

RatingsDirect®

Research Update:

Bank of North Dakota Ratings Affirmed At 'A+/A-1' Following Affirmation Of Ratings On The State; Outlook Remains Stable

Primary Credit Analyst:

Raphael A Hunter, Centennial (1) 347-346-3445; raphael.hunter@spglobal.com

Secondary Contact:

Nikola G Swann, CFA, FRM, Toronto (1) 416-507-2582; nikola.swann@spglobal.com

Table Of Contents

Overview

Rating Action

Rationale

Outlook

Ratings Score Snapshot

Related Criteria And Research

Ratings List

Research Update:

Bank of North Dakota Ratings Affirmed At 'A+/A-1' Following Affirmation Of Ratings On The State; Outlook Remains Stable

Overview

- The state of North Dakota recently identified a \$308.7 million revenue shortfall for the fiscal 2015-2017 biennium. To close the gap, the state decided to implement several measures, including reductions to general fund spending and planned drawdowns from the budget stabilization fund reserves. The state may also require the Bank of North Dakota (BND) to transfer up to \$100 million of its accumulated profits.
- Given BND's very strong capital ratios and its satisfactory liquidity contingency plans, we believe that a potential appropriation of up to \$100 million by the state (akin to a special dividend) would be manageable from a capital and liquidity standpoint. The bank has faced a significant decline in captive deposits during the past year, which prompted us to revise our funding score to average from above average. Despite this score change, the bank's stand-alone credit profile (SACP) remains unchanged at 'a'.
- On Aug. 31, 2016, S&P Global Ratings affirmed the 'AA+' general obligation rating, 'AA' appropriation rating, and 'A+' moral obligation ratings on the state of North Dakota. The outlook is stable.
- Following our government-related entities criteria, we are affirming our long-term and short-term issuer credit ratings on BND at 'A+/A-1' given the bank's role, and the links between the state and the bank. We are also affirming our deposit rating at 'AA'.
- The rating outlook remains stable, reflecting the link between the bank and the current ratings on the state of North Dakota.

Rating Action

On Sept. 2, 2016, S&P Global Ratings affirmed its issuer credit ratings on the Bank of North Dakota (BND) at 'A+/A-1'. The rating outlook remains stable.

We also affirmed the deposit rating at 'AA' and the short-term deposit rating at 'A-1+', and we maintained our stand-alone credit profile (SACP) at 'a'.

Rationale

The affirmation of the ratings on BND follows the recent affirmation of the ratings on the state of North Dakota at 'AA+' (see "North Dakota; Appropriations; General Obligation; Moral Obligation," published Aug. 31, 2016, on RatingsDirect.) As a state-run financial institution, the bank

participates in activities that broadly promote commerce, agriculture, and industry in North Dakota. Our ratings on the bank reflect our assessment of the likelihood of extraordinary support from the state to the bank, which we view as high based on our assessment of a very strong link and important role.

The state identified a \$308.7 million shortfall for the current 2015-2017 biennium. An option for the state to close this gap is through appropriation of BND's accumulated profits for up to \$100 million, if needed. We believe that the current capital levels of the bank are high enough to comfortably absorb the full \$100 million. As of June 30, 2016, the bank reported a Tier 1 risk-based capital ratio of 18.51%, a total capital ratio of 19.77%, and a leverage ratio of 11.05%. Our proprietary risk-adjusted capital (RAC) ratio was at a very strong 21.1% as of that date. We expect the RAC ratio to remain in the very strong range (above 15%) in the foreseeable future.

The state has been facing large revenue declines and is currently undergoing an economic recession. North Dakota's large reliance on the energy and agriculture sectors has caused revenues to drop more than the state had initially anticipated. We expect oil prices to remain in the \$50-\$60 range per barrel in the medium term but to become more volatile (see "The Rally In Oil Prices--Is It Sustainable?" , published June 28, 2016), and, as long as agricultural commodity prices do not decline further, we believe that North Dakota's economy will likely experience growth over 2017-2019.

As of June 30, 2016, nonperforming loans had increased year over year across all loan types with the exception of student loans. Still, 99% of student loans and 72% of residential loans benefitted from state or federal guarantees. Nonperforming assets totaled 2.49% (including those 90 days past due but accruing and restructured loans), up from 1.75% the prior year. Net charge-offs have also been increasing but remained low at 0.09% of average loans.

State law requires all monies of the state and state institutions to be deposited with BND. The recent tax revenue declines and budget cuts that were mandated to state agencies have caused a loss of deposits for BND. In comparison with last year, deposits fell by 19% as of June 30, 2016, the loan-to-deposit ratio increased to 88% from 62% (reflecting deposit declines combined with a greater need for loans), and the stable funding ratio was down to 127% from 160%. We expect this trend to continue because of the various spending cuts and challenging economic conditions. As a result, we have revised our funding score to average from above average.

We believe BND has an adequate liquidity contingency plan should it need to use it. It includes Federal Home Loan Bank advances, fed funds borrowings, loan sales, and repurchase agreements, and BND has access to the Fed discount window.

Outlook

The stable rating outlook reflects our view that the link between the bank and the current ratings on the state of North Dakota support the issuer credit and deposit ratings on BND. Given these links, a two-notch reduction in the SACP would leave the issuer credit ratings or the deposit ratings unchanged.

We could lower the SACP in the coming two years if the state's economy weakens further than we anticipated, if capital appropriations by the state increase by more than we currently expect--enough to impair BND's capital profile such that the risk-adjusted capital ratio remains below the 15% threshold on a consistent basis--or if the bank's asset quality deteriorates significantly. We are unlikely to raise the SACP in the near term given the cyclicity of the state's revenue base and the interdependence between the state and BND.

We could lower the ratings on the bank's deposits if we lowered the rating on the state by one notch to 'AA', and we could lower the issuer credit ratings should we downgrade the state by more than two notches.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	A+/Stable/A-1	A+/Stable/A-1
SACP	a	a
Anchor	bbb+	bbb+
Business Position	Adequate (0)	Adequate (0)
Capital and Earnings	Very Strong (+2)	Very Strong (+2)
Risk Position	Adequate (0)	Adequate (0)
Funding and Liquidity	Average and Adequate (0)	Above average and adequate (0)
Support	+1	+1
GRE Support	+1	+1
Group Support	0	0
Sovereign Support	0	0
Additional Factors	0	0

Related Criteria And Research

Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And

Assumptions, Jan. 29, 2015

- Group Rating Methodology, Nov. 19, 2013
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010
- Commercial Paper I: Banks, March 23, 2004

Related Research

- North Dakota; Appropriations; General Obligation; Moral Obligation, Aug. 31, 2016
- The Rally In Oil Prices--Is It Sustainable?, June 28, 2016

Ratings List

Ratings Affirmed

Bank of North Dakota

Issuer Credit Rating	A+/Stable/A-1
Certificate Of Deposit	AA/A-1+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

Copyright © 2016 by S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription) and www.spcapitaliq.com (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.