

BANK OF NORTH DAKOTA
Annual Report 2005



A STATE OF PROGRESS



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.

mission

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

from the P R E S I D E N T



Eric Hardmeyer,
President

In 1919, Bank of North Dakota (BND) began its mission of delivering quality, sound financial services that promote agriculture, commerce and industry. Staying true to this mission has led us to experience a year of progress in the programs, services and technology we utilize to better serve our customers and, in turn, strengthen our great state.

In 2005, BND realized an all-time record year for profitability with net bank earnings of \$36.4 million, an increase of \$2.2 million or 6.5 percent over 2004. This record profit is evidence of both the state's well being and BND's adherence to the vision and initiatives of the Bank's strategic plan.

Total assets at BND grew to \$2.06 billion with a loan portfolio that increased by approximately \$11 million in 2005. Return on average assets was 1.84 percent and return on average equity was 22.94 percent, compared to 1.77 percent and 22.1 percent respectively for 2004.

Among the highlights for 2005 was conversion from our previous computer systems to a single integrated software suite of core banking solutions in order to provide state-of-the-art technology to our valued customers. The implementation of the new programs enables BND to provide a variety of financial services to our customers including banks, state agencies and other organizations throughout the state.

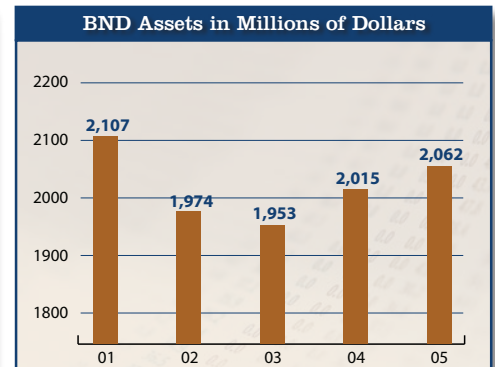
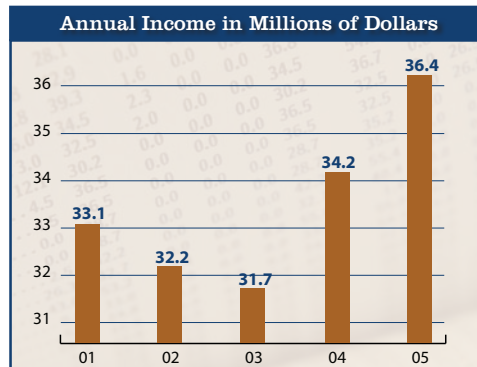
BND continues to find ways to intensify economic development, from working with small main street businesses to the large corporations involved in our energy boom.

In addition, details on design and construction of BND's new home have generated a wave of excitement for our employees and the state which we proudly serve.

We look forward to another year of progress, growth and opportunity as we continue to follow our vision of fostering growth and economic well-being for the state and its citizens.



Eric Hardmeyer
President



A STATE OF OPPORTUNITY

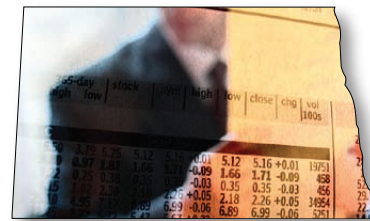
Loan Programs Generate Growth

Bank of North Dakota strengthened its core banking business by continuing to develop and provide solid loan programs that add value to the state and generate growth. Working in partnership with financial institutions and business owners, BND implemented progressive programs that helped provide growth by funding 190 business and industrial projects throughout the state in 2005.

New Programs Offer Opportunities

Lending is fundamental to BND's work as a development Bank. The Bank's loan programs attract borrowers by providing flexibility, low interest financing, long-term fixed rates and risk sharing with its banking partners. To help meet the needs of small business owners, farmers, ranchers and commercial businesses, BND enhanced eight existing loan programs and added four new programs: Feedlot Loan Guarantee Program, Livestock Waste Management System Program, Biodiesel PACE and Flex PACE Programs.

- The Feedlot Loan Guarantee Program helps expand the cattle feeding industry in North Dakota. The Bank works in partnership with other lenders to guarantee loans for feedlot owners who raise cattle to harvest-ready weight.
- The Livestock Waste Management System Loan Program provides low-interest financial assistance to producers for installing waste management facilities. The goal is to reduce or prevent water quality impacts associated with livestock waste.
- The Biodiesel PACE program provides funding for North Dakota production facilities involved in production of biodiesel.
- Flex PACE is a special feature of the PACE (Partnership in Assisting Community Expansion) program which provides interest buy down to non-PACE qualifying businesses. The Community determines eligibility and accountability standards. The Flex PACE program can be utilized for essential services without the criteria of creating new jobs.



Disaster Relief Loan Programs Assist North Dakotans

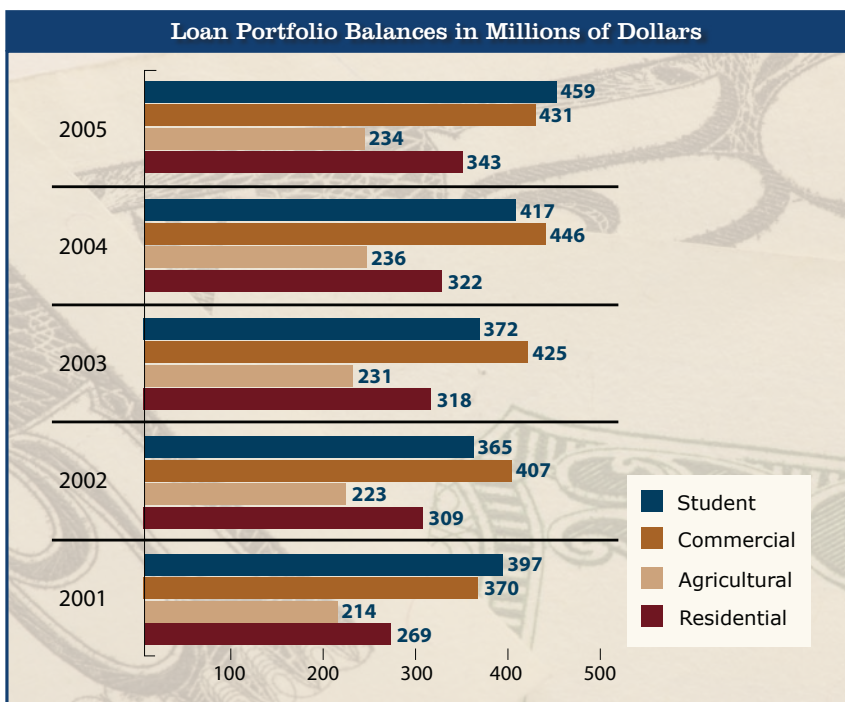
Helping out others in a time of need, BND created Disaster Relief Loan Programs for North Dakota residents impacted by severe weather-related events in 2005. BND provided residential, farm and business loan funding in alliance with financial institutions located in affected areas. The Disaster Relief Loan Programs were designed to assist homeowners, farmers and business owners in North Dakota counties and towns that were declared disaster areas.

A STATE OF GROWTH

Loan Portfolio Diversified

In 2005, BND generated loan growth in four major areas: business, agriculture, student and home lending. All of these areas provide diversity and a stable loan portfolio for BND, with commercial loans accounting for 30 percent, student loans 31 percent, residential loans 23 percent and agricultural loans 16 percent of the total loan portfolio.

The loan portfolio grew by approximately \$11 million in 2005, which is important due to the fact that BND sold approximately \$66 million in student loans to the Student Loan Trust.



Jeff and Jim Lyons

For Jeff and Jim Lyons of Lisbon, the Agriculture Partnership in Assisting Community Expansion (Ag PACE) program is all about percentages and opportunities. Borrowing at a lower rate of interest translated into a 60 percent expansion of their feedlot and the number of cattle in their herd.

The Ag PACE program is an interest rate buy-down program. Monies in the fund are used to reduce the borrower's interest rate on loans made by a local lender and BND.



Jeff and his father, Jim, jointly own equipment and equal shares of the cattle, but

farm separately. When Jeff lost 1,400 acres of farmland he was renting, he needed a way to supplement his income. The Lyons already owned cattle, so the plan was to improve their feedlot system and expand.

Their loan officer at Bremer Bank in Lisbon suggested they take advantage of the Ag PACE program. "The program helped us tremendously," Jeff said. "There is more of an incentive to expand because of the interest rate cut. You aren't as hesitant as you would be borrowing at the higher rate of a commercial loan."

The Ag PACE program made sense. "We saved a great amount of money and kept our costs down," he said.

The Lyons are still eligible for more Ag PACE loans. "Taking out another loan is a definite possibility," Jeff said. "The program has enhanced every facet of our operation."

"We saved a great amount of money and kept our costs down," Jeff said.

United Energy Corp.

Starting with just one oil well in 1984, United Energy Corporation (UEC) located in Bismarck, has evolved into a diversified energy industry leader with over \$1.25 billion in annual gross sales. UEC has four primary subsidiaries:

- Missouri River Royalty Corporation has oil and gas production/exploration activities in Stark, Dunn, Billings, McKenzie, Williams, Mountrail and Divide Counties in North Dakota, plus Fallon, Wibaux, Richland and Roosevelt Counties in Montana.

- Rainbow Gas Company serves 150-170 commercial industrial natural gas customers in North Dakota, South Dakota, Wyoming and Montana on the Williston Basin Interstate Pipeline. Rainbow Gas has served some of these customers since 1986.



State Saetz well #14-36

“This program helps us continue to grow the business...”

Rita said.

- Rainbow Energy Marketing Corporation provides marketing service to the wholesale power industry, mainly buying and selling electricity to utilities in the lower 48 states and five Canadian Provinces.

- United Energy Trading, LLC is a wholesale natural gas marketer for natural gas producers, assisting them in marketing their production. The company has a strong presence in the Rocky Mountain states and the Midwest Region.

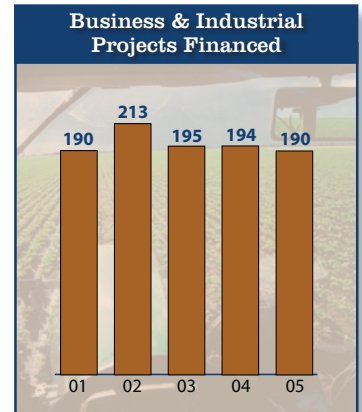
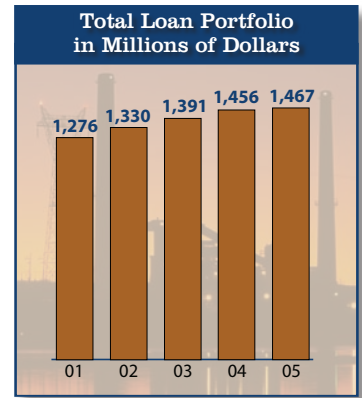
In partnership with the lead bank, BNC National Bank, Bismarck, BND provides letters of credit needed by UEC to secure normal trade activity of its subsidiaries.

“This program helps us continue to grow the business and take advantage of opportunities that might not be available to us without some form of collateral,” said Rita Lepp, UEC controller. “Letters of credit are a tool for us to help manage our cash and our ability to continue to trade, both vital components to our continued success.”

To learn more about United Energy Corporation, see their website at www.uecorporation.com.

Listed below is a breakdown of the major loan areas:

- Student loans led the way with a strong loan portfolio of \$459.2 million. Low student loan interest rates spurred the demand for loan consolidation and refinancing.
- The Bank’s dedication to economic development is reflected in commercial and business loans with a portfolio totaling \$431 million. BND loan programs financed 190 business and industrial projects.
- Residential loans followed with \$342.7 million in home loans.
- Agricultural loans totaled \$233.9 million.



Because of the nature of the portfolio, the Bank uses federal guaranty programs to reduce risk. Nearly 55 percent of BND’s loan portfolio is federally guaranteed.

Investments Grow

During 2005, our Investment Services area had over \$1.5 billion of securities in safe-keeping for North Dakota financial institutions, an increase of over \$100 million from 2004. Investment Services provide federal fund lines to 100 financial institutions with combined lines of over

Our commitment to North Dakota and its citizens continues as we invest in opportunities for economic growth.

\$350 million. Sales averaged over \$45 million per day during 2005, exceeding \$131 million in August. Additional liquidity was provided with the Letter of Credit for Public Deposits Program, which averaged \$100 million per day for all of 2005. Together these two programs on average provided North Dakota financial institutions with over \$145 million of liquidity for every day of 2005, topping out at over \$200 million in August.

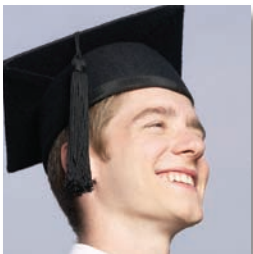
■ A STATE OF MOMENTUM

College Bound Family Calendar Created

Approximately 14,000 North Dakota high school juniors and seniors received a College Bound Family Calendar in 2005. Developed by Student Loans of North Dakota, the calendar featured step-by-step, monthly check lists for parents and students preparing for college. In addition, each month highlighted important dates, including standardized testing schedules, scholarships and grant deadlines, financial aid dates and other college-related information. The calendar also highlighted specific data relating to student loans including deadlines, financial aid products and services, and a list of colleges in the region.

BND Enhances Partnership with North Dakota Schools

Student Loans of North Dakota (SLND) provided every North Dakota high school with access to Guidance Central (which includes testGEAR for ACT, Choices Planner and Choices Explorer), and every North Dakota middle school with access to Choices Explorer, a career and education planning software program. The programs provide ACT testing preparation and college and career planning resources critical to helping students prepare for their future beyond high school.



Jamestown Avionics

Greg and Donna Earnest's hopes are soaring as they open the doors of their new business, Jamestown Avionics. The business installs, repairs and maintains the electronics in aircraft, including the navigation system and auto pilot.

Without the Beginning Entrepreneur Loan Guarantee Program, the business would not have gotten off the ground, says Greg. The loan, provided in partnership with BND and Stutsman County State Bank of Jamestown, was used primarily to finance testing equipment. "I want to be a shop of the future," he said. "Many shops have old technology. We went with the newest and best available."

Greg and Donna lived for many years in Lincoln, Neb. where Greg, an FAA-certified airframe and power plant mechanic, worked for a large avionics corporation. They enjoyed their visits to Donna's native North Dakota and eventually moved to Bismarck, where he worked in avionics. He is also a pilot and owns his own single engine airplane. Greg decided if he was to continue in the field, it would be through a business of his own.

For now, Greg wears many hats—everything from manager to technician performing repairs and installations. Donna will be involved with administrative duties.



Greg & Donna Earnest

The avionics market is changing with the availability of new technology.

"Older electronics are being replaced, and that's the market we're after," he said. "We're hoping that will really boom, and we'll be able to provide the upgrading service at a decent price."

And right now, for Greg and Donna, the sky's the limit.

"We went with the newest and best [technology] available," Greg said.

Redhawk Drilling

Redhawk Drilling began in 2005, the vision of three investors—Darleen Ballantyne, Greg Steiner and Conrad Peterson—who financed a single oil rig and began the Mohall-based contract drilling company. Drilling began in October 2005 with 18 employees on the payroll. With the assistance of Peoples State Bank of Westhope and the Bank of North Dakota, Redhawk Drilling will soon have a second rig in operation and an additional 17 employees. A third rig requiring 17 more hires is planned for later this year.

According to Redhawk Drilling VP of Operations Conrad Peterson, “In order to grow to a size that would be most cost effective and meet area companies’ demands for drilling, we wanted to buy at least one more rig, and possibly three.”

In order to expand, the company went to Peoples State Bank, who then contacted BND for the additional financing needed for the second and third rigs. “BND was extremely helpful and came through as our main source of financing,” Conrad said.

Redhawk Drilling benefited from two BND programs: a bank participation loan between Peoples State Bank and BND and a FLEX PACE loan. The FLEX Partnership in Assisting Community Expansion (PACE) funding is a special feature of the PACE program which offers interest buy down to non-PACE qualifying businesses. The community determines eligibility and accountability standards.

The expansion means the difference between Redhawk Drilling’s having 18 employees with only one rig versus having 54 when all three rigs are operational.

Without the loans, we would have been restricted to one rig,” Conrad continued. “Because these financing programs are available, the company is positioned to pursue greater opportunities.”



Redhawk #351

“BND was extremely helpful and came through as our main source of financing,” Conrad said.

BND Leadership Program Assists Dollars for Scholars

Realizing the need for local Dollars for Scholars chapters in Bismarck and Mandan, members of BND’s Leadership Program class started local chapters as part of their team project.



2005 BND Leadership Class

BND’s history of helping students and parents pursue the dream of higher education couples very nicely with Dollars for Scholars, an organization dedicated to increasing scholarship opportunities for students’ post-secondary education. Undergoing its inaugural year in 2005, BND’s Leadership Class is a training program for employees designed to enhance leadership ability and development.

Web-based Banking Technology Implemented

Partnerships with financial institutions, state or community agencies and customers are fundamental to our financial stability. With our customers in mind, BND continues to implement and improve Web-based technology. Our activity to improve banking services occurred as full implementation of the student loan system was completed and a new core banking system was launched in 2005. Student loan technology promotes convenience and efficiency, as it assists financial aid offices in colleges and universities across the state in providing a college education. The core banking system integrates the latest banking technology to provide enhanced business applications including cash management services, on-line account information and check imaging.

The Bank of North Dakota continues its proud tradition of providing quality financial services which offer opportunities for growth and progress to the state and its citizens.

A STATE OF PROGRESS

Continuing Our Mission

BND continues its mission and commitment to the state of North Dakota by providing \$60 million to the state's general fund over the 2005-2007 biennium. The Bank not only serves as an economic development bank but also as one of the top five generators of revenue for the state general fund. BND works with the State Industrial Commission, Entrepreneurial Center of North Dakota, community economic development organizations, and other agencies to promote growth and provide opportunities across the state.

In 2005, BND realized an all-time record year for profitability and the successful implementation of technology allowing us to provide new financial services to our valued customers. But beyond financial resources, it is the quality of our employees and their commitment to our customers that defines BND— a quality that sets us apart. This quality also reflects our vision of having knowledgeable, well-trained people delivering exceptional customer service, resulting in consistent financial returns to the state.

It is this dedication to our mission—delivering quality, sound financial services that promote agriculture, commerce and industry— that will help ensure Bank of North Dakota continues to offer progress, opportunity and growth in the years ahead.



Photo credit: Steve Crane, Basin Electric Power Cooperative



ND Industrial Commission



John Hoeven
Governor



Roger Johnson
Agriculture Commissioner



Wayne Stenehjem
Attorney General

BND Advisory Board



Standing: Pat Mahar,
Frank Larson, Karl Bollingberg.
Seated: Gary Petersen, Elaine Fremling,
Pat Clement, John Stewart.

BND Executive Committee



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

FINANCIAL STATEMENTS

INDEPENDENT AUDITOR'S REPORT.....	PAGE 1
BALANCE SHEETS.....	PAGE 2
STATEMENTS OF INCOME.....	PAGE 3
STATEMENTS OF EQUITY.....	PAGE 4
STATEMENTS OF CASH FLOWS.....	PAGE 5
NOTES TO FINANCIAL STATEMENTS	
NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES.....	PAGES 6-9
NOTE 2 - RESTRICTION ON CASH AND DUE FROM BANKS.....	PAGE 9
NOTE 3 - DEBT AND EQUITY SECURITIES.....	PAGES 10-12
NOTE 4 - LOANS.....	PAGES 12-13
NOTE 5 - LOAN SALES AND LOAN SERVICING.....	PAGES 14-15
NOTE 6 - BANK PREMISES, EQUIPMENT, AND SOFTWARE.....	PAGE 15
NOTE 7 - DEPOSITS.....	PAGE 16
NOTE 8 - SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE.....	PAGE 16
NOTE 9 - SHORT AND LONG-TERM DEBT.....	PAGES 16-17
NOTE 10 - OTHER LIABILITIES.....	PAGES 17-18
NOTE 11 - PENSION PLAN.....	PAGES 18-19
NOTE 12 - COMMITMENTS AND CONTINGENT LIABILITIES.....	PAGES 19-20
NOTE 13 - RELATED PARTY TRANSACTIONS.....	PAGE 20
NOTE 14 - OFF-BALANCE-SHEET ACTIVITIES.....	PAGES 20-21
NOTE 15 - FAIR VALUE OF FINANCIAL INSTRUMENTS.....	PAGES 21-23
NOTE 16 - COMPREHENSIVE INCOME.....	PAGE 24
NOTE 17 - SUPPLEMENTAL DISCLOSURES RELATED TO STATEMENTS OF CASH FLOWS.....	PAGE 24
TEN YEAR SUMMARY.....	PAGES 25-26

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, 2005 and 2004, 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control over financial reporting. Accordingly, we do not express such an opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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, 2005 and 2004, and the results of its operations and its cash flows for the years then ended on the basis of accounting described in Note 1.



Fargo, North Dakota
January 20, 2006

BANK OF NORTH DAKOTA
BALANCE SHEETS
DECEMBER 31, 2005 AND 2004

	(In Thousands)	
	2005	2004
ASSETS		
Cash and due from banks	\$ 240,574	\$ 184,173
Federal funds sold	195,370	122,230
Cash and cash equivalents	435,944	306,403
Securities	157,623	253,186
Loans	1,467,058	1,456,256
Less allowance for loan losses	(27,123)	(25,927)
	1,439,935	1,430,329
Interest receivable	20,362	16,228
Bank premises, equipment, and software, net	4,499	2,710
Other assets	3,884	5,669
Total assets	<u>\$ 2,062,247</u>	<u>\$ 2,014,525</u>
LIABILITIES AND EQUITY		
Deposits		
Non-interest bearing	\$ 213,899	\$ 208,277
Interest bearing	1,138,600	990,309
	1,352,499	1,198,586
Federal funds purchased and repurchase agreements	248,932	201,959
Short and long-term debt	275,926	436,593
Other liabilities	23,066	24,611
Total liabilities	<u>1,900,423</u>	<u>1,861,749</u>
Equity		
Capital	2,000	2,000
Capital surplus	42,000	42,000
Undivided profits	119,894	110,947
Accumulated other comprehensive income (loss)	(2,070)	(2,171)
Total equity	<u>161,824</u>	<u>152,776</u>
Total liabilities and equity	<u>\$ 2,062,247</u>	<u>\$ 2,014,525</u>

BANK OF NORTH DAKOTA
STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2005 AND 2004

	(In Thousands)	
	2005	2004
INTEREST INCOME		
Federal funds sold	\$ 5,005	\$ 1,653
Securities	7,040	7,432
Loans, including fees	<u>86,041</u>	<u>71,048</u>
Total interest income	<u>98,086</u>	<u>80,133</u>
INTEREST EXPENSE		
Deposits	26,838	13,622
Federal funds purchased and repurchase agreements	5,898	1,992
Short and long-term debt	<u>18,887</u>	<u>22,778</u>
Total interest expense	<u>51,623</u>	<u>38,392</u>
NET INTEREST INCOME	46,463	41,741
PROVISION FOR LOAN LOSSES	<u>2,400</u>	<u>2,400</u>
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	<u>44,063</u>	<u>39,341</u>
NONINTEREST INCOME		
Service fees and other	10,337	11,248
Gain (loss) on available-for-sale securities	<u>(1,005)</u>	<u>-</u>
Total noninterest income	<u>9,332</u>	<u>11,248</u>
NONINTEREST EXPENSE		
Salaries and benefits	8,502	8,108
Data processing	3,544	3,022
Occupancy and equipment	739	863
Other operating expenses	<u>4,253</u>	<u>4,380</u>
Total noninterest expenses	<u>17,038</u>	<u>16,373</u>
NET INCOME	<u>\$ 36,357</u>	<u>\$ 34,216</u>

BANK OF NORTH DAKOTA
STATEMENTS OF EQUITY
YEARS ENDED DECEMBER 31, 2005 AND 2004

	(In Thousands)				
	Capital	Capital Surplus	Undivided Profits	Accumulated Other Comprehensive Income (Loss)	Total
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
Comprehensive income					
Net income			36,357		36,357
Unrealized gain on securities available for sale				101	101
Total comprehensive income					36,458
Transfers to state general fund from current earnings			(27,323)		(27,323)
Transfers to Industrial Commission			(87)		(87)
BALANCE, DECEMBER 31, 2005	\$ 2,000	\$ 42,000	\$ 119,894	\$ (2,070)	\$ 161,824

BANK OF NORTH DAKOTA
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2005 AND 2004

	(In Thousands)	
	2005	2004
OPERATING ACTIVITIES		
Net income	\$ 36,357	\$ 34,216
Adjustments to reconcile net income to net cash from operating activities		
Depreciation and amortization	812	602
Provision for loan losses	2,400	2,400
Net amortization of securities	877	1,136
Gain on sale of residential loans	(20)	(25)
Gain on sale of other real estate and property owned	(239)	(299)
Increase in interest receivable	(4,134)	(986)
Decrease in other assets	1,541	538
Increase in other liabilities	1,088	1,605
NET CASH FROM OPERATING ACTIVITIES	38,682	39,187
INVESTING ACTIVITIES		
Securities available for sale transactions		
Purchase of securities	(19,478)	(18,082)
Proceeds from sales, maturities, and principal repayments	105,474	76,132
Securities held to maturity transactions		
Purchase of securities	-	(48,123)
Proceeds from sales, maturities, and principal repayments	2,377	15,201
Purchase of Federal Home Loan Bank stock	(3,745)	(15,763)
Sale of Federal Home Loan Bank stock	10,793	19,742
Purchase of other equity securities	(634)	(125)
Proceeds from sales of loans	68,546	30,504
Net increase in loans	(80,532)	(97,107)
Purchases of equipment and software	(2,601)	(139)
Proceeds from sale of other real estate and property owned	483	1,815
NET CASH FROM (USED FOR) INVESTING ACTIVITIES	80,683	(35,945)
FINANCING ACTIVITIES		
Net increase (decrease) in non-interest bearing deposits	5,622	(12,827)
Net increase in interest bearing deposits	148,291	147,198
Net increase in federal funds purchased and repurchase agreements	46,973	11,362
Proceeds from issuance of short and long-term debt	610,050	6,420,035
Payment of short and long-term debt	(770,717)	(6,509,237)
Payment of transfers	(30,043)	(30,037)
NET CASH FROM FINANCING ACTIVITIES	10,176	26,494
NET CHANGE IN CASH AND CASH EQUIVALENTS	129,541	29,736
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	306,403	276,667
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 435,944	\$ 306,403

BANK OF NORTH DAKOTA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004

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, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Student loans, of which 98% are federally guaranteed	31%	29%
Commercial loans, of which 8% and 7% are federally guaranteed	30%	33%
Residential loans, of which 83% are federally guaranteed	23%	22%
Agricultural loans, of which 16% and 17% 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 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 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 and agricultural 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 student and residential loans for impairment disclosures, except for such loans that are placed on nonaccrual.

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.

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.

(continued on next page)

NOTES TO FINANCIAL STATEMENTS

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 \$444,000 and \$687,000 as of December 31, 2005 and 2004.

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.

Financial Statement Presentation

Certain amounts in the 2004 financial statement have been reclassified to conform to the 2005 presentation.

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. In addition, BND also maintains a clearing balance of \$4 million with the Federal Reserve Bank.

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, 2005 and 2004 consists of the following:

	(In Thousands)	
	<u>2005</u>	<u>2004</u>
Securities available for sale, at fair value	\$ 142,127	\$ 180,887
Securities held to maturity, at amortized cost	-	50,389
Federal Home Loan Bank stock, at cost	14,737	21,785
Other equity securities, at cost	<u>759</u>	<u>125</u>
	<u>\$ 157,623</u>	<u>\$ 253,186</u>

NOTES TO FINANCIAL STATEMENTS

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, 2005				
Securities available for sale				
Federal agency	\$ 25,109	\$ -	\$ 150	\$ 24,959
Mortgage-backed	75,965	181	2,101	74,045
State and municipal	43,123	-	-	43,123
	<u>\$ 144,197</u>	<u>\$ 181</u>	<u>\$ 2,251</u>	<u>\$ 142,127</u>

	(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>

Securities carried at \$8,148,000 at December 31, 2005, and \$11,130,000 at December 31, 2004, were used to secure repurchase agreements and for other required pledging purposes. FHLB stock totaling \$14,737,000 at December 31, 2005 and \$21,785,000 at December 31, 2004 is pledged on the FHLB advances (Note 9).

NOTES TO FINANCIAL STATEMENTS

The maturity distribution of debt securities at December 31, 2005, 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	
	Amortized Cost	Fair Value
Within one year	\$ 15,621	\$ 15,527
Over one year through five years	86,009	83,904
Over five years through ten years	40,214	40,177
Over ten years	2,353	2,519
	<u>\$ 144,197</u>	<u>\$ 142,127</u>

For the year ended December 31, 2005, proceeds from the sales of securities available for sale amounted to \$33,027,000. Gross realized gains amounted to \$5,000 and gross realized losses amounted to \$1,010,000 in 2005. There were no sales of securities during 2004.

During the year ended December 31, 2005, the Bank transferred securities from the held to maturity classification to the available for sale classification with a carrying amount of \$47,994,000, unrealized gains of \$47,000 and unrealized losses of \$6,000. Management decided to transfer mortgage-backed securities to the available for sale classification since the Bank collected a substantial portion of the principal outstanding due to prepayments on the securities. Management decided to transfer state and municipal securities to the available for sale classification for asset-liability management purposes.

Information pertaining to securities with gross unrealized losses at December 31, 2005, 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	\$ 57	\$ 9,922	\$ 93	\$ 15,037
Mortgage-backed	39	6,075	2,062	60,970
	<u>\$ 96</u>	<u>\$ 15,997</u>	<u>\$ 2,155</u>	<u>\$ 76,007</u>

NOTES TO FINANCIAL STATEMENTS

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, 2005, there was one security with a fair value of \$3,088,000 that has an unrealized loss with aggregate depreciation of 5% from the Bank's amortized cost basis. As management has the ability to hold debt securities for the foreseeable future, no declines are deemed to be other than temporary.

NOTE 4 - LOANS

The composition of the loan portfolio at December 31, 2005 and 2004 is as follows:

	(In Thousands)	
	2005	2004
Student	\$ 459,287	\$ 417,356
Commercial	431,064	480,870
Residential	342,786	322,044
Agricultural	233,921	235,986
	<u>1,467,058</u>	<u>1,456,256</u>
Allowance for loan losses	<u>27,123</u>	<u>25,927</u>
	<u><u>\$ 1,439,935</u></u>	<u><u>\$ 1,430,329</u></u>

Student loans held for sale totaled \$5,138,000 and \$6,634,000 as of December 31, 2005 and 2004. Unamortized deferred student loan costs totaled \$2,176,000 and \$2,314,000 as of December 31, 2005 and 2004. Net unamortized loan premiums and discounts, including purchased servicing rights, on residential loans totaled \$2,126,000 and \$2,029,000 as of December 31, 2005 and 2004.

The composition of the allowance for loan losses for the years ended December 31, 2005 and 2004 is as follows:

	(In Thousands)	
	2005	2004
Balance - beginning of year	\$ 25,927	\$ 25,334
Provision for loan losses	2,400	2,400
Loans charged off	(1,432)	(1,971)
Recoveries	<u>228</u>	<u>164</u>
Balance - end of year	<u><u>\$ 27,123</u></u>	<u><u>\$ 25,927</u></u>

NOTES TO FINANCIAL STATEMENTS

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

	(In Thousands)	
	December 31,	
	2005	2004
Impaired loans without a valuation allowance	\$ -	\$ 152
Impaired loans with a valuation allowance	<u>2,157</u>	<u>3,147</u>
Total impaired loans	<u>\$ 2,157</u>	<u>\$ 3,299</u>
Valuation allowance related to impaired loans	\$ 884	\$ 1,488
Average investment in impaired loans	2,848	3,401
Total non-accrual loans	2,157	3,299
Total loans past-due ninety days or more and still accruing	16,101	18,866
Restructured loans	10,641	10,048

The interest income recorded on impaired loans is not significant.

Accruing loans 90 days or more past due include guaranteed student loans of \$13,812,000 and \$15,070,000 as of December 31, 2005 and 2004. 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, 2005 and 2004.

NOTE 5 - LOAN SALES AND LOAN SERVICING

A summary of BND's loan sales during 2005 and 2004 follows:

	(In Thousands)	
	2005	2004
Student loans sold to North Dakota Student Loan Trust	\$ 66,528	\$ 27,842
Residential loans sold on the secondary market	1,998	2,637

BND recognized gains on sale of loans of \$20,000 and \$25,000 in 2005 and 2004, which is included in non-interest income on the Statements of Income.

A servicing asset or liability was not recognized relative to the student loan and residential loan sales since the cost to service these loans approximates the servicing fee income generated on the sold loans.

NOTES TO FINANCIAL STATEMENTS

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, 2005 and 2004 were as follows:

	(In Thousands)	
	2005	2004
Student loans		
North Dakota Student Loan Trust	\$ 144,736	\$ 146,396
Others	3,865	5,498
Residential loans	26,011	29,261
Other state fund loans		
Board of University and School Lands	24,123	22,215
Community Water Facility Loan Fund	18,002	18,520
Beginning Farmer Revolving Loan Fund	8,681	8,583
Developmentally Disabled Facility Loan Program	2,331	2,700
Department of Human Services	10,380	10,754
Credit Review Board	-	2
	<u>\$ 238,129</u>	<u>\$ 243,929</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 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.

NOTE 6 - BANK PREMISES, EQUIPMENT, AND SOFTWARE

A summary of changes in bank premises, equipment, furniture, and software at December 31, 2005 and 2004 is as follows:

	(In Thousands)			
	Balance 2004	Additions	Retirements	Balance 2005
Land	\$ 672	\$ -	\$ -	\$ 672
Building	4,285	-	-	4,285
Equipment	1,559	1,036	750	1,845
Furniture	541	-	4	537
Software	4,496	1,565	-	6,061
	<u>11,553</u>	<u>2,601</u>	<u>754</u>	<u>13,400</u>
Less accumulated depreciation	8,843	812	754	\$ 8,901
	<u>\$ 2,710</u>	<u>\$ 1,789</u>	<u>\$ -</u>	<u>\$ 4,499</u>

NOTES TO FINANCIAL STATEMENTS

	(In Thousands)			Balance 2004
	Balance 2003	Additions	Retirements	
Land	\$ 672	\$ -	\$ -	\$ 672
Building	4,285	-	-	4,285
Equipment	1,559	28	28	1,559
Furniture	533	16	8	541
Software	4,481	95	80	4,496
	<u>11,530</u>	<u>139</u>	<u>116</u>	<u>11,553</u>
Less accumulated depreciation	<u>8,357</u>	<u>602</u>	<u>116</u>	<u>8,843</u>
	<u>\$ 3,173</u>	<u>\$ (463)</u>	<u>\$ -</u>	<u>\$ 2,710</u>

Depreciation and amortization expense on the above assets amounted to \$812,000 and \$602,000 in 2005 and 2004.

The 2005 North Dakota Legislature passed Senate Bill 2014 which provides for an \$11,000,000 appropriation for the construction of a new building for the Bank. The Industrial Commission will advertise for bids for the new building. Alternate bids must be solicited which would allow footings to be installed for up to three additional floors. The Industrial Commission may proceed with the construction of additional footings upon approval by the emergency commission and budget section of the State of North Dakota. In November 2005, the Bank entered into a Purchase Agreement to purchase land for the new building site for \$1,880,000. No additional construction commitments have been entered into by the Bank as of December 31, 2005.

NOTE 7 - DEPOSITS

The aggregate amount of locally sold certificates of deposit larger than \$100,000 was \$654,994,000 and \$569,139,000 as of December 31, 2005 and 2004.

At December 31, 2005, the scheduled maturities of certificates of deposits are as follows:

	(In Thousands)
One year or less	\$ 569,580
One to three years	43,581
Over three years	<u>66,018</u>
	<u>\$ 679,179</u>

NOTES TO FINANCIAL STATEMENTS

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)	
	2005	2004
Federal Home Loan Bank advances - short-term	\$ -	\$ 100,000
Federal Home Loan Bank advances - long-term	275,588	336,195
North Dakota Municipal Bond Bank, 3%, matures from September 2007 through September 2014	338	398
	<u>\$ 275,926</u>	<u>\$ 436,593</u>

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
2006	\$ 20,092	\$ 15,487	\$ 35,579
2007	11,214	14,672	25,886
2008	91,242	10,094	101,336
2009	6,820	8,782	15,602
2010	1,919	8,523	10,442
Later years	144,639	41,750	186,389
Totals	<u>\$ 275,926</u>	<u>\$ 99,308</u>	<u>\$ 375,234</u>

There are no Federal Home Loan Bank (FHLB) short-term advances outstanding at December 31, 2005. The FHLB long-term advances outstanding at December 31, 2005, mature from September 2006 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 \$332,773,000 in 2005 and \$315,338,000 in 2004 and guaranteed student loans totaling \$0 in 2005 and \$198,034,000 in 2004.

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.

NOTES TO FINANCIAL STATEMENTS

NOTE 10 - OTHER LIABILITIES

Other liabilities consist of:

	(In Thousands)	
	2005	2004
Transfers payable	\$ 17,140	\$ 19,773
Interest payable	3,346	2,142
Student loan origination fee payable	310	323
Accrued expenses and other liabilities	2,270	2,373
	<u>\$ 23,066</u>	<u>\$ 24,611</u>

The 2005 North Dakota Legislature passed House Bill 1015 which provides for a transfer during the biennium beginning July 1, 2005 and ending June 30, 2007 up to \$60,000,000 from the current earnings and the accumulated undivided profits of the Bank. The moneys shall be transferred in the amounts and at such times as requested by the director of the Office of Management and Budget.

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 \$150,000,000.

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.

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.

NOTES TO FINANCIAL STATEMENTS

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, 2005 and 2004 were approximately \$548,000 and \$526,000.

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

House Bill No. 1021 provides 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, for the biennium beginning July 1, 2005, and ending June 30, 2007. Bank of North Dakota has not funded and has not committed to fund any amount under the line of credit.

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 \$6,500,000 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 appropriations were made by the legislature for transfers from the Bank of North Dakota during the 2005 – 2007 biennium.

Center of Excellence – Office of Management and Budget

Senate Bill No. 2018 authorizes the Office of Management and Budget to borrow the sum of \$15,000,000, or so much of the sum as may be necessary, from the Bank of North Dakota, which is appropriated for the purpose of providing funding to centers of excellence as directed by the Centers of Excellence Commission, for the biennium beginning July 1, 2005, and ending June 30, 2007. By June 30, 2007, the office of management and budget shall repay any loan obtained pursuant to provisions of this section, including accrued interest, from funds available in the permanent oil tax trust fund. Repayment may be made from transfers into the permanent oil tax trust fund after a total of \$77,000,000 of oil tax revenues has been received by the general fund during the 2005-07 biennium, including the \$71,000,000 deposited in the general fund in accordance with section 57-51.1-07.2.

NOTES TO FINANCIAL STATEMENTS

Senate Bill No. 2018 also provides contingent borrowing authority to the Office of Management and Budget to borrow the sum of \$5,000,000, or so much of the sum as may be necessary, from the Bank of North Dakota, which is appropriated for the purpose of providing funding to centers of excellence as directed by the centers of excellence commission, for the biennium beginning July 1, 2005, and ending June 30, 2007. The office of management and budget shall request funding from the sixtieth legislative assembly to repay any loan obtained pursuant to provisions of section 13 of this bill, including accrued interest, from funds available in the permanent oil tax trust fund. The borrowing authority and appropriation provided for in this section is available only if all other funding provided by the fifty-ninth legislative assembly for centers of excellence has been obligated.

Farm Real Estate Loan Guarantee Program

Chapter 6-09.7 of the North Dakota Century Code provides that the Bank of North Dakota may guarantee the loan of money by eligible banks, credit unions, lending institutions that are part of the farm credit system, and savings and loan associations in the State of North Dakota 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 loan guarantee term may not exceed 5 years. As of December 31, 2005 and 2004, the Bank has guarantees outstanding totaling \$782,000 and \$884,000 and has no guarantee commitments outstanding. This program is effective through July 31, 2009.

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, 2005 and 2004, the Bank has guarantees outstanding totaling \$2,321,000 and \$1,746,000, and had guarantee commitments outstanding of \$79,000 and \$26,000 included in commitments to extend credit.

Feedlot Loan Guarantee Program

Chapter 6-09-41 of the North Dakota Century Code provides that the Bank of North Dakota establish and administer a livestock loan guarantee program that is designed to expand the livestock feeding industry in State of North Dakota. This program is effective through June 30, 2009.

The Bank may guarantee loans made by a bank, credit union, savings and loan association, or any other lending institution in the State of North Dakota to the owner of a commercial feedlot that backgrounds or feeds cattle to harvest-ready weight. In the event of a default, the Bank shall pay to the lender the amount agreed upon, provided that the amount may not exceed 85% of the principal due the lender at the time the claim is approved.

As of December 31, 2005, the Bank has guarantees outstanding totaling \$133,000 and has no guarantee commitments outstanding.

NOTES TO FINANCIAL STATEMENTS

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.

At December 31, 2005 and 2004, the following financial instruments were outstanding whose contract amounts represent credit risk:

	Contract Amount (In Thousands)	
	2005	2004
Commitments to extend credit	\$ 380,860	\$ 281,052
Financial standby letters of credit	175,047	130,725

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.

NOTES TO FINANCIAL STATEMENTS

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.

The carrying amounts and estimated fair values of the Bank's financial instruments as of December 31, 2005 and 2004 were as follows:

	(In Thousands)			
	2005		2004	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	\$ 435,944	\$ 435,944	\$ 306,403	\$ 306,403
Securities	157,623	157,623	253,186	253,187
Interest receivable	20,362	20,362	16,228	16,228
Loans				
Student loans	459,287	459,287	417,356	417,356
Residential loans	342,786	357,415	322,044	343,336
Other loans	664,985	644,146	716,856	700,578
Allowance for loan losses	(27,123)	-	(25,927)	-
Total loans	<u>1,439,935</u>	<u>1,460,848</u>	<u>1,430,329</u>	<u>1,461,270</u>
Total financial assets	<u>\$ 2,053,864</u>	<u>\$ 2,074,777</u>	<u>\$ 2,006,146</u>	<u>\$ 2,037,088</u>
Financial liabilities				
Non-maturity deposits	\$ 673,320	\$ 673,320	\$ 613,791	\$ 613,791
Deposits with stated maturities	679,179	680,914	584,795	592,428
Federal funds purchased and repurchase agreements	248,932	248,932	201,959	201,959
Short and long-term debt	275,926	287,206	436,593	453,276
Other liabilities	23,066	23,066	24,611	24,611
Total financial liabilities	<u>\$ 1,900,423</u>	<u>\$ 1,913,438</u>	<u>\$ 1,861,749</u>	<u>\$ 1,886,065</u>

(continued on next page)

NOTES TO FINANCIAL STATEMENTS

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.

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.

NOTES TO FINANCIAL STATEMENTS

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.

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	
	2005	2004
Balance, beginning of year	\$ (2,171)	\$ (1,203)
Unrealized holding gains (losses) arising during the period	(904)	(968)
Reclassification adjustment for (gains) losses realized in net income	1,005	-
Other comprehensive income	101	(968)
Balance, end of year	\$ (2,070)	\$ (2,171)

NOTES TO FINANCIAL STATEMENTS

NOTE 17 - SUPPLEMENTAL DISCLOSURES RELATED TO STATEMENTS OF CASH FLOWS

	(In Thousands)	
	<u>2005</u>	<u>2004</u>
Supplemental disclosures of cash flow information		
Cash payments for:		
Interest paid to customers	\$ 25,664	\$ 12,844
Interest paid on federal funds purchased and securities sold under repurchase agreements	5,855	1,985
Interest paid on short and long-term debt	18,900	22,770
Supplemental schedule of noncash investing and financing activities		
Transfers from undivided profits to other liabilities	27,410	34,216
Net change in unrealized gain (loss) on securities available for sale	101	(968)
Other real estate and property owned acquired in exchange for loans	-	148

BANK OF NORTH DAKOTA
TEN-YEAR SUMMARY

TEN YEAR SUMMARY	2005	2004	2003
OPERATING RESULTS (in thousands)			
Interest income	\$ 98,086	\$ 80,133	\$ 79,463
Interest expense	51,623	38,392	41,755
Net interest income	46,463	41,741	37,708
Provision for loan losses	2,400	2,400	2,000
Net interest income after provision for loan losses	44,063	39,341	35,708
Noninterest income	9,332	11,248	11,474
Noninterest expense	17,038	16,373	15,488
Net income	36,357	34,216	31,694
Payments to general fund	30,000	30,000	34,000
Payments to other funds	43	37	37
BALANCE SHEET - YEAR END (in thousands)			
TOTAL ASSETS	2,062,247	2,014,525	1,953,178
FEDERAL FUNDS SOLD AND RESELL AGREEMENTS	195,370	122,230	89,915
SECURITIES	157,623	253,186	284,272
LOANS	1,467,058	1,456,256	1,391,583
Student	459,287	417,356	372,362
Commercial	431,064	480,870	469,912
Residential	342,786	322,044	318,067
Agriculture	233,921	235,986	231,242
DEPOSITS	1,352,499	1,198,586	1,057,386
Non-interest bearing	213,899	208,277	214,275
Interest bearing	1,138,600	990,309	843,111
FEDERAL FUNDS PURCHASED AND REPURCHASE AGREEMENTS	248,932	201,959	190,597
SHORT AND LONG-TERM DEBT	275,926	436,593	525,795
EQUITY	161,824	152,776	153,744
Capital	2,000	2,000	2,000
Capital surplus	42,000	42,000	42,000
Undivided profits	119,894	110,947	110,947
Accumulated other comprehensive income (loss)	(2,070)	(2,171)	(1,203)

	2002	2001	2000	1999	1998	1997	1996
\$	90,315	\$ 114,490	\$ 117,163	\$ 99,350	\$ 87,788	\$ 70,891	\$ 67,377
	50,666	82,840	75,774	62,487	53,852	40,768	39,865
	39,649	41,650	41,389	36,863	33,936	30,123	27,512
	2,200	2,700	2,700	1,600	1,700	600	600
	37,449	38,950	38,689	35,263	32,236	29,523	26,912
	9,764	8,646	7,224	7,838	8,651	8,189	7,812
	15,022	14,537	13,331	12,642	12,750	12,168	11,533
	32,191	33,059	32,582	30,459	28,137	25,544	23,191
	30,000	50,000	-	15,000	29,600	12,715	37,500
	36	36	35	35	40	41	38
	1,974,448	2,107,456	1,806,517	1,687,167	1,609,039	1,162,415	1,068,082
	209,205	257,830	271,510	249,565	206,095	128,180	86,470
	235,365	329,632	192,093	235,007	427,842	269,860	284,491
	1,329,985	1,276,334	1,156,614	1,056,232	835,654	623,532	554,001
	364,816	399,002	376,535	335,687	292,896	244,154	205,787
	432,940	392,206	362,940	342,860	272,648	220,544	196,331
	309,267	271,385	213,009	188,474	113,934	38,089	29,595
	222,962	213,741	204,130	189,211	156,176	120,745	122,288
	1,070,853	1,208,601	1,135,731	910,652	943,537	719,508	728,122
	209,112	193,354	130,470	83,798	133,307	117,708	106,120
	861,741	1,015,247	1,005,261	826,854	810,230	601,800	622,002
	296,688	315,713	215,072	250,985	309,496	234,114	198,108
	421,065	399,553	254,439	363,076	203,779	54,087	14,500
	149,113	170,496	153,045	139,275	139,931	128,888	98,477
	2,000	2,000	2,000	2,000	22,000	22,000	22,000
	42,000	42,000	42,000	42,000	22,000	22,000	22,000
	104,237	126,237	108,707	96,703	95,736	84,786	54,538
	876	259	338	(1,428)	195	102	(61)



CORE VALUES

SERVICE - Excel and Deliver

TEAMWORK - Together We Accomplish More

ETHICS - Do The Right Thing

PEOPLE - Set Us Apart



A STATE OF PROGRESS

Remaining true to our vision and mission, Bank of North Dakota has proudly served the citizens and institutions of our state since 1919. We look forward to fostering growth and opportunities to continue this momentum and dynamic state of progress.

BND

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