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**Bank of North Dakota
Annual Report 2004**

vision

Bank of North Dakota is a financial services leader in North Dakota fostering growth and economic well-being for the state and its citizens, using a partnership approach. Bank of North Dakota has knowledgeable, well-trained people delivering exceptional customer service, resulting in consistent financial returns to the state.

North Dakota

mission

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

President's message



Eric Hardmeyer,
President

For 85 years, the Bank of North Dakota has been **Investing** in our great state, **Strengthening** its economy and helping it to **Grow**.

In 2004, BND delivered record profits, improved efficiency, implemented state-of-the-art student loan guarantee software and developed major strategic plans while furthering its mission of investing in continued economic growth.

Investment in partnerships with financial institutions, community organizations and customers was the key to growth in 2004. BND realized a record year for profitability with net bank earnings of \$34.2 million, an increase of \$2.5 million or 8 percent over 2003.

Loans grew by \$65 million or 4.6 percent pushing total assets to \$2.01 billion. Return on average assets was 1.77 percent and return on average equity was 22.1 percent, compared to 1.63 percent and 20.7 percent in 2003.

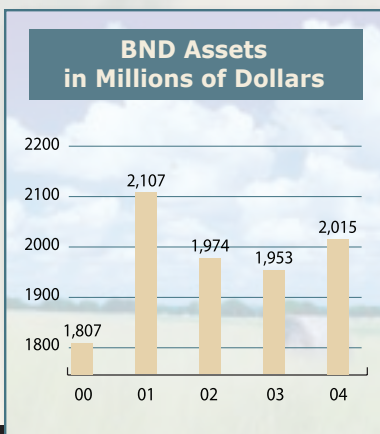
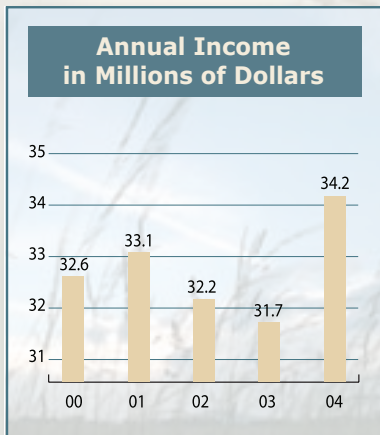
BND develops programs and services to foster growth and economic well-being for the state and its citizens. BND has distinguished itself by following its mission to deliver quality, sound financial services that promote agriculture, commerce and industry in our state.

BND invests in foundations for growth in North Dakota from supporting start-up business ventures, expansions and agricultural operations to strengthening our knowledge base through student loans that help educate our future leaders.

Today, BND remains focused on customer relationships by providing quality service and programs as it develops major technological advances to provide new services and easier access for its customers tomorrow.

The Bank of North Dakota is committed to offering high-quality banking services that invest, strengthen and grow North Dakota.

Eric Hardmeyer
President





Investing in Core Business

With a clear purpose and strong foundation, BND is improving efficiency by investing in new computer technology to strengthen its core business system within the Bank. The new project will update programs and utilize technology to provide payment systems, imaging services and solutions for state agencies and North Dakota banks. As a “banker’s bank” serving community banks and financial institutions, BND’s new core system will serve customers in innovative ways while focusing on industry-leading efficiency and cost control.

Strengthening Student Loan Technology

Investing with the customer in mind, BND successfully implemented new web-based technology for student loans. In 2004, BND completed development of student loan guarantee software as part of a comprehensive e-commerce project to serve customers. The technology enables students, colleges and lenders to access financial aid information in real time, and also allows immediate guarantee of student loans.

The student loan software is an Internet-based system created to integrate and accelerate services within the financial aid and student loan process. Implementation of this technology illustrates how BND is a leader in the student loan industry.

Growing Agricultural Programs

BND continues its tradition of investing in the future of North Dakota’s dominant industry, agriculture. To answer the needs of dairy operators, BND implemented a loan policy change to include dairy facility improvements and expansion through BND’s Ag Partnership in Assisting Community Expansion (PACE) program. The most recent Ag PACE expansion allows for dairy facility



improvements or expansion, which includes upgrading equipment, feeding facilities and waste management operations. The program change allows farmers and ranchers to add value to their operations.

Loan Programs Meet Borrowers’ and Lenders’ Needs

The Lending division remains committed to meeting the needs of North Dakota borrowers and lenders.

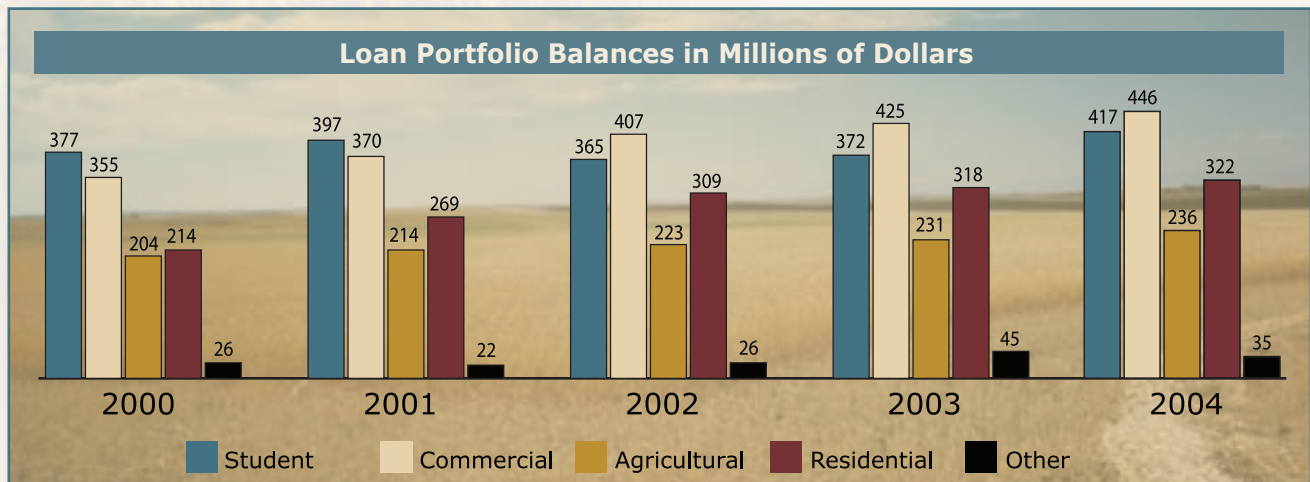
In order to learn more about state residents’ needs, BND representatives met with various groups across the state to discuss ideas to invest and strengthen local communities, businesses and farms through lending programs.

BND implemented programs such as Beginning Entrepreneur, Match, PACE and more to assist residents who are business owners or farmers. These programs make growth happen and help people achieve their dreams. In 2004, BND worked with private financial institutions and business owners to create programs that funded 194 business and industrial projects.

In 2004, BND’s total loan portfolio increased by \$65 million to \$1.46 billion, compared to \$1.39 billion in 2003. Loan volume was strong with low interest rates and continued refinancing activity. Loan growth came in four major loan categories: student, commercial/business, residential and agricultural.



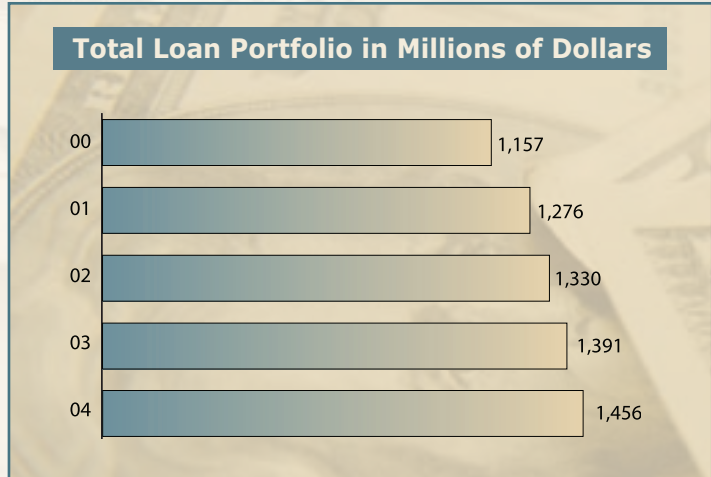
- **Student Loans increased by \$45 million.** BND invested in one of North Dakota’s outstanding resources, its students, with new student loans totaling \$90 million, consolidation loans of \$47 million, and \$3 million of student loans purchased from other banks. During this time, BND sold approximately \$28 million in student loans to the Student Loan Trust.
- **Commercial Loans grew by \$21 million.** In 2004, BND helped strengthen North Dakota’s economy by originating 290 business loans totaling \$142 million in 2004.



- **Residential Loans increased by \$4 million.** Continuation of low interest rates encouraged ongoing growth in the residential area, and BND purchased 736 home loans in 2004 totaling \$76 million.
- **Agricultural Loans increased by \$5 million.** In 2004, BND again demonstrated its commitment to North Dakota's agriculture industry with the origination of 510 loans totaling \$89 million.

Loan Portfolio Well Balanced

BND continues to strengthen and grow in the state through its well-balanced loan portfolio: commercial/business loans account for 33 percent, student loans 29 percent, residential 22 percent, and agricultural loans 16 percent of total BND loans. This balance provides diversity and generates consistent earnings. The Bank works with federal guaranty programs to reduce risk with 51 percent of the total portfolio guaranteed.



ND Dry Pea & Lentil Association

Missouri River Ag Processing

Construction began on Missouri River Ag Processing on May 1, 2004, and by the first part of November, the facility was already shipping product. Its core business is processing peas and lentils, but the plant also processes beans, soybeans and specialty crops where specific traits are desired or identity must be preserved.

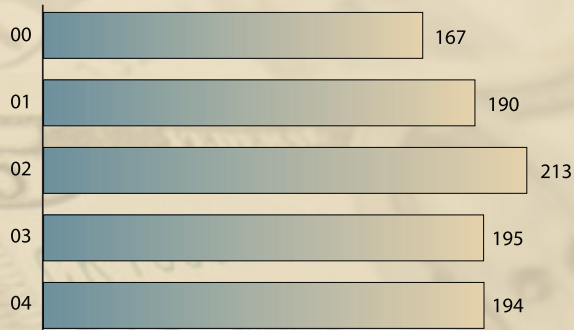
PACE funding helped to build the processing facility, construct storage and install the first processing line. This flexible line includes a large sieve mill, large drum mill and large gravity table that can process just about any of the products that the plant handles.

"The PACE loan is a fairly unique tool that gives the people of our state a significant advantage," said Les Knudson, Missouri River Ag Processing. "If we'd had to finance this project at regular interest rates, I'm not entirely sure that we could have gotten the financing or made the cash flows work."

Missouri River Ag Processing already has a second processing line in place and is in the final stages of construction on the facility. The plant ships product around the world, with customers on every continent except Antarctica.

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Business & Industrial Projects Financed



As BND's loan portfolio and services to other financial institutions continue to grow, securing funding sources becomes increasingly important. The Investment and Trust area of BND provided a record level of funding to North Dakota banks, hitting a peak of \$127 million in overnight federal funds in August of 2004.

The Bank invests and strengthens the state of North Dakota with a commitment to provide \$60 million over the 2003-2005 biennium. With this commitment BND remains among the top five revenue generators for the state general fund. For the first year of the 2003-2005 biennium, BND transferred a total of \$30 million to the general fund. Working closely with the North Dakota Industrial Commission, BND Advisory Board and the North Dakota Legislature the Bank provides a variety of programs to enhance growth throughout the state.

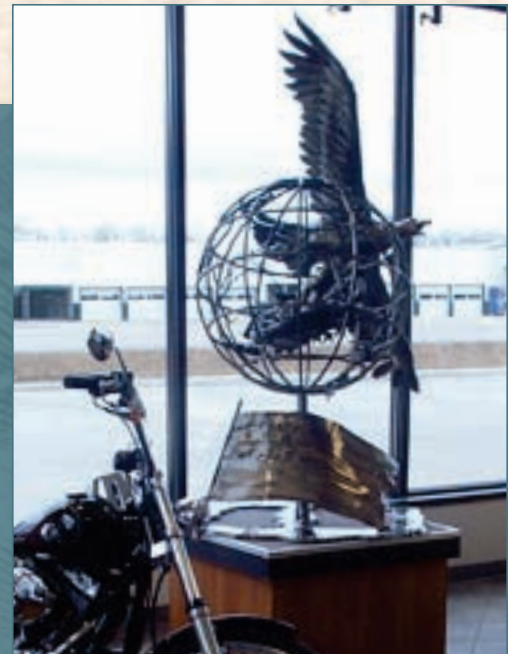
Bohl Ironworks

Bohl Iron Works started in May of 2002, when brothers Brad and Corey Bohl started doing custom metal work. They incorporated their father, Dave Bohl's, metal silhouette mailbox designs as one of their product lines. As the workload continued to grow, the three decided to take a chance on their own business.

A street-corner sale in Jamestown garnered a large order from a whole-sale company in Bismarck. The sale nudged the Bohls to take the next step in growing their business with a Beginning Entrepreneur Guarantee Program loan.

"Up until that point, we'd been cutting each piece by hand," said Brad. "In order to mass produce, we needed a computer-driven plasma cutter to create the various shapes. This also led to our line of grandfather clocks and home décor, and allowed us to refine and mainstream our previous line of products."

Bohl Iron Works opened an eBay store in November 2004 and is working on its first catalog. A group of investors has funded a sculpture honoring fallen soldiers of the war on terror, "Freedom Lives Within," which will be presented to President George W. Bush.



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Banking Services Remain Strong

BND provides a variety of financial services to banks, state agencies and other financial institutions throughout North Dakota. In this role, the Bank provides faster availability of funds drawn on North Dakota accounts and services business at a lower cost. The retail and bank operations services continue to focus on item and check processing in addition to improving automated services to customer banks and state agencies. In 2004, the Bank processed more than 4.1 million items per month.

Banking services also include the BND Direct Web Cash Management System. This system enables 117 financial institutions, state colleges and other agencies to access account data and reports through the Internet.

Strategic Planning Important Process

Based on its unique ownership, and recognizing the need to continually adapt to changing markets, BND developed a strategic plan. It established initiatives to assist in maintaining leadership while serving as an industry-leading model of efficiency and cost-control and providing quality customer service. These initiatives are designed to maintain growth, realize benefits, and create greater returns on investment while upgrading systems and delivery channels



Summers Manufacturing Co., Inc.

If there was a spokes-company for the BND Partnership in Assisting Community Expansion (PACE) program, Summers Manufacturing might very well be that company. The manufacturer of "Field Tested Tough" agricultural sprayers and tillage implements has successfully executed a series of PACE loans.

Most recently, Summers Manufacturing used a PACE loan to complete the largest expansion in its nearly 40-year history, with a 38,000 square foot addition at its Devils Lake facility. The expansion brought the total square footage in the Devils Lake complex to more than 104,000 square feet and necessitated adding 11 employees to the company's Devils Lake workforce.

"The new line of Ultimate Field Sprayer is larger than previous models, and we've increased the number of markets we sell to," said Deb Anderson, Summers Manufacturing Co., Inc. controller. "The PACE loan allowed us to increase the size of the facility, which also allowed for streamlining of the production process and adding additional workforce to keep up with the demand."

Summers distributes on a wholesale level to dealers and distributors throughout markets in 14 states and four Canadian provinces.

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necessary to grow and cement relationships. In 2004, BND also conducted a comprehensive survey of customers across the state to enable the Bank to plan for the future.

Remaining True to Our Vision and Mission

The accomplishments demonstrate that BND is true to its vision to be a financial services leader in North Dakota, and to foster growth and economic well-being for the state and its citizens using a partnership approach. BND's knowledgeable, well-trained people deliver exceptional customer service which results in consistent financial returns to the state.

The Bank's rich history demonstrates the ability to adapt to challenges and remain strong in its commitment to North Dakota and its people through its support of agriculture, education and economic development.

Overall, 2004 was a very good year for BND. With new programs, technology, and goals, Bank of North Dakota staff believe the Bank's and state's future look bright as BND strives to **Invest, Strengthen** and **Grow** North Dakota.

Infinity Replacement Windows

Created as a division of Marvin Windows and Doors, Infinity Windows' product line concentrates on high-quality, long-lasting, maintenance-free replacement windows that are custom-built to match the customer's existing window openings.

Available in a variety of styles, Infinity Windows provides superior thermal and energy performance, unmatched strength and durability, and features that allow homeowners to easily clean the exterior panes from inside the house.

The entirely new Infinity division was built from the ground up, and began selling products at the end of 2002. Currently in a high-growth phase, the company is looking to expand to a target level of several hundred employees in the next few years.

"As a start up operation, Infinity Windows was in need of capital to expand our manufacturing lines and add personnel to meet growing demand for our window products," said Dan Marvin, Business Unit Manager, Infinity Windows. "The competitive rates Infinity received through the PACE program allowed us to grow our infrastructure to meet demand and to price our products competitively in the marketplace. Our PACE loan has positioned Infinity well for future expansion in the state of North Dakota."



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ND leaders

ND industrial commission



John Hoeven
Governor



Roger Johnson
Commissioner of Agriculture



Wayne Stenehjem
Attorney General

BND advisory board



Standing: John Stewart, Elaine Fremling, Frank Larson, Karl Bollingberg. Seated: Gary Petersen, Shirley Montgomery, Bill Kingsbury.

BND executive committee



Standing: Ed Sather, Bob Humann, Kirby Martz, Tim Atkinson, Dale Eberle. Seated: Gayle Ciavarella, Eric Hardmeyer, Julie Kubisiak, Phyllis Lasher.

FINANCIAL STATEMENTS

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INDEPENDENT AUDITOR'S REPORT

The Industrial Commission
State of North Dakota
Bismarck, North Dakota

We have audited the accompanying balance sheets of the Bank of North Dakota as of December 31, 2004 and 2003, and the related statements of income, equity, and cash flows for the years then ended. These financial statements are the responsibility of the Bank's management. 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 1, the Bank of North Dakota is included as part of the primary government in the State of North Dakota's reporting entity. However, the Bank of North Dakota has prepared the accompanying financial statements in accordance with Financial Accounting Standards Board pronouncements, which is generally accepted accounting principles for financial institutions. This basis of accounting is a comprehensive basis of accounting other than generally accepted accounting principles applicable to governmental units.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank of North Dakota as of December 31, 2004 and 2003, and the results of its operations and its cash flows for the years then ended on the basis of accounting described in Note 1.

Eide Bailly LLP

Fargo, North Dakota
January 20, 2005

BANK OF NORTH DAKOTA
BALANCE SHEETS
DECEMBER 31, 2004 AND 2003

	(In Thousands)	
	<u>2004</u>	<u>2003</u>
ASSETS		
Cash and due from banks	\$ 184,173	\$ 186,752
Federal funds sold	122,230	89,915
	<u>306,403</u>	<u>276,667</u>
Cash and cash equivalents		276,667
Securities	253,186	284,272
Loans	1,456,256	1,391,583
Less allowance for loan losses	(25,927)	(25,334)
	<u>1,430,329</u>	<u>1,366,249</u>
Bank premises, equipment, and software, net	3,941	4,809
Interest receivable	16,228	15,242
Other assets	4,438	5,939
	<u>4,438</u>	<u>5,939</u>
Total assets	<u>\$ 2,014,525</u>	<u>\$ 1,953,178</u>
LIABILITIES AND EQUITY		
Deposits		
Non-interest bearing	\$ 201,448	\$ 214,275
Interest bearing	990,309	843,111
	<u>1,191,757</u>	<u>1,057,386</u>
Federal funds purchased and repurchase agreements	201,959	190,597
Short and long-term debt	436,593	525,795
Other liabilities	31,440	25,656
	<u>31,440</u>	<u>25,656</u>
Total liabilities	<u>1,861,749</u>	<u>1,799,434</u>
Equity		
Capital	2,000	2,000
Capital surplus	42,000	42,000
Undivided profits	110,947	110,947
Accumulated other comprehensive income (loss)	(2,171)	(1,203)
	<u>(2,171)</u>	<u>(1,203)</u>
Total equity	<u>152,776</u>	<u>153,744</u>
Total liabilities and equity	<u>\$ 2,014,525</u>	<u>\$ 1,953,178</u>

BANK OF NORTH DAKOTA
STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2004 AND 2003

	(In Thousands)	
	<u>2004</u>	<u>2003</u>
INTEREST INCOME		
Federal funds sold	\$ 1,653	\$ 1,849
Securities	7,432	7,292
Loans	<u>70,207</u>	<u>70,322</u>
Total interest income	<u>79,292</u>	<u>79,463</u>
INTEREST EXPENSE		
Deposits	13,622	14,843
Federal funds purchased and repurchase agreements	1,992	2,799
Short and long-term debt	<u>22,778</u>	<u>24,113</u>
Total interest expense	<u>38,392</u>	<u>41,755</u>
NET INTEREST INCOME	40,900	37,708
PROVISION FOR LOAN LOSSES	<u>2,400</u>	<u>2,000</u>
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	<u>38,500</u>	<u>35,708</u>
NONINTEREST INCOME		
Service fees and other	<u>12,494</u>	<u>11,474</u>
NONINTEREST EXPENSE		
Salaries	6,034	5,789
Pensions and other employee benefits	2,074	1,859
Data processing	2,690	2,496
Other operating expenses	4,973	4,404
Depreciation and amortization	<u>1,007</u>	<u>940</u>
Total noninterest expenses	<u>16,778</u>	<u>15,488</u>
NET INCOME	<u>\$ 34,216</u>	<u>\$ 31,694</u>

BANK OF NORTH DAKOTA
STATEMENTS OF EQUITY
YEARS ENDED DECEMBER 31, 2004 AND 2003

	(In Thousands)				
	Capital	Capital Surplus	Undivided Profits	Accumulated Other Comprehensive Income (Loss)	Total
BALANCE, DECEMBER 31, 2002	\$ 2,000	\$ 42,000	\$ 104,237	\$ 876	\$ 149,113
Comprehensive income					
Net income			31,694		31,694
Unrealized loss on securities available for sale				(2,079)	(2,079)
Total comprehensive income					29,615
Transfers to state general fund from current earnings			(28,209)		(28,209)
Reduction in contingency transfers to state general fund			3,300		3,300
Transfer to Industrial Commission			(85)		(85)
Reduction in transfer to Industrial Commission			10		10
BALANCE, DECEMBER 31, 2003	2,000	42,000	110,947	(1,203)	153,744
Comprehensive income					
Net income			34,216		34,216
Unrealized loss on securities available for sale				(968)	(968)
Total comprehensive income					33,248
Transfers to state general fund from current earnings			(34,216)		(34,216)
BALANCE, DECEMBER 31, 2004	\$ 2,000	\$ 42,000	\$ 110,947	\$ (2,171)	\$ 152,776

BANK OF NORTH DAKOTA
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2004 AND 2003

	(In Thousands)	
	2004	2003
OPERATING ACTIVITIES		
Net income	\$ 34,216	\$ 31,694
Adjustments to reconcile net income to net cash from operating activities		
Depreciation and amortization	1,007	940
Provision for loan losses	2,400	2,000
Net amortization of securities	1,136	2,034
Gain on sale of loans	(25)	(96)
Loss on retirement of equipment and software		-
Gain on sale of other real estate and property owned	(299)	(69)
(Increase) decrease in interest receivable	(986)	2,383
Decrease (increase) in other assets	133	(94)
Increase (decrease) in other liabilities	1,605	(2,020)
NET CASH FROM OPERATING ACTIVITIES	39,187	36,772
INVESTING ACTIVITIES		
Securities available for sale transactions		
Purchase of securities	(18,082)	(331,457)
Proceeds from sales, maturities, and principal repayments	76,132	249,526
Securities held to maturity transactions		
Purchase of securities	(48,123)	-
Proceeds from sales, maturities, and principal repayments	15,201	33,651
Purchase of Federal Home Loan Bank stock	(15,763)	(9,610)
Sale of Federal Home Loan Bank stock	19,742	4,870
Purchase of other equity securities	(125)	-
Proceeds from sales of loans	30,504	65,001
Net increase in loans	(97,107)	(131,828)
Purchases of equipment and software	(139)	(608)
Proceeds from sale of other real estate and property owned	1,815	621
NET CASH (USED FOR) INVESTING ACTIVITIES	(35,945)	(119,834)
FINANCING ACTIVITIES		
Net (decrease) increase in non-interest bearing deposits	(12,827)	5,163
Net increase (decrease) in interest bearing deposits	147,198	(18,630)
Net increase (decrease) in federal funds purchased and repurchase agreements	11,362	(106,091)
Proceeds from issuance of short and long-term debt	6,420,035	1,210,000
Payment of short and long-term debt	(6,509,237)	(1,105,270)
Payment of transfers	(30,037)	(34,037)
NET CASH FROM (USED FOR) FINANCING ACTIVITIES	26,494	(48,865)
NET CHANGE IN CASH AND CASH EQUIVALENTS	29,736	(131,927)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	276,667	408,594
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 306,403	\$ 276,667

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2004 AND 2003

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 made in tandem with financial institutions throughout the State of North Dakota. BND's primary deposit products are interest-bearing accounts for state and political subdivisions.

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. In accordance with GASB Statement No. 20, BND follows all applicable GASB pronouncements and all applicable Financial Accounting Standards Board (FASB) pronouncements issued, including those issued after November 30, 1989, unless they conflict with the GASB pronouncements.

However, the accompanying financial statements are prepared in accordance with Financial Accounting Standards Board pronouncements, which are generally accepted accounting principles for financial institutions. This basis of accounting is a comprehensive basis of accounting other than generally accepted accounting principles applicable to governmental units.

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 determination of the allowance for loan losses.

Significant Group Concentrations of Credit Risk

Most of the Bank's lending activities are with customers within the State of North Dakota. Due to the pervasive nature of agriculture in the economy of the state, all loans, regardless of type, are impacted by agriculture. The Bank's loan portfolio is comprised of the following concentrations as of December 31, 2004 and 2003:

	<u>2004</u>	<u>2003</u>
Student loans, of which 98% are federally guaranteed	29%	27%
Commercial loans, of which 7% are federally guaranteed	33%	34%
Residential loans, of which 83% and 84% are federally guaranteed	22%	23%
Agricultural loans, of which 17% and 20% are federally guaranteed	16%	16%
	<u>100%</u>	<u>100%</u>

NOTES TO FINANCIAL STATEMENTS

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 of which mature within 90 days.

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 change 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 issuer 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 settlement date and are determined using the specific identification method.

Because of its borrowing arrangement with the Federal Home Loan Bank, the Bank is required to hold Federal Home Loan Bank stock. Since ownership of this stock is restricted, these securities are carried at cost and evaluated periodically for impairment.

Other equity securities that do not have a readily determinable fair value are stated at cost.

Loans Held For Sale

Loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or fair value.

Loans

Loans are reported at the outstanding unpaid principal balance. Interest income on loans is accrued at the specific rate on the unpaid principal balance.

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. Interest income is subsequently recognized only to the extent cash payments are received.

Allowance for Loan Losses

The Bank uses the allowance method in providing for loan losses. Accordingly, the allowance is increased by the current year's provision for loan losses charged to operations and reduced by net charge-offs. Loan 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.

NOTES TO FINANCIAL STATEMENTS

The adequacy of the allowance for loan losses and the provision for loan losses charged to operations are based on management's evaluation of a number of factors, including recent loan 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 either 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-classified 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.

Impairment is measured on a loan-by-loan basis for commercial, agricultural, farm real estate, state institution and bank stock 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.

Loan Servicing

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of residential loans. Purchased servicing rights are capitalized at the cost to acquire the rights. Capitalized servicing rights are reported in other assets and are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying residential loans. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income prepayment speeds and default rates and losses. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche.

Credit Related Financial Instruments

In the ordinary course of business, the Bank has entered into commitments to extend credit and financial standby letters of credit. Such financial instruments are recorded when they are funded.

NOTES TO FINANCIAL STATEMENTS

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, 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.

Other Real Estate and Property Owned

Other real estate and property owned, which are included in other assets, represent assets acquired through loan foreclosure or other proceedings. Other real estate and property owned 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 other real estate and property owned 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. Other real estate and property owned totaled \$687,000 and \$3,050,000 as of December 31, 2004 and 2003.

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.

NOTE 2 - RESTRICTION ON CASH AND DUE FROM BANKS

Federal Reserve Board regulations require reserve balances on deposits to be maintained by BND with the Federal Reserve Bank. BND also maintains a clearing balance of \$4 million with the Federal Reserve Bank.

NOTES TO FINANCIAL STATEMENTS

NOTE 3 - DEBT AND EQUITY SECURITIES

Debt and equity securities have been classified in the financial statements according to management's intent. The carrying value of securities as of December 31, 2004 and 2003, consists of the following:

	(In Thousands)	
	2004	2003
Securities available for sale, at fair value	\$ 180,887	\$ 241,022
Securities held to maturity, at amortized cost	50,389	17,485
Federal Home Loan Bank stock, at cost	21,785	25,765
Other equity securities, at cost	125	-
	<u>\$ 253,186</u>	<u>\$ 284,272</u>

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

	(In Thousands)			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
DECEMBER 31, 2004				
Securities available for sale				
Federal agency	\$ 50,065	\$ 5	\$ 311	\$ 49,759
Mortgage-backed	132,993	94	1,959	131,128
	<u>\$ 183,058</u>	<u>\$ 99</u>	<u>\$ 2,270</u>	<u>\$ 180,887</u>
Securities held to maturity				
Mortgage-backed	\$ 10,425	\$ 45	\$ 44	\$ 10,426
State and municipal	39,964	-	-	39,964
	<u>\$ 50,389</u>	<u>\$ 45</u>	<u>\$ 44</u>	<u>\$ 50,390</u>

NOTES TO FINANCIAL STATEMENTS

	(In Thousands)			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
DECEMBER 31, 2003				
Securities available for sale				
Federal agency	\$ 84,335	\$ 323	\$ 242	\$ 84,416
Mortgage-backed	157,890	68	1,352	156,606
	<u>\$ 242,225</u>	<u>\$ 391</u>	<u>\$ 1,594</u>	<u>\$ 241,022</u>
Securities held to maturity				
Mortgage-backed	\$ 11,025	\$ 11	\$ 30	\$ 11,006
State and municipal	6,460	-	-	6,460
	<u>\$ 17,485</u>	<u>\$ 11</u>	<u>\$ 30</u>	<u>\$ 17,466</u>

Securities carried at \$11,130,000 at December 31, 2004, and \$20,854,000 at December 31, 2003, were used to secure repurchase agreements and for other required pledging purposes. FHLB stock totaling \$21,785,000 at December 31, 2004 and \$25,765,000 at December 31, 2003 is pledged on the FHLB advances (Note 9).

The maturity distribution of debt securities at December 31, 2004, 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.

	(In Thousands)			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within one year	\$ 30,078	\$ 29,881	\$ 981	\$ 981
Over one year through five years	149,904	147,921	3,649	3,671
Over five years through ten years	3,076	3,085	11,191	11,204
Over ten years	-	-	34,568	34,534
	<u>\$ 183,058</u>	<u>\$ 180,887</u>	<u>\$ 50,389</u>	<u>\$ 50,390</u>

There were no sales of securities during 2004 and 2003.

NOTES TO FINANCIAL STATEMENTS

Information pertaining to securities with gross unrealized losses at December 31, 2004, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	(In Thousands)			
	Less Than Twelve Months		Over Twelve Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Securities available for sale				
Federal agency	\$ 43	\$ 25,175	\$ 268	\$ 21,579
Mortgage-backed	373	17,650	1,586	96,818
	<u>\$ 416</u>	<u>\$ 42,825</u>	<u>\$ 1,854</u>	<u>\$ 118,397</u>
Securities held to maturity				
Mortgage-backed	\$ 41	\$ 5,452	\$ 3	\$ 576

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, 2004, there were no securities that have unrealized losses with aggregate depreciation of 5% from the Bank's amortized cost basis.

NOTE 4 - LOANS

The composition of the loan portfolio at December 31, 2004 and 2003, is as follows:

	(In Thousands)	
	2004	2003
Guaranteed student loans	\$ 417,356	\$ 372,362
Bank participation loans:		
Commercial	394,867	369,458
Agricultural	137,218	140,556
Residential loans	322,044	318,067
Farm real estate loans	98,768	90,686
State institutions	35,136	45,134
Bank stock	50,867	55,320
	<u>1,456,256</u>	<u>1,391,583</u>
Allowance for loan losses	25,927	25,334
	<u>\$ 1,430,329</u>	<u>\$ 1,366,249</u>

(continued on next page)

NOTES TO FINANCIAL STATEMENTS

Student loans held for sale totaled \$6,634,000 and \$6,231,000 as of December 31, 2004 and 2003. Unamortized deferred student loan costs totaled \$2,314,000 and \$2,114,000 as of December 31, 2004 and 2003. Net unamortized loan premiums and discounts, including purchased servicing rights, on residential loans totaled \$2,029,000 and \$2,215,000 as of December 31, 2004 and 2003.

The composition of the allowance for loan losses for the years ended December 31, 2004 and 2003, is as follows:

	(In Thousands)	
	2004	2003
Balance - beginning of year	\$ 25,334	\$ 25,091
Provision for loan losses	2,400	2,000
Loans charged off	(1,971)	(1,976)
Recoveries	164	219
Balance - end of year	<u>\$ 25,927</u>	<u>\$ 25,334</u>

The following is a summary of information pertaining to impaired, non-accrual and restructured loans:

	(In Thousands)	
	December 31,	
	2004	2003
Impaired loans without a valuation allowance	\$ 152	\$ 182
Impaired loans with a valuation allowance	3,147	4,043
Total impaired loans	<u>\$ 3,299</u>	<u>\$ 4,225</u>
Valuation allowance related to impaired loans	\$ 1,488	\$ 1,416
Average investment in impaired loans	3,401	8,927
Total non-accrual loans	3,299	4,225
Total loans past-due ninety days or more and still accruing	18,866	21,463
Restructured loans	10,048	12,594

The interest income recorded on impaired loans is not significant.

Accruing loans 90 days or more past due include guaranteed student loans of \$15,070,000 and \$13,762,000 as of December 31, 2004 and 2003. 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.

There were no material commitments to lend additional funds to customers whose loans were classified as impaired or restructured at December 31, 2004.

NOTES TO FINANCIAL STATEMENTS

NOTE 5 - LOAN SALES AND LOAN SERVICING

A summary of BND's loan sales during 2004 and 2003 follows:

	(In Thousands)	
	2004	2003
Student loans sold to North Dakota Student Loan Trust	\$ 27,842	\$ 51,957
Residential loans sold on the secondary market	2,637	12,948

BND recognized gains on sale of loans of \$25,000 and \$96,000 in 2004 and 2003, which is included in non-interest income on the Statements of Income.

A servicing asset or liability was not recognized in the student loan sales since BND receives adequate compensation relative to current market servicing prices to service the student loans sold. Servicing assets were recognized on the sale of residential loans.

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, 2004 and 2003 were as follows:

	(In Thousands)	
	2004	2003
Student loans		
North Dakota Student Loan Trust	\$ 146,396	\$ 153,854
Others	5,498	5,646
Residential loans	29,261	31,867
Other state fund loans		
Board of University and School Lands	22,215	26,802
Community Water Facility Loan Fund	18,520	16,522
Beginning Farmer Revolving Loan Fund	8,583	9,086
Developmentally Disabled Facility Loan Program	2,700	3,421
Department of Human Services	10,754	9,620
Credit Review Board	2	3

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 existing residential loan servicing agreements, the Bank generally agrees to reimburse lenders for all losses, damages, judgments or legal expenses that resulted from the actions or inactions of the Bank. Any potential liability for claims under these agreements is not considered significant.

The balance of capitalized servicing rights, net of valuation allowances, included in other assets at December 31, 2004 and 2003, was \$226,000 and \$251,000. The fair value of these rights was \$384,000 and \$368,000 at December 31, 2004 and 2003.

NOTES TO FINANCIAL STATEMENTS

The following table summarizes the changes in capitalized servicing rights for the years ended December 31, 2004 and 2003:

	(In Thousands)	
	2004	2003
Balance - beginning of year	\$ 251	\$ 248
Purchases	32	142
Amortization	(57)	(139)
	<u>226</u>	<u>251</u>
Less valuation allowance	-	-
Balance - end of year	<u>\$ 226</u>	<u>\$ 251</u>

NOTE 6 - BANK PREMISES, EQUIPMENT, AND SOFTWARE

A summary of changes in bank premises, equipment, furniture, and software at December 31, 2004 and 2003, is as follows:

	(In Thousands)			
	Balance 2003	Additions	Retirements	Balance 2004
Land	\$ 672	\$ -	\$ -	\$ 672
Building	4,285	-	-	4,285
Equipment	1,559	28	28	1,559
Furniture	533	16	8	541
Software	6,633	95	80	6,648
	<u>13,682</u>	<u>139</u>	<u>116</u>	<u>13,705</u>
Less accumulated depreciation	<u>8,873</u>	<u>1,007</u>	<u>116</u>	<u>\$ 9,764</u>
	<u>\$ 4,809</u>	<u>\$ (868)</u>	<u>\$ -</u>	<u>\$ 3,941</u>

	(In Thousands)			
	Balance 2002	Additions	Retirements	Balance 2003
Land	\$ 672	\$ -	\$ -	\$ 672
Building	4,285	-	-	4,285
Equipment	1,546	105	92	1,559
Furniture	518	29	14	533
Software	6,168	474	9	6,633
	<u>13,189</u>	<u>608</u>	<u>115</u>	<u>13,682</u>
Less accumulated depreciation	<u>8,048</u>	<u>940</u>	<u>115</u>	<u>8,873</u>
	<u>\$ 5,141</u>	<u>\$ (332)</u>	<u>\$ -</u>	<u>\$ 4,809</u>

Depreciation and amortization expense on the above assets amounted to \$1,007,000 and \$940,000 in 2004 and 2003.

NOTES TO FINANCIAL STATEMENTS

NOTE 7 - DEPOSITS

The aggregate amount of locally sold certificates of deposit larger than \$100,000 was \$569,139,000 and \$464,369,000 as of December 31, 2004 and 2003.

At December 31, 2004, the scheduled maturities of certificates of deposits are as follows:

	(In Thousands)
2005	\$ 483,773
2006	23,616
2007	19,561
2008	8,836
2009	7,781
Later years	41,228
	<u>\$ 584,795</u>

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. These agreements are secured by Fed book-entry securities.

NOTE 9 - SHORT AND LONG-TERM DEBT

Short and long-term debt consist of:

	(In Thousands)	
	<u>2004</u>	<u>2003</u>
Federal Home Loan Bank advances - short-term	\$ 100,000	\$ 125,000
Federal Home Loan Bank advances - long-term	336,195	400,330
North Dakota Municipal Bond Bank, 3%, matures from September 2007 through September 2014	<u>398</u>	<u>465</u>
	<u>\$ 436,593</u>	<u>\$ 525,795</u>

NOTES TO FINANCIAL STATEMENTS

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

	(In Thousands)		
	Principal	Interest	Total
2005	\$ 160,712	\$ 18,196	\$ 178,908
2006	20,087	15,486	35,573
2007	11,209	14,670	25,879
2008	91,237	10,093	101,330
2009	6,815	8,780	15,595
Later years	146,533	50,271	196,804
Totals	<u>\$ 436,593</u>	<u>\$ 117,496</u>	<u>\$ 554,089</u>

The Federal Home Loan Bank (FHLB) short-term advances outstanding at December 31, 2004, mature on January 4 through January 6, 2005 and have a weighted average interest rate of 2.20%. The FHLB long-term advances outstanding at December 31, 2004, mature from March 2005 through April 2022. The FHLB long-term advances have fixed rate interest, ranging from 2.98% to 7.35%. The advances must be secured by minimum qualifying collateral maintenance levels by pledging residential loans totaling \$315,338,000 in 2004 and \$304,388,000 in 2003 and guaranteed student loans totaling \$198,034,000 in 2004 and \$316,157,000 in 2003.

The North Dakota Municipal Bond Bank long-term borrowing is unsecured. Proceeds from the long-term borrowing are used to make irrigation loans at Bank of North Dakota.

NOTE 10 - OTHER LIABILITIES

Other liabilities consist of:

	(In Thousands)	
	2004	2003
Transfers payable	\$ 19,773	\$ 15,594
Buydown interest	4,296	3,560
Escrow balances	1,873	1,813
ACH clearing account	187	632
Interest payable	2,142	1,350
Student loan origination fee payable	323	326
Official checks	273	407
Accrued expenses	1,517	1,233
Other	1,056	741
	<u>\$ 31,440</u>	<u>\$ 25,656</u>

NOTES TO FINANCIAL STATEMENTS

The 2003 North Dakota Legislature passed Senate Bill 2015 which provides for two transfers to the State's General Fund from the Bank during the biennium beginning July 1, 2003 and ending June 30, 2005.

A transfer up to \$60,000,000 was approved from the current earnings and the accumulated undivided profits of the Bank. No more than \$15,000,000 of the amount transferred may come from accumulated undivided profits. The moneys must be transferred in the amounts and at such times as requested by the director of the Office of Management and Budget. \$30,000,000 was transferred to the State's General Fund in 2004.

A contingent Bank transfer will be required if during the biennium ending June 30, 2005 the director of the Office of Management and Budget determines through revised projections that general fund revenue collections will not meet the revenues as forecast in the March 2003 legislative forecast. The Industrial Commission shall transfer this additional amount as determined by the director of the Office of Management and Budget and approved by the budget section from the earnings and accumulated undivided profits of the Bank. The moneys must be transferred in amounts and at such times as requested by the director of the Office of Management and Budget. The additional amount transferred may not exceed the lesser of \$9,000,000 or the revenue shortfall of actual collections compared to the March 2003 legislative forecast. The director may determine what portion of the shortfall will be covered by this contingent transfer and what portion will be covered by allotment pursuant to section 54-44.1-12 of the North Dakota century code. As of December 31, 2004, projected revenues exceed the March 2003 legislative forecast for projected revenues.

Any transfer authorized by the fifty-eighth legislative assembly may only be made to the extent the transfer does not reduce the Bank's capital structure below \$140,000,000.

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 cost-sharing multiple-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.

NOTES TO FINANCIAL STATEMENTS

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). 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 4% 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 has implemented a salary reduction agreement and is currently contributing the employees share. Bank of North Dakota is required to contribute 4.12% of each participant's salary as the employer's share. In addition to the 4.12% employer contribution, the employer is required to contribute 1% 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 governing authority of NDPERS. Bank of North Dakota's required and actual contributions to NDPERS for the fiscal years ending December 31, 2004, and 2003, were approximately \$526,000 and \$513,000.

NDPERS issues a publicly available financial report that includes financial statements and the required supplementary information for NDPERS. 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

State Water Development Projects

Senate Bill No. 2022 provided the State Water Commission a line of credit – contingent appropriation, that states, if determined necessary by the State Water Commission, Bank of North Dakota shall extend a line of credit, not to exceed \$25,000,000, or so much of the sum as may be necessary, to the State Water Commission for the purpose of interim financing until bonds are issued under chapters 61-02 and 61-02.1, for the biennium beginning July 1, 2003, and ending June 30, 2005. As of December 31, 2004, Bank of North Dakota has funded \$11,000,000 under the line of credit.

Under chapters 61-02 and 61-02.1 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 or from payment from the Perkins County rural water system, 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 to pay bonds issued for a specific 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 \$6,500,000 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. No transfer was made from the Bank of North Dakota for statewide water development projects for the 2003-2005 biennium by the legislature.

NOTES TO FINANCIAL STATEMENTS

Farm Real Estate Loan Guarantee Program

Chapter 6-09.7 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 \$400,000. The Bank of North Dakota may have no more than \$5,000,000 in outstanding loan guarantees under this program. The Bank of North Dakota 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, 2004, the Bank of North Dakota has provided guarantees totaling \$884,000 and there were no guarantee commitments outstanding under this program. At December 31, 2003 there were no guarantees or guarantee commitments outstanding under this program.

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 of North Dakota shall pay the lender the amount agreed upon up to 85 percent of the amount of principal due the lender on a loan at the time the claim is approved. A lender may apply to the Bank of North Dakota for a loan guarantee for a loan of up to \$100,000. The term of the guarantee may not exceed five years. The Bank may provide guarantees totaling \$3,400,000. As of December 31, 2004 and 2003, the Bank has provided guarantees totaling \$1,746,000 and \$1,346,000, and has guarantee commitments outstanding of \$26,000 and \$32,000 included in commitments to extend credit.

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 the North Dakota Student Loan Trust and loans serviced for the North Dakota Student Loan Trust and other state funds.

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 and financial standby letters of credit. 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.

NOTES TO FINANCIAL STATEMENTS

At December 31, 2004 and 2003, the following financial instruments were outstanding whose contract amounts represent credit risk:

	Contract Amount (In Thousands)	
	<u>2004</u>	<u>2003</u>
Commitments to extend credit	\$ 281,052	\$ 237,582
Financial standby letters of credit	130,725	124,636

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 likelihood of funding any of these letters of credit is considered to be remote. The Bank generally holds collateral supporting those commitments if deemed necessary.

NOTE 15 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Bank's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. Statement of Financial Accounting Standards No. 107 excludes certain financial instruments and all non-financial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Bank.

NOTES TO FINANCIAL STATEMENTS

The carrying amounts and estimated fair values of the Bank's financial instruments as of December 31, 2004 and 2003, were as follows:

	(In Thousands)			
	2004		2003	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	\$ 306,403	\$ 306,403	\$ 276,667	\$ 276,667
Securities	253,186	253,187	284,272	284,253
Interest receivable	16,228	16,228	15,242	15,242
Loans				
Guaranteed student loans	417,356	417,356	372,362	372,362
Residential loans	322,044	343,336	318,067	337,684
Other loans	716,856	700,578	701,154	699,956
Allowance for loan losses	(25,927)	-	(25,334)	-
Total loans	1,430,329	1,461,270	1,366,249	1,410,002
Total financial assets	\$ 2,006,146	\$ 2,037,088	\$ 1,942,430	\$ 1,986,164
Financial liabilities				
Non-maturity deposits	\$ 606,962	\$ 606,962	\$ 576,758	\$ 576,758
Deposits with stated maturities	584,795	592,428	480,628	481,634
Federal funds purchased and repurchase agreements	201,959	201,959	190,597	190,597
Short and long-term debt	436,593	453,276	525,795	544,276
Other liabilities	31,440	31,440	25,656	25,656
Total financial liabilities	\$ 1,861,749	\$ 1,886,065	\$ 1,799,434	\$ 1,818,921

The following methods and assumptions were used by the Bank in estimating fair value disclosures for financial instruments:

Cash and Cash Equivalents

The carrying amounts of cash and cash equivalents approximate fair value due to the relatively short period of time between the origination of the instruments and their expected realization.

Securities

The fair value for securities is based on quoted market values, when available. If quoted market prices were not available, fair value was estimated using quoted market prices for similar assets. The carrying value of Federal Home Loan Bank stock approximates fair value based on the redemption provisions of the Federal Home Loan Bank.

NOTES TO FINANCIAL STATEMENTS

Guaranteed Student Loans

The fair value for student loans is based on market values as established by the secondary market.

Residential Loans

The fair value for residential loans has been estimated by discounting future cash flows to reflect management's estimate of current rates for financing borrowers under substantially similar terms and degrees of risk. Projected cash flows on non-accrual loans were reduced by the amount of the estimated losses in the portfolio.

Other Loans

The fair value for all other categories of loans has been estimated by discounting future cash flows to reflect management's estimate of current rates for financing borrowers under substantially similar terms and degrees of risk. Projected cash flows on non-accrual loans were reduced by the amount of the estimated losses on the portfolio.

Interest Receivable and Payable

The carrying amount of interest receivable and payable approximates fair value due to the relatively short period of time between accrual and expected realization.

Non-Maturity Deposits

The fair value for deposits with no stated maturity, such as demand deposits, savings, NOW, and money market accounts, are disclosed as the amount payable upon demand.

Deposits With Stated Maturities

The fair value for interest bearing certificates of deposit has been estimated by discounted future cash flows using rates currently offered for deposits of similar remaining maturities.

Federal Funds Purchased and Repurchase Agreements

The carrying amount of federal funds purchased and repurchase agreements approximates fair value due to the relatively short period of time between the origination of the instruments and their expected payments.

Short and Long-Term Debt

Current market prices were used to estimate the fair value of short and long-term debt using current market rates of similar maturity debt.

Other Liabilities

The carrying amount of other liabilities approximates fair value due to the short period of time until expected payment.

Off-Balance-Sheet Credit-Related Instruments

Fair values of off-balance-sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standing. The carrying amount and fair value of off-balance-sheet credit-related instruments are not significant.

NOTES TO FINANCIAL STATEMENTS

NOTE 16 - COMPREHENSIVE INCOME

The Bank recognizes and includes revenue, 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 a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

Changes in and determination of accumulated other comprehensive income (loss) is as follows:

	(In Thousands)	
	Unrealized Gain (Loss) on Securities Available for Sale	
	<u>2004</u>	<u>2003</u>
Balance, beginning of year	\$ (1,203)	\$ 876
Unrealized holding gains (losses) arising during the period	(968)	(2,079)
Reclassification adjustment for (gains) losses realized in net income	-	-
Other comprehensive income	(968)	(2,079)
Balance, end of year	<u>\$ (2,171)</u>	<u>\$ (1,203)</u>

NOTE 17 - SUPPLEMENTAL DISCLOSURES RELATED TO STATEMENTS OF CASH FLOWS

	(In Thousands)	
	<u>2004</u>	<u>2003</u>
Supplemental disclosures of cash flow information		
Cash payments for:		
Interest paid to customers	\$ 12,844	\$ 16,209
Interest paid on federal funds purchased and securities sold under repurchase agreements	1,985	2,802
Interest paid on short and long-term debt	22,770	24,112
Supplemental schedule of noncash investing and financing activities		
Reduction in transfers payable	-	(3,310)
Transfers from undivided profits to other liabilities	34,216	28,294
Net change in unrealized gain (loss) on securities available for sale	(968)	(2,079)
Other real estate and property owned acquired in exchange for loans	148	3,568

BANK OF NORTH DAKOTA
TEN-YEAR SUMMARY

TEN YEAR SUMMARY	2004	2003	2002
OPERATING RESULTS (in thousands)			
Interest income	\$ 79,292	\$ 79,463	\$ 90,315
Interest expense	38,392	41,755	50,666
Net interest income	40,900	37,708	39,649
Provision for loan losses	2,400	2,000	2,200
Net interest income after provision for loan losses	38,500	35,708	37,449
Non Interest Income	12,494	11,474	9,764
Non Interest Expense	16,778	15,488	15,022
Net income	34,216	31,694	32,191
Payments to general fund	30,000	34,000	30,000
Payments to other funds	37	37	36
BALANCE SHEET - YEAR END (in thousands)			
TOTAL ASSETS	2,014,525	1,953,178	1,974,448
FEDERAL FUNDS SOLD AND RESELL AGREEMENTS	122,230	89,915	209,205
SECURITIES	253,186	284,272	235,365
LOANS	1,456,256	1,391,583	1,329,985
Residential loans	322,044	318,067	309,267
Guaranteed student loans	417,356	372,362	364,816
Bank participation loans			
Commercial	394,867	369,458	356,576
Agriculture	137,218	140,556	146,378
Farm real estate loans	98,768	90,686	76,584
State institutions	35,136	45,134	25,954
Bank stock	50,867	55,320	50,410
DEPOSITS	1,191,757	1,057,386	1,070,853
Non-interest bearing	201,448	214,275	209,112
Interest bearing	990,309	843,111	861,741
FEDERAL FUNDS PURCHASED AND REPURCHASE AGREEMENTS	201,959	190,597	296,688
SHORT AND LONG-TERM DEBT	436,593	525,795	421,065
EQUITY	152,776	153,744	149,113
Capital	2,000	2,000	2,000
Capital surplus	42,000	42,000	42,000
Accumulated other comprehensive income (loss)	(2,171)	(1,203)	876
Undivided profits	110,947	110,947	104,237

	2001	2000	1999	1998	1997	1996	1995
\$ 114,490	\$ 117,163	\$ 99,350	\$ 87,788	\$ 70,891	\$ 67,377	\$ 62,742	
82,840	75,774	62,487	53,852	40,768	39,865	37,595	
41,650	41,389	36,863	33,936	30,123	27,512	25,147	
2,700	2,700	1,600	1,700	600	600	1,700	
38,950	38,689	35,263	32,236	29,523	26,912	23,447	
8,646	7,224	7,838	8,651	8,189	7,812	9,514	
14,537	13,331	12,642	12,750	12,168	11,533	11,322	
33,059	32,582	30,459	28,137	25,544	23,191	21,639	
50,000	-	15,000	29,600	12,715	37,500	-	
36	35	35	40	41	38	25,195	
2,107,456	1,806,517	1,687,167	1,609,039	1,162,415	1,068,082	1,033,816	
257,830	271,510	249,565	206,095	128,180	86,470	67,045	
329,632	192,093	235,007	427,842	269,860	284,491	347,180	
1,276,334	1,156,614	1,056,232	835,654	623,532	554,001	487,297	
271,385	213,009	188,474	113,934	38,089	29,595	27,808	
399,002	376,535	335,687	292,896	244,154	205,787	168,755	
356,848	328,205	311,787	228,723	190,088	181,179	155,654	
150,042	138,753	127,131	94,971	75,528	82,253	83,217	
63,699	65,377	62,080	61,205	45,217	40,035	33,314	
21,808	25,487	21,037	34,678	20,561	5,947	11,271	
13,550	9,248	10,036	9,247	9,895	9,205	7,278	
1,208,601	1,135,731	910,652	943,537	719,508	728,122	676,798	
193,354	130,470	83,798	133,307	117,708	106,120	117,579	
1,015,247	1,005,261	826,854	810,230	601,800	622,002	559,219	
315,713	215,072	250,985	309,496	234,114	198,108	164,956	
399,553	254,439	363,076	203,779	54,087	14,500	57,000	
170,496	153,045	139,275	139,931	128,888	98,477	76,000	
2,000	2,000	2,000	22,000	22,000	22,000	22,000	
42,000	42,000	42,000	22,000	22,000	22,000	22,000	
259	338	(1,428)	195	102	(61)	508	
126,237	108,707	96,703	95,736	84,786	54,538	31,492	

BANK OF NORTH DAKOTA

core values

SERVICE - Excel and Deliver

TEAMWORK - Together We Accomplish More

ETHICS - Do The Right Thing

PEOPLE - Set Us Apart



from
its very
beginning...

when the state legislature started the Bank in 1919, BND has been investing in the future of our state's strong agricultural economy.

Today we continue to **invest** in an array of programs, **strengthen** our services through technological advances and **grow** our partnerships through superior customer service with thousands of people and institutions in North Dakota.



Invest
strengthen
grow

BND

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