Quarterly Report

For the quarter ended September 30, 2023

BNCCORP, INC.

(OTCQX: BNCC)

322 East Main Avenue
Bismarck, North Dakota 58501
(701) 250-3040

BNCCORP, INC.
INDEX TO QUARTERLY REPORT
September 30, 2023

TABLE OF CONTENTS

Financial Statements

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

(In thousands, except share data)

	September 30, 2023	December 31, 2022
ASSETS	(unaudited)	
Cash and cash equivalents	$ 51,366	$ 73,968
Debt securities available for sale	158,016	174,876
Federal Reserve Bank and Federal Home Loan Bank stock	2,938	3,063
Loans held for sale-mortgage banking	120	37,764
Loans held for investment	665,026	616,645
Allowance for credit losses (1)	(9,146)	(8,831)
Net loans held for investment	655,880	607,814
Premises and equipment, net	10,951	11,764
Operating lease right of use asset	1,020	1,521
Accrued interest receivable	3,851	3,312
Other	29,215	29,239
Total assets	$ 913,357	$ 943,321
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Deposits:		
Non-interest-bearing	$ 180,045	$ 207,232
Interest-bearing –		
Savings, interest checking and money market	543,909	554,577
Time deposits	65,572	57,775
Total deposits	789,526	819,584
Guaranteed preferred beneficial interest in Company's subordinated debentures	15,000	15,000
Accrued interest payable	687	312
Accrued expenses	3,630	5,482
Operating lease liabilities	1,134	1,660
Other	1,133	937
Total liabilities	811,110	842,975
STOCKHOLDERS' EQUITY:		
Common stock, $.01 par value – Authorized 11,300,000 shares; 3,561,334 and 3,559,334 shares issued and outstanding	36	36
Capital surplus – common stock	26,670	26,399
Retained earnings	91,035	87,575
Treasury stock (107,319 and 109,319 shares, respectively)	(1,665)	(1,622)
Accumulated other comprehensive loss	(13,829)	(12,042)
Total stockholders' equity	102,247	100,346
Total liabilities and stockholders' equity	$ 913,357	$ 943,321

(1) The Company adopted ASU 2016-13 as of January 1, 2023. The prior year amounts presented are calculated under the prior accounting standard.

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Income
(In thousands, except per share data, unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2023	**2022**	**2023**	**2022**
INTEREST INCOME:				
Interest and fees on loans	$ 9,167	$ 7,279	$ 26,268	$ 19,950
Interest and dividends on investments				
Taxable	1,883	1,479	5,394	3,714
Tax-exempt	-	58	19	173
Dividends	36	37	108	110
Total interest income	11,086	8,853	31,789	23,947
INTEREST EXPENSE:				
Deposits	2,963	600	6,696	1,258
Short-term borrowings	-	1	-	1
Federal Home Loan Bank advances	-	2	6	3
Subordinated debentures	263	143	743	291
Total interest expense	3,226	746	7,445	1,553
Net interest income	7,860	8,107	23,344	22,394
PROVISION (CREDIT) FOR CREDIT LOSSES:	230	150	635	(400)
Net interest income after provision for credit losses	7,630	7,957	23,709	22,794
NON-INTEREST INCOME:				
Bank charges and service fees	815	1,215	2,792	2,568
Wealth management revenues	504	489	1,474	1,517
Mortgage banking revenues, net	(381)	2,468	3,767	10,392
Gains on sales of loans, net	5	3	15	242
Gains on sales of debt securities, net	-	-	12	-
Other	175	290	401	1,036
Total non-interest income	1,118	4,465	8,461	15,755
NON-INTEREST EXPENSE:				
Salaries and employee benefits	3,673	5,170	13,677	16,330
Professional services	529	954	3,115	2,870
Data processing fees	862	993	2,915	2,964
Marketing and promotion	225	1,596	2,954	4,388
Occupancy	382	499	1,376	1,609
Regulatory costs	134	120	334	360
Depreciation and amortization	261	310	838	927
Office supplies and postage	94	99	322	316
Other	618	658	1,993	2,210
Total non-interest expense	6,778	10,399	27,524	31,974
Income before income taxes	1,970	2,023	4,646	6,575
Income tax expense	463	475	1,092	1,545
NET INCOME	$ 1,507	$ 1,548	$ 3,554	$ 5,030
Basic earnings per common share	$ 0.42	$ 0.43	$ 0.99	$ 1.41
Diluted earnings per common share	$ 0.42	$ 0.43	$ 0.99	$ 1.41

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive (Loss) Income

(In thousands, unaudited)

	For the Three Months Ended September 30,				For the Nine Months Ended September 30,			
	2023		2022		2023		2022	
NET INCOME		$ 1,507		$ 1,548		$ 3,554		$ 5,030
Unrealized loss on debt securities available for sale	$ (2,813)		$ (6,660)		$ (2,358)		$ (21,158)	
Reclassification adjustment for gains included in net income	-		-		(12)		-	
Other comprehensive loss before tax	(2,813)		(6,660)		(2,370)		(21,158)	
Income tax benefit related to items of other comprehensive loss	692		1,638		583		5,205	
Other comprehensive loss	$ (2,121)	(2,121)	$ (5,022)	(5,022)	$ (1,787)	(1,787)	$ (15,953)	(15,953)
TOTAL COMPREHENSIVE (LOSS) INCOME		$ (614)		$ (3,474)		$ 1,767		$ (10,923)

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES

Consolidated Statements of Stockholders' Equity
For the Nine Months Ended September 30,
(In thousands, except share data, unaudited)

	Common Stock		Capital Surplus Common Stock	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount					
BALANCE, December 31, 2021	3,554,983	$ 36	$ 26,068	$ 87,378	$ (1,650)	$ 3,154	$ 114,986
Net income	-	-	-	5,030	-	-	5,030
Other comprehensive loss	-	-	-	-	-	(15,953)	(15,953)
Impact of share-based compensation	4,283	-	288	-	25	-	313
Dividends declared on common stock ($1.75)	-	-	-	(6,303)	-	-	(6,303)
BALANCE, September 30, 2022	3,559,266	$ 36	$ 26,356	$ 86,105	$ (1,625)	$ (12,799)	$ 98,073
BALANCE, December 31, 2022	3,559,334	$ 36	$ 26,399	$ 87,575	$ (1,622)	$ (12,042)	$ 100,346
Cumulative effect adjustment for adoption of ASU 2016-13, Measurement of Credit Losses on Financial Instruments	-	-	-	(94)	-	-	(94)
Net income	-	-	-	3,554	-	-	3,554
Other comprehensive loss	-	-	-	-	-	(1,787)	(1,787)
Impact of share-based compensation	2,000	-	271	-	(43)	-	228
BALANCE, September 30, 2023	3,561,334	$ 36	$ 26,670	$ 91,035	$ (1,665)	$ (13,829)	$ 102,247

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
For the Nine Months Ended September 30,
(In thousands, unaudited)

	2023	2022
OPERATING ACTIVITIES:		
Net income	$ 3,554	$ 5,030
Adjustments to reconcile net income to net cash provided by operating activities -		
Provision (credit) for credit losses	635	(400)
Depreciation	838	927
Amortization of right of use asset	484	582
Net amortization of premiums on debt securities and subordinated debentures	1,242	2,565
Share-based compensation	228	313
Change in accrued interest receivable and other assets, net	(554)	2,202
Loss on sale of bank premises and equipment	142	2
Net realized gain on sales of debt securities	(12)	-
(Increase) decrease in deferred taxes	(31)	230
Change in other liabilities, net	(1,697)	(1,905)
Originations of loans held for sale, mortgage banking	(439,618)	(888,700)
Proceeds from sales of loans held for sale, mortgage banking	477,270	913,793
Fair value adjustment for loans held for sale, mortgage banking	52	788
Fair value adjustment on mortgage banking derivatives	409	58
Proceeds from sales of loans	-	1,096
Gains on sales of loans, net	(15)	(242)
Gain on sale of assets held for sale	-	(532)
Net cash provided by operating activities	42,927	35,807
INVESTING ACTIVITIES:		
Purchases of debt securities	(9,555)	(19,562)
Proceeds from sales of debt securities	9,483	-
Proceeds from maturities of debt securities	13,330	24,051
Purchases of Federal Reserve and Federal Home Loan Bank Stock	(1,640)	(1,717)
Sales of Federal Reserve and Federal Home Loan Bank Stock	1,765	1,750
Net increase in loans held for investment	(48,687)	(63,150)
Proceeds from sales of premises and equipment	102	4
Purchases of premises and equipment	(269)	(469)
Net cash used in investing activities	(35,471)	(59,093)

See accompanying notes to consolidated financial statements.

BNCCORP, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows, continued
For the Nine Months Ended September 30,
(In thousands, unaudited)

	2023	2022
FINANCING ACTIVITIES:		
Net decrease in deposits	$ (30,058)	$ (82,976)
Repayments of Federal Home Loan Bank advances	(41,000)	(42,910)
Proceeds from Federal Home Loan Bank advances	41,000	42,910
Dividends paid on common stock	-	(6,303)
Net cash used in financing activities	(30,058)	(89,279)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(22,602)	(112,565)
CASH AND CASH EQUIVALENTS, beginning of period	73,968	188,060
CASH AND CASH EQUIVALENTS, end of period	$ 51,366	$ 75,495
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid	$ 7,070	$ 1,545
Income taxes paid	$ 1,161	$ 565
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Additions to repossessed assets in the settlement of loans	$ 73	$ 15
Right of use assets obtained in exchange for lease obligations	$ 340	$ 167

See accompanying notes to consolidated financial statements.

NOTE 1 – Organization of Operations, BNCCORP, INC.

BNCCORP, INC. ("BNCCORP") is a registered bank holding company incorporated under the laws of Delaware. It is the parent company of BNC National Bank (the "Bank"). BNC National Bank operates community banking and wealth management businesses through 11 locations in North Dakota and Arizona.

NOTE 2 – Basis of Presentation and Accounting Policies

The accounting and reporting policies of BNCCORP and its subsidiaries (collectively, the "Company") conform to accounting principles generally accepted in the United States of America and general practices within the financial services industry. The consolidated financial statements included herein are for BNCCORP and its subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

The accompanying unaudited interim consolidated financial statements have been prepared under the presumption that users of the interim consolidated financial information have either read or have access to the audited consolidated financial statements of BNCCORP, INC. and subsidiaries for the year ended December 31, 2022. Accordingly, footnote disclosures which would substantially duplicate the disclosures contained in the December 31, 2022 audited consolidated financial statements have been omitted from these interim consolidated financial statements. These interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2022, and the notes thereto.

The accompanying interim consolidated financial statements have been prepared by the Company in accordance with generally accepted accounting principles (GAAP) in the United States of America for interim financial information. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of income and expenses during the reporting period. These estimates are based on information available to management at the time the estimates are made.

The unaudited consolidated financial statements as of September 30, 2023, include, in the opinion of management, all adjustments, consisting primarily of normal recurring adjustments, necessary for a fair presentation of the financial results for the respective interim periods and are not necessarily indicative of results of operations to be expected for the entire fiscal year.

RECENTLY ISSUED OR ADOPTED ACCOUNTING PRONOUNCEMENTS & INTERPRETATIONS

ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*, replaces the current incurred loss methodology for recognizing credit losses with a current expected credit loss model, which requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. This amended guidance broadens the information that an entity must consider in developing its expected credit loss estimates. Additionally, this update amends the accounting for credit losses for available-for-sale debt securities and purchased financial assets with a more-than-insignificant amount of credit deterioration since origination. This update requires enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of a company's loan portfolio. This update is effective for fiscal years beginning after December 15, 2022.

The Company adopted the standard on January 1, 2023, and applied the standard as a cumulative effect adjustment to retained earnings. At adoption, the Company recorded a $125 thousand increase to the allowance for credit losses, which was comprised of a $64 thousand decrease in the allowance for loan losses and a $189 thousand increase to the allowance for unfunded commitments. The after-tax impact resulted in a $94 thousand decrease to retained earnings. The tax effect resulted in an increase to deferred tax assets.

ASU No. 2022-02, *Financial Instruments – Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures*, eliminates the accounting guidance for TDRs by creditors in ASC 310-40, *Receivables – Troubled Debt Restructurings by Creditors*, in its entirety and requires entities to evaluate all receivable modifications under ASC 310-20-35-9 through 35-11 to determine whether a modification made to a borrower results in a new loan or a continuation of the existing loan. For entities that have already adopted ASU 2016-13, the amendments in ASU 2022-02 are effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. For entities that have not yet adopted ASU 2016-13, the amendments in ASU 2022-02 are effective upon adoption of ASU 2016-13. The Company adopted the standard on January 1, 2023 and the adoption did not have a material impact on the Company's consolidated financials.

NOTE 3 – Debt Securities Available for Sale

Debt securities have been classified in the consolidated balance sheets according to management's intent. The Company had no securities designated as trading or held-to-maturity in its portfolio at September 30, 2023, or December 31, 2022. The carrying amount of available-for-sale debt securities and their estimated fair values were as follows (in thousands):

	As of September 30, 2023			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. treasury securities	$ 25,750	$ -	$ (1,397)	$ 24,353
U.S. government sponsored entity mortgage-backed securities issued by FNMA/FHLMC	21,709	-	(4,013)	17,696
U.S. government agency small business administration pools guaranteed by SBA	12,447	-	(791)	11,656
Collateralized mortgage obligations guaranteed by GNMA	8,544	-	(486)	8,058
Collateralized mortgage obligations issued by FNMA/FHLMC	57,657	-	(6,945)	50,712
Commercial mortgage-backed securities issued by FHLMC	16,952	-	(1,781)	15,171
Other commercial mortgage-backed securities	26,713	-	(2,883)	23,830
State and municipal bonds	8,065	-	(1,525)	6,540
	$ 177,837	$ -	$ (19,821)	$ 158,016

	As of December 31, 2022			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. treasury securities	$ 19,864	$ -	$ (1,828)	$ 18,036
U.S. government sponsored entity mortgage-backed securities issued by FNMA/FHLMC	23,485	-	(3,338)	20,147
U.S. government agency small business administration pools guaranteed by SBA	15,572	-	(1,191)	14,381
Collateralized mortgage obligations guaranteed by GNMA	10,096	-	(338)	9,758
Collateralized mortgage obligations issued by FNMA/FHLMC	64,285	-	(5,533)	58,752
Commercial mortgage-backed securities issued by FHLMC	17,557	-	(1,476)	16,081
Other commercial mortgage-backed securities	27,906	-	(2,617)	25,289
State and municipal bonds	13,562	341	(1,471)	12,432
	$ 192,327	$ 341	$ (17,792)	$ 174,876

The amortized cost and estimated fair market value of available-for-sale debt securities classified according to their contractual maturities at September 30, 2023, were as follows (in thousands):

	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 14,854	$ 14,746
Due after one year through five years	22,658	20,475
Due after five years through 10 years	16,137	14,408
Due after 10 years	124,188	108,387
Total	$ 177,837	$ 158,016

The table above is not intended to reflect actual maturities, cash flows, or interest rate risk. Actual maturities may differ from the contractual maturities shown above as a result of prepayments.

The following table shows the Company's debt securities fair value and gross unrealized losses; aggregated by debt security category and length of time that individual debt securities have been in a continuous unrealized loss position (dollars are in thousands):

	September 30, 2023								
	Less Than 12 Months			12 Months or More			Total		
Description of Securities	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss
U.S. treasury securities	1	$ 9,827	$ (27)	4	$ 14,526	$ (1,370)	5	$ 24,353	$ (1,397)
U.S. government sponsored entity mortgage-backed securities issued by FNMA/FHLMC	-	-	-	8	17,696	(4,013)	8	17,696	(4,013)
U.S. government agency small business administration pools guaranteed by SBA	-	-	-	4	11,656	(791)	4	11,656	(791)
Collateralized mortgage obligations guaranteed by GNMA	-	-	-	8	8,058	(486)	8	8,058	(486)
Collateralized mortgage obligations issued by FNMA/ FHLMC	1	174	(7)	18	50,538	(6,938)	19	50,712	(6,945)
Commercial mortgage-backed securities issued by FHLMC	-	-	-	3	15,171	(1,781)	3	15,171	(1,781)
Other commercial mortgage-backed securities	-	-	-	11	23,830	(2,883)	11	23,830	(2,883)
State and municipal bonds	-	-	-	2	6,540	(1,525)	2	6,540	(1,525)
Total temporarily impaired securities	2	$ 10,001	$ (34)	58	$ 148,015	$ (19,787)	60	$ 158,016	$ (19,821)

	December 31, 2022								
	Less Than 12 Months			12 Months or More			Total		
Description of Securities	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss	#	Fair Value	Unrealized Loss
U.S. treasury securities	1	$ 4,817	$ (185)	3	$ 13,219	$ (1,643)	4	$ 18,036	$ (1,828)
U.S. government sponsored entity mortgage-backed securities issued by FNMA/FHLMC	2	2,092	(109)	6	18,055	(3,229)	8	20,147	(3,338)
U.S. government agency small business administration pools guaranteed by SBA	-	-	-	4	14,381	(1,191)	4	14,381	(1,191)
Collateralized mortgage obligations guaranteed by GNMA	8	9,758	(338)	-	-	-	8	9,758	(338)
Collateralized mortgage obligations issued by FNMA/FHLMC	14	34,501	(1,186)	5	24,251	(4,347)	19	58,752	(5,533)
Commercial mortgage-backed securities issued by FHLMC	2	12,312	(816)	1	3,769	(660)	3	16,081	(1,476)
Other commercial mortgage-backed securities	7	18,458	(1,157)	4	6,831	(1,460)	11	25,289	(2,617)
State and municipal bonds	3	9,550	(1,471)	-	-	-	3	9,550	(1,471)
Total temporarily impaired securities	37	$ 91,488	$ (5,262)	23	$ 80,506	$ (12,530)	60	$ 171,994	$ (17,792)

As identified in the recently issued or adopted accounting pronouncements and interpretations section, the Company's January 1, 2023, adoption of ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*, requires an evaluation of debt securities available for sale to determine if a credit loss exists.

The Company's evaluation first assesses whether it intends to sell, or it is more likely than not that it will be required to sell the security before recovery of its amortized cost basis. If either criteria is met, the security's amortized cost basis is written down to fair value through income. For AFS debt securities that do not meet the aforementioned criteria, the Company evaluates whether the decline in fair value has resulted from credit losses or other factors. In making this assessment, management considers the extent to which fair value is less than amortized cost, any changes to the rating of the security by a rating agency, and adverse conditions specifically related to the security, among other factors. If this assessment indicates that a credit loss exists, the present value of cash flows expected to be collected from the security are compared to the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis, a credit loss exists and an allowance for credit losses is recorded for the credit loss, limited by the amount that the fair value is less than the amortized cost basis. Changes in the allowance for credit losses are recorded as a provision for (or reversal of) credit losses and can change over time.

The Company does not believe that the debt securities available for sale that were in an unrealized loss position as of September 30, 2023 represent a credit loss impairment. As of September 30, 2023, the gross unrealized loss positions were primarily related to mortgage-backed securities issued by U.S. government agencies or U.S. government-sponsored enterprises. These securities carry the explicit and/or implicit guarantee of the U.S. government and have a history of zero credit loss. Total gross unrealized losses were attributable to changes in interest rates, relative to when the investment securities were purchased, and not due to the credit quality of the debt securities. The Company does not intend to sell the debt securities that were in an unrealized loss position and it is unlikely that the Company will be required to sell the debt securities before recovery of their amortized cost basis, which may be at maturity.

At December 31, 2022, management evaluated each debt security with unrealized losses to determine whether losses are other-than-temporary. When determining whether a debt security is other-than-temporarily impaired, management assesses whether it has the intent to sell the debt security or whether it is more likely than not that it will be required to sell the debt security before a recovery of amortized cost.

There were no debt securities that management concluded were other-than-temporarily impaired at December 31, 2022.

NOTE 4 – Loans

The composition of loans is as follows (in thousands):

	September 30, 2023	December 31, 2022
Loans held for sale-mortgage banking	$ 120	$ 37,764
Commercial and industrial	$ 210,399	$ 205,429
Commercial real estate	231,251	230,243
SBA	59,905	48,638
Consumer	110,572	95,891
Land and land development	8,129	10,758
Construction	43,612	24,690
Gross loans held for investment	663,868	615,649
Unearned income and net unamortized deferred fees and costs	1,158	996
Loans, net of unearned income and unamortized fees and costs	665,026	616,645
Allowance for credit losses	(9,146)	(8,831)
Net loans held for investment	$ 655,880	$ 607,814

NOTE 5 – Allowance for Credit Losses

As identified in the recently issued or adopted accounting pronouncements and interpretations section, the Company's January 1, 2023 adoption of ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*, resulted in changes to the methodology for estimating the allowance for credit losses. As a result of this adoption, the Company recorded a $125 thousand increase to the allowance for credit losses as a cumulative-effect adjustment on January 1, 2023.

The Company is required to estimate the credit losses expected over the life of the loan. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the estimated collectability of the loan portfolio.

The Company's methodology for estimating the allowance for credit losses is applied consistently to the loan portfolio. The following identifies the methodology by which the Company estimates the allowance for credit losses:

Collective Pools. The Company makes a significant number of loans that, due to their underlying similar characteristics, are assessed for loss as "collective" pools. The Bank segments the pools by type of loan and using historical loss and peer group loss information estimates an expected credit loss for each individual loan or lease within the pool. Loans of this nature are generally internally designated as a "pass" rated credit.

Collective Risk Grade. The Company has loans where the risk grade classification deteriorates below an internally assigned grade of "pass". In these cases, the Company generally experiences higher historical loss rates and expects the credit losses on the contractual balance to increase. Loans in this category are pooled by risk grade and historic loss rates are applied to the contractual balances of each individual loan or lease.

Individual Reserves. The Company estimates specific reserves for individually evaluated loans through a loan-by-loan analysis of problem loans that considers expected future cash flows, the value of collateral and other factors that may impact the borrower's ability to make payments when due. Included in this group are loans in nonaccrual status or modified loans.

Qualitative / Forecast Reserve. The Company also considers qualitative adjustments to the quantitative baseline. Utilizing a framework based on the Interagency Policy Statement on Allowance for Credit Losses, the Company considers prevailing and anticipated economic trends, such as current and forecasted economic conditions, economic trends, an assessment of credit risk inherent in the loan portfolio, and delinquency trends. The Company also considers information to the extent the Company expects current conditions and reasonable and supportable forecasts to differ from the conditions that existed for the period over which historical information was evaluated. The Company's forecast period is generally 1 to 2 years.

The following table presents transactions in the allowance for credit losses by portfolio segment (in thousands):

	Three Months Ended September 30, 2023						
	Commercial and Industrial	Commercial Real Estate	SBA	Consumer	Land and Land Development	Construction	Total
Balance, beginning of period	$ 3,264	$ 3,276	$ 892	$ 1,006	$ 126	$ 436	$ 9,000
Provision (credit)	(16)	(92)	84	161	6	102	245
Loans charged off	-	-	(4)	(99)	-	-	(103)
Loan recoveries	-	-	-	4	-	-	4
Balance, end of period	$ 3,248	$ 3,184	$ 972	$ 1,072	$ 132	$ 538	$ 9,146

	Three Months Ended September 30, 2022						
	Commercial and Industrial	Commercial Real Estate	SBA	Consumer	Land and Land Development	Construction	Total
Balance, beginning of period	$ 2,429	$ 3,469	$ 1,435	$ 903	$ 99	$ 152	$ 8,487
Provision (credit)	(17)	56	(36)	117	(5)	35	150
Loans charged off	-	-	-	(25)	-	-	(25)
Loan recoveries	-	-	-	5	-	-	5
Balance, end of period	$ 2,412	$ 3,525	$ 1,399	$ 1,000	$ 94	$ 187	$ 8,617

The Company recorded a $230 thousand provision for credit losses in the third quarter of 2023. A provision of $245 thousand was recorded as an allowance for loan losses and $15 thousand was recorded as a reduction in the allowance for unfunded commitments. At September 30, 2023, the Company maintained an allowance for unfunded commitments of $197 thousand. The allowance for unfunded commitments are included as part of the Other Liabilities line on the Company's Consolidated Balance Sheets.

	Nine Months Ended September 30, 2023						
	Commercial and Industrial	Commercial Real Estate	SBA	Consumer	Land and Land Development	Construction	Total
Balance, beginning of period	$ 2,519	$ 3,621	$ 1,396	$ 982	$ 87	$ 226	$ 8,831
Cumulative effect- CECL adoption	511	(300)	(467)	(13)	66	139	(64)
Provision (credit)	290	(137)	98	224	(21)	173	627
Loans charged off	(72)	-	(55)	(141)	-	-	(268)
Loan recoveries	-	-	-	20	-	-	20
Balance, end of period	$ 3,248	$ 3,184	$ 972	$ 1,072	$ 132	$ 538	$ 9,146

	Nine Months Ended September 30, 2022						
	Commercial and Industrial	Commercial Real Estate	SBA	Consumer	Land and Land Development	Construction	Total
Balance, beginning of period	$ 2,173	$ 4,129	$ 1,641	$ 836	$ 148	$ 153	$ 9,080
Provision (credit)	239	(604)	(245)	250	(74)	34	(400)
Loans charged off	-	-	-	(99)	-	-	(99)
Loan recoveries	-	-	3	13	20	-	36
Balance, end of period	$ 2,412	$ 3,525	$ 1,399	$ 1,000	$ 94	$ 187	$ 8,617

The Company recorded a $635 thousand provision for credit losses in the nine months ended September 30, 2023. A provision of $627 thousand was recorded as an allowance for loan losses and $8 thousand was recorded as an allowance for unfunded commitments. At September 30, 2023, the Company maintained an allowance for unfunded commitments of $197 thousand. The allowance for unfunded commitments are included as part of the Other liabilities line on the Company's Consolidated Balance Sheets.

Impaired loans are loans on non-accrual status and troubled debt restructurings, which are individually evaluated for impairment, and other loans deemed to have similar risk characteristics. With the adoption of ASU 2016-13, *Measurement of Credit Losses on Financial Instruments*, this disclosure is no longer a required disclosure after December 31, 2022.

The following table shows the balance in the allowance for credit losses at December 31, 2022, and the related loan balances, segregated on the basis of impairment methodology (in thousands).

	Allowance For Credit Losses			Gross Loans Held for Investment		
	Impaired	**Other**	**Total**	**Impaired**	**Other**	**Total**
December 31, 2022						
Commercial and industrial	$ -	$ 2,519	$ 2,519	$ 644	$ 204,785	$ 205,429
Commercial real estate	-	3,621	3,621	-	230,243	230,243
SBA	457	939	1,396	830	47,808	48,638
Consumer	-	982	982	34	95,857	95,891
Land and land development	-	87	87	-	10,758	10,758
Construction	-	226	226	-	24,690	24,690
Total	$ 457	$ 8,374	$ 8,831	$ 1,508	$ 614,141	$ 615,649

Credit Quality Indicators

The Company maintains an internal risk rating process in order to increase the precision and effectiveness of credit risk management. Loans are assigned one of the following four internally assigned grades: pass, watch list, substandard, and doubtful. The following are the definitions of the Company's credit quality indicators:

Pass. Loans designated as pass are not adversely rated, are contractually current as to principal and interest, and are otherwise in compliance with the contractual terms of the loan or lease agreement. Management believes that there is a low likelihood of loss related to those loans and leases that are considered Pass.

Watch list. Loans designated as watch list are loans that possess some credit deficiency that deserves close attention due to emerging problems. Such loans pose unwarranted financial risk that, if left uncorrected, may result in deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date.

Substandard. Loans graded as substandard or doubtful are considered "Classified" loans for regulatory purposes. Loans classified as substandard are loans that are generally inadequately protected by the current net worth and paying capacity of the obligor, or by the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the loan. Substandard loans are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful. Loans classified as doubtful have the weaknesses of those classified as substandard, with additional characteristics that make collection in full on the basis of currently existing facts, conditions and values questionable, and there is a higher probability of loss.

The following presents by credit quality indicator, loan class, and year of origination, the amortized cost basis of the Company’s loans as of September 30, 2023 (in thousands):

	Term Loans by Origination Year							
September 30, 2023	**2023**	**2022**	**2021**	**2020**	**2019**	**Prior**	**Revolving Loans**	**Total**
Commercial and industrial								
Pass	$ 25,052	$ 68,655	$ 27,572	$ 20,229	$ 7,815	$ 28,179	$ 29,006	$ 206,508
Watch List	-	19	-	102	-	-	-	121
Substandard	28	126	116	64	1,139	1,812	-	3,285
Doubtful	-	485	-	-	-	-	-	485
Total commercial and industrial	$ 25,080	$ 69,285	$ 27,688	$ 20,395	$ 8,954	$ 29,991	$ 29,006	$ 210,399
Commercial and industrial loans:								
Current period gross write-offs:	$ -	$ -	$ 72	$ -	$ -	$ -	$ -	$ 72
Commercial Real Estate								
Pass	$ 13,680	$ 48,197	$ 35,938	$ 18,925	$ 10,051	$ 95,705	$ 6,859	$ 229,355
Watch List	-	-	1,896	-	-	-	-	1,896
Substandard	-	-	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-	-	-
Total commercial real estate	$ 13,680	$ 48,197	$ 37,834	$ 18,925	$ 10,051	$ 95,705	$ 6,859	$ 231,251
Commercial real estate:								
Current period gross write-offs:	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Small Business Administration								
Pass	$ 7,920	$ 18,157	$ 9,076	$ 1,900	$ 11,393	$ 8,798	$ 653	$ 57,897
Watch List	-	197	-	194	86	-	-	477
Substandard	-	517	31	-	265	263	-	1,076
Doubtful	-	-	-	-	-	455	-	455
Total small business administration	$ 7,920	$ 18,871	$ 9,107	$ 2,094	$ 11,744	$ 9,516	$ 653	$ 59,905
Small business administration loans:								
Current period gross write-offs:	$ -	$ -	$ -	$ 51	$ -	$ 4	$ -	$ 55
Consumer								
Pass	$ 27,465	$ 33,746	$ 13,661	$ 10,290	$ 4,255	$ 6,753	$ 14,322	$ 110,492
Watch List	-	-	-	-	-	-	-	-
Substandard	-	-	22	11	-	47	-	80
Doubtful	-	-	-	-	-	-	-	-
Total consumer	$ 27,465	$ 33,746	$ 13,683	$ 10,301	$ 4,255	$ 6,800	$ 14,322	$ 110,572
Consumer loans:								
Current period gross write-offs:	$ 20	$ 12	$ 77	$ 1	$ -	$ 31	$ -	$ 141
Land and Land Development								
Pass	$ 1,964	$ 1,703	$ 1,699	$ 280	$ -	$ 228	$ 2,255	$ 8,129
Watch List	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-	-	-
Total land and land development	$ 1,964	$ 1,703	$ 1,699	$ 280	$ -	$ 228	$ 2,255	$ 8,129
Land and land development loans:								
Current period gross write-offs:	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Construction								
Pass	$ 1,673	$ -	$ -	$ -	$ -	$ -	$ 41,939	$ 43,612
Watch List	-	-	-	-	-	-	-	-
Substandard	-	-	-	-	-	-	-	-
Doubtful	-	-	-	-	-	-	-	-
Total Construction	$ 1,673	$ -	$ -	$ -	$ -	$ -	$ 41,939	$ 43,612
Construction loans:								
Current period gross write-offs:	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total gross loans	$ 77,782	$ 171,802	$ 90,011	$ 51,995	$ 35,004	$ 142,240	$ 95,034	$ 663,868

The following presents by credit quality indicator and the amortized cost basis of the Company's loans as of December 31, 2022 (in thousands):

	December 31, 2022				
	Pass	Watch List	Substandard	Doubtful	Total Loans Held for Investment
Commercial and industrial	$ 203,059	$ 238	$ 1,641	$ 491	$ 205,429
Commercial real estate	228,309	1,934	-	-	230,243
SBA	46,936	300	876	526	48,638
Consumer	95,810	-	81	-	95,891
Land and land development	10,758	-	-	-	10,758
Construction	24,690	-	-	-	24,690
Total gross loans	$ 609,562	$ 2,472	$ 2,598	$ 1,017	$ 615,649

Performing and Non-Accrual Loans

The Bank's key credit quality indicator is a loan's performance status, defined as accrual or non-accrual. Performing loans are considered to have a lower risk of loss and are on accrual status. Non-accrual loans include loans on which the accrual of interest has been discontinued. Accrual of interest is discontinued when the Bank believes that the borrower's financial condition is such that the collection of interest is doubtful. A delinquent loan is generally placed on non-accrual status when it becomes 90 days or more past due unless the loan is well secured and in the process of collection. When a loan is placed on non-accrual status, accrued but uncollected interest income applicable to the current reporting period is reversed against interest income. Accrued but uncollected interest income applicable to previous reporting periods is charged against the allowance for credit losses. No additional interest is accrued on the loan balance until the collection of both principal and interest becomes reasonably certain. Delinquent balances are determined based on the contractual terms of the loan adjusted for charge-offs and payments applied to principal.

The following table sets forth information regarding the Bank's performing and non-accrual loans (in thousands):

	September 30, 2023					
	Current	31-89 Days Past Due	90 Days or More Past Due And Accruing	Total Performing	Non-accrual	Total
Commercial and industrial:						
Business loans	$ 93,034	$ 2	$ -	$ 93,036	$ 666	$ 93,702
Agriculture	35,795	-	-	35,795	-	35,795
Owner-occupied commercial real estate	80,902	-	-	80,902	-	80,902
Commercial real estate	224,885	6,366	-	231,251	-	231,251
SBA	59,219	-	-	59,219	686	59,905
Consumer:						
Automobile	10,391	88	-	10,479	-	10,479
Home equity	13,433	-	-	13,433	-	13,433
1st mortgage	25,707	-	-	25,707	-	25,707
Other	60,788	112	-	60,900	53	60,953
Land and land development	8,074	55	-	8,128	-	8,129
Construction	43,612	-	-	43,612	-	43,612
Total loans held for investment	655,840	6,623	-	662,463	1,405	663,868
Loans held for sale	120	-	-	120	-	120
Total gross loans	$ 655,960	$ 6,623	$ -	$ 662,583	$ 1,405	$ 663,988

	December 31, 2022					
	Current	31-89 Days Past Due	90 Days or More Past Due And Accruing	Total Performing	Non-accrual	Total
Commercial and industrial:						
Business loans	$ 95,844	$ 54	$ -	$ 95,898	$ 491	$ 96,389
Agriculture	30,850	-	-	30,850	-	30,850
Owner-occupied commercial real estate	78,190	-	-	78,190	-	78,190
Commercial real estate	230,243	-	-	230,243	-	230,243
SBA	47,757	52	-	47,809	829	48,638
Consumer:						
Automobile	13,879	81	-	13,960	-	13,960
Home equity	13,555	-	-	13,555	-	13,555
1st mortgage	18,862	-	-	18,862	-	18,862
Other	49,434	45	1	49,480	34	49,514
Land and land development	10,758	-	-	10,758	-	10,758
Construction	24,690	-	-	24,690	-	24,690
Total loans held for investment	614,062	232	1	614,295	1,354	615,649
Loans held for sale	37,704	60	-	37,764	-	37,764
Total gross loans	$ 651,766	$ 292	$ 1	$ 652,059	$ 1,354	$ 653,413

The following table sets forth information on non-accrual loans as of September 30, 2023, and December 31, 2022 (in thousands):

	September 30, 2023			December 31, 2022
	Non-accrual loans with a related ACL	Non-accrual loans without a related ACL	Total Non-Accrual Loans	Total Non-Accrual Loans
Commercial and industrial: Business loans	$ 666	$ -	$ 666	$ 491
SBA	686	-	686	829
Consumer: Other	53	-	53	34
Total	$ 1,405	$ -	$ 1,405	$ 1,354

The following table indicates the effect on interest income on loans if interest on non-accrual loans outstanding at period end had been recognized at original contractual rates (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Interest income that would have been recorded	$ 44	$ 39	$ 124	$ 117
Interest income recorded	-	-	-	-
Effect on interest income on loans	$ 44	$ 39	$ 124	$ 117

Impaired loans

As identified in the recently issued or adopted accounting pronouncements and interpretations section, the Company adopted ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*, on January 1, 2023. As a result of adoption, the Company is no longer required to provide information on impaired loans. Information on impaired loans as of December 31, 2022 is being provided for comparative purposes.

Impaired loans include loans the Bank will not be able to collect all amounts due in accordance with the terms of the loan agreement. Impaired loans include non-accrual loans and loans that have been modified in a troubled debt restructuring. All loans are individually reviewed for impairment.

The following tables summarize impaired loans and related allowances (in thousands):

	December 31, 2022				
	Unpaid Principal	**Recorded Investment**	**Related Allowance**	**Average Recorded Balance (12-months)**	**Interest Income Recognized (12-months)**
Impaired loans with an allowance recorded:					
SBA	$ 661	$ 527	$ 457	$ 578	$ -
Total impaired loans with an allowance recorded	$ 661	$ 527	$ 457	$ 578	$ -
Impaired loans without an allowance recorded:					
Commercial and industrial:					
Business loans	$ 2,004	$ 491	$ -	$ 519	$ -
Owner-occupied commercial real estate	175	153	-	160	7
SBA	450	303	-	324	-
Consumer: Other	57	34	-	37	-
Total impaired loans without an allowance recorded	$ 2,686	$ 981	$ -	$ 1,040	$ 7
Total impaired loans	$ 3,347	$ 1,508	$ 457	$ 1,618	$ 7

Loan Modifications

The Company adopted ASU No. 2022-02, *Financial Instruments – Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures*, on January 1, 2023. ASU 2022-02 requires the Company to evaluate all loan modifications under ASC 310-20-35-9 through 35-11 to determine whether a modification made to a borrower results in a new loan or a continuation of the existing loan.

The Company individually evaluates all modification to loans where the borrower is experiencing financial difficulty. In cases where the modification is determined to be at least as favorable to the Company as the terms for comparable loans to other borrowers with similar risk characteristics the loan is considered a new origination. In the event the evaluation determines that the modification is not in-line with terms for comparable loans, the Company considers these loans to be a modified loan. These types of modifications generally take the form of principal forgiveness, interest rate reduction, other-than-insignificant payment delay, or a term extension.

The following presents the amortized cost of loans to borrowers experiencing financial difficulty that were modified during the period by loan segment and modification type (in thousands):

	September 30, 2023				
	Term Extension and Payment Deferment (1)	**Term Extension, Payment Modification, Interest Rate Reduction (2)**	**Payment Deferral (3)**	**Total**	**Percentage of Total Loans**
Commercial and industrial	$ 133	$ 58	$ -	$ 191	- %
SBA	1,791	-	3,103	4,894	0.7
	$ 1,924	$ 58	$ 3,103	$ 5,085	0.8 %

(1) Modifications extended term by seven months and deferred payments up to seven months.
(2) Modifications extended term by twelve months, reduced payment, and reduced interest rate by 8.75%.
(3) Modifications deferred payment by six months.

Loan modifications to borrowers experiencing financial difficulty during first nine months of 2023 did not result in principal forgiveness.

All loans modified during the first nine months of 2023 were current as of September 30, 2023.

Troubled Debt Restructuring (TDR)
As identified in the recently issued or adopted accounting pronouncements and interpretations section, the Company adopted ASU No. 2022-02, *Financial Instruments – Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures*, on January 1, 2023. As a result of adoption, the Company is no longer required to provide information on troubled debt restructuring. Information on troubled debt restructuring as of December 31, 2022 is being provided for comparative purposes.

TDRs are certain loans that have been modified in order to maximize collection of loan balances. If the Company, for legal or economic reasons related to the borrower's financial difficulties, grants a concession that would not otherwise be considered, compared to the original terms and conditions of the loan, the modified loan is considered a troubled debt restructuring.

The tables below summarize the amounts of restructured loans (in thousands):

	December 31, 2022			
	Accrual	**Non-accrual**	**Total**	**Allowance**
Commercial and industrial:				
Business loans	$ -	$ 491	$ 491	$ -
Owner-occupied commercial real estate	153	-	153	-
SBA	-	282	282	48
	$ 153	$ 773	$ 926	$ 48

NOTE 6 – Leases

The Company has operating leases, primarily for office space, which expire over the next six years. These leases generally contain renewal options for periods ranging from one to five years. The Company has evaluated each individual lease to determine if exercising the renewal option was probable and considered the renewal into determining the lease term and associated payments. The Company's leases generally do not include termination options for either party to the lease or restrictive financial or other covenants. Payments due under the lease contracts include both fixed and variable payments. The variable payments are for the Company's proportionate share of the building's property taxes, insurance, and common area maintenance. As most of the Company's leases do not provide an implicit rate, the Company uses its incremental borrowing rate based on the information available at the lease commencement date in determining the present value of the lease payments.

The components of lease cost for the three- and nine-month period ended September 30, 2023, and September 30, 2022, were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Operating lease costs	$ 105	$ 232	$ 308	$ 704
Variable lease costs	15	1	37	12
Short-term lease costs	-	15	4	67
Total lease costs	$ 120	$ 248	$ 349	$ 783

Amounts reported in the consolidated balance sheet as of September 30, 2023, and December 31, 2022, are as follows (in thousands):

	As of September 30, 2023	As of December 31, 2022
Operating lease right of use (ROU) assets	$ 1,020	$ 1,521
Operating lease liabilities	1,134	1,660

Other supplementary information related to leases is as follows (dollars are in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Cash paid for lease liabilities	$ 123	$ 273	$ 561	$ 815
Amortization of ROU assets	87	205	484	582

	As of September 30, 2023	As of December 31, 2022
Weighted average remaining lease term	3.86 years	3.64 years
Weighted average discount rate	5.82%	5.55%

Maturities of lease liabilities under non-cancellable leases as of September 30, 2023, are as follows (in thousands):

	Operating Leases
2023	$ 102
2024	418
2025	340
2026	193
2027	41
Thereafter	167
Total future minimum lease payments	1,261
Amounts representing interest	(127)
Total lease liabilities	$ 1,134

NOTE 7 – Earnings Per Share

The following table shows the amounts used in computing per share results:

	Three Months Ended September 30, 2023	Nine Months Ended September 30, 2023
Denominator for basic earnings per share*:*		
Average common shares outstanding	3,578,029	3,577,216
Dilutive effect of stock compensation	3,193	2,585
Denominator for diluted earnings per share	3,581,222	3,579,801
Numerator (in thousands):		
Net income	$ 1,507	$ 3,554
Basic earnings per common share	$ 0.42	$ 0.99
Diluted earnings per common share	$ 0.42	$ 0.99

	Three Months Ended September 30, 2022	Nine Months Ended September 30, 2022
Denominator for basic earnings per share*:*		
Average common shares outstanding	3,574,677	3,573,963
Dilutive effect of stock compensation	825	877
Denominator for diluted earnings per share	3,575,502	3,574,840
Numerator (in thousands):		
Net income	$ 1,548	$ 5,030
Basic earnings per common share	$ 0.43	$ 1.41
Diluted earnings per common share	$ 0.43	$ 1.41

NOTE 8 – Share-Based Compensation

The Company may grant share-based compensation at prices equal to the fair value of the stock at the grant date. The Company has two share-based plans for certain key employees and directors whereby shares of common stock have been reserved for awards in the form of stock options or restricted stock awards. The plans are as follows:

	1995	2015	Total
Total Shares in Plan	250,000	50,000	300,000
Total Shares Available for Issuance	45,951	20,061	66,012

Following is a summary of restricted stock activities for the nine-month periods ending September 30:

	Nine Months Ended September 30, 2023		Nine Months Ended September 30, 2022	
	Number Restricted Stock Shares	Weighted Average Grant Date Fair Value	Number Restricted Stock Shares	Weighted Average Grand Date Fair Value
Outstanding, beginning of period	5,500	$ 39.91	5,750	$ 39.68
Granted	-	-	-	-
Vested	(250)	34.77	(250)	34.77
Forfeited	-	-	-	-
Outstanding, end of period	5,250	40.15	5,500	39.91

The Company recognized share-based compensation expense of $19 thousand related to restricted stock for the three-month periods ended September 30, 2023 and 2022. The Company recognized share based compensation expense of $57 thousand for the nine-month periods ended September 30, 2023 and 2022.

At September 30, 2023, the Company had $70 thousand of unamortized restricted stock compensation expense. The cost of a restricted stock grant is recognized over the vesting period, which is generally three to four years.

NOTE 9 – Revenue from Contracts with Customers

The following table disaggregates non-interest income subject to ASC 606 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Service charges on deposits	$ 166	$ 170	$ 492	$ 500
Bankcard fees	295	288	873	829
Bank charges and service fees not within scope of ASC 606	354	757	1,427	1,239
Total bank charges and service fees	815	1,215	2,792	2,568
Total wealth management revenues	504	489	1,474	1,517
Other	11	11	31	35
Other not within the scope of ASC 606 (a)	164	279	370	1,001
Total other	175	290	401	1,036
Other non-interest income not within the scope of ASC 606 (a)	(376)	2,471	3,794	10,634
Total non-interest income	$ 1,118	$ 4,465	$ 8,461	$ 15,755

(a) This revenue is not within the scope of ASC 606, and includes fees related to mortgage banking operations, gains on sale of loans, revenue from investments in SBIC, and various other transactions.

The Company had no material contract assets or remaining performance obligations as of September 30, 2023. Total receivables from revenue recognized under the scope of ASC 606 were $503 thousand as of September 30, 2023, and $478 thousand as of December 31, 2022. These receivables are included as part of the Other assets line on the Company's Consolidated Balance Sheets.

NOTE 10 – Fair Value Measurements

FASB ASC 820, *Fair Value Measurement,* defines fair value and establishes a framework for measuring fair value of assets and liabilities using a hierarchy system consisting of three levels based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

> Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets that the Company has the ability to access.
>
> Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which significant assumptions are observable in the market.
>
> Level 3: Valuation is generated from model-based techniques that use significant assumptions not observable in the market and are used only to the extent that observable inputs are not available. These unobservable assumptions reflect the Company's own estimates of assumptions that market participants would use in pricing the asset or liability.

For the periods presented, Treasury Securities were considered to be Level 1 while all other assets and liabilities valued at fair value were considered to be Level 2. There were no transfers into or out of the respective levels during the periods presented.

The following tables summarize the financial assets and liabilities of the Company for which fair values are determined on a recurring basis (in thousands):

	Carrying Value at September 30, 2023				Nine Months Ended September 30, 2023
	Total	**Level 1**	**Level 2**	**Level 3**	**Total Gains/(Losses)**
ASSETS					
Debt securities available for sale	$ 158,016	$ 24,353	$ 133,663	$ -	$ 12
Loans held for sale	120	-	120	-	(52)
Commitments to originate mortgage loans	-	-	-	-	57
Commitments to sell mortgage loans	-	-	-	-	(434)
Mortgage banking short positions	-	-	-	-	(32)
Total assets at fair value	$ 158,136	$ 24,353	$ 133,783	$ -	$ (449)

	Carrying Value at December 31, 2022				Twelve Months Ended December 31, 2022
	Total	**Level 1**	**Level 2**	**Level 3**	**Total Gains/(Losses)**
ASSETS					
Debt securities available for sale	$ 174,876	$ 18,036	$ 156,840	$ -	$ -
Loans held for sale	37,764	-	37,764	-	(1,592)
Commitments to originate mortgage loans	205	-	205	-	(1,534)
Commitments to sell mortgage loans	32	-	32	-	20
Mortgage banking short positions	434	-	434	-	437
Total assets at fair value	$ 213,311	$ 18,036	$ 195,275	$ -	$ (2,669)

The Company sells short positions in mortgage-backed securities to hedge interest-rate risk on the loans committed for mandatory delivery. The commitments to originate and sell mortgage banking loans and the short positions are derivatives and are recorded at fair value.

NOTE 11 – Fair Value of Financial Instruments

The estimated fair values of the Company's financial instruments are as follows (in thousands):

	Level in Fair Value Measurement Hierarchy	September 30, 2023		December 31, 2022	
		Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:					
Cash and cash equivalents	Level 1	$ 51,366	$ 51,366	$ 73,968	$ 73,968
Federal Reserve Bank and Federal Home Loan Bank stock	Level 2	2,938	2,938	3,063	3,063
Gross loans held for investment	Level 2	663,868	641,110	614,668	597,644
Gross loans held for investment (a)	Level 3	-	-	981	674
Accrued interest receivable	Level 2	3,851	3,851	3,312	3,312
		$ 722,023	$ 699,265	$ 695,992	$ 678,661
Liabilities and Stockholders' Equity:					
Deposits, noninterest-bearing	Level 2	$ 180,045	$ 180,045	$ 207,232	$ 207,232
Deposits, interest-bearing	Level 2	609,481	607,693	612,352	610,000
Accrued interest payable	Level 2	687	687	312	312
Guaranteed preferred beneficial interests in Company's subordinated debentures	Level 2	15,000	11,849	15,000	12,760
		$ 805,213	$ 800,274	$ 834,896	$ 830,304
Financial instruments with off-balance-sheet risk:					
Commitments to extend credit	Level 2	$ -	$ 284	$ -	$ 339
Standby and commercial letters of credit	Level 2	$ -	$ 41	$ -	$ 25

(a) Company adopted ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*, on January 1, 2023. As a result of adoption, the Company no longer reports impaired loans. Information on impaired loans as of December 31, 2022 is being provided for comparative purposes.

NOTE 12 – Federal Home Loan Bank Advances

As of September 30, 2023, the Bank had no Federal Home Loan Bank (FHLB) advances outstanding. At September 30, 2023, the Bank had loans with unamortized principal balances of approximately $176.8 million pledged as collateral to the FHLB.

As of December 31, 2022, the Bank had no FHLB advances outstanding. At December 31, 2022, the Bank had loans with unamortized principal balances of approximately $211.0 million pledged as collateral to the FHLB.

As of September 30, 2023, the Bank has the ability to draw advances up to approximately $112.3 million based upon the aggregate collateral that is currently pledged, subject to additional FHLB stock purchase requirements.

NOTE 13 – Other Borrowings

The following table presents selected information regarding other borrowings (in thousands):

September 30, 2023

Unsecured Borrowing Lines:		**Line**	**Outstanding**	**Available**
BNC National Bank lines (1)		$ 34,500	$ -	$ 34,500

Secured Borrowing Lines:	**Collateral Pledged**	**Line**	**Outstanding**	**Available**
BNC National Bank line	$ 3,269	$ 1,515	$ -	$ 1,515
BNCCORP line	99,591	10,000	-	10,000
Total	$ 102,860	$ 11,515	$ -	$ 11,515

(1) The unsecured BNC National Bank Lines consists of three separate lines with three institutions in individual amounts of $12.5 million, $12 million, and $10 million.

At September 30, 2023, the pledged collateral for the secured BNC National Bank line was comprised of commercial real estate loans and the pledged collateral for the secured BNCCORP line is the common stock of BNC National Bank.

December 31, 2022

Unsecured Borrowing Lines:		**Line**	**Outstanding**	**Available**
BNC National Bank lines (1)		$ 39,500	$ -	$ 39,500

Secured Borrowing Lines:	**Collateral Pledged**	**Line**	**Outstanding**	**Available**
BNC National Bank line	$ 2,050	$ 1,086	$ -	$ 1,086
BNCCORP line	96,959	10,000	-	10,000
Total	$ 99,009	$ 11,086	$ -	$ 11,086

(1) The unsecured BNC National Bank Lines consists of four separate lines with three institutions in individual amounts of $12.5 million, $10 million, $12 million, and $5 million.

At December 31, 2022, the pledged collateral for the secured BNC National Bank line was comprised of commercial real estate loans and the pledged collateral for the secured BNCCORP line is the common stock of BNC National Bank.

NOTE 14 – Guaranteed Preferred Beneficial Interests in Company's Subordinated Debentures

In July 2007, BNCCORP issued $15.0 million of floating rate subordinated debentures. During the third quarter of 2023 the index rate and spread converted from three-month LIBOR plus 1.40% to three-month SOFR plus 1.66%. The interest rate at September 30, 2023, and December 31, 2022, was 6.93% and 5.14%, respectively. The subordinated debentures mature on October 1, 2037. The subordinated debentures may be redeemed at par and the corresponding debentures may be prepaid at the option of BNCCORP, subject to approval by the Federal Reserve Board.

NOTE 15 – Stockholders' Equity

Regulatory restrictions exist regarding the ability of the Bank to transfer funds to BNCCORP in the form of cash dividends. Approval of the Office of the Comptroller of the Currency (OCC), the Bank's principal regulator, is required for BNC National Bank to pay dividends to BNCCORP in excess of the Bank's net profits from the current year plus retained net profits for the preceding two years.

BNCCORP is required to consult with the Federal Reserve Board prior to declaring a cash dividend to stockholders. On May 3, 2022, BNCCORP's Board of Directors declared a $1.75 per share special cash dividend that was paid on June 21, 2022.

The Company currently has an outstanding 175,000 share repurchase authorization with no expiration date set on the authorization. No share repurchases have been made under the authorization as of September 30, 2023.Share repurchases can be made through open market purchases, unsolicited and solicited privately negotiated transactions, or in accordance with terms of Rule 10b-18 promulgated under the Securities Exchange Act of 1934. The Company will not repurchase shares from directors or officers of the Company under the authorization. The Company will contemplate share repurchases subject to market conditions and other factors, including legal and regulatory restrictions and required approvals.

NOTE 16 – Regulatory Capital and Current Operating Environment

BNCCORP and BNC National Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet capital requirements mandated by regulators can trigger certain mandatory and discretionary actions by regulators. Such actions, if undertaken, could have a direct material adverse effect on the Company's financial condition and results of operations. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, BNCCORP and BNC National Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. Regulators may also impose capital requirements that are specific to individual institutions. The requirements are generally above the statutory ratios.

At September 30, 2023, the Company's capital ratios exceeded all regulatory capital thresholds and maintained sufficient capital conservation buffers to avoid limitations on certain types of capital distributions.

At September 30, 2023, and December 31, 2022, the regulatory capital amounts and ratios were as follows (dollars in thousands):

	Actual		For Capital Adequacy Purposes		To be Well Capitalized		Amount in Excess of Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
September 30, 2023								
Total Risk-Based Capital:								
Consolidated	$ 140,075	17.37 %	$ 64,511	≥8.00 %	$ N/A	N/A %	$ N/A	N/A %
BNC National Bank	122,009	15.14	64,452	≥8.00	80,566	10.00	41,444	5.14
Tier 1 Risk-Based Capital:								
Consolidated	130,929	16.24	48,384	≥6.00	N/A	N/A	N/A	N/A
BNC National Bank	112,864	14.01	48,339	≥6.00	64,452	8.00	48,412	6.01
Common Equity Tier 1 Risk-Based Capital:								
Consolidated	115,929	14.38	36,288	≥4.50	N/A	N/A	N/A	N/A
BNC National Bank	112,864	14.01	36,254	≥4.50	52,368	6.50	60,496	7.51
Tier 1 Leverage Capital:								
Consolidated	130,929	14.31	36,594	≥4.00	N/A	N/A	N/A	N/A
BNC National Bank	112,864	12.35	36,550	≥4.00	45,688	5.00	67,176	7.35
Tangible Common Equity (to total assets): (a)								
Consolidated	102,156	11.18	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	99,500	10.91	N/A	N/A	N/A	N/A	N/A	N/A
December 31, 2022								
Total Risk-Based Capital:								
Consolidated	$ 135,744	17.57%	$ 61,814	≥8.00%	$ N/A	N/A%	$ N/A	N/A%
BNC National Bank	117,267	15.19	61,776	≥8.00	77,219	10.00	40,048	5.19
Tier 1 Risk-Based Capital:								
Consolidated	126,913	16.43	46,360	≥6.00	N/A	N/A	N/A	N/A
BNC National Bank	108,436	14.04	46,332	≥6.00	61,776	8.00	46,660	6.04
Common Equity Tier 1 Risk-Based Capital:								
Consolidated	111,913	14.48	34,770	≥4.50	N/A	N/A	N/A	N/A
BNC National Bank	108,436	14.04	34,749	≥4.50	50,193	6.50	58,243	7.54
Tier 1 Leverage Capital:								
Consolidated	126,913	13.99	36,279	≥4.00	N/A	N/A	N/A	N/A
BNC National Bank	108,436	11.97	36,237	≥4.00	45,297	5.00	63,139	6.97
Tangible Common Equity (to total assets): (a)								
Consolidated	100,246	10.63	N/A	N/A	N/A	N/A	N/A	N/A
BNC National Bank	96,860	10.28	N/A	N/A	N/A	N/A	N/A	N/A

(a) Tangible common equity ratio is calculated by dividing common equity, less intangible assets, by total period end assets.

The most recent notifications from the OCC categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. Management believes the Bank remains well capitalized through the date for which subsequent events have been evaluated.

NOTE 17 – Segment Reporting

The Company determines reportable segments based on the way that management organizes the segments within the Company for making operating decisions, allocating resources, and assessing performance. The Company has determined that it has three reportable segments: Community Banking, Mortgage Banking and Holding Company.

Community Banking

The Community Banking segment serves the needs of businesses and consumers through 11 locations in North Dakota and Arizona. Within this segment, the following products and services are provided: business and personal loans, commercial real estate loans, SBA loans, business and personal checking, savings products, and cash management, as well as trust and wealth management services and retirement plan administration. These products and services are supported through web and mobile based applications. Revenues for community banking consist primarily of interest earned on loans and debt securities, bankcard fees, loan fees, services charges on deposits and fees for wealth management services.

Mortgage Banking

The Mortgage Banking segment originates residential mortgage loans for the primary purpose of sale on the secondary market. The segment consists of both a consumer direct channel located in Kansas utilizing internet leads and a call center to originate residential mortgage loans throughout the United States complemented by a relationship based retail channels. Revenues for mortgage banking consist primarily of interest earned on mortgage loans held for sale, gains on sales of loans, unrealized gains or losses on mortgage financial instruments, and loan origination fees. On June 16, 2023, the Company sold certain operating assets and assigned certain liabilities to First Federal Bank. As of September 30, 2023, the Company reported one $120 thousand loan as loans held for sale that is anticipated to be sold in the fourth quarter of 2023.

Holding Company

The Holding Company segment represents BNCCORP, the parent company of BNC National Bank. Revenue for the Holding Company segment primarily consists of interest earned on cash and cash equivalents and management fees charged to the Community Banking and Mortgage Banking segments for management services. Interest expense for the Holding Company segment consists of interest expense on the Company’s subordinated debentures. Non-interest expense for the segment includes parent company costs for certain centralized functions such as corporate administration, accounting, audit, consulting, and governance.

The Company’s operating segments are presented based on its management structure and management accounting practices. The structure and practices are specific to the Company and therefore, the financial results of the Company’s business segments are not necessarily comparable with similar information for other financial institutions.

	Three Months Ended September 30, 2023				
	Community Banking	Mortgage Banking	Holding Company	Intercompany Eliminations (1)	BNCCORP Consolidated
Interest income	$ 10,915	$ 383	$ 44	$ (256)	$ 11,086
Interest expense	3,007	212	263	(256)	3,226
Net interest income (expense)	7,908	171	(219)	-	7,860
Provision for credit losses	230	-	-	-	230
Net interest income after provision for credit losses	7,678	171	(219)	-	7,630
Non-interest Income	1,578	(381)	559	(638)	1,118
Non-interest Expense	6,379	322	715	(638)	6,778
Income (loss) before income taxes	2,877	(532)	(375)	-	1,970
Income tax expense (benefit)	683	(132)	(88)	-	463
Net income (loss)	$ 2,194	$ (400)	$ (287)	$ -	$ 1,507
Total Assets at September 30, 2023	$ 911,677	$ 538	$ 18,811	$ (17,669)	$ 913,357

	Three Months Ended September 30, 2022				
	Community Banking	Mortgage Banking	Holding Company	Intercompany Eliminations (1)	BNCCORP Consolidated
Interest income	$ 8,463	$ 649	$ 2	$ (261)	$ 8,853
Interest expense	603	260	144	(261)	746
Net interest income (expense)	7,860	389	(142)	-	8,107
Provision for credit losses	150	-	-	-	150
Net interest income after provision for credit losses	7,710	389	(142)	-	7,957
Non-interest Income	2,489	2,468	641	(1,133)	4,465
Non-interest Expense	6,064	4,741	727	(1,133)	10,399
Income (loss) before income taxes	4,135	(1,884)	(228)	-	2,023
Income tax expense (benefit)	997	(468)	(54)	-	475
Net income (loss)	$ 3,138	$ (1,416)	$ (174)	$ -	$ 1,548
Total Assets at September 30, 2022	$ 885,803	$ 59,369	$ 6,094	$ (5,092)	$ 946,174

(1) Intercompany eliminations remove internal shared service costs for intercompany use of funds to originate mortgage loans held for sale and costs related to internal services rendered to segments by centralized function of the Company such as administration, audit, accounting, compliance, governance, consulting and technology expense.

	Nine Months Ended September 30, 2023									
	Community Banking		Mortgage Banking		Holding Company		Intercompany Eliminations (1)		BNCCORP Consolidated	
Interest income	$	31,315	$	1,513	$	95	$	(1,134)	$	31,789
Interest expense		6,796		1,040		743		(1,134)		7,445
Net interest income (expense)		24,519		473		(648)		-		24,344
Provision for credit losses		635		-		-		-		635
Net interest income after provision for credit losses		23,884		473		(648)		-		23,709
Non-interest Income		5,755		3,638		1,630		(2,562)		8,461
Non-interest Expense		19,068		8,781		2,237		(2,562)		27,524
Income (loss) before income taxes		10,571		(4,670)		(1,255)		-		4,646
Income tax expense (benefit)		2,545		(1,158)		(295)		-		1,092
Net income (loss)	$	8,026	$	(3,512)	$	(960)	$	-	$	3,554
Total Assets at September 30, 2023	$	911,677	$	538	$	18,811	$	(17,669)	$	913,357

	Nine Months Ended September 30, 2022									
	Community Banking		Mortgage Banking		Holding Company		Intercompany Eliminations (1)		BNCCORP Consolidated	
Interest income	$	22,666	$	1,582	$	10	$	(311)	$	23,947
Interest expense		1,270		302		292		(311)		1,553
Net interest income (expense)		21,396		1,280		(282)		-		22,394
Credit for credit losses		(400)		-		-				(400)
Net interest income after credit for credit losses		21,796		1,280		(282)		-		22,794
Non-interest Income		6,982		10,389		1,689		(3,305)		15,755
Non-interest Expense		18,086		15,003		2,190		(3,305)		31,974
Income (loss) before income taxes		10,692		(3,334)		(783)		-		6,575
Income tax expense (benefit)		2,556		(827)		(184)		-		1,545
Net income (loss)	$	8,136	$	(2,507)	$	(599)	$	-	$	5,030
Total Assets at September 30, 2022	$	885,803	$	59,369	$	6,094	$	(5,092)	$	946,174

(1) Intercompany eliminations remove internal shared service costs for intercompany use of funds to originate mortgage loans held for sale and costs related to internal services rendered to segments by centralized function of the Company such as administration, audit, accounting, compliance, governance, consulting and technology expense.

Management's Discussion and Analysis of Financial Condition and Results of Operations

References to "BNCCORP" or "the Company" refer to BNCCORP, INC. and its consolidated subsidiaries, collectively; references to "the Bank" only refer to BNC National Bank. Where not otherwise indicated below, financial condition and results of operations discussed are of BNCCORP, INC.

Comparison of Results for the Three Months Ended September 30, 2023, and 2022

The Community Banking Segment reported net income of $2.2 million, or $0.61 per diluted share, for the quarter compared to $3.1 million in the third quarter of 2022. Net interest income in the third quarter of 2023 was slightly higher and was offset by reduced income from bank charges and service fees and other income and a higher provision for credit losses. Non-interest expense was higher in the 2023 period due to increased salary and employee benefits, data processing and occupancy costs, and other expenses compared to the same period in 2022.

The Mortgage Banking Segment reported a net loss of $400 thousand in the third quarter of 2023 compared to a net loss of $1.4 million in the 2022 period. The losses sustained in the third quarter of 2023 resulted from selling the remaining inventory of loans held for sale and final settlement of outstanding hedge positions. At September 30, 2023, the Company reported one $120 thousand loan as loans held for sale that is anticipated to be sold in the fourth quarter of 2023.

Consolidated net interest income for the third quarter of 2023 was $7.9 million, a decrease of $247 thousand, or 3.0%, from $8.1 million in the third quarter of 2022. Net interest margin decreased to 3.57% in the third quarter of 2023 from the 3.66% reported in the prior year period. Net interest income from the Community Banking Segment was unchanged year-over-year at $7.9 million. The increase in loans held for investment at higher yields were equally offset by lower loans held for sale and the significant increase in cost of deposits.

On a consolidated basis, third-quarter interest income increased $2.2 million, or 25.2%, from $8.9 million to $11.1 million. The average yield on interest-earning assets was substantially higher in the third quarter of 2023, growing to 5.04% compared to 3.99% in the 2022 third quarter. The Community Banking Segment reported interest income of $10.9 million in the third quarter of 2023 compared to $8.5 million for the 2022 quarter. The increase resulted from higher yields on interest-earning assets, a $79.4 million quarter-over-quarter increase in the average balance of loans held for investment and higher yields on cash and debt securities. It is noteworthy that the Company's variable rate assets have continued to re-price in step with interest rate movements by the Federal Reserve. The weighted average interest rate on loans held for investment originated in the third quarter of 2023 was 7.46%, compared to the third quarter 2022 average yield on loans held for investment of 4.61%.

Consolidated interest expense in the third quarter of 2023 was $3.2 million, an increase of $2.5 million from the 2022 period. As a result, the cost of core deposits in the third quarter of 2023 rose to 1.47% versus 0.29% in the third quarter of 2022. Within the Community Banking Segment, the average balance of deposits decreased by $4.8 million in the third quarter of 2023 compared to the third quarter of 2022. The cost of interest-bearing liabilities was 2.01% during the third quarter of 2023, compared to 0.47% in the same period of 2022. The Company has managed its overall cost of deposits at levels well below the prevailing brokered deposit rates offered by national brokerage firms even while staying focused on maintaining strong liquidity levels.

As of September 30, 2023, credit metrics remained stable with $1.4 million of nonperforming assets, representing a ratio of nonperforming assets to total assets of 0.16%. These results are comparable to the $1.4 million in nonperforming assets, a 0.15% ratio of nonperforming assets to total assets held on December 31, 2022. The Company recorded a $230 thousand provision for credit losses in the third quarter of 2023 compared to a $150 thousand provision in the third quarter of 2022. The allowance for credit losses decreased slightly to 1.38% of loans held for investment on September 30, 2023, from 1.43% on December 31, 2022.

Non-interest income for the Community Banking Segment during the third quarter of 2023 was $1.6 million, compared to $2.5 million in the 2022 third quarter. Bank charges and service fees were $400 thousand lower quarter-over-quarter due to lower deposits held in one-way sell positions. Fees derived from the movement of deposits off the balance sheet began late in the first quarter of 2022 and can fluctuate significantly based on customers' excess funding needs. As of September 30, 2023, off-balance sheet deposits amounted to $40.2 million compared to $218.6 million as of September 30, 2022. Through the use of an associated banking network, the Company is able to generate fee income on deposits that are not otherwise deployed by placing those deposits with another financial institution to meet their liquidity needs. The deposits can be reclaimed for future liquidity use by the Company at any time. Other income in the third quarter of 2023 decreased by $115 thousand compared to the third quarter of 2022 as the Company received lower SBIC revenue in 2023 and recorded life insurance proceeds in the third quarter of 2022.

Non-interest expense for the Community Banking Segment during the third quarter of 2023 increased $315 thousand, or 5.2%, to $6.4 million from $6.1 million in the third quarter of 2022. The increase is primarily due to higher salaries, data processing, occupancy, and other expenses. These higher costs reflect normal inflationary increases as well as the assumption of a greater percentage of shared service costs compared to the prior year period. No shared service costs were charged to the Mortgage Banking Segment during the third quarter of 2023.

In the third quarter of 2023, income tax expense on a consolidated basis was $463 thousand, compared to $475 thousand in the third quarter of 2022. The effective tax rate was 23.5% in the third quarter of 2023, unchanged from the same period of 2022.

Tangible book value per common share on September 30, 2023, was $28.71, compared to $28.19 at December 31, 2022. The increase in tangible book value per common share was driven by increased retained earnings offset by negative adjustments to the tax-effected fair value of debt securities available for sale as evidenced in the increase of accumulated other comprehensive losses. The Company's tangible common equity capital ratio was 11.18% on September 30, 2023, compared to 10.63% on December 31, 2022.

Comparison of Results for the Nine Months Ended September 30, 2023, and 2022

The Community Banking Segment reported net income of $8.0 million in the first nine months of 2023, compared to $8.1 million in the same period of 2022. In the first nine months of 2023, earnings per diluted share was $2.24 versus $2.29 in the first nine months of 2022. The first nine months of 2023 produced higher net interest income and higher bank charges and service fees compared to the same period of 2022. These results were offset by lower wealth management revenue, gains on sale of loans, other income and an increased provision for credit losses and higher non-interest expense when compared to the 2022 period.

The Mortgage Banking Segment reported a net loss of $3.5 million in the first nine months of 2023 compared to a net loss of $2.5 million in the same period of 2022. The decrease was driven by a reduction in mortgage segment revenues to $3.8 million in the first nine months of 2023 versus $10.4 million in the prior-year period. Non-interest expenses related to mortgage operations decreased by $6.2 million year-over-year, which included $1.4 million of expenses associated with the sale of certain assets to and the assumption of certain operating liabilities by First Federal Bank on June 16, 2023.

Consolidated net interest income in the first nine months of 2023 was $24.3 million, an increase of $2.0 million, or 8.7%, from $22.4 million in the first nine months of 2022. Net interest margin increased to 3.74% in the 2023 nine-month period from 3.24% in the year-earlier period. The Community Banking Segment reported a year-over-year increase in net interest income of $3.1 million, or 14.6%, from $21.4 million in the first nine months of 2022 to $24.5 million in the comparable 2023 period. The increase was primarily driven by growth in loans held for investment and overall higher yields that were partially offset by an increase in the cost of deposits.

On a consolidated basis, interest income increased by $7.9 million, or 32.7%, to $31.8 million for the nine months of 2023, compared to $23.9 million in the nine months of 2022. The yield on average interest-earning assets improved significantly to 4.88% in the first nine months of 2023, compared to 3.47% in the 2022 first nine months. The Community Banking Segment reported interest income of $31.3 million in the first nine months of 2023 compared to $22.7 million in the same 2022 period, an increase of $8.6 million, or 38.2%. The increase is the result of higher yields on interest-earning assets and an $85.7 million increase in average balances of loans held for investment. It is noteworthy that the Company's variable rate assets have continued to re-price in step with interest rate movements by the Federal Reserve and that the Company is receiving higher yields on new loan originations.

Consolidated interest expense in the first nine months of 2023 was $7.4 million, an increase of $5.9 million from the 2022 period. The cost of core deposits in the first nine months of 2023 and 2022 was 1.12% and 0.20%, respectively. Within the Community Banking Segment, the average balance of deposits decreased by $38.5 million compared to the first nine months of 2022. The Company has experienced elevated levels of customers deploying excess deposit balances to national brokered deposits to capture short-term rates offered in the market, most often by non-bank brokerage firms. The cost of interest-bearing liabilities was 1.59% during the first nine months of 2023, compared to 0.31% in the same period of 2022. The Company has managed its overall cost of deposits at levels well below the prevailing brokered deposit rates offered by national brokerage firms while staying focused on maintaining liquidity.

The Community Bank Segment recorded a $635 thousand provision for credit losses in the first nine months of 2023. By comparison, the Community Bank Segment credited provision expense to release $400 thousand of its allowance for credit losses in the first nine months of 2022. The allowance for credit losses decreased slightly to 1.38% of loans held for investment on September 30, 2023, compared to 1.43% on December 31, 2022.

Non-interest income for the Community Banking Segment in the first nine months of 2023 was $5.8 million, compared to $7.0 million in the first nine months of 2022. The decrease was driven by a reduction in wealth management revenues, gains on sale of loans, and other income that were partially offset by increased bank charges and service fees. Wealth management revenues decreased $43 thousand, or 2.8%, largely due to the mix of fees associated with more conservative investment vehicles. During 2023, the Company has seen increases in assets under administration from new investments in U.S. Treasury securities. Assets under administration were $369.4 million at September 30, 2023 compared to $321.1 million at September 30, 2022. Gains on sales of loans decreased period-over-period by $227 thousand as the premiums earned on the sale of the guaranteed portion of SBA loans have become less attractive in recent quarters. Other income for the 2023 period decreased by $635 thousand when compared to the first nine months of 2022 as the Company recorded gains on the sale of its Golden Valley, MN location and recorded life insurance proceeds in the 2022 period. Bank charges and service fees were $224 thousand higher in the first nine months of 2023 due to higher letter of credit fees and from fees associated with the movement of deposits to one-way sell positions.

Non-interest expense for the Community Banking Segment increased $982 thousand, or 5.4%, to $19.1 million from $18.1 million in the first nine months of 2022. The increase is primarily due to higher salaries, data processing, occupancy, and other expenses being partially offset by lower regulatory costs and depreciation expense. These higher costs reflect normal inflationary increases as well as assuming a greater percentage of shared service costs because of significantly reduced mortgage banking operations compared to the prior year period.

During the nine-month period ended September 30, 2023, income tax expense on a consolidated basis was $1.1 million, compared to $1.5 million in the first nine months of 2022. The effective tax rate was 23.5% in the first nine months of 2023 unchanged from the same period of 2022.

Net Interest Income

The following table presents average balance sheet information, yields on interest-earning assets and costs on interest-bearing liabilities (dollars are in thousands):

	Three Months Ended September 30,								
	2023			2022			Change		
	Average Balance	Interest Earned or Owed	Average Yield or Cost	Average Balance	Interest Earned or Owed	Average Yield or Cost	Average Balance	Interest Earned or Owed	Average Yield or Cost
Interest-earning assets									
Cash and cash equivalents	$ 40,980	$ 561	5.43%	$ 67,779	$ 394	2.31%	$ (26,799)	$ 167	3.12% (a)
FHLB Stock	1,131	9	3.00%	1,267	9	3.04%	(136)	-	-0.04%
Federal Reserve Stock	1,807	27	6.00%	1,807	28	6.00%	-	(1)	0.00%
Debt securities – taxable	163,192	1,322	3.21%	185,117	1,085	2.33%	(21,925)	237	0.88% (b)
Debt securities – tax exempt	-	-	0.00%	5,873	58	3.89%	(5,873)	(58)	-3.89% (b)
Loans held for sale – mortgage banking	24,378	384	6.24%	55,127	649	4.67%	(30,749)	(265)	1.57% (c)
Loans held for investment	650,109	8,783	5.36%	570,702	6,630	4.61%	79,407	2,153	0.75% (d)
Allowance for loan losses	(8,980)	-	0.00%	(8,474)	-	0.00%	(506)	-	0.00%
Total interest-earning assets	$ 872,617	$ 11,086	5.04%	$ 879,198	$ 8,853	3.99%	$ (6,581)	$ 2,233	1.05%
Interest-bearing liabilities									
Interest checking and money market	$ 515,959	$ 2,655	2.04%	$ 497,430	$ 515	0.41%	$ 18,529	$ 2,140	1.63% (e)
Savings	43,957	12	0.11%	51,338	5	0.04%	(7,381)	7	0.07% (e)
Certificates of deposit	61,909	296	1.90%	62,967	80	0.51%	(1,058)	216	1.39% (e)
Total interest-bearing deposits	621,825	2,963	1.89%	611,735	600	0.39%	10,090	2,363	1.50%
Short-term borrowings	-	-	0.00%	213	1	0.30%	(213)	(1)	-0.30%
Federal Home Loan Bank advances	-	-	0.00%	833	2	3.32%	(833)	(2)	-3.32%
Subordinated debentures	15,000	263	6.95%	15,000	143	3.80%	-	120	3.15%
Total borrowings	15,000	263	6.95%	16,046	146	3.61%	(1,046)	117	3.34%
Total interest-bearing liabilities	$ 636,825	3,226	2.01%	$ 627,781	746	0.47%	$ 9,044	2,480	1.54%
Net interest income/spread		$ 7,860	3.03%		$ 8,107	3.52%		$ (247)	-0.49%
Net interest margin			3.57%			3.66%			-0.09% (f)
Notation:									
Non-interest-bearing deposits	$ 179,467	-		$ 197,123	-	0.00%	$ (17,656)	-	0.00% (e)
Total deposits	$ 801,292	$ 2,963		$ 808,858	$ 600	0.29%	$ (7,566)	$ 2,363	-0.29%
Taxable equivalents:									
Total interest-earning assets	$ 872,617	$ 11,120	5.06%	$ 879,199	$ 8,903	4.02%	$ (6,581)	$ 2,217	1.04%
Net interest income/spread	-	$ 7,894	3.05%	-	$ 8,156	3.55%	-	$ (262)	-0.50%
Net interest margin	-	-	3.59%	-	-	3.68%	-	-	-0.09%

(a) Cash balances decreased as the Company utilized the cash balances to grow loans held for investment. Yields on cash have increased due to rate increases by the Federal Reserve.
(b) The average balance of debt securities decreased as the Company is utilizing the cash flow from the portfolio to provide liquidity for loan growth.
(c) Loans held for sale decreased as the remaining inventory of loans is reaching final disposition.
(d) The increase in average loans held for investment is due to the significant loan growth produced by the Company during 2022 that continued through the first nine months of 2023.
(e) Overall, average deposit balances decreased slightly as the Company has experienced elevated levels of customers deploying excess deposit balances to national brokered deposits to capture short-term rates offered in the market.
(f) Yields on interest earning assets have increased as the Federal Reserve continues to drive rates higher. Cost of liabilities has increased due to market competition for deposits along with higher variable rates on the Company's subordinate debentures.

	Nine Months Ended September 30,								
	2023			2022			Change		
	Average Balance	Interest Earned or Owed	Average Yield or Cost	Average Balance	Interest Earned or Owed	Average Yield or Cost	Average Balance	Interest Earned or Owed	Average Yield or Cost
Interest-earning assets									
Cash and cash equivalents	$ 36,351	$ 1,353	4.98%	$ 127,782	$ 696	0.73%	$ (91,431)	$ 657	4.25% (a)
FHLB Stock	1,177	26	3.03%	1,273	28	3.02%	(96)	(2)	0.01%
Federal Reserve Stock	1,807	82	6.03%	1,807	82	6.03%	-	-	0.00%
Debt securities – taxable	168,570	4,041	3.20%	191,347	3,018	2.11%	(22,777)	1,023	1.09% (b)
Debt securities – tax exempt	689	19	3.71%	6,037	173	3.83%	(5,348)	(154)	-0.12% (b)
Loans held for sale – mortgage banking	35,724	1,514	5.67%	55,091	1,554	3.77%	(19,367)	(40)	1.90% (c)
Loans held for investment	634,460	24,754	5.22%	548,769	18,396	4.48%	85,691	6,358	0.73% (d)
Allowance for loan losses	(8,890)	-	0.00%	(8,665)	-	0.00%	(225)	-	0.00%
Total interest-earning assets	$ 869,888	$ 31,789	4.89%	$ 923,441	$ 23,947	3.47%	$ (53,553)	$ 7,842	1.42%
Interest-bearing liabilities									
Interest checking and money market	$ 507,211	$ 6,135	1.62%	$ 535,645	$ 1,008	0.25%	$ (28,434)	$ 5,127	1.37% (e)
Savings	48,306	35	0.10%	51,173	15	0.04%	(2,867)	20	0.06% (e)
Certificates of deposit	56,621	526	1.24%	67,334	235	0.47%	(10,713)	291	0.77% (f)
Total interest-bearing deposits	612,138	6,696	1.46%	654,152	1,258	0.26%	(42,014)	5,438	1.20%
Short-term borrowings	182	1	0.30%	240	1	0.30%	(58)	-	0.00%
Federal Home Loan Bank advances	150	5	4.87%	355	3	1.09%	(205)	2	3.78%
Subordinated debentures	15,000	743	6.62%	15,001	291	2.60%	(1)	452	4.02%
Total borrowings	15,332	749	6.53%	15,596	295	2.53%	(264)	454	4.00%
Total interest-bearing liabilities	$ 627,470	7,445	1.59%	$ 669,748	1,553	0.31%	$ (42,278)	5,892	1.28%
Net interest income/spread		$ 24,344	3.29%		$ 22,394	3.16%		$ 1,950	0.13%
Net interest margin			3.74%			3.24%			0.50% (g)
Notation:									
Non-interest-bearing deposits	$ 187,109	-	0.00%	$ 192,522	-	0.00%	$ (5,414)	-	0.00% (e)
Total deposits	$ 799,246	$ 6,696	1.12%	$ 846,674	$ 1,258	0.20%	$ (47,428)	$ 5,438	0.92%
Taxable equivalents:									
Total interest-earning assets	$ 869,888	$ 31,902	4.90%	$ 923,441	$ 24,098	3.49%	$ (53,553)	$ 7,804	1.41%
Net interest income/spread	-	$ 24,457	3.32%	-	$ 22,545	3.18%	-	$ 1,912	0.14%
Net interest margin	-	-	3.76%	-	-	3.26%	-	-	0.50%

(a) Cash balances decreased due to the transfer of excess deposits from the balance sheet along with utilization of cash for loan growth. Yields on cash increased with rate increases by the Federal Reserve.
(b) The average balance of debt securities decreased as the Company is utilizing the cash flow from the portfolio to provide liquidity for loan growth.
(c) The average balance of loans held for sale decreased as mortgage origination activity during the first nine months of 2023 was significantly lower when compared to first nine months of 2022 due to significant rate increases and exit of the segment.
(d) The increase in average loans held for investment is due to the significant loan growth produced by the Company during 2022 and continuing through the first nine months of 2023.
(e) Overall, average deposit balances decreased as the Company continued moving deposits off the balance sheet beginning at the end of the first quarter of 2022 through the use of an associated banking network and excess deposit balances leaving the balance sheet as customers deploy excess deposit balances to capture higher short-term rates.
(f) The Company continues to manage certificates of deposit balances to meet the needs of its customers.
(g) Yields on interest earning assets have increased as the Federal Reserve continues to drive rates higher. Cost of liabilities has increased due to market competition for deposits along with higher variable rates on the Company's subordinate debentures.

Non-interest Income

The following table presents the major categories of the Company’s non-interest income (dollars are in thousands):

	Three Months Ended September 30,		Increase (Decrease)		Nine Months Ended September 30,		Increase (Decrease)		
	2023	2022	$	%	2023	2022	$	%	
Bank charges and service fees	$ 815	$ 1,215	$ (400)	(33) %	$ 2,792	$ 2,568	$ 224	9 %	(a)
Wealth management revenues	504	489	15	3	1,474	1,517	(43)	(3)	
Mortgage banking revenues	(381)	2,468	(2,849)	(115)	3,767	10,392	(6,625)	(64)	(b)
Gains on sales of loans, net	5	3	2	67	15	242	(227)	(94)	(c)
Gains on sales of debt securities, net	-	-	-	-	12	-	12	100	(d)
Other	175	290	(115)	(40)	401	1,036	(635)	(61)	(e)
Total non-interest income	$ 1,118	$ 4,465	$ (3,347)	(75) %	$ 8,461	$ 15,755	$ (7,294)	(46) %	

(a) Bank charges and services fees decreased in the third quarter comparison primarily due to lower fees earned from the movement of deposits to a one-way sell position and increased during the comparative nine month period due to higher fees associated with issuances of letters of credit and fees earned from the movement of deposits to a one-way sell position.
(b) Mortgage banking revenues decreased as the industry has been negatively impacted by higher interest rates and higher home values coupled with the Company’s exit from the mortgage segment in 2023.
(c) Gains on sales of loans decreased as the premiums earned on the sale of the guaranteed portion of SBA loans has become less attractive in recent quarter.
(d) Gains on sales of debt securities may vary significantly from period to period as the Company manages its risk and return profile through changing economic conditions.
(e) The decrease in other income is primarily due to the Company recording a gain on the sale of the Golden Valley, MN location in 2022 along with lower SBIC revenue than the 2022 period. The Company also recorded a loss on sale of fixed assets during 2023 relating to the sale of assets to First Federal Bank.

Non-interest Expense

The following table presents the major categories of the Company’s non-interest expense (dollars are in thousands):

	Three Months Ended September 30,		Increase (Decrease)		Nine Months Ended September 30,		Increase (Decrease)		
	2023	2022	$	%	2023	2022	$	%	
Salaries and employee benefits	$ 3,673	$ 5,170	$ (1,497)	(29) %	$ 13,677	$ 16,330	$ (2,653)	(16) %	(a)
Professional services	529	954	(425)	(45)	3,115	2,870	245	9	(b)
Data processing fees	862	993	(131)	(13)	2,915	2,964	(49)	(2)	
Marketing and promotion	225	1,596	(1,371)	(86)	2,954	4,388	(1,434)	(33)	(c)
Occupancy	382	499	(117)	(23)	1,376	1,609	(233)	(14)	(d)
Regulatory costs	134	120	14	12	334	360	(26)	(7)	(e)
Depreciation and amortization	261	310	(49)	(16)	838	927	(89)	(10)	(f)
Office supplies and postage	94	99	(5)	(5)	322	316	6	2	
Other	618	658	(40)	(6)	1,993	2,210	(217)	(10)	(g)
Total non-interest expense	$ 6,778	$ 10,399	$ (3,621)	(35) %	$ 27,524	$ 31,974	$ (4,450)	(14) %	
Efficiency ratio	75.5%	82.7%			83.9%	83.8%			

(a) Salaries and employee benefits expense decreased primarily due to a reduction of staff within the mortgage banking segment.
(b) Professional services expense decreased for the three month period due to lower mortgage operating costs. For the nine month period, expenses increased due to recording $840 thousand of one-time expenses related to the Company’s exit from the mortgage business, which was partially offset by lower mortgage operating costs.
(c) Marketing and promotion decreased primarily due to lower marketing costs within the mortgage segment.
(d) Occupancy expense decreased due to fewer locations within the mortgage banking segment.
(e) Regulatory costs decreased primarily due to lower average asset balances.
(f) Depreciation and amortization expense decreased as groups of depreciable assets completed their estimated useful life in addition to the disposal of assets within the mortgage banking segment.
(g) Other expense decreased primarily due decreased travel & meals expense, insurance costs, and director’s fees.

Mortgage Banking Division Selected Data

The following table sets forth information related to mortgage banking products funded and sold with servicing released by the Bank. The following selected data is not intended to be interpreted as a statement of profit and loss as it excludes interest income, interest expense, shared service expenses, and tax expense (dollars in thousands).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Number of funded mortgage loans held for sale	101	692	1,023	2,170
Mortgage loans held for sale funded	$ 44,570	$ 294,393	$ 439,618	$ 888,700
Average loans held for sale-mortgage banking	$ 24,378	$ 55,127	$ 35,724	$ 55,091
Loans held for sale-mortgage banking	$ 120	$ 54,996	$ 120	$ 54,996
Non-Interest Income:				
Gains on sale of loans held for sale, net of commission expense	$ 1,039	$ 2,671	$ 4,228	$ 11,238
Change in fair value of mortgage banking instruments (1)	$ (1,420)	$ (203)	$ (461)	$ (846)

(1) Includes changes in fair value of mortgage commitments, hedge instruments, and loans held for sale

The Company's mortgage banking division originates and sells a variety of conventional and government sponsored mortgage loan products with servicing released through two primary channels. The retail channel is predominantly relationship driven with originators capitalizing on local relationships to originate loans through retail bank branches and retail mortgage locations. The consumer direct channel is a nationwide mortgage platform operating from Overland Park, Kansas, which uses a call center with internet sales focused on both purchase and refinance transactions.

Beginning in 2022 and continuing through the first quarter of 2023, the Company's mortgage business was negatively affected by higher interest rates and higher home values which negatively impacted both purchase and refinance originations. This trend witnessed by the Company is consistent with overall performance of the industry.

On June 16, 2023 BNCCORP, INC. executed on the previously announced transaction with First Federal Bank (First Federal) under which First Federal purchased certain operating assets and assumed certain liabilities of BNC National Bank's mortgage division as part of the Company's strategic decision to exit the residential mortgage origination business. As of September 30, 2023, the Company maintained one loan for $120 thousand of mortgage loans held for sale that is anticipated to be sold in the fourth quarter of 2023.

Income Taxes

In the third quarter of 2023, income tax expense on a consolidated basis was $463 thousand, compared to $475 thousand in the third quarter of 2022. The effective tax rate was 23.5% in the third quarter of 2023, unchanged from the same period of 2022.

During the nine-month period ended September 30, 2023, income tax expense on a consolidated basis was $1.1 million, compared to $1.5 million in the first nine months of 2022. The effective tax rate was 23.5% in the first nine months of 2023 unchanged from the same period of 2022.

Comparison of Financial Condition at September 30, 2023 and December 31, 2022

Assets

The following table presents the Company's assets by category (dollars are in thousands):

	September 30, 2023	December 31, 2022	Increase (Decrease) $	Increase (Decrease) %	
Cash and cash equivalents	$ 51,366	$ 73,968	$ (22,602)	(31) %	(a)
Debt securities available for sale	158,016	174,876	(16,860)	(10)	(b)
Federal Reserve Bank and Federal Home Loan Bank stock	2,938	3,063	(125)	(4)	
Loans held for sale-mortgage banking	120	37,764	(37,644)	(100)	(c)
Loans held for investment, net	665,026	616,645	48,381	8	(d)
Allowance for credit losses	(9,146)	(8,831)	(315)	4	
Premises and equipment, net	10,951	11,764	(813)	(7)	(e)
Operating lease right of use asset	1,020	1,521	(501)	(33)	(f)
Accrued interest receivable	3,851	3,312	539	16	(g)
Other assets	29,215	29,239	(24)	-	
Total assets	$ 913,357	$ 943,321	$ (29,964)	(3) %	

(a) Cash balances decreased as the Company experienced reductions from customers deploying excess deposits in the market for short-term market rates and utilization of cash to fund loans.
(b) Debt securities available for sale decreased as the Company is utilizing the cash flow from the portfolio to provide liquidity for loan growth.
(c) Loans held for sale decreased as the Company continues to exit the mortgage banking segment.
(d) Loans held for investment increased as the Company continues to experience organic growth in core markets.
(e) Premises and equipment, net decreased due to normal depreciation along with the sale and disposal of assets from the mortgage banking segment.
(f) Decrease is primarily due to the assumption of the Company's Overland Park lease by First Federal Bank as a part of the mortgage transaction on June 16, 2023.
(g) Accrued interest receivable increased due to increases in rates on interest earning assets.

Loan Participations

Pursuant to the Company's lending policy, loans may not exceed 85 percent of the Bank's legal lending limit (except to the extent collateralized by U.S. Treasury securities or Bank deposits) unless the Bank's Chief Credit Officer or the Executive Credit Committee grant prior approval. To accommodate creditworthy customers whose financing needs exceed lending limits and internal restrictions, the Bank sells loan participations to outside participants without recourse. Loan participations sold on a nonrecourse basis to outside financial institutions were $121.4 million as of September 30, 2023, and $123.7 million as of December 31, 2022. The sales of participations are accounted for pursuant to FASB ASC 860, *Transfers and Servicing*.

Concentrations of Credit

The following table summarizes the locations and balances of the Company's borrowers (dollars are in thousands):

	September 30, 2023		December 31, 2022	
North Dakota	$ 415,233	63 %	$ 390,006	63 %
Arizona	125,326	19	115,767	19
Minnesota	34,111	5	29,676	5
Other	89,198	13	80,200	13
Total gross loans held for investment	$ 663,868	100 %	$ 615,649	100 %

The Company's borrowers use loan proceeds for projects in various geographic areas. The following table summarizes the locations and balances where borrowers are using loan proceeds (dollars are in thousands):

	September 30, 2023		December 31, 2022	
North Dakota	$ 381,952	57 %	$ 362,354	59 %
Arizona	151,513	23	149,973	24
South Dakota	24,587	4	16,088	3
Minnesota	23,714	3	15,248	2
California	23,648	3	22,154	4
Colorado	10,554	2	13,245	2
Montana	10,442	2	4,521	1
Ohio	6,430	1	6,725	1
Texas	6,123	1	7,086	1
Other	24,905	4	18,255	3
Total gross loans held for investment	$ 663,868	100 %	$ 615,649	100 %

BNC's loans held for investment are concentrated geographically in North Dakota and Arizona which comprise 57% and 23% of the Company's total loan portfolio, respectively. The North Dakota economy is influenced by the energy and agriculture industries. Changes in energy supply and demand have recently caused an increase in oil prices to the benefit of the oil industry and ancillary services. Potential risks to North Dakota's energy industry include the possibility of adverse legislation and changes in economic conditions that reduce energy demand. Depending on the severity of their impact, these factors could present potential challenges to credit quality in North Dakota. The Arizona economy continues to diversify, but continues to be influenced by the leisure and travel industries. Positive trends in both industries have been noted, but an extended slowdown in these industries may negatively impact credit quality in Arizona. While the Company's portfolio includes various sized loans spread over a large number of industry sectors, it has meaningful concentrations of loans to the hospitality and commercial real estate industries.

The following table describes the Company's approximate concentrations by industry as of September 30, 2023 and December 31, 2022, respectively (dollars are in thousands):

	September 30, 2023		December 31, 2022	
Non-owner occupied commercial real estate – not otherwise categorized	$ 204,427	31 %	$ 177,674	29 %
Consumer, not otherwise categorized	98,896	15	85,648	14
Hotels	82,852	13	91,388	15
Retail trade	35,794	5	36,607	6
Healthcare and social assistance	32,508	5	33,327	5
Agriculture, forestry, fishing and hunting	32,056	5	30,641	5
Transportation and warehousing	26,856	4	23,951	4
Non-hotel accommodation and food service	24,482	4	21,538	4
Art, entertainment and recreation	23,630	4	19,024	3
Mining, oil and gas extraction	22,518	3	22,480	4
Construction contractors	15,874	2	11,124	2
Other service	11,158	2	11,810	2
Professional, scientific, and technical services	9,588	1	8,209	1
Real estate and rental and leasing support services	8,615	1	9,233	1
Public administration	8,038	1	8,316	1
Manufacturing	8,004	1	7,572	1
Finance and insurance	6,810	1	5,022	1
Educational services	4,293	1	4,435	1
All other	7,469	1	7,650	1
Gross loans held for investment	$ 663,868	100 %	$ 615,649	100 %

The Company's loans within the hospitality industry have shown signs of improved credit quality that are reflected by improved hotel occupancy and restaurant utilization trends. Hotel operators in the Company's loan portfolio are reporting positive trends, and in some cases stronger balance sheets. Despite these positive indications, labor shortages limit the ability of the industry to fully capitalize on these trends and the potential for inflationary impacts on travel and leisure activities continue to be closely monitored.

Loan Maturities(1)

The following table sets forth the maturities of loans in each major category of the Company's portfolio as of September 30, 2023 (in thousands):

	One Year or Less	Over 1 Year Through 5 Years: Fixed Rate	Over 1 Year Through 5 Years: Indexed Rate	Over 5 Years: Fixed Rate	Over 5 Years: Indexed Rate	Total Loans Held for Investment
Commercial and industrial	$ 23,168	$ 22,318	$ 3,395	$ 61,478	$ 100,040	$ 210,399
Commercial real estate	1,305	21,469	9,483	27,382	171,612	231,251
SBA	40	155	2,258	3,542	53,910	59,905
Consumer	666	4,872	5,832	80,360	18,842	110,572
Land and land development	1,350	2,922	167	61	3,629	8,129
Construction	2,019	821	15,162	6,800	18,810	43,612
Total principal amount of loans	$ 28,548	$ 52,557	$ 36,297	$ 179,623	$ 366,843	$ 663,868

(1) Maturities are based on contractual maturities. Indexed rate loans include loans that would reprice prior to maturity if base rates change.

Actual maturities may differ from the contractual maturities shown above as a result of renewals and prepayments. Loan renewals are evaluated in the same manner as new credit applications.

Allocation of the Allowance for Credit Losses

The table below presents the allocation of the allowance for credit losses among the various loan categories and sets forth the percentage of loans in each category to gross loans. The allocation of the allowance for credit losses as shown in the table should neither be interpreted as an indication of future charge-offs, nor as an indication that charge-offs in future periods will necessarily occur in these amounts or in the indicated proportions (dollars are in thousands).

	September 30, 2023		December 31, 2022	
	Allocation of Allowance	Loans as a % of Gross Loans Held for Investment	Allocation of Allowance	Loans as a % of Gross Loans Held for Investment
Commercial and industrial	$ 3,248	32 %	$ 2,519	33 %
Commercial real estate	3,184	35	3,621	37
SBA	972	9	1,396	8
Consumer	1,072	17	982	16
Land and land development	132	1	87	2
Construction	538	6	226	4
Total	$ 9,146	100 %	$ 8,831	100 %

Nonperforming Loans

The following table sets forth information concerning the Company's nonperforming loans as of the dates indicated (in thousands):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2023		2022		2023		2022	
Balance, beginning of period	$	1,434	$	1,406	$	1,355	$	1,673
Additions to nonperforming		25		29		357		102
Charge-offs		(8)		(15)		(95)		(62)
Reclassified back to performing		-		-		(1)		(165)
Principal payment received		(46)		(101)		(165)		(214)
Transferred to repossessed assets		-		-		(46)		(15)
Balance, end of period	$	1,405	$	1,319	$	1,405	$	1,319

Nonperforming Assets

The following table sets forth information concerning the Company's nonperforming assets as of the dates indicated (dollars are in thousands):

	September 30, 2023		December 31, 2022	
Nonperforming loans:				
Loans 90 days or more delinquent and still accruing interest	$	-	$	1
Non-accrual loans		1,405		1,354
Total nonperforming loans	$	1,405	$	1,355
Repossessed assets, net		11		64
Total nonperforming assets	$	1,416	$	1,419
Allowance for credit losses	$	9,146	$	8,831
Ratio of total nonperforming loans to total loans		0.21%		0.21%
Ratio of total nonperforming loans to loans held for investment		0.21%		0.22%
Ratio of total nonperforming assets to total assets		0.16%		0.15%
Ratio of nonperforming loans to total assets		0.15%		0.14%
Ratio of allowance for credit losses to nonperforming loans		651%		652%

Problem Loans

Management attempts to quantify potential problem loans with more immediate credit risk. The table below summarizes the amounts of potential problem loans (in thousands):

	Watch List						Substandard						Doubtful	
	Impaired(1)		Other		Total		Impaired(1)		Other		Total		Impaired(1)	
September 30, 2023	$	-	$	2,494	$	2,494	$	-	$	4,441	$	4,441	$	940
December 31, 2022		-		2,472		2,472		336		2,262		2,598		1,018

(1) The Company adopted ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*, on January 1, 2023. As a result of adoption, the Company is no longer required to provide information on impaired loans. Information on impaired loans as of December 31, 2022 is being provided for comparative purposes.

At September 30, 2023, the Bank had $5.4 million of classified loans and $1.4 million of loans on non-accrual. This compares to $3.6 million of classified loans and $1.4 million of loans on non-accrual at December 31, 2022, and $3.5 million of classified loans and $1.3 million of loans on non-accrual at September 30, 2022.

A significant portion of these potential problem loans are not in default but may have characteristics such as recent adverse operating cash flows or general risk characteristics that the loan officer feels might jeopardize the future timely collection of principal and interest payments. The ultimate resolution of these credits is subject to changes in economic conditions and other factors. These loans are closely monitored to ensure that the Company's position as creditor is protected to the fullest extent possible.

Liabilities

The following table presents the Company's liabilities (dollars are in thousands):

	September 30, 2023	December 31, 2022	Increase (Decrease) $	Increase (Decrease) %	
Deposits:					
Non-interest-bearing	$ 180,045	$ 207,232	$ (27,187)	(13) %	(a)
Interest-bearing-					
Savings, interest checking and money market	543,909	554,577	(10,668)	(2)	(a)
Time deposits	65,572	57,775	7,797	13	(b)
Guaranteed preferred beneficial interests in Company's subordinated debentures	15,000	15,000	-	-	
Accrued interest payable	687	312	375	120	(c)
Accrued expenses	3,630	5,482	(1,852)	(34)	(d)
Operating lease liabilities	1,134	1,660	(526)	(32)	(e)
Other liabilities	1,133	937	196	21	(f)
Total liabilities	$ 811,110	$ 842,975	$ (31,865)	(4) %	

(a) Deposits decreased as the Company has experienced elevated levels of customers deploying excess deposit balances to national brokered deposits to capture short-term rates offered in the market.
(b) Time deposits have increased as the Company continues to receive active requests from customer for time deposits.
(c) Accrued interest payable increased primarily due to increased cost of deposits and subordinated debentures.
(d) Accrued expenses decreased due to the payout of incentive accruals, reduction in 401k matching contributions, and vacation accruals.
(e) Decrease is primarily due to the assumption of the Company's Overland Park lease by First Federal Bank as a part of the mortgage transaction on June 16, 2023.
(f) Increase primarily relates to recording an allowance for unfunded commitments.

Deposits

Total deposits decreased $30.1 million to $789.5 million on September 30, 2023, from $819.6 million on December 31, 2022. The Company continues to focus on new deposit relationships and is keenly focused on the importance of liquidity.

The following table provides additional detail to the Company's total deposit relationships:

	As of		
(In thousands)	September 30, 2023	December 31, 2022	September 30, 2022
Deposits:			
Non-interest-bearing	$ 180,045	$ 207,232	$ 198,698
Interest-bearing –			
Savings, interest checking and money market	543,909	554,577	563,717
Time deposits	65,572	57,775	61,277
Total on balance sheet deposits	789,526	819,584	823,692
Off-balance sheet deposits (1)	40,232	187,407	218,602
Total available deposits	$ 829,758	$ 1,006,991	$ 1,042,294

(1) The off-balance sheet deposits above do not include off-balance sheet time deposit that can be brought back on the balance sheet at various future maturity dates. As of September 30, 2023, the Company managed off-balance sheet time deposit balances of $20.7 million, compared to no time deposit balances as of December 31, 2022 and September 30, 2022.

The Company remains highly focused on meeting the needs of its customers and ensuring deposit rates reflect changing market conditions. The Company estimates that deposit insurance and other deposit protection programs secure greater than 70% of its customer's deposit balances. This fact, combined with a strong balance sheet and relationship-focused culture has allowed the Company to maintain a significant deposit base.

Off-balance sheet accounts are primarily utilized to custody larger business customer deposits that require daily access to funds and provide for FDIC insurance coverage. The Company maintained $62.8 million of off balance sheet deposits late in the first quarter of 2022 and proceeded to further expand its use throughout 2022. These off-balance sheet deposits grew to $187.4 million at year-end 2022 and were $40.2 million at September 30, 2023. Off-balance sheet deposits can fluctuate greatly as customers balance utilization demands evolve. Competition for deposits increased significantly in the second quarter of 2023 as national news prompted greater focus on deposit rates. Customers with deposit balances beyond their near-term needs redeployed portions of their cash to high-yielding instruments. The Company earns non-interest income through the associated banking network for the utilization of these funds.

At September 30, 2023, and December 31, 2022, the Bank had $17.6 million and $14.9 million, respectively, in time deposits greater than $250 thousand.

Mortgage Banking Obligations

Included in accrued expenses is an estimate of mortgage banking reimbursement obligations. Although the Company sells mortgage banking loans without recourse, industry standards require standard representations and warranties, which can require sellers to reimburse investors for economic losses if loans default or prepay after the sale. Repurchase risk is also evident within the mortgage banking industry as disputes arise between lenders and investors. Such requests for repurchase are commonly due to faulty representation and generally emerge at varied timeframes subsequent to the original sale of the loan. To estimate the contingent obligation, the Company tracks historical reimbursements and calculates the ratio of reimbursement to loan production volumes. Using reimbursement ratios and recent production levels, the Company estimates the future reimbursement amounts and record the estimated obligation. The following is a summary of activity related to mortgage banking obligations (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2023	2022	2023	2022
Balance, beginning of period	$ 537	$ 646	$ 656	$ 820
Provision	10	43	91	103
Refunds (write offs), net	88	(118)	(112)	(352)
Balance, end of period	$ 635	$ 571	$ 635	$ 571

Stockholders' Equity

The Company's stockholders' equity increased $1.9 million from December 31, 2022, to September 30, 2023, primarily driven by increased retained earnings offset by a negative adjustment to the tax-effected fair value of debt securities available for sale as evidenced in the increase of accumulated other comprehensive losses. As presented in Note 16 – Regulatory Capital and Current Operating Environment, the Company maintains capital in excess of regulatory requirements.

The Company routinely evaluates the sufficiency of its capital in order to ensure compliance with regulatory capital standards and to provide a source of strength for the Bank. The Company manages capital by assessing the composition of capital and the amounts available for growth, risk, or other purposes. On May 3, 2022, BNCCORP's Board of Directors declared a $1.75 per share special cash dividend that was paid on June 21, 2022.

Liquidity Risk Management

Liquidity risk is the possibility of being unable to meet present and future financial obligations in a timely manner. Liquidity risk management encompasses the Company's ability to meet all present and future financial obligations in a timely manner. The objectives of the Company's liquidity management policies are to maintain adequate liquid assets, liability diversification among instruments, maturities and customers and a presence in both the wholesale purchased funds market and the retail deposit market.

The Consolidated Statements of Cash Flows in the Consolidated Financial Statements present data on cash and cash equivalents provided by and used in operating, investing, and financing activities. In addition to liquidity from core deposit growth, together with repayments and maturities of loans and debt securities, the Company may utilize brokered deposits, sell debt securities under agreements to repurchase and borrow overnight Federal funds. The Bank is a member of the FHLB of Des Moines. Advances from the FHLB are collateralized by the Bank's mortgage loans. Funding through the issuance of subordinated notes, subordinated debentures, and long-term borrowings also has been utilized.

The Company's liquidity is defined by its ability to meet cash and collateral obligations at a reasonable cost and with a minimum loss of income. Given the uncertain nature of customers' demands, as well as the Company's desire to take advantage of earnings enhancement opportunities, the Company must have adequate sources of on- and off-balance-sheet funds that can be acquired in time of need.

The Company's liquidity position is measured on an as-needed basis, but no less frequently than monthly using each of the following items:

1. Estimated liquid assets and certain off-balance sheet considerations less estimated volatile liabilities using the aforementioned methodology ($107.6 million as of September 30, 2023);
2. Borrowing capacity from the FHLB ($112.3 million as of September 30, 2023); and
3. Capacity to issue brokered deposits with maturities of less than 12 months ($127.8 million as of September 30, 2023).

On an ongoing basis, the Company uses a variety of factors to assess the Company's liquidity position including, but not limited to, the following:

- Stability of its deposit base;
- Amount of unpledged debt securities;
- Liquidity of its loan portfolio; and
- Potential loan demand.

The Company's liquidity assessment process segregates its balance sheet into liquid assets along with certain off-balance sheet considerations and short-term liabilities assumed to be vulnerable to non-replacement over a 30-day horizon in abnormally stringent conditions. Assumptions for the vulnerable short-term liabilities are based upon historical factors. The Company has a targeted range for its liquidity position over this horizon and manage operations to achieve these targets.

The Company further projects cash flows over a 12-month horizon based on its assets and liabilities and sources and uses of funds for anticipated events.

Pursuant to the Company's contingency funding plan, it estimates cash flows over a 12-month horizon under a variety of stressed scenarios to identify potential funding needs and funding sources. The Company's contingency plan identifies actions that could be taken in response to adverse liquidity events.

The Company believes this process, combined with its policies and guidelines, should provide for adequate levels of liquidity to fund the anticipated needs of on- and off- balance sheet items.

Quantitative and Qualitative Disclosures about Market Risk

Market risk arises from changes in interest rates, exchange rates, and commodity and equity prices and represents the possibility that changes in future market rates or prices will have a negative impact on the Company's earnings or value. The Company's principal market risk is interest rate risk.

Interest rate risk arises from changes in interest rates. Interest rate risk can result from: (1) Repricing risk – timing differences in the maturity/repricing of assets, liabilities, and off-balance-sheet contracts; (2) Options risk – the effect of embedded options, such as loan prepayments, interest rate caps/floors, and deposit withdrawals; (3) Basis risk – risk resulting from unexpected changes in the spread between two or more different rates of similar maturity, and the resulting impact on the behavior of lending and funding rates; and (4) Yield curve risk – risk resulting from unexpected changes in the spread between two or more rates of different maturities from the same type of instrument. The Company has risk management policies to monitor and limit exposure to interest rate risk. The Company's asset/liability management process is utilized to manage its interest rate risk. The measurement of interest rate risk associated with financial instruments is meaningful only when all related and offsetting on- and off-balance-sheet transactions are aggregated, and the resulting net positions are identified.

The Company's interest rate risk exposure is actively managed with the objective of managing the level and potential volatility of net interest income in addition to the long-term growth of equity, bearing in mind that it will always be in the business of taking on rate risk and that rate risk immunization is not entirely possible. Also, it is recognized that as exposure to interest rate risk is reduced, so too may the overall level of net interest income and equity.

The Company's primary tool for measuring and managing interest rate risk is net interest income simulation. This exercise includes assumptions regarding the changes in interest rates and the impact on the Company's current balance sheet. Interest rate caps and floors are included to the extent that they are exercised in the 12-month simulation period. Additionally, changes in prepayment behavior of the residential mortgage, CMOs, and mortgage-backed securities portfolios in each rate environment are captured using industry estimates of prepayment speeds for various coupon segments of the portfolio. For purposes of this simulation, projected month-end balances of the various balance sheet accounts are held constant at their September 30, 2023 levels. Cash flows from a given account are reinvested back into the same account so as to keep the month end balance constant at its September 30, 2023, level. The static balance sheet assumption is made so as to project the interest rate risk to net interest income embedded in the existing balance sheet. With knowledge of the balance sheet's existing net interest income profile, more informed strategies and tactics may be developed as it relates to the structure/mix of growth.

The Company monitors the results of net interest income simulation on a regular basis. Net interest income is generally simulated for the upcoming 12-month horizon in seven interest rate scenarios. The scenarios generally modeled are parallel interest rate ramps of +/- 100bp, 200bp, and 300bp along with a rates unchanged scenario. Given the current low level of interest rates as of September 30, 2023, the downward scenarios for interest rate movements is limited to -200bp. The parallel movement of interest rates means all projected market interest rates move up or down by the same amount. A ramp in interest rates means that the projected change in market interest rates occurs over the 12-month horizon on a pro-rata basis. For example, in the +100bp scenario, the projected Prime rate is projected to increase from 8.50% to 9.50% 12 months later. The Prime rate in this example will increase 1/12th of the overall increase of 100 basis points each month.

The net interest income simulation results for the 12-month horizon are shown below (dollars are in thousands):

Net Interest Income Simulation

Movement in interest rates	-200bp	-100bp	Unchanged	+100bp	+200bp	+300bp
Projected 12-month net interest income	$ 32,876	$ 33,141	$ 33,726	$ 32,771	$ 32,442	$ 32,107
Dollar change from unchanged scenario	$ (850)	$ (585)	$ -	$ (955)	$ (1,284)	$ (1,619)
Percentage change from unchanged scenario	(2.52)%	(1.73)%	-	(2.83)%	(3.81)%	(4.80)%

Since there are limitations inherent in any methodology used to estimate the exposure to changes in market interest rates, these analyses are not intended to be a forecast of the actual effect of changes in market interest rates, such as those indicated above on the Company. Further, these analyses are based on assets and liabilities as of September 30, 2023 (without forward adjustments for planned growth and anticipated business activities) and do not reflect any actions the Company might undertake in response to changes in market interest rates.

Static gap analysis is another tool that may be used for interest rate risk measurement. The net differences between the amount of assets, liabilities, equity and off-balance-sheet instruments repricing within a cumulative calendar period is typically referred to as the "rate sensitivity position" or "gap position." The following table sets forth the Company's rate sensitivity position as of September 30, 2023. Assets and liabilities are classified by the earliest possible repricing date or maturity, whichever occurs first.

Interest Sensitivity Gap Analysis

	Estimated Maturity or Repricing at September 30, 2023				
	0–3 Months	4–12 Months	1–5 Years	Over 5 Years	Total
	(dollars are in thousands)				
Interest-earning assets:					
Interest-bearing deposits with banks	$ 38,738	$ -	$ -	$ -	$ 38,738
Debt securities (a)	14,219	23,899	68,256	62,561	168,935
FRB and FHLB stock	2,938	-	-	-	2,938
Loans held for sale-mortgage banking, fixed rate	120	-	-	-	120
Loans held for investment, fixed rate	16,329	50,897	146,532	27,919	241,677
Loans held for investment, indexed rate	111,909	54,243	245,986	10,053	422,191
Total interest-earning assets	$ 184,253	$ 129,039	$ 460,774	$ 100,533	$ 874,599
Interest-bearing liabilities:					
Interest checking and money market accounts	$ 500,734	$ -	$ -	$ -	$ 500,734
Savings	43,175	-	-	-	43,175
Time deposits	14,189	42,010	9,338	35	65,572
Subordinated debentures	-	15,000	-	-	15,000
Total interest-bearing liabilities	$ 558,098	$ 57,010	$ 9,338	$ 35	$ 624,481
Interest rate gap	$ (373,845)	$ 72,029	$ 451,436	$ 100,498	$ 250,118
Cumulative interest rate gap at September 30, 2023	$ (373,845)	$ (301,816)	$ 149,620	$ 250,118	
Cumulative interest rate gap to total assets	(40.93%)	(33.04%)	16.38%	27.38%	

(a) Values for debt securities reflect the timing of the estimated principal cash flows from the securities based on par values, which vary from the amortized cost and fair value of the debt securities.

The table assumes that all savings and interest-bearing demand deposits reprice in the earliest period presented, however, management believes that a significant portion of these accounts are generally not rate sensitive. Management's view is supported by historical non-maturity deposit studies, which indicate that the Company's deposit rates have largely lagged broader market rate changes and the fact that changes in interest rates paid on these deposits historically have not caused notable reductions in balances or net interest income because the repricing of certain assets and liabilities is discretionary and is subject to competitive and other pressures. As a result, assets and liabilities indicated as repricing within the same period may in fact reprice at different times and at different rate levels.

Static gap analysis does not fully capture the impact of embedded options, lagged interest rate changes, administered interest rate products, or certain off-balance-sheet sensitivities to interest rate movements. Therefore, this tool generally cannot be used in isolation to determine the level of interest rate risk exposure in banking institutions.

Since there are limitations inherent in any methodology used to estimate the exposure to changes in market interest rates, these analyses are not intended to be a forecast of the actual effect of changes in market interest rates such as those indicated above on the Company. Further, these analyses are based on the Company's assets and liabilities as of September 30, 2023, and do not contemplate any actions the Company might undertake in response to changes in market interest rates.

Legal Proceedings

From time to time in the ordinary course of business, the Company and its subsidiaries may be a party to legal proceedings arising out of the Company's lending, deposit operations, or other activities. The Company engages in foreclosure proceedings and other collection actions as part of its loan collection activities. From time to time, borrowers may also bring actions against the Company, in some cases claiming damages.

Management is not aware of any material pending or threatening litigation as of September 30, 2023.

Signatures

This report is submitted on behalf of the Company by the duly authorized undersigned.

BNCCORP, INC.

Date:	November 9, 2023	By:	/s/ Daniel J. Collins
			Daniel J. Collins President and Chief Executive Officer
		By:	/s/ Justin C. Currie
			Justin C. Currie Chief Financial Officer