Bank of North Dakota
Annual Report 2006




groundbreaking year

Mission

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

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.

President's Message

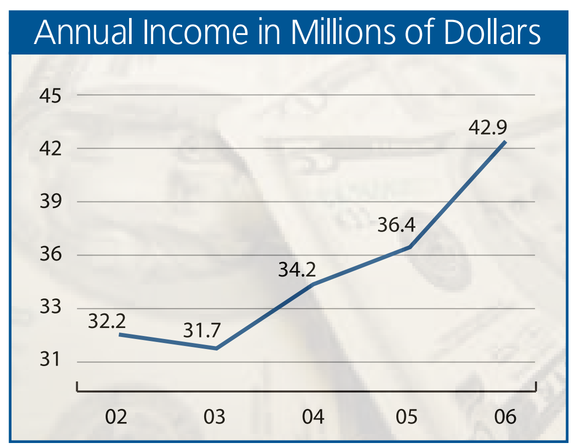
In Bank of North Dakota's nearly 90-year history, 2006 ranks as groundbreaking in terms of financial growth as well as construction of our new home overlooking the Missouri River. By embracing our mission to deliver quality, sound financial services that promote agriculture, commerce and industry we were able to continue an upward trend of profitability.

Eric Hardmeyer,
President

By every benchmark and industry standard that we adhere to as the only state-owned bank in the nation, our performance exceeded expectations. Net earnings increased $6.4 million to $42.9 million, or 18 percent over 2005. Total assets grew to $2.33 billion, or 13 percent in 2006.

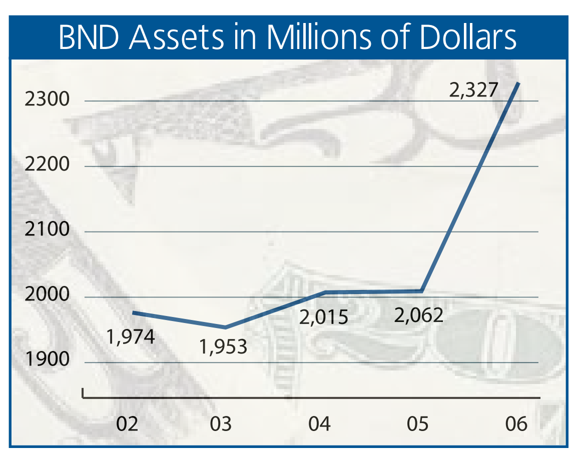
After a year of progress in 2005, we have reached new heights in virtually every facet of business at BND. Loan volumes climbed $290 million to $1.756 billion. Disaster Relief Programs provided $20.2 million to business owners and farmers. Banking Services made rapid use of new technology for cash management and check clearing with BND Image Product and Image Exchange.

By making changes to our student loan programs, we have lowered interest rates and added student-friendly features to an alternative loan program. Additionally, BND is paying origination fees and default fees on new loans. This proactive approach is having an impact by decreasing borrower debt.



Our promise to foster business partnerships within the state and beyond has not wavered. We remain active in economic development opportunities through new funding limits in the MATCH loan program and by increasing our internal lending limits so we can more readily act as a catalyst for economic growth.

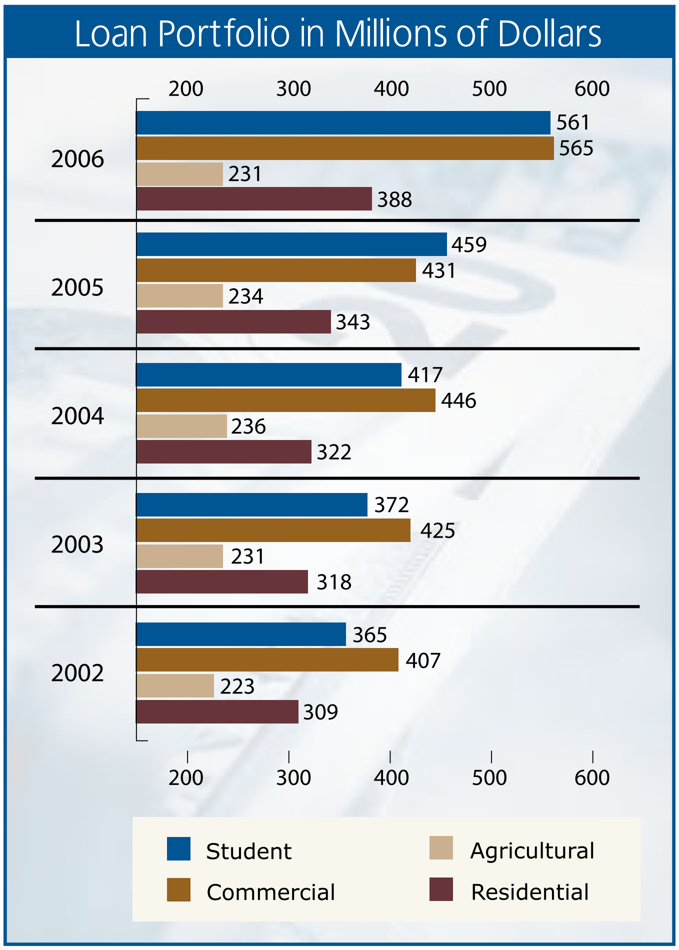
Our commitment to serve the best interests of the state drives our desire to reach even higher goals. As we look beyond this groundbreaking year, we are eager to construct our future home and contribute to the economic well-being of the state in 2007 and beyond.



Eric Hardmeyer
President

Groundbreaking growth

BND's commitment to foster and promote agriculture, commerce and industry is shown through record-breaking loan growth in 2006. Growth in residential, commercial, student and agriculture lending programs demonstrates diversity and strength of our loan portfolio. Overall, loans totaled $1.756 billion at the close of 2006. New loan growth was $290 million.



- The Bank's emphasis on economic development is reflected in the commercial loan portfolio with business and industrial financing increasing 31 percent to $565 million in 2006. BND participated in commercial loans to 212 North Dakota businesses.

- Acting as a secondary market for financial institutions seeking to sell mortgages, BND booked $90 million in new residential loans resulting in net loan growth of $45 million. Overall, the residential loan portfolio grew 16 percent to $388 million.

- The student loan portfolio totaled $561 million, or an increase of 22 percent. Contributing to its steady growth is demand for alternative loans and loan consolidation.

- Agricultural loans totaled $241 million of which $20.2 million were disaster relief related.

BND maintains a strong financial presence through its distribution of $60 million to North Dakota's general fund in the 2005 – 2007 biennium. This makes BND the sixth largest source of revenue in the state. With BND profits of $42.9 million, it has been a financially groundbreaking year.



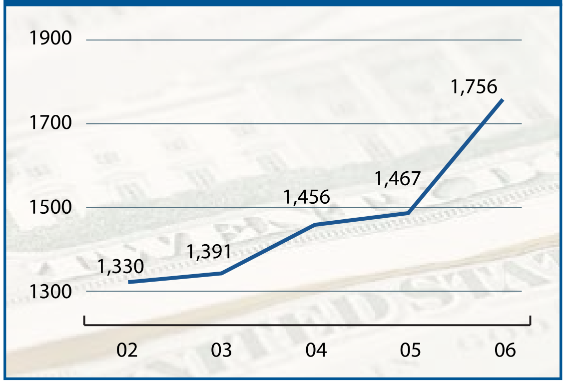

Milestones in student lending

Student Loan's emphasis on education as an economic development tool is part of a comprehensive approach to helping students through new program improvements, loans and college savings.

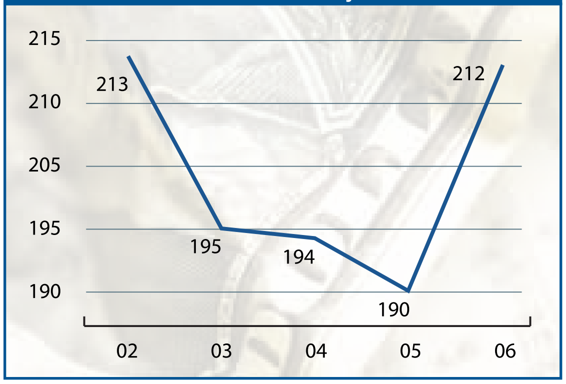
Enhanced DEAL - The Dakota Education Alternative Loan (DEAL) has been an option to standard federal financing for North Dakota students for the past nine years. Keeping North Dakota's future generations and changing business climate in mind, BND implemented major changes to DEAL and other loan programs for 2006. These enhancements are paying off, proven by a 52 percent growth in DEAL loans along with a low default rate.

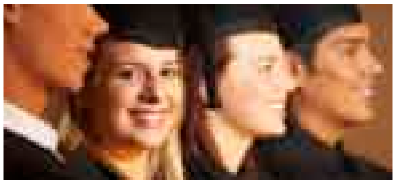
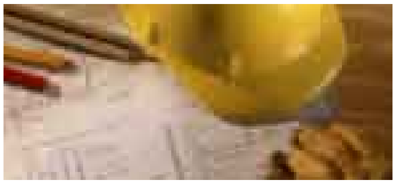
- BND instituted a zero fee, or waiver, of the 4 percent administrative/origination fee on loans disbursed after January 1, 2007. In combination with our commitment

Total Loan Portfolio in Millions of Dollars



Business & Industrial Projects Financed




to pay the 1 percent federal default fee for new Stafford Loans, our assistance keeps more money in the pockets of college-bound students.

- A borrower cosignor release after 24 consecutive on-time payments and consolidation of DEAL loans makes it a more viable choice for North Dakota families.

- Meeting the needs of the state's colleges and universities, the DEAL "look back" loan allows borrowers to pay off existing school debts at the end of the school year.

Low default rate - Historically, BND's lender default rate of slightly over 1 percent is among the lowest in the nation. In 2006, we worked diligently to help customers find resolution resulting in default claims of less than 0.5 percent, demonstrating our commitment to a high ethical standard.

Dedicated to higher education - BND became more active in the Dollars for Scholars program in 2005 as part of a team project for BND's Leadership Program class. We continued our relationship in 2006 by helping students and parents via local scholarship and grant opportunities. We also helped establish a North Dakota Jump$tart coalition consisting of state agencies and institutions with a focus on financial literacy.

BND administers College SAVE, the state's 529 plan, and chose new plan manager Upromise Investments, Inc. in

Fueling a dream

When establishing an ethanol plant in western North Dakota was still a dream, the Richardton Development Group looked to Bank of North Dakota.

"Not only did BND hold our equity funds, but they are also acting as a participant lender," explained Mick Miller, Red Trail Energy CEO. "Our senior lender, First National Bank of Omaha, couldn't take on the entire debt and needed to sub a portion of it to participant banks. With BND stepping in to fund a $5 million loan, it's obviously a significant factor for us."

Miller describes Red Trail Energy as "a North Dakota project using North Dakota energy and North Dakota people." That fits BND's mission to "promote agriculture, commerce and industry in North Dakota."

The Bank of North Dakota's commitment to our state helped make Red Trail Energy a reality.

The Richardton plant consumes about 133,000 tons of North Dakota lignite to process the 18 million bushels of corn required for the production of 50 million gallons of fuel grade ethanol per year. The plant also produces 165,000 tons of distillers grain, which is a value-added high protein feed product for the cattle industry.

"We've provided this great market for the potential of 18 million bushels of corn right here in the western part of the state," he said. "The plant provides renewable energy to be consumed within our state and surrounding areas. Our local economy is benefiting greatly."

"Red Trail Energy is no longer a dream," said Miller. "It's a reality, and BND was a part of it. Their willingness to support North Dakota industries goes a long way."

Making their mark in the world

BND's Bank Participation Loan has translated into an edge in a global market for one North Dakota-based company. "Work is shipped to us from around the world, and our new, efficient equipment makes us more competitive," said Greg Butler, president of Gremada Industries, Inc.

Gremada Industries utilizes laser cladding technology to restore, remanufacture and enhance new products.

Gremada Industries is predominantly a remanufacturer of heavy machinery parts and assemblies. "We use some special techniques including laser application of metals to repair worn surfaces," Butler explained. They are also involved in new production of parts for heavy industry.

Gremada Industries first took advantage of Partnership in Assisting Community Expansion (PACE) funds in 1994 and 1995 to finance the construction of additions to their West Fargo facility. The PACE Fund is designed to assist North Dakota communities in expanding their economic base by providing for new job development.

"The PACE funding lowered our cost of borrowing to finance the buildings," he said. "In turn, we agreed to hire more people, and we did. Our current payroll of 175 employees is more than double what it was in the mid-90s."

The recent Bank Participation loan helped finance more efficient equipment for remanufacturing or new production processes. "Compared to older manual equipment, this modern CNC equipment produces more which keeps our cost down," he said. The new equipment can support complex machining opportunities which in turn supports higher skilled and paying jobs.

"Gremada Industries has made wise investments working in partnership with the Bank of North Dakota through Alerus Financial in Fargo," he said. "We've been pleased working with both of them."

2006. College SAVE allows individuals to invest money into a tax-exempt account for education expenses. The new connection with Upromise also gives participants access to a rewards service in which members can earn back a percentage of qualified spending and invest it into the plan. Investments in the $320 million portfolio are now overseen by The Vanguard Group, giving investors an assortment of options to suit their risk tolerance.

Solid foundation of economic development

BND works to strengthen the state's economy through increased loan activity. Our ability to distribute funds and generate revenue through our loan portfolio, helps expand businesses, improve agriculture, provide relief for those suffering economic hardships and position the state for future growth.

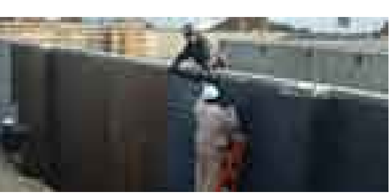
MATCH invigorates economy - Energy production and its secondary and byproduct businesses are pumping revenue into the state. Significant increases in energy production and demand pave the way for further infrastructure and larger loans. BND has responded to meet those needs through the MATCH program.

Established in 1990, MATCH targets companies that generate new wealth in the state. The State Investment Board partners with BND and together we agreed to continue MATCH by raising the funding cap from $100 to $150 million. Since its inception, BND has invigorated North Dakota's economy by financing 16 projects totaling over $126 million.

Programs provide disaster relief - Successfully utilized in the past, our Disaster Relief Programs continue to provide low interest rate financial assistance for North Dakota farmers and business owners impacted by the extreme weather conditions in 2006. The programs are designed to help farmers and business owners recover from damage and restructure their debt. In 2006, 101 disaster relief loans totaling $20.2 million were granted.

Treasury Services - Investment Services had over $1.6 billion of securities in safe-keeping for North Dakota financial institutions, an increase in 2006 of over $100 million. Investment Services provide federal fund lines to 98 financial institutions with combined lines of over $346 million. During 2006, sales averaged over $66 million per day, exceeding $139 million in July. The Letter of Credit for Public Deposits Program provides $108 million in additional liquidity on a daily average. These two programs provided a daily average of over $174 million of liquidity to North Dakota financial institutions, topping out at over $233 million in July 2006.

Business banking made easy - As businesses and consumers move toward electronic banking and operate at the speed of technology, BND strives to be at the forefront of changing industry standards with BND Image Product and Image Exchange. The investment in state-of-the-art image exchange technology provides better customer service, allows our business customers quicker access to funds and is easy to use. With the addition of this technology, BND is positioned for future advances in the industry and further growth opportunities.



Agriculture programs help overall operation

The partnership between Dakota Western Bank in Scranton and Bank of North Dakota has opened doors to opportunity for Kevin and Lynette Symanowski.

Kevin and Lynette Symanowski used an Ag PACE loan to expand their feedlot. They also received interest buy downs through a BND Farm Operating Loan and Farm Disaster Loan.

The couple farms west of Reeder with their three teenage sons, Tyson, Cody and Joe, who help during the summer months. Their hired man, Bill Norton, also partners with them on a portion of the cattle and land.

"Diane Pierce at Dakota Western Bank informed me about Bank of North Dakota loan programs and made all the arrangements," Kevin Symanowski said. "Bank of North Dakota has helped me improve my overall operation."

With the assistance of an Agriculture Partnership in Assisting Community Expansion (Ag PACE) loan, Symanowski expanded his feedlot and now owns and custom feeds nearly 1,400 calves. The Ag PACE program is an interest rate buy-down program on loans made by a local lender and BND.

"I cross shared with the government to build this feedlot," he said. "The funds I put in myself are from the Ag PACE loan."

Kevin has also benefited from interest buy downs through a BND Farm Operating Loan and Farm Disaster Loan made available the past two years in order to help North Dakota residents in a time of need.

"The interest buy down has been great because of the savings," he said. "The operating money it takes to run a farm has increased probably three fold in the past 20 years. You rely on a bank to make the money available. Between Dakota Western Bank and the Bank of North Dakota, they've been able to get it done."

Expansion is taking root

As the owner of a nursery, Fred Lundeby is in the business of growing. With the help of Bank of North Dakota, he is looking forward to watching his business grow along with the high-quality evergreens he has been providing to wholesale nurseries throughout the Midwest and Canada for 40 years.

Fred and Leah Lundeby and their family own and operate Lundeby Evergreens and Manufacturing south of Tolna. They plant about 15,000 seedlings each year on their 100-acre nursery and manufacture specialized nursery equipment including the popular Lundeby Plant Lifter.

Protecting their trees from deer depredation had been a costly, ongoing battle. “One year, deer ate every tree in one of our plots,” Lundeby said. “The loss for that acre alone over three to five years was $50,000.”

Fred and Leah Lundeby are already realizing the benefits of the fence funded by a Flex PACE loan.

None of their attempts to keep the deer away, including feeding 1,000 of them in locations two miles from the nursery, were successful.

The answer came in the form of a four-mile fence, funded by a Flex Partnership in Assisting Community Expansion (PACE) loan, which offers interest buy down. The community in which the business is located determines eligibility and accountability standards.

They already are realizing an increase in their inventory after only one growing season. “We know that by keeping the deer out, we can increase and expand,” he said. They’ve already broken new ground for hardwoods, which wasn’t an option prior to the Flex PACE Loan.

“This is an excellent program for starting or expanding a business,” said Lundeby. “The interest buy down is worth a lot to the business owner and the community in which it resides.”

BND remains focused

We will soon be moving to our new location and beginning the latest chapter in Bank of North Dakota’s unique history. Our focus remains on providing the best possible customer service and seeking new opportunities through a partnership approach that promotes agriculture, commerce and industry in North Dakota.

Strategic planning initiatives and technological advances through our core banking system will allow for new product development, and a proactive stance on new and existing loan programs will provide future momentum.

Optimism and financial stability are the cornerstones of North Dakota’s recent economic success and BND plans on using 2006 as a gateway to growth. Exciting times lie ahead for North Dakota and our groundbreaking year is proof positive that we are headed in the correct direction.

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

The Industrial Commission
State of North Dakota
Bismarck, North Dakota

We have audited the accompanying balance sheet of the Bank of North Dakota as of December 31, 2006 and the related statements of income, equity, and cash flows for the year 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. The financial statements of Bank of North Dakota as of December 31, 2005, were audited by other auditors whose report dated January 20, 2006, expressed an unqualified opinion on those financial statements.

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 audit provides 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 2006 financial statements referred to above present fairly, in all material respects, the financial position of the Bank of North Dakota as of December 31, 2006 and the results of its operations and its cash flows for the year then ended on the basis of accounting described in Note 1.

Brady, Martz

BRADY, MARTZ & ASSOCIATES, P.C.
February 2, 2007

BANK OF NORTH DAKOTA
BALANCE SHEETS
DECEMBER 31, 2006 AND 2005

	(In Thousands)	
	2006	2005
ASSETS		
Cash and due from banks	**$ 212,962**	$ 240,574
Federal funds sold	**129,135**	195,370
Cash and cash equivalents	**342,097**	435,944
Securities	**219,412**	157,623
Loans	**1,755,562**	1,467,061
Less allowance for loan losses	**(30,136)**	(27,123)
	1,725,426	1,439,938
Interest receivable	**30,199**	20,363
Bank premises, equipment, and software, net	**7,119**	4,499
Other assets	**2,440**	3,880
Total assets	**$ 2,326,693**	$ 2,062,247
LIABILITIES AND EQUITY		
Deposits		
Non-interest bearing	**$ 230,993**	$ 205,854
Interest bearing	**1,386,143**	1,146,662
	1,617,136	1,352,516
Federal funds purchased and repurchase agreements	**249,145**	248,932
Short and long-term debt	**257,209**	275,926
Other liabilities	**39,661**	23,049
Total liabilities	**2,163,151**	1,900,423
Equity		
Capital	**2,000**	2,000
Capital surplus	**42,000**	42,000
Undivided profits	**119,894**	119,894
Accumulated other comprehensive income (loss)	**(352)**	(2,070)
Total equity	**163,542**	161,824
Total liabilities and equity	**$ 2,326,693**	$ 2,062,247

BANK OF NORTH DAKOTA
STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2006 AND 2005

	(In Thousands)	
	2006	2005
INTEREST INCOME		
Federal funds sold	**$ 9,368**	$ 5,005
Securities	**7,830**	7,040
Loans, including fees	**109,400**	86,041
Total interest income	**126,598**	98,086
INTEREST EXPENSE		
Deposits	**44,461**	26,838
Federal funds purchased and repurchase agreements	**9,819**	5,898
Short and long-term debt	**17,004**	18,887
Total interest expense	**71,284**	51,623
NET INTEREST INCOME	**55,314**	46,463
PROVISION FOR LOAN LOSSES	**3,400**	2,400
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	**51,914**	44,063
NONINTEREST INCOME		
Service fees and other	**8,257**	10,337
Gain (loss) on available-for-sale securities	**(509)**	(1,005)
Total noninterest income	**7,748**	9,332
NONINTEREST EXPENSE		
Salaries and benefits	**8,611**	8,502
Data processing	**2,885**	3,680
Occupancy and equipment	**619**	603
Other operating expenses	**4,693**	4,253
Total noninterest expenses	**16,808**	17,038
NET INCOME	**$ 42,854**	$ 36,357

BANK OF NORTH DAKOTA
STATEMENTS OF EQUITY
YEARS ENDED DECEMBER 31, 2006 AND 2005

	(In Thousands)				
	Capital	Capital Surplus	Undivided Profits	Accumulated Other Comprehensive Income (Loss)	Total
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			(27,323)		(27,323)
Transfers to Industrial Commission			(87)		(87)
BALANCE, DECEMBER 31, 2005	2,000	42,000	119,894	(2,070)	161,824
Comprehensive income					
Net income			42,854		42,854
Unrealized loss on securities available for sale				1,718	1,718
Total comprehensive income					44,572
Transfers to state general fund			(42,854)		(42,854)
BALANCE, DECEMBER 31, 2006	$ 2,000	$ 42,000	$ 119,894	$ (352)	$ 163,542

BANK OF NORTH DAKOTA
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2006 AND 2005

	(In Thousands)	
	2006	2005
OPERATING ACTIVITIES		
Net income	**$ 42,854**	$ 36,357
Adjustments to reconcile net income to net cash from operating activities		
Depreciation and amortization	**962**	812
Provision for loan losses	**3,400**	2,400
Net amortization of securities	**988**	877
Gain on sale of residential loans	**(20)**	(20)
Loss on retirement of fixed assets	**9**	-
Gain on sale of other real estate and property owned	**(3)**	(239)
Increase in interest receivable	**(9,836)**	(4,134)
Decrease in other assets	**1,612**	1,541
Increase in other liabilities	**3,801**	1,088
NET CASH FROM OPERATING ACTIVITIES	**43,767**	38,682
INVESTING ACTIVITIES		
Securities available for sale transactions		
Purchase of securities	**(130,688)**	(19,478)
Proceeds from sales, maturities, and principal repayments	**70,821**	105,474
Securities held to maturity transactions		
Proceeds from sales, maturities, and principal repayments	**-**	2,377
Purchase of Federal Home Loan Bank stock	**(6,677)**	(3,745)
Sale of Federal Home Loan Bank stock	**7,025**	10,793
Purchase of other equity securities	**(1,540)**	(634)
Proceeds from sales of loans	**7,075**	68,546
Net increase in loans	**(296,127)**	(80,532)
Purchases of equipment and software	**(3,591)**	(2,601)
Proceeds from sale of other real estate and property owned	**15**	483
NET CASH FROM (USED FOR) INVESTING ACTIVITIES	**(353,687)**	80,683
FINANCING ACTIVITIES		
Net increase in non-interest bearing deposits	**25,139**	5,622
Net increase in interest bearing deposits	**239,481**	148,291
Net increase in federal funds purchased and repurchase agreements	**213**	46,973
Proceeds from issuance of short and long-term debt	**930,408**	610,050
Payment of short and long-term debt	**(949,125)**	(770,717)
Payment of transfers	**(30,043)**	(30,043)
NET CASH FROM FINANCING ACTIVITIES	**216,073**	10,176
NET CHANGE IN CASH AND CASH EQUIVALENTS	**(93,847)**	129,541
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	**435,944**	306,403
CASH AND CASH EQUIVALENTS, END OF YEAR	**$ 342,097**	$ 435,944

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, 2006 and 2005:

	2006	2005
Student loans, of which 98% are federally guaranteed	**32%**	31%
Commercial loans, of which 9% and 8% are federally guaranteed	**32%**	30%
Residential loans, of which 80% and 83% are federally guaranteed	**22%**	23%
Agricultural loans, of which 15% and 16% are federally guaranteed	**14%**	16%
	100%	100%

(continued on next page)

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 issue for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the 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 balances net of charge-offs, unamortized deferred fees and costs on originated loans and premiums or discounts on purchased loans. Interest income on loans is accrued at the specific rate on the unpaid principal balance. Unearned income, deferred fees and costs, and discounts and premiums are amortized to income over the estimated life of the loan using the interest or straight line method.

The accrual of interest is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. When interest accrual is discontinued, all unpaid accrued interest is reversed. 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.

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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, 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.

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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 $617,000 and $444,000 as of December 31, 2006 and 2005.

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 2005 financial statements have been reclassified to conform to the 2006 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. 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, 2006 and 2005, consists of the following:

	(In Thousands)	
	2006	2005
Securities available for sale, at fair value	**$ 202,724**	$ 142,127
Federal Home Loan Bank stock, at cost	**14,389**	14,737
Other equity securities, at cost	**2,299**	759
	$ 219,412	$ 157,623

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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, 2006				
Securities available for sale				
Federal agency	**$ 76,041**	**$ 171**	**$ 197**	**$ 76,015**
Mortgage-backed	**99,952**	**214**	**540**	**99,626**
State and municipal	**27,083**	**-**	**-**	**27,083**
	$ 203,076	**$ 385**	**$ 737**	**$ 202,724**

	(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
	$ 144,197	$ 181	$ 2,251	$ 142,127

Securities carried at $27,651,000 at December 31, 2006, and $8,148,000 at December 31, 2005, were used to secure repurchase agreements and for other required pledging purposes. FHLB stock totaling $14,388,000 at December 31, 2006 and $14,737,000 at December 31, 2005 is pledged on the FHLB advances (Note 9).

The maturity distribution of debt securities at December 31, 2006, 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.

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	(In Thousands)	
	Available for Sale	
	Amortized Cost	Fair Value
Within one year	$ 5,032	$ 4,964
Over one year through five years	130,438	130,191
Over five years through ten years	63,580	63,472
Over ten years	4,026	4,097
	$ 203,076	$ 202,724

For the year ended December 31, 2006, proceeds from the sales of securities available for sale amounted to $13,136,000. Gross realized losses amounted to $509,000. 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.

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, 2006, 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	$ 128	$ 21,161	$ 69	$ 14,913
Mortgage-backed	200	37,447	340	21,741
	$ 328	$ 58,608	$ 409	$ 36,654

(continued on next page)

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, 2006, there are no securities with aggregate depreciation of 5% from the Bank's amortized cost basis.

NOTE 4 - LOANS

The composition of the loan portfolio at December 31, 2006 and 2005 is as follows:

	(In Thousands)	
	2006	2005
Student	**$ 561,178**	$ 459,287
Commercial	**564,946**	431,068
Residential	**388,043**	342,786
Agricultural	**241,395**	233,920
	1,755,562	1,467,061
Allowance for loan losses	**30,136**	27,123
	$ 1,725,426	$ 1,439,938

Student loans held for sale totaled $0 and $5,138,000 as of December 31, 2006 and 2005. Unamortized deferred student loan costs totaled $4,263,000 and $2,716,000 as of December 31, 2006 and 2005. Net unamortized loan premiums and discounts, including purchased servicing rights, on residential loans totaled $2,084,000 and $2,126,000 as of December 31, 2006 and 2005.

The composition of the allowance for loan losses for the years ended December 31, 2006 and 2005 is as follows:

	(In Thousands)	
	2006	2005
Balance - beginning of year	**$ 27,123**	$ 25,927
Provision for loan losses	**3,400**	2,400
Loans charged off	**(680)**	(1,432)
Recoveries	**293**	228
Balance - end of year	**$ 30,136**	$ 27,123

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

	(In Thousands)	
	December 31,	
	2006	2005
Impaired loans with a valuation allowance	**$ 1,109**	$ 2,157
Valuation allowance related to impaired loans	**$ 345**	$ 884
Average investment in impaired loans	**2,304**	2,848
Total non-accrual loans	**1,109**	2,157
Total loans past-due ninety days or more and still accruing	**16,978**	16,101
Restructured loans	**13,842**	10,641

The interest income recorded on impaired loans is not significant.

Accruing loans 90 days or more past due include guaranteed student loans of $15,935,000 and $13,812,000 as of December 31, 2006 and 2005. 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, 2006 and 2005.

NOTE 5 - LOAN SALES AND LOAN SERVICING

A summary of BND's loan sales during 2006 and 2005 follows:

	(In Thousands)	
	2006	2005
Student loans sold to North Dakota Student Loan Trust	**$ 5,138**	$ 66,528
Residential loans sold on the secondary market	**1,917**	1,998

BND recognized gains on sale of loans of $20,000 in both 2006 and 2005, which is included in non-interest income on the Statements of Income.

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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, 2006 and 2005 were as follows:

	(In Thousands)	
	2006	2005
Student loans		
North Dakota Student Loan Trust	**$ 98,028**	$ 144,736
Others	**3,382**	3,865
Residential loans		
Fannie Mae	**23,895**	26,011
Other state fund loans		
Board of University and School Lands	**28,232**	24,123
Community Water Facility Loan Fund	**17,756**	18,002
Beginning Farmer Revolving Loan Fund	**8,347**	8,681
Developmentally Disabled Facility Loan Program	**1,939**	2,331
Department of Human Services	**9,970**	10,380
	$ 191,549	$ 238,129

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.

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NOTE 6 - BANK PREMISES, EQUIPMENT, AND SOFTWARE

A summary of changes in bank premises, equipment, furniture, and software at December 31, 2006 and 2005 is as follows:

	(In Thousands)			
	Balance 2005	Additions	Retirements	Balance 2006
Land	$ 672	$ 1,932	$ -	$ 2,604
Building	4,285	-	-	4,285
Equipment	1,845	29	98	1,776
Furniture	537	-	1	536
Software	6,061	34	95	6,000
Construction in progress	-	1,691	-	1,691
	13,400	3,686	194	16,892
Less accumulated depreciation	8,901	962	90	9,773
	$ 4,499	$ 2,724	$ 104	$ 7,119

	(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
	11,553	2,601	754	13,400
Less accumulated depreciation	8,843	812	754	8,901
	$ 2,710	$ 1,789	$ -	$ 4,499

Depreciation and amortization expense on the above assets amounted to $962,000 and $812,000 in 2006 and 2005.

The 2005 North Dakota Legislature Senate Bill 2014 provided for the construction of a new building for the Bank. In November 2005, the Bank entered into a Purchase Agreement to purchase land for the new building site. Total costs associated with the land is $1,932,000. The building construction project contracted dollar amount as of December 31, 2006 is $9,798,000. The amount of these contracts paid as of December 31, 2006 is $1,691,000. The balance remaining on these contracts is $8,107,000.

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NOTE 7 - DEPOSITS

The aggregate amount of locally sold certificates of deposit larger than $100,000 was $970,869,000 and $654,994,000 as of December 31, 2006 and 2005.

At December 31, 2006, the scheduled maturities of certificates of deposits are as follows:

	(In Thousands)
One year or less	$ 837,350
One to three years	62,574
Over three years	86,794
	$ 986,718

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)	
	2006	2005
Federal Home Loan Bank advances - long-term	**$ 256,600**	$ 275,588
ND Public Finance Authority, 3%, matures from September 2007 through September 2016	**609**	338
	$ 257,209	$ 275,926

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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
2007	$ 9,651	$ 14,606	$ 24,257
2008	89,592	10,131	99,723
2009	5,064	8,928	13,992
2010	49	8,784	8,833
2011	33,049	8,025	41,074
Later years	119,804	38,389	158,193
Totals	$ 257,209	$ 88,863	$ 346,072

The FHLB long-term advances outstanding at December 31, 2006, mature from August 2007 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. Residential loans totaling $376,323,000 in 2006 and $332,773,000 in 2005 are currently being used as security to meet these minimum levels.

The ND Public Finance Authority 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)	
	2006	2005
Transfers payable	**$ 29,951**	$ 17,140
Interest payable	**6,212**	3,345
Salary and benefits payable	**919**	768
Student loan related payables	**597**	677
Accounts payable, accrued expenses and other liabilities	**1,982**	1,119
	$ 39,661	$ 23,049

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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. The Bank transferred $30,000,000 to the State's General Fund in 2006.

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.

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, 2006 and 2005, were approximately $562,000 and $548,000.

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.

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NOTE 12 - COMMITMENTS AND CONTINGENT LIABILITIES

State Water Development Projects

House Bill No. 1021 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, 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 provides for the ability to the Office of Management and Budget to borrow the sum of $15,000,000, or so much 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, inluding 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.

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.

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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, 2006 and 2005, the Bank has guarantees outstanding totaling $1,391,000 and $782,000 and has no guarantee commitments outstanding. This program is effective through July 31, 2007.

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, 2006 and 2005, the Bank has guarantees outstanding totaling $2,970,000 and $2,321,000, and had guarantee commitments outstanding of $174,000 and $79,000 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 the State of North Dakota. This program is effective through June 30, 2009.

The Bank may guarantee loans made by the bank, credit union, a savings and loan association, or any other lending institution in this state 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, 2006 and 2005, the Bank has guarantees outstanding totaling $1,258,000 and $133,000 and has no guarantee commitments outstanding.

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.

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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, 2006 and 2005, the following financial instruments were outstanding whose contract amounts represent credit risk:

	Contract Amount (In Thousands)	
	2006	2005
Commitments to extend credit	**$ 367,026**	$ 380,860
Financial standby letters of credit	**189,337**	175,047

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.

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The carrying amounts and estimated fair values of the Bank's financial instruments as of December 31, 2006 and 2005 were as follows:

	(In Thousands)			
	2006		2005	
	Carrying Amount	**Fair Value**	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	**$ 342,097**	**$ 342,097**	$ 435,944	$ 435,944
Securities	**219,412**	**219,412**	157,623	157,623
Interest receivable	**30,199**	**30,199**	20,362	20,362
Loans				
Student loans	**561,178**	**561,178**	459,287	459,287
Residential loans	**388,043**	**399,409**	342,786	357,415
Other loans	**806,341**	**786,194**	664,985	644,146
Allowance for loan losses	**(30,136)**	**-**	(27,123)	-
Total loans	**1,725,426**	**1,746,781**	1,439,935	1,460,848
Total financial assets	**$ 2,317,134**	**$ 2,338,489**	$ 2,053,864	$ 2,074,777
Financial liabilities				
Non-maturity deposits	**$ 630,418**	**$ 630,418**	$ 673,337	$ 673,337
Deposits with stated maturities	**986,718**	**986,848**	679,179	680,914
Federal funds purchased and repurchase agreements	**249,145**	**249,145**	248,932	248,932
Short and long-term debt	**257,209**	**262,599**	275,926	287,206
Other liabilities	**39,661**	**39,661**	23,049	23,049
Total financial liabilities	**$ 2,163,151**	**$ 2,168,671**	$ 1,900,423	$ 1,913,438

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.

(continued on next page)

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.

(continued on next page)

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	
	2006	2005
Balance, beginning of year	**$ (2,070)**	$ (2,171)
Unrealized holding gains (losses) arising during the period	**1,209**	(904)
Reclassification adjustment for (gains) losses realized in net income	**509**	1,005
Other comprehensive income	**1,718**	101
Balance, end of year	**$ (352)**	$ (2,070)

NOTE 17 - SUPPLEMENTAL DISCLOSURES RELATED TO STATEMENTS OF CASH FLOWS

	(In Thousands)	
	2006	2005
Supplemental disclosures of cash flow information		
Cash payments for:		
Interest paid to customers	**$ 41,646**	$ 25,664
Interest paid on federal funds purchased and securities sold under repurchase agreements	**9,769**	5,855
Interest paid on short and long-term debt	**17,002**	18,890
Supplemental schedule of noncash investing and financing activities		
Transfers from undivided profits to other liabilities	**42,854**	27,410
Net change in unrealized gain (loss) on securities available for sale	**1,718**	101
Other real estate and property owned acquired in exchange for loans	**184**	-

BANK OF NORTH DAKOTA
TEN-YEAR SUMMARY

TEN YEAR SUMMARY	2006	2005	2004
OPERATING RESULTS (in thousands)			
Interest income	$ 126,598	$ 98,086	$ 80,133
Interest expense	71,284	51,623	38,392
Net interest income	55,314	46,463	41,741
Provision for loan losses	3,400	2,400	2,400
Net interest income after provision for loan losses	51,914	44,063	39,341
Noninterest income	7,748	9,332	11,248
Noninterest expense	16,808	17,038	16,373
Net income	**42,854**	**36,357**	**34,216**
Payments to general fund	30,000	30,000	30,000
Payments to other funds	43	43	37
BALANCE SHEET - YEAR END (in thousands)			
TOTAL ASSETS	**2,326,693**	**2,062,247**	**2,014,525**
FEDERAL FUNDS SOLD AND RESELL AGREEMENTS	129,135	195,370	122,230
SECURITIES	219,412	157,623	253,186
LOANS	**1,755,562**	**1,467,061**	**1,456,256**
Student	561,178	459,287	417,356
Commercial	564,946	431,068	480,870
Residential	388,043	342,786	322,044
Agriculture	241,395	233,920	235,986
DEPOSITS	**1,617,136**	**1,352,516**	**1,198,586**
Non-interest bearing	230,993	205,854	208,277
Interest bearing	1,386,143	1,146,662	990,309
FEDERAL FUNDS PURCHASED AND REPURCHASE AGREEMENTS	249,145	248,932	201,959
SHORT AND LONG-TERM DEBT	257,209	275,926	436,593
EQUITY	**163,542**	**161,824**	**152,776**
Capital	2,000	2,000	2,000
Capital surplus	42,000	42,000	42,000
Undivided profits	119,894	119,894	110,947
Accumulated other comprehensive income (loss)	(352)	(2,070)	(2,171)

2003	2002	2001	2000	1999	1998	1997
$ 79,463	$ 90,315	$ 114,490	$ 117,163	$ 99,350	$ 87,788	$ 70,891
41,755	50,666	82,840	75,774	62,487	53,852	40,768
37,708	39,649	41,650	41,389	36,863	33,936	30,123
2,000	2,200	2,700	2,700	1,600	1,700	600
35,708	37,449	38,950	38,689	35,2633	2,236	29,523
11,474	9,764	8,646	7,224	7,838	8,651	8,189
15,488	15,022	14,537	13,331	12,642	12,750	12,168
31,694	**32,191**	**33,059**	**32,582**	**30,459**	**28,137**	**25,544**
34,000	30,000	50,000	-	15,000	29,600	12,715
37	36	36	35	35	40	41
1,953,178	**1,974,448**	**2,107,456**	**1,806,517**	**1,687,167**	**1,609,039**	**1,162,415**
89,915	209,205	257,830	271,510	249,565	206,095	128,180
284,272	235,365	329,632	192,093	235,007	427,842	269,860
1,391,583	**1,329,985**	**1,276,334**	**1,156,614**	**1,056,232**	**835,654**	**623,532**
372,362	364,816	399,002	376,535	335,687	292,896	244,154
469,912	432,940	392,206	362,940	342,860	272,648	220,544
318,067	309,267	271,385	213,009	188,474	113,934	38,089
231,242	222,962	213,741	204,130	189,211	156,176	120,745
1,057,386	**1,070,853**	**1,208,601**	**1,135,731**	**910,652**	**943,537**	**719,508**
214,275	209,112	193,354	130,470	83,798	133,307	117,708
843,111	861,741	1,015,247	1,005,261	826,854	810,230	601,800
190,597	296,688	315,713	215,072	250,985	309,496	234,114
525,795	421,065	399,553	254,439	363,076	203,779	54,087
153,744	**149,113**	**170,496**	**153,045**	**139,275**	**139,931**	**128,888**
2,000	2,000	2,000	2,000	2,000	22,000	22,000
42,000	42,000	42,000	42,000	42,000	22,000	22,000
110,947	104,237	126,237	108,707	96,703	95,736	84,786
(1,203)	876	259	338	(1,428)	195	102

CORE VALUES

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