand at June 30, 2014 and $176 thousand at December 31, 2013. Also, we estimate there are loans risk rated “substandard” which are not impaired aggregating $7.2 million at June 30, 2014 and $8.1 million at December 31, 2013.

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 included in the quarterly report.

Liabilities

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

Liabilities	June 30, 2014	December 31, 2013	Increase (Decrease) $	Increase (Decrease) %	
Deposits:					
Non-interest-bearing	$ 129,114	$ 141,788	$ (12,674)	(9) %	(a)
Interest-bearing-					
Savings, interest checking and money market	430,145	378,355	51,790	14 %	(a)
Time deposits under $100,000	112,155	123,058	(10,903)	(9) %	(a)
Time deposits $100,000 and over	101,463	80,028	21,435	27 %	(a)
Short-term borrowings	21,848	19,967	1,881	9 %	(b)
Guaranteed preferred beneficial interests in Company's subordinated debentures	22,519	22,432	87	- %	(c)
Accrued interest payable	756	771	(15)	(2) %	
Accrued expenses	6,095	6,307	(212)	(3) %	(d)
Other liabilities	969	552	417	76 %	(e)
Total liabilities	$ 825,064	$ 773,258	$ 51,806	7 %	

(a) Total deposits have increased primarily due to growth in our North Dakota branches. Balances were elevated at March 31, 2014 due to an increase in customer deposits late in the first quarter of 2014. Customers have redeployed a portion of these deposits in the second quarter.

(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) The Company plans to redeem $7.5 million of subordinated debentures in the third quarter of 2014.

(d) Accrued expenses decreased primarily due to annual incentive payouts distributed in the first quarter of 2014.

(e) Other liabilities increased primarily due to an increase in mortgage banking derivatives.

Mortgage Banking Obligations

Included in accrued expenses is an estimate of mortgage banking reimbursement obligations which aggregated \$1.6 million at June 30, 2014 and \$1.7 million at December 31, 2013. 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,	
	2014	2013	2014	2013
Balance, beginning of period	$ 1,607	$ 1,614	$ 1,679	$ 1,500
Provision	115	166	198	368
Write offs, net	(145)	(78)	(300)	(166)
Balance, end of period	$ 1,577	$ 1,702	$ 1,577	$ 1,702

Stockholders' Equity

Our stockholders' equity increased \$8.0 million between December 31, 2013 and June 30, 2014 primarily due to \$3.2 million in additional retained earnings and an increase in unrealized gains and losses in our investment portfolio of \$4.8 million.

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 (\$272.6 million as of June 30, 2014);
2. Borrowing capacity from the FHLB (\$63.3 million as of June 30, 2014); and
3. Capacity to issue brokered deposits with maturities of less than 12 months (\$127.4 million as of June 30, 2014).
4. Borrowing capacity from a line of credit with Bank of North Dakota (\$10.0 million as of June 30, 2014).

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.

Item 3. 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, 2014 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, 2014 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, 2014, 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	$ 23,445	$ 24,442	$ 24,170	$ 23,816	$ 23,340	$ 22,857
Dollar change from unchanged scenario	$ (997)	$ -	$ (272)	$ (626)	$ (1,102)	$ (1,585)
Percentage change from unchanged scenario	(4.08)%	-	(1.11)%	(2.56)%	(4.51)%	(6.48)%

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, 2014 (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, 2014. 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, 2014				
	0–3 months	4–12 Months	1–5 Years	Over 5 years	Total
	(dollars are in thousands)				
Interest-earning assets:					
Interest-bearing deposits with banks	$ 51,277	$ -	$ -	$ -	$ 51,277
Investment securities (a)	53,692	38,065	174,696	158,552	425,005
FRB and FHLB stock	2,817	-	-	-	2,817
Fed funds sold	-	-	-	-	-
Loans held for sale-mortgage banking, fixed rate	-	37,057	-	-	37,057
Loans held for sale-mortgage banking, floating rate	-	-	-	-	-
Loans held for investment, fixed rate	31,278	33,262	61,719	27,950	154,209
Loans held for investment, floating rate	98,254	6,189	60,220	6,062	170,725
Total interest-earning assets	$ 237,318	$ 114,573	$ 296,635	$ 192,564	$ 841,090
Interest-bearing liabilities:					
Interest checking and money market accounts	$ 405,252	$ -	$ -	$ -	$ 405,252
Savings	24,893	-	-	-	24,893
Time deposits under $100,000	12,567	30,234	39,660	29,694	112,155
Time deposits $100,000 and over	44,730	45,439	10,919	375	101,463
Short-term borrowings	21,848	-	-	-	21,848
FHLB advances		-	-	-	-
Other borrowing		-	-	-	-
Subordinated debentures	15,000	-	-	7,519	22,519
Total interest-bearing liabilities	$ 524,290	$ 75,673	$ 50,579	$ 37,588	$ 688,130
Interest rate gap	$ (286,972)	$ 38,900	$ 246,056	$ 154,976	$ 152,960
Cumulative interest rate gap at June 30, 2014	$ (286,972)	$ (248,072)	$ (2,016)	$ 152,960	
Cumulative interest rate gap to total assets	(31.78)%	(27.47)%	(0.22)%	16.94%	

(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, 2014 and do not contemplate any actions we might undertake in response to changes in market interest rates.

Other Information

Item 1. 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 15, 2014	By:	/s/ Timothy J. Franz
			Timothy J. Franz President and Chief Executive Officer
		By:	/s/ Daniel J. Collins
			Daniel J. Collins Chief Financial Officer