



BNCCORP

Quarterly Report

For the quarter ended September 30, 2013

BNCCORP, INC.

(OTCQB: BNCC)

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BNCCORP, INC.
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September 30, 2013

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FINANCIAL INFORMATION

Item 1. Financial Statements

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Balance Sheets
(In thousands, except share data)

ASSETS	September 30, 2013 (unaudited)	December 31, 2012
CASH AND CASH EQUIVALENTS	\$ 56,728	\$ 40,790
INVESTMENT SECURITIES AVAILABLE FOR SALE	405,300	300,549
FEDERAL RESERVE BANK AND FEDERAL HOME LOAN BANK STOCK	2,729	2,601
LOANS HELD FOR SALE-MORTGAGE BANKING	34,344	95,095
LOANS AND LEASES HELD FOR INVESTMENT	294,876	289,469
ALLOWANCE FOR CREDIT LOSSES	(9,897)	(10,091)
Net loans and leases held for investment	284,979	279,378
OTHER REAL ESTATE, net	2,186	5,131
PREMISES AND EQUIPMENT, net	14,197	15,932
ACCRUED INTEREST RECEIVABLE	2,833	2,590
OTHER	25,936	28,710
Total assets	\$ 829,232	\$ 770,776
LIABILITIES AND STOCKHOLDERS' EQUITY		
DEPOSITS:		
Non-interest-bearing	\$ 124,246	\$ 131,593
Interest-bearing –		
Savings, interest checking and money market	379,678	313,051
Time deposits under \$100,000	124,320	128,150
Time deposits \$100,000 and over	78,251	76,810
Total deposits	706,495	649,604
SHORT-TERM BORROWINGS	22,021	11,700
GUARANTEED PREFERRED BENEFICIAL INTERESTS IN COMPANY'S SUBORDINATED DEBENTURES	22,431	22,430
ACCRUED INTEREST PAYABLE	597	5,045
ACCRUED EXPENSES	6,013	10,144
OTHER	1,604	3,123
Total liabilities	759,161	702,046
STOCKHOLDERS' EQUITY:		
Preferred stock, \$.01 par value – Authorized 2,000,000 shares:		
Preferred stock - 5% Series A 20,093 shares outstanding;	20,027	19,859
Preferred stock - 9% Series B 1,005 shares outstanding;	1,012	1,029
Common stock, \$.01 par value – Authorized 35,000,000 shares; 3,324,584 and 3,300,652 shares issued and outstanding	33	33
Capital surplus – common stock	27,091	27,257
Retained earnings	26,421	20,655
Treasury stock (344,069 and 368,001 shares, respectively)	(4,876)	(5,064)
Accumulated other comprehensive income (loss), net	363	4,961
Total stockholders' equity	70,071	68,730
Total liabilities and stockholders' equity	\$ 829,232	\$ 770,776

See accompanying notes to consolidated financial statements

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Income

(In thousands, except per share data, unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2013	2012	2013	2012
INTEREST INCOME:				
Interest and fees on loans	\$ 3,811	\$ 4,287	\$ 11,726	\$ 12,500
Interest and dividends on investments				
Taxable	1,351	1,515	4,012	4,851
Tax-exempt	370	265	947	694
Dividends	28	28	84	85
Total interest income	<u>5,560</u>	<u>6,095</u>	<u>16,769</u>	<u>18,130</u>
INTEREST EXPENSE:				
Deposits	645	910	2,038	3,094
Short-term borrowings	10	20	30	57
Subordinated debentures	289	398	869	1,168
Total interest expense	<u>944</u>	<u>1,328</u>	<u>2,937</u>	<u>4,319</u>
Net interest income	<u>4,616</u>	<u>4,767</u>	<u>13,832</u>	<u>13,811</u>
PROVISION FOR CREDIT LOSSES	-	-	700	100
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES	<u>4,616</u>	<u>4,767</u>	<u>13,132</u>	<u>13,711</u>
NON-INTEREST INCOME:				
Bank charges and service fees	698	626	1,989	1,754
Wealth management revenues	302	266	935	912
Mortgage banking revenues, net	2,422	7,787	17,413	21,427
Gains on sales of loans, net	301	245	1,408	864
Gains on sales of securities, net	37	181	1,247	279
Insurance claim settlement	-	7,500	-	7,500
Life insurance benefits received	1,055	-	1,055	-
Other	186	221	630	540
Total non-interest income	<u>5,001</u>	<u>16,826</u>	<u>24,677</u>	<u>33,276</u>
NON-INTEREST EXPENSE:				
Salaries and employee benefits	3,637	4,607	12,991	12,799
Professional services	861	1,332	2,883	3,403
Insurance settlement legal fees	-	2,500	-	2,500
Data processing fees	717	735	2,218	2,116
Marketing and promotion	718	516	1,927	1,482
Occupancy	597	478	1,765	1,440
Regulatory costs	146	304	680	901
Depreciation and amortization	311	278	928	836
Office supplies and postage	139	166	461	506
Other real estate costs	38	48	164	1,988
Impairment charge	1,500	-	1,500	-
Other	787	1,339	2,390	3,025
Total non-interest expense	<u>9,451</u>	<u>12,303</u>	<u>27,907</u>	<u>30,996</u>
Income before income taxes	166	9,290	9,902	15,991
Income tax expense (benefit)	(321)	(5,755)	3,154	(5,652)
Net income	<u>487</u>	<u>15,045</u>	<u>6,748</u>	<u>21,643</u>
Preferred stock costs	(330)	(369)	(981)	(1,089)
Net income available to common shareholders	<u>\$ 157</u>	<u>\$ 14,676</u>	<u>\$ 5,767</u>	<u>\$ 20,554</u>
Basic earnings per common share	<u>\$ 0.05</u>	<u>\$ 4.46</u>	<u>\$ 1.75</u>	<u>\$ 6.24</u>
Diluted earnings per common share	<u>\$ 0.05</u>	<u>\$ 4.41</u>	<u>\$ 1.66</u>	<u>\$ 6.21</u>

See accompanying notes to consolidated financial statements.

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2013	2012	2013	2012
NET INCOME	\$ 487	\$ 15,045	\$ 6,748	\$ 21,643
Unrealized gain (loss) on securities available for sale	\$ 2,422	\$ 2,521	\$ (6,170)	\$ 3,390
Reclassification adjustment for (gain) loss included in net income	<u>(37)</u>	<u>(181)</u>	<u>(1,247)</u>	<u>(279)</u>
Other comprehensive income (loss) before tax	2,385	2,340	(7,417)	3,111
Income tax benefit (expense) related to items of other comprehensive income	<u>(906)</u>	<u>-</u>	<u>2,819</u>	<u>-</u>
Other comprehensive income (loss)	<u>1,479</u>	<u>2,340</u>	<u>(4,598)</u>	<u>3,111</u>
TOTAL COMPREHENSIVE INCOME (LOSS)	<u>\$ 1,966</u>	<u>\$ 17,385</u>	<u>\$ 2,150</u>	<u>\$ 24,754</u>

See accompanying notes to consolidated financial statements.

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

	Preferred Stock		Common Stock		Capital	Retained	Treasury	Accumulated	Total
	Shares	Amount	Shares	Amount	Surplus	Earnings	Stock	Other	
					Common	(Deficit)		Comprehensive	
BALANCE, December 31, 2011	21,098	\$ 20,687	3,301,007	\$ 33	\$ 27,217	\$ (4,508)	\$ (5,076)	\$ 3,514	\$ 41,867
Net income	-	-	-	-	-	21,643	-	-	21,643
Other comprehensive income	-	-	-	-	-	-	-	3,111	3,111
Preferred stock amortization, net	-	151	-	-	-	(151)	-	-	-
Dividend on preferred stock	-	-	-	-	-	(937)	-	-	(937)
Impact of share-based compensation	-	-	(1,038)	-	52	-	(3)	-	49
BALANCE, September 30, 2012	21,098	\$ 20,838	3,299,969	\$ 33	\$ 27,269	\$ 16,047	\$ (5,079)	\$ 6,625	\$ 65,733
BALANCE, December 31, 2012	21,098	\$ 20,888	3,300,652	\$ 33	\$ 27,257	\$ 20,655	\$ (5,064)	\$ 4,961	\$ 68,730
Net income	-	-	-	-	-	6,748	-	-	6,748
Other comprehensive loss	-	-	-	-	-	-	-	(4,598)	(4,598)
Preferred stock amortization, net	-	151	-	-	-	(151)	-	-	-
Dividend on preferred stock	-	-	-	-	-	(831)	-	-	(831)
Impact of share-based compensation	-	-	23,932	-	(166)	-	188	-	22
BALANCE, September 30, 2013	21,098	\$ 21,039	3,324,584	\$ 33	\$ 27,091	\$ 26,421	\$ (4,876)	\$ 363	\$ 70,071

See accompanying notes to consolidated financial statements.

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

	<u>2013</u>	<u>2012</u>
OPERATING ACTIVITIES:		
Net income	\$ 6,748	\$ 21,643
Adjustments to reconcile net income to net cash provided by operating activities -		
Provision for credit losses	700	100
Provision for other real estate losses	40	1,700
Depreciation and amortization	928	836
Net amortization of premiums and (discounts)	6,298	3,854
Share-based compensation	22	49
Impairment charge	1,500	-
Change in interest receivable and other assets, net	(1,860)	(1,596)
(Gain) loss on sale of other real estate	-	128
(Gain) loss on sale of bank premises and equipment	11	3
Net realized gain on sales of investment securities	(1,247)	(279)
Provision for deferred income taxes	(1,049)	(5,656)
Change in other liabilities, net	(8,466)	960
Funding of originations of loans held for sale	(807,258)	(847,340)
Proceeds from sales of loans held for sale	865,932	827,726
Fair value adjustment for loans held for sale	2,077	(832)
Unrealized (gain) loss on mortgage banking financial instruments	3,481	(2,371)
Proceeds from sales of loans	13,793	10,359
Gains on sales of loans, net	<u>(1,408)</u>	<u>(864)</u>
Net cash provided by (used in) operating activities	<u>80,242</u>	<u>8,420</u>
INVESTING ACTIVITIES:		
Purchases of investment securities	(217,741)	(81,609)
Proceeds from sales of investment securities	58,109	8,853
Proceeds from maturities of investment securities	44,875	31,087
Purchases of Federal Reserve and Federal Home Loan Bank Stock	(129)	-
Sales of Federal Reserve and Federal Home Loan Bank Stock	1	150
Net (increase) decrease in loans held for investment	(18,686)	(1,821)
Proceeds from sales of other real estate	3,705	2,458
Proceeds from sales of bank premises and equipment	-	8
Additions to bank premises and equipment	<u>(1,650)</u>	<u>(691)</u>
Net cash provided by (used in) investing activities	<u>(131,516)</u>	<u>(41,565)</u>

See accompanying notes to consolidated financial statements.

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

	2013	2012
FINANCING ACTIVITIES:		
Net increase (decrease) in deposits	\$ 56,891	\$ 46,742
Net increase (decrease) in short-term borrowings	10,321	3,627
Repayments of Federal Home Loan Bank advances	(20)	(10,810)
Proceeds from Federal Home Loan Bank advances	20	10,810
Net cash provided by (used in) financing activities	67,212	50,369
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	15,938	17,224
CASH AND CASH EQUIVALENTS, beginning of period	40,790	19,296
CASH AND CASH EQUIVALENTS, end of period	\$ 56,728	\$ 36,520
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	\$ 7,385	\$ 3,219
Income taxes paid	\$ 1,360	\$ 706
 SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Transfer of premises and equipment to other real estate owned	\$ 800	\$ -

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
September 30, 2013

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 12 locations in Arizona, Minnesota, North Dakota, Illinois, Kansas, Nebraska and Missouri.

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 for the year ended December 31, 2012. Accordingly, footnote disclosures which would substantially duplicate the disclosures contained in the December 31, 2012 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, 2012 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 September 30, 2013 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, 2012.

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 5 in the Company's notes to the consolidated financial statements.

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurement (Topic 820), Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The amendments

in this ASU changed the wording used to describe the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements in order to improve consistency in wording between U.S. GAAP and IFRS. For BNCCORP, this ASU was effective for annual periods beginning after December 15, 2011. The adoption of this ASU in 2012 did not have a material impact on the Company's consolidated financial statements other than to change the disclosures relating to fair value measurements.

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 Accounting Standards Update 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 in 2014 is not anticipated to have a material impact on the Company's consolidated financial statements.

On July 17, 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.

On July 18, 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 2014 is not anticipated to have a material impact 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
September 30, 2013								
Total Risk Based Capital:								
Consolidated	\$ 95,308	24.18 %	\$ 31,528	≥8.0 %	\$ N/A	N/A %	\$ N/A	N/A %
BNC National Bank	91,583	23.43	31,269	≥8.0	39,086	10.0	52,497	13.43
Tier 1 Risk Based Capital :								
Consolidated	89,060	22.60	15,764	≥4.0	N/A	N/A	N/A	N/A
BNC National Bank	86,635	22.17	15,635	≥4.0	23,452	6.0	63,183	16.17
Tier 1 Leverage Capital:								
Consolidated	89,060	10.99	32,412	≥4.0	N/A	N/A	N/A	N/A
BNC National Bank	86,635	10.70	32,377	≥4.0	40,472	5.0	46,163	5.70
Tangible Equity (to total assets):								
Consolidated tangible equity	70,005	8.46	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	87,386	10.55	N/A	N/A	N/A	N/A	N/A	N/A
Tangible Common Equity (to total assets):								
Consolidated tangible common equity	48,966	5.92	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	87,386	10.55	N/A	N/A	N/A	N/A	N/A	N/A
December 31, 2012								
Total Risk Based Capital:								
Consolidated	\$ 90,766	22.43 %	\$ 32,371	≥8.0 %	\$ N/A	N/A %	\$ N/A	N/A %
BNC National Bank	84,003	21.06	31,905	≥8.0	39,881	10.0	44,122	11.06
Tier 1 Risk Based Capital :								
Consolidated	82,908	20.49	16,185	≥4.0	N/A	N/A	N/A	N/A
BNC National Bank	78,954	19.80	15,953	≥4.0	23,929	6.0	55,025	13.80
Tier 1 Leverage Capital:								
Consolidated	82,908	11.17	29,679	≥4.0	N/A	N/A	N/A	N/A
BNC National Bank	78,954	10.68	29,579	≥4.0	36,973	5.0	41,981	5.68
Tangible Equity (to total assets):								
Consolidated tangible equity	68,690	8.92	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	84,330	10.97	N/A	N/A	N/A	N/A	N/A	N/A
Tangible Common Equity (to total assets):								
Consolidated tangible common equity	47,801	6.21	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	84,330	10.97	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.

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.

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.

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. Although we believe we are compliant with the fully phased in standards, we have not completed our assessment of the proposed standards. The Company routinely evaluates the need to raise capital to comply with regulatory capital standards and for other corporate purposes.

NOTE 4 – Loans and Leases

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

	<u>September 30, 2013</u>	<u>December 31, 2012</u>
Loans held for sale-mortgage banking	\$ 34,344	\$ 95,095
Commercial and industrial	\$ 127,931	\$ 116,891
Commercial real estate	80,760	87,258
SBA	18,314	15,823
Consumer	31,250	26,614
Land and land development	28,240	31,065
Construction	8,347	11,814
	<u>294,842</u>	<u>289,465</u>
Unearned income and net unamortized deferred fees and costs	<u>34</u>	<u>4</u>
Loans, net of unearned income and unamortized fees and costs	294,876	289,469
Allowance for credit losses	<u>(9,897)</u>	<u>(10,091)</u>
Net loans and leases held for investment	<u>\$ 284,979</u>	<u>\$ 279,378</u>

NOTE 5 – Allowance for Credit Losses

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

Three Months Ended September 30, 2013

	<u>Commercial and industrial</u>	<u>Commercial real estate</u>	<u>SBA</u>	<u>Consumer</u>	<u>Land and land development</u>	<u>Construction</u>	<u>Total</u>
Balance, beginning of period	\$ 2,156	\$ 4,413	\$ 734	\$ 469	\$ 2,025	\$ 101	\$ 9,898
Provision	40	(358)	89	39	187	3	-
Loans charged off	-	-	-	(16)	-	-	(16)
Loan recoveries	-	-	-	3	12	-	15
Balance, end of period	<u>\$ 2,196</u>	<u>\$ 4,055</u>	<u>\$ 823</u>	<u>\$ 495</u>	<u>\$ 2,224</u>	<u>\$ 104</u>	<u>\$ 9,897</u>

Three Months Ended September 30, 2012

	<u>Commercial and industrial</u>	<u>Commercial real estate</u>	<u>SBA</u>	<u>Consumer</u>	<u>Land and land development</u>	<u>Construction</u>	<u>Total</u>
Balance, beginning of period	\$ 2,248	\$ 5,548	\$ 533	\$ 348	\$ 1,881	\$ 7	\$ 10,565
Provision	337	(71)	(4)	53	(326)	11	-
Loans charged off	-	(51)	-	(6)	-	-	(57)
Loan recoveries	-	-	-	2	11	-	13
Balance, end of period	<u>\$ 2,585</u>	<u>\$ 5,426</u>	<u>\$ 529</u>	<u>\$ 397</u>	<u>\$ 1,566</u>	<u>\$ 18</u>	<u>\$ 10,521</u>

Nine Months Ended September 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	566	(740)	207	166	545	(44)	700
Loans charged off	(916)	(3)	-	(64)	-	-	(983)
Loan recoveries	-	8	-	11	70	-	89
Balance, end of period	<u>\$ 2,196</u>	<u>\$ 4,055</u>	<u>\$ 823</u>	<u>\$ 495</u>	<u>\$ 2,224</u>	<u>\$ 104</u>	<u>\$ 9,897</u>

Nine Months Ended September 30, 2012

	Commercial and industrial	Commercial real estate	SBA	Consumer	Land and land development	Construction	Total
Balance, beginning of period	\$ 1,639	\$ 5,518	\$ 436	\$ 448	\$ 2,583	\$ 6	\$ 10,630
Provision	946	251	92	(43)	(1,158)	12	100
Loans charged off	-	(358)	(10)	(15)	-	-	(383)
Loan recoveries	-	15	11	7	141	-	174
Balance, end of period	<u>\$ 2,585</u>	<u>\$ 5,426</u>	<u>\$ 529</u>	<u>\$ 397</u>	<u>\$ 1,566</u>	<u>\$ 18</u>	<u>\$ 10,521</u>

Performing and non-accrual loans

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

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

September 30, 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	\$ 72,367	\$ -	\$ 9	\$ 72,376	\$ 3,000	\$ 75,376
Agriculture	18,230	-	-	18,230	-	18,230
Owner-occupied commercial real estate	34,325	-	-	34,325	-	34,325
Commercial real estate	76,492	-	-	76,492	4,268	80,760
SBA	18,314	-	-	18,314	-	18,314
Consumer:						
Automobile	6,904	40	38	6,982	12	6,994
Home equity	4,185	-	-	4,185	-	4,185
1st mortgage	10,518	-	-	10,518	-	10,518
Other	9,536	7	10	9,553	-	9,553
Land and land development	25,448	-	-	25,448	2,792	28,240
Construction	8,347	-	-	8,347	-	8,347
Total loans held for investment	<u>284,666</u>	<u>47</u>	<u>57</u>	<u>284,770</u>	<u>10,072</u>	<u>294,842</u>
Loans held for sale	<u>34,344</u>	<u>-</u>	<u>-</u>	<u>34,344</u>	<u>-</u>	<u>34,344</u>
Total gross loans	<u>\$ 319,010</u>	<u>\$ 47</u>	<u>\$ 57</u>	<u>\$ 319,114</u>	<u>\$ 10,072</u>	<u>\$ 329,186</u>

December 31, 2012

	<u>Current</u>	<u>31-89 Days Past Due</u>	<u>90 Days or More Past Due and Accruing</u>	<u>Total Performing</u>	<u>Non-accrual</u>	<u>Total</u>
Commercial and industrial:						
Business loans	\$ 64,390	\$ 3	\$ -	\$ 64,393	\$ 3,211	\$ 67,604
Agriculture	16,319	-	-	16,319	-	16,319
Owner-occupied commercial real estate	32,968	-	-	32,968	-	32,968
Commercial real estate	82,761	-	-	82,761	4,497	87,258
SBA	15,823	-	-	15,823	-	15,823
Consumer:						
Automobile	5,762	58	-	5,820	-	5,820
Home equity	3,779	-	-	3,779	-	3,779
1st mortgage	9,462	-	-	9,462	-	9,462
Other	7,534	8	11	7,553	-	7,553
Land and land development	28,273	-	-	28,273	2,792	31,065
Construction	11,814	-	-	11,814	-	11,814
Total loans held for investment	<u>278,885</u>	<u>69</u>	<u>11</u>	<u>278,965</u>	<u>10,500</u>	<u>289,465</u>
Loans held for sale	<u>95,094</u>	<u>-</u>	<u>1</u>	<u>95,095</u>	<u>-</u>	<u>95,095</u>
Total gross loans	<u>\$ 373,979</u>	<u>\$ 69</u>	<u>\$ 12</u>	<u>\$ 374,060</u>	<u>\$ 10,500</u>	<u>\$ 384,560</u>

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

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2013</u>	<u>2012</u>	<u>2013</u>	<u>2012</u>
Interest income that would have been recorded	\$ 133	\$ 59	\$ 378	\$ 176
Interest income recorded	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Effect on interest income	<u>\$ 133</u>	<u>\$ 59</u>	<u>\$ 378</u>	<u>\$ 176</u>

Impaired loans

Impaired loans include loans on which the Bank will not be able to collect all amounts due in accordance with the terms of the loan agreement. Impaired loans include non-accruing 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):

September 30, 2013

	<u>Unpaid Principal</u>	<u>Recorded Investment</u>	<u>Related Allowance</u>	<u>Average Recorded Balance</u>	<u>Interest Income Recognized</u>
Impaired loans with an allowance recorded:					
Commercial and industrial:					
Business loans	\$ 3,000	\$ 3,000	\$ 450	\$ 3,000	\$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	6,857	4,268	905	4,387	-
SBA	-	-	-	-	-
Consumer:					
Automobile	17	12	2	12	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	2,792	2,792	419	2,792	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans with an allowance recorded	<u>\$ 12,666</u>	<u>\$ 10,072</u>	<u>\$ 1,776</u>	<u>\$ 10,191</u>	<u>\$ -</u>
Impaired loans without an allowance recorded:					
Commercial and industrial:					
Business loans	\$ -	\$ -	\$ -	\$ -	\$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	-	-	-	-	-
SBA	-	-	-	-	-
Consumer:					
Automobile	-	-	-	-	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	-	-	-	-	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans without an allowance recorded	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
TOTAL IMPAIRED LOANS	<u><u>\$ 12,666</u></u>	<u><u>\$ 10,072</u></u>	<u><u>\$ 1,776</u></u>	<u><u>\$ 10,191</u></u>	<u><u>\$ -</u></u>

December 31, 2012

	<u>Unpaid Principal</u>	<u>Recorded Investment</u>	<u>Related Allowance</u>	<u>Average Recorded Balance</u>	<u>Interest Income Recognized</u>
Impaired loans with an allowance recorded:					
Commercial and industrial:					
Business loans	\$ 3,220	\$ 3,201	\$ 601	\$ 3,204	\$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	6,857	4,497	1,200	4,640	-
SBA	-	-	-	-	-
Consumer:					
Automobile	-	-	-	-	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	660	660	300	660	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans with an allowance recorded	<u>\$ 10,737</u>	<u>\$ 8,358</u>	<u>\$ 2,101</u>	<u>\$ 8,504</u>	<u>\$ -</u>
Impaired loans without an allowance recorded:					
Commercial and industrial:					
Business loans	\$ -	\$ -	\$ -	\$ -	\$ -
Agriculture	-	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-	-
Commercial real estate	-	-	-	-	-
SBA	-	-	-	-	-
Consumer:					
Automobile	-	-	-	-	-
Home equity	-	-	-	-	-
1st mortgage	-	-	-	-	-
Other	-	-	-	-	-
Land and land development	2,130	2,130	-	2,130	-
Construction	-	-	-	-	-
Loans held for sale	-	-	-	-	-
Total impaired loans without an allowance recorded	<u>\$ 2,130</u>	<u>\$ 2,130</u>	<u>\$ -</u>	<u>\$ 2,130</u>	<u>\$ -</u>
TOTAL IMPAIRED LOANS	<u><u>\$ 12,867</u></u>	<u><u>\$ 10,488</u></u>	<u><u>\$ 2,101</u></u>	<u><u>\$ 10,634</u></u>	<u><u>\$ -</u></u>

Troubled Debt Restructuring (TDRs)

Included in net loans receivable 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):

September 30, 2013				
	Accrual	Non-accrual	Total	Reserve
Commercial and industrial:				
Business loans	\$ 93	\$ -	\$ 93	\$ 14
Agriculture	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-
Commercial real estate	3,795	4,269	8,064	1,000
SBA	-	-	-	-
Consumer:				
Automobile	-	-	-	-
Home equity	-	-	-	-
1st mortgage	497	-	497	12
Other	-	-	-	-
Land and land development	-	-	-	-
Construction	-	-	-	-
Loans held for sale	-	-	-	-
	<u>\$ 4,385</u>	<u>\$ 4,269</u>	<u>\$ 8,654</u>	<u>\$ 1,026</u>

December 31, 2012				
	Accrual	Non-accrual	Total	Reserve
Commercial and industrial:				
Business loans	\$ 101	\$ -	\$ 101	\$ 2
Agriculture	-	-	-	-
Owner-occupied commercial real estate	-	-	-	-
Commercial real estate	3,810	4,497	8,307	1,276
SBA	-	-	-	-
Consumer:				
Automobile	-	-	-	-
Home equity	-	-	-	-
1st mortgage	799	-	799	16
Other	-	-	-	-
Land and land development	3,161	-	3,161	63
Construction	-	-	-	-
Loans held for sale	-	-	-	-
	<u>\$ 7,871</u>	<u>\$ 4,497</u>	<u>\$ 12,368</u>	<u>\$ 1,357</u>

TDR concessions can include reduction of interest rates, extension of maturity dates, forgiveness of principal and/or interest due, or acceptance of real estate or other assets in full or partial satisfaction of the debt. Loan modifications are not reported as TDRs 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 TDRs for the three and nine month periods ending September 30, 2013 and one new TDR with a pre-modification and post-modification outstanding amount of \$202 thousand for the three and nine month periods ending September 30, 2012.

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		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Interest income that would have been recorded	\$ 139	\$ 186	\$ 384	\$ 555
Interest income recorded	55	82	168	244
Effect on interest income	<u>\$ 84</u>	<u>\$ 104</u>	<u>\$ 216</u>	<u>\$ 311</u>

The amount of additional funds committed to borrowers who are in TDR status was \$232 thousand at September 30, 2013 and \$232 thousand at September 30, 2012.

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 \$0 of loans that were restructured within the 12 months preceding September 30, 2013 and September 30, 2012 and defaulted during the three and nine months ended September 30, 2013 and September 30, 2012.

NOTE 6 – 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 September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Balance, beginning of period	\$ 2,966	\$ 7,932	\$ 5,131	\$ 10,145
Transfers from nonperforming loans	-	-	-	-
Transfers from premises and equipment	800	-	800	-
Real estate sold	(1,548)	(1,971)	(3,713)	(2,458)
Net gains (losses) on sale of assets	8	(102)	8	(128)
Provision	(40)	-	(40)	(1,700)
Balance, end of period	<u>\$ 2,186</u>	<u>\$ 5,859</u>	<u>\$ 2,186</u>	<u>\$ 5,859</u>

	September 30, 2013	December 31, 2012
Other real estate	\$ 5,120	\$ 8,146
Valuation allowance	(2,934)	(3,015)
Other real estate, net	<u>\$ 2,186</u>	<u>\$ 5,131</u>

NOTE 7 – Earnings Per Share

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

	Three months ended September 30, 2013	Nine months ended September 30, 2013
Denominator for basic earnings per share:		
Average common shares outstanding	3,299,236	3,299,467
Dilutive effect of stock compensation	178,265	172,731
Denominator for diluted earnings per share	<u>3,477,501</u>	<u>3,472,198</u>
Numerator (in thousands):		
Net income	\$ 487	\$ 6,748
Preferred stock costs	(330)	(981)
Net income available to common shareholders	<u>\$ 157</u>	<u>\$ 5,767</u>
Basic earnings per common share	<u>\$ 0.05</u>	<u>\$ 1.75</u>
Diluted earnings per common share	<u>\$ 0.05</u>	<u>\$ 1.66</u>
	Three months ended September 30, 2012	Nine months ended September 30, 2012
Denominator for basic earnings per share:		
Average common shares outstanding	3,291,569	3,291,793
Dilutive effect of stock compensation	37,536	20,391
Denominator for diluted earnings per share	<u>3,329,105</u>	<u>3,312,184</u>
Numerator (in thousands):		
Net income	\$ 15,045	\$ 21,643
Preferred stock costs	(369)	(1,089)
Net income available to common shareholders	<u>\$ 14,676</u>	<u>\$ 20,554</u>
Basic earnings per common share	<u>\$ 4.46</u>	<u>\$ 6.24</u>
Diluted earnings per common share	<u>\$ 4.41</u>	<u>\$ 6.21</u>

NOTE 8 – Share-Based Compensation

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

	1995	2002	2006	2010	Total
Total Shares in Plan	250,000	125,000	200,000	250,000	825,000
Total Shares Available	250,000	125,000	200,000	250,000	825,000
Maximum Restricted Shares Available	48,751	-	15,850	250,000	314,601

Following is a summary of fully vested stock options and options expected to vest as of September 30, 2013:

	<u>Stock Options Outstanding</u>	<u>Stock Options Currently Exercisable</u>	<u>Stock Options Vested and Expected to Vest</u>
Number	228,000	228,000	228,000
Weighted-average exercise price	\$3.00	\$3.00	\$3.00
Weighted-average remaining contractual term	6.46 years	6.46 years	6.46 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 \$10,000 related to restricted stock for the three month period ended September 30, 2013, and \$21,000 for the nine month period ended September 30, 2013. The Company recognized share-based compensation expense of \$8,000 related to restricted stock for the three month period ended September 30, 2012, and \$24,000 for the nine month period ended September 30, 2012.

At September 30, 2013, the Company had \$279,000 of unamortized restricted stock compensation expense. All of this expense will be amortized by September 15, 2016. The cost of restricted stock granted is recognized over the vesting period, which is generally three or more years.

NOTE 9 – Investment Securities Available for Sale

Investment securities have been classified in the consolidated balance sheets according to management's intent. The Company had no securities designated as trading or held-to-maturity in its portfolio at September 30, 2013 or December 31, 2012. The net unrealized gain/(loss) of investment securities decreased between the two periods due to the general increase in interest rates and steepening of the yield curve since the middle of the second quarter. Conversely this increase presents an opportunity to invest earning assets at higher rates in the future.

The carrying amount of available-for-sale securities and their approximate fair values were as follows (in thousands):

	As of September 30, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agency mortgage-backed securities guaranteed by GNMA	\$ 63,294	\$ 753	\$ (908)	\$ 63,139
U.S. government agency mortgage-backed securities issued by FNMA or FHLMC	34,454	151	(999)	33,606
U.S. government agency small business administration pools guaranteed by SBA	49,431	181	(86)	49,526
Collateralized mortgage obligations guaranteed by GNMA/VA	141,043	1,107	(1,625)	140,525
Collateralized mortgage obligations issued by FNMA or FHLMC	60,000	701	(789)	59,912
Other collateralized mortgage obligations	1,899	34	-	1,933
State and municipal bonds	56,116	1,162	(619)	56,659
	<u>\$ 406,237</u>	<u>\$ 4,089</u>	<u>\$ (5,026)</u>	<u>\$ 405,300</u>
	As of December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government agency mortgage-backed securities guaranteed by GNMA	\$ 60,673	\$ 3,007	\$ (93)	\$ 63,587
U.S. government agency mortgage-backed securities issued by FNMA	20,727	188	(307)	20,608
U.S. government agency small business administration pools guaranteed by SBA	13,498	87	(31)	13,554
Collateralized mortgage obligations guaranteed by GNMA/VA	122,404	1,319	(708)	123,015
Collateralized mortgage obligations issued by FNMA or FHLMC	36,167	342	(98)	36,411
Other collateralized mortgage obligations	4,656	148	(1)	4,803
State and municipal bonds	35,944	2,646	(19)	38,571
	<u>\$ 294,069</u>	<u>\$ 7,737</u>	<u>\$ (1,257)</u>	<u>\$ 300,549</u>

The amortized cost and estimated fair market value of available-for-sale securities classified according to their contractual maturities at September 30, 2013 were as follows (in thousands):

	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ -	\$ -
Due after one year through five years	120	122
Due after five years through ten years	14,196	14,614
Due after ten years	391,921	390,564
Total	<u>\$ 406,237</u>	<u>\$ 405,300</u>

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

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

September 30, 2013

Description of Securities	Less than 12 months			12 months or more			Total		
	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss
	U.S. government agency mortgage-backed securities guaranteed by GNMA	4	\$ 24,073	\$ (908)	-	\$ -	\$ -	4	\$ 24,073
U.S. government agency mortgage-backed securities issued by FNMA or FHLMC	7	28,831	(999)	-	-	-	7	28,831	(999)
U.S. government agency small business administration pools guaranteed by SBA	7	18,617	(86)	-	-	-	7	18,617	(86)
Collateralized mortgage obligations guaranteed by GNMA/VA	13	48,382	(1,377)	2	8,410	(247)	15	56,792	(1,625)
Collateralized mortgage obligations issued by FNMA or FHLMC	3	16,380	(626)	2	7,139	(163)	5	23,519	(789)
Other collateralized mortgage obligations	-	-	-	-	-	-	-	-	-
State and municipal bonds	8	16,736	(619)	-	-	-	8	16,736	(619)
Total temporarily impaired securities	<u>42</u>	<u>\$ 153,019</u>	<u>\$ (4,615)</u>	<u>4</u>	<u>\$ 15,549</u>	<u>\$ (410)</u>	<u>46</u>	<u>\$ 168,568</u>	<u>\$ (5,026)</u>

December 31, 2012

Description of Securities	Less than 12 months			12 months or more			Total		
	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss
	U.S. government agency mortgage-backed securities guaranteed by GNMA	2	\$ 9,238	\$ (93)	-	\$ -	\$ -	2	\$ 9,238
U.S. government agency mortgage-backed securities issued by FNMA	2	15,398	(304)	1	53	(3)	3	15,451	(307)
U.S. government agency small business administration pools guaranteed by SBA	1	3,348	(31)	-	-	-	1	3,348	(31)
Collateralized mortgage obligations guaranteed by GNMA/VA	6	36,023	(329)	4	16,601	(379)	10	52,624	(708)
Collateralized mortgage obligations issued by FNMA or FHLMC	2	8,498	(98)	-	-	-	2	8,498	(98)
Other collateralized mortgage obligations	1	602	(1)	-	-	-	1	602	(1)
State and municipal bonds	2	4,103	(19)	-	-	-	2	4,103	(19)
Total temporarily impaired securities	<u>16</u>	<u>\$ 77,210</u>	<u>\$ (875)</u>	<u>5</u>	<u>\$ 16,654</u>	<u>\$ (382)</u>	<u>21</u>	<u>\$ 93,864</u>	<u>\$ (1,257)</u>

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 September 30, 2013 or December 31, 2012.

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.

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

	Carrying Value at September 30, 2013				Nine Months Ended September 30, 2013
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
ASSETS					
Securities available for sale	\$ 405,300	\$ -	\$ 405,300	\$ -	\$ 1,247
Loans held for sale	34,344	-	34,344	-	(1,863)
Commitments to originate mortgage loans	2,142	-	2,142	-	(2,792)
Total assets at fair value	<u>\$ 441,786</u>	<u>\$ -</u>	<u>\$ 441,786</u>	<u>\$ -</u>	<u>\$ (3,408)</u>
LIABILITIES					
Commitments to sell mortgage loans	\$ 298	\$ -	\$ 298	\$ -	\$ (762)
Mortgage banking short positions	814	-	814	-	1,935
Total liabilities at fair value	<u>\$ 1,112</u>	<u>\$ -</u>	<u>\$ 1,112</u>	<u>\$ -</u>	<u>\$ 1,173</u>

	Carrying Value at December 31, 2012				Twelve Months Ended December 31, 2012
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
ASSETS					
Securities available for sale	\$ 300,549	\$ -	\$ 300,549	\$ -	\$ 279
Loans held for sale	95,095	-	95,095	-	649
Commitments to originate mortgage loans	4,499	-	4,499	-	2,183
Total assets at fair value	<u>\$ 400,143</u>	<u>\$ -</u>	<u>\$ 400,143</u>	<u>\$ -</u>	<u>\$ 3,111</u>
LIABILITIES					
Commitments to sell mortgage loans	\$ 2,233	\$ -	\$ 2,233	\$ -	\$ 2,143
Mortgage banking short positions	52	-	52	-	(52)
Total liabilities at fair value	<u>\$ 2,285</u>	<u>\$ -</u>	<u>\$ 2,285</u>	<u>\$ -</u>	<u>\$ 2,091</u>

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

	Carrying Value at September 30, 2013				Nine Months Ended September 30, 2013
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
Impaired loans ⁽¹⁾	\$ 8,297	\$ -	\$ 8,297	\$ -	\$ 326
Other real estate ⁽²⁾	2,186	-	2,186	-	(40)
Total	<u>\$ 10,483</u>	<u>\$ -</u>	<u>\$ 10,483</u>	<u>\$ -</u>	<u>\$ 286</u>
	Carrying Value at December 31, 2012				Twelve Months Ended December 31, 2012
	Total	Level 1	Level 2	Level 3	Total gains/(losses)
Impaired loans ⁽¹⁾	\$ 8,394	\$ -	\$ 8,394	\$ -	\$ (1,431)
Other real estate ⁽²⁾	5,131	-	5,131	-	(1,808)
Total	<u>\$ 13,525</u>	<u>\$ -</u>	<u>\$ 13,525</u>	<u>\$ -</u>	<u>\$ (3,239)</u>

(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	September 30, 2013		December 31, 2012	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:					
Cash and cash equivalents	Level 1	\$ 56,728	\$ 56,728	\$ 40,790	\$ 40,790
Investment securities available for sale	Level 2	405,300	405,300	300,549	300,549
Federal Reserve Bank and Federal Home Loan Bank stock	Level 2	2,729	2,729	2,601	2,601
Loans held for sale-mortgage banking	Level 2	34,344	34,344	95,095	95,095
Commitments to originate mortgage loans	Level 2	2,142	2,142	4,499	4,499
Loans and leases held for investment, net	Level 2	284,979	287,697	279,378	278,705
Accrued interest receivable	Level 2	2,833	2,833	2,590	2,590
		<u>\$ 789,055</u>	<u>\$ 791,773</u>	<u>\$ 725,502</u>	<u>\$ 724,829</u>
Liabilities and Stockholders' Equity:					
Deposits, noninterest-bearing	Level 2	\$ 124,246	\$ 124,246	\$ 131,593	\$ 131,593
Deposits, interest-bearing	Level 2	582,249	581,697	518,011	520,795
Borrowings and advances	Level 2	22,021	22,021	11,700	11,700
Accrued interest payable	Level 2	597	597	5,045	5,045
Accrued expenses	Level 2	6,013	6,013	10,144	10,144
Commitments to sell mortgage loans	Level 2	298	298	2,233	2,233
Mortgage banking short positions	Level 2	814	814	52	52
Guaranteed preferred beneficial interests in Company's subordinated debentures	Level 2	22,431	17,567	22,430	14,849
		<u>\$ 758,669</u>	<u>\$ 753,253</u>	<u>\$ 701,208</u>	<u>\$ 696,411</u>
Financial instruments with off-balance-sheet risk:					
Commitments to extend credit	Level 2	\$ -	\$ 220	\$ -	\$ 94
Standby and commercial letters of credit	Level 2	\$ -	\$ 20	\$ -	\$ 14

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 Nine Months Ended September 30, 2013 and 2012

Summary for the Three Months Ended September 30, 2013 and 2012

Net income was \$487 thousand and the net income available to common shareholders was \$157 thousand, or \$0.05 per share on a diluted basis, for the quarter ended September 30, 2013. This compared to net income of \$15.045 million and net income available to common shareholders of \$14.676 million, or \$4.41 per diluted share, in the third quarter of 2012.

Net interest income for the third quarter of 2013 was \$4.616 million, a decrease of \$151 thousand, or 3.2%, from \$4.767 million in the same period of 2012. The net interest margin for the current period decreased to 2.44% from 2.90%.

In the third quarter of 2013 and 2012, the Company's provision for credit losses was \$0.

Non-interest income for the third quarter of 2013 was \$5.001 million compared to \$16.826 million in the third quarter of 2012. In the third quarter of 2013 the Company recognized life insurance benefits of \$1.055 million while an insurance settlement of \$7.5 million was recognized in the third quarter of 2012. Excluding the insurance amounts, non-interest income was \$3.946 million in the third quarter of 2013 compared to \$9.326 million in 2012, a decrease of \$5.380 million, or 57.7%.

Non-interest expense for the third quarter of 2013 was \$9.451 million, compared to \$12.303 million in the third quarter of 2012. Non-interest expense in the third quarter of 2013 included an impairment charge of \$1.5 million while the same period in 2012 included \$2.5 million of legal expenses associated with the insurance settlement received in the period. When these expenses are excluded, non-interest expense declined to \$7.951 million in 2013, compared to \$9.803 million in 2012, a decrease of \$1.852 million, or 18.9%. As economic conditions and organic growth in Minnesota is limited when compared to North Dakota, we consolidated all Minnesota operations to one location to reduce operating costs and decided to sell a branch building which was underutilized. This resulted in an impairment charge of \$1.5 million to reflect the fair market value of the property.

In the third quarter of 2013, we recorded a tax benefit of \$321 thousand. A tax benefit of \$5.755 million was recognized during the third quarter of 2012. The tax benefit in 2013 was due to a change in our effective tax rate, primarily relating to the impairment charge noted above while the benefit in 2012 arose from the reversal of the valuation allowance on deferred tax assets.

Summary for the Nine Months Ended September 30, 2013 and 2012

Net income was \$6.748 million, and the income available to common shareholders was \$5.767 million, or \$1.66 per share on a diluted basis, for the nine months ended September 30, 2013. For the nine months ended September 30, 2012, the net income was \$21.643 million, and the income available to common shareholders was \$20.554 million, or \$6.21 per share on a diluted basis.

Net interest income for the nine months ended September 30, 2013 was \$13.832 million, an increase of \$21 thousand, or 0.2%, from \$13.811 million in the same period of 2012. The year to date net interest margin decreased to 2.50% from 2.88%.

In the first nine months of 2013 and 2012, the Company's provision for credit losses was \$700 thousand and \$100 thousand, respectively.

Non-interest income for the first nine months of 2013 was \$24.677 million compared to \$33.276 million in the same period of 2012. In 2013, the Company recognized life insurance benefits of \$1.055 million while an insurance settlement of \$7.5 million was recognized in 2012. Excluding the insurance amounts, non-interest income was \$23.622 million in the first nine months of 2013 compared to \$25.776 million in the same period of 2012, a decrease of \$2.154 million, or 8.4%.

Non-interest expense was \$27.907 million in the first nine months of 2013, compared to \$30.996 million in the same period of 2012. Non-interest expense in 2013 included an impairment charge of \$1.5 million while the same period in 2012 included \$2.5 million of non-recurring legal expenses associated with the insurance settlement received in the period. When these expenses are excluded, non-interest expense was \$26.407 million in 2013 compared to \$28.496 million in 2012 a decrease of \$2.089 million or 7.3%.

During the nine month period ended September 30, 2013, we recorded tax expense of \$3.154 million which resulted in an effective tax rate of 31.85% on a year-to-date basis. A tax benefit of \$5.652 million was recognized during the nine month period ended September 30, 2012. The tax benefit in 2012 arose because of the reversal of the valuation allowance on deferred tax assets.

Net Interest Income

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

	Three Months Ended September 30,								
	2013			2012			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	\$ 70,502	\$ 47	0.26%	\$ 15,201	\$ 11	0.29%	\$ 55,301	\$ 36	-0.03%(a)
Investments - taxable	322,102	1,332	1.64%	255,742	1,532	2.38%	66,360	(200)	-0.74%(b)
Investments - tax exempt	43,500	370	3.37%	35,022	265	3.01%	8,478	105	0.36%(b)
Loans held for sale – mortgage banking	46,872	410	3.47%	75,350	602	3.18%	(28,478)	(192)	0.29%(c)
Loans and leases held for investment	277,257	3,401	4.87%	283,017	3,685	5.18%	(5,760)	(284)	-0.31%(d)
Allowance for loan losses	(9,894)	-		(10,559)	-		665	-	
Total interest-earning assets	<u>\$ 750,339</u>	<u>\$ 5,560</u>	2.94%	<u>\$ 653,773</u>	<u>\$ 6,095</u>	3.71%	<u>\$ 96,566</u>	<u>\$ (535)</u>	-0.77%
Interest-bearing liabilities									
Interest checking and money market	\$ 345,024	\$ 129	0.15%	\$ 269,959	\$ 153	0.23%	\$ 75,065	\$ (24)	-0.08%(e)
Savings	20,027	3	0.06%	15,698	4	0.10%	4,329	(1)	-0.04%
Certificates of deposit under \$100,000	125,311	383	1.21%	125,753	541	1.71%	(442)	(158)	-0.50%(e)
Certificates of deposit \$100,000 and over	80,623	130	0.64%	67,790	212	1.25%	12,833	(82)	-0.61%(e)
Total interest-bearing deposits	570,985	645	0.45%	479,200	910	0.76%	91,785	(265)	-0.31%
Short-term borrowings	20,965	10	0.19%	15,198	20	0.52%	5,767	(10)	-0.33%(f)
Federal Home Loan Bank advances	-	-	0.00%	-	-	0.00%	(811)	-	0.00%
Subordinated debentures	22,431	289	5.11%	22,429	398	7.06%	2	(109)	-1.95%
Total borrowings	43,396	299	2.73%	38,438	418	4.33%	4,958	(119)	-1.60%
Total interest-bearing liabilities	<u>\$ 614,381</u>	<u>944</u>	0.61%	<u>\$ 517,638</u>	<u>1,328</u>	1.02%	<u>\$ 96,743</u>	<u>(384)</u>	-0.41%
Net interest income/spread		<u>\$ 4,616</u>	2.33%		<u>\$ 4,767</u>	2.69%		<u>\$ (151)</u>	-0.36%
Net interest margin			2.44%			2.90%			-0.46%
Notation:									
Non-interest-bearing deposits	<u>\$ 119,334</u>	-		<u>\$ 126,799</u>	-		<u>\$ (7,465)</u>	-	
Total deposits	<u>\$ 690,319</u>	<u>\$ 645</u>	0.37%	<u>\$ 605,999</u>	<u>\$ 910</u>	0.60%	<u>\$ 84,320</u>	<u>\$ (265)</u>	-0.23%
Taxable equivalents:									
Total interest-earning assets	\$ 750,339	\$ 5,754	3.04%	\$ 653,773	\$ 6,235	3.79%	\$ 96,566	\$ (481)	-0.75%
Net interest income/spread	-	\$ 4,810	2.43%	-	\$ 4,907	2.77%	-	\$ (97)	-0.34%
Net interest margin	-	-	2.54%	-	-	2.99%	-	-	-0.45%

Overall, interest rates on assets and liabilities have declined due to the current interest rate environment. In this quarter we saw both a spike in rates and a subsequent reduction.

- Cash balances are up due to deposit growth and we have been emphasizing liquidity in recent periods.
- Investment growth has been funded by an increase in deposits.
- Loans held for sale declined as production was reduced by the recent increase in interest rates.
- The balance of loans held for investment has declined slightly due to repayments, sales and charge-offs. Between 2009 and 2012 we were reducing our exposure to credit risk. In 2013 we implemented measures to increase our loan portfolio and the end of the period balances exceeded earlier levels.
- Checking and money market 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.
- Short term borrowings will vary depending on our customers need to use repurchase agreements.

Nine Months Ended September 30,

	2013			2012			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	\$ 66,483	\$ 127	0.26%	\$ 35,365	\$ 66	0.25%	\$ 31,118	\$ 61	0.01%(a)
Investments – taxable	295,973	3,969	1.79%	240,402	4,870	2.71%	55,571	(901)	-0.92%(b)
Investments - tax exempt	40,463	947	3.13%	29,138	694	3.18%	11,325	253	-0.05%(b)
Loans held for sale – mortgage banking	66,411	1,585	3.19%	62,013	1,597	3.44%	4,398	(12)	-0.25%(c)
Loans and leases held for investment	278,884	10,141	4.86%	283,529	10,903	5.14%	(4,645)	(762)	-0.28%(d)
Allowance for loan losses	(9,951)	-		(10,609)	-		658	-	
Total interest-earning assets	<u>\$ 738,263</u>	<u>\$ 16,769</u>	3.04%	<u>\$ 639,838</u>	<u>\$ 18,130</u>	3.78%	<u>\$ 98,425</u>	<u>\$ (1,361)</u>	-0.74%
Interest-bearing liabilities									
Interest checking and money market	\$ 338,145	\$ 452	0.18%	\$ 267,878	\$ 488	0.24%	\$ 70,267	\$ (36)	-0.06%(e)
Savings	19,483	12	0.08%	15,217	11	0.10%	4,266	1	-0.02%
Certificates of deposit under \$100,000	126,319	1,163	1.23%	126,567	1,936	2.04%	(248)	(773)	-0.81%(e)
Certificates of deposit \$100,000 and over	79,964	411	0.69%	63,708	659	1.38%	16,256	(248)	-0.69%(e)
Total interest-bearing deposits	563,911	2,038	0.48%	473,370	3,094	0.87%	90,541	(1,056)	-0.39%
Short-term borrowings	17,634	30	0.23%	13,037	57	0.58%	4,597	(27)	-0.35%(f)
Federal Home Loan Bank advances	-	-	0.00%	270	-	0.00%	(270)	-	0.00%
Subordinated debentures	22,431	869	5.18%	22,428	1,168	6.96%	3	(299)	-1.78%
Total borrowings	40,065	899	3.00%	35,735	1,225	4.58%	4,330	(326)	-1.58%
Total interest-bearing liabilities	<u>\$ 603,976</u>	<u>2,937</u>	0.65%	<u>\$ 509,105</u>	<u>4,319</u>	1.13%	<u>\$ 94,871</u>	<u>(1,382)</u>	-0.48%
Net interest income/spread		<u>\$ 13,832</u>	2.39%		<u>\$ 13,811</u>	2.65%		<u>\$ 21</u>	-0.26%
Net interest margin			2.50%			2.88%			-0.38%
Notation:									
Non-interest-bearing deposits	<u>\$ 115,334</u>	-		<u>\$ 126,659</u>	-		<u>\$ (11,325)</u>	-	
Total deposits	<u>\$ 679,245</u>	<u>\$ 2,038</u>	0.40%	<u>\$ 600,029</u>	<u>\$ 3,094</u>	0.69%	<u>\$ 79,216</u>	<u>\$ (1,056)</u>	-0.29%
Taxable equivalents:									
Total interest-earning assets	\$ 738,263	\$ 17,266	3.13%	\$ 639,838	\$ 18,497	3.86%	\$ 98,425	\$ (1,231)	-0.73%
Net interest income/spread	-	\$ 14,329	2.48%	-	\$ 14,178	2.73%	-	\$ 151	-0.25%
Net interest margin	-	-	2.59%	-	-	2.96%	-	-	-0.37%

Overall, interest rates on assets and liabilities have declined due to the current interest rate environment.

- (a) Cash balances are up due to deposit growth and we have been emphasizing liquidity in recent periods.
- (b) Investment growth has been funded by an increase in deposits.
- (c) Loans held for sale were higher as volumes of mortgage loans funded and sold were higher for the first half of 2013 prior to the recent increase in interest rates in the third quarter of 2013.
- (d) The balance of loans held for investment has declined slightly due to repayments, sales and charge-offs. Between 2009 and 2012 we were reducing our exposure to credit risk. In 2013 we implemented measures to increase our loan portfolio and the end of the period balances exceeded earlier levels.
- (e) Checking and money market 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.
- (f) Short term borrowings will vary depending on our customers need to use repurchase agreements.

Non-interest Income

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

	Three Months Ended				Nine Months Ended			
	September 30,		Increase (Decrease)		September 30,		Increase (Decrease)	
	2013	2012	\$	%	2013	2012	\$	%
Bank charges and service fees	\$ 698	\$ 626	\$ 72	12 %	\$ 1,989	\$ 1,754	\$ 235	13 % (a)
Wealth management revenues	302	266	36	14 %	935	912	23	3 %
Mortgage banking revenues	2,422	7,787	(5,365)	(69) %	17,413	21,427	(4,014)	(19) % (b)
Gains on sales of loans, net	301	245	56	23 %	1,408	864	544	63 % (c)
Gains on sales of securities, net	37	181	(144)	(80) %	1,247	279	968	347 % (d)
Other	186	221	(35)	(16) %	630	540	90	17 % (e)
Subtotal non-interest income	3,946	9,326	(5,380)	(58) %	23,622	25,776	(2,154)	(8) %
Insurance settlement	-	7,500	(7,500)	(100) %	-	7,500	(7,500)	(100) % (f)
Life insurance benefit received	1,055	-	1,055	100 %	1,055	-	1,055	100 % (f)
Total non-interest income	<u>\$ 5,001</u>	<u>\$ 16,826</u>	<u>\$ (11,825)</u>	(70) %	<u>\$ 24,677</u>	<u>\$ 33,276</u>	<u>\$ (8,599)</u>	(26) %

- (a) These fees are growing as we continue to grow deposits and open new accounts.
- (b) Mortgage banking revenues were significantly impacted year-to-date in 2013 by the increase in interest rates. Revenues began to decline mid-year as rates rose. In addition, margins were unusually high in the second quarter of 2012.
- (c) Gains and losses on sales will vary significantly from period to period. The secondary market for SBA loans is currently acquisitive and loans can be sold at attractive prices; however the recent shutdown of federal government operations prevented sales early in the fourth quarter which may impact earnings as the year ends.
- (d) Gains and losses on sales of securities will vary significantly from period to period.
- (e) The year-to-date increase is due to gains and losses associated with other real estate sales.
- (f) In the third quarter of 2013 the Company recognized life insurance benefits of \$1.055 million while an insurance settlement of \$7.5 million was recognized in the third quarter of 2012.

Non-interest Expense

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

	Three Months Ended				Nine Months Ended			
	September 30,		Increase (Decrease)		September 30,		Increase (Decrease)	
	2013	2012	\$	%	2013	2012	\$	%
Salaries and employee benefits	\$ 3,637	\$ 4,607	\$ (970)	(21) %	\$ 12,991	\$ 12,799	\$ 192	2 % (a)
Professional services	861	1,332	(471)	(35) %	2,883	3,403	(520)	(15) %
Data processing fees	717	735	(18)	(2) %	2,218	2,116	102	5 %
Marketing and promotion	718	516	202	39 %	1,927	1,482	445	30 % (b)
Occupancy	597	478	119	25 %	1,765	1,440	325	23 % (c)
Regulatory costs	146	304	(158)	(52) %	680	901	(221)	(25) % (d)
Depreciation and amortization	311	278	33	12 %	928	836	92	11 %
Office supplies and postage	139	166	(27)	(16) %	461	506	(45)	(9) %
Other real estate costs	38	48	(10)	(21) %	164	1,988	(1,824)	(92) % (e)
Other	787	1,339	(552)	(41) %	2,390	3,025	(635)	(21) %
Subtotal non-interest expense	7,951	9,803	(1,852)	(19) %	26,407	28,496	(2,089)	(7) %
Insurance settlement legal fees	-	2,500	(2,500)	(100) %	-	2,500	(2,500)	(100) % (f)
Impairment charge	1,500	-	1,500	100 %	1,500	-	1,500	100 % (g)
Total non-interest expense	<u>\$ 9,451</u>	<u>\$ 12,303</u>	<u>\$ (2,852)</u>	(23) %	<u>\$ 27,907</u>	<u>\$ 30,996</u>	<u>\$ (3,089)</u>	(10) %
Efficiency ratio	<u>98.3%</u>	<u>57.0%</u>			<u>72.5%</u>	<u>65.8%</u>		

- (a) Early in 2013 the Company recognized increased compensation costs relating to mortgage banking and incentive accruals. In the third quarter of 2013 our compensation costs and incentive accruals abated in accordance with our

current business. As revenues decreased in response to rising interest rates, the Company reduced operations personnel in mortgage banking in the third quarter of 2013. That reduction is estimated to reduce future compensation by approximately \$1.2 million annually.

- (b) Marketing costs have increased for the banking and mortgage banking operations to drive volume.
- (c) Occupancy costs increased in conjunction with facility improvements and office relocations. We consolidated all Minnesota operations in the third quarter of 2013 to one location to ultimately reduce operating costs.
- (d) The decrease is due to lower regulatory assessments.
- (e) Other real estate costs will vary from period to period depending on valuation adjustments on our foreclosed properties— see Note 6. In the first nine months of 2013, costs related to valuation allowances decreased as values of foreclosed properties stabilized.
- (f) In the prior year we incurred \$2.5 million of legal expenses associated with the insurance settlement that we received in that period.
- (g) In the third quarter we consolidated all Minnesota operations to one location to reduce operating costs and decided to sell a branch building which was underutilized. This resulted in an impairment charge of \$1.5 million to reflect the fair market value of the property.

Income Taxes

In the third quarter of 2013, we recorded a tax benefit of \$321 thousand. A tax benefit of \$5.755 million was recognized during the third quarter of 2012. The provision for income taxes was low in 2012 because of the reversal of the valuation allowance on deferred tax assets.

Comparison of Financial Condition at September 30, 2013 and December 31, 2012

Assets

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

	September 30,	December 31,	Increase (Decrease)		
	2013	2012	\$	%	
Cash and cash equivalents	\$ 56,728	\$ 40,790	\$ 15,938	39 %	(a)
Investment securities available for sale	405,300	300,549	104,751	35 %	(b)
Federal Reserve Bank and Federal Home Loan Bank of Des Moines stock	2,729	2,601	128	5 %	
Loans held for sale-mortgage banking	34,344	95,095	(60,751)	(64) %	(c)
Loans and leases held for investment, net	284,979	279,378	5,601	2 %	(d)
Other real estate, net	2,186	5,131	(2,945)	(57) %	(e)
Premises and equipment, net	14,197	15,932	(1,735)	(11) %	(f)
Accrued interest receivable	2,833	2,590	243	9 %	
Other assets	25,936	28,710	(2,774)	(10) %	(g)
Total assets	<u>\$ 829,232</u>	<u>\$ 770,776</u>	<u>\$ 58,456</u>	8 %	

- (a) Cash balances can fluctuate significantly, but we generally emphasize liquidity.
- (b) The increase in investments has primarily been funded by deposit growth.
- (c) Loans held for sale declined as production was reduced by the recent increase in interest rates.
- (d) Between 2009 and 2012 we were reducing our exposure to credit risk. In 2013 we implemented measures to increase our loan portfolio and the end of the period balances exceeded earlier levels.
- (e) Decrease is due to sales of foreclosed assets.
- (f) Premises and equipment decreased due to the transfer of underutilized property to OREO as part of the consolidation in Minnesota
- (g) Other assets decreased primarily due to reduction in the cash value of insurance policies relating to the life insurance benefits received and a decrease in the fair value of mortgage banking derivatives.

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 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 \$212.4 million as of September 30, 2013 and \$218.1 million as of December 31, 2012. 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 current balances of our borrowers (dollars are in thousands):

	September 30, 2013		December 31, 2012	
North Dakota	\$ 193,987	66 %	\$ 176,653	61 %
Minnesota	26,167	9	38,188	13
Arizona	32,144	11	29,238	10
Other	42,544	14	45,386	16
Total gross loans held for investment	<u>\$ 294,842</u>	<u>100 %</u>	<u>\$ 289,465</u>	<u>100 %</u>

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

	September 30, 2013		December 31, 2012	
North Dakota	\$ 198,316	67 %	\$ 168,198	58 %
Arizona	42,252	14	40,215	14
California	16,556	6	22,088	8
Minnesota	11,743	4	17,561	6
Colorado	8,985	3	7,686	3
Other	16,990	6	33,717	11
Total gross loans held for investment	<u>\$ 294,842</u>	<u>100 %</u>	<u>\$ 289,465</u>	<u>100 %</u>

Loan Maturities⁽¹⁾

The following table sets forth the remaining maturities of loans in each major category of our portfolio as of September 30, 2013 (in thousands):

	Over 1 year through 5 years			Over 5 years		Total Loans and Leases Held for Investment
	One year or less	Fixed Rate	Floating Rate	Fixed Rate	Floating rate	
Commercial and industrial	\$ 60,636	\$ 34,330	\$ 9,190	\$ 15,033	\$ 8,742	\$ 127,931
Commercial real estate	25,200	29,619	5,856	6,864	13,221	80,760
SBA	1,202	127	1,256	991	14,738	18,314
Consumer	3,268	17,861	4,065	5,664	392	31,250
Land and land development	9,863	5,683	8,850	1,053	2,791	28,240
Construction	2,080	-	-	-	6,267	8,347
Total principal amount of loans	<u>\$ 102,249</u>	<u>\$ 87,620</u>	<u>\$ 29,217</u>	<u>\$ 29,605</u>	<u>\$ 46,151</u>	<u>\$ 294,842</u>

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

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

Allocation of the Allowance for Loan Losses

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

	September 30, 2013		December 31, 2012	
	Total Loans and Leases Held for Investment Allowance	Loans in Category as a Percentage of Total Gross Loans and Leases Held for Investment	Total Loans and Leases Held for Investment Allowance	Loans in Category as a Percentage of Total Gross Loans and Leases Held for Investment
Commercial and industrial	\$ 2,196	43%	\$ 2,546	40%
Commercial real estate	4,055	27%	4,790	30%
SBA	823	6%	616	6%
Consumer	495	11%	382	9%
Land and land development	2,224	10%	1,609	11%
Construction	104	3%	148	4%
Total	<u>\$ 9,897</u>	<u>100%</u>	<u>\$ 10,091</u>	<u>100%</u>

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		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
Balance, beginning of period	\$ 10,183	\$ 4,893	\$ 10,512	\$ 6,169
Additions to nonperforming	74	40	811	74
Charge-offs	(5)	-	(909)	(317)
Reclassified back to performing	(12)	-	(19)	(815)
Principal payment received	(111)	(77)	(242)	(255)
Transferred to repossessed assets	-	-	(24)	-
Transferred to other real estate owned	-	-	-	-
Balance, end of period	<u>\$ 10,129</u>	<u>\$ 4,856</u>	<u>\$ 10,129</u>	<u>\$ 4,856</u>

Nonperforming Assets

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

	September 30, 2013	December 31, 2012
Nonperforming loans:		
Loans 90 days or more delinquent and still accruing interest	\$ 57	\$ 12
Non-accrual loans	10,072	10,500
Total nonperforming loans	<u>10,129</u>	<u>10,512</u>
Other real estate, net	2,186	5,131
Total nonperforming assets	<u>\$ 12,315</u>	<u>\$ 15,643</u>
Allowance for credit losses	<u>\$ 9,897</u>	<u>\$ 10,091</u>
Ratio of total nonperforming loans to total loans	3.08%	2.73%
Ratio of total nonperforming loans to loans and leases held for investment	3.44%	3.63%
Ratio of total nonperforming assets to total assets	1.49%	2.03%
Ratio of nonperforming loans to total assets	1.22%	1.36%
Ratio of allowance for credit losses to nonperforming loans	98%	96%

Potential Problem Loans

The macroeconomic environment has been challenging in recent years. As long as these conditions persist, many loans are potentially problematic assets.

Notwithstanding the prior paragraph, we attempt to quantify potential problem loans with more immediate credit risk. At September 30, 2013, the Bank had \$13.0 million of classified loans and \$10.1 million of loans on non-accrual. This compares to \$13.6 million of classified loans and \$10.5 million of loans on non-accrual at December 31, 2012 and \$17.4 million of classified loans and \$4.8 million of loans on non-accrual at September 30, 2012. We estimate there are loans risk rated “watch list” which are not impaired aggregating \$109 thousand at September 30, 2013 and \$5.2 million at December 31, 2012. Also, we estimate there are loans risk rated “substandard” which are not impaired aggregating \$3.0 million at September 30, 2013 and \$3.1 million at December 31, 2012.

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 6 included in the quarterly report.

Liabilities

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

Liabilities	September 30,	December 31,	Increase (Decrease)	
	2013	2012	\$	%
Deposits:				
Non-interest-bearing	\$ 124,246	\$ 131,593	\$ (7,347)	(6) % (a)
Interest-bearing-				
Savings, interest checking and money market	379,678	313,051	66,627	21 % (a)
Time deposits under \$100,000	124,320	128,150	(3,830)	(3) % (a)
Time deposits \$100,000 and over	78,251	76,810	1,441	2 % (a)
Short-term borrowings	22,021	11,700	10,321	88 % (b)
Guaranteed preferred beneficial interests in Company's subordinated debentures	22,431	22,430	1	- %
Accrued interest payable	597	5,045	(4,448)	(88) % (c)
Accrued expenses	6,013	10,144	(4,131)	(41) % (c)
Other liabilities	1,604	3,123	(1,519)	(49) % (d)
Total liabilities	<u>\$ 759,161</u>	<u>\$ 702,046</u>	<u>\$ 57,115</u>	8 %

- (a) Total deposits have increased primarily due to growth in our North Dakota branches.
- (b) Short term borrowings will vary depending on our customers need to use repurchase agreements.
- (c) Accrued expenses and interest payable decreased due to payments made on interest and dividend obligations that were deferred until the first quarter of 2013.
- (d) Other liabilities decreased due to a reduction in mortgage banking derivatives.

Mortgage Banking Obligations

Through our mortgage banking operations, the Company originates and sells residential mortgage loans servicing released to third parties. These loans are sold without recourse to the Bank. However, standard industry practices require representations and warranties which generally require sellers to reimburse a portion of the sales proceeds if a sold loan defaults or pays off shortly after the sale of the loan (i.e. generally within four months of the sale.) In addition, disputes regarding industry practices are becoming relatively common in recent years. The following is a summary of activity related to mortgage banking obligations (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Balance, beginning of period	\$ 1,702	\$ 1,063	\$ 1,500	\$ 800
Provision	200	250	568	588
Write offs, net	(361)	(38)	(527)	(113)
Balance, end of period	<u>\$ 1,541</u>	<u>\$ 1,275</u>	<u>\$ 1,541</u>	<u>\$ 1,275</u>

Stockholders' Equity

Our stockholders' equity increased \$1.3 million between December 31, 2012 and September 30, 2013 primarily due to earnings and changes in unrealized gains and losses in our investment portfolio and dividends on preferred stock.

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 (\$254.7 million as of September 30, 2013);
2. Borrowing capacity from the FHLB (\$49.7 million as of September 30, 2013); and
3. Capacity to issue brokered deposits with maturities of less than 12 months (\$112.6 million as of September 30, 2013).

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 September 30, 2013 levels. Cash flows from a given account are reinvested back into the same account so as to keep the month end balance constant at its September 30, 2013 level. The static balance sheet assumption is made so as to project the interest rate risk to net interest income embedded in the existing balance sheet. With knowledge of the balance sheet's existing net interest income profile, more informed strategies and tactics may be developed as it relates to the structure/mix of growth.

We monitor the results of net interest income simulation on a regular basis. Net interest income is generally simulated for the upcoming 12-month horizon in seven interest rate scenarios. The scenarios generally modeled are parallel interest rate ramps of +/- 100bp, 200bp, and 300bp along with a rates unchanged scenario. Given the current low absolute level of interest rates as of September 30, 2013, 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	<u>-100bp</u>	<u>Unchanged</u>	<u>+100bp</u>	<u>+200bp</u>	<u>+300bp</u>	<u>+400bp</u>
Projected 12-month net interest income	\$ 20,772	\$ 21,800	\$ 21,745	\$ 21,679	\$ 21,530	\$ 21,345
Dollar change from unchanged scenario	\$ (1,028)	\$ -	\$ (55)	\$ (121)	\$ (270)	\$ (455)
Percentage change from unchanged scenario	(4.72)%	-	(0.25)%	(0.56)%	(1.24)%	(2.09)%

Since there are limitations inherent in any methodology used to estimate the exposure to changes in market interest rates, these analyses are not intended to be a forecast of the actual effect of changes in market interest rates, such as those indicated above on the Company. Further, these analyses are based on our assets and liabilities as of September 30, 2013 (without forward adjustments for planned growth and anticipated business activities) and do not contemplate any actions we might undertake in response to changes in market interest rates.

Static gap analysis is another tool that may be used for interest rate risk measurement. The net differences between the amount of assets, liabilities, equity and off-balance-sheet instruments repricing within a cumulative calendar period is typically referred to as the “rate sensitivity position” or “gap position.” The following table sets forth our rate sensitivity position as of September 30, 2013. Assets and liabilities are classified by the earliest possible repricing date or maturity, whichever occurs first.

Interest Sensitivity Gap Analysis

Estimated maturity or repricing at September 30, 2013

	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	\$ 56,728	\$ -	\$ -	\$ -	\$ 56,728
Investment securities (a)	52,828	35,409	133,928	156,842	379,007
FRB and FHLB stock	2,729	-	-	-	2,729
Fed funds sold	-	-	-	-	-
Loans held for sale-mortgage banking, fixed rate	-	34,344	-	-	34,344
Loans held for sale-mortgage banking, floating rate	-	-	-	-	-
Loans held for investment, fixed rate	17,920	49,091	68,742	16,313	152,066
Loans held for investment, floating rate	111,100	4,436	23,615	3,659	142,810
Total interest-earning assets	<u>\$ 241,305</u>	<u>\$ 123,280</u>	<u>\$ 226,285</u>	<u>\$ 176,814</u>	<u>\$ 767,684</u>
Interest-bearing liabilities:					
Interest checking and money market accounts	\$ 359,479	\$ -	\$ -	\$ -	\$ 359,479
Savings	20,199	-	-	-	20,199
Time deposits under \$100,000	11,501	31,529	51,179	30,111	124,320
Time deposits \$100,000 and over	22,614	41,768	13,516	353	78,251
Short-term borrowings	22,021	-	-	-	22,021
FHLB advances	-	-	-	-	-
Other borrowing	-	-	-	-	-
Subordinated debentures	15,000	-	-	7,431	22,431
Total interest-bearing liabilities	<u>\$ 450,814</u>	<u>\$ 73,297</u>	<u>\$ 64,695</u>	<u>\$ 37,895</u>	<u>\$ 626,701</u>
Interest rate gap	<u>\$ (209,509)</u>	<u>\$ 49,983</u>	<u>\$ 161,590</u>	<u>\$ 138,919</u>	<u>\$ 140,983</u>
Cumulative interest rate gap at September 30, 2013	<u>\$ (209,509)</u>	<u>\$ (159,526)</u>	<u>\$ 2,064</u>	<u>\$ 140,983</u>	
Cumulative interest rate gap to total assets	(24.96)%	(19.01)%	0.25%	16.80%	

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

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

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

Since there are limitations inherent in any methodology used to estimate the exposure to changes in market interest rates, these analyses are not intended to be a forecast of the actual effect of changes in market interest rates such as those indicated above on the Company. Further, these analyses are based on our assets and liabilities as of September 30, 2013 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: December 4, 2013

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

By: /s/ Susan Weinberg
Susan Weinberg
Chief Financial Officer

By: /s/ Justin C. Currie
Justin C. Currie
Principal Accounting Officer