FINANCIAL REPORT

ALERUS FINANCIAL CORPORATION
2014 ANNUAL FINANCIAL REPORT

ALERUS

ABOUT ALERUS FINANCIAL CORPORATION

Alerus Financial Corporation (the "Company") through its subsidiaries Alerus Financial, N.A., Alerus Securities Corporation, Alerus Investment Advisors, Inc., and Alerus Financial Insurance Services Corporation, offers business and consumer banking products and services, residential mortgage financing, employer-sponsored retirement plan administration, and wealth management services including trust, brokerage, insurance, and asset management. The Company's banking and wealth management offices are located in Grand Forks and Fargo, North Dakota, the Minneapolis-St. Paul, Minnesota metropolitan area, and Scottsdale, Arizona. Alerus Retirement Solutions plan administration offices are located in St. Paul, Minnesota, East Lansing and Troy, Michigan, and Manchester, New Hampshire. The common stock of the Company trades on the OTCQX market under the symbol ALRS.

ACQUISITIONS

During the two years ended December 31, 2014, the Company completed the following acquisitions:

Retirement Alliance, Inc.

On October 1, 2014, the Company acquired Retirement Alliance, Inc., and its affiliate Fiduciary Consulting Group, LLC, located in Manchester, New Hampshire. The purchase, consisting of approximately 700 retirement plan clients with more than 42,000 retirement plan participants, grew the Company's retirement services division by $2.1 billion in retirement and individual asset managed accounts. As part of the transaction, $12.7 million was allocated to an identified customer intangible, based on the estimated value as of the acquisition date, which the Company immediately began amortizing over a five-year period, resulting in an annualized intangible amortization expense of $2.5 million. This resulted in earnings dilution of $390,000 in the fourth quarter of 2014, after giving effect to $600,000 of intangible amortization expense.

Private Bank Minnesota

On June 25, 2014, the Company acquired Private Bancorporation, Inc., with one branch located in downtown Minneapolis. The Company assumed approximately $116.3 million of deposits and other liabilities, and purchased approximately $130.1 million in cash, securities, loans, and other assets. As part of the transaction, the Company allocated $1.2 million to a core deposit intangible and $852,000 to goodwill. The core deposit intangible is being amortized over five years, generating an amortization expense of $240,000 per year, while the goodwill is not subject to amortization. Neither the core deposit intangible nor the goodwill is deductible for tax purposes. The transaction also included a net operating loss deferred tax asset valued at $943,000 that will be utilized to offset taxable income as permitted by applicable tax laws. The transaction generated $2.0 million of one-time restructuring charges, all of which were incurred in 2014

Tegrit Administrators, LLC

On September 30, 2013, the acquisition of Tegrit Administrators, LLC, was completed. The acquisition initially increased the Company's retirement services division assets under administration by $1.3 billion and expanded the Company's presence in Michigan.

Since December 31, 2014, the Company completed the following acquisition:

Interactive Retirement Solutions, LTD

On January 2, 2015, the Company acquired Interactive Retirement Solutions, LTD, located in Bloomington, Minnesota. The purchase, consisting of approximately 160 retirement plans with more than 16,200 retirement participants, grew the Company's retirement division by $1.25 billion in retirement and individual asset managed accounts. As part of the transaction, $4.5 million was allocated to an identified customer intangible, based on the estimated value as of the acquisition date, which the Company immediately began amortizing over a five-year period, resulting in an annualized intangible amortization expense of $899,000.

Stock Split and Per Share Data

The Company completed a 3-for-1 stock split of shares of its common stock effective September 12, 2014, payable in the form of a stock dividend to shareholders of record as of September 8, 2014. All current and historical share information and per share data has been adjusted to reflect the stock split.

COVERED ASSET AND RELATED FDIC LOSS-SHARE INDEMNIFICATION ASSET

Effective January 1, 2015, the losses on commercial-related loans (commercial, commercial real estate, and construction real estate) acquired in the FDIC-assisted acquisition of Prosperan Bank ceased being covered under the loss-share agreement. The carrying amount of those loans was $10.7 million as of December 31, 2014. Any recoveries, net of expenses, received on commercial-related loans on which losses were incurred prior to January 1, 2015, will continue to be covered by the loss-share agreement (and any such net recoveries must be shared with the FDIC) through December 31, 2017. Losses and recoveries on single family related loans acquired in connection with the Prosperan Bank transaction will continue to be covered under the loss-share agreement through December 31, 2019.

FDIC Loss-Share True-Up Liability

During the 1st quarter of 2015, the Company determined that under the terms of the FDIC loss share agreement entered into as part of the Prosperan Bank acquisition, a true-up liability should have been recorded in the year ended December 31, 2012. As a result, the financial statements as of and for the years ended December 31, 2012 and 2013 have been restated to reflect this liability. The Company determined an FDIC true-up liability of $2.6 million should have been recorded as of December 31, 2012. The net effect of this error on the Company's financial statements for the year ended December 31, 2012 was that Other Liabilities were understated by $2.6 million, Deferred Taxes were understated by $0.99 million, and as a result, net income and retained earnings were overstated by $1.6 million. The net effect of the error on the 2013 financial statements was that Other Liabilities were understated by $2.6 million, Deferred Taxes were understated by $0.99 million and retained earnings was overstated by $1.6 million. There was no impact to net income in 2013 or 2014. All adjustments have been made and are reflected in the financial statements for the years ending 2014, 2013, and 2012.

TAX

During the fourth quarter of 2014, the Company completed an analysis of revenue apportionment across all filed states applying an alternative method of allocation utilized by other financial institutions. As a result of that analysis, the Company determined that use of an alternative method of allocating revenue is permitted. The principal effect of this change is to reduce the revenues allocated to North Dakota and Minnesota in a manner that, in turn, reduces aggregate state income tax expense based on currently applicable rates. In addition, the Company filed amended tax returns for the 2011 through 2013 tax years seeking refunds based on this alternative method of allocating revenue. As a result, the Company increased its current income taxes receivable by $1.2 million and recognized a current tax benefit of approximately $1.2 million to reflect expected cash flow from anticipated refunds. Of this amount, refunds have already been received in the aggregate amount of $287,000 from the State of North Dakota; however, the State of North Dakota retains the ability to review these refunds since all relevant tax years remain open.

CHANGE IN EXTERNAL AUDIT FIRM

As a result of a request for proposals and review process, the Company engaged CliftonLarsonAllen LLP as its external audit firm, beginning with the audit of the 2014 annual financial statements.

TABLE 1 – SELECTED FINANCIAL DATA

For years ended December 31 (dollars in thousands except per-share data)

RESULTS OF OPERATIONS	2014	2013	2012	2011	2010	5-Year Compound Growth Rate
Interest income	$ 54,394	$ 50,510	$ 52,852	$ 47,381	$ 45,983	6.94%
Interest expense	3,316	3,712	4,586	6,821	10,785	-21.60%
Net interest income	51,078	46,798	48,266	40,560	35,198	13.02%
Taxable equivalent adjustment	483	426	461	539	525	1.79%
Taxable equivalent net interest income	51,561	47,224	48,727	41,099	35,723	12.88%
Non-interest income	78,406	79,269	79,115	56,784	53,101	13.10%
Net revenue	129,967	126,493	127,842	97,883	88,824	13.01%
Non-interest expense	100,115	92,913	100,834	76,740	72,649	14.11%
Provision for loan losses	(400)	1,200	833	4,418	6,820	-156.12%
Net Income	$ 20,231	$ 20,270	$ 16,256	$ 10,709	$ 5,873	22.38%
Net Income Applicable to Shareholders	$ 20,031	$ 20,070	$ 15,917	$ 10,636	$ 5,873	22.14%
PER SHARE						
Earnings per common share	$ 1.44	$ 1.46	$ 1.17	$ 0.80	$ 0.44	20.79%
Common dividends declared	$ 0.38	$ 0.34	$ 0.31	$ 0.30	$ 0.29	6.30%
Book value per common share	$ 10.85	$ 9.65	$ 8.90	$ 7.97	$ 7.34	10.23%
Weighted average common shares	13,887,344	13,762,044	13,591,335	13,319,550	13,217,592	1.12%
AVERAGE BALANCES						
Interest-bearing deposits with banks	$ 19,787	$ 56,339	$ 42,121	$ 59,423	$ 38,561	137.66%
Federal funds sold	17	8	2,675	553	1,238	-75.41%
Investment securities	258,705	264,978	262,030	272,431	261,415	11.23%
Loans held for sale	27,090	43,361	51,548	26,447	35,106	40.89%
Loans – excluding covered assets	976,257	807,278	680,749	606,259	547,599	12.67%
Covered assets	17,790	25,167	37,901	52,685	68,995	5.9%
Total interest-bearing assets	1,299,646	1,197,131	1,077,024	1,017,798	952,914	12.74%
Total assets	1,424,331	1,308,159	1,197,807	1,128,835	1,079,425	10.92%
Non-interest-bearing deposits	278,005	221,199	195,939	162,106	126,513	18.89%
Interest-bearing deposits	913,841	879,974	807,910	820,434	803,779	8.56%
Total deposits	1,191,846	1,101,173	1,003,849	982,540	930,292	10.51%
Short-term borrowings	29,007	13,964	19,203	9,406	1,679	191.85%
Other borrowed funds	21,562	22,650	21,817	22,449	41,249	-8.77%
Shareholders' equity	$ 164,203	$ 150,300	$ 136,624	$ 105,930	$ 93,947	15.11%
RATIOS						
Return on average assets	1.42%	1.55%	1.36%	0.95%	0.54%	1.19%
Return on average common equity	13.89%	15.40%	13.65%	10.80%	6.25%	12.15%
Return on average tangible common equity	16.70%	17.99%	16.78%	12.96%	8.02%	
Net interest margin	3.97%	3.94%	4.52%	4.04%	3.75%	
Efficiency ratio	77.32%	73.70%	79.16%	78.83%	82.28%	
Dividend payout ratio	26.39%	23.29%	26.78%	37.08%	66.17%	
Average shareholders' equity to average total assets	11.53%	11.49%	11.41%	9.38%	8.70%	

RESULTS OF OPERATIONS

The following is Management's discussion and analysis of the significant changes in the results of operations, capital resources, and liquidity presented in the accompanying consolidated financial statements. The Company's consolidated financial condition and results of operations are comprised primarily of the financial condition and results of operations of its subsidiary bank, Alerus Financial, N.A. Current performance does not guarantee, and may not be indicative of, similar performance in the future. For more information on the factors that could affect performance, see "Forward Looking Statements."

EARNINGS SUMMARY

The Company's diversified revenue model continued to generate strong core earnings in 2014, reflecting record revenue from the banking, retirement services, and wealth management divisions, offset in part by a decline in mortgage division revenue consistent with the overall decrease in residential mortgage volumes across the industry. For the year ended December 31, 2014, the Company reported net income of $20.2 million, a decrease of $0.1 million, or 0.2%, from the $20.3 million earned during 2013. Earnings per common share were $1.44 in 2014, a decrease of $0.02, or 1.4%, from the $1.46 earned during 2013. The Company's 2014 earnings reflect the effect of $4.2 million of amortization of identified intangibles from acquisitions or $0.18 per share net of taxes, compared to $3.3 million or $0.14 per share in 2013. The year to year change in net income over the last five years is illustrated in Chart A, and the year to year change in earnings per share is illustrated in Chart B.

Cash dividends per share were $0.38 in 2014, compared to $0.34 in 2013. The year to year change in cash dividends over the last five years is illustrated in Chart C.

Return on Average Common Equity (ROE) is net income stated as a percentage of common shareholders' equity. ROE was 13.89% in 2014, compared to 15.40% in 2013, and 13.65% in 2012, as further illustrated in Chart D. The average ROE over the past five years is 12.00%.

Return on Average Assets (ROA) is net income stated as a percentage of average total assets. As Chart E illustrates, ROA was 1.42% in 2014, compared to 1.55% in 2013, and 1.36% in 2012. The average ROA over the past five years is 1.16%.

NET INTEREST INCOME

Net interest income is a major source of earnings for the Company. Net interest income is calculated as the difference between interest income (which includes yield-related loan fees) and interest expense. Net interest income, on a taxable-equivalent basis, expressed as a percentage of average total earning assets, is referred to as the net interest margin, which represents the average net effective yield on earning assets.

While the Company believes that it has the ability to increase net interest income over time, net interest income and the net interest margin in any one period can be significantly affected by a variety of factors including the mix and overall size of our earning asset portfolio and the cost of funding those assets. In addition, some variable sources of interest income such as loan prepayment fees and the collection of interest on nonaccrual loans can vary from period to period.

Net interest income on a taxable-equivalent basis was $51.6 million in 2014, an increase of $4.4 million, or 9.2%, from the $47.2 million reported in 2013. Net interest margin was 3.97% in 2014, up three basis points from 3.95% in 2013. The primary reason for the increase in net interest income from the year ended December 31, 2013, was organic loan growth of $96.3 million and acquired loans of $90.1 million associated with the acquisition of Private Bank Minnesota, offset in part by a $61.0 million restructuring of the investment portfolio to reduce price and credit exposure. The Company has elected to account for purchased credit impaired loans under the cost recovery method. Under the cost recovery method, no yield is accreted into income until the Company's cost is recovered, thus no accretable yield is reported for the years ending December 31, 2014 and 2013.

Chart A
Net Income

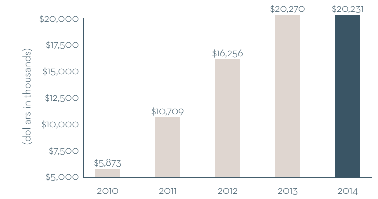


Chart B
Earnings Per Share

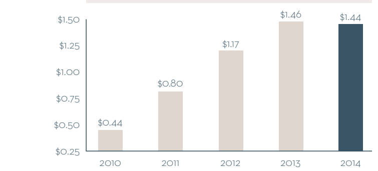


Chart C
Dividends Per Share

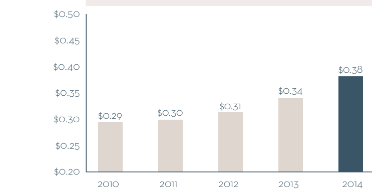


Chart D
Return on Equity

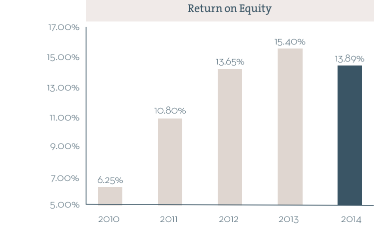


Chart E
Return on Assets

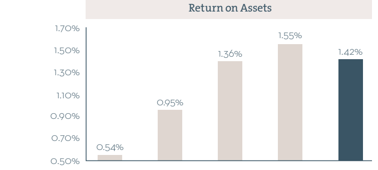


Chart F
Net Interest Income

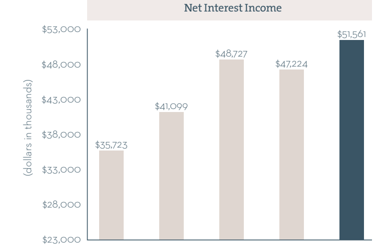
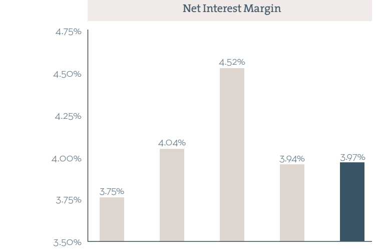


Chart G
Net Interest Margin



Average interest-bearing assets were $1.3 billion in 2014, an increase of $0.1 billion, or 8.6%, from the $1.2 billion reported in 2013. The increases were driven by demand for loans and lines by new and existing credit-worthy borrowers, the acquisition of Private Bank Minnesota, and partially offset by a cyclical decrease in the real estate warehouse line utilized to fund residential mortgages awaiting sale.

Core deposits are an important low-cost source of funding and affect both net interest income and the net interest margin. Core deposits include non-interest-bearing deposits, interest-bearing checking, savings certificates, and money market savings deposits. Average core deposits were $969 million in 2014, an increase of $105 million from the $864 million in 2013, and funded 74.6% and 72.2% of the Company's average interest-bearing assets in 2014 and 2013, respectively.

Chart F illustrates net interest income on a tax equivalent basis for the past five years.

The Company positions the balance sheet to be interest rate neutral to slightly asset sensitive, defined as allowing assets on the balance sheet to reprice faster than the liabilities that fund them. Financial institutions will feel additional pressure on net interest margin the longer short-term rates remain at lower levels since there is limited opportunity to reprice deposits and fixed-rate loans mature or renew at lower rates. The Company actively implements risk management strategies as detailed in the "Interest Rate Risk" discussion to minimize the effects of interest rate volatility. **Chart G** illustrates net interest margin for the past five years.

Table 2 provides detailed information as to average balances, interest income and expense, and rates earned and paid by major balance sheet categories for the years 2012 through 2014. **Table 3** provides an analysis of the change in net interest income that is attributable to changes in volume of interest-earning assets or interest-bearing liabilities, and to changes in rates earned and paid.

PROVISION FOR LOAN LOSSES

The allowance for loan losses (allowance) is an estimate of loan losses inherent in the Company's loan portfolio. The allowance is established through a provision for loan losses. Additions to the allowance are expected to maintain the adequacy of the total allowance after loan losses and recoveries, loan growth, and changes in management's assessment of credit quality and estimates of probable loan losses. Loan losses are charged off against the allowance when the Company determines the loan balance to be uncollectible. Cash received on previously charged off amounts is recorded as a recovery to the allowance. Annual fluctuations in the provision for loan losses result from management's regular assessment of the adequacy of the allowance for loan losses based on the foregoing factors.

The provision for loan losses for 2014 was negative $0.4 million compared to $1.2 million during 2013. This was the result of a suspension of the provision for loan losses at the Company's subsidiary bank to allow the bank's allowance for loan losses to realign with regular quarterly assessments of the reduced risk in the bank's loan portfolio due to improved credit quality and recoveries. While there was no negative provision taken at the bank level, the Company itself recorded a negative provision for loan losses of $0.4 million in response to repayment of a loan held at the Company as opposed to its subsidiary bank. The ratio of allowance for loan losses to end-of-year non-covered loans was 1.56% for 2014, compared to 1.88% for 2013. This reflects continued strength in the Company's overall loan portfolio, fair value adjustments of $2.5 million to loans acquired in the Private Bank transaction based in part on the allowance for loan losses that would otherwise have been attributed to those acquired loans as of the closing of that transaction, and the termination of FDIC loss-share coverage on non-residential real estate loans acquired in the Prosperan Bank transaction effective December 31, 2014. Average loans excluding covered assets were $976.3 million in 2014, an increase of $169 million, or 20.9%, from the $807.3 million reported in 2013. The amount of provision to be taken in future periods will depend on management's assessment of the adequacy of the allowance for loan losses in relation to the loss experience of the entire loan portfolio.

NON-INTEREST INCOME

The Company continues to expand non-interest income associated with the Company's banking, retirement services, and wealth management divisions. The Company's primary sources of non-interest income consist of trust services, retirement plan and recordkeeping services, service charges on deposit accounts, loan fees, and mortgage originations. Non-interest income is a significant source of revenue for the Company, representing 60.3% of taxable equivalent net revenue in 2014, compared with 62.7% in 2013. Non-interest income was $78.4 million in 2014, a $0.9 million, or 1.1%, decrease from the $79.3 million reported in 2013. Growth in retirement services income helped to offset the decline in mortgage origination income, which declined as a result of a reduction in mortgage refinancing activity across the industry. **Table 4** provides a summary of changes in non-interest income the past three years.

Retirement services, which includes retirement plan administration and retirement plan investment advisory, is the Company's largest source of non-interest income. Retirement services income was $41.1 million in 2014, a $5.1 million, or 14.0%, increase from the $36.0 million reported in 2013. At December 31, 2014, assets under administration totaled $15.5 billion, up $2.6 billion, or 20.2%, from $12.9 billion at December 31, 2013. The acquisition of Retirement Alliance, Inc., which closed on October 1, 2014, included 700 retirement plans, with more than 42,000 participants, and added $2.1 billion in assets under administration.

TABLE 2 – AVERAGE BALANCE SHEETS AND AVERAGE RATES

For years ended December 31 (dollars in thousands)

ASSETS	2014 Average Balance	2014 Average Rate	2014 Interest	2013 Average Balance	2013 Average Rate	2013 Interest	2012 Average Balance	2012 Average Rate	2012 Interest
Interest-bearing deposits with banks	$ 19,787	0.26%	$ 52	$ 56,339	0.26%	$ 148	$ 42,121	0.24%	$ 100
Federal funds sold	17	0.00%	-	8	0.00%	-	2,675	0.11%	3
Investment securities (a)	258,705	2.67%	6,915	264,978	2.64%	7,001	262,030	3.03%	7,937
Loans held for sale	27,090	3.46%	936	43,361	2.78%	1,206	51,548	3.07%	1,581
Loans – excluding covered assets									
Commercial and financial (a)	341,516	4.44%	15,173	292,449	4.85%	14,194	234,126	5.18%	12,121
Agricultural	40,731	4.16%	1,693	43,741	4.40%	1,924	42,078	5.00%	2,105
Real estate	525,873	4.89%	25,729	418,397	4.78%	19,999	364,411	5.45%	19,866
Consumer loans	68,137	4.57%	3,117	52,691	4.74%	2,495	40,134	5.19%	2,083
Total loans – excluding covered assets	976,257	4.68%	45,712	807,278	4.78%	38,612	680,749	5.31%	36,175
Covered assets	17,790	7.09%	1,262	25,167	15.77%	3,969	37,901	19.83%	7,517
Total Earning Assets	$ 1,299,646	4.22%	$ 54,877	$ 1,197,131	4.25%	$ 50,936	$ 1,077,024	4.95%	$ 53,313
Cash and due from banks	23,408			21,098			32,429		
Loan loss reserve	(16,792)			(15,673)			(14,611)		
Goodwill and other intangibles	18,271			15,251			16,795		
Bank premises and equipment	22,174			22,440			21,908		
Other	77,624			67,912			64,262		
Total Assets	$ 1,424,331			$1,308,159			$ 1,197,807		
LIABILITIES AND SHAREHOLDERS EQUITY									
Savings, NOW, and money market deposits	$ 690,898	0.15%	$ 1,023	$ 642,934	0.18%	$ 1,174	$ 556,282	0.24%	$ 1,344
Time deposits	222,943	0.74%	1,650	237,040	0.81%	1,927	251,628	1.01%	2,530
Short-term borrowings	29,007	0.08%	22	13,964	0.21%	30	19,203	0.34%	65
Other borrowed funds	21,562	2.88%	621	22,650	2.57%	581	21,817	2.97%	647
Total Interest-Bearing Liabilities	$ 964,410	0.34%	$ 3,316	$ 916,588	0.40%	$ 3,712	$ 848,930	0.54%	$ 4,586
Non-interest-bearing deposits	278,005			221,199			195,939		
Other liabilities	17,713			20,072			16,314		
Shareholders' equity	164,203			150,300			136,624		
Total Liabilities and Shareholders' Equity	$ 1,424,331			$1,308,159			$ 1,197,807		
Net Interest Margin/ Income		3.97%	$ 51,561		3.95%	$ 47,224		4.52%	$ 48,727
Interest Rate Spread		3.88%			3.85%			4.41%	

(a) Taxable equivalent adjustment was calculated utilizing a marginal federal income tax rate of 35.5 percent.

Wealth management income, which includes personal trust services and investment services offered by Alerus Investment Advisors and Alerus Securities, was $11.3 million, a $0.7 million, or 6.2%, increase from the $10.6 million reported in 2013. The Company earns trust, investment, and individual retirement account fees from managing and administering assets, including mutual funds, corporate trusts, personal trusts, and separately managed accounts. Trust and investment fees are primarily based on a tiered scale relative to the market value of the assets under management. At December 31, 2014, assets under management totaled $2.9 billion, up $0.2 billion, or 8.2%, from the $2.7 billion reported in 2013, and includes some assets also reported under assets under administration that also generate investment management fees.

Mortgage origination and loan servicing fees were $18.4 million in 2014, an $8.8 million, or 32.2%, decrease from the $27.2 million reported in 2013. The Company's mortgage division originated $749.2 million in loans 2014, a $250.8 million, or 25.0% decrease from the $1.0 billion originated in 2013. Other non-interest income was $6.0 million in 2014, a $2.3 million, or 56.9%, increase from the $3.7 million reported in 2013. Overall, mortgage originations experienced an industry-wide decline of roughly 39% in 2014, reflecting further declines from the record levels of mortgage refinance activity seen over the previous four years. The Company's mix of refinance and home purchase mortgage originations shifted from 45% refinance and 55% purchase in 2013 to 15% and 85%, respectively, in 2014.

TABLE 3 – VOLUME/RATE VARIANCE ANALYSIS

(dollars in thousands)

	Change from 2013 to 2014			Change from 2012 to 2013		
Increase (decrease) in:	Volume	Rate	Total	Volume	Rate	Total
Interest income						
Interest bearing deposits with banks	$ (96)	$ -	$ (96)	$ 34	$ 14	$ 48
Federal funds sold	-	-	-	(3)	(0)	(3)
Investment securities	(166)	(80)	(86)	89	(1,025)	(936)
Loans Held for Sale	(453)	183	(270)	(251)	(124)	(375)
Loans - excluding covered assets	-	-		-	-	
Commercial and financial	2,381	(1,402)	979	3,019	(946)	2,073
Agricultural	(132)	(99)	(231)	83	(264)	(181)
Real estate	5,137	593	5,730	2,943	(2,810)	133
Consumer loans	731	(109)	622	652	(240)	412
Total loans excluding covered assets	8,118	(1,018)	7,100	6,697	(4,260)	2,437
Covered assets	(1,163)	(1,544)	(2,707)	(2,526)	(1,022)	(3,548)
Total Interest Income	$ 6,240	$ (2,299)	$ 3,941	$ 4,041	$ (6,418)	$ (2,377)
Interest expense						
Savings, NOW, and money market deposits	88	(239)	(151)	209	(379)	(170)
Time deposits	(115)	(162)	(277)	(147)	(456)	(603)
Short term borrowings	32	(40)	(8)	(18)	(17)	(35)
Other borrowed funds	(28)	68	40	25	(91)	(66)
Total Interest Expense	(23)	(373)	(396)	70	(944)	(874)
Net Variance	$ 6,263	$ (1,926)	$ 4,337	$ 3,971	$ (5,474)	$ (1,503)

TABLE 4 – NON-INTEREST INCOME

For years ended December 31 (dollars in thousands)

	2014	2013	2012	% Increase/ Decrease 2014/2013	% Increase/ Decrease 2013/2012
Retirement services income	$ 41,058	$ 36,003	$ 32,484	14.04%	10.83%
Wealth management income					
Trusts, agencies, wills, estates and other	8,249	7,352	6,908	12.20%	6.43%
Brokerage commissions	2,041	1,951	1,978	4.61%	-1.37%
Investment advisory fees	995	1,321	1,251	-24.68%	5.60%
Total Wealth Management Income	$ 11,285	$ 10,624	$ 10,137	6.22%	4.80%
Service charges on deposit accounts	1,626	1,639	1,626	-0.79%	0.80%
Mortgage origination and loan servicing fees	18,435	27,177	31,061	-32.17%	-12.50%
Investment security gains (losses)	2,179	(70)	217	3212.86%	-132.26%
Other non-interest income	3,823	3,896	3,590	-1.87%	8.52%
Total Non-Interest Income	$ 78,406	$ 79,269	$ 79,115	-1.09%	0.19%

NON-INTEREST EXPENSE

Total non-interest expense was $100.1 million in 2014, a $7.2 million, or 7.8% increase from the $92.9 million reported in 2013. In 2012, non-interest expense was impacted by a non-recurring impairment of the FDIC indemnification asset and the recording of an FDIC True-Up Liability, both as a result of the Prosperan Bank acquisition in 2009. In 2014, non-interest expense was impacted by $2.0 million in one-time restructuring charges associated with the Private Bank acquisition and amortization of identified intangibles resulting from the Retirement Alliance, Inc. transaction that began amortizing in the fourth quarter.

The Company's efficiency ratio, defined as the percent of expense to total income, increased to 77.3% in 2014, compared to 73.7% in 2013.

Chart H (page 9) illustrates the trend in the efficiency ratio over the last five years.

While control of non-interest expense is a top priority of management, the higher-than-average efficiency ratio is partially due to the Company's goal of generating 50% of total revenue from non-interest income sources. The efficiency ratio for a business comprised solely of net interest margin income is generally lower than a business comprised solely of asset management income and mortgage origination income; however, the income generated from asset management has higher risk-adjusted returns since the Company allocates significant amounts of capital and reserves to the balance sheet risks generated by more traditional banking activities.

Salary and employee benefit costs are the largest expense component for the Company. Salary and employee benefit costs represented 60.4% of total expenses in 2014, compared to 64.4% in 2013. Salary and employee benefit costs were $60.4 million in 2014, a $0.6 million, or 0.1%, increase from the $59.8 million reported in 2013. This marginal increase in salary and employee benefit costs was influenced by increased staffing associated with acquisitions completed in 2014, offset by declines in variable commissions associated with declines in mortgage origination activity.

Occupancy expense was $4.4 million in 2014, a $0.6 million, or 16.7%, increase from the $3.8 million reported in 2013. This increase in occupancy expense is primarily the result of costs associated with acquisitions completed in 2014.

Furniture and equipment expense was $4.7 million in 2014, reflecting no material change from 2013.

Other non-interest expense was $13.3 million in 2014, a $2.9 million, or 28.1%, increase from the $10.4 million reported in 2013. The increase in other non-interest expense is the result of expenses associated with acquisitions completed in 2014, including $2 million of one-time restructuring charges relating to the Private Bank Minnesota transaction and the amortization of identified intangibles associated with the Retirement Alliance transaction.

The Company has acquired 16 companies since 2002 for an aggregate premium of $41.1 million in excess of book value creating identified intangible assets of $39.6 million and $1.5 million in goodwill on the balance sheet. The identified intangible assets amortize for book purposes and are reported in other non-interest expense. For most transactions, goodwill does not amortize for book purposes and is not deductible for tax purposes. The amortization schedules vary based on the type and quality of the acquisition. The aggregate unamortized intangible balance as of December 31, 2014, is $20.8 million and will fully amortize by December 31, 2019. The intangible amortization expense for 2014 was $4.1 million. **Table 5** provides a summary of changes in non-interest expenses for the past three years.

TABLE 5 – NON-INTEREST EXPENSE

For years ended December 31 (dollars in thousands)

	2014	2013	2012	% Increase/ Decrease 2014/2013	% Increase/ Decrease 2013/2012
Salaries	$ 48,839	$ 49,203	$ 49,072	-0.74%	0.27%
Employee benefits	11,580	10,621	10,302	9.03%	3.10%
Occupancy expense	4,424	3,791	4,189	16.70%	-9.50%
Furniture and equipment expense	4,659	4,687	4,147	-0.60%	13.02%
Marketing, business development and public relations	2,745	2,613	3,052	5.05%	-14.38%
Supplies, telephone and postage	3,838	3,033	3,148	26.54%	-3.65%
FDIC insurance	1,040	960	893	8.33%	7.50%
Professional fees (legal, audit and consulting)	2,667	2,042	1,894	30.61%	7.81%
Correspondent and other service fees	6,982	5,547	5,668	25.87%	-2.13%
Other non-interest expenses	13,341	10,416	18,649	28.08%	-43.60%
Total Non-Interest Expenses	$ 100,115	$ 92,913	$ 100,834	7.75%	-7.86%

STATEMENT OF FINANCIAL CONDITION

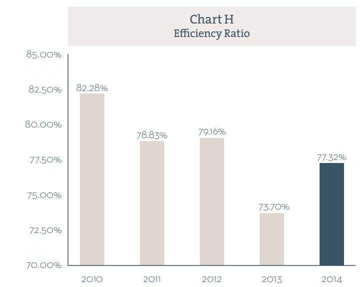
OVERVIEW

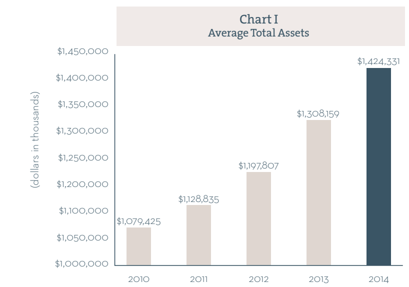
Total assets of the Company were $1.5 billion at December 31, 2014, a $0.1 billion, or 7.7% increase from the $1.4 billion reported at December 31, 2013. Total average assets of the Company were $1.4 billion in 2014, a $0.1 billion, or 9.1%, increase from the $1.3 billion reported in 2013. **Chart I** illustrates average total assets for the past five years. Average earning assets were $1.3 billion in 2014, an increase of $0.1 billion, or 8.6%, from the $1.2 billion reported in 2013. Average earning assets represent 91.2% of average total assets in 2014, compared to 91.5% in 2013. The change in average earning assets was primarily driven by an increase in non-covered loans, which was offset by a decrease in covered loans and loans to be sold. Average interest-bearing liabilities represented 74.2% of average earning assets in 2014, compared to 76.6% in 2013.

SECURITIES

The Company uses its investment securities portfolio to manage enterprise interest rate risk, provide liquidity (including the ability to meet proposed regulatory requirements), generate interest and dividend income, and as collateral for public funds. While it is the Company's intent to hold its investment securities to maturity, the Company may take actions to sell before maturity in response to structural changes in interest rate risks and to meet liquidity requirements, among other factors.

At December 31, 2014, investment securities totaled $206.1 million, compared with $279.7 million at December 31, 2013. The $73.6 million year-over-year decrease was associated with $18.4 million in purchases, $85.5 million in sales, and the continued monthly amortization of our agency-backed mortgage portfolio. The weighted average yield of the investment portfolio was 2.61% at December 31, 2014, compared with 2.64% at December 31, 2013. The decrease in weighted average yield was associated with unscheduled prepayments on the agency-backed mortgage portfolio and reinvestments made under a lower interest rate environment.





The investment portfolio was rebalanced during the third quarter of 2014 to reduce risk and duration. Corporate securities with a face amount of $61 million were liquidated for a pre-tax gain of $1.8 million. Additional portfolio restructuring resulted in a gain of $0.4 million during the reporting period. The investment securities portfolio contains amortizing securities resulting in monthly cash flow of approximately $2.5 million.

During 2014, the Company transferred all held-to-maturity securities to available-for-sale. At the time of transfer the book value of the securities was $53.8 million. The unrealized gain of $1.9 million was recorded immediately in other comprehensive income. The transaction was the result of a strategic decision by the Company to liquidate its corporate bond portfolio which comprised 51.4% of the held-to-maturity portfolio.

The Company's available-for-sale securities are carried at fair value with changes in fair value reflected in other comprehensive income (loss) unless a security is deemed to be other-than-temporarily impaired. At December 31, 2014, the Company's gross unrealized gains on the available-for-sale securities were $3.8 million, compared with $5.3 million at December 31, 2013. Gross unrealizable losses on available-for-sale securities totaled $1.7 million, compared with $4.9 million at December 31, 2013.

The Company conducts a regular assessment of its investment portfolio to determine whether any securities are other-than-temporarily impaired. When assessing unrealized losses for other-than-temporary impairment, the Company considers the nature of the investment, the financial condition of the issuer, the extent and duration of the unrealized loss, and expected cash flows of the underlying assets and market conditions. On December 31, 2014, the Company held certain investments having continuous unrealized loss positions for more than 12 months. As of December 31, 2014, the unrealized losses on these securities totaled $1.6 million. Substantially all of these losses were in the government agency debt securities. During the year ended December 31, 2014, the Company evaluated all of its debt securities for credit impairment and determined there were no credit losses evident and did not record any other-than-temporary impairment. At December 31, 2014, the Company had no plans to sell securities with unrealized losses and believes it is likely that it would not be required to sell such securities before a recovery of their amortized cost.

LOANS

Total loans were $1.1 billion at December 31, 2014, a $181 million, or 19.8%, increase from the $914 million reported at December 31, 2013. The increase was driven by the acquisition of Private Bank as well as organic growth in commercial loans of $7.4 million (2.2%), real estate mortgages of $81.2 million (15.0%), and consumer loans of $12.8 million (19.0%). **Table 6A** provides a summary of changes in loans, excluding covered loans, for the past five years. **Table 6B** provides a summary of the loan mix on covered loans. Average loans were $994 million in 2014, a $162 million, or 19.4%, increase from the $832 million reported in 2013. The increase in average loans was driven by strong organic growth across all geographic locations and loans acquired in the Private Bank Minnesota transaction. The loan/deposit ratio increased to 87.2% at December 31, 2014, compared to 77.33% at December 31, 2013, as the Company utilized excess liquidity to fund loan growth.

The Company periodically sells loans to a participation network to manage concentration risk and reduce credit exposure. The sold loan portfolio was $518.8 million on December 31, 2014, a $54.9 million, or 11.8%, increase from the $464.1 million reported at December 31, 2013. The Company originated and sold $87.1 million of real estate mortgages to Fannie Mae and FHLB during 2014 and retained the servicing asset. The Company also held $35.0 million of loans for sale at December 31, 2014, a $4.8 million, or 15.8%, increase from the $30.3 million reported at December 31, 2013. Loans held for sale are all single family residential mortgage loans that will be sold to the secondary market.

DEPOSITS

Core deposits provide the Company's major source of funds from individuals, businesses, and local government units. Core deposits include non-interest-bearing deposits, interest-bearing checking, savings certificates, and money market saving deposits. Core deposits funded 70.7% and 69.3% of total assets at December 31, 2014 and 2013, respectively.

Total deposits were $1.3 billion at December 31, 2014, an $80 million, or 6.7%, increase from the $1.2 billion reported at December 31, 2013. The increase was the result of the Private Bank Minnesota acquisition which added $116 million in deposits. Average deposits were $1.2 billion in 2014, a $90.7 million, or 8.2%, increase compared with the $1.1 billion reported in 2013.

Non-interest-bearing deposits were $330.2 million at December 31, 2014, a $25.2 million, or 8.3%, increase from the $305.0 million reported at December 31, 2013. Average non-interest-bearing deposits were $278.0 million in 2014, a $56.8 million, or 25.7 %, increase compared with $221.2 million in 2013. The increase in non-interest-bearing deposits was primarily attributable to the Private Bank Minnesota transaction.

TABLE 6A – LOANS EXCLUDING COVERED ASSETS BY TYPE

As of December 31 (dollars in thousands)

	2014	2013	2012	2011	2010
Commercial and financial	$ 345,249	$ 327,388	$ 260,518	$ 209,406	$ 185,645
Agricultural	49,081	54,214	46,607	44,328	48,073
Real estate	615,956	452,874	381,672	336,874	278,542
Consumer loans	79,741	60,067	49,289	34,773	23,420
Total Loans	$ 1,090,027	$ 894,543	$ 738,086	$ 625,381	$ 535,681
PERCENT OF LOANS BY TYPE					
Commercial and financial	31.67%	36.60%	35.30%	33.48%	34.66%
Agricultural	4.50%	6.06%	6.31%	7.09%	8.97%
Real estate	56.51%	50.63%	51.71%	53.87%	52.00%
Consumer loans	7.32%	6.71%	6.68%	5.56%	4.37%
Total Loans	100.00%	100.00%	100.00%	100.00%	100.00%
SOLD LOANS					
Commercial and financial	$ 72,107	$ 68,156	$ 57,146	$ 57,446	$ 54,294
Agricultural	2,000	10,892	5,049	-	-
Real estate	443,898	385,060	332,590	285,184	267,076
Consumer loans	816	-	4,600	-	-
Total Sold Loans	$ 518,821	$ 464,108	$ 399,385	$ 342,630	$ 321,370

TABLE 6B – COVERED LOANS BY TYPE

As of December 31 (dollars in thousands)

	2014	2013	2012	2011	2010
Commercial and financial	$ -	$ 793	$ 1,457	$ 3,379	$ 5,246
Agricultural	-	31	64	74	85
Real estate	5,432	19,099	30,998	44,318	56,455
Consumer loans	-	98	173	279	392
Total Covered Loans	$ 5,432	$ 20,021	$ 32,692	$ 48,050	$ 62,179
PERCENT OF LOANS BY TYPE					
Commercial and financial	0.00%	3.96%	4.46%	7.03%	8.44%
Agricultural	0.00%	0.15%	0.20%	0.15%	0.14%
Real estate	100.00%	95.39%	94.82%	92.23%	90.79%
Consumer loans	0.00%	0.49%	0.53%	0.58%	0.63%
Total Loans	100.00%	100.00%	100.00%	100.00%	100.00%

TABLE 7 – DEPOSITS BY TYPE

As of December 31 (dollars in thousands)

	2014	2013	2012	2011	2010
Non-interest-bearing deposits	$ 330,218	$ 305,042	$ 267,208	$ 188,630	$ 156,844
Interest-bearing deposits					
Saving accounts	30,397	24,750	20,168	20,427	14,033
NOW accounts	243,334	186,916	188,995	138,579	136,392
Money market deposit accounts	447,346	439,946	386,089	377,003	363,169
Time deposits in excess of $250,000	28,774	35,182	40,103	34,389	31,712
Time deposits of $250,000 and less	182,099	190,767	213,187	226,082	248,631
Total Deposits	$ 1,262,168	$ 1,182,603	$ 1,115,750	$ 985,110	$ 950,780
PERCENT OF DEPOSITS BY TYPE					
Non-interest-bearing deposits	26.16%	25.79%	23.95%	19.15%	16.50%
Interest-bearing deposits					
Saving accounts	2.41%	2.09%	1.81%	2.07%	1.48%
NOW accounts	19.28%	15.81%	16.94%	14.07%	14.35%
Money market deposit accounts	35.44%	37.20%	34.60%	38.27%	38.20%
Time deposits in excess of $250,000	2.28%	2.97%	3.59%	3.49%	3.34%
Time deposits of $250,000 and less	14.43%	16.13%	19.11%	22.95%	26.15%
Total Deposits	100.00%	100.00%	100.00%	100.00%	100.00%

Interest-bearing non-maturity deposits totaled $721.1 million at December 31, 2014, a $69.5 million, or 10.7%, increase from the $651.5 million reported at December 31, 2013. Average interest-bearing non-maturity deposits were $690.9 million in 2014, a $48.0 million, or 7.5%, increase compared with $642.9 million in 2013. The increase in these deposits was primarily the result of the Private Bank Minnesota transaction.

Interest-bearing time deposits were $210.9 million at December 31, 2014, a $15.1 million, or 6.7%, decrease from the $225.9 million reported at December 31, 2013. Average interest-bearing time deposits were $222.9 million in 2014, a $14.1 million, or 5.9%, decrease compared with $237.0 million reported in 2013. Time certificates of deposit are largely viewed as purchased funds and are managed to levels deemed appropriate given alternative funding sources. **Table 7** provides a summary of changes in deposits for the past five years.

OTHER BORROWED FUNDS

The Company utilizes both short-term and long-term borrowings to fund growth of earning assets in excess of deposit growth. Other borrowed funds, as of December 31, 2014, totaled $21.5 million, a $0.13 million, or 0.63%, decrease from the $21.6 million reported at December 31, 2013. Other borrowed funds consists of one Federal Home Loan Bank advance totaling $20 million, and obligations under a capital lease associated with the lease agreement on the Corporate Center office located in Grand Forks, North Dakota, of $1.5 million.

CAPITAL RESOURCES

The Company is committed to managing capital for maximum shareholder benefit and maintaining strong protection for depositors and creditors. The Company continually assesses its business risk and capital position. The Company also manages its capital to exceed regulatory capital requirements for well-capitalized bank holding companies. To achieve these capital goals, the Company employs a variety of capital management tools including dividends and common share repurchases. Total common shareholders' equity was $151.1 million at December 31, 2014, a $17.8 million, or 13.35%, increase from the $133.3 million reported at December 31, 2013. The increase is the result of current year's earnings less dividend payments to shareholders, common stock repurchases, and the market value change in the investment portfolio.

In 2012 the Company applied for and received approval for $20 million in Small Business Lending Funds (SBLF) at an initial interest rate of 1%. The Company is committed to small business lending and is proud to contribute to the nation's recovery. The Company views the SBLF as an intermediate source of capital and its plans to repay these funds will depend, in part, on other potential uses of excess capital and the cost and quality of other alternative capital sources.

The Company paid dividends of $0.38 during 2014, representing a $0.04, or 12.74%, increase over the $0.34 paid during 2013. Dividends per share data was adjusted for a 3-for-1 stock split completed in the third quarter of 2014. The Company's dividend policy is influenced by the belief that most shareholders are interested in long-term appreciation as well as current yield. The current dividend yield is considered reasonable given the Company's present cash flow position, level of earnings, and the strength of its capital.

Banking industry regulators define minimum capital requirements for banks and holding companies. The Company's Tier 1 and total risk-based capital ratios as of December 31, 2014, amounted to 11.8% and 13.1%, respectively, well above the requirements to be considered well capitalized of 6.00% for Tier 1 and 10.00% for total risk based capital. This compares to Tier 1 and total risk-based capital ratios of 12.8% and 14.1% at December 31, 2013. Regulatory authorities also have established a minimum leverage ratio of 5.00%, which is defined as Tier 1 capital to average assets. The Company's leverage ratio was 10.1% in 2014, compared to 10.6% in 2013.

RISK ANALYSIS

ASSET QUALITY RISK

Management believes its ability to identify and assess risk and return characteristics of the Company's loan portfolio is critical for profitability and growth. It is in the best interest of shareholders, regional communities, customers, and the Company to follow a credit policy that carefully balances risk and return tradeoffs, and ensures that potential credit problems are closely monitored. The Company's strategy for credit risk management includes well-defined, centralized credit policies; uniform underwriting criteria; and ongoing risk monitoring and review processes for all commercial and consumer credit exposures. The strategy also emphasizes diversification on a geographic, industry, and customer level; regular credit examinations; and management reviews of loans experiencing deterioration of credit quality. The Company strives to identify potential problem loans early, take necessary charge-offs promptly, and maintain adequate reserve levels for probable loan losses inherent in the portfolio. Management performs ongoing, internal reviews of any problem credits and continually assesses the adequacy of the allowance for possible loan loss. The Company utilizes an internal lending division, Special Credit Services, to develop and implement strategies for the management of individual non-performing loans.

The allowance for credit losses provides coverage for probable and estimable losses inherent in the Company's loan portfolio. Management evaluates the allowance each quarter to determine if it is adequate to cover inherent losses. The evaluation of each element and the overall allowance is based on a continuing assessment of problem loans and related off-balance sheet items, recent loss experience, and other factors including regulatory guidance and economic conditions.

At December 31, 2014, non-performing assets excluding covered assets were $6.1 million, compared to $3.4 million

TABLE 8A – NON-PERFORMING ASSETS EXCLUDING COVERED ASSETS
As of December 31 (dollars in thousands)

	2014	2013	2012	2011	2010
Non-accrual loans					
Commercial and financial	$ 572	$ 1,209	$ 941	$ 2,620	$ 1,738
Agricultural	-	109	-	69	-
Real estate	3,013	510	854	3,395	4,956
Consumer loans	20	9	354	-	-
Total Non-Accrual Loans	$ 3,605	$ 1,837	$ 2,149	$ 6,084	$ 6,694
Foreclosed assets	11	11	19	20	-
Other real estate owned	2,478	1,558	2,603	2,866	4,780
Total Non-Performing Assets	$ 6,094	$ 3,406	$ 4,771	$ 8,970	$ 11,474
Loans past due 90 days or more					
Commercial and financial	-	-	$ 95	$ 332	-
Agricultural	-	-	-	-	-
Real estate	$ 392	-	1	87	26
Consumer loans	-	-	-	-	-
Total Loans Past Due 90 Days or More	$ 392	-	$ 96	$ 419	$ 26
Percentage of non-performing loans to loans	0.33%	0.21%	0.29%	0.97%	1.25%
Percentage of non-performing assets to assets	0.41%	0.25%	0.36%	0.78%	1.02%
Percentage of allowance for loan losses to non-performing loans	426.90%	916.60%	672.65%	197.23%	131.56%

TABLE 8B – NON-PERFORMING COVERED ASSETS
As of December 31 (dollars in thousands)

	2014	2013	2012	2011	2010
Non-accrual loans					
Commercial and financial	-	$ 227	$ 380	$ 459	$ 271
Agricultural	-	-	8	-	-
Real estate	-	3,313	3,746	6,083	11,021
Consumer loans	-	-	-	-	-
Total Non-Accrual Loans	-	$ 3,540	$ 4,134	$ 6,542	$ 11,292
Foreclosed assets	-	-	-	-	-
Other real estate owned	-	3,319	7,439	9,050	7,638
Total Non-Performing Covered Assets*	-	$ 6,859	$ 11,573	$ 15,592	$ 18,930
Loans past due 90 days or more					
Commercial and financial	-	-	-	-	-
Agricultural	-	-	-	-	-
Real estate	-	-	$ 541	-	$ 377
Consumer loans	-	-	-	-	-
Total Loans Past Due 90 Days or More	-	-	$ 541	-	$ 377

**Exposure on covered assets is limited to 20% on the first $66 million and 5% thereafter.*

in 2013, and $4.8 million in 2012. Non-performing assets excluding covered assets represented 0.41% of total assets and other non-performing assets in 2014, compared to 0.25% in 2013, and 0.36% in 2012. **Table 8A** provides a summary of the non-performing history for the past five years. At December 31, 2014, there were no non-performing covered assets. **Table 8B** provides a summary of the non-performing covered assets.

At December 31, 2014, the allowance for loan losses was $17.1 million, or 1.56% of total loans excluding covered assets, compared with $16.8 million, or 1.88%, at December 31, 2013, and $15.1 million, or 2.05%, at December 31, 2012. The provision for loan losses was $(400,000) in 2014, $1.2 million in 2013, and $0.8 million in 2012. Net recoveries in 2014 were $625,000, or 0.06% of average total loans excluding cover assets, compared with net recoveries of $537,000, or 0.07%, in 2013, and net recoveries of $1.4 million, or 0.21%, in 2012. The Company considers the allowance for loan losses of $17.1 million adequate to cover losses inherent in loans, commitments to extend credit, and standby letters of credit at December 31, 2014. **Table 9** provides a summary of the loan loss experience for the past five years.

LIQUIDITY RISK

The Company's liquidity risk management process is designed to identify, measure, and manage the Company's funding and liquidity risk to meet its daily funding needs and to address expected and unexpected changes in its funding requirements. The Asset/Liability Committee ("ALCO") establishes policies, as well as analyzes and manages the Company's liquidity to ensure adequate funds are always available at reasonable rates to meet normal operating requirements in addition to unexpected customer demands for funds, such as high levels of deposit withdrawals or loan demand, in a timely and cost effective manner. Liquidity needs are provided for on both the asset and liability side of the balance sheet. Asset liquidity is provided by regular maturities of loans and maintaining relatively short-term, marketable investments and federal funds. As of December 31, 2014, the Company had $60.1 million of un-pledged, available-for-sale securities. Liability liquidity is provided through short-term federal fund borrowings and borrowing capacity at the Federal Home Loan Bank. As of December 31, 2014, the Company had $87 million of unsecured lines of credit for federal funds that may be drawn as needed and borrowing capacity at the Federal Home Loan Bank of $120.3 million.

TABLE 9 – SUMMARY OF LOAN LOSS EXPERIENCE
As of December 31 (dollars in thousands)

	2014	2013	2012	2011	2010
Average loans excluding covered assets	$ 976,257	$ 807,278	$ 680,749	$ 606,259	$ 547,599
Allowance for loan losses					
Balance at beginning of year	$ 16,838	$ 15,101	$ 12,826	$ 8,841	$ 11,053
Charge-offs					
Commercial and financial	(408)	(538)	(440)	(739)	(2,592)
Agricultural	(73)	-	(22)	(7)	(14)
Real estate	(351)	(16)	(1,191)	(321)	(7,256)
Consumer loans	(188)	(531)	(409)	(199)	(82)
Total Charge-Offs	$ (1,020)	$ (1,085)	$ (2,062)	$ (1,266)	$ (9,944)
Recoveries					
Commercial and financial	$ 968	$ 1,187	$ 230	$ 371	$ 684
Agricultural	20	19	1	13	12
Real estate	512	275	3,084	318	163
Consumer loans	145	141	189	131	53
Total Recoveries	$ 1,645	$ 1,622	$ 3,504	$ 833	$ 912
(Net charge-offs)/Recoveries	625	537	1,442	(433)	(9,032)
Provision charged to earnings	(400)	1,200	833	4,418	6,820
Balance at end of year	$ 17,063	$ 16,838	$ 15,101	$ 12,826	$ 8,841
Ratio of net charge-offs to average loans					
Commercial and financial	-0.16%	-0.22%	0.09%	0.17%	1.02%
Agricultural	0.13%	-0.04%	0.05%	-0.01%	0.01%
Real estate	-0.03%	-0.06%	-0.52%	0.00%	2.34%
Consumer loans	0.06%	0.74%	0.55%	0.24%	0.12%
Total loans	-0.06%	-0.07%	-0.21%	0.07%	1.65%
Ratio of allowance for loan losses to end-of-year non-covered loans	1.57%	1.88%	2.05%	2.05%	1.65%

INTEREST RATE RISK

The Company's major market risk exposure is changing interest rates. To minimize the volatility of net interest income and exposure to economic loss, the Company manages its exposure to interest rate risk through asset/liability management activities within the guidelines established by ALCO.

Interest rate risk can be broken down into four components which are as follows: 1) repricing risk results from the difference in the timing of rate changes and the timing of cash flows that occur in the pricing and maturity of the bank's assets and liabilities, 2) basis risk occurs when market rates for different financial instruments, or the indices used to price assets and liabilities change at different times or by different amounts, 3) option risk occurs when customers have the right to alter the level and/or timing of the cash flows of an asset or a liability, and 4) term structure risk occurs from variations in the movement of interest rates across maturity spectrums. Interest rate risk is managed within an overall asset/liability framework for the Company. The Company positions the balance sheet to be interest rate neutral to slightly asset sensitive, defined as allowing assets on the balance sheet to reprice faster than the liabilities. The Company chooses to manage the balance sheet to be slightly asset sensitive to take advantage of a normally upward sloping yield curve.

The Company employs a sensitivity analysis in the form of a net interest income simulation to help quantify the existing interest rate risk embedded in the Company's balance sheet and to help identify ways to minimize the risk. The monthly analysis incorporates substantially all of the Company's assets and liabilities and off-balance sheet instruments, together with forecasted changes in the balance sheet and assumptions that reflect the current interest rate environment. The simulation model is used to measure the impact on net interest income, relative to a base case scenario, of interest rates increasing or decreasing 100, 200, and 300 basis points over the next 12 months. The simulation run at December 31, 2014, illustrates a negative 5.55% change in net interest income for a 100 basis point decline in interest rates, and a positive 3.69% change in net interest income for a 100 basis point rise in interest rates. The base case interest rates for the simulation included the prime rate at 3.25% and the federal funds rate at 0.25%.

TABLE 10 – CONSOLIDATED AVERAGE BALANCE SHEET
As of December 31 (dollars in thousands)

ASSETS	2014	2013	2012	2011	2010
Cash and due from banks	$ 23,408	$ 21,098	$ 32,429	$ 34,326	$ 53,466
Interest bearing deposits with banks	19,787	56,339	42,121	59,423	38,561
Federal funds sold	17	8	2,675	553	1,238
Investment securities:					
Taxable	230,998	242,082	242,121	254,668	241,819
Exempt from federal tax	27,707	22,896	19,909	17,763	19,596
Total Investment Securities	258,705	264,978	262,030	272,431	261,415
Loans held for sale	27,090	43,361	51,548	26,447	35,106
Loans – excluding covered assets					
Commercial and financial	341,516	292,449	34,126	210,851	187,058
Agricultural	40,731	43,741	42,078	41,670	33,333
Real estate	525,873	418,397	364,411	325,633	303,293
Consumer loans	68,137	52,691	40,134	28,105	23,915
Total Loans	976,257	807,278	680,749	606,259	547,599
Allowance for loan losses	(16,792)	(15,673)	(14,611)	(10,665)	(11,209)
Net Loans – Excluding Covered Assets	959,465	791,605	666,138	595,594	536,390
Covered loans	17,790	25,167	37,901	52,685	68,995
Bank premises and equipment	22,174	22,440	21,908	22,763	19,233
Goodwill and other intangibles	18,271	15,251	16,795	12,213	15,025
FDIC indemnification asset	200	1,530	9,295	12,583	23,011
Interest receivable and other assets	77,424	66,382	54,967	39,817	26,985
Total Assets	$ 1,424,331	$ 1,308,159	$ 1,197,807	$ 1,128,835	$ 1,079,425
LIABILITIES AND SHAREHOLDERS' EQUITY					
Deposits					
Non-interest-bearing deposits	$ 278,005	$ 221,199	$ 195,939	$ 162,106	$ 126,513
Savings, NOW, and money market deposits	690,898	642,934	556,282	548,362	503,143
Time deposits	222,943	237,040	251,628	272,072	300,636
Total Deposits	1,191,846	1,101,173	1,003,849	982,540	930,292
Federal funds purchased and other short-term borrowings	29,007	13,964	19,203	9,406	1,679
Other borrowed funds	21,562	22,650	21,817	22,449	41,249
Other liabilities	17,713	20,072	16,314	8,510	12,258
Total Liabilities	$ 1,260,128	$ 1,157,859	$ 1,061,183	$ 1,022,905	$ 985,478
Preferred stock and related surplus	$ 20,000	$ 20,000	$ 20,000	$ 7,419	-
Common stock and surplus	30,990	25,733	23,509	20,973	19,585
Retained earnings	113,213	104,567	93,115	77,538	74,362
Total Shareholders' Equity	$ 164,203	$ 150,300	$ 136,624	$ 105,930	$ 93,947
Total Liabilities and Shareholders' Equity	$ 1,424,331	$ 1,308,159	$ 1,197,807	$ 1,128,835	$ 1,079,425

The Company has successfully implemented interest rate floors in a substantial number of underlying loan contracts at rates above market indications. These interest rate floors have preserved net interest rate margin in the current environment but will cause slight interest rate compression when interest rates begin to rise since these loans will not reprice until the floor rate is surpassed.

REGULATORY CHANGES

Financial institutions, their holding companies and their affiliates, along with securities broker dealers, registered investment advisors, and insurance agencies, are extensively regulated under federal and state law. As a result, the growth and earnings performance of the Company may be affected not only by management decisions and general economic conditions, but also by requirements of federal and state statutes and by the regulations and policies of various bank regulatory agencies, including the Office of the Comptroller of the Currency (the "OCC"), the Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Federal Deposit Insurance Corporation (the "FDIC"), and the recently created Bureau of Consumer Financial Protection (the "CFPB"). Furthermore, taxation laws administered by the Internal Revenue Service and state taxing authorities, accounting rules developed by the Financial Accounting Standards Board (the "FASB"), and securities laws administered by the Securities and Exchange Commission (the "SEC") and state securities authorities have an impact on the business of the Company. The effect of these statutes, regulations, regulatory policies, and accounting rules are significant to the operations and results of the Company, its subsidiary bank, Alerus Financial, N.A. (the "Bank"), and its indirect subsidiaries, Alerus Securities, Alerus Investment Advisors, and Alerus Insurance Services.

Federal and state banking laws impose a comprehensive system of supervision, regulation, and enforcement on the operations of financial institutions, their holding companies, and affiliates that is intended primarily for the protection of the FDIC-insured deposits and depositors of banks, rather than shareholders. These federal and state laws, and the regulations of the bank regulatory agencies issued under them, affect, among other things, the scope of business, the kinds and amounts of investments banks may make, reserve requirements, capital levels relative to operations, the nature and amount of collateral for loans, the establishment of branches, the ability to merge, consolidate and acquire, dealings with insiders and affiliates, and the payment of dividends. Federal and state securities and insurance laws impose a comprehensive system of supervision, regulation, and enforcement on the operations of securities broker dealers, registered investment advisors, and insurance agencies' financial institutions, that is intended primarily for the protection of customers, rather than shareholders.

The following is a summary of the material elements of the supervisory and regulatory framework applicable to the Company and the Bank. It does not describe all of the statutes, regulations, and regulatory policies that apply, nor does it restate all of the requirements of those that are described. The descriptions are qualified in their entirety by reference to the particular statutory and regulatory provision.

FINANCIAL REGULATORY REFORM

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") into law. The Dodd-Frank Act represented a sweeping reform of the U.S. supervisory and regulatory framework applicable to financial institutions and capital markets in the wake of the global financial crisis. In particular, and among other things, the Dodd-Frank Act: (i) created a Financial Stability Oversight Council as part of a regulatory structure for identifying emerging systemic risks and improving interagency cooperation; (ii) created the CFPB, which is authorized to regulate providers of consumer credit, savings, payment, and other consumer financial products and services; (iii) narrowed the scope of federal preemption of state consumer laws enjoyed by national banks and federal savings associations and expanded the authority of state attorneys general to bring actions to enforce federal consumer protection legislation; (iv) imposed more stringent capital requirements on bank holding companies and subjected certain activities, including interstate mergers and acquisitions, to heightened capital conditions; (v) with respect to mortgage lending, (a) significantly expanded requirements applicable to loans secured by 1-4 family residential real property, (b) imposed strict rules on mortgage servicing, and (c) required the originator of a securitized loan, or the sponsor of a securitization, to retain at least 5% of the credit risk of securitized exposures unless the underlying exposures are qualified residential mortgages or meet certain underwriting standards; (vi) repealed the prohibition on the payment of interest on business checking accounts; (vii) restricted the interchange fees payable on debit card transactions for issuers with $10 billion in assets or greater; (viii) in the so-called "Volcker Rule," subject to numerous exceptions, prohibited depository institutions and affiliates from certain investments in, and sponsorship of, hedge funds and private equity funds and from engaging in proprietary trading; (ix) provided for enhanced regulation of advisers to private funds and of the derivatives markets; (x) enhanced oversight of credit rating agencies; and (xi) prohibited banking agency requirements tied to credit ratings. These statutory changes shifted the regulatory framework for financial institutions, impacted the way in which they do business and have the potential to constrain revenues. Numerous provisions of the Dodd-Frank Act are required to be implemented through rulemaking by the appropriate federal regulatory agencies. Furthermore, while the reforms primarily target systemically important financial service providers, their influence is expected to filter down in varying degrees to smaller institutions over time.

THE INCREASING REGULATORY EMPHASIS ON CAPITAL

Regulatory capital represents the net assets of a financial institution available to absorb losses. Because of the risks attendant to their businesses, depository institutions are generally required to hold more capital than other businesses, which directly affects earnings capabilities. Certain provisions of the Dodd-Frank Act and Basel III establish strengthened capital standards for banks and bank holding companies, require more capital to be held in the form of common stock, and disallow certain funds from being included in capital determinations. Once fully implemented, these standards will represent regulatory capital requirements that are meaningfully more stringent than those in place historically.

THE COMPANY AND BANK REQUIRED CAPITAL LEVELS

Bank holding companies have historically had to comply with less stringent capital standards than their bank subsidiaries and were able to raise capital with hybrid instruments such as trust preferred securities. The Dodd-Frank Act mandated the Federal Reserve to establish minimum capital levels for bank holding companies on a consolidated basis that are as stringent as those required for insured depository institutions.

Under current federal regulations, the Bank is subject to the following minimum capital standards:

- A leverage requirement, consisting of a minimum ratio of Tier 1 Capital to total adjusted book assets of 3% for the most highly-rated banks with a minimum requirement of at least 4% for all others; and
- A risk-based capital requirement, consisting of a minimum ratio of Total Capital to total risk-weighted assets of 8% and a minimum ratio of Tier 1 Capital to total risk-weighted assets of 4%.

TABLE 11 – CONSOLIDATED STATEMENT OF INCOME
For years ended December 31 (dollars in thousands except per-share data)

INTEREST INCOME	2014	2013	2012	2011	2010
Deposits with banks	$ 52	$ 148	$ 100	$ 154	$ 93
Investment securities					
Taxable	5,649	5,905	6,853	7,754	7,155
Exempt from federal income taxes	817	707	699	700	782
Total Investment Securities	6,466	6,612	7,552	8,454	7,937
Federal funds sold	–	–	3	1	2
Loans held for sale	936	1,206	1,581	1,076	1,553
Loans and leases, including fees	46,940	42,544	43,616	37,696	36,398
Total Interest Income	$ 54,394	$ 50,510	$ 52,852	$ 47,381	$ 45,983
INTEREST EXPENSE					
Deposits	$ 2,673	$ 3,101	$ 3,874	$ 6,070	$ 9,464
Federal funds purchased and other short-term borrowings	22	30	65	39	47
Other borrowed funds	621	581	647	712	1,274
Total Interest Expense	$ 3,316	$ 3,712	$ 4,586	$ 6,821	$ 10,785
Net interest income	51,078	46,798	48,266	40,560	35,198
Provision for loan losses	(400)	1,200	833	4,418	6,820
Net Interest Income After Provision for Loan Losses	$ 51,478	$ 45,598	$ 47,433	$ 36,142	$ 28,378
NON-INTEREST INCOME					
Retirement services and wealth management income	$ 52,343	$ 46,627	$ 42,621	$ 34,925	$ 32,840
Service charges on deposit accounts	1,626	1,639	1,626	1,655	1,940
Mortgage origination and loan servicing fees	18,435	27,177	31,061	15,746	18,073
Other	3,823	3,896	3,590	4,469	3,030
Investment security gains (losses)	2,179	(70)	217	(11)	(2,782)
Total Non-Interest Income	$ 78,406	$ 79,269	$ 79,115	$ 56,784	$ 53,101
NON-INTEREST EXPENSE					
Salaries and employee benefits	$ 60,419	$ 59,824	$ 59,374	$ 45,164	$ 44,161
Net occupancy expense	4,424	3,791	4,189	4,112	3,959
Furniture and equipment expense	4,658	4,687	4,147	3,698	3,297
Other	30,614	24,611	33,124	23,766	21,231
Total Non-Interest Expense	$ 100,115	$ 92,913	$ 100,834	$ 76,740	$ 72,649
Income before income taxes and extraordinary items	29,769	31,954	25,714	16,186	8,830
Applicable income taxes	9,538	11,684	9,458	5,477	2,958
Net Income	$ 20,231	$ 20,270	$ 16,256	$ 10,709	$ 5,873
Net Income Applicable to Common Shareholders	**$ 20,031**	**$ 20,070**	**$ 15,917**	**$ 10,636**	**$ 5,873**

For these purposes, "Tier 1 Capital" consists primarily of common stock, noncumulative perpetual preferred stock, and related surplus less intangible assets (other than certain loan servicing rights and purchased credit card relationships). Total Capital consists primarily of Tier 1 Capital plus "Tier 2 Capital," which includes other nonpermanent capital items, such as certain other debt and equity instruments that do not qualify as Tier 1 Capital, and a portion of the Bank's allowance for loan and lease losses. Further, "risk-weighted assets" for the purposes of the risk-weighted ratio calculations are balance sheet assets and off-balance sheet exposures to which required risk-weightings of 0% to 100% are applied. These capital standards are minimum requirements and will be increased under Basel III, as discussed below. Bank regulatory agencies are uniformly encouraging banks and bank holding companies to be "well-capitalized" and, to that end, federal law and regulations provide various incentives for banking organizations to maintain regulatory capital at levels in excess of minimum regulatory requirements. Under the capital regulations of the OCC and Federal Reserve, in order to be "well capitalized," a banking organization, under current federal regulations, must maintain:

- A leverage ratio of Tier 1 Capital to total assets of 5% or greater;
- A ratio of Tier 1 Capital to total risk-weighted assets of 6% or greater; and
- A ratio of Total Capital to total risk-weighted assets of 10% or greater.

The OCC and Federal Reserve guidelines also provide that banks and bank holding companies experiencing internal growth or making acquisitions will be expected to maintain capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. Furthermore, the guidelines indicate that the agencies will continue to consider a "tangible Tier 1 leverage ratio" (deducting all intangibles) in evaluating proposals for expansion or to engage in new activities. Higher capital levels may also be required if warranted by the particular circumstances or risk profiles of individual banking organizations.

PROMPT CORRECTIVE ACTION

A banking organization's capital plays an important role in connection with regulatory enforcement as well. Federal law provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators' powers depends on whether the institution in question is "adequately capitalized," "undercapitalized," "significantly undercapitalized," or "critically undercapitalized," in each case as defined by regulation. Depending upon the capital category to which an institution is assigned, the regulators' corrective powers include: (i) requiring the institution to submit a capital restoration plan; (ii) limiting the institution's asset growth and restricting its activities; (iii) requiring the institution to issue additional capital stock (including additional voting stock) or to be acquired; (iv) restricting transactions between the institution and its affiliates; (v) restricting the interest rate that the institution may pay on deposits; (vi) ordering a new election of directors of the institution; (vii) requiring that senior executive officers or directors be dismissed; (viii) prohibiting the institution from accepting deposits from correspondent banks; (ix) requiring the institution to divest certain subsidiaries; (x) prohibiting the payment of principal or interest on subordinated debt; and (xi) ultimately, appointing a receiver for the institution.

As of December 31, 2014: (i) the Bank exceeded its minimum regulatory capital requirements under OCC capital adequacy guidelines; and (ii) the Bank was "well-capitalized," as defined by OCC regulations. As of December 31, 2014, the Company had regulatory capital in excess of the Federal Reserve's requirements and met the Dodd-Frank Act's capital requirements.

THE BASEL III INTERNATIONAL CAPITAL ACCORD

After an extended rulemaking process, the U.S. federal banking agencies approved the implementation of the Basel III regulatory capital reforms in pertinent part, and, at the same time, promulgated rules effecting certain changes required by the Dodd-Frank Act (the "Basel III Rule").

The Basel III Rule not only increases most of the required minimum capital ratios, but it also introduces the concept of Common Equity Tier 1 Capital, which consists primarily of common stock, related surplus (net of treasury stock), retained earnings, and Common Equity Tier 1 minority interests subject to certain regulatory adjustments. The Basel III Rule also expanded the definition of capital as in effect currently by establishing more stringent criteria that instruments must meet to be considered Additional Tier 1 Capital (Tier 1 Capital in addition to Common Equity) and Tier 2 Capital. A number of instruments that now qualify as Tier 1 Capital will not qualify, or their qualifications will change. For example, cumulative preferred stock and certain hybrid capital instruments, including trust preferred securities, will no longer qualify as Tier 1 Capital of any kind, with the exception, subject to certain restrictions, of such instruments issued before May 10, 2010, by bank holding companies with total consolidated assets of less than $15 billion as of December 31, 2009. For those institutions, trust preferred securities and other nonqualifying capital instruments currently included in consolidated Tier 1 Capital are permanently grandfathered under the Basel III Rule, subject to certain restrictions. Noncumulative perpetual preferred stock, which now qualifies as simple Tier 1 Capital, will not qualify as Common Equity Tier 1 Capital, but will qualify as Additional Tier 1 Capital. The Basel III Rule also constrains the inclusion of minority interests, mortgage-servicing assets, and deferred tax assets in capital and requires deductions from Common Equity Tier 1 Capital in the event such assets exceed a certain percentage of a bank's Common Equity Tier 1 Capital.

The Basel III Rule requires:

- A new required ratio of minimum Common Equity Tier 1 equal to 4.5% of risk-weighted assets;
- An increase in the minimum required amount of Tier 1 Capital from the current level of 4% of total assets to 6% of risk-weighted assets;
- A continuation of the current minimum required amount of Total Capital (Tier 1 plus Tier 2) at 8% of risk-weighted assets; and
- A minimum leverage ratio of Tier 1 Capital to total assets equal to 4% in all circumstances.

In addition, institutions that seek the freedom to make capital distributions (including for dividends and repurchases of stock) and pay discretionary bonuses to executive officers without restriction must also maintain 2.5% of risk-weighted assets in Common Equity Tier 1 attributable to a capital conservation buffer to be phased-in over three years beginning in 2016. The purpose of the conservation buffer is to ensure that banks maintain a buffer of capital that can be used to absorb losses during periods of financial and economic stress. Factoring in the fully phased-in conservation buffer increases the minimum ratios depicted above to 7% for Common Equity Tier 1, 8.5% for Tier 1 Capital, and 10.5% for Total Capital. The leverage ratio is not impacted by the conservation buffer.

The Basel III Rule maintained the general structure of the current prompt corrective action framework, while incorporating the increased requirements. The prompt corrective action guidelines were also revised to add the Common Equity Tier 1 Capital ratio. In order to be a "well-capitalized" depository institution under the new regime, a bank and holding company must maintain a Common Equity Tier 1 Capital ratio of 6.5% or more, a Tier 1 Capital ratio of 8% or more, a Total Capital ratio of 10% or more, and a leverage ratio of 5% or more. It is possible under the Basel III Rule to be well-capitalized while remaining out of compliance with the capital conservation buffer discussed above.

The Basel III Rule revises a number of the risk weightings (or their methodologies) for bank assets that are used to determine the capital ratios. For nearly every class of assets, the Basel III Rule requires a more complex, detailed and calibrated assessment of credit risk and calculation of risk weightings.

Furthermore, there was significant concern noted by the financial industry in connection with the Basel III rulemaking as to the proposed treatment of accumulated other comprehensive income ("AOCI"). Basel III requires unrealized gains and losses on available-for-sale securities to flow through to regulatory capital as opposed to the current treatment, which neutralizes such effects. Recognizing the problem for community banks, the U.S. bank regulatory agencies adopted the Basel III Rule with a one-time election for smaller institutions like the Company and the Bank to opt out of, including most elements of AOCI in regulatory capital. This opt-out, which must be made in the first quarter of 2015, would exclude from regulatory capital both unrealized gains and losses on available-for-sale debt securities and accumulated net gains and losses on cash-flow hedges and amounts attributable to defined benefit post-retirement plans. The Company intends to make the opt-out election.

Generally, financial institutions (except for large, internationally active financial institutions) became subject to the new rules on January 1, 2015. However, there will be separate phase-in/phase-out periods for: (i) the capital conservation buffer; (ii) regulatory capital adjustments and deductions; (iii) nonqualifying capital instruments; and (iv) changes to the prompt corrective action rules. The phase-in periods commence on January 1, 2016, and extend until 2019.

THE COMPANY

GENERAL

The Company, as the sole shareholder of the Bank, is a bank holding company. As a bank holding company, the Company is registered with, and is subject to regulation by, the Federal Reserve under the Bank Holding Company Act of 1956, as amended (the "BHCA"). In accordance with Federal Reserve policy, and as now codified by the Dodd-Frank Act, the Company is legally obligated to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances where the Company might not otherwise do so. Under the BHCA, the Company is subject to periodic examination by the Federal Reserve. The Company is required to file with the Federal Reserve periodic reports of the Company's operations and such additional information regarding the Company and its subsidiaries as the Federal Reserve may require.

DIVIDEND PAYMENTS

The Company's ability to pay dividends to its shareholders may be affected by both general corporate law considerations and the policies of the Federal Reserve applicable to bank holding companies. As a Delaware corporation, the Company is subject to the limitations of the Delaware General Corporation Law (the "DGCL"). The DGCL allows the Company to pay dividends only out of its surplus (as defined and computed in accordance with the provisions of the DGCL) or, if the Company has no such surplus, out of its net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year.

As a general matter, the Federal Reserve has indicated that the board of directors of a bank holding company should eliminate, defer, or significantly reduce dividends to shareholders if: (i) the company's net income available to shareholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends; (ii) the prospective rate of earnings retention is inconsistent with the company's capital needs and overall current and prospective financial condition; or (iii) the company will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. The Federal Reserve also possesses enforcement powers over bank holding companies and their nonbank subsidiaries to prevent or remedy actions that represent unsafe or unsound practices or violations of applicable statutes and regulations. Among these powers is the ability to proscribe the payment of dividends by banks and bank holding companies.

THE BANK

GENERAL

The Bank is a national bank, chartered by the OCC under the National Bank Act. The deposit accounts of the Bank are insured by the FDIC's Deposit Insurance Fund (the "DIF") to the maximum extent provided under federal law and FDIC regulations, and the Bank is a member of the Federal Reserve System. As a national bank, the Bank is subject to the examination, supervision, reporting, and enforcement requirements of the OCC. The FDIC, as administrator of the DIF, also has regulatory authority over the Bank.

DEPOSIT INSURANCE

As an FDIC-insured institution, the Bank is required to pay deposit insurance premium assessments to the FDIC. The FDIC has adopted a risk-based assessment system whereby FDIC-insured depository institutions pay insurance premiums at rates based on their risk classification. An institution's risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to the regulators.

The Dodd-Frank Act permanently increases the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per insured depositor, retroactive to January 1, 2009.

BANK DIVIDEND PAYMENTS

The primary source of funds for the Company is dividends from the Bank. Under the National Bank Act, a national bank may pay dividends out of its undivided profits in such amounts and at such times as the bank's board of directors deems prudent. Without prior OCC approval, however, a national bank may not pay dividends in any calendar year that, in the aggregate, exceed the bank's year-to-date net income plus the bank's retained net income for the two preceding years.

The payment of dividends by any financial institution is affected by the requirement to maintain adequate capital pursuant to applicable capital adequacy guidelines and regulations, and a financial institution generally is prohibited from paying any dividends if, following payment thereof, the institution would be undercapitalized. As described above, the Bank exceeded its minimum capital requirements under applicable guidelines as of December 31, 2014. Notwithstanding the availability of funds for dividends, however, the OCC may prohibit the payment of dividends by the Bank if it determines such payment would constitute an unsafe or unsound practice.

SAFETY AND SOUNDNESS STANDARDS/RISK MANAGEMENT

The federal banking agencies have adopted guidelines that establish operational and managerial standards to promote the safety and soundness of federally insured depository institutions. The guidelines set forth standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation, fees and benefits, asset quality and earnings.

During the past decade, the bank regulatory agencies have increasingly emphasized the importance of sound risk management processes and strong internal controls when evaluating the activities of the institutions they supervise. Properly managing risks has been identified as critical to the conduct of safe and sound banking activities and has become even more important as new technologies, product innovation, and the size and speed of financial transactions have changed the nature of banking markets. The agencies have identified a spectrum of risks facing a banking institution including, but not limited to, credit, market, liquidity, operational, legal, and reputational risk.

COMMUNITY REINVESTMENT ACT REQUIREMENTS

The Community Reinvestment Act requires the Bank to have a continuing and affirmative obligation in a safe and sound manner to help meet the credit needs of its entire community, including low- and moderate-income neighborhoods. Federal regulators regularly assess the Bank's record of meeting the credit needs of its communities. Applications for additional acquisitions would be affected by the evaluation of the Bank's effectiveness in meeting its Community Reinvestment Act requirements.

FORWARD-LOOKING STATEMENTS

The following information appears in accordance with the Private Securities Litigation Reform Act of 1995:

This annual report contains forward-looking statements about Alerus Financial Corporation. Statements that are not historical or current facts, including statements about beliefs and expectations, are forward-looking statements and are based on the information available to, and assumptions and estimates made by, management as of the date made. These forward-looking statements cover, among other things, anticipated future revenue and expenses and the future plans and prospects of Alerus Financial Corporation. Forward-looking statements involve inherent risks and uncertainties, and important factors could cause actual results to differ materially from those anticipated. Global and domestic economies could fail to recover from the recent economic downturn or could experience another severe contraction, which could adversely affect Alerus Financial Corporation's revenues and the values of its assets and liabilities. Global financial markets could experience a recurrence of significant turbulence, which could reduce the availability of funding to certain financial institutions and lead to a tightening of credit, a reduction of business activity, and increased market volatility. Alerus Financial Corporation's results could also be adversely affected by continued deterioration in general business and economic conditions; changes in interest rates; deterioration in the credit quality of its loan portfolios or in the value of the collateral securing those loans; deterioration in the value of securities held in its investment securities portfolio; legal and regulatory developments; increased competition from both banks and non-banks; cyber-attacks; changes in customer behavior and preferences; effects of mergers and acquisitions and related integration; effects of critical accounting policies and judgments; and management's ability to effectively manage credit risk, residual value risk, market risk, operational risk, interest rate risk, liquidity risk, and cybersecurity.

Forward-looking statements speak only as of the date they are made, and Alerus Financial Corporation undertakes no obligation to update them in light of new information or future events.

CONSUMER FINANCIAL SERVICES

There are numerous developments in federal and state laws regarding consumer financial products and services that impact the Bank's business. Importantly, the current structure of federal consumer protection regulation applicable to all providers of consumer financial products and services changed significantly on July 21, 2011, when the CFPB commenced operations to supervise and enforce consumer protection laws. The CFPB has broad rulemaking authority for a wide range of consumer protection laws that apply to all providers of consumer products and services, including the Bank, as well as the authority to prohibit "unfair, deceptive, or abusive" acts and practices. The CFPB has examination and enforcement authority over providers with more than $10 billion in assets. Banks and savings institutions with $10 billion or less in assets, like the Bank, will continue to be examined by their applicable bank regulators. Below are additional recent regulatory developments relating to consumer mortgage lending activities. The Company does not currently expect these provisions to have a significant impact on Bank operations; however, additional compliance resources will be needed to monitor changes.

ABILITY-TO-REPAY REQUIREMENT AND QUALIFIED MORTGAGE RULE

The Dodd-Frank Act contains additional provisions that affect consumer mortgage lending. First, it significantly expands underwriting requirements applicable to loans secured by 1-4 family residential real property and augments federal law combating predatory lending practices. In addition to numerous new disclosure requirements, the Dodd-Frank Act imposes new standards for mortgage loan originations on all lenders, including banks and savings associations, in an effort to strongly encourage lenders to verify a borrower's ability to repay, while also establishing a presumption of compliance for certain "qualified mortgages."

On January 10, 2013, the CFPB issued a final rule, effective January 10, 2014, that implements the Dodd-Frank Act's ability-to-repay requirements and clarifies the presumption of compliance for "qualified mortgages." In assessing a borrower's ability to repay a mortgage-related obligation, lenders generally must consider eight underwriting factors: (i) current or reasonably expected income or assets; (ii) current employment status; (iii) monthly payment on the subject transaction; (iv) monthly payment on any simultaneous loan; (v) monthly payment for all mortgage-related obligations; (vi) current debt obligations, alimony, and child support; (vii) monthly debt-to-income ratio or residual income; and (viii) credit history. Further, the final rule also clarifies that qualified mortgages do not include "no-doc" loans and loans with negative amortization, interest-only payments, balloon payments, terms in excess of 30 years, or points and fees paid by the borrower that exceed 3% of the loan amount, subject to certain exceptions. In addition, for qualified mortgages, the monthly payment must be calculated on the highest payment that will occur in the first five years of the loan, and the borrower's total debt-to-income ratio generally may not be more than 43%.

Jerrod Hanson

Jerrod Hanson, Controller
Alerus Financial Corporation
February 20, 2015

INDEPENDENT AUDITORS' REPORT

REPORT ON CONSOLIDATED FINANCIAL STATEMENTS

We have audited the accompanying consolidated financial statements of Alerus Financial Corporation and Subsidiaries, which comprise the consolidated balance sheet of December 31, 2014, and the related consolidated statement of income, comprehensive income, change in stockholders' equity, and cash flows for the year then ended, and the related notes to the consolidated financial statements.

MANAGEMENT'S RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Alerus Financial Corporation and Subsidiaries as of December 31, 2014, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

EMPHASIS OF MATTER

Correction of Error
As described in Note 19 to the consolidated financial statements, Alerus Financial Corporation and Subsidiaries discovered and corrected an error in the 2012 and 2013 consolidated financial statements related to recognition of the FDIC true-up liability arising from the loss share agreements with the FDIC. Our opinion is not modified with respect to that matter.

OTHER MATTERS

Report on Internal Control over Financial Reporting
We also have audited in accordance with attestation standards established by the American Institute of Certified Public Accountants, Alerus Financial Corporation and Subsidiaries' internal control over financial reporting as of December 31, 2014, based on criteria established in *2013 Internal Control – Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 20, 2015, except for Notes 13 and 19, as to which the date is March 31, 2015, expressed an adverse opinion on the Company's internal control over financial reporting because of a material weakness.

Prior Period Consolidated Financial Statements
The consolidated financial statements of Alerus Financial Corporation and Subsidiaries as of December 31, 2013 and 2012 were audited by other auditors whose report, dated February 18, 2014, expressed an unqualified opinion on those statements, before the restatement described in Note 19 to the consolidated financial statements.

As part of our audit of the 2014 consolidated financial statements, we also audited adjustments described in Note 19 that were applied to restate the 2012 and 2013 consolidated financial statements. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 2012 and 2013 consolidated financial statements of the Company other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2012 and 2013 consolidated financial statements as a whole.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP
Minneapolis, Minnesota
March 31, 2015 Independent Auditors' REPORT

FDICIA COMPLIANCE ASSERTIONS

2014 MANAGEMENT ASSERTION FDICIA COMPLIANCE

Statement of Management's Responsibilities

Management of Alerus Financial (the "Bank") is responsible for preparing the Bank's annual financial statements in accordance with generally accepted accounting principles; for establishing and maintaining an adequate internal control structure and procedures for financial reporting, including controls over the preparation of regulatory financial statements in accordance with Federal Financial Institutions Examination Council Instructions for Consolidated Reports of Condition and Income (call report instructions); and for complying with the Federal laws and regulations pertaining to insider loans and the Federal laws and regulations pertaining to dividend restrictions.

Management's Assessment of Compliance with Designated Laws and Regulations

Management of the Bank has assessed the Bank's compliance with the Federal laws and regulations pertaining to insider loans and the Federal laws and regulations pertaining to dividend restrictions during the fiscal year that ended December 31, 2014. Based upon its assessment, management has concluded that the Bank complied with the Federal laws and regulations pertaining to insider loans and the Federal laws and regulations pertaining to dividend restrictions during the fiscal year ended on December 31, 2014.

Management's Assessment of Control Over Financial Reporting

The Bank's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America and financial statements for regulatory reporting purposes, i.e. the Consolidated Reports of Condition and Income. The Bank's internal control over financial reporting includes those policies and procedures that 1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and disposition of the assets of the Bank; 2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America and financial statements for regulatory reporting purposes, and that receipts and expenditures of the Bank are being made only in accordance with authorization of management and directors of the Bank; and 3) provided reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use or disposition of the Bank's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures deteriorate.

Management assessed the effectiveness of the Bank's internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the call report as of December 31, 2014, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *2013 Internal Control- Integrated Framework*.

Because of the material weakness noted below, management determined that the institution's internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the Federal Financial Institutions Examination Council Instructions for Consolidated Reports of Condition and Income, was not effective as of December 31, 2014, based on the criteria established in *2013 Internal Control-Integrated Framework*.

Management determined controls surrounding business combination accounting over its failed bank acquisition in 2009 were not effective, which resulted in an overstatement of earnings in 2012 of approximately $1.6 million.

Management's assessment of the effectiveness of internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the call report, as of December 31, 2014, has been audited by CliftonLarsonAllen LLP, an independent public accounting firm, as stated in their report dated March 31, 2015.

Randy L. Newman

Randy Newman, Chief Executive Officer
Alerus Financial, N.A.
March 31, 2015

Jerrod Hanson

Jerrod Hanson, Controller
Alerus Financial, N.A.
March 31, 2015

INDEPENDENT AUDITORS' REPORT

We have audited management's assertion included in the accompanying 2014 Management Assertion FDICIA Compliance that Alerus Financial maintained effective internal control over financial reporting, including controls over the preparation of regulatory financial statements in accordance with the instructions for the Consolidated Reports of Condition and Income as of December 31, 2014, based on criteria established in 2013 Internal Control – Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Alerus Financial's management is responsible for maintaining effective internal control over financial reporting, and for its assertion about the effectiveness of internal control over financial reporting, included in the accompanying Management Assertion FDICIA Compliance. Our responsibility is to express an opinion on management's assertion based on our audit.

We conducted our audit in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe our audit provides a reasonable basis for our opinion.

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. Because management's assessment and our audit were conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), our audit of Alerus Financial's internal control over financial reporting included controls over the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America and with the Federal Financial Institutions Examination Council Instructions for Consolidated Reports of Condition and Income (call report instructions). An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that the transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Based on inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may be come inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. The following material weakness has been identified and included in the accompanying 2014 Management Assertion FDICIA Compliance:

Management determined controls surrounding business combination accounting over its failed bank acquisition in 2009 were not effective, which resulted in an overstatement of earnings in 2012 of approximately $1.6 million.

In our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, Alerus Financial has not maintained effective internal control over financial reporting as of December 31, 2014 based on criteria established in *2013 Internal Control - Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated financial statements of Alerus Financial. We considered the material weakness identified above in determining the nature, timing, and extent of audit tests applied in our audit of the 2014 consolidated financial statements, and this report does not affect our report dated March 31, 2015, which expressed unqualified opinion.

This report is intended solely for the information and use of the audit committee and management of Alerus Financial and its regulators and is not intended to be and should not be used by anyone other than these specified parties.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP
Minneapolis, Minnesota
March 31, 2015

SUMMARY CONSOLIDATED BALANCE SHEET

For years ended December 31 (dollars in thousands)

ASSETS	2014	2013	2012	2011	2010
Cash and deposits with banks	$ 45,526	$ 72,544	$ 123,679	$ 58,894	$ 141,094
Investments and federal funds sold	206,101	279,672	263,659	278,112	246,004
Loans held for sale	35,042	30,254	77,432	48,910	35,789
Net loans and leases - non-covered	1,072,963	877,705	722,985	612,554	526,840
Covered loans and leases	5,432	20,021	32,692	48,050	62,179
Covered other assets	-	3,319	7,439	9,050	7,638
FDIC indemnification asset	-	632	2,229	11,255	14,297
Bank premises, equipment and other assets	123,243	97,580	92,972	89,784	85,899
Total Assets	$ 1,488,307	$ 1,381,727	$ 1,323,087	$ 1,156,609	$ 1,119,739
LIABILITIES AND SHAREHOLDERS' EQUITY					
Deposits	$ 1,262,168	$ 1,182,603	$ 1,115,750	$ 985,110	$ 950,780
Federal funds/repo agreements	10,532	7,875	12,603	6,194	358
Other borrowed funds	21,494	21,630	21,755	21,871	32,261
Interest payable and other liabilities	23,027	16,308	31,698	16,184	39,350
Total Liabilities	$ 1,317,221	$ 1,228,416	$ 1,181,806	$ 1,029,359	$ 1,022,750
Preferred stock and surplus	$ 20,000	$ 20,000	$ 20,000	$ 20,000	-
Common stock and capital surplus	38,265	26,581	24,167	22,258	19,750
Retained earnings	115,258	109,840	94,623	82,972	76,578
Unearned stock compensation	(3,807)	(3,319)	(2,362)	(1,762)	(1,715)
Accumulated other comprehensive income	1,370	209	4,853	3,782	2,377
Total Shareholders' Equity	$ 171,086	$ 153,311	$ 141,281	$ 127,250	$ 96,989
Total Liabilities and Shareholders' Equity	$ 1,488,307	$ 1,381,727	$ 1,323,087	$ 1,156,609	$ 1,119,739

SUMMARY CONSOLIDATED INCOME STATEMENT

For years ended December 31 (dollars in thousands)

Interest income and expenses	2014	2013	2012	2011	2010
Interest income	$ 54,394	$ 50,510	$ 52,852	$ 47,381	$ 45,983
Interest expense	3,316	3,712	4,586	6,821	10,785
Provision for loan losses	(400)	1,200	833	4,418	6,820
Net Interest Income After Provision for Loan Losses	$ 51,478	$ 45,598	$ 47,433	$ 36,142	$ 28,378
Other operating income and expense					
Retirement services and wealth management income	$ 52,343	$ 46,627	$ 42,621	$ 34,925	$ 32,840
Other income	26,063	32,642	36,494	21,859	20,261
Other Non-Interest Income	$ 78,406	$ 79,269	$ 79,115	$ 56,784	$ 53,101
Salaries and employee benefits	$ 60,419	$ 59,824	$ 59,374	$ 45,164	$ 44,161
Occupancy and equipment expense	9,083	8,478	8,336	7,811	7,256
Other expenses	30,613	24,611	33,124	23,765	21,231
Other Operating Expenses	$ 100,115	$ 92,913	$ 100,834	$ 76,740	$ 72,648
Income before taxes and extraordinary items	$ 29,769	$ 31,954	$ 25,714	$ 16,186	$ 8,831
Income taxes	9,538	11,684	9,458	5,477	2,958
Net Income	$ 20,231	$ 20,270	$ 16,256	$ 10,709	$ 5,873
Net Income Applicable to Common Shareholders	$ 20,031	$ 20,070	$ 15,917	$ 10,636	$ 5,873

SUMMARY CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

For years ended December 31 (dollars in thousands)

	2014	2013	2012	2011	2010
Balance at January 1	$ 153,311	$ 141,281	$ 127,250	$ 96,989	$ 88,342
Net income for the year	20,231	20,270	16,256	10,709	5,873
Cash dividend declared preferred	(200)	(200)	(339)	(74)	-
Cash dividends declared common	(5,332)	(4,689)	(4,266)	(3,961)	(3,882)
Stock-based compensation expense	1,061	943	799	709	655
Increase from stock plans and other adjustments	854	351	509	21,823	327
Repurchase of stock	-	-	-	(350)	(41)
Comprehensive income	1,161	(4,645)	1,072	1,405	5,714
Balance at December 31	$ 171,086	$ 153,311	$ 141,281	$ 127,250	$ 96,989