

RatingsDirect®

Bank of North Dakota

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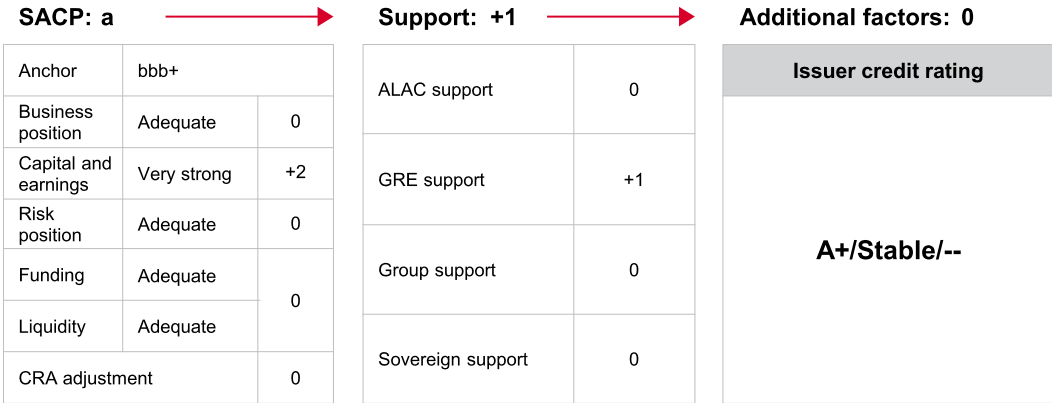
Related Criteria

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Bank of North Dakota

Rating Score Snapshot

Issuer Credit Rating
A+/Stable/--



ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government-related entity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

Credit Highlights

Overview

Key strengths	Key risks
Very strong risk-adjusted capital.	Geographic concentration in North Dakota.
Stable ownership by the state of North Dakota since 1919.	Direct and indirect lending exposure to the cyclical energy and agriculture sectors.
Strong credit quality and conservative management.	Subject to annual capital transfers to North Dakota.

We see a high likelihood of support from the state of North Dakota in case of stress at the bank. Bank of North Dakota (BND) is the only remaining state-owned bank in the continental U.S. It partners with private-sector banks in providing credit to North Dakota-based businesses, holds the deposits of the state and certain agencies, and provides disaster assistance lending.

BND has one of the highest risk-adjusted capital (RAC) ratios for rated U.S. banks and we expect it to maintain very strong capital levels. However, capital ratios could decline if net income is less than capital transfers (dividends) to the state's general fund and various other initiatives funded by BND. The North Dakota legislature determines appropriations from the general fund every legislative session. However, these dividends have not typically exceeded net income by a large enough amount to significantly affect the bank's capitalization.

While the bank has higher nonperforming assets (NPAs) than peers, these rarely translate to high credit losses, and BND maintains a robust loan loss reserve. As of June 30, 2023, adjusted NPAs excluding Troubled Debt Restructurings were 0.98% of loans and real estate owned, though a portion of these were residential loans guaranteed by the federal government or student loans guaranteed by the state of North Dakota. BND has elevated exposures to cyclical industries such as energy and agriculture, but credit losses have been minimal. Over the past 10 years, the net charge-off (NCO) rate has been under 15 basis points (bps) annually despite significant energy and agricultural commodity price volatility, which we think reflects BND's strong credit selection and underwriting. Furthermore, the bank maintains a loan loss reserve of 1.73% of total loans and 1.89% of nonguaranteed loans--among the highest of rated U.S. banks.

Outlook

The stable outlook on BND is based on S&P Global Ratings' view that over the next two years the bank will maintain very strong capital and appropriately manage its credit risk. We also expect that there will be no change in BND's policy role or link to the state of North Dakota. In addition, we expect the bank to continue its prudent management of funding and liquidity as interest rates remain higher for longer.

Downside scenario

Because we base our issuer credit rating on BND on a combination of its stand-alone credit profile (SACP) and likelihood of support from the state of North Dakota, we do not expect to lower the rating absent a sharp negative change to either the SACP or our rating on North Dakota, or some combination of more modest changes to both. For instance, we would lower the rating if either the SACP or our rating on the state fell by at least three notches.

Since we factor in more uplift to our 'AA' deposit ratings for BND, we would lower those ratings even if our rating on the state fell by a notch.

Upside scenario

An upgrade of BND would require a one-notch improvement in either the rating on the state of North Dakota or BND's SACP. We see a higher SACP as unlikely given the cyclical nature of the state's revenue and the interdependence between the state and BND.

Key Metrics

Bank of North Dakota--Key ratios and forecasts

(%)	--Fiscal year ended Dec. 31--				
	2021a	2022a	2023f	2024f	2025f
Growth in operating revenue	-3.8	23.2	6.2-7.5	16.7-20.5	3.4-4.1
Growth in customer loans	-2.5	14.6	4.1-5.0	4.0-4.9	4.0-4.9
Growth in total assets	29.5	1.7	2.9-3.5	3.4-4.1	3.3-4.1

Bank of North Dakota--Key ratios and forecasts (cont.)

(%)	--Fiscal year ended Dec. 31--				
	2021a	2022a	2023f	2024f	2025f
Net interest income/average earning assets (NIM)	2.5	2.6	2.2-2.5	2.6-2.8	2.6-2.8
Cost to income ratio	17.7	14.5	13.9-14.6	12.3-12.9	12.4-13.1
Return on average common equity	15.2	19.3	18.7-20.6	21.3-23.5	19.4-21.4
Return on assets	1.6	1.9	1.7-2.1	2.0-2.4	2.0-2.4
New loan loss provisions/average customer loans	0.1	N.M.	0.2-0.2	0.2-0.2	0.2-0.2
Net charge-offs/average customer loans	0.1	0	0.1-0.1	0.2-0.2	0.1-0.1
Risk-adjusted capital ratio	22.7	20.3	18.8-19.7	19.9-20.9	21.2-22.2

All figures are S&P Global Ratings-adjusted. a--Actual. e--Estimate. f--Forecast. NIM--Net interest margin. N.M.--Not meaningful.

Anchor: 'bbb+' Starting Point For Banks Operating Only In The U.S.

Our anchor for a bank operating mainly in the U.S. is 'bbb+', based on an economic risk score of '3' and an industry risk score of '3'. The U.S.'s diversified, high-income, and resilient economy underpins our assessment of economic risk, which we consider to have a stable trend. In their base case, S&P Global Ratings economists expect multiple quarters of below-potential growth with monetary policy rates staying higher for longer and the balance of risks tilted to the downside. We believe banks in the country generally have strong enough balance sheets and earnings power to weather such a period or at least a moderate downturn.

Our view of industry risk in the U.S. balances the regulatory enhancements made after the global financial crisis, the relatively good risk-adjusted profitability of the banking system, and the country's deep capital markets against its history of periodic financial crises and the complexity of the financial and regulatory system. The trend on industry risk is stable, reflecting further enhancements to regulation that are likely to follow the bank failures in the first half of 2023, a declining but still high share of deposit funding, and our expectation that banks will continue to generate sufficient risk-adjusted profits to build capital.

Business Position: Unique Relationship With The State Of North Dakota And Conservative Management Strategy

BND benefits from its well-established history in North Dakota, record of high profitability and robust credit quality, and good financial governance. However, factors like high geographic concentration, a very low proportion of noninterest income, small domestic market share, and less regulatory oversight relative to most commercial banks roughly offset BND's positive factors.

BND has a long, stable history in North Dakota. Headquartered in Bismarck, BND is the only state-owned lender in the continental U.S. The bank was established by the state legislature in 1919 in response to a shortage of lenders in the state willing to support the credit needs of North Dakota farmers and businesses. Driven by its primary role in financing economic development in the state, BND grew rapidly, particularly from 2012, when North Dakota became a large producer of shale energy.

The bank acts as a lender, a correspondent bank to private-sector financial institutions in North Dakota, the agent of several state-legislated programs, and a depository for state agency funds--supporting our view of BND's very strong link to the state's government.

We view BND's management strategy as conservative and supportive of the bank's business goals, as well as the larger North Dakota community. BND's management closely monitors economic activity in the state and coordinates disaster relief programs to assist borrowers in stress and identify borrowing needs of communities in North Dakota.

Capital And Earnings: Very Strong Capital Ratios And Good Earnings Generation

BND has a high RAC ratio, strong core earnings generation, and very low operating costs. We expect BND to generate strong earnings and maintain high capital ratios amid higher interest rates and after a one-time capital transfer that temporarily impacted its capital.

The S&P Global Ratings RAC ratio for the bank was 18.5% as of June 30, 2023, by our calculation, down significantly from 22% in the previous year period because of a large capital transfer to the state of North Dakota at the end of the 2021-2023 biennium, which ended June 30, 2023. That said, BND's RAC ratio remains the highest of all U.S. rated banks. We expect the RAC ratio will likely increase over the next several years because we expect net income during the 2023-2025 biennium (July 1, 2023-June 30, 2025) to comfortably exceed the projected capital transfers to the state. Therefore, we expect the RAC ratio to remain comfortably in the very strong category (above 15%) over the next two years.

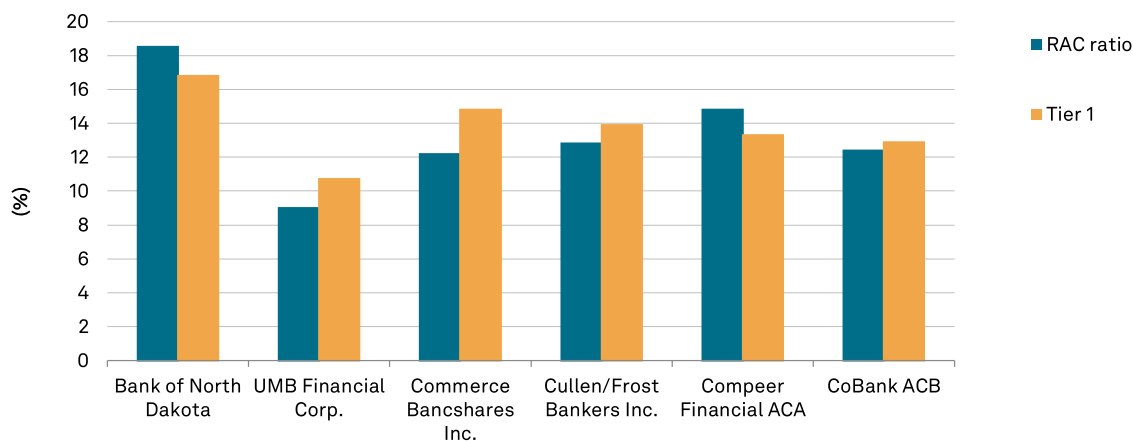
The bank makes capital transfers to the state's general fund and assists other state programs through dividend contributions. Historically, these dividends have fluctuated depending on the state's needs and the capital needs of the bank. In 2022, dividends were \$30 million out of BND's net income of \$191 million. For the first half of 2023, the bank distributed \$161 million, mainly to the state's general fund but also to buydown programs and other state programs. For the 2023-2025 biennium, BND expects the state to require a \$233 million capital transfer.

BND's earnings have been strong and consistent over the past few years despite its heavy reliance on spread-based income. We expect earnings to remain somewhat stable for the remainder of 2023--absent any material credit issues--as the state economy continues to attract big projects and benefit from higher energy prices. BND's very low operating costs, tax exemption, and lack of deposit insurance premiums bolster its earnings capacity. That said, the company reported 7.35% lower preprovision earnings in the first half of 2023. This is due to the bank paying higher interest rates for deposits, as it benchmarks its deposit rates to the average of the 15 largest banks in the state by deposit market share.

Noninterest income remains minimal as 98% of revenue is from net interest income. Positively though, due to its low overhead expenses, BND's return on average assets remained high at 1.87% through the first half of 2023, compared to 1.89% at year-end 2022.

Chart 1**Bank of North Dakota's risk-adjusted capital exceeds that of peers**

As of June 30, 2023



Source: S&P Global Ratings.

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Risk Position: Concentrations In Cyclical Portfolios Offset By Good Asset Quality

BND benefits from its historically strong asset quality and well-reserved allowance for credit losses, offset by its substantial concentrations, including energy and agricultural lending. Overall, BND's asset quality remains solid, reflecting careful underwriting and well-managed concentrations.

BND continues to have higher energy exposures than most rated U.S. banks as energy is an important sector in the North Dakota economy--though, positively, the proportion of oil country exposure remained below its peak from the previous decade. Energy loan exposure (including oil services, refining, ethanol production, power generation, mining, energy marketing, and natural gas distribution) amounted to \$636 million as of June 30, 2023, which is 11.8% of total loans. Energy prices have rebounded since the pandemic, and hotel occupancies in the oil-producing regions have improved. North Dakota's unemployment rate continues to be among the lowest in the country at 1.9% as of September 2023. The rebound in energy prices has supported the credit performance of the bank's direct and indirect energy loan portfolios as oil production and employment in oil-producing geographies has been consistent over the last two years.

Overall, the level of adjusted NPAs excluding troubled debt restructurings has increased 33 bps from year-end 2022 to 0.98% due to a deterioration in some large commercial credits. That said, the high degree of guarantees helps support the bank's credit quality, with 29% of the total loan portfolio either fully or partially guaranteed: residential loans by the federal government and student loans by the state of North Dakota.

The commercial portfolio (excluding agriculture), which has the lowest level of guarantees, has generally maintained

steady NPAs and currently 1% of that portfolio is over 90 days past due--the second highest by loan category. We expect the proportion of guaranteed loans and loan portfolio diversification to decline over time as BND has exited the underwriting and servicing of new residential loans and has collaborated with the North Dakota Housing Finance Agency, which performs similar services.

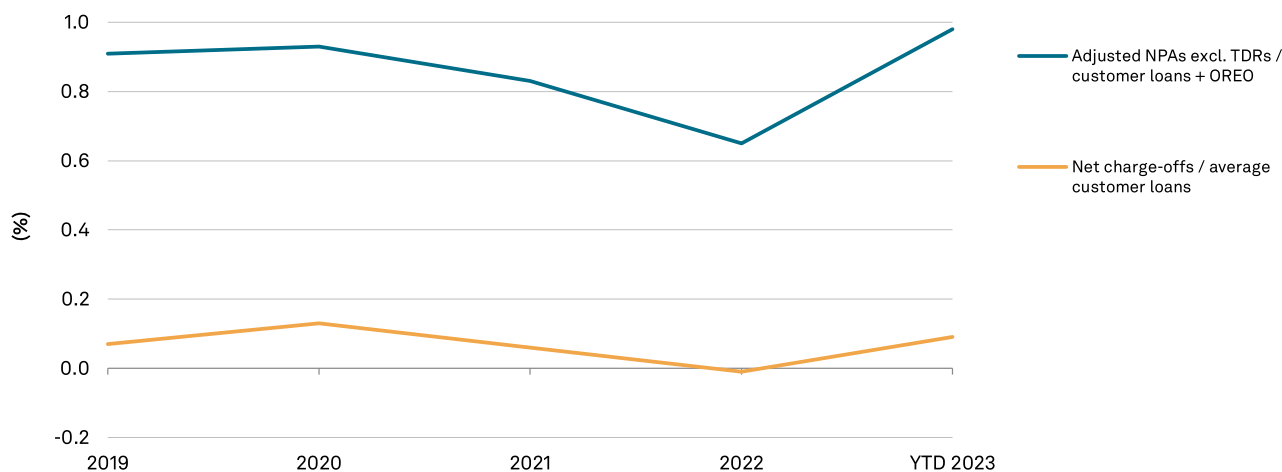
Agricultural loans represented 14% of total loans and residential real estate loans represented 6% as of June 30, 2023. The bank transitioned all of its residential originations to the state housing finance agency in August 2021, and transitioned nearly all its residential servicing and collections to the agency in October 2021. As a result, the residential loan portfolio has decreased by \$74 million since year-end 2021. The state's agricultural economy has been resilient after a drier summer and fall in 2022 followed by near-record snowfall. Despite these challenges, delinquencies in the farm loan portfolio have generally been consistent.

BND maintains robust hedging to manage its interest rate sensitivity. If interest rates fell by 100 bps, the market value of its equity would increase 10.26%, and if rates rose 100 bps, the market value of its equity would fall 9.51%. Off balance sheet, the bank uses pay-fixed/receive-floats swaps to keep a portion of its liabilities at a low fixed rate.

Chart 2

Uptick in Bank of North Dakota's nonperforming assets remains consistent with historical performance

As of June 30, 2023



NPAs--Nonperforming assets. TDR--Troubled debt restructurings. OREO--Other real estate owned. YTD--Year-to-date.
 Source: S&P Global Ratings.
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Funding And Liquidity: Deposit Levels Continue To Bolster Funding And Liquidity

We consider the state-sourced captive deposits--mandated by legislation--as core to the bank. After substantial deposit growth in 2021 (mainly from federal assistance to the state of North Dakota through the CARES Act) and a slight drop

in 2022, BND's deposits jumped again in the first half of 2023 as oil prices recovered.

Meanwhile, funding metrics remained relatively strong compared with other U.S. regional banks. The loan-to-customer deposit ratio was 60% as of June 30, 2023. Furthermore, the stable funding ratio, calculated as available stable funding as a proportion of stable funding needs, improved to 161% as of June 30, 2023, from 153% at year-end 2022.

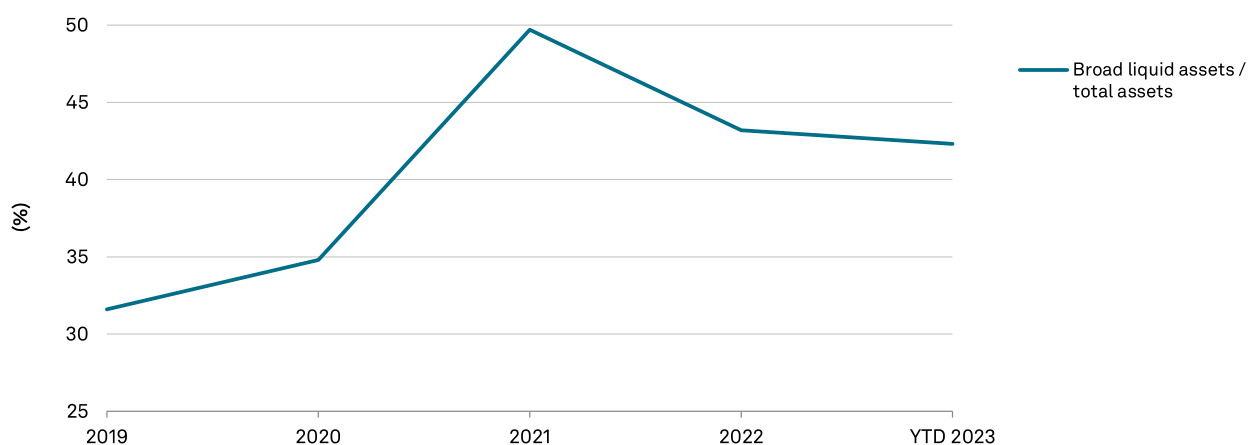
There is some concentration given captive certificates of deposit have generally accounted for a significant portion of the company's total balance sheet funding. Positively, the bank has no brokered deposits and short-term wholesale funding is manageable at only 5% of the funding base as of June 30, 2023.

We expect funding metrics could decline modestly over the next two years as government agencies continue to withdraw their stimulus-related deposits and spend their budgets, coupled with North Dakota's conservative forecast that oil and gas prices will decline to \$62 per barrel in fiscal year 2025 from around \$70 in 2023.

Chart 3

Bank of North Dakota's balance sheet remains liquid

As of June 30, 2023



YTD--Year-to-date. Source: S&P Global Ratings.

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BND's liquidity metrics have improved in the first half of 2023. The ratio of broad liquid assets to short-term wholesale funding improved substantially to 9.3x, from 3.8x at year-end 2022. The company had roughly \$4.4 billion of broad liquid assets, or 42% of total assets as of June 30, 2023--among the highest for regional U.S. bank peers. Liquid assets include cash due from banks, federal funds sold, and unpledged securities.

We believe BND has an adequate liquidity contingency plan, which includes Federal Home Loan Bank availability of \$1.5 billion, Federal Reserve discount window availability of \$210 million, unused federal funds lines of \$180 million, and unused repurchase agreements of \$1.1 billion as of June 30, 2023.

Support: High Likelihood Of Government Support

We incorporate one notch of uplift to our issuer credit rating on BND because we think the state of North Dakota is highly likely to provide it with extraordinary support if necessary. We base this view on BND's important role in promoting the state's economic development and its very strong link to the state government.

The 'AA' rating on the bank's deposits includes three notches of uplift from the SACP and reflects our assessment that the likelihood of extraordinary support for the bank's deposits is extremely high. These deposits are explicitly backed by the state and play a critical role in its public finances.

State law requires all monies of the state and state institutions to be deposited with BND; any changes to this arrangement would necessitate a change in the state legislative code. These arrangements serve to maintain trust in and the financial stability of BND and state finances, in our view.

We believe defaulting on the deposits would have a critical impact on the government. The bank has never defaulted on these state-guaranteed deposits in its over 100 years of operation.

Environmental, Social, And Governance

Environmental factors are a moderately negative consideration in our credit rating analysis of BND. The bank has higher direct exposure to the oil and gas industry and much higher indirect exposure through North Dakota's greater economic dependence on this industry, offset by a history of very good credit performance. Social factors are a positive consideration in our rating analysis. We view BND's key role in funding North Dakota's policy initiatives--through specific lending programs or direct cash appropriations--as a credit strength.

Key Statistics

Table 1

Bank of North Dakota--Key figures					
--Year-ended Dec. 31--					
(Mil. \$)	2023*	2022	2021	2020	2019
Adjusted assets	10,350.6	10,195.8	10,028.1	7,744.3	7,058.4
Customer loans (gross)	5,459.9	5,314.6	4,638.8	4,756.5	4,537.9
Adjusted common equity	1,113.4	1,174.7	1,013.9	944.3	940.7
Operating revenues	117.3	222.7	180.8	188.0	211.0
Noninterest expenses	15.7	32.3	32.1	30.2	29.0
Core earnings	96.1	190.5	144.0	141.0	176.0

*Data as of June 30.

Table 2

Bank of North Dakota--Business position					
	--Year-ended Dec. 31--				
(%)	2023*	2022	2021	2020	2019
Total revenues from business line (currency in millions)	117.9	224.3	181.9	189.1	211.9
Commercial & retail banking/total revenues from business line	98.0	97.8	97.6	97.9	98.2
Trading and sales income/total revenues from business line	0.0	0.0	0.0	0.0	0.0
Corporate finance/total revenues from business line	0.1	0.0	0.0	0.0	0.1
Brokerage/total revenues from business line	0.0	0.0	0.0	0.0	0.0
Insurance activities/total revenues from business line	0.0	0.0	0.0	0.0	0.0
Agency services/total revenues from business line	0.2	0.2	0.2	0.1	0.1
Payments and settlements/total revenues from business line	1.2	1.2	1.5	1.4	1.1
Other revenues/total revenues from business line	0.5	0.7	0.6	0.6	0.4
Investment banking/total revenues from business line	0.1	0.0	0.0	0.0	0.1
Return on average common equity	19.8	19.3	15.2	15.2	18.8

*Data as of June 30.

Table 3

Bank of North Dakota--Capital and earnings					
	--Year-ended Dec. 31--				
(%)	2023*	2022	2021	2020	2019
Tier 1 capital ratio	16.8	18.4	19.8	19.2	20.9
S&P Global Ratings' RAC ratio before diversification	18.5	20.3	22.7	21.9	23.1
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	98.0	98.6	97.1	98.1	97.2
Fee income/operating revenues	1.9	2.1	2.6	2.1	1.6
Market-sensitive income/operating revenues	0.0	-0.8	0.3	-0.4	1.2
Cost to income ratio	13.4	14.5	17.7	16.1	13.8
Preprovision operating income/average assets	2.0	1.9	1.7	2.1	2.6
Core earnings/average managed assets	1.9	1.9	1.6	1.9	2.5

*Data as of June 30.

Table 4

Bank of North Dakota--Risk position					
	--Year-ended Dec. 31--				
(%)	2023*	2022	2021	2020	2019
Growth in customer loans	5.5	14.6	-2.5	4.8	-1.0
Total diversification adjustment/S&P Global Ratings' RWA before diversification	35.4	35.6	36.1	36.7	37.3
Total managed assets/adjusted common equity (x)	9.3	8.7	9.9	8.2	7.5
New loan loss provisions/average customer loans	0.2	N.M.	0.1	0.4	0.1
Net charge-offs/average customer loans	0.1	0.0	0.1	0.1	0.1
Adjusted nonperforming assets excl. troubled debt restructurings/customer loans + other real estate owned	0.98	0.65	0.83	0.93	0.91

Table 4

Bank of North Dakota--Risk position (cont.)					
	--Year-ended Dec. 31--				
(%)	2023*	2022	2021	2020	2019
Loan loss reserves/gross nonperforming assets	72.4	95.6	77.6	59.9	64.6

*Data as of June 30. N.M.--Not meaningful.

Table 5

Bank of North Dakota--Funding and liquidity					
	--Year-ended Dec. 31--				
(%)	2023*	2022	2021	2020	2019
Core deposits/funding base	95.0	87.4	92.9	87.7	82.7
Customer loans (net)/customer deposits	60.2	64.8	54.2	78.4	88.3
Long-term funding ratio	95.5	88.7	94.1	90.6	87.6
Stable funding ratio	161.5	152.6	182.8	135.4	125.7
Short-term wholesale funding/funding base	5.0	12.6	6.5	10.7	14.3
Broad liquid assets/short-term wholesale funding (x)	9.3	3.8	8.5	3.7	2.6
Broad liquid assets/total assets	42.3	43.2	49.7	34.8	31.6
Broad liquid assets/customer deposits	49.1	54.7	59.6	45.5	44.3
Net broad liquid assets/short-term customer deposits	54.8	50.5	65.8	41.7	33.8
Short-term wholesale funding/total wholesale funding	100.0	100.0	91.4	87.0	82.3

*Data as of June 30.

Bank of North Dakota--Rating component scores

Issuer Credit Rating	A+ / Stable / --
SACP	a
Anchor	bbb+
Economic risk	3
Industry risk	3
Business position	Adequate
Capital and earnings	Very strong
Risk position	Adequate
Funding	Adequate
Liquidity	Adequate
Comparable ratings analysis	0
Support	1
ALAC support	0
GRE support	1
Group support	0
Sovereign support	0
Additional factors	0

ALAC--Additional loss-absorbing capacity. GRE--Government-related entity. SACP--Stand-alone credit profile.

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Ratings Detail (As Of November 6, 2023)*

Bank of North Dakota

Issuer Credit Rating A+/Stable/--

Issuer Credit Ratings History

19-Feb-2016	A+/Stable/--
06-Dec-2011	AA-/Stable/--
30-Jul-2009	A+/Stable/--

Ratings Detail (As Of November 6, 2023)*(cont.)

Sovereign Rating

United States

AA+/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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