FINANCIAL REPORT

ALERUS FINANCIAL CORPORATION
2015 ANNUAL FINANCIAL REPORT

ALERUS

TABLE 1 – SELECTED FINANCIAL DATA
Year ended December 31,
(dollars in thousands, except per share amounts)

	2015	2014	2013	2012	2011
Income Statement Data					
Interest income	$ 56,328	$ 54,394	$ 50,510	$ 52,852	$ 47,381
Interest expense	3,458	3,316	3,712	4,586	6,821
Net interest income	52,870	51,078	46,798	48,266	40,560
Provision for credit losses	4,200	(400)	1,200	833	4,418
Net interest income, after provision for credit losses	48,670	51,478	45,598	47,433	36,142
Non-interest income	93,255	78,406	79,269	79,115	56,784
Non-interest expense	118,134	100,115	92,913	100,834	76,740
Income before income taxes	23,791	29,769	31,954	25,714	16,186
Income tax expense	7,289	9,538	11,684	9,458	5,477
Net income	**$ 16,502**	**$ 20,231**	**$ 20,270**	**$ 16,256**	**$ 10,709**
Diluted earnings per common share	$ 1.17	$ 1.44	$ 1.46	$ 1.17	$ 0.80
Performance Ratios					
Net interest margin	3.81%	3.97%	3.94%	4.52%	4.04%
Return on average total assets	1.08	1.42	1.55	1.36	0.95
Return on average common equity	10.13	13.89	15.40	13.65	10.80
Return on average tangible common equity	12.99	16.67	17.99	16.78	12.96
Efficiency ratio	80.84	77.32	73.70	79.16	78.83
Balance Sheet Data					
Cash and due from banks	$ 266,159	$ 45,526	$ 72,544	$ 123,679	$ 58,894
Investment securities	192,343	206,101	279,672	263,659	278,112
Mortgages held for sale	48,642	35,042	30,254	77,432	48,910
Loans	1,126,921	1,095,458	914,564	770,778	673,431
Allowance for loan and lease losses	(14,688)	(17,063)	(16,838)	(15,101)	(12,826)
Goodwill	3,683	3,264	664	664	664
Other intangible assets	21,751	22,442	15,014	15,251	11,316
Total assets	1,744,863	1,487,732	1,381,727	1,323,087	1,156,609
Deposits	1,458,021	1,262,168	1,182,603	1,115,750	985,110
Subordinated notes payable	49,375	-	-	-	-
Total liabilities	1,562,042	1,316,646	1,228,416	1,181,806	1,029,359
Stockholders' equity	182,821	171,086	153,311	141,281	1,322,095
Capital					
Common equity tier 1 ratio	10.9%	N/A	N/A	N/A	N/A
Tier 1 capital ratio	12.3	11.8%	12.8%	12.8%	13.7%
Total capital ratio	17.0	13.0	14.1	14.1	14.9
Tier 1 leverage ratio	10.9	10.1	10.6	9.9	9.9
Tangible common equity / tangible assets	8.2	8.8	8.8	9.2	8.5
Asset Quality					
Nonperforming assets	$ 12,028	$ 6,484	$ 10,265	$ 16,326	$ 24,979
OREO	842	2,478	4,877	9,386	11,916
Nonperforming assets / loans and other real estate	1.07%	0.59%	1.12%	2.09%	3.64%
Net charge-offs (recoveries) / average total loans	0.58	-0.06	-0.06	-0.20	0.07
Allowance for loan and lease losses / total loans	1.30	1.56	1.84	1.96	1.90
Other					
Assets under management	$ 2,734,850	$ 2,583,808	$ 2,424,642	$ 1,991,841	$ 1,747,377
Assets under administration	17,459,308	15,518,303	12,860,780	9,762,247	7,634,209
Mortgage originations	986,979	729,913	1,028,208	1,174,514	584,836

ABOUT ALERUS FINANCIAL CORPORATION

Alerus Financial Corporation (the "Company") through its subsidiaries Alerus Financial, N.A., Alerus Securities Corporation and Alerus Investment Advisors, Inc., 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 is a diversified financial services company with $1.7 billion in banking assets, $2.7 billion of assets under management and $17.5 billion of assets under administration. 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 years ended December 31, 2015 and 2014, the Company completed the following acquisitions:

Interactive Retirement Systems, LTD

On January 2, 2015, the Company acquired Interactive Retirement Systems, LTD, located in Bloomington, Minnesota, for cash consideration of $4.1 million. The purchase, consisting of approximately 160 retirement plans with more than 16,200 retirement participants, increased the Company's retirement division by $1.3 billion in retirement assets under administration. As part of the transaction, $3.8 million was allocated to an identified customer intangible and $420 thousand to goodwill, based on the estimated value of the acquired assets and liabilities as of the acquisition date. The identified customer intangible is being amortized over a 10-year period, resulting in an annualized intangible amortization expense of $378 thousand, while the goodwill is not subject to amortization.

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, for cash consideration of $12.0 million. The purchase, consisting of approximately 700 retirement plan clients with more than 42,000 retirement plan participants, increased the Company's retirement services division by $2.1 billion in retirement assets under administration. As part of the transaction, $10.1 million was allocated to an identified customer intangible and $2.0 million to goodwill, based on the estimated value of the acquired assets and liabilities as of the acquisition date. The identified customer intangible is being amortized over a 10-year period, resulting in an annualized intangible amortization expense of $1.0 million, while the goodwill is not subject to amortization.

Private Bank Minnesota

On June 25, 2014, the Company acquired Private Bancorporation, Inc., with one branch located in downtown Minneapolis, Minnesota, for cash consideration of $15.9 million. 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 thousand to goodwill. The core deposit intangible is being amortized over five years, generating an amortization expense of $240 thousand per year, while the goodwill is not subject to amortization. Neither the core deposit intangible nor the goodwill is deductible for tax purpose. The transaction also included a net operating loss deferred tax asset valued at $943 thousand 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.

Since December 31, 2015, the Company completed the following acquisitions:

Alliance Benefit Group North Central States, Inc. (ABGNCS)

On January 1, 2016, the Company acquired Alliance Benefit Group North Central States, Inc., with locations in Albert Lea and Eden Prairie, Minnesota, for initial cash consideration of $17.5 million, with the potential for an additional $4.4 million consideration, during an earn-out period. The purchase, consisting of approximately 900 retirement plans with more than 75,000 retirement participants, increasing the Company's retirement division by $6.0 billion in retirement assets under administration. As part of the transaction, approximately $22 million will be allocated to goodwill and an identified customer intangible, based on the estimated value as of the acquisition date. The actual allocation between goodwill and a customer intangible will be determined through a third-party evaluation. The identified customer intangible will be amortized over the estimated life, resulting in an intangible amortization expense, while the goodwill is not subject to amortization. If these intangibles are valued similar to other recent transactions, approximately 20% may be allocated to goodwill and 80% to a customer intangible. The customer intangible will likely be amortized over a ten-year period, whereas goodwill is not subject to amortization.

Beacon Bank

On January 15, 2016, the Company acquired Beacon Bank and its five branches, three located in the southwestern suburbs of Minneapolis, Minnesota and two located in Duluth, Minnesota, for cash consideration of $46.0 million. The Company assumed approximately $315.5 million of deposits and other liabilities, including $10.0 million of Trust Preferred Securities and purchased approximately $350.0 million in cash, securities, loans, and other assets. As part of the transaction, the Company will allocate approximately $20 million to goodwill and a core deposit intangible, based on a third-party evaluation. The core deposit intangible will be amortized over the estimated life, resulting in an intangible amortization expense, while the goodwill is not subject to amortization.

SUBORDINATED NOTES OFFERING

On December 17, 2015, Alerus issued $50 million of Subordinated Notes maturing December 30, 2025. The Kroll Bond Rating Agency assigned a rating of BBB+ on the Company's senior unsecured debt and BBB on its subordinated debt, and a rating of A- on the senior unsecured debt of the Bank. The notes bear a fixed rate of interest at 5.75%, through December 30, 2020, and then convert to floating rate notes that reset quarterly to an interest rate equal to three month LIBOR plus 412 basis points. Through December 30, 2020, interest is payable semi-annually on June 30 and December 30, and thereafter interest is paid quarterly on March 30, June 30, September 30, and December 30. The Subordinated Notes qualify as Tier 2 capital for regulatory purposes. The proceeds were utilized primarily to retire the Small Business Lending Fund (SBLF) preferred stock of $20.0 million and for the acquisitions of ABGNCS and Beacon Bank.

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 stockholders 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.

In connection with the Prosperan Bank acquisition in 2009, the Bank agreed to pay the FDIC, should the estimated losses on the acquired loan portfolios as well as servicing fees earned on the acquired loan portfolios not meet thresholds as stated in the loss sharing agreements (the "true-up liability"). This contingent consideration is classified as a liability within other liabilities on the Consolidated Balance Sheet and is re-measured at fair value each reporting date until the contingency is resolved. The changes in fair value are recognized in non-interest income or expense. The fair value of the true-up liability associated with the Prosperan acquisition was $2.8 million and $2.6 million as of December 31, 2015, and 2014, respectively.

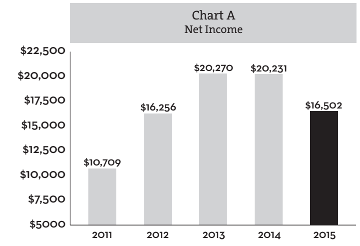
TAX

In 2015, Alerus made two contributions, totaling $1.0 million, to housing-related projects in North Dakota, sponsored by the North Dakota Housing Incentive Fund, for which the Company received a State of North Dakota income tax credit of $1.0 million. The contributions are tax deductible for Federal Income tax purposes, and increased other operating expenses by $1.0 million, but reduced North Dakota state income tax expense by the same amount. The full tax credit was not utilized in 2015, resulting in a deferred tax asset, which will be utilized in 2016 and future years.

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 current 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. Refunds were received in the aggregate amount of $928 thousand from the State of Minnesota and $287 thousand 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.

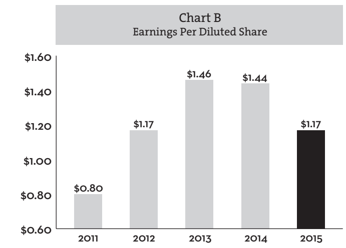
RESULTS OF OPERATIONS

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."

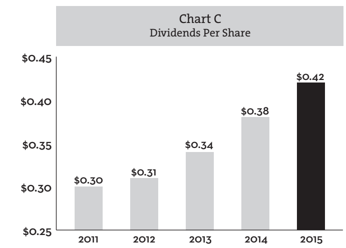


EARNINGS SUMMARY

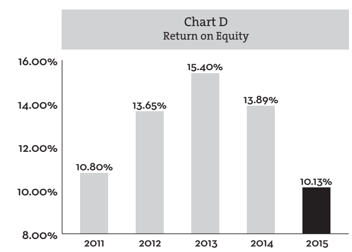
Net income for 2015 was $16.5 million ($1.17 diluted earnings per common share), compared with $20.2 million ($1.44 diluted per share) for 2014 and $20.3 million ($1.46 diluted per share) for 2013. The Company's financial performance in 2015 reflects a $4.2 million provision for credit losses, an increase of $4.6 million from 2014, reflecting a return to a more normal credit environment after three years of less than $1.2 million in annual provisions. The 2014 results also included $2.1 million of gains on sales of securities from a restructuring of the investment portfolio. The Company's 2015 earnings reflect the effect of $4.4 million of amortization of identified intangibles from acquisitions, which lower earnings per share, net of taxes, by $0.19, compared to $4.2 million or $0.18 per share in 2014. 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 diluted share is illustrated in **Chart B**.



Revenue, the sum of net interest income and non-interest income, was $146.1 million in 2015, compared with $129.5 million in 2014 and $126.1 million in 2013. The Company's diversified revenue model continued to generate strong core earnings in 2015, reflecting revenue growth in all business divisions: banking, mortgage, retirement services, and wealth management. The increase in revenue for 2015 compared to 2014 was predominantly due to an increase in non-interest income in the retirement services and mortgage divisions of the Company. Retirement services revenue increased by 24% as a result of the acquisitions that occurred in late 2014 and early 2015, as well as organic growth in the business. The increased level of mortgage originations during 2015 ($987 million vs. $730 million in 2014) increased mortgage banking revenue by 34%. In 2015, non-interest income of $93.3 million represented 64% of revenue, compared with $78.4 million (61%) in 2014 and $79.3 million (63%) in 2013.

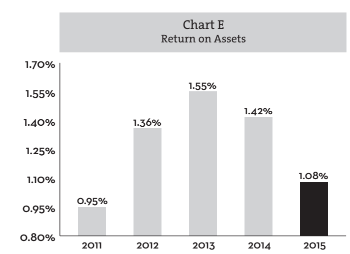


Net interest income was $52.9 million in 2015, representing 36% of revenue, compared to $51.1 million, or 39% of revenue, in 2014 and $46.8 million, or 37% of revenue, in 2013. The net interest income increase in 2015 was due to higher average earning asset balances, although at a lower yield.



Non-interest expense was $118.1 million in 2015, compared with $100.1 million in 2014 and $92.9 million in 2013. The increase in non-interest expense in 2015, compared to 2014, reflected higher personnel, occupancy, and other operating expenses resulting from higher mortgage origination volumes, acquisitions, and added infrastructure.

Cash dividends per common share were $0.42 in 2015, compared to $0.38 in 2014 and $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 stockholders' equity. ROE was 10.13% in 2015, compared to 13.89% in 2014, and 15.40% in 2013, as further illustrated in **Chart D**. The average ROE over the past five years is 12.77%.

Return on Average Assets (ROA) is net income stated as a percentage of average total assets. As **Chart E** illustrates, ROA was 1.08% in 2015, compared to 1.42% in 2014, and 1.55% in 2013. The average ROA over the past five years is 1.27%.

NET INTEREST INCOME

Net interest income is the interest earned on investment securities, loans (including yield-related loan fees) and other interest-earning assets minus the interest paid for deposits, short-term borrowings and long-term debt. Net interest margin is the average yield on earning assets minus the average interest rate paid for deposits and other sources of funding. Net interest income and net interest margin are presented on a taxable-equivalent basis in **Table 2** to consistently reflect income from taxable and tax-exempt loans and securities based on a 35.5% federal statutory rate.

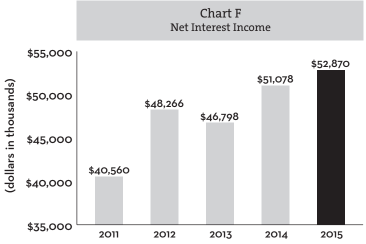
While the Company believes that it has the ability to increase net interest income over time, net interest income and net interest margin in any one period can be significantly affected by a variety of factors, including the mix and overall size of our earning asset portfolio and the cost of funding those assets.

Interest income was $56.3 million in 2015, an increase of $1.9 million, or 3.6%, from the $54.4 million reported in 2014 and the $50.5 million in 2013. The increase in interest income for 2015, compared with 2014, was largely driven by higher average loans outstanding, $1.1 billion vs. $994 million, although at a lower average rate: 4.48% vs. 4.72%. As loans matured and/or repriced during the year, they were renewed at lower rates which were in effect throughout the year. Average earning assets increased by $100 million to $1.4 billion in 2015; however the average rate decreased to 4.06% from 4.22% in 2014.

In 2015 the average interest bearing liabilities increased by $40 million to $1.0 billion, with an average rate of 0.34%, the same as the prior year. Average non-interest bearing deposits increased to $328 million in 2015, from $278 million in 2014.

Core deposits are an important low-cost source of funding and affect both net interest income and net interest margin. Core deposits include non-interest-bearing deposits, interest-bearing checking, certificates of deposit less than $250 thousand, and money market savings deposits. Core deposits rose to $1.4 billion at December 31, 2015, an increase of $200 million from the $1.2 billion in 2014. Net interest margin was 3.81% in 2015, down 16 basis points from 3.97% in 2014, and 3.94% in 2013 as a result of lower yields on average earning assets.

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



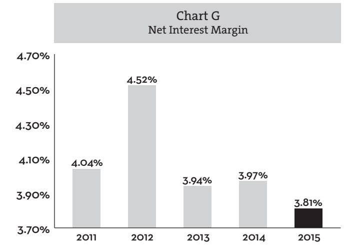


TABLE 2 – AVERAGE BALANCE SHEETS AND AVERAGE RATES

Year ended December 31,

(dollars in thousands)

Assets	2015 Average Balance	2015 Average Rate	2015 Interest	2014 Average Balance	2014 Average Rate	2014 Interest	2013 Average Balance	2013 Average Rate	2013 Interest
Interest bearing deposits with banks	$ 48,273	0.25%	$ 123	$ 19,787	0.26%	$ 52	$ 56,339	0.26%	$ 148
Federal funds sold	95	0.00	-	17	0.00	-	8	0.00	-
Investment securities (a)	183,103	2.69	4,474	258,705	2.68	6,496	264,978	2.64	6,612
Mortgages held for sale	43,515	3.24	1,409	27,090	3.46	936	43,361	2.78	1,206
Loans									
Commercial:									
Commercial and industrial (a)	383,098	4.58	17,526	341,516	4.43	15,109	292,449	4.85	14,157
Real estate mortgage	257,110	4.65	11,963	260,907	5.21	13,590	251,688	5.90	14,850
Construction and land development	34,772	4.15	1,442	18,846	5.41	1,019	12,342	5.30	654
Farmland and agricultural	55,067	4.18	2,300	51,338	4.39	2,252	43,741	4.40	1,924
Total commercial (a)	730,047	4.55	33,231	672,607	4.76	31,970	600,220	5.27	31,585
Consumer:									
Real estate 1-4 family first mortgage	155,137	4.42	6,862	128,123	4.46	5,713	92,664	4.58	4,243
Real estate 1-4 family junior lien mortgage	159,772	4.82	7,700	125,180	4.88	6,110	86,870	4.85	4,210
Automobile	59,982	2.92	1,753	50,340	4.11	2,068	40,286	4.46	1,796
Other revolving and installment	19,663	3.95	776	17,797	5.89	1,049	12,405	5.72	710
Total consumer	394,554	4.33	17,091	321,440	4.65	14,940	232,225	4.72	10,959
Total loans (a)	1,124,601	4.48	50,322	994,047	4.72	46,910	832,445	5.12	42,544
Total earning assets (a)	**1,399,587**	**4.06**	**56,328**	**1,299,646**	**4.22**	**54,394**	**1,197,131**	**4.25**	**50,510**
Cash and due from banks	23,676			23,408			21,098		
Loan loss reserve	(17,218)			(16,792)			(15,673)		
Goodwill & other intangibles	28,093			18,271			15,251		
Bank premises and equipment	21,375			22,174			22,440		
Other	77,884			77,624			67,912		
Total assets	**$1,533,397**			**$1,424,331**			**$1,308,159**		
Liabilities and Stockholders' Equity									
Savings, Checking, and money market deposits	$ 743,237	0.15	$ 1,106	$ 690,898	0.15	$ 1,023	$ 642,934	0.18	$ 1,174
Certificates of deposit	225,096	0.73	1,652	222,943	0.74	1,650	237,040	0.81	1,927
Short term borrowings	12,599	0.25	32	29,007	0.29	83	13,964	0.21	30
Other borrowed funds	21,441	2.56	548	21,562	2.60	560	22,650	2.57	581
Subordinated notes payable	2,039	5.89	120	-	0.00	-	-	0.00	-
Total interest bearing liabilities	**1,004,412**	**0.34**	**3,458**	**964,410**	**0.34**	**3,316**	**916,588**	**0.40**	**3,712**
Non-interest bearing deposits	327,654			278,005			221,199		
Other liabilities	20,400			17,713			20,072		
Stockholders' equity	180,931			164,203			150,300		
Total liabilities and stockholders' equity	**$1,533,397**			**$1,424,331**			**$1,308,159**		
Net interest margin/income (a)		**3.81%**	**$ 52,870**		**3.97%**	**$51,078**		**3.94%**	**$46,798**
Interest rate spread (a)		3.71%			3.88%			3.85%	

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

The Company manages 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.

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 2013 through 2015. **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.

TABLE 3 – VOLUME AND RATE VARIANCE ANALYSIS
(dollars in thousands)

	Change from 2015 to 2014			Change from 2014 to 2013		
Increase(decrease) in:	Volume	Rate	Total	Volume	Rate	Total
Interest income:						
Interest bearing deposits with banks	$ 75	$ (4)	$ 71	$ (96)	$ -	$ (96)
Federal funds sold	-	-	-	-	-	-
Investment securities	(2,030)	8	(2,022)	(166)	50	(116)
Mortgages held for sale	568	(95)	473	(453)	183	(270)
Loans						
Commercial:						
Commercial and industrial	1,844	573	2,417	2,381	(1,429)	952
Real estate mortgage	(198)	(1,429)	(1,627)	544	(1,804)	(1,260)
Construction and land development	861	(438)	423	345	20	365
Farmland and agricultural	164	(116)	48	334	(6)	328
Total commercial	2,671	(1,410)	1,261	3,604	(3,219)	385
Consumer:						
Real estate 1-4 family first mortgage	1,205	(56)	1,149	1,624	(154)	1,470
Real estate 1-4 family junior lien mortgage	1,688	(98)	1,590	1,857	43	1,900
Automobile	396	(711)	(315)	448	(176)	272
Other revolving and installment	110	(383)	(273)	309	30	339
Total consumer	3,399	(1,248)	2,151	4,238	(257)	3,981
Total loans	6,070	(2,658)	3,412	7,842	(3,476)	4,366
Total	**4,683**	**(2,749)**	**1,934**	**7,127**	**(3,243)**	**3,884**
Interest expense:						
Savings, checking, and money market deposits	77	6	83	88	(239)	(151)
Certificates of deposit	16	(14)	2	(115)	(162)	(277)
Short term borrowings	(47)	(4)	(51)	32	21	53
Other borrowed funds	(3)	(9)	(12)	(28)	7	(21)
Subordinated notes payable	-	120	120	-	-	-
Total interest expense	43	99	142	(23)	(373)	(396)
Increase (decrease) in net interest income	**$4,640**	**$(2,848)**	**$1,792**	**$7,150**	**$(2,870)**	**$4,280**

PROVISION FOR CREDIT LOSSES

The allowance for loan and lease losses (allowance) is an estimate of losses inherent in the Company's loan and lease portfolios and is established through a regular provision for credit losses (provision) based on historical losses incurred on similar pools of loans and periodic analysis of the portfolios' credit quality. Provisions are expected in order to maintain the adequacy of the total allowance after loan losses and recoveries, loan growth, 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 result from management's quarterly assessment of the adequacy of the allowance based on the factors described above.

The provision for 2015 was $4.2 million compared to negative $0.4 million during 2014. This was the result of reinstatement of a regular monthly provision, based on growth in the loan portfolio, as well as identified loan losses. No regular provision was recorded in 2014 at the Company's subsidiary bank. This allowed the bank to realign its allowance based on 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 in 2014, the Company itself recorded a negative provision of $0.4 million in response to repayment of a loan held at the Company as opposed to its subsidiary bank. The ratio of the end-of-year balance of the allowance to end-of-year loans was 1.30% for 2015, compared to 1.56% for 2014. Average loans and leases were $1,124.6 million in 2015, an increase of $130.6 million, or 13.1%, from the $994.0 million reported in 2014. The amount of provision to be taken in future periods will depend on management's assessment of the adequacy of the allowance in relation to the loss experience of the entire loan portfolio and periodic analysis of the portfolio's credit quality.

The Company's banking assets are distributed across eastern North Dakota, Minneapolis-St. Paul, Minnesota and the Phoenix, Arizona metropolitan area. The Company has minimal exposure to the western North Dakota oil-related areas. The bank has less than 2.0% of its loan and lease portfolio in oil and gas related credits and less than 4.0% in loans in western North Dakota. The Company believes the allowance is adequate to cover any losses in the portfolio.

NON- INTEREST INCOME

The Company continues to expand non-interest income associated with the Company's banking, mortgage, retirement services, and wealth management divisions. The Company's primary sources of non-interest income consist of retirement plan and recordkeeping services, trust services, service charges on deposit accounts, loan fees, and net gains on mortgage loan origination/sales activities. Non-interest income of $93.3 million represented 64% of revenue for 2015 compared with $78.4 million, or 61% of revenue, for 2014, and $79.3 million, or 63% of revenue, for 2013. The increase in non-interest income in 2015 was primarily due to additional retirement services fee income related to acquisitions and organic growth, as well as increased mortgage banking revenue from higher originations/sales. **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, reporting fees of $51.1 million in 2015, a $10.0 million, or 24% increase, from the $41.1 million reported in 2014. A majority of retirement services fees are transaction or participant based plan fees, with the remainder based on the market value of assets under administration. At December 31, 2015, assets under administration totaled $17.5 billion, up $1.9 billion, or 12.5%, from $15.5 billion at December 31, 2014. The acquisition of Interactive Retirement Systems, LTD, which closed on January 2, 2015, included 160 retirement plans, with more than 16,000 participants, and added $1.2 billion in assets under administration.

Wealth management income, which includes personal trust services and investment services offered by Alerus Investment Advisors and Alerus Securities, was $11.4 million, a $0.3 million, or 2.7%, increase from the $11.1 million reported in 2014. 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, 2015, assets under management totaled $2.7 billion, up $0.1 billion, or 5.8%, from the $2.6 billion reported in 2014.

Mortgage banking income, consisting of net servicing income and net gains on loan origination/sales activities, totaled $24.6 million in 2015, a $6.2 million, or 33.6%, increase from the $18.4 million reported in 2014. The Company's mortgage division originated $987 million in loans in 2015, a $257 million, or 35%, increase from the $730 million in loans originated in 2014. The Company's mix of refinance and home purchase mortgage originations shifted from 20% refinance and 80% purchase in 2014 to 32% and 68%, respectively, in 2015.

TABLE 4 – NON-INTEREST INCOME
Year ended December 31,
(dollars in thousands)

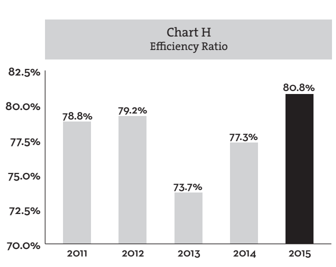
	2015	2014	2013	% Increase/ decrease 2015/2014	% Increase/ decrease 2014/2013
Retirement services	$51,059	$41,058	$36,003	24.36%	14.04%
Wealth management	11,418	11,119	10,313	2.69	7.82
Mortgage banking	24,630	18,435	27,177	33.60	-32.17
Service charges on deposit accounts	1,611	1,626	1,639	-0.92	-0.79
Investment security gains (losses)	(17)	2,179	(70)	100.78	-3,212.86
Other non-interest income	4,554	3,989	4,207	14.16	-5.18
Total non-interest income	**$93,255**	**$78,406**	**$79,269**	**18.94%**	**-1.09%**

NON- INTEREST EXPENSE

Total non-interest expense was $118.1 million in 2015, an $18.0 million, or 18.0%, increase from the $100.1 million reported in 2014. Operating expenses increased in 2015 as a result of several factors, including higher mortgage loan originations, acquisition expenses, and investments in the Company's infrastructure to support growth.

The Company's efficiency ratio, defined as the percent of non-interest expense to total revenue, increased to 80.8% in 2015, compared to 77.3% in 2014.

Chart H illustrates the trend in the efficiency ratio over the last five years.



While control of non-interest expense is a priority for management, the higher-than-average efficiency ratio is partially due to the Company generating 64% of total revenue from non-interest income sources. The efficiency ratio for a business comprised primarily of net interest margin income is generally lower than a business comprised primarily of asset management income and mortgage origination income.

Personnel expenses, which include salaries, commissions, incentive compensation, and employee benefits, are the largest expense component for the Company, representing 60% of non-interest expenses in both 2015 and 2014. Salary and employee benefit costs were $71.9 million in 2015, an $11.5 million, or 19.0%, increase from the $60.4 million reported in 2015. The increase in salary and employee benefit costs was influenced by increased staffing associated with acquisitions completed in 2015 and 2014, as well as to support the infrastructure of the Company, and in variable commissions associated with increased mortgage origination activity, which increased 35% in 2015.

Occupancy expense was $5.2 million in 2015, a $0.8 million, or 17.6%, increase from the $4.4 million reported in 2014. The increase in occupancy expense is primarily the result of facilities costs associated with acquisitions completed in 2015 and 2014. Furniture and equipment expense was $5.0 million in 2015, reflecting a 7.7% increase from the $4.7 million reported in 2014.

The Company has acquired 16 companies since 2002 for an aggregate premium of $42.7 million in excess of book value, creating identified intangible assets of $39.0 million and $3.7 million in goodwill on the balance sheet. The identified intangible assets amortize for book purposes and are reported in other non-interest expense. Goodwill does not amortize for book purposes. The amortization schedules vary based on the type and quality of the acquisition. The aggregate unamortized intangible balance as of December 31, 2015, is $17.6 million, which will fully amortize by December 31, 2024. The intangible amortization expense for 2015 was $4.4 million, up from $4.2 million in 2014.

Marketing, business development, and public relations expenses were $3.9 million in 2015, a $1.2 million increase from 2014. The increase resulted from $1.0 million in contributions to projects of the North Dakota Housing Incentive Fund, which provided $1.0 million of North Dakota state income tax credits. The contributions are deductible for federal income tax and provide a dollar-for-dollar tax credit for North Dakota state income taxes. The Company's income tax expense was reduced for these credits, which will be utilized in 2015 and future years.

Correspondent and other service fees increased 34.6% to $9.4 million in 2015, from $7.0 million in 2014, primarily as a result of expenditures for information technology to support the growth of the Company. **Table 5** provides a summary of changes in non-interest expenses for the past three years.

TABLE 5 – NON-INTEREST EXPENSE
Year ended December 31,
(dollars in thousands)

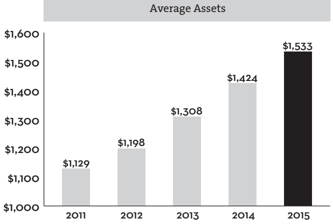
	2015	2014	2013	% Increase/ decrease 2015/2014	% Increase/ decrease 2014/2013
Salaries	$ 59,122	$ 48,839	$49,203	21.06%	-0.74%
Employee benefits	12,804	11,580	10,621	10.57	9.03
Occupancy expense	5,203	4,424	3,791	17.61	16.70
Furniture and equipment expense	5,018	4,658	4,687	7.73	-0.62
Intangible amortization expense	4,361	4,196	3,321	3.93	26.35
Marketing, business development and public relations	3,907	2,745	2,613	42.37	5.05
Supplies, telephone and postage	4,404	3,838	3,033	14.75	26.54
FDIC insurance	1,175	1,040	960	12.98	8.33
Professional fees (legal, audit and consulting)	2,512	2,667	2,042	-5.81	30.61
Correspondent and other service fees	9,394	6,982	5,547	34.55	25.87
Other non-interest expenses	10,234	9,146	7,095	11.87	28.91
Total non-interest expenses	**$118,134**	**$100,115**	**$92,913**	**18.00%**	**7.75%**

STATEMENT OF FINANCIAL CONDITION

OVERVIEW

At December 31, 2015, total assets were $1.7 billion, up $257.1 million from December 31, 2014. Cash and due from banks increased by $220.6 million as the Company increased liquidity and raised funds for the acquisitions of Alliance Benefit Group North Central States, Inc., and Beacon Bank, which were completed in January 2016, and the redemption of the SBLF preferred stock in February 2016. Total average assets of the Company were $1.5 billion in 2015, a $109.1 million, or 7.7%, increase from the $1.4 billion reported in 2014. **Chart I** illustrates average total assets for the past five years. Average earning assets were $1.4 billion in 2015, an increase of $99.9 million, or 7.7%, from the $1.3 billion reported in 2014. Average earning assets represent 91.3% of average total assets in 2015, compared to 91.2% in 2014. The change in average earning assets was primarily driven by an increase in loans. Average interest-bearing liabilities represented 71.8% of average earning assets in 2015, compared to 74.2% in 2014.

Chart I
Average Assets



INVESTMENT 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, 2015, investment securities totaled $192.3 million, with a weighted average tax equivalent yield of 2.69%, compared with $206.1 million, with a weighted average yield of 2.68%, at December 31, 2014.

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, 2015, the Company's gross unrealized gains on the available-for-sale securities were $2.7 million, compared with $3.9 million at December 31, 2014. Gross unrealizable losses on available-for-sale securities totaled $1.1 million at December 31, 2015, compared with $1.7 million at December 31, 2014.

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, 2015, the Company held certain investments having continuous unrealized loss positions for more than 12 months. As of December 31, 2015, the unrealized losses on these securities totaled $0.6 million. Substantially all of these losses were in government agency debt securities. During the year ended December 31, 2015, the Company evaluated all of its debt securities for credit impairment and determined no credit losses were evident. At December 31, 2015, the Company had no plans to sell securities with unrealized losses and believes it is likely it will not be required to sell such securities before the recovery of their amortized cost.

LOANS

Total loans were $1.1 billion at December 31, 2015, a $31.5 million increase from December 31, 2014. The increase was driven by organic growth in commercial loans of $20.9 million (3.0%), real estate mortgages of $7.6 million (2.3%), and consumer loans of $3.0 million (3.7%). **Table 6** provides a summary of loans for the past five years. Average loans were $1.1 billion in 2015, a $130.5 million, or 13.1%, increase from the $994.0 million reported in 2014. The increase in average loans was driven by strong organic growth across all geographic locations. The average loan/deposit ratio increased to 86.8% for 2015, compared to 83.4% for 2014.

The Company periodically sells loans to a participation network to manage concentration risk and reduce credit exposure. The sold loan portfolio was $572.1 million on December 31, 2015, a $53.3 million, or 10.3%, increase from the $518.8 million reported at December 31, 2014. The Company also had $48.6 million of mortgages held for sale at December 31, 2015, a $13.6 million, or 38.8%, increase from the $35.0 million reported at December 31, 2014. Mortgages held for sale are all single-family residential mortgage loans that will be sold to the secondary market, usually within 30 days of origination.

TABLE 6 – LOANS AND LEASES
As of December 31,
(dollars in thousands)

	2015	2014	2013	2012	2011
Commercial:					
Commercial and industrial	$ 379,914	$ 351,460	$328,183	$ 261,974	$212,786
Real estate mortgage	261,345	256,281	259,681	244,994	233,040
Construction and land development	16,780	20,544	8,260	15,574	14,756
Farmland and agricultural	53,514	62,340	54,245	46,670	44,402
Total commercial	711,553	690,625	650,369	569,212	504,984
Consumer:					
Real estate 1-4 family first mortgage	170,397	167,177	108,682	75,628	71,797
Real estate 1-4 family junior lien mortgage	162,295	157,921	95,348	76,476	61,598
Automobile	62,509	57,214	46,150	33,414	21,451
Other revolving and installment	20,167	22,521	14,015	16,048	13,601
Total consumer	415,368	404,833	264,195	201,566	168,447
Total loans and leases	**$1,126,921**	**$ 1,095,458**	**$ 914,564**	**$ 770,778**	**$673,431**
Percent of Loans by Type					
Commercial:					
Commercial and industrial	33.7%	32.1%	35.9%	34.0%	31.6%
Real estate mortgage	23.2	23.4	28.4	31.8	34.6
Construction and land development	1.5	1.9	0.9	2.0	2.2
Farmland and agricultural	4.7	5.7	5.9	6.1	6.6
Total commercial	63.1	63.0	71.1	73.8	75.0
Consumer:					
Real estate 1-4 family first mortgage	15.1	15.3	11.9	9.8	10.7
Real estate 1-4 family junior lien mortgage	14.4	14.4	10.4	9.9	9.1
Automobile	5.5	5.2	5.0	4.3	3.2
Other revolving and installment	1.8	2.1	1.5	2.1	2.0
Total consumer	36.9	37.0	28.9	26.2	25.0
Total loans and leases	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

DEPOSITS

Deposits totaled $1.5 billion at December 31, 2015, compared with $1.3 billion at December 31, 2014, representing an increase of $195.9 million, or 15.5%. 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, certificates of deposit less than $250 thousand, and money market saving deposits. Core deposits funded 82.1% and 82.9% of total assets at December 31, 2015, and 2014, respectively. At year-end there was a temporary increase in short-term deposits which were withdrawn in January. Average deposits were $1.3 billion in 2015, an $89.7 million, or 7.2%, increase compared with the $1.2 billion reported in 2014.

Non-interest-bearing deposits were $425.6 million at December 31, 2015, a $95.4 million, or 28.9%, increase from the $330.2 million reported at December 31, 2014. Average non- interest-bearing deposits were $327.7 million in 2015, a $49.6 million, or 17.9 %, increase compared with $278.0 million in 2014.

Interest-bearing non-maturity deposits totaled $816.0 million at December 31, 2015, a $94.9 million, or 13.2%, increase from the $721.1 million reported at December 31, 2014. Average interest-bearing non-maturity deposits were $743.2 million in 2015, a $52.3 million, or 7.6%, increase compared with $690.9 million in 2014. Interest-bearing time deposits were $216.5 million at December 31, 2015, a $5.6 million, or 2.6%, increase from the $210.9 million reported at December 31, 2014. Average interest-bearing time deposits were $225.1 million in 2015, a $2.1 million, or 1.0%, increase compared with $222.9 million reported in 2014. 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.

TABLE 7 – DEPOSITS
As of December 31,
(dollars in thousands)

	2015	2014	2013	2012	2011
Non-interest-bearing deposits	$ 425,608	$ 330,218	$ 305,042	$ 267,208	$188,630
Interest bearing deposits:					
Savings	37,798	30,397	24,750	20,168	20,427
Checking	291,979	243,334	186,916	188,995	138,579
Money market deposit	486,181	447,346	439,946	386,089	377,003
Certificates of deposits of $250,000 and less	191,568	182,099	190,767	213,187	226,082
Certificates of deposits in excess of $250,000	24,887	28,774	35,182	40,103	34,389
Total deposits	**$1,458,021**	**$1,262,168**	**$1,182,603**	**$1,115,750**	**$985,110**
Percent of Deposits by Type					
Non-interest bearing deposits	29.19%	26.16%	25.79%	23.95%	19.15%
Interest bearing deposits:					
Savings	2.59	2.41	2.09	1.81	2.07
Checking	20.03	19.28	15.81	16.94	14.07
Money market deposit	33.35	35.44	37.20	34.60	38.27
Certificates of deposits of $250,000 and less	13.14	14.43	16.13	19.11	22.95
Certificates of deposits in excess of $250,000	1.71	2.28	2.97	3.59	3.49
Total deposits	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**

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, 2015, totaled $21.4 million, a $0.1 million, or 0.6%, decrease from the $21.5 million reported at December 31, 2014. Other borrowed funds consists of Federal Home Loan Bank advances 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 $1.4 million.

SUBORDINATED NOTES PAYABLE

On December 17, 2015 the Company issued $50 million of Subordinated Notes with a maturity date of December 30, 2025. The notes bear a fixed rate of interest at 5.75%, through December 30, 2020 and then convert to floating-rate notes that reset quarterly to an interest rate equal to three month LIBOR plus 412 basis points. Through December 30, 2020, interest is payable semi-annually on June 30 and December 30 and thereafter interest is paid quarterly on March 30, June 30, September 30 and December 30. The Subordinated Notes qualify as Tier 2 capital for regulatory purposes. The proceeds were utilized for the acquisitions of Alliance Benefit Group North Central States, Inc., (ABGNCS) and Beacon Bank in January 2016 and to retire the $20.0 million of SBLF preferred stock in February 2016.

CAPITAL RESOURCES

The Company is committed to managing capital for maximum stockholder 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. Total common stockholders' equity was $162.8 million at December 31, 2015, an $11.7 million, or 7.8%, increase from the $151.1 million reported at December 31, 2014. The increase is the result of current year's earnings less dividend payments to preferred and common stockholders, and the market value change in the investment portfolio.

In 2012 the Company applied for and received approval for $20 million in SBLF at an initial interest rate of 1%. The Company viewed the SBLF as an intermediate source of capital and redeemed the preferred stock in February 2016 utilizing a portion of the proceeds from the subordinated note issuance. The SBLF preferred stock interest rate was scheduled to increase to 9% in February 2016.

The Company paid dividends of $0.42 during 2015, representing a $0.04, or 10.53%, increase over the $0.38 paid during 2014. 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 stockholders 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 and well capitalized standards for banks and holding companies (see The Company and Bank Required Capital Levels below).

The Company's regulatory capital ratios, as of December 31, for the past five years are set forth in **Table 8** and exceeded all minimum capital and well capitalized standards. While the acquisitions that closed in January 2016 utilized a substantial amount of the Company's excess capital, the Company continues to maintain capital above the levels required for well capitalized banks.

The Basel III Capital Rules contain provisions which require certain adjustments and deductions from common equity Tier 1 capital, including goodwill and other intangible assets (excluding mortgage servicing rights). Basel III provided for a phase-in period for certain deductions from capital that requires deductions of 40% in 2015, 60% in 2016, 80% in 2017, and 100% thereafter of the deduction. The Company's deduction for goodwill and identifiable intangible assets, net of deferred tax liabilities, represents goodwill of $3.5 million and identifiable intangible assets of $7.0 million (40% of $17.5 million). As a result of the acquisitions of ABGNCS and Beacon Bank and the phase-in rules, these amounts will increase in 2016, net of intangible amortization.

TABLE 8 – REGULATORY CAPITAL
As of December 31,

	Well Capitalized (a)	2015	2014	2013	2012	2011
Common equity tier 1 ratio	6.5%	10.9%	N/A	N/A	N/A	N/A
Tier 1 capital ratio	8.0	12.3	11.8%	12.8%	12.8%	13.7%
Total capital ratio	10.0	17.0	13.0	14.1	14.1	14.9
Tier 1 leverage ratio	5.0	10.9	10.1	10.6	9.9	9.9

(a) Well capitalized ratios as of December 31, 2015.

RISK ANALYSIS

ASSET QUALITY RISK

Management believes its ability to identify and assess the risk and return characteristics of the Company's loan portfolio is critical for profitability and growth. It is in the best interest of stockholders, regional communities, customers, and the Company to follow a credit policy that carefully balances risk and return, 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. 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 provides coverage for probable and estimable losses inherent in the Company's loan and lease portfolios. 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, historic loss experience, and other factors including regulatory guidance and economic conditions.

At December 31, 2015, non-performing assets were $12.0 million, compared to $6.5 million in 2014, and $10.3 million in 2013. Non-performing assets represented 1.07% of total loans and other real estate in 2015, compared to 0.59% in 2014, and 1.12% in 2013. **Table 9** provides a summary of non-performing assets for the past five years.

At December 31, 2015, the allowance for loan and leases losses was $14.7 million, or 1.30%, of total loans compared with $17.1 million, or 1.56%, at December 31, 2014, and $16.8 million, or 1.88%, at December 31, 2013. The provision for credit losses was $4.2 million in 2015, as compared to a net recovery of $0.4 million in 2014, and provisions of $1.2 million in 2013. Net charge-offs in 2015 were $6.6 million, or 0.58%, of average total loans, compared with net recoveries of ($0.6) million, or (0.06%), in 2014, and net recoveries of ($0.5) million, or (0.07%), in 2013.

TABLE 9 – NONPERFORMING ASSETS
As of December 31,
(dollars in thousands)

	2015	2014	2013	2012	2011
Nonperforming loans					
Commercial:					
Commercial and industrial	$ 6,011	$ 572	$ 1,437	$ 1,769	$ 3,479
Real estate mortgage	2,634	1,844	3,091	3,468	4,433
Construction and land development	-	-	-	1,152	3,353
Farmland and agricultural	158	-	108	8	-
Total commercial	**8,803**	**2,416**	**4,636**	**6,397**	**11,265**
Consumer:					
Real estate 1-4 family first mortgage	1,501	144	277	96	927
Real estate 1-4 family junior lien mortgage	825	1,400	455	427	852
Automobile	-	35	9	-	-
Other revolving and installment	22	-	-	-	-
Total consumer	**2,348**	**1,579**	**741**	**523**	**1,779**
Total nonperforming loans	11,151	3,995	5,377	6,920	13,044
Foreclosed assets	35	11	11	19	20
Other real estate owned	842	2,478	4,877	9,387	11,915
Total nonperforming assets	**$ 12,028**	**$ 6,484**	**$ 10,265**	**$ 16,326**	**$ 24,979**
Nonperforming assets / loans and other real estate	1.07%	0.59%	1.12%	2.09%	3.64%
Allowance for loan and lease losses / nonperforming loans	131.72%	427.11%	313.15%	218.22%	98.33%

TABLE 10 – SUMMARY OF CREDIT LOSS EXPERIENCE
As of December 31,
(dollars in thousands)

	2015	2014	2013	2012	2011
Average loans and leases	$1,124,601	$ 994,047	$ 832,445	$ 718,650	$658,944
Allowance for loan and lease losses:					
Balance at beginning of year	$ 17,063	$ 16,838	$ 15,101	$ 12,826	$ 8,841
Charge-offs:					
Commercial:					
Commercial and industrial	6,797	408	538	593	739
Real estate mortgage	400	79	16	924	41
Construction and land development	-	4	2	41	106
Farmland and agricultural	109	73	-	22	7
Total commercial	7,306	564	556	1,580	893
Consumer:					
Real estate 1-4 family first mortgage	5	1	10	80	9
Real estate 1-4 family junior lien mortgage	596	267	146	146	165
Automobile	155	128	148	41	16
Other revolving and installment	115	60	225	215	183
Total consumer	871	456	529	482	373
Total charge-offs	**8,177**	**1,020**	**1,085**	**2,062**	**1,266**
Recoveries:					
Commercial:					
Commercial and industrial	230	968	1,187	325	371
Real estate mortgage	166	201	75	1,552	72
Construction and land development	697	128	200	1,515	162
Farmland and agricultural	3	20	19	2	13
Total commercial	1,096	1,317	1,481	3,394	618
Consumer:					
Real estate 1-4 family first mortgage	10	70	6	17	3
Real estate 1-4 family junior lien mortgage	287	113	36	-	81
Automobile	93	55	15	23	2
Other revolving and installment	116	90	84	70	129
Total consumer	506	328	141	110	215
Total recoveries	**1,602**	**1,645**	**1,622**	**3,504**	**833**
Net (charge-offs)/recoveries	(6,575)	625	537	1,442	(433)
Provision for credit losses	4,200	(400)	1,200	833	4,418
Balance at end of year	**$ 14,688**	**$ 17,063**	**$ 16,838**	**$ 15,101**	**$ 12,826**

After three consecutive years of net recoveries, 2012 through 2014, the Company returned to a more normal credit risk environment. During 2015, the Company recorded total charge-offs of $8.2 million, of which $7.3 million was in the commercial loan portfolio, primarily with two credit relationships. The Company considers its allowance of $14.7 million adequate to cover losses inherent in loans, commitments to extend credit, and standby letters of credit at December 31, 2015. **Table 10** provides a summary of the credit loss experience for the past five years.

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, 2015, the Company had $80.8 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, 2015, the Company had $87.0 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 $186.4 million.

INTEREST RATE RISK

The Company's major market risk exposure is to changes in 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, 2015, illustrates a negative 2.10% change in net interest income for a 100 basis point decline in interest rates, and a positive 5.03% 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 3.50% and the federal funds rate at 0.50%.

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 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 and Alerus Investment Advisors.

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 stockholders. 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 stockholders.

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, and impacted the way in which they do business.

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 returns on equity. 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

The Company and the Bank are subject to various regulatory capital adequacy requirements administered by the Federal Reserve and the Office of the Comptroller of Currency (OCC). 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 and subordinated debentures. 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. Additionally, 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"), effective beginning January 1, 2015.

The Basel III Rule not only increased most of the required minimum capital ratios, but it also introduced the concept of Common Equity Tier 1 Capital (CET1), which consists primarily of common stock, related surplus (net of treasury stock), retained earnings, and CET1 minority interests subject to certain regulatory adjustments. The Basel III Rule also expanded the definition of capital 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 previously qualified as Tier 1 Capital do not qualify, or their qualifications changed. For example, cumulative preferred stock and certain hybrid capital instruments, including trust preferred securities, 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 non-qualifying capital instruments previously included in consolidated Tier 1 Capital are permanently grandfathered under the Basel III Rule, subject to certain restrictions. Qualifying trust preferred securities may also be assumed in conjunction with a bank acquisition without impairing their grandfathered Tier 1 capital status. Noncumulative perpetual preferred stock, which qualified as simple Tier 1 Capital, does not qualify as CET1, but does 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 CET1 in the event such assets exceed a certain percentage of a bank's CET1.

The Basel III Capital Rules contain provisions which require certain adjustments and deductions from common equity Tier 1 capital, including goodwill and other intangible assets (excluding mortgage servicing rights). Basel III provided for a phase-in period for certain deductions from capital that requires deductions of 40% in 2015, 60% in 2016, 80% in 2017, and 100% thereafter of the deduction. Identifiable intangible assets that are not deducted during the transitional period are risk weighted.

Under current federal regulations, incorporating the Basel III Capital Rules, the Bank is subject to the following minimum capital standards:

- 4.5% CET1 to risk-weighted assets;
- 6.0% Tier 1 capital (i.e., CET1 plus Additional Tier 1) to risk-weighted assets;
- 8.0% Total capital (i.e., Tier 1 plus Tier 2) to risk-weighted assets; and
- 4.0% Tier 1 capital to average consolidated assets as reported on consolidated financial statements (leverage ratio).

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 7.0% for CET1, 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 CET1 Capital ratio. In order to be a "well-capitalized" depository institution under the new regime, a bank and holding company must maintain a CET1 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 revised 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 required 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 previous 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 was required to be made in the first quarter of 2015, excluded 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 elected to opt-out.

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

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 of an institution that is not adequately capitalized, 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, 2015: (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, 2015, the Company had regulatory capital in excess of the Federal Reserve's requirements and met the Dodd-Frank Act's capital requirements.

THE COMPANY

GENERAL

The Company, as the sole stockholder of the Bank, is a financial holding company. As a financial 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 stockholders 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 financial holding company should eliminate, defer, or significantly reduce dividends to stockholders if: (i) the company's net income available to stockholders 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, 2015. 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.

Information security risks for financial institutions have generally increased in recent years in part because of the proliferation of new technologies, the use of the Internet and telecommunications technologies to conduct financial transactions, and the increased sophistication and activities of organized crime, hackers, terrorists, activists, and other external parties. The Company relies on the secure processing, transmission, and storage of confidential information in our computer systems and networks. Cybersecurity and the continued development and enhancement of the controls, processes, and systems designed to protect our networks, computers, software, and data is a priority for the Company.

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.

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%.

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.

Dan J. Cheever

Dan J. Cheever
Executive Vice President and Chief Financial Officer
Alerus Financial Corporation
March 4, 2016

ALERUS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2015 AND 2014
(dollars in thousands, except share and per share amounts)

	2015	2014
Assets		
Cash and cash equivalents	$ 28,482	$ 28,861
Interest-bearing deposits	237,677	16,665
Cash and due from banks	266,159	45,526
Investment securities		
Securities held for trading	1,947	1,960
Securities available for sale at fair value (Amortized cost $188,743 and $201,984)	190,396	204,141
Mortgages held for sale	48,642	35,042
Loans and leases		
Loans and leases	1,126,921	1,095,458
Less: Allowance for loan and lease losses	(14,688)	(17,063)
Net loans and leases	1,112,233	1,078,395
Premises and equipment, net	22,419	21,456
Accrued interest receivable	4,830	4,774
Bank-owned life insurance	28,308	27,484
Goodwill	3,683	3,264
Other intangible assets, net	21,751	22,442
Deferred tax assets, net	13,780	14,177
Other assets	30,715	29,071
Total assets	**$ 1,744,863**	**$ 1,487,732**
Liabilities and Stockholders' Equity		
Liabilities		
Deposits:		
Noninterest-bearing	$ 425,608	$ 330,218
Interest-bearing	1,032,413	931,950
Total deposits	1,458,021	1,262,168
Federal funds purchased and repurchase agreements	-	10,532
Other borrowed funds	21,369	21,494
Subordinated notes payable	49,375	-
Accrued interest payable	711	634
Accrued expenses	8,509	8,562
Other liabilities	24,057	13,256
Total liabilities	**1,562,042**	**1,316,646**
Stockholders' Equity		
Preferred stock, $1 par value, 2,000,000 shares authorized 20,000 shares issued and outstanding	20	20
Common stock, $1 par value, 30,000,000 shares authorized; 13,433,801 and 13,346,346 issued and outstanding	13,434	13,346
Additional paid-in capital	42,617	41,092
Retained earnings	125,701	115,258
Accumulated other comprehensive income	1,049	1,370
Total stockholders' equity	**182,821**	**171,086**
Total liabilities and stockholders' equity	**$ 1,744,863**	**$ 1,487,732**

ALERUS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2015, 2014 AND 2013
(dollars in thousands, except share and per share amounts)

	2015	2014	2013
Interest Income			
Loans and leases, including fees	$ 51,731	$ 47,876	$ 43,750
Investment securities			
Taxable	3,496	5,483	5,905
Exempt from federal income taxes	808	817	707
Other	293	218	148
Total interest income	**56,328**	**54,394**	**50,510**
Interest Expense			
Deposits	2,758	2,673	3,101
Short term borrowings	18	22	30
Other borrowed funds	562	621	581
Subordinated notes payable	120	-	-
Total interest expense	**3,458**	**3,316**	**3,712**
Net Interest Income	52,870	51,078	46,798
Provision for credit losses	4,200	(400)	1,200
Net interest income, after provision for credit losses	48,670	51,478	45,598
Non-Interest Income			
Retirement services	51,059	41,058	36,003
Wealth management	11,418	11,119	10,313
Mortgage banking	24,630	18,435	27,177
Service charges on deposit accounts	1,611	1,626	1,639
Net gain (loss) on investment securities	(17)	2,179	(70)
Other	4,554	3,989	4,207
Total non-interest income	**93,255**	**78,406**	**79,269**
Non-Interest Expense			
Salaries	59,122	48,839	49,203
Employee benefits	12,804	11,580	10,621
Net occupancy expense	5,203	4,424	3,791
Furniture and equipment expense	5,018	4,658	4,687
Intangible amortization expense	4,361	4,196	3,321
Other	31,626	26,418	21,290
Total non-interest expenses	**118,134**	**100,115**	**92,913**
Income before income tax expense	23,791	29,769	31,954
Income tax expense	7,289	9,538	11,684
Net Income	16,502	20,231	20,270
Less preferred stock dividends	200	200	200
Net Income Applicable to Common Stock	**$ 16,302**	**$ 20,031**	**$ 20,070**
Per Share Information			
Earnings per common share	$ 1.22	$ 1.51	$ 1.52
Diluted earnings per common share	$ 1.17	$ 1.44	$ 1.46
Dividends declared per common share	$ 0.42	$ 0.38	$ 0.34
Average common shares outstanding	13,412,586	13,289,714	13,205,604
Diluted average common shares outstanding	13,947,136	13,877,344	13,762,044

ALERUS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2015, 2014 AND 2013
(dollars in thousands, except share and per share amounts)

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance, December 31, 2012	**$ 20**	**$ 4,382**	**$ 37,403**	**$ 94,623**	**$ 4,854**	**$141,282**
Net income	-	-	-	20,270	-	20,270
Other comprehensive loss	-	-	-	-	(4,645)	(4,645)
Cash dividend declared preferred – 1.0%	-	-	-	(200)	-	(200)
Cash dividend declared common ($1.02 per share)	-	-	-	(4,689)	-	(4,689)
Issued 8,279 shares under director's retainer plan	-	8	286	-	-	294
Redemption of 4,901 shares of common stock	-	(5)	(34)	(164)	-	(203)
Income tax benefit equity related items	-	-	267	-	-	267
Stock-based compensation expense	-	-	935	-	-	935
Vesting of 31,338 shares of restricted stock	-	31	(31)	-	-	-
Balance, December 31, 2013	**20**	**4,416**	**38,826**	**109,840**	**209**	**153,311**
Net income	-	-	-	20,231	-	20,231
Other comprehensive income	-	-	-	-	1,161	1,161
Issued 5,877 shares under director's retainer plan	-	6	309	-	-	315
Stock dividend 3 for 1	-	8,895	386	(9,281)	-	-
Cash dividend declared preferred – 1.0%	-	-	-	(200)	-	(200)
Cash dividend declared common ($.38 per share)	-	-	-	(5,332)	-	(5,332)
Income tax benefit equity related items	-	-	539	-	-	539
Stock-based compensation expense	-	-	1,061	-	-	1,061
Vesting of 28,872 shares of restricted stock	-	29	(29)	-	-	-
Balance, December 31, 2014	**20**	**13,346**	**41,092**	**115,258**	**1,370**	**171,086**
Net income	-	-	-	16,502	-	16,502
Other comprehensive loss	-	-	-	-	(321)	(321)
Repurchase of stock	-	(1)	(26)	-	-	(27)
Issued 16,326 shares under director's retainer plan	-	16	299	-	-	315
Cash dividend declared preferred – 1.0%	-	-	-	(200)	-	(200)
Cash dividend declared common ($.42 per share)	-	-	-	(5,859)	-	(5,859)
Income tax benefit equity related items	-	-	606	-	-	606
Stock-based compensation expense	-	-	719	-	-	719
Vesting of 72,540 shares of restricted stock	-	73	(73)	-	-	-
Balance, December 31, 2015	**$ 20**	**$ 13,434**	**$ 42,617**	**$125,701**	**$ 1,049**	**$182,821**

ALERUS FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2015, 2014 AND 2013
(dollars in thousands)

	2015	2014	2013
Cash Flows From Operating Activities			
Net income	$ 16,502	$ 20,231	$ 20,270
Adjustments to reconcile net income to net cash			
Deferred income taxes	581	(1,726)	(974)
Provision for credit losses	4,200	(400)	1,200
Provision for foreclosed asset losses	53	-	-
Depreciation and amortization	8,727	8,160	7,465
Compensation related stock plans	1,034	1,376	1,229
Investment security premium amortization	636	1,372	1,783
Increase in value of bank-owned life insurance	(824)	(821)	(832)
Realized loss (gain) on forward sale derivatives	(186)	91	173
Realized loss (gain) on rate lock commitments	139	(104)	(133)
Realized loss (gain) on sale of premises and equipment	-	163	(5)
Realized loss (gain) on sale of foreclosed assets	540	546	299
Realized loss (gain) on sale of investment securities	-	(2,130)	(56)
Realized loss (gain) on servicing rights	(1,178)	(1,045)	(2,214)
Net change in:			
Securities held for trading	13	(59)	(156)
Mortgages held for sale	(13,600)	(4,788)	47,178
Accrued interest receivable	(56)	667	(523)
Other assets	(2,867)	(6,548)	(1,405)
Accrued interest payable	78	(95)	(169)
Accrued taxes and expenses	(54)	2,756	(2,944)
Other liabilities	10,015	3,187	(12,317)
Net cash provided by operating activities	23,753	20,833	57,869
Cash Flows From Investing Activities			
Proceeds from maturities of securities held to maturity	-	-	2,515
Purchases of securities held to maturity	-	-	(11,318)
Proceeds from sales of securities available for sale	-	85,549	3,623
Proceeds from maturities of securities available for sale	40,096	21,516	39,279
Purchases of securities available for sale	(27,490)	(18,391)	(56,328)
Net (increase) decrease in loans and leases	(38,723)	(88,094)	(144,621)
Proceeds from business combinations	(4,314)	(10,843)	(1,882)
Purchases of bank premises and equipment	(3,906)	(2,101)	(3,818)
Proceeds from sales of bank premises and equipment	-	3	21
Proceeds from sales of foreclosed assets	2,126	3,341	6,351
Net cash used by investing activities	(32,211)	(9,020)	(166,178)
Cash Flows From Financing Activities			
Net increase (decrease) in deposits	195,853	(36,359)	66,854
Net increase (decrease) in short-term borrowings	(10,532)	2,657	(4,729)
Repayments of notes payable	(125)	(136)	(126)
Proceeds from issuance of subordinated debt	49,375	-	-
Cash dividends paid on preferred stock	(200)	(200)	(200)
Cash dividends paid on common stock	(5,859)	(5,332)	(4,689)
Tax benefits on stock plans	606	539	267
Repurchase of common stock	(27)	-	(203)
Net cash provided (used) by financing activities	229,091	(38,831)	57,174
Net Change in Cash and Due From Banks	**220,633**	**(27,018)**	**(51,135)**
Cash and due from banks at beginning of year	45,526	72,544	123,679
Cash and Due From Banks	**$266,159**	**$ 45,526**	**$ 72,544**

	2015	2014	2013
Supplemental Cashflow Disclosures			
Loan collateral transferred to foreclosed assets	$ 684	$ 1,499	$ 1,371
Unrealized gain/(loss) on securities available for sale	(321)	1,161	(4,645)
Interest paid for the period	3,381	3,394	3,881
Income tax payments net of refunds received	10,165	11,257	15,128
Acquisitions			
Noncash assets acquired	4,572	127,650	1,882
Liabilities assumed	(258)	(116,807)	-
Net noncash asset acquired	4,314	10,843	1,882
Cash & cash equivalents acquired	-	17,690	-

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INDEPENDENT AUDITORS' REPORT

Board of Directors and Audit Committee
Alerus Financial Corporation and Subsidiaries
Grand Forks, North Dakota

We have audited, in accordance with the auditing standards generally accepted in the United States of America, the consolidated financial statements of Alerus Financial Corporation and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for years then ended, and the related notes to the consolidated financial statements (not presented herein); and in our report dated March 4, 2016, we expressed an unqualified opinion on those consolidated financial statements.

Other Matters

Prior Period Consolidated Financial Statements

The consolidated financial statements of Alerus Financial Corporation and Subsidiaries for the year ended December 31, 2013 were audited by other auditors whose report, dated February 18, 2014, expressed an unqualified opinion on those statements.

Opinion

In our opinion, the information set forth in the accompanying consolidated balance sheets, statements of income, changes in stockholders' equity and cash flows are fairly stated, in all material respects, in relation to the consolidated financial statements from which they were derived.

CliftonLarsonAllen LLP

CliftonLarsonAllen LLP
Minneapolis, Minnesota
March 18, 2016

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