

Senate Appropriations, Education and Environment Division
SB2014 / Industrial Commission
Don Morgan, President & CEO
Bank of North Dakota

Chairman Monson and members of the Committee, I am Don Morgan, President and CEO of the Bank of North Dakota. Thank you for the opportunity to present today on the proposed 2025-2027 biennium budget. I was selected to lead the Bank of North Dakota in August, so I'm a little over 5 months into the job.

Today, I want to start with a focus on the mission of BND, "to deliver financial services to promote agriculture, commerce and industry in North Dakota." This mission has remained the same for 105 years. It's part of why I put in my application to serve as President and CEO. The Bank is integrated into the fabric of the state and serves as a generational leader.

Mission Prioritization and Stacking

Today, I want to take a different approach to "Mission" and outline how the Bank is defining its mission prioritization and stacking. I'm sure you are asking what's that mean so let me give some context. My arrival at the Bank in August coincided with the conclusion of the cash management study. This study brought forth a broad discussion about return on investment of the state's operating cash. What became apparent was a misunderstanding of implementation of the Bank's mission. I want to talk through that with you today and describe how BND stacks its priorities in relation to mission:

1. First and foremost, management of the Bank are risk managers. This risk management occurs in three primary areas: liquidity risk, interest rate risk management and credit risk. There are many risk the Bank manages holistically, but these are the "Big 3".
2. The Bank is a provider of liquidity access for the state through effective management of its investment portfolio. Today, that portfolio is \$4 billion dollars.
3. As you know, in the founding documents, BND was charged with coordinating, enhancing and supporting the private sector financial sector in North Dakota. This is executed through the participations BND undertakes with local financial institutions. Today, the commercial and agriculture loan portfolio, for the first time, exceeds \$4 Billion dollars. With an average 50% participation rate with our financial institution partners, that is leveraged to nearly \$8 billion dollars invested into North Dakota.
4. BND supports the state as a processor of funds for state agencies and the legislature. This includes everything from the day-to-day support of agencies to implementation of legislative directed programs and disaster programs.
5. Finally, at the bottom of the stack, is a return on investment. In its simplest form, BND provides a 3-4% return to the state. On the average, this return is comprised of approximately \$200 million paid in interest to state agencies and a \$200 million return on assets.

BND Organizational Structure

You are all familiar with BND's organizational structure, so I am just going to highlight a couple of key things. The Bank of North Dakota's board of directors is the Industrial Commission. As we look to the future, it seems prudent to continue strengthening the oversight of the IC and I'll touch more on that a bit later in the presentation.

In line with ensuring strong oversight, BND enhanced the role of the advisory board in the last biennium. After several years of discussion, the board implemented a committee system. The committee structure includes: leadership development and compensation, finance and credit, and audit and risk. Changing to this structure enables the advisory board to spend significant more time in their monthly meetings discussing issues of strategic importance as opposed to reviewing reports.

Key Accomplishments

Over the last biennium, BND established a list of accomplishments in support of its mission. These include:

- A successful transition in leadership from Todd Steinwand to Don Morgan.
- Record loan portfolio of \$6.1 billion, 14.5% growth since 2022
 - Commercial portfolio +27.0%
 - Match program +60%
 - Pace programs +50.0%
 - Ag portfolio +11.9%
- Supported the state's cattle ranchers issuing 190 loans for \$16.7 million through the Livestock Rebuilders Program.
- Completed a Legislatively directed study on Sustainability. The STAND report provides a roadmap for the state on policy issues and provides a framework for the state to tell its story.
- Played a significant role in the cash management study.
- Implementation of a robust capital policy.
- Legislative directed programs have grown to 26 with over \$1.1 billion in total assets.
- BND continues to administer the various revolving loan funds and disburse loans for LIFT in coordination with the Department of Commerce.
- Maintain S&P Rating A+
- No findings in the Bank's 2023 FASB audit.

Strategic Priorities

As a legislative body, it is important that we keep you informed of the strategic priorities of the Bank. In my first few months at the Bank, I've spent a considerable amount of time meeting with our management team, the Industrial Commission and key stakeholders to ensure our priorities are aligned with the key issues impacting North Dakota and our local financial institutions. The strategic priorities are broken into some key areas. these include:

Strong Banking

- Protect the State's "working capital" in a volatile/polarized world
- Strong banking practices, principles and policies at all times
- Evolved, robust enterprise risk management that drives strategy and capital
- Balanced credit risk management and risk mitigation at all times
- Strong banking partnerships throughout the State
- Strong state agency partnerships with robust financial advisership

Public Affairs

- "Tell the story" of the BND mission
- Proactive solutions with partner agencies, Industrial Commission and Legislature
- Financial literacy
- Promote balanced culture that remains true to core values and BND mission in a volatile world
- Education resource for ND banking, industry, and ag

Digital Transformation and Innovation

- Embrace technology evolution (AI, cloud computing, blockchain, digital niche, embedded banking)
- "Carbon Leader" digital niche bank sourcing out-of-state deposit base
- "BND Embedded Banking" sourcing out-of-state deposit base

Talent Management

- Attract, develop, and retain a talented workforce
- Embrace changing workforce dynamics
- Promote talent management culture with dynamic succession planning
- Support workforce housing and childcare needs statewide

Energy & Agriculture

- Support and promote capital flow to all forms of sustainable energy
- Support and promote removal of capital flow bottlenecks for all forms of sustainable energy
- Carbon Exchange to bridge credit infrastructure gap between energy and agriculture
- Support evolution of base-load power needs of the future

I want to highlight how BND undertook telling its story because it fits into our overall philosophy which is strong on partnership. In this instance, BND wanted to highlight its partnership and local entities with the Legislature to provide low interest infrastructure and school construction loans to local political subdivisions. In the videos we are about to show, the goal was to have local partners tell the story of the partnership with the legislature to provide funding that reduced the burden on local property taxpayers.

Proposed 2025-2027 Biennium Budget

I now want to introduce Rob Pfennig, BND's Chief Financial Officer to provide a review of the proposed 2025-2027 biennium budget. Before I do that, I want to extend a word of thanks to the Legislature for the 6 & 4 salary increase and the equity pool passed last session. After several sessions of low or no salary increases, last session's employee package enabled BND to catch up on salary and assisted with our retention and recruitment efforts.

Chairman Sorvaag and members of the committee, I am Rob Pfennig, Chief Financial Officer for the Bank of North Dakota. Thank you for the opportunity to provide an overview of the proposed budget for BND for the upcoming biennium. In the following spreadsheet, I want to highlight for you the proposed change package specifically highlighting the operations change package. We will be covering a separate change package related capital expenditures later on in the presentation.

Line Item	2023-25 Biennium Appropriation	OMB Proposed 2025-27 Budget	Change from prior Biennium	Change	BND Proposed 2025-27 Budget	Change from OMB Proposed	Change	Change Package
BND Operations (1)	\$ 73,329,746 *	\$ 70,606,179	\$ (2,723,567)	-3.7%	\$ 73,794,669	\$ 3,188,490	4.5%	\$ 3,188,490
Capital Assets (2)	1,510,000	1,510,000	-	0.0%	1,510,000	-	0.0%	-
Contingency	3,000,000	3,000,000	-	0.0%	3,000,000	-	0.0%	-
	\$ 77,839,746	\$ 75,116,179	\$ (2,723,567)	-3.5%	\$ 78,304,669	\$ 3,188,490	4.2%	\$ 3,188,490
(1) BND Operations:								
Salaries and Benefits	\$ 45,275,085	\$ 45,275,085	\$ -	0.0%	\$ 48,463,575	\$ 3,188,490	7.0%	\$ 3,188,490
IT & System Costs	19,628,366	16,904,799	(2,723,567)	-13.9%	16,904,799	-	0.0%	-
Operating Expenses	7,218,845	7,218,845	-	0.0%	7,218,845	-	0.0%	-
Occupancy and Equipment	1,207,450	1,207,450	-	0.0%	1,207,450	-	0.0%	-
Other Operating Expenses	\$ 28,054,661	\$ 25,331,094	\$ (2,723,567)	-9.7%	\$ 25,331,094	\$ -	0.0%	\$ -
BND Operations								
(2) Capital Budget includes:								
Building	\$ -	\$ -	\$ -	n/a	\$ 1,010,000	\$ 1,010,000	n/a	\$ 1,010,000
Office Equipment	250,000	250,000	-	0.0%	250,000	-	0.0%	-
IT Equipment	-	-	-	n/a	-	-	n/a	-
Software	1,260,000	1,260,000	-	0.0%	250,000	(1,010,000)	-80.2%	(1,010,000)
	\$ 1,510,000	\$ 1,510,000	\$ -	0.0%	\$ 1,510,000	\$ -	0.0%	\$ -

At the direction of the Office of Management and Budget, BND reduced its operating expenses for the proposed 2025-27 biennium budget to match the requested 3% cut.

Highlighted in yellow on the far right of the spreadsheet, you will see BND is requesting a change package of \$3,188,490 for a true-up of compensation costs which represents less than a 1% increase over our 23-25 biennium operations line. I want to briefly walk through the reasons for the proposed increase of \$3,188,490.

- \$641,643 is requested as the 4% legislatively approved salary increase was implemented 7.1.24 and not included in OMBs proposed budget.
- \$438,905 is a true up for 7 positions in OMBs budget that excluded health insurance costs in the current biennium.
- \$2,107,942 accounts for prior years reclassifications to accommodate 26% loan growth and 6 additional legislatively directed programs as well as compensation package decisions approved by IC.

FTE Overview

As requested by the Committee, the next couple of slides will provide an overview of the current FTE count and a review of the vacancy pool savings. As we start this part of the discussion, I want to emphasize that BND is operated as a business. Regardless of the allocated employee authorization by the legislature, we only hire employees when needed and after a review of how efficiency might be gained. With that in mind, let me walk through the numbers.

- The allocated FTE count for employees at BND is for 187.
 - Current employee count is 173.
 - Pending 1 employee starting.
 - Intention to fill 13 in lending and credit administration due to loan growth.

I want to highlight a couple things on the slide.

- First is that the staff of BND continues to show an amazing amount of productivity. If you look back to 2015, BND was a \$7.4 Billion bank with 168 employees. Today, BND is a \$10.5 billion bank with authorization for 183. This is an incredible amount of growth in productivity.
- As noted earlier, BND's loan portfolio continues to increase and today is over \$6 Billion including the student loan and housing portfolios. It was only 2019 when BND was doing about \$1 Billion in loans and renewals a year. That number jumped to \$2.5 Billion through the Covid-19 pandemic and for 2024 will be just over \$2.1 Billion in loans and renewals.

Prior to 2021 BND averaged \$41.7M assets per FTE. Since 2021 BND has averaged \$61.4M assets per FTE. Adding the requested employees would decrease the assets per FTE to \$57.7M, if assets remain the same. If BND would want to get back to our pre-2021 assets per FTE level we would need to request 58 employees. This would increase our FTE count to 245 employees.

Regarding the vacancy FTE pool established by the Legislature last session, I want to highlight a couple of things:

1. As President and CEO, my role is to ensure our staff is productive while managing risk. I want to stress today that the balance of hiring the additional staff is essential to effective management of the Bank. If our local financial institutions continue to grow, BND will need to grow with them and approaching the 2027 legislative session may require additional staffing.
2. BND continues to have a relatively low turnover rate. However, when we look at the tenure of our staff, there are a number of key employees that are eligible or soon to be eligible for retirement. As you know, operating BND is unlike any other bank in America and having the right staff and enabling the knowledge transfer is essential to our institution.

Capital Expenditures

In BND's proposed capital budget for the 2025-2027 biennium, you will note a proposed increase of \$2,633,299. There are two reasons for the proposed increase.

Project	23-25 Biennium Budget	23-25 Biennium Projected Spend	25-27 Biennium Budget as submitted	25-27 Biennium Change Package	25-27 Biennium Total
Office Equipment	\$ 250,000	\$ 205,000	\$ 250,000		\$ 250,000
Software	1,260,000	100,000	260,000		260,000
Building Refresh (carpet, walls, etc.)		-	848,000	2,468,299	3,316,299
Furniture		82,000	75,000	65,000	140,000
Drive Thru		221,000	-		-
Teller Line reconfiguration		-	50,000		50,000
Lobby Remodel		167,000	27,000		27,000
ECO HVAC Install - 1x State unification fee			-	100,000	100,000
Total	\$ 1,510,000	\$ 775,000	\$ 1,510,000	\$ 2,633,299	\$ 4,143,299

First, BND's office space is in need of updating. The building was opened in 2008 there's been very limited interior replacement since that time to flooring, furniture and wall coverings. As with your own home, there just comes a time when updates are needed and putting them off is not prudent or fiscally responsible. You will note BND is proposing \$2.5 million for this renovation.

Second, I want to highlight a structural change that BND is undertaking. This was brought up last session and is now moving to the implementation stage. This is the installation of a drive through and remodeling of the lobby to enhance security. There are two slides to review with you on this project.

1. The first is a drive through on the north side of the building. The need for this aspect came to light during Covid-19 and social distancing. However, as we look to the future, it's just a good business practice to provide drive through access which then enables BND to enhance lobby security. This should also help efficiency as the super majority of our customers are state agencies.
2. The second part of the project is to remodel the lobby and better secure the front entrance. As BND is not a retail bank, access to the lobby is something that's gotten considerable attention. It really came to light when the DAPL protestors demonstrated in the lobby and since then, BND has encountered some other security incidents. Keeping our staff safe is the highest priority and as we all know, with the changing political and cultural environment, building safety is essential for our staff and customers.

Capital Policy

At the end of last session, in HB 1014, the Legislature identified the need to better identify a process for the appropriation of BND's dividend to the general fund and for other programming. I want to highlight for you progress on this issue during the biennium.

First, Bank of North Dakota had its biennial examination with the North Dakota Department of Financial Institutions. The exam, by the way, went really well with no findings. However, DFI recommended to the Industrial Commission the development and implementation of a capital policy. This type of policy is required through the regulatory bodies of all public and private banks in America. While BND is not subject to FDIC or OCC oversight, BND implements best practices from these regulatory agencies.

The overall purpose of the Bank's capital policy is to ensure the safety and soundness of the Bank, ensure the Bank can meet its mission and objectives and is aligned with industry best practices. A strong capital policy benefits the Bank by providing a framework for achieving its mission and strategic plan objectives consistent with maintaining regulatory guidance and providing for the safety and soundness of the Bank's depositors and operations.

The development of this capital policy was driven by the following factors:

1. The size and complexity of the Bank's operations has reached a critical juncture where a robust, dynamic, industry best practice capital policy is prudent for continued safe and sound operations.
2. The Department of Financial institutions, as part of its biennial review recommended BND develop a capital policy as a best practice.
3. The legislature as part of the HB 1014 in the 68th legislative session included language in section 28 to "consider developing procedures or adopting legislative rules for introducing bills and amendments related to the use of Bank of North Dakota Profits".
4. To create a dividend policy that provides a level of funding for use by the legislature while maintaining appropriate capital levels at BND to mitigate risk and comply with industry best practices and continued safe and sound operations.

Bank Management, Advisory Board, and the Industrial Commission together, establish policies, procedures, and controls that mitigate material risks such as economic, interest rate volatility, credit, liquidity requirements, competitive environment changes, financial, operational, cybersecurity, and reputational risk. The Bank must be prepared to respond quickly to unforeseen major events such as interest rate shock environments, natural disasters, economic disruptions, and state budget deficits.

The capital policy was adopted by the Industrial Commission last Thursday and as part of today's hearing, we want to share with you the projected capital contributions by BND for the 2025-2027 biennium.

2021-22 Calendar Yr. Earnings

Dividends	\$ 335,321,000
General Fund	\$ 14,000,000
BND Buydown Programs	\$ 60,000,000
Skilled Workforce / Dual Credit	\$ 8,300,000
SBDC	\$ 1,500,000
AG PUC	\$ 3,000,000
Interoperable Radio	\$ 20,000,000
Infrastructure Revolving Loan	\$ 52,000,000
Permanent Disaster Program	\$ 20,000,000
R WISH	\$ 10,000,000
FHLB Housing Grant	\$ 1,281,533
Dividend Percentage	94.3%

2023-24 Calendar Yr Earnings

Dividends	\$ 392,739,000
General Fund	\$ 140,000,000
BND Buydown Programs	\$ 60,000,000
Skilled Workforce / Dual Credit	\$ 8,300,000
SBDC	\$ 15,000,000
AG PUC	\$ 30,000,000
Dividend Percentage	54.2%

Total Return to State

BND 2023-2024 Earnings	\$ 392,739,000
Interest Paid to State Agencies	\$ 254,307,784
Total Return to State	\$ 647,046,784

First, let me walk you through the earnings, proposed dividend and total return to the state. I'll then show you how the capital policy helped the Industrial Commission to arrive at that number.

- In calendar year 21-22, BND earned \$335.3 Million. Of that amount, 94.3% or \$316 million was utilized for general fund or other program dividends.
- Based on the capital policy and capital needed to safely operate the bank, the Industrial Commission for the 2025-2027 biennium, via the capital policy is setting a dividend percentage of 54.2% or \$212,800,000.

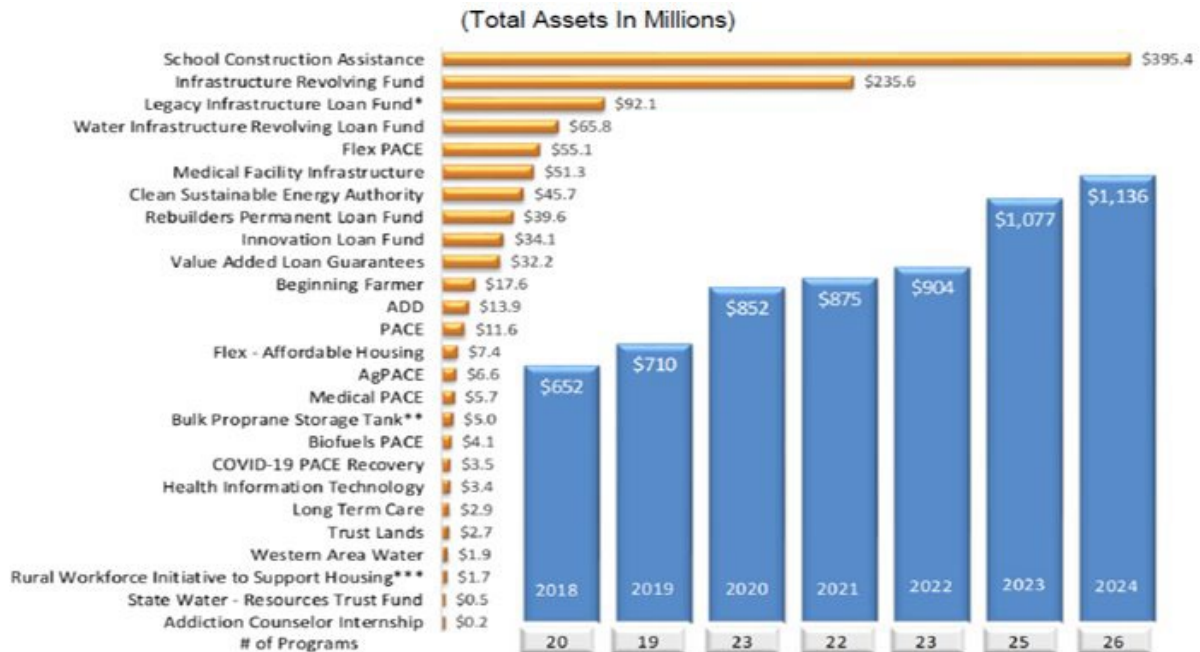
Now, I'll demonstrate how that number was determined. In development of the capital policy, a variety of risk factors were considered to determine the average capital ratio required for safety and soundness of the Bank. Examples of some factors that were included:

- BND's Enterprise Risk Management Factors or Key Risk Indicators
- The restricted deposit base and not having access to additional capital tools.
- Correspondent Risk as BND is not the primary underwriter or servicer of a credit.
- Anticipating disaster needs for the next biennium and programming that may be required.
- Governmental Risk in case of a downturn and the legislature requiring a special dividend.

As determined by the capital policy, the tier one leverage ratio required is 12.1%. With projected year end 2024 average assets of \$10,657,084 Billion, tier one capital required is \$1,288,617 Billion.

Legislatively Directed Programs

Currently, BND administers \$1.1 Billion in 26 legislatively directed programs. As you know, these programs serve a wide range of purposes to assist local political subdivisions with lower cost infrastructure financing.



As you consider legislatively directed programs this session, a few things to keep in mind.

1. Last session, the Legislature provided access of up to \$150 Million in the Legacy Fund for the Legacy Infrastructure Loan Fund. To date, BND has transferred approximately \$100 Million in loans to the Legacy Fund. If there is not a cash infusion this session to the fund, BND will transfer the other \$50 million in the 25-27 biennium and will most likely have applications in excess of available funding.
2. Last session, the Legislature changed the lending limits for the School Construction Revolving Loan Fund. The increases and refinancing enabled last session quickly drew upon the \$75 million appropriated during the biennium. If the legislature retains the higher loan limits, a capital infusion into the fund will be required.

As the session progresses, it is anticipated additional legislatively directed programs will be proposed and we look forward to working with Legislature to effectively structure and implement these programs.

Proposed Amendments

Today, BND is asking the committee to accept the proposed program amendments as approved by the Senate.

The first is related to open records request. BND is requesting that participation loans with local financial institutions be exempted from open records requests. The reason for the request is that BND's role is to support the local financial institutions in serving their customers. Many times, local customers are not aware BND is participating in a loan and may suddenly find their information subject to an open records request. BND is asking for the same confidentiality provided by local financial institutions.

Direct loans or loans that utilize a program such as PACE will still be subject to open records requests. In addition, any loans determined to be uncollectable will also be subject to open records. Normally, these loans are brought before the IC at the December or January meeting.

Section 13 Amendment on Page 8

This chapter does not apply to any of the following:

7. The release by the industrial commission, in its capacity as the managing body of the Bank of North Dakota, of the following:

- a. The name of any person who has obtained approval for direct ~~or indirect~~ financing or security, including a loan guarantee or a letter of credit, through the Bank of North Dakota primarily for purposes other than personal, family, or household purposes.
- b. The amount of any financing or security referenced in subdivision a.
- c. The amount of any net write off or loan forgiveness ~~associated with the financing or security referenced in subdivision a~~ which the industrial commission determines is uncollectible.
- d. The program under which any financing or security referenced in subdivision a was made.

Section 14 Amendment on Page 9

The amendment adopted by the Senate enables BND to maintain confidentiality of records related to bond and cyber insurance coverage.

Amendment to 6-09.14-04--PACE Program on Page 10

The Senate adopted an amendment to provide BND with additional latitude in the administration of the PACE program. The added language enables BND to provide up to an additional one million dollars in buydown to a project with a substantial economic impact without requiring additional matching funds from the local community.

If the Bank determines the project has a substantial economic impact and qualifies as a primary sector business, the maximum amount from the fund in the interest rate buydown may be increased by up to one million dollars, in addition to the amount under subdivision a, without a required community match.

Finally, we are seeking a change to how PACE programs funds are allocated. In previous biennium's, the legislature dedicated a specific amount to the various programs. BND was then authorized to move funding within the programs to meet the demand. As opposed to specifying an amount per program, BND is asking for \$60 million to be transferred and then will determine when and where it's needed. This is really just an administrative change that will create efficiency in our internal transfer and accounting procedures.

SECTION 9. TRANSFER - BANK OF NORTH DAKOTA PROFITS TO ECONOMIC

DEVELOPMENT PROGRAMS. During the biennium beginning July 1, 2025, and ending June 30, 2027, the Bank of North Dakota shall transfer the following amounts from the Bank's current earnings and undivided profits:

~~1. \$39,000,000 to the partnership in assisting community expansion;~~

~~2. \$5,000,000 to the agriculture partnership in assisting community expansion fund;~~

~~3. \$1,000,000 to the biofuels partnership in assisting community expansion fund;~~

~~4. \$15,000,000 to the beginning farmer revolving loan fund; and~~

1. \$60,000,000 to the Partnership in assisting community expansion; agriculture partnership in assisting community expansion; biofuels partnership and beginning farmer revolving loan fund.

2. \$1,900,000 to the university of North Dakota for the North Dakota small business development center for the purpose of matching federal grants.