AGENCY OVERVIEW

471 Bank of North Dakota

Date: 12/07/2012
Time: 13:54:48

Statutory Authority
North Dakota Century Code Chapter 6-09.

Agency Description
The Bank of North Dakota serves as the development bank for agriculture, commerce, and industry in North Dakota. The strategic objectives of the Bank include delivering quality programs and services to expand the economy of North Dakota; providing a culture that develops the skills of its people and is a model of efficient business and government; and generating a consistent financial return to the State of North Dakota while maintaining the strength and financial integrity of BND.

Agency Mission Statement
Bank of North Dakota's mission is to deliver quality, sound financial services that promote agriculture, commerce, and industry in North Dakota.

Agency Performance Measures
In meeting BND's performance, there are three areas that we believe should be monitored: Financial performance, achieving BND's mission, and meeting legislative expectations.

1. Financial Performance - The Department of Financial Institutions (DFI) evaluates the safety and soundness of banks utilizing the "CAMELS" rating system. CAMELS is an acronym standing for: Capital, Asset Quality, Management, Earnings, Liquidity and funds management, and Sensitivity.
2. Meeting the Mission - To deliver quality, sound financial services that promote agriculture, commerce, and industry. We measure our success in achieving our mission by the quality and usage of our programs.
3. Meeting Legislative expectations - ND legislature has two distinct expectations of BND. They expect that BND will continue to be a major player in the economic evolution of the State of North Dakota and that BND can be a source of revenue for the State's General Fund. We believe that if we meet our mission and financial performance objectives, we will fulfill the expectations of the legislature.

Return on Average Assets: Return on assets for 2011, 2010, and 2009 were 1.48 percent, 1.5 percent. and 1.6 percent.

Return on Average Equity: Return on average equity for 2011, 2010, and 2009 were 19.3 percent, 20.8 percent, and 23.8 percent.

Leverage Ratio: The leverage ratio for 2011, 2010, and 2009 were 7.7 percent, 7.9 percent, and 7.2 percent. BND's benchmark is 8.0 percent.

Major Accomplishments
1. Experienced tremendous asset growth. As of June 30, 2011, BND's asset size was $4.73 billion. Today BND's asset size is $5.72 billion, an increase of 21.0 percent. Over the past 5 years, BND's assets have nearly doubled while its FTE count has remained the same.
2. Closed 2011 with a nearly $3.00 billion loan portfolio, up a modest 6.4 percent over 2010. BND's loan portfolio concentrates on 4 main loan program areas: agriculture, commercial, residential, and student loans. Overall, loans totaled $2.99 billion after $178.0 million in new loan growth for the year 2011.
3. Launched a Loan Sub-Participation initiative in 2012 in response to strong loan demand from oil impacted western ND counties and as part of BND's efforts to manage loan concentration risk. This initiative provides for BND to sell loans to ND banks from its portfolio.
4. Participated in 291 North Dakota business and industrial projects in 2011. BND spurred economic development by funding or renewing $573.0 million of commercial participation with financial institution partners in the $1.04 billion commercial loan portfolio.
5. Increased BND's residential portfolio by over $100.0 million in 2011. BND made 25 loans through two new rural housing programs, accounting for $3.8 million of its $574.0 million portfolio. BND also started a conventional mortgage loan origination program approved by the 2011 legislature that was just starting to see usage at the end of 2011.
6. Disbursed over $103.0 million in student loans in 2011 and the total portfolio increased by 1.8 percent to $1.09 billion. The loss of the Federal Family Education Loan (FFEL) Program in 2010 impacted the overall portfolio's growth, but was replaced by increased activity in BND's Dakota Education Alternative Loan (DEAL) Program. DEAL volume increased by 6.0 percent in 2011. BND disbursed over $47.7 million in DEAL loans in the first 6 months of 2012.

7. Grew the agriculture loan portfolio by 4.0 percent in 2011 to $289.0 million. Increased activity in farm real estate loans contributed to the overall growth of the Ag portfolio in 2011.
8. Grew BND's earnings in 2011 by 13.7 percent over 2010 to $70.3 million. BND's return on average equity was 19.3 percent, which reflects the state's return on its investment in BND.
9. Established the College Planning Center to consolidate programs including College Save, Dollars for Scholars, NDCAN and education outreach under one entity. Created a new user friendly website to help North Dakotans plan for college from cradle to career.
10. Entered into a service contract with the Missouri Higher Education Loan Authority (MOHELA) to service BND's allotment of Federal Direct Student Loans. This agreement will result in BND recognizing additional earnings of approximately $625,000 the first 4 years and $250,000 thereafter.
11. Implemented the Rebuilders Loan Program, which was authorized during the 2011 Special Session by designating $50.0 million to help flood-impacted homeowners rebuild or purchase a home in the same community. The Rebuilders Loan Program allowed homeowners to apply for up to $30,000 to cover qualifying expenses. The first $30.0 million of this program was funded with BND's retained earnings. At the end of 2011, nearly $10.0 million in loans were closed or in process for 322 homeowners. As of August 31, 2012, BND has made 1,094 loans totaling nearly $32.0 million, with 284 more loans in process.
12. Received an upgraded credit rating, from A+ to AA-, in 2011 by Standard and Poors (S&P), putting BND in a rating category with the highest-rated U.S. banks. The rating of AA- was affirmed in July, 2012.
13. Acquired two adjacent properties for $517,020 in December 2011 at the direction of the 2011 Legislature.

Future Critical Issues

The CAMELS rating system is utilized in the banking industry to evaluate the safety and soundness of a bank. In order to meet the financial objectives of maintaining the strength of BND and providing a consistent return to the State of North Dakota, it is critical that capital, asset quality, earnings, liquidity and fund management, and sensitivity continue to be managed. The components of the CAMELS rating system are:

- Capital: BND monitors its risk based capital ratios and primary capital ratio identified in conjunction with the banking industry standards. Capital is needed to maintain the strength of the bank. Industry and regulatory requirements will put pressure on the financial industry to increase capital levels. BND has a capital level benchmark of 8.0 percent that has proven to be difficult to attain. Capital growth is obtained in only one way for BND - net profits retained. Despite the fact that BND has had solid earnings for many years and the legislature has limited the amount transferred from BND profits, the leverage ratio at BND has not met its capital benchmark. Primarily this is due to asset growth fueled by significant captive deposit growth as well as the overall excess liquidity within all financial institutions across the State.
- Asset quality: BND monitors delinquencies, classified loans, non-accrual loans, allowance for loan loss, concentrations of credit, restructured loans, loan distribution, off-balance sheet risk, loan documentation exceptions, loan charge offs and recoveries, adversely classified assets and investment ratings. Asset quality is needed to maintain the strength and provide consistent earnings for the bank.
- Management: BND management is responsible for monitoring and controlling the components of the CAMELS rating system.
- Earnings: BND monitors interest margin, income and expenses as a percentage of average assets, and return on assets and equity. Sufficient earnings are needed to maintain adequate capital and provide resources to the general fund.
- Liquidity and funds management: The objective of liquidity and funds management is to ensure the continuous availability of funds to meet the demands of depositors and borrowers.
- Sensitivity (Interest Rate Risk): BND's principal objective for interest rate risk management is to control exposure of net interest income to risks associated with interest rate movements.

It is continually important to balance the financial and business objectives of the bank with the social and political objectives to expand North Dakota's economy. It is equally important to provide a culture that develops people, acts as a model of efficient business and government, and exemplifies the core values of the bank. BND strives to be a leader in technology in order to provide quality customer service and meet customer needs.

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BND's continues to deal with increased regulatory requirements related to financial institutions. The effects of Dodd Frank, Basel III, SOX 404, and information security program requirements are burdensome. The role of compliance in the banking industry cannot be overstated and our entire bank feels the effects on a daily basis.

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REQUEST SUMMARY

471 Bank of North Dakota **Bill#: SB2014** **Date:** 12/07/2012
Biennium: 2013-2015 **Time:** 13:54:48

Description	Expenditures 2009-2011 Biennium	Present Budget 2011-2013	Budget Request Change	Requested Budget 2013-2015 Biennium	Optional Budget Request
By Major Program					
Bank of North Dakota Operations	47,238,957	91,253,155	(31,713,592)	59,539,563	28,821,698
Total Major Program	**47,238,957**	**91,253,155**	**(31,713,592)**	**59,539,563**	**28,821,698**
By Line Item					
Capital Assets	318,510	1,266,000	(521,000)	745,000	0
Western Area Water Supply	0	35,000,000	(35,000,000)	0	0
PACE Fund	8,000,000	6,000,000	0	6,000,000	21,718,000
Agriculture PACE Prog.	1,400,000	1,000,000	0	1,000,000	1,000,000
Beginning Farmer Prog.	0	1,400,000	0	1,400,000	4,600,000
Biofuels PACE	700,000	1,000,000	0	1,000,000	1,000,000
BND Operations	36,820,447	45,587,155	3,807,408	49,394,563	503,698
Total Line Items	**47,238,957**	**91,253,155**	**(31,713,592)**	**59,539,563**	**28,821,698**
By Funding Source					
General Fund	10,100,000	34,400,000	(25,000,000)	9,400,000	28,318,000
Federal Funds	693,244	3,000,000	0	3,000,000	0
Special Funds	36,445,713	53,853,155	(6,713,592)	47,139,563	503,698
Total Funding Source	**47,238,957**	**91,253,155**	**(31,713,592)**	**59,539,563**	**28,821,698**
Total FTE	**176.50**	**176.50**	**0.00**	**176.50**	**3.00**

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REQUEST DETAIL

471 Bank of North Dakota **Bill#: SB2014** **Date:** 12/07/2012
Biennium: 2013-2015 **Time:** 13:54:48

Description	Expenditures 2009-2011 Biennium	Present Budget 2011-2013	Budget Request Change	Requested Budget 2013-2015 Biennium	Optional Budget Request
Capital Assets					
Equipment Over $5000	124,640	132,000	118,000	250,000	0
IT Equip/Sftware Over $5000	193,870	1,134,000	(639,000)	495,000	0
Total	**318,510**	**1,266,000**	**(521,000)**	**745,000**	**0**
Capital Assets					
General Fund	0	0	0	0	0
Federal Funds	0	0	0	0	0
Special Funds	318,510	1,266,000	(521,000)	745,000	0
Total	**318,510**	**1,266,000**	**(521,000)**	**745,000**	**0**
Western Area Water Supply					
Transfers Out	0	35,000,000	(35,000,000)	0	0
Total	**0**	**35,000,000**	**(35,000,000)**	**0**	**0**
Western Area Water Supply					
General Fund	0	25,000,000	(25,000,000)	0	0
Federal Funds	0	0	0	0	0
Special Funds	0	10,000,000	(10,000,000)	0	0
Total	**0**	**35,000,000**	**(35,000,000)**	**0**	**0**
PACE Fund					
Transfers Out	8,000,000	6,000,000	0	6,000,000	21,718,000
Total	**8,000,000**	**6,000,000**	**0**	**6,000,000**	**21,718,000**
PACE Fund					
General Fund	8,000,000	6,000,000	0	6,000,000	21,718,000
Federal Funds	0	0	0	0	0
Special Funds	0	0	0	0	0
Total	**8,000,000**	**6,000,000**	**0**	**6,000,000**	**21,718,000**
Agriculture PACE Prog.					
Transfers Out	1,400,000	1,000,000	0	1,000,000	1,000,000
Total	**1,400,000**	**1,000,000**	**0**	**1,000,000**	**1,000,000**
Agriculture PACE Prog.					
General Fund	1,400,000	1,000,000	0	1,000,000	1,000,000
Federal Funds	0	0	0	0	0
Special Funds	0	0	0	0	0

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REQUEST DETAIL

471 Bank of North Dakota **Bill#: SB2014** **Date:** 12/07/2012
Biennium: 2013-2015 **Time:** 13:54:48

Description	Expenditures 2009-2011 Biennium	Present Budget 2011-2013	Budget Request Change	Requested Budget 2013-2015 Biennium	Optional Budget Request
Total	**1,400,000**	**1,000,000**	**0**	**1,000,000**	**1,000,000**
Beginning Farmer Prog.					
Transfers Out	0	1,400,000	0	1,400,000	4,600,000
Total	**0**	**1,400,000**	**0**	**1,400,000**	**4,600,000**
Beginning Farmer Prog.					
General Fund	0	1,400,000	0	1,400,000	4,600,000
Federal Funds	0	0	0	0	0
Special Funds	0	0	0	0	0
Total	**0**	**1,400,000**	**0**	**1,400,000**	**4,600,000**
Biofuels PACE					
Transfers Out	700,000	1,000,000	0	1,000,000	1,000,000
Total	**700,000**	**1,000,000**	**0**	**1,000,000**	**1,000,000**
Biofuels PACE					
General Fund	700,000	1,000,000	0	1,000,000	1,000,000
Federal Funds	0	0	0	0	0
Special Funds	0	0	0	0	0
Total	**700,000**	**1,000,000**	**0**	**1,000,000**	**1,000,000**
BND Operations					
Salaries - Permanent	15,855,064	18,178,473	958,127	19,136,600	369,352
Temporary Salaries	667,373	330,000	573,460	903,460	0
Fringe Benefits	6,003,300	7,207,926	344,821	7,552,747	134,346
Travel	315,671	442,000	0	442,000	0
Supplies - IT Software	290,789	495,000	30,000	525,000	0
Supply/Material-Professional	42,639	55,000	0	55,000	0
Office Supplies	389,222	470,000	25,000	495,000	0
Postage	1,146,416	1,220,000	80,000	1,300,000	0
IT Equip Under $5,000	390,027	430,000	90,000	520,000	0
Other Equip Under $5,000	158,294	100,000	0	100,000	0
Utilities	192,338	225,000	20,000	245,000	0
Insurance	37,291	50,000	0	50,000	0
Rentals/Leases-Equip & Other	42,802	55,000	0	55,000	0
Repairs	371,469	455,000	10,000	465,000	0
Salary Increase	0	0	0	0	0
Benefit Increase	0	0	0	0	0

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REQUEST DETAIL

471 Bank of North Dakota **Bill#: SB2014**

Biennium: 2013-2015

Date: 12/07/2012
Time: 13:54:48

Description	Expenditures 2009-2011 Biennium	Present Budget 2011-2013	Budget Request Change	Requested Budget 2013-2015 Biennium	Optional Budget Request
IT - Data Processing	3,305,164	2,650,000	718,000	3,368,000	0
IT - Communications	579,840	690,000	(60,000)	630,000	0
IT Contractual Srvcs and Rprs	1,959,875	3,876,000	182,000	4,058,000	0
Professional Development	747,357	750,000	113,400	863,400	0
Operating Fees and Services	993,435	3,142,756	260,244	3,403,000	0
Fees - Professional Services	1,543,852	1,565,000	418,000	1,983,000	0
Special Line Other	1,788,229	3,200,000	44,356	3,244,356	0
Total	**36,820,447**	**45,587,155**	**3,807,408**	**49,394,563**	**503,698**
BND Operations					
General Fund	0	0	0	0	0
Federal Funds	693,244	3,000,000	0	3,000,000	0
Special Funds	36,127,203	42,587,155	3,807,408	46,394,563	503,698
Total	**36,820,447**	**45,587,155**	**3,807,408**	**49,394,563**	**503,698**
Funding Sources					
General Fund	10,100,000	34,400,000	(25,000,000)	9,400,000	28,318,000
Federal Funds	693,244	3,000,000	0	3,000,000	0
Special Funds	36,445,713	53,853,155	(6,713,592)	47,139,563	503,698
Total Funding Sources	**47,238,957**	**91,253,155**	**(31,713,592)**	**59,539,563**	**28,821,698**

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CHANGE PACKAGE SUMMARY

471 Bank of North Dakota **Bill#: SB2014**
Biennium: 2013-2015

Date: 12/07/2012
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Description	Priority	FTE	General Fund	Federal Funds	Special Funds	Total Funds
Base Budget Changes						
One Time Budget Changes						
A-E 5 Remove Western Area Water Supply Appropriation		0.00	(25,000,000)	0	(10,000,000)	(35,000,000)
Total One Time Budget Changes		**0.00**	**(25,000,000)**	**0**	**(10,000,000)**	**(35,000,000)**
Ongoing Budget Changes						
A-A 1 Purchase or Replacement of IT Equipment		0.00	0	0	495,000	495,000
A-A 2 Changes in Operating Expenses		0.00	0	208,947	1,722,053	1,931,000
A-A 3 Purchase or Replacement of Capital Equip		0.00	0	0	250,000	250,000
A-F 4 Remove Current Biennium Capital Assets		0.00	0	0	(1,266,000)	(1,266,000)
Base Payroll Change		0.00	0	(208,947)	2,085,355	1,876,408
Total Ongoing Budget Changes		**0.00**	**0**	**0**	**3,286,408**	**3,286,408**
Total Base Budget Changes		**0.00**	**(25,000,000)**	**0**	**(6,713,592)**	**(31,713,592)**
Optional Budget Changes						
Ongoing Optional Changes						
A-C 8 Optional Request for PACE/Flex PACE Funds	2	0.00	22,000,000	0	0	22,000,000
A-C 7 New FTE - Loan Officer	3	1.00	0	0	217,702	217,702
A-C 9 New FTE - Compliance Officer	4	1.00	0	0	165,534	165,534
A-C 10 New FTE - Collection Officer II (CSR)	5	1.00	0	0	120,462	120,462
A-C 12 Optional Request for Beginning Farmer Fund	6	0.00	4,600,000	0	0	4,600,000
A-C 13 Optional Request for Ag Pace Funds	7	0.00	1,000,000	0	0	1,000,000
A-C 14 Optional Request for Biofuels PACE Program	8	0.00	1,000,000	0	0	1,000,000
Total Ongoing Optional Changes		**3.00**	**28,600,000**	**0**	**503,698**	**29,103,698**
Total Optional Budget Changes		**3.00**	**28,600,000**	**0**	**503,698**	**29,103,698**
Optional Savings Changes						
A-G 1 Optional Savings	1	0.00	(282,000)	0	0	(282,000)
Total Optional Savings Changes		**0.00**	**(282,000)**	**0**	**0**	**(282,000)**

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BUDGET CHANGES NARRATIVE

Date: 12/07/2012

471 Bank of North Dakota **Bill#: SB2014** **Time:** 13:54:48

Change Group: A	**Change Type:** A	**Change No:** 1	**Priority:** 1

Purchase or Replacement of IT Equipment

This change package represents the Bank's capital expenditure needs for replacment or new IT equipment and software.

Change Group: A	**Change Type:** A	**Change No:** 2	**Priority:** 1

Changes in Operating Expenses

This change package represents the changes in the needs for maintaining the operations of the Bank.

Change Group: A	**Change Type:** A	**Change No:** 3	**Priority:** 1

Purchase or Replacement of Capital Equip

This change package represents BND's capital expenditures for new or replacement equipment.

Change Group: A	**Change Type:** C	**Change No:** 7	**Priority:** 3

New FTE - Loan Officer

BND is requesting a new FTE for a Loan Officer position. Since 2004, our lending portfolio has doubled primarily driven by the commercial and student loan areas. In addition to this growth, we are currently piloting a mortgage loan origination program which also adds to our overall loan portfolio. For these reasons, we believe that we will need to add at least 1 FTE to effectively manage not only these but our agriculture loan portfolio as well.

Change Group: A	**Change Type:** C	**Change No:** 8	**Priority:** 2

Optional Request for PACE/Flex PACE Funds

The base budget of $6,000,000, plus an increase of $22,000,000 is requested for the Pace/Flex Pace fund. For the Optional increase, $10,000,000 is requested to meet the current usage demands for the Flex Pace program and $12,000,000 is for what the Governor is budgeting for affordable housing. There has been a high demand for these programs.

Change Group: A	**Change Type:** C	**Change No:** 9	**Priority:** 4

New FTE - Compliance Officer

BND is requesting an additional FTE for a Compliance Officer position for the Risk Management function. Many changes have occurred in the regulatory environment related to financial institutions, some of which have not yet been fully integrated. The effects of Dodd Frank and BASEL III, a review of our internal control environment related to SOX404, and also continued implementation of our information security program indicate a need for an additional FTE in this area. The role of compliance in the banking industry cannot be overstated and our entire bank feels the effects on a daily basis.

Change Group: A	**Change Type:** C	**Change No:** 10	**Priority:** 5

New FTE - Collection Officer II (CSR)

BUDGET CHANGES NARRATIVE

471 Bank of North Dakota **Bill#: SB2014** **Date:** 12/07/2012 **Time:** 13:54:48

BND is requesting a new FTE for a Collection Officer II (CSR) position for Student Loans. Due to the increase in our DEAL loan portfolio and also the addition of the DEAL consolidation program, an additional FTE in the customer service area of student loans is necessary in order to continue to provide excellent customer service to our borrowers. Due to the downturn in the US economy, our ability to keep our delinquency rates at a manageable level is directly related to the service we provide to our student loan customers.

Change Group: A	**Change Type:** C	**Change No:** 12	**Priority:** 6

Optional Request for Beginning Farmer Fund

Additional funds of $4,600,000 are requested to meet the demands for the chattel and real estate buydown funds.

Change Group: A	**Change Type:** C	**Change No:** 13	**Priority:** 7

Optional Request for Ag Pace Funds

Additional funds of $1,000,000 are requested to meet the demand for field tiling projects.

Change Group: A	**Change Type:** C	**Change No:** 14	**Priority:** 8

Optional Request for Biofuels PACE Program

Additional funds of $1,000,000 are requested based on the usage of these funds during the current biennium.

Change Group: A	**Change Type:** E	**Change No:** 5	**Priority:** 2

Remove Western Area Water Supply Appropriation

This change package is to remove the Western Area Water Supply project appropriation.

Change Group: A	**Change Type:** F	**Change No:** 4	**Priority:** 1

Remove Current Biennium Capital Assets

This change package is to reduce the Bank's request related to the current biennium's capital asset requests.

Change Group: A	**Change Type:** G	**Change No:** 1	**Priority:** 1

Optional Savings

This change package represents the 3% optional savings package for general fund monies.

Change Group: R	**Change Type:** A	**Change No:** 1	**Priority:**

New FTE Loan Officer

BUDGET CHANGES NARRATIVE

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Authorizes 1.00 FTE and $217,702 in special funds for a loan officer position to meet the demands of BND's growing loan portfolio.

Change Group: R	**Change Type:** A	**Change No:** 2	**Priority:**

New FTE Compliance Officer

Authorizes 1.00 FTE and $165,534 in special funds for a compliance officer to address the increase of regulatory demands placed on financial institutions.

Change Group: R	**Change Type:** A	**Change No:** 3	**Priority:**

New FTE Collection Officer

Authorizes 1.00 FTE and $120,462 in special funds for a collection officer position for student loans in order to keep delinquency rates at a manageable level.

Change Group: R	**Change Type:** A	**Change No:** 4	**Priority:**

Remove GF Transfer to PACE & Beg. Farmer Funds

The executive budget includes a $38.0 million transfer from Bank of North Dakota profits to PACE and Beginning Farmer programs allocated as follows: PACE/Flex PACE - $28.0 million, includes $12.0 for affordable housing projects; Ag PACE - $2.0 million; Biofuels PACE - $2.0 million; and Beginning Farmer program - $6.0 million. This change package removes the agency's base budget request for a $9.4 million general fund transfer to PACE and Beginning Farmer programs.

Change Group: R	**Change Type:** A	**Change No:** 5	**Priority:**

Remove Salary Increases Related to Potential Reclasses

Removes $462,000 in special funds for potential position reclassifications included in the agency's base budget request.

Change Group: R	**Change Type:** A	**Change No:** 100	**Priority:**

Executive Compensation Package Adjustment

This budget change provides funding for recommended 2013-15 compensation adjustments. Compensation adjustments for each agency were calculated following the recommendations of the Hay Group developed through the 2011 study of the state's classified employee compensation system. Pursuant to those recommendations, compensation adjustments were calculated to provide funding to allow for both performance-based salary adjustments and market-based salary adjustments. This funding allows for increases of 2% to 4% for employees in the first quartile of the pay range and 1% to 2% for those in the second quartile of the range. For employees in the third and fourth quartiles, which are above the market policy position, no market policy increase is funded. Performance-based increases are assumed to be 3% for employees meeting performance standards and up to 5% for employees exceeding performance standards. No performance-based increases are provided for employees that fail to meet performance standards.