



BND 

Bank of North Dakota

Achieve more.

ANNUAL REPORT 2018

ROI

Mission

To deliver quality, sound financial services that promote agriculture, commerce and industry in North Dakota.

Vision

BND is an agile partner that creates financial solutions for current and emerging economic needs.

Core Values

Our core values of service, teamwork, ethics and people-centered allow us to excel and deliver while accomplishing more together by doing the right thing and setting ourselves apart.

Culture Initiative

By creating a coaching culture, we will inspire curiosity, empower individuals and identify opportunities to collaborate.



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President's Message



In 1919, the 16th Assembly of the North Dakota Legislature started Bank of North Dakota (BND) with a \$2 million bond sale. As we close out 2018 and enter our 100th year, we are being asked how we've gotten to this point. How have we survived, and ultimately thrived, as the only state-owned bank in the country?

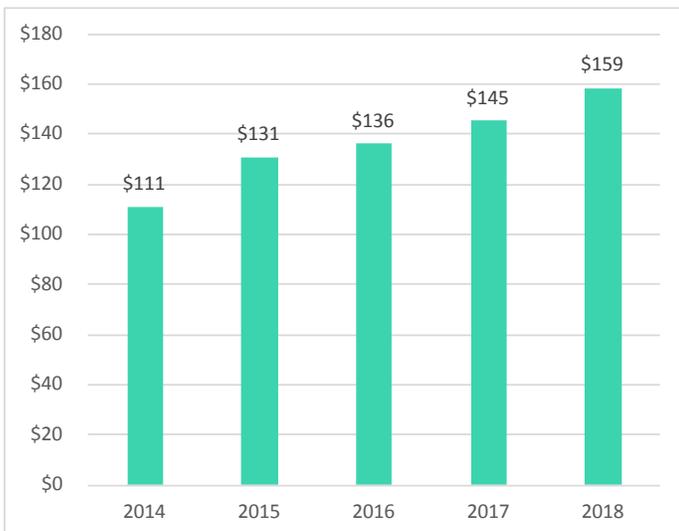
A bank needs to provide a return on investment for its stakeholders. BND's investors are the citizens of North Dakota. Each of them has a stake in this unique and progressive institution that affects their lives daily.

Taxes are lower because the Bank's profits are returned to the general fund under the direction of the Legislature. Profits support infrastructure needs and disaster relief. Businesses begin and expand. Residents save for college with College SAVE, then attend college and refinance afterward with our student loan program. Farmers and ranchers start value-added businesses and sell their farms to the next generation.

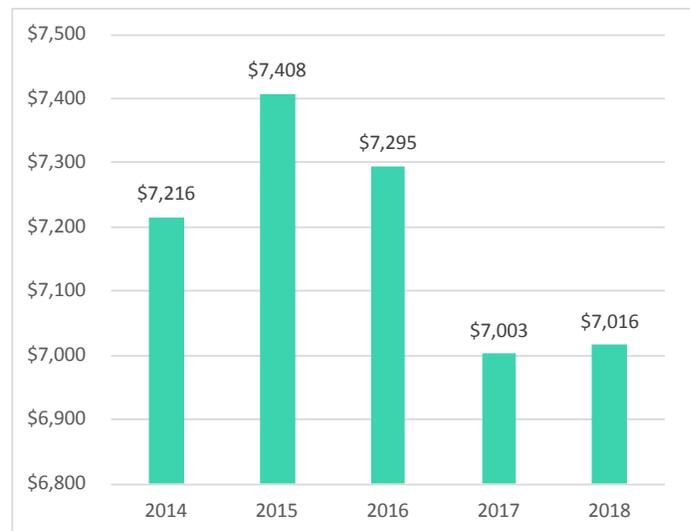
To ensure our programs are agile and meet the needs of North Dakota residents, meetings are held across the state with legislators, economic developers, bankers, business owners, higher education officials and other stakeholders. We invest time and energy in building stronger, deeper relationships with the people we serve.

Positive impacts were recognized internally this year from investing in our staff and integrating more innovation into our culture. Our employees are our greatest asset, and we have an excellent group that gives back to their community in addition to the time they work at the Bank.

Annual Income
(in millions)



BND Assets
(in millions)



We've made significant investments in deploying a more defined risk management model at BND this year, including cybersecurity advancements. Although we are often reminded that it's not if a cybersecurity event will occur but when, our highly skilled team works diligently to educate employees and monitor attacks on our system every minute of the day. Additionally, a more robust concentration model was implemented as part of the overall credit underwriting process. Finally, key risk indicators and tolerances with playbooks have been established to empower employees to respond more quickly if there is an event with a potentially negative impact to the Bank or our customers.

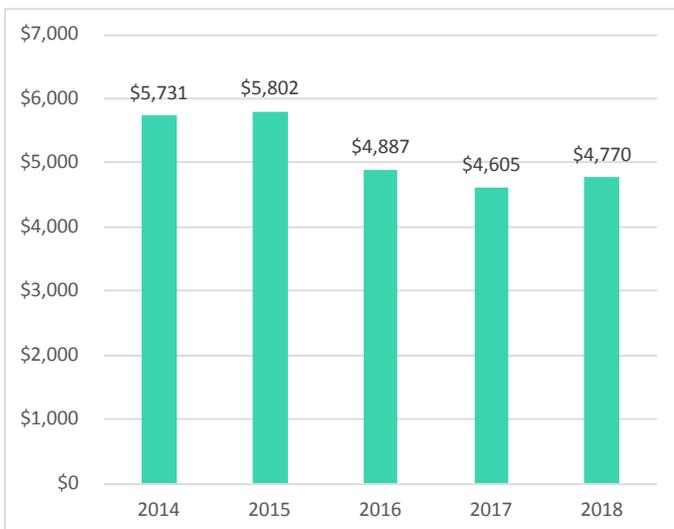
I am pleased to announce that it was our 15th consecutive year of record profits, earning \$159 million in 2018. The state's return on investment was a healthy 18 percent.

The Bank has changed in many ways since its early days, but the commitment to its mission "to promote agriculture, commerce and industry" hasn't wavered. During its first 99 years, BND returned more than \$1 billion to the state through the general fund, infrastructure, disaster relief and other special programs. This doesn't count the thousands of student, business, home and agricultural loans that allowed our residents to achieve their dreams. I think our forefathers who started the Bank in 1919 would agree their \$2 million was well worth it.

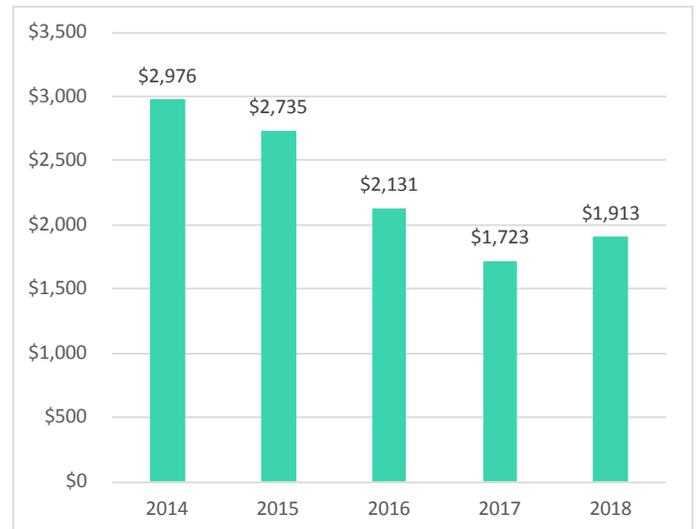


Eric Hardmeyer
President/CEO

Deposit Size
(in millions)



Investment Portfolio
(in millions)



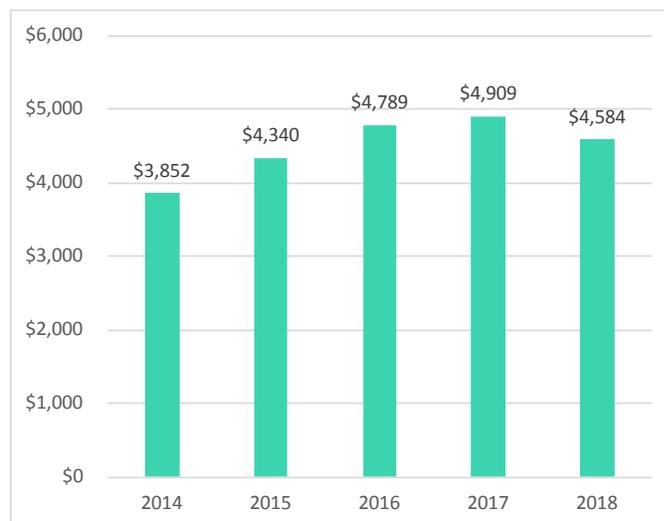
Lending Portfolio



Total Loan Portfolio

There were 17,299 loans for \$1.33 billion originated or renewed in 2018. BND's loan portfolio shrunk by \$325 million, primarily due to strategic decisions that were made which impacted the student loan and home loan portfolios.

Total Loan Portfolio
(in millions)



Agricultural Loan Portfolio

The agricultural loan portfolio decreased by \$3 million this year. Increases in three specific agricultural loans – Beginning Farmer Real Estate, Beginning Farmer Chattel and Ag PACE – are positive indicators for the ag economy.

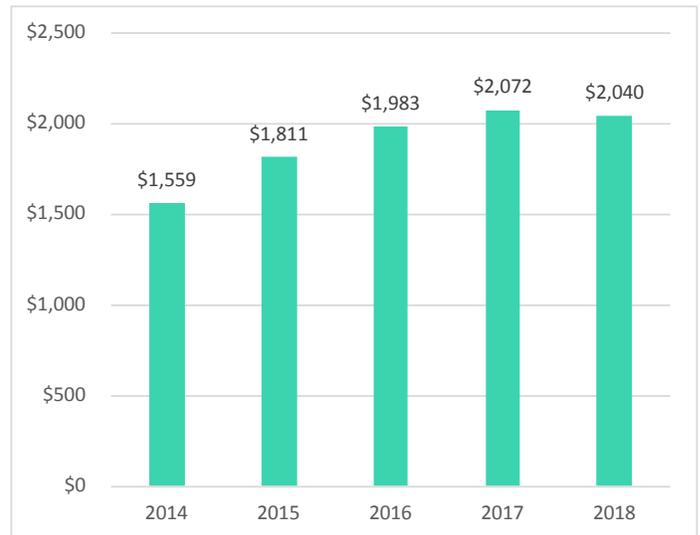
Agricultural Loan Portfolio
(in millions)



Business Loan Portfolio

The business loan portfolio decreased by \$32 million in 2018. The number of commercial loans originated and renewed is stable, but there was a decrease in the dollar amount of these loans. Significant growth was seen in PACE and Flex PACE programs due to the expansion of parameters which was instituted in 2017.

Business Loan Portfolio
(in millions)



Home Loan Portfolio

The home loan portfolio decreased by \$68 million, largely due to a newly implemented strategy to book fewer fixed-rate mortgages. This allows BND to meet the area of greatest need in the home loan arena: rural mortgage origination and purchase.

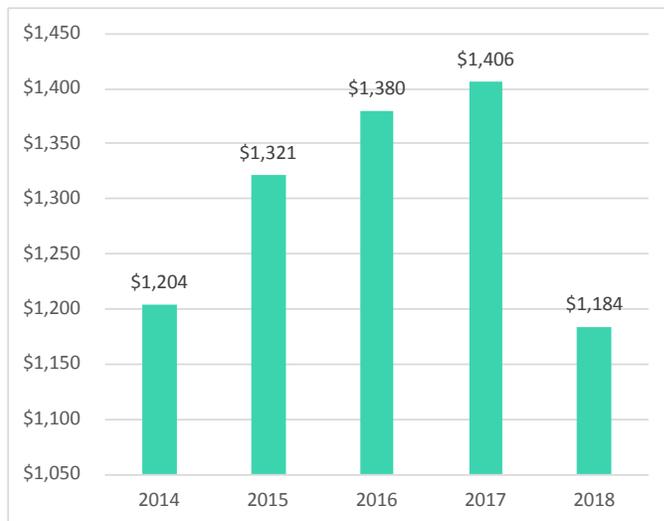
Home Loan Portfolio
(in millions)



Student Loan Portfolio

In early 2018, BND sold off the remaining \$246 million of federal student loans in its portfolio. This sale, along with fewer residents benefiting from refinancing their student loans, led to a portfolio decrease of \$222 million.

Student Loan Portfolio
(in millions)

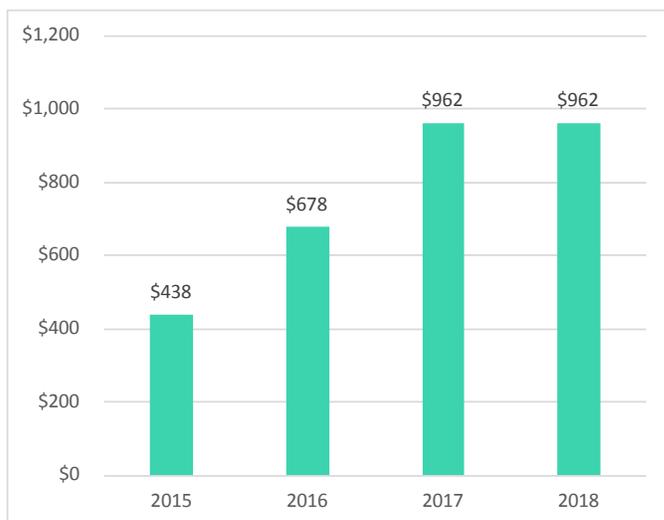


State and Administered Loan Portfolio

BND has been asked to take on a greater responsibility when it comes to financing state obligations like municipal infrastructure and K-12 school construction.

Although only a portion of these loans are reflected on BND's balance sheet, the Bank's involvement in administering them is significant. The funding dollars and loan requirements for each program are set by the state Legislature.

State and Administered Loan Portfolio
(in millions)

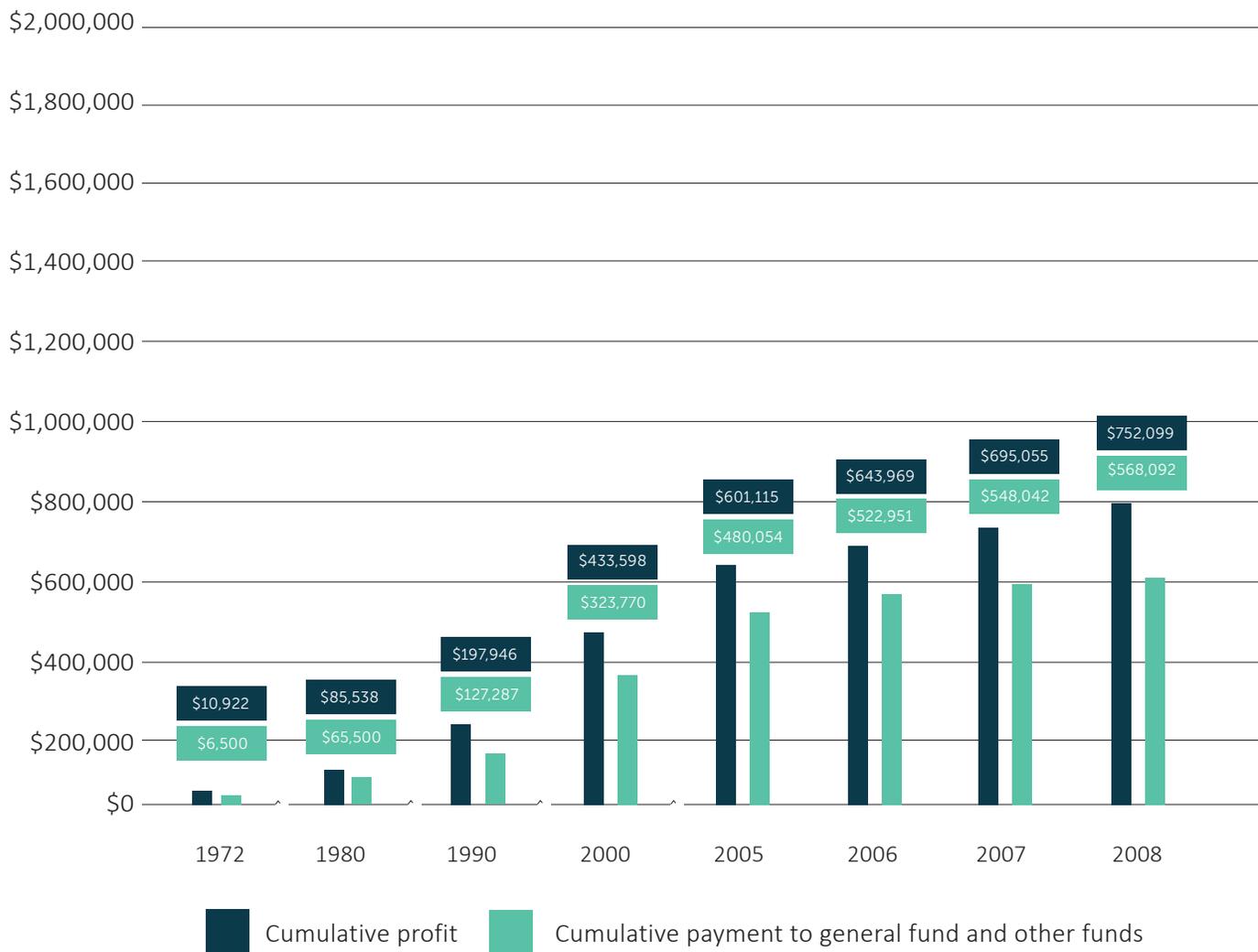


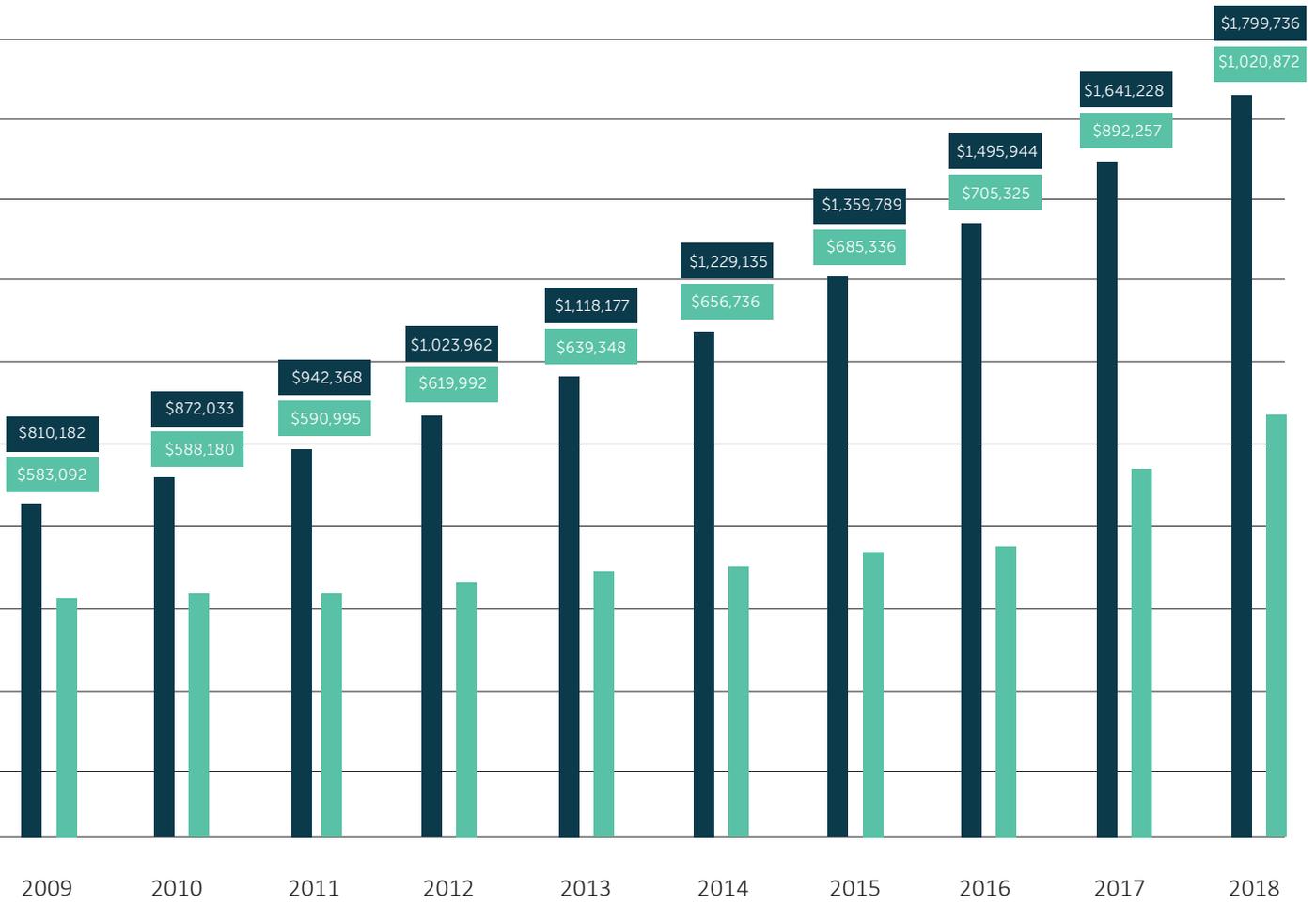


BND profits and payments

The Bank's first transfer to the state's general fund occurred in 1945 for \$1,725. Since then, more than \$1 billion has been transferred to the general fund and for special programs.

BND Profits and Payments to General Fund and Other Funds
(in thousands)





Return on investment

How are Bank profits invested?

The Bank's profits are utilized in three ways: appropriation through the North Dakota Legislature, mission-driven loan programs and BND's capital.

The Legislature appropriates the transfer of capital to the state's general fund. Every legislative session, the state's budget needs are reviewed and the amounts designated from BND's capital vary based upon the needs of the state and BND's goal to maintain liquidity and capital.

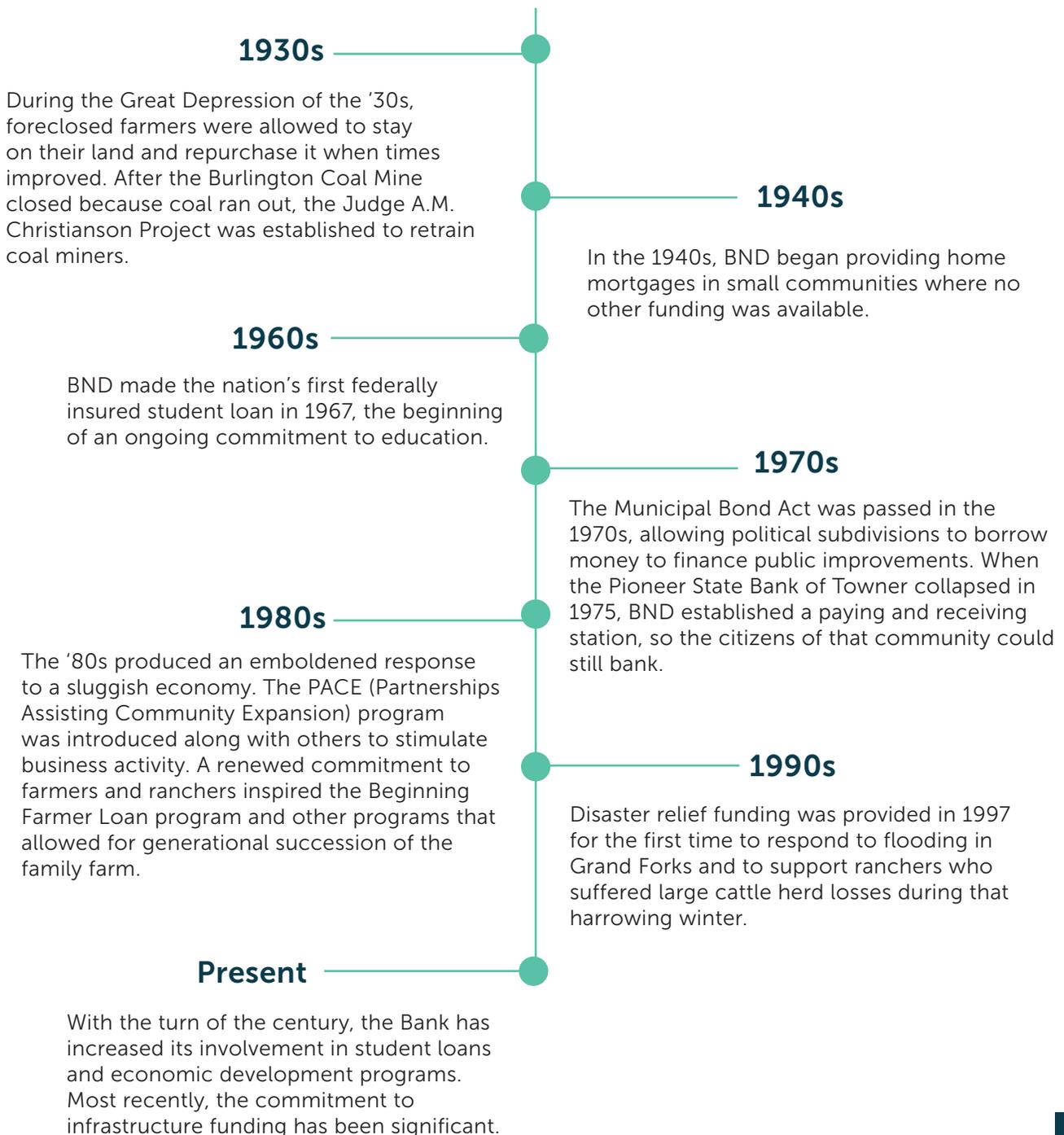
The Bank's profits are also used to support its mission-driven loan programs. Pending legislative approval, BND funds interest rate buydowns and off-balance sheet programs that help drive economic development and infrastructure projects across the state.

Lastly, BND's excess earnings are retained and accumulated to fund capital. The Bank's target is to maintain a Tier 1 capital of 10 percent.



Solving problems over the years

The Bank has proven itself as a tool to address a variety of issues impacting the state. Our vision statement, "BND is an agile partner that creates financial solutions for current and emerging economic needs," compels us to keep a pulse on the new opportunities and challenges we can stimulate, support or relieve.



Enhanced risk management protects investment

Bank of North Dakota makes a significant effort to mitigate risk and ensure the state's investments are protected. Intelligent money management strategies and strong risk management practices are in place to ensure this occurs.

In 2018, the Bank implemented a more robust concentration model which considers economic trends such as unemployment levels, vacancies in apartments and hotels, and sales tax revenues when assessing loan participation opportunities. Loans are also reviewed based on the region and type of business to ensure the Bank isn't overconcentrated in an area.

The Information Security team monitors attacks on BND systems, controls access to records, conducts vulnerability assessments and trains employees to recognize attacks from the outside. Training is essential because the primary way a system is hacked is through an employee unconsciously clicking on an email link that opens entire systems for access. Routine security walkthroughs are also conducted to monitor record safety.

Key risk indicators have been established bankwide to proactively identify factors that could negatively impact the Bank and empower employees to respond quickly.

Giving back to our communities

Bank of North Dakota employees enjoy volunteering together, giving back to their friends and neighbors across the state. They read in classrooms with National Education Association's Read Across America program, participate in quarterly blood drives and deliver Meals on Wheels.

Employees support United Way efforts by raising money through the Little Black Dress Campaign, serving meals in community parks with the Ending Summer Hunger program and sprucing up local nonprofit facilities on United Way Day of Caring. Special donation drives support the United Way Homeless Shelter, Lutheran Social Services, United Way's Holiday Giving Tree and the Bismarck-Mandan Metro Area Ambulance Services' Little Free Pantry.

Numerous activities raise funds for the American Cancer Society Relay for Life. Participation in the chamber's Leadership Fargo Moorhead West Fargo program also offered even more opportunities to connect with the community in 2018.



Bank of North Dakota volunteers helped to paint walls and spruce up hallways at the Missouri Valley Family YMCA in Bismarck during United Way's annual Day of Caring.



For more than 20 years, Bank employees have formed a Relay for Life team which holds numerous bankwide events to raise funds for the American Cancer Society and cancer research.



Spreading holiday cheer and making the season brighter, a team of employees spent time at Spirit of Life Church in Mandan handing out Christmas grocery boxes to those in need.



Bank of North Dakota's Cat in the Hat brought excitement to young readers during Read Across America, to honor the birthday of Dr. Seuss.

2018-2020 Strategic Plan



Five strategies will focus the Bank's efforts through 2020.

Strategy 1: Facilitate economic growth and diversity

BND will build on its role to facilitate economic diversification by innovatively enhancing BND's financing solutions.

Strategy 2: Expand access to postsecondary education

BND will strive to be the preferred and trusted resource North Dakotans choose for planning, preparing for and financing postsecondary education.

Strategy 3: Utilize BND's unique competitive advantage

BND will utilize its unique competitive advantage as a statewide resource to provide relevant correspondent banking services that meet the current and emerging needs of our financial institution partners.

Strategy 4: Enhance innovation and agility to be a model of effective government

BND will effectively use innovation and collaboration to be more agile in partnering with other agencies and stakeholders to create solutions leading to more effective government.

Strategy 5: Optimize technology and the use of data

BND will extract maximum value from technology and leverage available data to serve customers and internal users in a secure environment.

North Dakota Industrial Commission



Doug Burgum
Governor



Doug Goehring
Ag Commissioner



Wayne Stenehjem
Attorney General

BND Advisory Board



Gary Petersen



Karl Bollingberg



Pat Clement



Dennis Johnson



Pat Mahar



Sue Morton



Christie Obenauer

BND Executive Committee



Eric Hardmeyer



Kirby Evanger



Joe Herslip



Lori Leingang



Tim Porter



Todd Steinwand



Jeff Weiler

Ending Balance Sheet

Bank of North Dakota
December 31, 2018 (Unaudited)

(In thousands)

Assets

Cash and Due from Banks	\$	470,227
Federal Funds Sold		39,465
Securities		1,912,743
Loans		
Commercial		2,039,833
Agricultural		665,691
Residential		694,577
Student		1,184,132
Total Loans		<u>4,584,233</u>
Less Allowance for Loan Loss		<u>(92,750)</u>
Total Loans Less Allowance		4,491,483
Other Assets		<u>101,916</u>
Total Assets	\$	<u><u>\$7,015,834</u></u>

Liabilities and Equity

Deposits		
Noninterest Bearing	\$	567,352
Interest Bearing		<u>4,202,467</u>
Total Deposits		\$4,769,819
Federal Funds Purchased and Repurchase Agreements		271,505
Short- and Long-term Borrowings		1,103,436
Other Liabilities		<u>9,190</u>
Total Liabilities		6,153,950
Equity		<u>861,884</u>
Total Liabilities and Equity	\$	<u><u>\$7,015,834</u></u>

Ending Income Statement

Bank of North Dakota
December 31, 2018 (Unaudited)

	(In thousands)
Interest Income	\$ 240,003
Interest Expense	(46,442)
Net Interest Income	<u>193,561</u>
Provision for Loan Losses	(12,000)
Net Interest Income After Provision	<u>181,561</u>
Noninterest Income	7,170
Noninterest Expense	
Salaries and Benefits	(16,870)
Data Processing	(5,253)
Occupancy and Equipment	(932)
Other Operating Expense	(7,168)
Total Noninterest Expense	<u>(30,223)</u>
Net Income	<u><u>\$ 158,508</u></u>

*View a complete copy of the Audited Financial Statements
at bnd.nd.gov/annualreport.*

Ten-Year Summary

Bank of North Dakota

December 31, 2018 (Unaudited)

	2018	2017	2016	2015
Operating Results (in thousands)				
Interest income	\$240,002	\$219,700	\$210,803	\$194,298
Interest expense	46,442	37,865	33,975	32,164
Net interest income	193,560	181,835	176,828	162,134
Provision for loan losses	12,000	12,000	16,000	12,500
Net interest income after provision for loan losses	181,560	169,835	160,828	149,634
Noninterest income	7,170	6,335	6,323	7,688
Noninterest expense	30,222	30,886	30,996	26,668
Net Income	158,508	145,284	136,155	130,654
Payments to general fund	70,000	170,000	-	-
Payments to other funds	58,614	16,932	19,989	28,645
Balance Sheet (in thousands)				
Total Assets - Year End	7,015,834	7,003,302	7,295,268	7,407,942
Federal funds sold and resell agreements	39,465	57,555	63,070	77,905
Securities	1,912,743	1,665,252	2,068,327	2,657,527
Loans	4,584,233	4,909,278	4,789,553	4,339,618
Agriculture	665,691	668,904	687,486	513,899
Commercial	2,039,833	2,071,953	1,982,625	1,811,259
Residential	694,577	762,480	739,412	693,712
Student	1,184,132	1,405,941	1,380,030	1,320,748
Deposits	4,769,819	4,604,958	4,887,192	5,802,142
Noninterest bearing	567,352	555,020	663,156	641,264
Interest bearing	4,202,467	4,049,938	4,224,036	5,160,878
Federal funds purchased and repurchase agreements	271,505	299,775	242,480	119,500
Short- and Long-Term Debt	1,103,436	1,263,569	1,280,538	727,322
Equity	861,884	824,802	875,732	749,493
Capital	2,000	2,000	2,000	2,000
Capital surplus	72,000	72,000	72,000	72,000
Undivided profits	777,742	747,848	789,496	673,330
Accumulated other comprehensive income (loss)	10,142	2,954	12,236	2,163

2014	2013	2012	2011	2010	2009
\$174,584	\$153,182	\$145,870	\$137,459	\$133,400	\$132,277
31,455	30,217	35,349	39,541	45,188	50,994
143,129	122,965	110,521	97,918	88,212	81,283
8,000	-	2,000	11,000	12,100	10,300
135,129	122,965	108,521	86,918	76,112	70,983
7,987	7,422	4,659	4,911	6,113	6,206
32,157	36,172	31,586	21,494	20,374	19,106
110,959	94,215	81,594	70,335	61,851	58,083
-	-	-	-	-	30,000
17,345	19,356	28,997	2,815	5,088	-
7,215,687	6,873,409	6,155,201	5,375,073	4,029,927	3,959,669
42,105	36,645	24,050	18,315	33,100	24,190
2,933,570	2,584,169	2,171,546	1,008,051	537,157	397,370
3,852,155	3,476,946	3,279,778	2,995,154	2,814,548	2,713,611
436,970	361,756	342,826	289,002	276,693	267,575
1,559,137	1,388,104	1,278,403	1,068,598	1,022,002	1,038,589
652,076	629,931	594,508	575,020	471,411	475,124
1,203,972	1,097,155	1,064,041	1,062,534	1,044,442	932,323
5,730,611	5,601,127	5,003,562	4,179,837	3,058,726	2,939,059
700,446	798,559	891,197	649,922	387,040	442,867
5,030,165	4,802,568	4,112,365	3,529,915	2,671,686	2,496,192
178,455	245,110	275,960	318,325	240,725	337,627
645,126	465,961	406,252	471,422	397,365	405,005
652,134	551,797	463,662	399,903	327,297	271,649
2,000	2,000	2,000	2,000	2,000	2,000
72,000	72,000	42,000	42,000	42,000	42,000
571,276	477,705	402,846	350,249	282,729	225,966
6,858	92	16,816	5,654	568	1,683

**FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017**



BANK OF NORTH DAKOTA

Table of Contents

	<u>Page</u>
INDEPENDENT AUDITOR'S REPORT	1
FINANCIAL STATEMENTS	
Balance Sheets	3
Statements of Income	4
Statements of Comprehensive Income	5
Statements of Equity	6
Statements of Cash Flows	7
Notes to Financial Statements	8



Independent Auditor's Report

Governor of North Dakota and
the Legislative Assembly
State of North Dakota
Bismarck, North Dakota

Report on the Financial Statements

We have audited the accompanying financial statements of Bank of North Dakota, which comprise the balance sheets as of December 31, 2018 and 2017 and the related statements of income, comprehensive income, equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles for Governmental Entities

As described in Note 1 of the financial statements, Bank of North Dakota is a governmental entity as defined by the Governmental Accounting Standards Board (GASB). Accordingly, the standards as promulgated by GASB are the appropriate accounting standards for Bank of North Dakota to follow. However, Bank of North Dakota has prepared its financial statements in accordance with accounting standards as promulgated by the Financial Accounting Standards Board (FASB) even though the entity meets the “governmental” criteria.

The effects on the financial statements of the variances between the accounting policies described in Note 1 and generally accepted accounting principles for governmental entities, although not reasonably determinable, are presumed to be material.

Adverse Opinion on U.S. Generally Accepted Accounting Principles for Governmental Entities

In our opinion, because of the significance of the matter discussed in the “Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles for Governmental Entities,” the financial statements referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America for governmental entities, the financial position of Bank of North Dakota as of December 31, 2018 and 2017, or changes in financial position or cash flows thereof for the years then ended.

Opinion on Accounting Standards as Promulgated by the Financial Accounting Standards Board

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Bank of North Dakota as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the year then ended in accordance with accounting standards as promulgated by FASB.



Bismarck, North Dakota
February 14, 2019

BANK OF NORTH DAKOTA
BALANCE SHEETS
DECEMBER 31, 2018 AND 2017
(In Thousands)

	<u>2018</u>	<u>2017</u>
ASSETS		
Cash and due from banks	\$ 470,227	\$ 357,042
Federal funds sold	39,465	57,555
	<u>509,692</u>	<u>414,597</u>
Cash and cash equivalents		414,597
Securities	1,912,743	1,665,252
Loans held for investment	4,584,233	4,661,432
Loans held for sale	-	247,846
Less allowance for loan losses	(92,750)	(84,958)
	<u>4,491,483</u>	<u>4,824,320</u>
Interest receivable	56,865	53,525
Bank premises, equipment, and software, net	10,249	10,919
Rebuilders loan program receivable	10,288	13,682
Other assets	24,514	21,007
	<u>56,865</u>	<u>53,525</u>
Total assets	<u>\$ 7,015,834</u>	<u>\$ 7,003,302</u>
LIABILITIES AND EQUITY		
Deposits		
Non-interest bearing	\$ 567,352	\$ 555,020
Interest bearing	4,202,467	4,049,938
	<u>4,769,819</u>	<u>4,604,958</u>
Federal funds purchased and repurchase agreements	271,505	299,775
Short and long-term debt	1,103,436	1,263,569
Other liabilities	9,190	10,198
	<u>6,153,950</u>	<u>6,178,500</u>
Total liabilities		6,178,500
Equity		
Capital	2,000	2,000
Capital surplus	72,000	72,000
Undivided profits	777,742	747,848
Accumulated other comprehensive income	10,142	2,954
	<u>861,884</u>	<u>824,802</u>
Total equity		824,802
Total liabilities and equity	<u>\$ 7,015,834</u>	<u>\$ 7,003,302</u>

BANK OF NORTH DAKOTA
STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2018 AND 2017
(In Thousands)

	<u>2018</u>	<u>2017</u>
INTEREST INCOME		
Federal funds sold	\$ 1,092	\$ 569
Securities	40,225	30,321
Loans, including fees	<u>198,686</u>	<u>188,810</u>
Total interest income	<u>240,003</u>	<u>219,700</u>
INTEREST EXPENSE		
Deposits	17,341	10,469
Federal funds purchased and repurchase agreements	4,705	2,818
Short and long-term debt	<u>24,396</u>	<u>24,578</u>
Total interest expense	<u>46,442</u>	<u>37,865</u>
NET INTEREST INCOME	193,561	181,835
PROVISION FOR LOAN LOSSES	<u>12,000</u>	<u>12,000</u>
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	<u>181,561</u>	<u>169,835</u>
NONINTEREST INCOME		
Service fees and other	<u>7,170</u>	<u>6,335</u>
Total noninterest income	<u>7,170</u>	<u>6,335</u>
NONINTEREST EXPENSE		
Salaries and benefits	16,870	16,608
Data processing	5,253	5,157
Occupancy and equipment	932	1,448
Other operating expenses	7,168	7,673
Total noninterest expenses	<u>30,223</u>	<u>30,886</u>
NET INCOME	<u>\$ 158,508</u>	<u>\$ 145,284</u>

BANK OF NORTH DAKOTA
STATEMENTS OF COMPREHENSIVE INCOME
YEARS ENDED DECEMBER 31, 2018 AND 2017
(In Thousands)

	<u>2018</u>	<u>2017</u>
Net income	<u>\$ 158,508</u>	<u>\$ 145,284</u>
Other comprehensive income (loss)		
Unrealized loss on securities available for sale	(703)	(10,498)
Unrealized gain on interest rate swap	7,632	861
Reclassification adjustment for losses realized in net income	<u>259</u>	<u>355</u>
Other comprehensive income (loss)	<u>7,188</u>	<u>(9,282)</u>
Comprehensive income	<u>\$ 165,696</u>	<u>\$ 136,002</u>

BANK OF NORTH DAKOTA
STATEMENTS OF EQUITY
YEARS ENDED DECEMBER 31, 2018 AND 2017
(In Thousands)

	Capital	Capital Surplus	Undivided Profits	Accumulated Other Comprehensive Income (Loss)	Total
BALANCE, DECEMBER 31, 2016	\$ 2,000	\$ 72,000	\$ 789,496	\$ 12,236	\$ 875,732
Net income			145,284		145,284
Unrealized loss on securities available for sale				(10,498)	(10,498)
Unrealized gain on interest rate swap				861	861
Reclassification adjustment for losses realized in net income				355	355
Transfers to other state funds			(186,932)		(186,932)
BALANCE, DECEMBER 31, 2017	2,000	72,000	747,848	2,954	824,802
Net income			158,508		158,508
Unrealized loss on securities available for sale				(703)	(703)
Unrealized gain on interest rate swap				7,632	7,632
Reclassification adjustment for losses realized in net income				259	259
Transfers to other state funds			(128,614)		(128,614)
BALANCE, DECEMBER 31, 2018	<u>\$ 2,000</u>	<u>\$ 72,000</u>	<u>\$ 777,742</u>	<u>\$ 10,142</u>	<u>\$ 861,884</u>

BANK OF NORTH DAKOTA
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2018 AND 2017
(In Thousands)

	<u>2018</u>	<u>2017</u>
OPERATING ACTIVITIES		
Net income	\$ 158,508	\$ 145,284
Adjustments to reconcile net income to net cash from operating activities		
Depreciation and amortization	813	858
Provision for loan losses	12,000	12,000
Net amortization/(accretion) of securities	4,238	(7,455)
(Gain) loss on available-for-sale securities	(58)	55
Other than temporary impairment on equity securities	317	300
Gain on sale of residential and student loans	(1,620)	(108)
Write-off cost incurred for ND Financial Center	-	470
Loss (gain) on sale of foreclosed assets	(705)	43
Increase in interest receivable	(3,340)	(2,700)
Decrease (increase) in other assets	1,895	(5,756)
Increase in other liabilities	674	1,302
	<u>172,722</u>	<u>144,295</u>
NET CASH FROM OPERATING ACTIVITIES		
INVESTING ACTIVITIES		
Securities available for sale transactions		
Purchase of securities	(861,167)	(199,590)
Proceeds from sales, maturities, and principal repayments	603,033	599,311
Purchase of Federal Home Loan Bank stock	(250,080)	(140,600)
Sale of Federal Home Loan Bank stock	256,857	141,409
Purchase of other equity securities	(1,787)	(1,100)
Sale of other equity securities	712	602
Proceeds from sales of loans	283,647	7,561
Net (increase) decrease in loans	36,204	(137,172)
Purchases of premises and equipment	(143)	(305)
Payments from rebuilders loan program	3,394	3,793
Proceeds from sale of foreclosed assets	3,859	357
	<u>74,529</u>	<u>274,265</u>
NET CASH FROM INVESTING ACTIVITIES		
FINANCING ACTIVITIES		
Net increase (decrease) in non-interest bearing deposits	12,332	(108,136)
Net increase (decrease) in interest bearing deposits	152,529	(174,098)
Net increase (decrease) in federal funds purchased and repurchase agreements	(28,270)	57,295
Proceeds from issuance of short and long-term debt	6,377,000	3,515,001
Payment of short and long-term debt	(6,537,133)	(3,531,969)
Payment of transfers to other state funds	(128,614)	(186,932)
	<u>(152,156)</u>	<u>(428,839)</u>
NET CASH USED FOR FINANCING ACTIVITIES		
NET CHANGE IN CASH AND CASH EQUIVALENTS	95,095	(10,280)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	414,597	424,877
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 509,692	\$ 414,597

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Bank of North Dakota (BND) is owned and operated by the State of North Dakota under the supervision of the Industrial Commission as provided by Chapter 6-09 of the North Dakota Century Code. BND is a unique institution combining elements of banking, fiduciary, investment management services, and other financial services, and state government with a primary role in financing economic development. BND is a participation lender; the vast majority of its loans are purchased from financial institutions throughout the State of North Dakota. BND's primary deposit products are interest-bearing accounts for state and political subdivisions. Deposits held at the Bank are not covered by depository insurance, but rather are guaranteed by the State of North Dakota as described in NDCC Section 6-09-10.

Bank of North Dakota is included as part of the primary government in the State of North Dakota's reporting entity. As such, BND is required to follow the pronouncements of the Government Accounting Standards Board (GASB), which is the nationally accepted standard setting body for establishing generally accepted accounting principles for governmental entities.

However, the accompanying financial statements are prepared in accordance with Financial Accounting Standards Board Accounting Standards Codification, which are generally accepted accounting principles for financial institutions.

BND also prepares financial statements in accordance with GASB pronouncements.

Use of Estimates

In preparing financial statements in conformity with generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determinations of the allowance for loan losses and the fair market value of interest rate swaps.

Significant Group Concentrations of Credit Risk

Most of the Bank's lending activities are with customers within the State of North Dakota. The Bank's loan portfolio is comprised of the following concentrations as of December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Commercial loans, of which 2% and 2% are federally guaranteed	45%	43%
Student loans, of which 99% and 99% are guaranteed	26%	29%
Residential loans, of which 68% and 68% are federally guaranteed	15%	15%
Agricultural loans, of which 4% and 4% are federally guaranteed	14%	13%
	<u>100%</u>	<u>100%</u>

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents include cash and balances due from banks and federal funds sold, all with original maturities of three months or less.

Securities

Securities that may be sold before maturity in response to changes in interest rates or prepayment risk, or due to liquidity needs or changes in funding sources or terms are classified as available for sale. These securities are recorded at fair value, with unrealized gains and losses reported in equity. The changes in unrealized gains and losses are excluded from earnings and reported in other comprehensive income. Securities that management has the positive intent and ability to hold to maturity are classified as held to maturity and recorded at amortized cost.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issue for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

In order to borrow from the Federal Home Loan Bank (FHLB), the Bank is required to hold FHLB stock. The amount of stock that the Bank must hold is equal to .12% of total bank assets plus 4% of total FHLB advances. Since ownership of this stock is restricted, these securities are carried at cost and evaluated periodically for impairment.

Nonmarketable equity securities represent venture capital equity securities that are not publicly traded. The Bank reviews these assets at least annually for possible other-than-temporary impairment. These securities do not have a readily determinable fair value and are stated at cost. The Bank reduces the asset value when it considers declines in value to be other than temporary. The Bank would recognize any estimated loss as a loss from equity securities in the line item net gain/(loss) on available for sale securities included in non-interest expense. Other-than-temporary write-downs totaled \$317 and \$300 as of December 31, 2018 and 2017, respectively.

Loans Held For Sale

Mortgage loans held for sale are generally sold with the mortgage servicing rights retained by the Bank. The carrying value of the mortgage loans sold is reduced by the cost allocated to the associated mortgage servicing rights. Loans held for sale are carried at the lower of aggregate cost or market value. Gains or losses on sale of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

Loans

Loans are reported at the outstanding unpaid principal balances, adjusted for charge-offs, unamortized deferred fees and costs on originated loans and premiums or discounts on purchased loans. Interest income on loans is accrued at the specific rate on the unpaid principal balance. Unearned income, deferred fees and costs, and discounts and premiums are amortized to income over the estimated life of the loan using the interest or straight line method.

The accrual of interest is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. When interest accrual is discontinued, all unpaid accrued interest is reversed against interest income. Future payments are generally applied against principal until the loan balance is at zero. Any further payments are then recorded as interest income on the cash basis. Loans can be returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Credit Losses

The Bank uses the allowance method in providing for credit losses. Accordingly, the allowance is increased by the current year's provision for credit losses charged to operations and reduced by net charge-offs. Credit losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The adequacy of the allowance for credit losses and the provision for credit losses charged to operations are based on management's evaluation of a number of factors, including recent credit loss experience, continuous evaluation of the loan portfolio quality, current and anticipated economic conditions, and other pertinent factors. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and amount of the shortfall in relation to the principal and interest owed.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

Impairment is measured on a loan-by-loan basis for commercial participations, bank stock, all other business loans, farm and ranch, farm real estate, all other farm loans, and residential real estate loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual guaranteed student and residential loans for impairment disclosures, except for such loans that are placed on nonaccrual.

Loan Charge-Offs

Loans are generally fully or partially charged down to the fair value of collateral securing the asset when:

- An unsecured loan that has principal or interest 120 or more days past due.
- A loan secured by a commercial real estate mortgage, farm real estate mortgage, conventional real estate mortgage, or by other than real property that has principal or interest 120 or more day past due.
- A loan classified as a "loss" by the North Dakota Department of Financial Institutions.
- A loan where there is a recognized loss in conjunction with the acquisition of real estate by the Bank.
- A loan where the Bank deems itself insecure due to the financial condition of the borrower.
- A loan or portion of a loan has been forgiven.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Bank Premises, Equipment, and Software

Bank premises, equipment, hardware and software are stated at cost less accumulated depreciation or amortization. Depreciation and amortization are provided over the estimated useful lives of the individual assets using the straight-line method.

Foreclosed Assets

Foreclosed assets, which are included in other assets, represent assets acquired through loan foreclosure or other proceedings. Foreclosed assets are recorded at the lower of the amount of the loan or fair market value of the assets. Any write-down to fair market value at the time of the transfer to foreclosed assets is charged to the allowance for loan losses. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and change in the valuation allowance are included in other operating expenses. Foreclosed assets totaled \$4,152 and \$4,700 as of December 31, 2018 and 2017, respectively, and are included in other assets on the balance sheet.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

Derivatives and Hedging Activities

At the inception of a derivative contract, the Bank designates the derivative as one of three types based on the Bank's intentions and belief as to likely effectiveness as a hedge. These three types are (1) a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value hedge"), (2) a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow hedge"), or (3) an instrument with no hedging designation ("stand-alone derivative"). For a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item, are recognized in current earnings as fair values change. For a cash flow hedge, the gain or loss on the derivative is reported in other comprehensive income and is reclassified into earnings in the same periods during which the hedged transaction affects earnings. For both types of hedges, changes in the fair value of derivatives that are not highly effective in hedging the changes in fair value or expected cash flows of the hedged item are recognized immediately in current earnings. Changes in the fair value of derivatives that do not qualify for hedge accounting are reported currently in earnings, as non-interest income.

Net cash settlements on derivatives that qualify for hedge accounting are recorded in interest income or interest expense, based on the item being hedged. Net cash settlements on derivatives that do not qualify for hedge accounting are reported in non-interest income. Cash flows on hedges are classified in the cash flow statement the same as the cash flows of the items being hedged.

The Bank formally documents the relationship between derivatives and hedged items, as well as the risk-management objective and the strategy for undertaking hedge transactions at the inception of the hedging relationship. This documentation includes linking fair value or cash flow hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Bank also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivative instruments that are used are highly effective in offsetting changes in fair values or cash flows of the hedged items. The Bank discontinues hedge accounting when it determines that the derivative is no longer effective in offsetting changes in the fair value or cash flows of the hedged item, the derivative is settled or terminates, a hedged forecasted transaction is no longer probable, a hedged firm commitment is no longer firm, or treatment of the derivative as a hedge is no longer appropriate or intended.

When hedge accounting is discontinued, subsequent changes in fair value of the derivative are recorded as non-interest income. When a fair value hedge is discontinued, the hedged asset or liability is no longer adjusted for changes in fair value and the existing basis adjustment is amortized or accreted over the remaining life of the asset or liability. When a cash flow hedge is discontinued but the hedged cash flows or forecasted transactions are still expected to occur, gains or losses that were accumulated in other comprehensive income into earnings over the same periods which the hedged transactions will affect earnings.

Defined Benefit Plan

The Bank funds amounts equal to pension costs accrued.

Income Taxes

Bank of North Dakota is a governmental agency of the State of North Dakota and, as such, is not subject to federal or state income taxes.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

NOTE 2 - RESTRICTION AND CONCENTRATION ON CASH AND DUE FROM BANKS

Federal Reserve Board regulations require the Bank to maintain reserve balances with the Federal Reserve Bank. The average required reserve balances maintained at the Federal Reserve Bank were approximately \$73,917 in 2018 and \$52,979 in 2017.

The Bank has depository relationships where it is a requirement of the other institution in order to have a business relationship. Deposits at these institutions are insured up to \$250,000 with the Federal Deposit Insurance Corporation except for deposits with the Federal Reserve Bank and the Federal Home Loan Bank. The amount of cash deposits not covered by FDIC insurance was \$155,813 and \$96,317 as of December 31, 2018 and 2017, respectively. Of these amounts, \$153,465 and \$94,330 were deposited at the Federal Reserve Bank.

NOTE 3 - SECURITIES

Securities have been classified in the financial statements according to management's intent. The carrying value of securities as of December 31, 2018 and 2017 consists of the following:

	<u>2018</u>	<u>2017</u>
Securities available for sale, at fair value	\$ 1,853,806	\$ 1,600,296
Federal Home Loan Bank stock, at cost	52,539	59,316
Other equity securities, at cost	<u>6,398</u>	<u>5,640</u>
	<u>\$ 1,912,743</u>	<u>\$ 1,665,252</u>

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

The amortized cost and fair value of securities with gross unrealized gains and losses follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
DECEMBER 31, 2018				
Securities available for sale				
Federal agency	\$ 1,181,821	\$ 3,461	\$ 3,477	\$ 1,181,805
Mortgage-backed	671,144	1,798	1,941	671,001
State and municipal	1,000	-	-	1,000
	<u>\$ 1,853,965</u>	<u>\$ 5,259</u>	<u>\$ 5,418</u>	<u>\$ 1,853,806</u>
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
DECEMBER 31, 2017				
Securities available for sale				
Federal agency	\$ 1,005,369	\$ 3,071	\$ 3,202	\$ 1,005,238
Mortgage-backed	573,664	1,921	1,495	574,090
U.S. treasuries	19,978	-	10	19,968
State and municipal	1,000	-	-	1,000
	<u>\$ 1,600,011</u>	<u>\$ 4,992</u>	<u>\$ 4,707</u>	<u>\$ 1,600,296</u>

There were \$435,162 and \$687,203 of securities pledged as of December 31, 2018 and 2017 for other required pledging purposes. FHLB stock totaling \$52,539 and \$59,316 at December 31, 2018 and 2017, respectively, are pledged on the FHLB advances (Note 9).

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

The maturity distribution of debt securities at December 31, 2018, is shown below. The distribution of mortgage-backed securities is based on average expected maturities. Actual maturities may differ because issuers may have the right to call or prepay obligations.

	<u>Available for Sale</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>
Within one year	\$ 614,769	\$ 613,224
Over one year through five years	1,074,032	1,074,255
Over five years through ten years	104,573	105,115
Over ten years	<u>60,591</u>	<u>61,212</u>
	<u>\$ 1,853,965</u>	<u>\$ 1,853,806</u>

For the year ended December 31, 2018, proceeds from the sale of securities available for sale were \$25,522. Gross realized gains were \$58 on these sales. For the year ended December 31, 2017, proceeds from the sale of securities available for sale were \$308,830. Gross realized gains were \$14 on these sales. Gross realized losses were \$69 on these sales.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

Information pertaining to securities with gross unrealized losses at December 31, 2018 and 2017 aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	Less Than Twelve Months		Over Twelve Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
DECEMBER 31, 2018				
Securities available for sale				
Federal agency	\$ 583	\$ 147,988	\$ 2,894	\$ 565,764
Mortgage-backed	693	200,070	1,248	207,724
	<u>\$ 1,276</u>	<u>\$ 348,058</u>	<u>\$ 4,142</u>	<u>\$ 773,488</u>
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
DECEMBER 31, 2017				
Securities available for sale				
Federal agency	\$ 2,543	\$ 692,752	\$ 659	\$ 93,352
Mortgage-backed	700	293,686	795	112,447
U.S. treasuries	10	19,968	-	-
	<u>\$ 3,253</u>	<u>\$ 1,006,406</u>	<u>\$ 1,454</u>	<u>\$ 205,799</u>

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At December 31, 2018 and 2017, no available for sale securities were written down as other-than-temporary impairments. The unrealized loss position is primarily driven by changes in interest rates and not due to underlying credit losses. The Bank has evaluated and concluded that it does not intend to sell any of these securities, and that it is more likely than not that it will not be required to sell prior to recovery.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

NOTE 4 - LOANS

The composition of the loan portfolio at December 31, 2018 and 2017 is as follows:

	<u>2018</u>	<u>2017</u>
Commercial	\$ 2,039,833	\$ 2,071,953
Student	1,184,132	1,405,941
Residential	694,577	762,480
Agricultural	<u>665,691</u>	<u>668,904</u>
	4,584,233	4,909,278
Allowance for loan losses	<u>(92,750)</u>	<u>(84,958)</u>
	<u>\$ 4,491,483</u>	<u>\$ 4,824,320</u>

Unamortized deferred student loan costs totaled \$14,476 and \$14,788 as of December 31, 2018 and 2017, respectively. Net unamortized loan premiums and discounts, including purchased servicing rights, on residential loans totaled \$904 and \$1,421 as of December 31, 2018 and 2017, respectively.

In the normal course of business, overdrafts of deposit accounts are reclassified as loans. There were no overdrafts of deposit accounts at December 31, 2018 and 2017.

Management has an established methodology to determine the adequacy of the allowance for credit losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for credit losses, the Bank has segmented certain loans in the portfolio by product type. Loans are segmented into the following pools: commercial, agricultural, residential real estate, and student loans. The Bank also sub-segments the commercial and agricultural segments into classes based on the associated risks within those segments. Commercial loans are divided into three classes: commercial participations, bank stock, and all other business loans (including PACE). Agricultural loans are also divided into three classes: farm & ranch, farm real estate, and all other farm loans. Each class of loan exercises significant judgment to determine the estimation method that fits the credit risk characteristics of its portfolio segment.

The adequacy of the allowance for credit losses and the provision for credit losses charged to operations are based on management's evaluation of a number of factors, including recent credit loss experience, continuous evaluation of the loan portfolio quality, current and anticipated economic conditions, and other pertinent factors. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. Changes in the allowance for credit loss and the related provision expense can materially affect net income.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

The total allowance reflects management's estimate of credit losses inherent in the loan portfolio at the balance sheet date. The Bank considers the allowance for credit losses of \$92,750 adequate to cover loan losses inherent in the loan portfolio at December 31, 2018. The following tables represent, by portfolio segment, the changes in the allowance for credit losses and the recorded investment in loans.

	2018				
	<u>Commercial</u>	<u>Agricultural</u>	<u>Residential</u>	<u>Student</u>	<u>TOTAL</u>
Beginning Balance:	\$ 65,712	\$ 16,395	\$ 2,490	\$ 361	\$ 84,958
Charge-offs	(5,977)	-	(131)	(49)	(6,157)
Recoveries	1,944	1	2	2	1,949
Provision	10,939	588	744	(271)	12,000
Ending Balance	<u>\$ 72,618</u>	<u>\$ 16,984</u>	<u>\$ 3,105</u>	<u>\$ 43</u>	<u>\$ 92,750</u>

	2017				
	<u>Commercial</u>	<u>Agricultural</u>	<u>Residential</u>	<u>Student</u>	<u>TOTAL</u>
Beginning Balance:	\$ 58,267	\$ 17,070	\$ 2,431	\$ 979	\$ 78,747
Charge-offs	(5,887)	-	(238)	(459)	(6,584)
Recoveries	787	7	-	1	795
Provision	12,545	(682)	297	(160)	12,000
Ending Balance	<u>\$ 65,712</u>	<u>\$ 16,395</u>	<u>\$ 2,490</u>	<u>\$ 361</u>	<u>\$ 84,958</u>

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

The following tables disaggregate the Bank's allowance for credit losses by impairment methodology.

	2018				
	<u>Commercial</u>	<u>Agricultural</u>	<u>Residential</u>	<u>Student</u>	<u>TOTAL</u>
Collectively evaluated	\$ 53,746	\$ 16,004	\$ 3,105	\$ 43	\$ 72,898
Individually evaluated	18,872	980	-	-	19,852
Total	\$ 72,618	\$ 16,984	\$ 3,105	\$ 43	\$ 92,750

	2017				
	<u>Commercial</u>	<u>Agricultural</u>	<u>Residential</u>	<u>Student</u>	<u>TOTAL</u>
Collectively evaluated	\$ 53,388	\$ 16,058	\$ 2,490	\$ 361	\$ 72,297
Individually evaluated	12,324	337	-	-	12,661
Total	\$ 65,712	\$ 16,395	\$ 2,490	\$ 361	\$ 84,958

The following tables disaggregate the Bank's loan portfolio by impairment methodology.

	2018				
	<u>Commercial</u>	<u>Agricultural</u>	<u>Residential</u>	<u>Student</u>	<u>TOTAL</u>
Collectively evaluated	\$1,768,131	\$ 596,230	\$ 689,726	\$ 43	\$3,054,130
Individually evaluated	77,618	43,019	4,818	-	125,455
Loan types excluded from allowance	194,084	26,442	33	1,184,089	1,404,648
Total	\$2,039,833	\$ 665,691	\$ 694,577	\$1,184,132	\$4,584,233

	2017				
	<u>Commercial</u>	<u>Agricultural</u>	<u>Residential</u>	<u>Student</u>	<u>TOTAL</u>
Collectively evaluated	\$ 1,815,189	\$ 600,857	\$ 758,406	\$ 249,309	\$ 3,423,761
Individually evaluated	63,094	43,608	4,027	-	110,729
Loan types excluded from allowance	193,670	24,439	47	1,156,632	1,374,788
Total	\$ 2,071,953	\$ 668,904	\$ 762,480	\$ 1,405,941	\$ 4,909,278

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

The Bank's internally assigned ratings are as follows:

	Risk Code	Description
Exceptional	1	Loan considered prime on the basis of very substantial financial capacity with minimal risk of non payment.
Excellent	2	Loan considered sound on the basis of strong financial capacity with little or no apparent weakness and very limited risk of non payment. The probability of serious financial deterioration is highly unlikely.
Good	3	Loan may reveal weaknesses in some areas, however, not of a serious nature and the debt remains collectible in its entirety. The collateral may be characterized as being less marketable than that of a higher rated borrower.
Acceptable	4	Bank feels that the credit risk is acceptable, but may require above average officer attention. Credit in this class exhibit the earliest signs of potential problems. A greater reliance will be placed on the quality and marketability of the underlying collateral as the cash flow may be unproven or somewhat erratic.
Special Mention	5	May be bankable based on certain types of loan programs which fall within the Bank's mission. This type of loan may be currently protected, but has potential unrealized weaknesses. The loan will require close monitoring as deterioration remains a strong possibility. The potential problems must remain manageable and must not pose a serious threat to repayment.
Substandard	6	Well defined weaknesses jeopardize orderly repayment. The loan is no longer protected by sound net worth or repayment capacity of the borrower. Even though elements of loss are present, the borrower can potentially repay if deficiencies are corrected. Close monitoring of this type of loan is extremely important to prevent loss to the Bank.
Doubtful	7	Loan had deteriorated to the point where collection or liquidation in full on the basis of current information, conditions and values is highly questionable and improbable. A doubtful classification is warranted during this period of quantifying/defining the amount of exposure or loss. A well defined corrective action or liquidation plan should be developed and implemented as soon as possible to limit further loss potential for the Bank.
Loss	8	Loan is considered uncollectible and of such value that it should be charged-off. This classification does not mean that the asset has no recovery or salvage value.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

The following table represents credit exposures by internally assigned risk ratings for the years ended December 31, 2018 and 2017. The rating analysis estimates the capability of the borrower to repay the contractual obligations of the loan agreements as scheduled or at all. The Bank's internal credit risk rating is based on experiences with similarly rated loans. Credit risk ratings are refreshed periodically as they become available, at which time management analyzes the resulting scores, as well as other external statistics and factors, to track loan performance.

2018					
<u>Risk Rating</u>	Commercial Participations	Bank Stock	Business Loans (Including PACE)	Farm & Ranch	Farm Real Estate
No assigned risk rating	\$ -	\$ -	\$ -	\$ -	\$ -
1	-	-	-	-	-
2	251	-	140,677	6,097	130
3	229,485	191,660	89,187	47,433	57,842
4	707,588	44,083	233,365	88,227	234,861
5	95,274	-	24,725	19,639	26,685
6	72,951	-	3,531	4,491	1,879
7	10,250	-	2,703	628	-
8	19	-	-	-	-
Loan types excluded from allowance	-	-	194,084	-	-
Total	\$ 1,115,818	\$ 235,743	\$ 688,272	\$ 166,515	\$ 321,397

<u>Risk Rating</u>	All Other Farm Loans	Residential Real Estate	Student Loans	Total
No assigned risk rating	\$ -	\$ 694,544	\$ 43	\$ 694,587
1	-	-	-	-
2	1,944	-	-	149,099
3	17,847	-	-	633,454
4	84,966	-	-	1,393,090
5	37,866	-	-	204,189
6	8,612	-	-	91,464
7	102	-	-	13,683
8	-	-	-	19
Loan types excluded from allowance	26,442	33	1,184,089	1,404,648
Total	\$ 177,779	\$ 694,577	\$ 1,184,132	\$ 4,584,233

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

2017					
Risk Rating	Commercial Participations	Bank Stock	All Other Business Loans (Including PACE)	Farm & Ranch	Farm Real Estate
No assigned risk rating	\$ -	\$ -	\$ -	\$ -	\$ -
1	-	-	-	-	-
2	1,916	-	224,459	2,016	80
3	209,536	159,056	79,914	42,857	57,978
4	737,525	70,299	211,341	102,067	200,434
5	87,622	-	26,071	32,598	34,850
6	59,190	-	5,801	5,297	719
7	4,846	-	707	366	-
8	-	-	-	-	-
Loan types excluded from allowance	-	-	193,670	-	-
Total	\$ 1,100,635	\$ 229,355	\$ 741,963	\$ 185,201	\$ 294,061

Risk Rating	All Other Farm Loans	Residential Real Estate	Student Loans	Total
No assigned risk rating	\$ -	\$ 762,433	\$ 249,309	\$ 1,011,742
1	-	-	-	-
2	741	-	-	229,212
3	16,040	-	-	565,381
4	86,999	-	-	1,408,665
5	51,892	-	-	233,033
6	9,184	-	-	80,191
7	347	-	-	6,266
8	-	-	-	-
Loan types excluded from allowance	24,439	47	1,156,632	1,374,788
Total	\$ 189,642	\$ 762,480	\$ 1,405,941	\$ 4,909,278

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

Following are tables which include an aging analysis of the recorded investment of past due financing receivables as of December 31, 2018 and 2017. Also included are loans that are 90 days or more past due as to interest and principal and still accruing, because they are (1) well-secured and in the process of collection, (2) real estate loans or loans exempt under regulatory rules from being classified as nonaccrual or (3) student loans where accrued interest is guaranteed.

Loan Class	2018						
	31-60 days past due	61 - 90 days past due	Greater than 90 days	Total Past Due	Current	Total Loans	Investment >90 days and accruing
Commercial							
Participations	\$ 10,903	\$ 1,304	\$ 13,853	\$ 26,060	\$1,089,758	\$1,115,818	\$ -
Bank Stock	-	-	-	-	235,743	235,743	-
All other Business							
Loans (Including							
PACE)	1,560	557	3,109	5,226	683,046	688,272	242
Farm & Ranch	5,396	-	1,360	6,756	159,759	166,515	1,359
Farm Real Estate	1,908	924	-	2,832	318,565	321,397	-
All other Farm loans	69	-	30	99	177,680	177,779	-
Residential Real							
Estate	15,753	5,422	11,620	32,795	661,782	694,577	11,518
Student Loans	6,561	2,749	15,221	24,531	1,159,601	1,184,132	15,178
Totals	\$ 42,150	\$ 10,956	\$ 45,193	\$ 98,299	\$ 4,485,934	\$ 4,584,233	\$ 28,297

Loan Class	2017						
	31-60 days past due	61 - 90 days past due	Greater than 90 days	Total Past Due	Current	Total Loans	Investment >90 days and accruing
Commercial							
Participations	\$ 3,473	\$ -	\$ 11,080	\$ 14,553	\$ 1,086,082	\$ 1,100,635	\$ 2,443
Bank Stock	-	-	-	-	229,355	229,355	-
All other Business							
Loans (Including							
PACE)	3,420	97	5,280	8,797	733,166	741,963	4,235
Farm & Ranch	2,002	-	366	2,368	182,833	185,201	-
Farm Real Estate	2,440	-	153	2,593	291,468	294,061	153
All other Farm loans	380	1,081	362	1,823	187,819	189,642	15
Residential Real							
Estate	20,308	6,307	14,246	40,861	721,619	762,480	14,246
Student Loans	16,942	5,903	23,133	45,978	1,359,963	1,405,941	23,076
Totals	\$ 48,965	\$ 13,388	\$ 54,620	\$ 116,973	\$ 4,792,305	\$ 4,909,278	\$ 44,168

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

Management considers a loan to be impaired when, based on current information and events, it is determined that the Bank will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. Determination of impairment is treated the same across all classes of loans. When management identifies a loan as impaired, the impairment is measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In these cases management uses the current fair value of the collateral, less selling costs when foreclosure is probable, instead of discounted cash flows. If management determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized through an allowance estimate or a charge-off to the allowance.

When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is on nonaccrual status, all payments are applied to principal, under the cost recovery method. When the ultimate collectability of the total principal of an impaired loan is not in doubt and the loan is on nonaccrual status, contractual interest is credited to interest income when received, under the cash basis method.

The following tables include the recorded investment and unpaid principal balances for impaired financing receivables with the associated allowance amount, if applicable. Management determined the specific allowance based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the remaining source of repayment for the loan is the operation or liquidation of the collateral. In those cases, the current fair value of the collateral, less selling costs was used to determine the specific allowance recorded.

Also presented are the average recorded investments in the impaired loans during the time within the period that the impaired loans were impaired. When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is on nonaccrual status, all payments are applied to principal, under the cost recovery method. When the ultimate collectability of the total principal of an impaired loan is not in doubt and the loan is on nonaccrual status, contractual interest is credited to interest income when received, under the cash basis method.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

Loan Class	2018				
	Recorded Investment	Unpaid Principal Balance (1)	Associated Allowance	Average Recorded Investment	Interest Income Recognized
With No Specific Allowance Recorded:					
Commercial Participations	\$ 22,658	\$ 22,658	\$ -	\$ 22,847	\$ 902
Bank Stock	307	307	-	391	16
All other Business Loans (Including PACE)	2,175	2,175	-	2,235	105
Farm & Ranch	11,406	11,406	-	11,678	192
Farm Real Estate	2,513	2,513	-	2,542	139
All other Farm loans	25,421	25,421	-	26,649	1,102
Residential Real Estate	4,818	4,818	-	4,857	182
With an Allowance Recorded:					
Commercial Participations	\$ 49,285	\$ 50,418	\$ 17,833	\$ 53,065	\$ 1,670
Bank Stock	-	-	-	-	-
All other Business Loans (Including PACE)	3,193	4,717	1,039	4,745	23
Farm & Ranch	2,078	2,078	603	2,100	-
Farm Real Estate	-	-	-	-	-
All other Farm loans	1,601	1,601	377	1,651	39
Residential Real Estate	-	-	-	-	-
Totals:					
Commercial Participations	\$ 71,943	\$ 73,076	\$ 17,833	\$ 75,912	\$ 2,572
Bank Stock	307	307	-	391	16
All other Business Loans (Including PACE)	5,368	6,892	1,039	6,980	128
Farm & Ranch	13,484	13,484	603	13,778	192
Farm Real Estate	2,513	2,513	-	2,542	139
All other Farm loans	27,022	27,022	377	28,300	1,141
Residential Real Estate	4,818	4,818	-	4,857	182

(1) Represents the borrower's loan obligation, gross of any previously charged-off amounts.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

Loan Class	2017				
	Recorded Investment	Unpaid Principal Balance (1)	Associated Allowance	Average Recorded Investment	Interest Income Recognized
With No Specific Allowance Recorded:					
Commercial Participations	\$ -	\$ -	\$ -	\$ -	\$ -
Bank Stock	434	434	-	512	19
All other Business Loans (Including PACE)	-	-	-	-	-
Farm & Ranch	-	-	-	-	-
Farm Real Estate	2,514	2,514	-	2,521	100
All other Farm loans	-	-	-	-	-
Residential Real Estate	4,027	4,027	-	4,055	161
With an Allowance Recorded:					
Commercial Participations	\$ 56,207	\$ 60,083	\$ 9,524	\$ 62,302	\$ 2,120
Bank Stock	-	-	-	-	-
All other Business Loans (Including PACE)	6,452	6,452	2,800	6,581	257
Farm & Ranch	13,176	13,176	210	13,587	638
Farm Real Estate	-	-	-	-	-
All other Farm loans	27,918	27,918	127	28,591	1,017
Residential Real Estate	-	-	-	-	-
Totals:					
Commercial Participations	\$ 56,207	\$ 60,083	\$ 9,524	\$ 62,302	\$ 2,120
Bank Stock	434	434	-	512	19
All other Business Loans (Including PACE)	6,452	6,452	2,800	6,581	257
Farm & Ranch	13,176	13,176	210	13,587	638
Farm Real Estate	2,514	2,514	-	2,521	100
All other Farm loans	27,918	27,918	127	28,591	1,017
Residential Real Estate	4,027	4,027	-	4,055	161

(1) Represents the borrower's loan obligation, gross of any previously charged-off amounts.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

A loan which meets any of the following criteria must be placed in a non-accrual status:

- The following loans on which the principal and interest is 90 or more days past due: Unsecured loans, loans secured by other than real property, loans secured by a mortgage on commercial real estate, loans secured by a farm real estate mortgage, loans secured by a conventional residential real estate mortgage.
- A loan where the borrower has filed for bankruptcy or where the lead bank or the Bank deems itself insecure due to the financial condition of the borrower.
- A loan which the North Dakota Department of Financial Institutions recommends to be placed in a non-accrual status.

A loan which meets the criteria for non-accrual status may be retained in accrual status if it is (1) guaranteed or insured by the state or federal government or secured by collateral with a fair market value sufficient to discharge the outstanding principal and interest and (2) in the process of collection supported by a document source of collection.

A loan which has been placed in a non-accrual status may be returned to an accrual status only if principal and interest are no longer due and unpaid and if current principal and interest appear to be collectable. In addition, the loan must either be secured by collateral with a fair market value sufficient to discharge the outstanding principal and interest or the borrower must demonstrate through a documented repayment plan the ability to discharge the outstanding principal and interest.

On the following table are the financing receivables on nonaccrual status as of December 31, 2018 and 2017. The balances are presented by class of financing receivable.

	<u>2018</u>	<u>2017</u>
Commercial Participations	\$ 21,001	\$ 12,782
Bank Stock	-	-
All Other Business Loans (Including PACE)	3,039	1,404
Farm & Ranch	1,350	1,166
Farm Real Estate	-	-
All Other Farm Loans	471	347
Residential Real Estate	102	-
Student Loans	43	57
TOTAL	<u>\$ 26,006</u>	<u>\$ 15,756</u>

Accruing loans 90 days or more past due include guaranteed student loans of \$15,178 and \$23,076 as of December 31, 2018 and 2017, respectively. The Bank is entitled to reimbursement from the guarantor 270 days after default in the case of a student loan payable in monthly installments and 330 days in the case of a student loan payable in less frequent installments.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

Residential loans of \$11,518 and \$14,246 as of December 31, 2018 and 2017, respectively, are also included in accruing loans 90 days or more past due. In the event of a foreclosure a residential loan guaranteed by the Federal Housing Administration will be paid in full and the property title is transferred to them with the exception of flooded properties. The Department of Veterans Affairs has the option of paying their guaranty percentage and the Bank keeps the foreclosed property as well as any gain or loss from the sale or they can pay the loan in full and title is transferred to them.

The Bank's loan portfolio also includes certain loans that have been modified in a Trouble Debt Restructuring (TDR), where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from the Bank's loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months.

When the Bank modifies a loan, management evaluates any possible impairment based on the present value of expected future cash flows, discounted at the contractual interest rate of the original loan agreement, except when the sole (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In these cases management uses the current fair value of the collateral, less selling costs, instead of discounted cash flows. If management determines that the value of the modified loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized by segment or class of loan, as applicable, through an allowance estimate or a charge-off to the allowance. Segment and class status is determined by the loan's classification at origination.

The following table presents information related to loans modified in a troubled debt restructuring during the years ended December 31, 2018 and 2017. Seven of these loans subsequently defaulted after modification.

	2018		2017	
	Number of Modifications	Recorded Investment	Number of Modifications	Recorded Investment
Commercial Participations	17	\$ 22,633	6	\$ 10,329
Bank Stock	-	-	-	-
All Other Business Loans (Including PACE)	4	1,501	6	5,102
Farm & Ranch	6	4,019	9	6,711
Farm Real Estate	-	-	1	1,286
All Other Farm Loans	10	7,824	6	2,744
Residential Real Estate	9	1,098	21	3,265
Student Loans	-	-	-	-
TOTAL	46	\$ 37,075	49	\$ 29,437

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

The following table presents the unpaid principal of loans modified in a troubled debt restructuring during the years ended December 31, 2018 and 2017, by type of modification.

	2018			
	To Interest Only	Below Market Rate	Other (1)	Total
Commercial Participations	\$ 4,033	\$ 4,751	\$ 13,849	\$ 22,633
Bank Stock	-	-	-	-
All Other Business Loans (Including PACE)	-	304	1,197	1,501
Farm & Ranch	-	-	4,019	4,019
Farm Real Estate	-	-	-	-
All Other Farm Loans	3,461	-	4,363	7,824
Residential Real Estate	-	-	1,098	1,098
Student Loans	-	-	-	-
TOTAL	\$ 7,494	\$ 5,055	\$ 24,526	\$ 37,075

	2017			
	To Interest Only	Below Market Rate	Other (1)	Total
Commercial Participations	\$ -	\$ -	\$ 10,329	\$ 10,329
Bank Stock	-	-	-	-
All Other Business Loans (Including PACE)	169	-	4,933	5,102
Farm & Ranch	-	-	6,711	6,711
Farm Real Estate	-	-	1,286	1,286
All Other Farm Loans	-	-	2,744	2,744
Residential Real Estate	-	-	3,265	3,265
Student Loans	-	-	-	-
TOTAL	\$ 169	\$ -	\$ 29,268	\$ 29,437

(1) Other modifications include reamortization of payments, extended maturity and reduction of interest rate.

There were no material commitments to lend additional funds to customers whose loans were classified as impaired or restructured at December 31, 2018 and 2017.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

NOTE 5 - LOAN SALES AND LOAN SERVICING

A summary of BND loan sales during 2018 and 2017 follows:

	<u>2018</u>	<u>2017</u>
Student loans sold on the secondary market	\$ 245,663	\$ -
Residential loans sold on the secondary market	<u>28,905</u>	<u>7,453</u>
	<u>\$ 274,568</u>	<u>\$ 7,453</u>

BND recognized gains on sale of loans of \$1,620 in 2018 and \$108 in 2017 which is included in non-interest income on the Statements of Income.

BND has contracts to provide servicing of loans for others. These loans are not included in the accompanying balance sheets. The unpaid principal balances of loans serviced for others as of December 31, 2018 and 2017 were as follows:

	<u>2018</u>	<u>2017</u>
Student loans		
North Dakota Student Loan Trust	\$ 1,033	\$ 1,357
Residential loans		
Fannie Mae	44,523	46,587
Other state fund loans		
School Construction Assistance Revolving Loan Fund	188,000	155,237
Western Area Water	74,500	74,500
Infrastructure Revolving Loan Fund	77,896	44,722
Medical Facility Infrastructure Loan Fund	45,836	43,847
Rebuilders Loan Program	28,152	31,567
State Water Commission	24,137	22,179
Community Water Facility Loan Fund	21,344	22,163
Board of University and School Lands	13,560	8,520
Information Technology Department	4,753	6,050
Department of Human Services	4,622	5,125
Addiction Counseling Internship Loan Program	123	114
Workforce Safety	<u>93</u>	<u>112</u>
	<u>\$ 528,572</u>	<u>\$ 462,080</u>

Under existing student loan servicing agreements, the Bank generally agrees to reimburse lenders for all principal, accrued interest and special allowance which the lender has been denied if the denial resulted from the actions or inactions of the Bank. Under the existing residential loan servicing agreement with Fannie Mae, the Bank will indemnify Fannie Mae and hold them harmless against all losses, damages, judgments or legal expenses that result from the Bank's failure in any way to perform its services and duties.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

NOTE 6 - BANK PREMISES, EQUIPMENT, AND SOFTWARE

A summary of changes in bank premises, equipment, furniture, and software at December 31, 2018 and 2017 is as follows:

	Balance 2017	Additions	Retirements	Balance 2018
Land	\$ 2,449	\$ -	\$ -	\$ 2,449
Building	10,317	-	-	10,317
Equipment	736	22	27	731
Furniture	777	-	-	777
Hardware	173	-	-	173
Software	6,122	121	-	6,243
	<u>20,574</u>	<u>143</u>	<u>27</u>	<u>20,690</u>
Less accumulated depreciation	<u>9,655</u>	<u>813</u>	<u>27</u>	<u>10,441</u>
	<u>\$ 10,919</u>	<u>\$ (670)</u>	<u>\$ -</u>	<u>\$ 10,249</u>

	Balance 2016	Additions	Retirements	Balance 2017
Land	\$ 2,449	\$ -	\$ -	\$ 2,449
Building	10,787	-	470	10,317
Equipment	754	-	18	736
Furniture	705	73	1	777
Hardware	173	-	-	173
Software	5,890	232	-	6,122
	<u>20,758</u>	<u>305</u>	<u>489</u>	<u>20,574</u>
Less accumulated depreciation	<u>8,816</u>	<u>858</u>	<u>19</u>	<u>9,655</u>
	<u>\$ 11,942</u>	<u>\$ (553)</u>	<u>\$ 470</u>	<u>\$ 10,919</u>

Depreciation and amortization expense on the above assets amounted to \$813 and \$858 in 2018 and 2017.

NOTE 7 - DEPOSITS

At December 31, 2018, the scheduled maturities of certificates of deposits are as follows:

One year or less	\$ 2,559,339
One to three years	90,129
Over three years	<u>85,500</u>
	<u>\$ 2,734,968</u>

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

NOTE 8 - REPURCHASE AGREEMENTS

The Bank enters into agreements to repurchase the same securities that it previously sold. These agreements may have a fixed maturity or be open-ended, callable at any time. There were no repurchase agreements as of December 31, 2018 and 2017.

NOTE 9 - SHORT AND LONG-TERM DEBT

Short and long-term debt consists of:

	<u>2018</u>	<u>2017</u>
Federal Home Loan Bank advances - long-term	\$ 426,375	\$ 463,450
Federal Home Loan Bank advances - short-term	677,000	800,000
ND Public Finance Authority, 3%, matures from September 2019 through September 2021	<u>61</u>	<u>120</u>
	<u>\$ 1,103,436</u>	<u>\$ 1,263,569</u>

A summary, by years, of future minimum payments required to amortize the outstanding short and long-term debt is as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2019	\$ 724,335	\$ 13,385	\$ 737,720
2020	27,560	11,342	38,902
2021	100,793	9,857	110,650
2022	61,035	6,710	67,745
2023	108,295	4,965	113,260
Later years	<u>81,418</u>	<u>4,898</u>	<u>86,316</u>
Totals	<u>\$ 1,103,436</u>	<u>\$ 51,157</u>	<u>\$ 1,154,593</u>

The FHLB long-term advances outstanding at December 31, 2018, mature from October 2019 through October 2029. The FHLB long-term advances have fixed rate interest, ranging from 1.61% to 5.56%. All FHLB advances must be secured by minimum qualifying collateral maintenance levels. Residential, agriculture, and commercial loans with carrying values of \$1,466,515 and \$1,608,672 at December 31, 2018 and 2017, respectively, are currently being used as security to meet these minimum levels.

The money borrowed from the ND Public Finance Authority is unsecured and was used to fund irrigation and livestock waste program loans.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

NOTE 10 - OTHER LIABILITIES

Other liabilities consist of:

	<u>2018</u>	<u>2017</u>
Interest payable	\$ 1,367	\$ 1,697
Salary and benefits payable	2,668	1,270
Interest rate swap payable	2,544	4,227
Accounts payable, accrued expenses and other liabilities	<u>2,610</u>	<u>3,004</u>
	<u>\$ 9,190</u>	<u>\$ 10,198</u>

NOTE 11 - PENSION PLAN

Bank of North Dakota participates in the North Dakota Public Employees' Retirement System (NDPERS) administered by the State of North Dakota. Following is a brief description of the plan.

NDPERS is a multi-employer defined benefit pension plan covering substantially all classified employees of Bank of North Dakota. The Plan provides retirement, disability, and death benefits. If an active employee dies with less than three years of credited service, a death benefit equal to the value of the employee's accumulated contributions, plus interest, is paid to the employee's beneficiary. If the employee has earned more than three years of credited service, the surviving spouse will be entitled to a single payment refund, lifetime monthly payments in an amount equal to 50% of the employee's accrued normal retirement benefit, 60 monthly payments equal to the employee's accrued normal retirement benefit calculated as if the employee were age 65 the day before death occurred, or monthly payments in an amount equal to the employee's accrued 100% joint and survivor retirement benefit if the member had reached normal retirement age prior to date of death. If the surviving spouse dies before the employee's accumulated pension benefits are paid, the balance will be payable to the surviving spouse's designated beneficiary.

Eligible employees who become totally disabled after a minimum of 180 days of service receive monthly disability benefits that are equal to 25% of their final average salary with a minimum benefit of \$100. To qualify under this section, the employee must meet the criteria established by the Retirement Board for being considered totally disabled.

Employees are entitled to unreduced monthly pension benefits equal to 2.0% of their final average salary for each year of service beginning when the sum of age and years of credited service equal or exceed 85, or at normal retirement age (65). For employee with an effective employment date on and after January 1, 2016, pension benefits will begin when the sum of age and years of credited service equal or exceed 90, or at normal retirement age (65). The Plan permits early retirement at ages 55-64, with five or more years of service.

Benefit and contribution provisions are administered in accordance with chapter 54-52 of the North Dakota Century Code. This state statute requires that 5% of the participant's salary be contributed to the Plan by either the employee or by the employer under a "salary reduction" agreement. Bank of North Dakota is required to contribute 7.12% of each participant's salary as the employer's share. In addition to the 7.12% employer contribution, the employer is required to contribute 1.14% of each participating employee's gross wage to a prefunded retiree health insurance program. The required contributions are determined using an entry age normal actuarial funding method. The North Dakota Retirement Board was created by the State Legislature and is the

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

governing authority of NDPERS. Bank of North Dakota's required and actual contributions to NDPERS for the fiscal years ending December 31, 2018 and 2017 were approximately \$1,399 and \$1,383, respectively, and are charged directly to operations. There were no surcharges paid by the Bank to the Plan in 2018 and 2017.

Specific plan assets and accumulated benefit information for the Bank's portion of the fund is not available. Under the Employee Retirement Income and Security Act of 1974 ("ERISA"), a contributor to a multi-employer pension plan may be liable in the event of complete or partial withdrawal for the benefit payments guaranteed under ERISA, but there is no intention to withdraw. NDPERS operates as a multi-employer plan for accounting purposes and as a multiple-employer plan under ERISA and the Internal Revenue Code. There are no collective bargaining agreements in place that require contributions to the Plan. As of December 31, 2018 and 2017, there were no funding improvement plans or rehabilitation plans implemented. The Plan is a single plan under Internal Revenue Code 413(c) and, as a result, all of the assets stand behind all of the liabilities. Accordingly, contributions made by a participating employer may be used to provide benefits to participants of other participating employers.

NDPERS issues a publicly available financial report that includes financial statements and the required supplementary information for NDPERS. The Bank's contributions to the Plan do not represent more than 5 percent of total contributions to the Plan as indicated in the Plan's most recently available annual report as of June 30, 2018. That report may be obtained by writing to NDPERS; 400 East Broadway, Suite 505; PO Box 1657; Bismarck, ND 58502-1657.

NOTE 12 - COMMITMENTS AND CONTINGENT LIABILITIES

Legislative Action – Various legislative bills provide state agencies the authority to borrow money from the Bank of North Dakota during the biennium beginning July 1, 2017 and ending June 30, 2019. Following is a summary of legislative action and/or North Dakota Statute in effect:

S.B. 2014, Section 9 – The industrial commission shall transfer to the general fund \$140,000 from the current earnings and the accumulated undivided profits of the Bank of North Dakota during the biennium beginning July 1, 2017, and ending June 30, 2019. The moneys must be transferred in the amounts and at the times requested by the director of the office of management and budget after consultation with the Bank of North Dakota president. As of December 31, 2018, the Bank had transferred \$140,000.

S.B. 2014, Section 10 – The Bank shall transfer up to \$16,000 from its current earnings and undivided profits to the Partnership in Assisting Community Expansion Fund. As of December 31, 2018, the Bank had transferred \$11,750.

S.B. 2014, Section 11 – The Bank shall transfer up to \$2,000 from its current earnings and undivided profits to the Agriculture Partnership in Assisting Community Expansion Fund. As of December 31, 2018, the Bank had transferred \$500.

S.B. 2014, Section 12 – The Bank shall transfer up to \$1,000 from its current earnings and undivided profits to the Biofuels Partnership in Assisting Community Expansion Fund. As of December 31, 2018, the Bank had transferred \$100.

S.B. 2014, Section 13 – The Bank shall transfer up to \$6,000 from its current earnings and undivided profits to the Beginning Farmer Revolving Loan Fund. As of December 31, 2018, the Bank had transferred \$2,750.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

S.B. 2014, Section 14 – The Bank shall transfer up to \$6,000 from its current earnings and undivided profits for interest rate buydowns on outstanding school construction loans. As of December 31, 2018, the Bank had transferred \$4,497.

S.B. 2014, Section 22 – The Bank of North Dakota’s budget approved during the 2015-2017 Session included \$17,000 from the assets of the Bank of North Dakota which could be used for the purpose of constructing a North Dakota Financial Center on a site adjacent to the existing building on which the Bank is located. Legislation passed during that Session stated that the Bank may spend the funding only if the Bank's net income, reported in accordance with Financial Accounting Standards Board accounting standards, for calendar year 2015 exceeds \$125,000. The Bank’s net income exceeded this threshold as of December 31, 2015. During the 2017-2019 Session, language was modified to state that the funding appropriated for this purpose is available through June 30, 2021. Cost incurred through December 31, 2017 totaled \$470. No additional costs were incurred through December 31, 2018.

S.B. 2014, Section 28 – In regards to the North Dakota financial center, Section 28 further states that the Bank of North Dakota may not construct a North Dakota financial center on a site adjacent to the existing building on which the Bank of North Dakota is located related to the funding provided in section 1 of chapter 14 of the 2015 Session Laws and identified in sections 2 and 26 of chapter 14 of the 2015 Session Laws until after June 30, 2019. No such construction took place during 2018.

H.B. 1015, Section 20 – The state treasurer and the director of the office of management and budget may, when the balance in the state general fund is insufficient to meet legislative appropriations, borrow from the Bank of North Dakota in an amount that at no time exceeds the total principal amount of \$50,000 with principal maturity not to extend beyond the biennium in which the borrowing occurs. The state industrial commission may direct the Bank of North Dakota to make loans to the state general fund at such rates of interest as the industrial commission may prescribe. The state treasurer and the director of the office of management and budget shall establish a repayment plan for the repayment of the principal upon maturity and the interest when due. The office of management and budget shall report to the budget section of the legislative management regarding any loans obtained pursuant to this section. As of December 31, 2018, there was no outstanding loan balance.

H.B. 1018, Section 7 – Session Law from the 2015-2017 biennium (Section 6) states that the State Historical Society may obtain a loan from the Bank of North Dakota in an amount not to exceed \$1,250, the sum of which is appropriated to the State Historical Society for the purpose of defraying the expenses of repairs to the Double Ditch historic site. The loan authorization and appropriation in this section is contingent on the State Historical Society being unable to obtain assistance from other sources. Section 6 of H.B. 1018 from 2017-2019 Session Law appropriated \$500 from the state disaster relief fund and \$500 from a grant from the parks and recreation department. As such, Section 7 of H.B. 1018 from 2017-2019 Session Law would modify the loan amount from \$1,250 to \$250. As of December 31, 2018, there was no outstanding loan balance.

H.B. 1020, Section 9 – The Bank of North Dakota shall consolidate the \$40,000 loan to the western area water supply authority authorized in section 5 of chapter 20 of the 2013 Session Laws, the \$50,000 loan to the western area water supply authority authorized in section 2 of chapter 500 of the 2011 Session Laws, and the \$25,000 loan from the general fund to the western area water supply authority authorized in section 3 of chapter 500 of the 2011 Session Laws. The terms and conditions of the consolidation loan must be negotiated by the western area water supply authority and the Bank of North Dakota. The interest rate on the \$10,000 loan to the western area water supply authority authorized in section 4 of chapter 500 of the 2011 Session Laws must be 2.5 percent on any outstanding balance remaining after the effective date of this Act. The consolidation and interest rate change, as noted above, were both completed during 2017.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

H.B. 1020, Section 20 – The Bank of North Dakota shall extend a line of credit not to exceed \$75,000 at a rate of one and one-half percent over the three month London interbank offered rate, but may not exceed three percent to the state water commission. The state water commission shall repay the line of credit from funds available in the resources trust fund, water development trust fund, or other funds, as appropriated by the legislative assembly. The state water commission may access the line of credit, as necessary, to provide funding as authorized by the legislative assembly for water supply projects approved before June 30, 2019, and flood control projects that have approval for funding before June 30, 2019. As of December 31, 2018, there was no outstanding loan balance.

H.B. 1024, Section 3 – The office of the adjutant general may borrow the sum of \$10,000, or so much of the sum as may be necessary, from the Bank of North Dakota, for law enforcement support costs that were incurred after June 30, 2015, related to unlawful activity associated with the construction of the Dakota access pipeline, for the period beginning with the effective date of this Act, and ending June 30, 2019. The proceeds of the loan authorized in this section are appropriated to the office of the adjutant general for the purpose of defraying expenses of law enforcement support which were incurred after June 30, 2015, related to unlawful activity associated with the construction of the Dakota access pipeline, for the period beginning with the effective date of this Act, and ending June 30, 2019. The department of emergency services shall include any amounts borrowed under this section in the request for reimbursement from the federal government related to the state's expenses incurred due to unlawful activity associated with the construction of the Dakota access pipeline. As of December 31, 2018, the outstanding balance was \$10,000.

H.B. 1024, Section 7 – It is the intent of the sixty-fifth legislative assembly that the department of emergency services seek reimbursement from the federal government for the costs of responding to unlawful activity associated with the construction of the Dakota access pipeline. It is further the intent of the sixty-fifth legislative assembly that these reimbursements be used to repay the Bank of North Dakota loans authorized by the emergency commission and the legislative assembly, including loans of \$17,000 previously authorized by the emergency commission; loans in Senate Bill No. 2174, as approved by the sixty-fifth legislative assembly; and loans authorized in section 3 of this Act, which were all obtained to provide the funding necessary to respond to the unlawful activity associated with the construction of the Dakota access pipeline. As of December 31, 2017, the federal government had reimbursed the State \$10,000, all of which was applied to loans as described above, no additional reimbursements were received as of December 31, 2018.

S.B. 2174, Section 1 – The office of the adjutant general may borrow the sum of \$8,000, or so much of the sum as may be necessary, from the Bank of North Dakota, for law enforcement support costs related to unlawful activity associated with the construction of the Dakota access pipeline, for the period beginning with the effective date of this Act and ending June 30, 2019. The proceeds of the loan authorized in this section are appropriated to the office of the adjutant general for the purpose of defraying expenses of law enforcement support related to unlawful activity associated with the construction of the Dakota access pipeline for the period beginning with the effective date of this Act and ending June 30, 2019. The office of the adjutant general shall request from the legislative assembly a deficiency appropriation sufficient for the repayment of the amount borrowed plus interest. As of December 31, 2018, the outstanding balance was \$426.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

S.B. 2174, Section 2 – The office of the adjutant general may borrow the sum of \$3,000, or so much of the sum as may be necessary, from the Bank of North Dakota, for the purpose of providing a grant to a county that has experienced an emergency related to protest activities, for the period beginning with the effective date of this Act and ending June 30, 2019. Notwithstanding any other provision of law, the proceeds of the loan authorized in this section are appropriated to the office of the adjutant general for the purpose of providing a grant to a county that has experienced an emergency related to protest activities, for the period beginning with the effective date of this Act and ending June 30, 2019. The grant funds must be used to reimburse the county for extraordinary personnel, equipment, and materials expenditures related to the protest activities which are not otherwise eligible for reimbursement by the state or federal government. The office of the adjutant general shall request from the legislative assembly a deficiency appropriation sufficient for the repayment of the amount borrowed plus interest. As of December 31, 2018, the outstanding balance was \$1,819.

H.B. 1178, Section 7 – The information technology department may obtain a loan, subject to budget section approval, from the Bank of North Dakota in an amount not to exceed \$15,000 the sum of which is appropriated to the information technology department, for the purpose of defraying the expenses of the statewide interoperable radio network for the biennium beginning July 1, 2017, and ending June 30, 2019. The term of the loan may not exceed six years. The loan authorized in this section must be repaid from funds available in the statewide interoperable radio network fund. As of December 31, 2018, there was no outstanding loan balance.

S.B. 2021, Section 10 – The state agencies named in this section may borrow from the Bank of North Dakota, the amounts listed below, or so much of the amounts as may be necessary, which are appropriated to the respective agency for the purpose of defraying the expenses of implementing a new electronic payment system for the biennium beginning July 1, 2017, and ending June 30, 2019.

	<u>Borrowing Authority</u>	<u>Outstanding at 12/31/2018</u>
Department of Transportation	\$147	\$0
Secretary of State’s Office	93	\$0
Parks and Recreation Dept.	42	\$0
Game and Fish Dept.	36	\$0
Workforce Safety and Insurance	36	\$0
Highway Patrol	<u>21</u>	<u>\$0</u>
Total	\$375	\$0

S.B. 2044, Section 1 – The Bank of North Dakota shall conduct dynamic revenue analysis of economic development tax incentives selected for review by the interim committee tasked with reviewing economic development tax incentives under section 54 - 35 - 26 and bills selected by the dynamic fiscal impact bill selection committee. During 2017, the Bank purchased software in the amount of \$136 to aide in such analysis. No additional costs were incurred through December 31, 2018.

S.B. 2124, Section 1 – The Bank of North Dakota shall adopt rules to administer, manage, promote, and market the North Dakota achieving a better life experience plan. The Bank shall ensure the North Dakota achieving a better life experience plan is maintained in compliance with internal revenue service standards for qualified state disability expense programs. The Bank, as trustee of the North Dakota achieving a better life experience plan, may impose an annual administrative fee to recover expenses incurred in connection with operation of the plan. Administrative fees received by the Bank are appropriated to the Bank on a continuing basis to be used as provided under this section. Money and assets in North Dakota achieving a better life experience plan accounts or in qualified achieving a better life experience plan accounts in any state may not be considered for the purpose of determining eligibility to receive, or the amount of, any assistance or benefits from local or state means-tested programs.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

S.B. 2134, Section 3 – There is appropriated out of any moneys held in reserve in the strategic investment and improvements fund for mineral title disputes, not otherwise appropriated, the sum of \$100,000, or so much of the sum as may be necessary, to the commissioner of university and school lands for the purpose of mineral revenue repayments, for the biennium beginning July 1, 2017, and ending June 30, 2019. Upon adoption of the final review findings by the industrial commission, the commissioner of university and school lands shall calculate the amount necessary for mineral revenue repayments based on the final review findings. As soon as a repayment amount for a known recipient is calculated but after the expenditure of the \$100,000: (a) The commissioner of university and school lands shall request from the sixty-sixth legislative assembly additional funding sufficient for any remaining mineral revenue or other repayments. (b) If the \$100,000 is expended before the repayment of all amounts calculated for known recipients and before additional funds are made available by the sixty-sixth legislative assembly, the Bank of North Dakota shall extend a line of credit, not to exceed \$87,000, to the commissioner of university and school lands. The commissioner of university and school lands shall access the line of credit, to the extent necessary, the sum of which is appropriated, for the purpose of mineral revenue and other repayments under this Act for the biennium beginning July 1, 2017, and ending June 30, 2019. The commissioner of university and school lands shall repay the line of credit from funds available in the strategic investment and improvements fund as appropriated by the legislative assembly. As of December 31, 2018, there was no outstanding loan balance.

S.B. 2178, Section 1 – This bill is an amendment to Section 6-09-49 regarding the Infrastructure Revolving Loan Fund, and provide definition for “essential infrastructure projects”. No new funding was provided, and no other changes to the program were made. The infrastructure revolving loan fund is a special fund in the state treasury from which the Bank of North Dakota shall provide loans to political subdivisions for essential infrastructure projects. The Bank shall administer the infrastructure revolving loan fund. The maximum term of a loan made under this section is thirty years. A loan made from the fund under this section must have an interest rate that does not exceed two percent per year. For purposes of this section, "essential infrastructure projects" means capital construction projects for the following: (a) New or replacement of existing water treatment plants; (b) New or replacement of existing wastewater treatment plants; (c) New or replacement of existing sewer lines and water lines; and (d) New or replacement of existing storm water and transportation infrastructure, including curb and gutter construction. As of December 31, 2018, outstanding loans totaled \$77,896.

S.B. 2272, Section 3 – In addition to any construction loans made available under section 15.1-36-02, the Bank of North Dakota may provide up to \$250,000 to eligible school districts for school construction loans until June 30, 2017. After June 30, 2017, no new loans may be provided under this section. With the advice and consent of the Superintendent of Public Instruction, the Bank of North Dakota shall award the loans in accordance with a prioritization system that is based on a review of all applications filed during the twelve-month period preceding April 1st. The term of a loan under this section is twenty years, unless a shorter term is requested by the board of a school district in its application. The interest rate on a loan under this section may not exceed two percent, until July 1, 2025. Thereafter, the interest rate on the loan is subject to change. The maximum loan amount to which a school district is entitled under this section is \$20,000. As of December 31, 2018, the outstanding balance was \$82,263.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

S.B. 2272, Section 4 – Provides for the creation of the School Construction Assistance Revolving Loan Fund. The school construction assistance revolving loan fund is a special revolving loan fund administered by the Bank of North Dakota. The fund consists of all moneys appropriated or transferred to the fund by the legislative assembly and all interest or other earnings of the fund, and all repayments of loans made from the fund. Moneys in the fund, interest upon the moneys in the fund, and payments to the fund of principal and interest are appropriated to the Bank of North Dakota on a continuing basis for the purpose of providing low-interest school construction loans and for paying administrative costs, in accordance with this section. With the advice and consent of the Superintendent of Public Instruction, the Bank of North Dakota shall award the loans in accordance with a prioritization system that is based on a review of all applications filed during the twelve-month period preceding April 1st. The maximum loan amount for which a school district may qualify is \$10,000. The term of the loan is twenty years, unless the board of the school district requests a shorter term in the written loan application. The interest rate of the loan may not exceed two percent per year. The Bank may adopt policies and establish guidelines to administer this loan program in accordance with this section. The Bank of North Dakota may use a portion of the interest paid on the outstanding loans as a servicing fee to pay for administration costs which may not exceed one - half of one percent of the amount of the interest payment. The Bank of North Dakota shall deposit principal and interest payments made by school districts for loans under this section in the school construction assistance revolving loan fund. The Bank of North Dakota shall arrange for the conduct of an annual audit of the school construction assistance revolving loan fund, the cost of which must be paid from the fund and which must be conducted by an independent accounting firm. As of December 31, 2018, outstanding loans in the School Construction Assistance Revolving Loan Fund totaled \$188,001.

S.B. 2272, Section 13 – The office of management and budget shall transfer the sum of \$75,000 from the foundation aid stabilization fund to the school construction assistance revolving loan fund during the period beginning with the effective date of this Act, and ending June 30, 2019. Of the \$75,000 transferred to the school construction assistance revolving loan fund, up to \$50,000 must be used to repay the Bank of North Dakota for the outstanding principal balance on a portion of the loans issued under section 15.1-36-06 for the purpose of transferring a portion of the loans issued under section 15.1-36-06 from the Bank of North Dakota to the school construction assistance revolving loan fund. The remaining amount transferred to the school construction assistance revolving loan fund is available for new school construction loans. As of December 31, 2017, the office of management and budget transferred \$75,000 to the school construction assistance revolving loan fund. As of December 31, 2018 \$43,386 of the \$50,000 earmarked for Bank of North Dakota repayment has been used.

S.B. 2311, Section 1 – The Bank of North Dakota shall provide a letter of credit to a city, in the northwest corner of the state with a population over twenty thousand residents, which is constructing an airport and is subject to the bonding requirements under section 52-04-06.1. The letter of credit shall cover the length of the construction term not to exceed five years. The Bank of North Dakota shall charge a one-time fee of no more than three quarters of one percent of the total amount of the letter of credit. The city obtaining the letter of credit assumes all liability for the letter of credit, the fee to be paid to the Bank of North Dakota, and any other requirements under section 52-04-06.1. As of December 31, 2018, the letter of credit has been provided.

H.B. 1008, Section 4 – The Bank of North Dakota shall transfer from the Beginning Farmer Revolving Loan Fund to the Public Service Commission the sum of \$900, or so much of the sum as may be necessary, included in the estimated income line item in section 1 of this Act to pay for costs associated with a rail rate complaint case. Transfers must be made during the biennium beginning July 1, 2017, and ending June 30, 2019, upon order of the Commission. If any amounts are spent pursuant to this section, the Public Service Commission shall reimburse the Beginning Farmer Revolving Loan Fund using amounts available from damages or proceeds received, net of legal fees, from a successful outcome of a rail complaint case. As of December 31, 2018, the Bank had transferred \$0.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

S.B. 2379, Section 4 – During the North Dakota Special Legislative Session held in August 2016, Senate Bill 2379 was passed that states that if the Office of Management and Budget (OMB) determines the State General Fund will not have a projected positive June 30, 2017 balance, the Industrial Commission shall transfer \$100,000, or so much of the sum as may be necessary, from the earnings and accumulated and undivided profits of BND to the State General Fund. The monies must be transferred in amounts and at such times as requested by OMB. The sum of the amounts transferred may not exceed the lesser of \$100,000 or the amount necessary to provide for a positive June 30, 2017 General Fund Balance. During the 2017-2019 Regular Legislative Session, H.B. 1024, Section 9 amended this Special Session language to state the following: During the period beginning with the effective date of this Act and ending June 30, 2017, the Industrial Commission shall transfer \$100,000 from the earnings and accumulated profits of the Bank of North Dakota to the State General Fund. The monies must be transferred in amounts and at such times as requested by the Director of the Office of Management and Budget. As of December 31, 2017, the Bank had transferred \$100,000.

State Water Commission

Under chapter 61-02.1-04 of North Dakota Century Code, principal and interest on bonds issued are payable from transfers to be made and appropriated by the legislative assembly from the Water Development Trust Fund as provided in section 61-02.1-05, then from transfers to be made and appropriated by the legislative assembly from revenues in the Resources Trust Fund other than revenues from state taxes, then from appropriations of other available revenues in the then current biennium, and then from any other revenues the State Water Commission makes available during the then current biennium for that purpose, including any federal moneys received by the state for the construction of flood control or reduction projects to pay bonds issued for that project. If sufficient funds from these sources are not available, then from transfers to be made and appropriated by the legislative assembly from the first available current biennial earnings of the Bank of North Dakota not to exceed \$6,500 per biennium prorated with any other bonds payable from transfers to be made and appropriated by the legislative assembly from the available current biennial earnings of the Bank of North Dakota, to be credited by the Trustee to the Fund established for paying principal and interest on the bonds under a trust indenture. If the Bank has to provide a transfer to the State Water Commission to make principal and interest payments on these bonds, the State Water Commission would then have to request from the next legislative assembly funding to repay the transfer made by the bank. As of December 31, 2018, the Bank has provided no such transfers.

Farm Real Estate Loan Guarantee Program

Chapter 6-09.7-09 provides that the Bank of North Dakota may guarantee the loan of money by banks, credit unions, lending institutions that are part of the farm credit system, and savings and loan associations in this state to eligible persons for the purchase of agricultural real estate or the restructuring of agricultural real estate loans, provided the transactions do not exceed a loan to value ratio of 80% and further provided that no single loan exceeds \$400. The Bank may have no more than \$8,000 in outstanding loan guarantees under this Program. The Bank may guarantee up to 75% of the amount of principal due the lender. The guarantee term may not exceed 5 years. As of December 31, 2018 and 2017, the Bank has guarantees outstanding totaling \$807 and \$827, respectively, and had no guarantee commitments outstanding, respectively, included in commitments to extend credit. The Bank has not recorded a contingent liability related to the guarantee loan program as of December 31, 2018 and 2017.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

Beginning Entrepreneur Loan Guarantee Program

Chapter 6-09.15 provides that the Bank of North Dakota provide a Beginning Entrepreneur Loan Guarantee Program. The Program includes an agreement with a lender that in the event of default by a beginning entrepreneur under a note and mortgage or other loan or financing agreement, the Bank shall pay the lender the amount agreed upon up to 85% of the amount of principal due the lender on a loan at the time the claim is approved. The total outstanding loans that the Bank may guarantee cannot exceed 5% of the Bank's tier one capital as defined by the Department of Financial Institutions. A lender may apply to the Bank for a loan guarantee for a loan up to \$500. The term of the guarantee may not exceed five years. As of December 31, 2018 and 2017, the Bank has guarantees outstanding totaling \$8,070 and \$5,927, respectively, and had guarantee commitments outstanding of \$613 and \$674, respectively, included in commitments to extend credit. The Bank has not recorded a contingent liability related to the guarantee loan program as of December 31, 2018 and 2017.

NOTE 13 - RELATED PARTY TRANSACTIONS

The Bank, because of its unique relationship with the State of North Dakota, is a party in many business transactions with other entities of state government. All state funds and funds of all state penal, education, and industrial institutions must be deposited in the Bank under state law. These transactions are a normal part of bank business and, accordingly, are included in the Bank's financial statements.

See Note 5 for disclosure relating to loans sold to other state funds and/or loans serviced for other state funds, including the North Dakota Student Loan Trust.

Dakota Education Alternative Loans are fully guaranteed by the North Dakota Guaranteed Student Loan Program, which is administered by the Bank. The outstanding principal balance of these loans was \$1,169,613 and \$1,143,266 at December 31, 2018 and 2017, respectively.

In the ordinary course of business, the Bank holds loans and deposits of principal officers and directors and their affiliates. Outstanding principal balances of these loans held by the Bank at December 31, 2018 and 2017 amounted to \$27,646 and \$25,131, respectively. Deposits and short-term borrowings held by the Bank were \$4,995 and \$4,001, respectively.

The Bank also made transfers to the Rebuilders Loan Program to fund loans to owners of homes damaged in the 2011 floods. These funds will be repaid to the Bank as payments are received from the borrowers. At year end December 31, 2018 the Bank had a receivable from this program for \$10,288. At year end December 31, 2017 the Bank had a receivable from this program for \$13,682.

NOTE 14 - OFF-BALANCE-SHEET ACTIVITIES

The Bank is a party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, financial standby letters of credit, and guarantees related to loan programs as discussed in Note 12. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The Bank's exposure to credit loss is represented by the contractual amount of these commitments. The Bank follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

At December 31, 2018 and 2017, the following financial instruments were outstanding whose contract amounts represent credit risk:

	Contract Amount	
	2018	2017
Commitments to extend credit	\$ 861,421	\$ 812,606
Financial standby letters of credit	412,614	389,664
Guarantees provided	9,490	7,428

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained by the Bank upon extension of credit is based on management's credit evaluation of the customer. Collateral held may include accounts receivable, inventory, property, plant, and equipment, and income-producing commercial properties.

Financial standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank has segmented this category into three components: (1) letters of credit, (2) confirming letters of credit, and (3) letters of credit pledged for public deposits to North Dakota financial institutions.

Letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party which require this type of facility. The maturities for these letters of credit range from one month to ten years, and the likelihood of funding any of these letters of credit is considered to be remote. The Bank holds collateral supporting those commitments. The Bank also has letters of credit with the North Dakota Public Finance Authority (NDPFA) with maturities ranging from 17 months to 29 years. If the letters issued to the NDPFA were ever drawn upon, the NDPFA is legally obligated to reimburse the Bank from funds legally available, or from any appropriation made available from the Legislative Assembly after certification by the Industrial Commission. The likelihood of funding any of these letters of credit is also considered to be remote. Outstanding issued letters of credit as of December 31, 2018 and 2017 were \$106,834 and \$104,807, respectively.

Confirming letters of credit are issued to North Dakota financial institutions to support letters of credit they have issued but are still in need of backing from an institution with a long-term, high quality bond rating. In the event these letters were to be drawn upon, based on the terms of the agreement, the Bank would immediately withdraw funds from the institution's correspondent bank account held at the Bank to cover the amount drawn. These agreements generally have terms of 12 months or less. The likelihood of funding any of these confirming letters of credit is also considered to be remote. Outstanding issued confirming letters of credit as of December 31, 2018 and 2017 were \$3,525 and \$2,857, respectively.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

Letters of credit pledged for public deposits to North Dakota financial institutions are issued to support public borrowing arrangements. These letters are fully collateralized by a pool of loans pledged to the Bank. These agreements generally have terms of 12 months or less. Financial standby letters for public deposits by North Dakota banks totaled \$302,255 and \$282,000 at December 31, 2018 and 2017, respectively. The likelihood of funding any of these letters of credit is also considered to be remote. These letters of credit are an authorized form of collateral for public deposits per North Dakota Century Code 21-04-09.

The Bank has not recorded a contingent liability related to off-balance sheet activity as of December 31, 2018 and 2017.

NOTE 15 - INTEREST RATE SWAP CONTRACTS

Interest rate swap contracts are entered into primarily as an asset/liability management strategy of the Bank to help manage its interest rate risk position. The primary risk associated with all swaps is the exposure to movements in interest rates and the ability of the counterparties to meet the terms of the contract. The Bank is exposed to losses if the counterparty fails to make its payments under a contract in which the Bank is in a receiving status. The Bank minimizes its risk by monitoring the credit standing of the counterparties. The Bank anticipates the counterparties will be able to fully satisfy their obligations under the remaining agreements. These contracts are typically designated as cash flow hedges.

The Bank has outstanding interest rate swap agreements with a notional amount totaling \$350,000 as of December 31, 2018, and \$250,000 as of December 31, 2017, to convert variable rate federal funds and variable rate LIBOR-indexed deposits into fixed-rate instruments over the term of the contracts. The notional amount of the interest rate swaps does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and other terms of the individual interest rate swap agreements. These cash flow hedges were determined to be fully effective during all periods presented, and as such, no amount of ineffectiveness has been included in net income. Therefore, the aggregate fair value of the swaps is recorded in other assets or other liabilities with changes in fair value recorded in other comprehensive income (loss). In the event a hedge is no longer considered effective, the resulting impact would be reclassified to current year earnings. The Bank expects the hedges to remain fully effective during the remaining terms of the swaps.

The following table summarizes the derivative financial instruments utilized at December 31, 2018:

	Balance sheet location	Notional amount	Estimated fair value	
			Gain	Loss
Cash flow hedge	Other assets	\$ 50,000	\$ 2,492	
Cash flow hedge	Other assets	\$ 50,000	\$ 2,710	
Cash flow hedge	Other assets	\$ 50,000	\$ 6,240	
Cash flow hedge	Other assets	\$ 50,000	\$ 1,404	
Cash flow hedge	Other liabilities	\$ 50,000		\$ 2,180
Cash flow hedge	Other liabilities	\$ 50,000		\$ 45
Cash flow hedge	Other liabilities	\$ 50,000		\$ 320

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

The following table details the derivative financial instruments, the remaining maturities, and the interest rates being paid and received at December 31, 2018:

	Notional value	Maturity (years)	Fair value gain/(loss)	Receive	Pay
Interest rate swap	\$ 50,000	10.4	\$ (2,180)	2.28%	2.86%
Interest rate swap	\$ 50,000	11.3	\$ 2,492	2.28%	1.92%
Interest rate swap	\$ 50,000	12.7	\$ 6,240	2.35%	1.48%
Interest rate swap	\$ 50,000	13.3	\$ 1,404	2.35%	2.39%
Interest rate swap	\$ 50,000	13.5	\$ 2,710	2.28%	1.99%
Interest rate swap	\$ 50,000	14.3	\$ (45)	2.28%	2.47%
Interest rate swap	\$ 50,000	14.5	\$ (320)	2.28%	2.52%

Amongst all swap counterparties for the transactions noted above, the Bank holds a net \$12,150 in cash pledged under collateral arrangements related to the interest rate swaps at December 31, 2018, to satisfy the collateral requirements.

The following table summarizes the derivative financial instrument utilized at December 31, 2017:

	Balance sheet location	Notional amount	Estimated fair value	
			Gain	Loss
Cash flow hedge	Other assets	\$ 50,000	\$ 894	
Cash flow hedge	Other assets	\$ 50,000	\$ 5,222	
Cash flow hedge	Other assets	\$ 50,000	\$ 780	
Cash flow hedge	Other liabilities	\$ 50,000		\$ 4,101
Cash flow hedge	Other liabilities	\$ 50,000		\$ 126

The following table details the derivative financial instruments, the remaining maturities, and the interest rates being paid and received at December 31, 2017:

	Notional value	Maturity (years)	Fair value gain/(loss)	Receive	Pay
Interest rate swap	\$ 50,000	11.4	\$ (4,101)	1.30%	2.86%
Interest rate swap	\$ 50,000	12.3	\$ 894	1.30%	1.92%
Interest rate swap	\$ 50,000	13.7	\$ 5,222	1.36%	1.48%
Interest rate swap	\$ 50,000	14.3	\$ (126)	1.36%	2.39%
Interest rate swap	\$ 50,000	14.5	\$ 780	1.30%	1.99%

Amongst all swap counterparties for the transactions noted above, the Bank holds a net \$2,600 in cash pledged under collateral arrangements related to the interest rate swaps at December 31, 2017, to satisfy the collateral requirements.

Interest expense recorded on these swap transactions totaled \$896 and \$2,210 as of December 31, 2018 and December 31, 2017, and is reported as a component of interest expense on short- and long-term debt.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

NOTE 16 - FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value measurements are used to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Available for sale securities are recorded at fair value on a recurring basis.

Fair Value Hierarchy

Under ASC 820-10, assets and liabilities are grouped at fair value in 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 in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.
- Level 2 – Valuation is based upon quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and model-based valuation techniques for which all 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. 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.

Determination of Fair Value

Under ASC 820-10, fair values are based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It is Bank policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements, in accordance with the fair value hierarchy of ASC 820-10.

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value and for estimating fair value for financial instruments not recorded at fair value (ASC 825-10 disclosures).

Securities Available for Sale

Securities available for sale consist primarily of Federal agencies and mortgage backed securities. Securities available for sale are recorded at fair value on a recurring basis. Fair value is based upon quoted prices, if available. If quoted market prices are not available, fair values are measured using observable market prices from independent pricing models, or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded in an active market; examples would include U.S. Treasury securities and Agency securities. Level 2 securities as defined above would include mortgage-backed securities, collateralized mortgage obligations, and state and political subdivision securities. FHLB stock and nonmarketable securities are not publicly traded and management has determined fair value approximate cost.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

Loans

The carrying value of loans is described in Note 1, “Summary of Significant Accounting Policies”. The Bank does not record loans at fair value on a recurring basis. As such, valuation techniques discussed herein for loans are primarily for estimating fair value for ASC 825-10 disclosure purposes. However, from time to time, the Bank records nonrecurring fair value adjustments to loans to reflect (1) partial write-downs that are based on the observable market price or current appraised value of the collateral, or (2) the full charge-off of the loan carrying value.

The fair value estimates for ASC 825-10 purposes differentiates loans based on their financial characteristics, such as product classification, loan category, pricing features and remaining maturity. Prepayment and credit loss estimates are evaluated by product and loan rate.

- The fair value of student loans is based on market values as established by the secondary market.
- For real estate 1-4 family first and junior lien mortgages, fair value is based on market values as established by the secondary market.
- The fair value of all other loans is calculated by discounting contractual cash flows using discount rates that reflect our current pricing for loans with similar characteristics and remaining maturity.
- Off-Balance Sheet Credit-Related Instruments include loan commitments, standby letters of credit, and guarantees. These instruments generate ongoing fees at our current pricing levels, which are recognized over the term of the commitment period. The fair value of these instruments is estimated based upon fees charged for similar agreements. The carrying value of the deferred fees is a reasonable estimate of the fair value of the commitments.

Interest Rate Swap Agreements

Fair values for interest rate swap agreements are based upon the amounts required to settle the contracts.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The tables below presents the balances of assets and liabilities measured at fair value on a recurring basis at December 31, 2018 and 2017.

	2018			
	Total	Quoted Prices in Active Markets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
ASSETS				
Available-for-sale debt securities				
Mortgage-backed securities				
Agency	\$ 153,591	\$ -	\$ 153,591	\$ -
Collateralized mortgage obligations				
Agency	517,387	-	517,387	-
Non-agency	23	-	23	-
Agency bonds	1,181,805	1,181,805	-	-
U.S. treasuries	-	-	-	-
Municipal bonds	1,000	-	1,000	-
Interest rate swaps	12,846	-	12,846	-
Totals	\$ 1,866,652	\$1,181,805	\$ 684,847	\$ -
LIABILITIES				
Interest rate swap	\$ 2,545	\$ -	\$ 2,545	\$ -
Totals	\$ 2,545	\$ -	\$ 2,545	\$ -

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

	2017			
	Total	Quoted Prices in Active Markets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Assets				
Available-for-sale debt securities				
Mortgage-backed securities				
Agency	\$ 155,346	\$ 1,382	\$ 153,964	\$ -
Collateralized mortgage obligations				
Agency	418,700	-	418,700	-
Non-agency	44	-	44	-
Agency bonds	1,005,239	1,005,239	-	-
U.S. treasuries	19,968	19,968	-	-
Municipal bonds	1,000	-	1,000	-
Interest rate swap	6,896	-	6,896	-
Totals	\$ 1,607,193	\$ 1,026,589	\$ 580,604	\$ -
LIABILITIES				
Interest rate swap	\$ 4,227	\$ -	\$ 4,227	\$ -
Totals	\$ 4,227	\$ -	\$ 4,227	\$ -

Assets Measured at Fair Value on a Nonrecurring Basis

The tables below presents the Bank's balances of financial instruments measured at fair value on a nonrecurring basis at December 31, 2018 and 2017.

The significant unobservable inputs used in the fair value measurement of collateral for collateral-dependent impaired loans primarily relate to customized discounting criteria applied to the customer's reported amount of collateral. The amount of the collateral discount depends upon the marketability of the underlying collateral. The Bank's primary objective in the event of default would be to monetize the collateral to settle the outstanding balance of the loan, in which collateral with lesser marketability characteristics would receive a larger discount.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

The valuations are reviewed at least quarterly by the internal Problem Loan Committee and are considered in the overall calculation of the allowance for credit losses. Unobservable inputs are monitored and adjusted if market conditions change.

	2018		
	Quoted Prices in Active Markets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Impaired loans	\$ -	\$ -	\$ 105,603
Totals	\$ -	\$ -	\$ 105,603
	2017		
	Quoted Prices in Active Markets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Impaired loans	\$ -	\$ -	\$ 98,067
Totals	\$ -	\$ -	\$ 98,067

NOTE 17 - ACCUMULATED OTHER COMPREHENSIVE INCOME

The Bank recognizes and includes revenues, expenses, gains and losses in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

The changes in accumulated other comprehensive income by component for the years ended December 31, 2018 and 2017 follows:

	Unrealized gain and losses on available-for- sale securities	Gains and losses on cash flow hedges	Total
Year ended December 31, 2018			
Beginning balance	\$ 286	\$ 2,669	\$ 2,954
Other comprehensive income (loss) before reclassifications	(703)	7,632	6,929
Amount reclassified from accumulated other comprehensive income	259	-	259
Net current period other comprehensive income	(444)	7,632	7,188
Ending balance	<u>\$ (158)</u>	<u>\$ 10,301</u>	<u>\$ 10,142</u>
	Unrealized gain and losses on available-for- sale securities	Gains and losses on cash flow hedges	Total
Year ended December 31, 2017			
Beginning balance	\$ 10,429	\$ 1,808	\$ 12,236
Other comprehensive income (loss) before reclassifications	(10,498)	861	(9,637)
Amount reclassified from accumulated other comprehensive income	355	-	355
Net current period other comprehensive income	(10,143)	861	(9,282)
Ending balance	<u>\$ 286</u>	<u>\$ 2,669</u>	<u>\$ 2,954</u>

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

The line items in the statements of income affected by the reclassifications out of accumulated other comprehensive income for the years ended December 31, 2018 and 2017 is as follows:

2018		
Details About Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income	Affected Line Item in the Statement where Net Income is Presented
Unrealized gains and losses on available-for sale securities	\$ (259)	Other operating expenses
2017		
Details About Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income	Affected Line Item in the Statement where Net Income is Presented
Unrealized gains and losses on available-for sale securities	\$ (355)	Other operating expenses

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017
(In Thousands)

NOTE 18 - SUPPLEMENTAL DISCLOSURES RELATED TO STATEMENTS OF CASH FLOWS

	<u>2018</u>	<u>2017</u>
Supplemental disclosures of cash flow information		
Cash payments for:		
Interest paid to customers	\$ 16,950	\$ 10,355
Interest paid on federal funds purchased and securities sold under repurchase agreements	4,693	2,785
Interest paid on short and long-term debt	25,128	23,901
Supplemental schedule of noncash investing and financing activities		
Transfers from undivided profits to other liabilities	128,614	186,932
Net change in unrealized loss on securities available for sale	(444)	(10,143)
Net change in unrealized gain on interest rate swap	7,632	861
Foreclosed assets acquired in exchange for loans	986	4,205

NOTE 19 - SUBSEQUENT EVENTS

Subsequent events have been evaluated through February 14, 2019, which is the date these financial statements were available to be issued.



Economic Development Report 2018



Postsecondary Education Report 2018

View a complete copy of the *Economic Development Report 2018* and the *Postsecondary Education Report 2018* at bnd.nd.gov/financing-reports.



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