

BANK OF SOUTH CAROLINA CORP  
Form 10-Q  
November 06, 2015

**Securities and Exchange Commission**

**Washington, D.C. 20549**

**Form 10-Q**

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2015

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number: 0-27702

**Bank of South Carolina Corporation**

(Exact name of registrant issuer as specified in its charter)

<u>South Carolina</u>	<u>57-1021355</u>
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)

J56 Meeting Street, Charleston, SC 29401

(Address of principal executive offices)

(843) 724-1500

(Registrant's telephone number)

Indicate by check mark whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its Company Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer Accelerated Filer  
Non-accelerated filer Smaller reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  
No

As of November 6, 2015 there were 4,916,600 Common Shares outstanding.

Bank of South Carolina Corporation and Subsidiary

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**Part I. Financial Information****Item 1. Financial Statements****Bank of South Carolina Corporation and Subsidiary****Consolidated Balance Sheets**

	<b>(Unaudited)</b>	<b>(Audited)</b>
<b>Assets:</b>	<b><u>September</u></b>	<b><u>December 31,</u></b>
	<b><u>30, 2015</u></b>	<b><u>2014</u></b>
Cash and due from banks	\$6,516,874	\$4,698,435
Interest bearing deposits in other banks	12,468,073	5,680,613
Investment securities available for sale	116,001,867	113,994,112
Mortgage loans to be sold	7,018,137	7,325,081
Loans	241,250,253	234,117,792
Less: Allowance for loan losses	(3,289,271 )	(3,334,848 )
Net loans	237,960,982	230,782,944
Premises and equipment, net	2,297,831	2,352,423
Other real estate owned	620,394	521,943
Accrued interest receivable	1,118,076	1,290,380
Other assets	556,859	579,871
 Total assets	 \$384,559,093	 \$367,225,802
 <b>Liabilities and Shareholders' Equity:</b>		
<b>Liabilities</b>		
<b>Deposits:</b>		
Non-interest bearing demand	\$116,488,824	\$107,072,271
Interest bearing demand	79,865,760	79,397,647
Money market accounts	56,659,892	47,450,210
Time deposits over \$250,000	34,121,413	32,363,615
Other time deposits	30,297,705	29,457,720
Other savings deposits	26,318,910	26,677,564
Total deposits	343,752,504	322,419,027
 Short-term borrowings	 481,141	 6,980,681
Accrued interest payable and other liabilities	1,328,087	1,066,112
Total liabilities	345,561,732	330,465,820
 Shareholders' Equity		
Common Stock - No par value;		

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12,000,000 shares authorized; Shares issued 5,157,006  
at September 30, 2015 and 4,680,839 at December 31, 2014.

Shares outstanding 4,915,610 at September 30, 2015 and  
4,461,388 at December 31, 2014.

Additional paid in capital	—	—
Retained earnings	36,312,008	28,779,108
Treasury stock: 241,396 shares at September 30, 2015 and 219,451 at December 31, 2014	3,477,121	8,640,291
Accumulated other comprehensive income, net of income taxes	(2,247,415 )	(1,902,439 )
	1,455,647	1,243,022
Total shareholders' equity	38,997,361	36,759,982
Total liabilities and shareholders' equity	\$384,559,093	\$367,225,802

See accompanying notes to consolidated financial statements

**Bank of South Carolina Corporation and Subsidiary****Consolidated Statements of Income (Unaudited)**

	Three Months Ended September 30,	
	2015	2014
Interest and fee income		
Interest and fees on loans	\$2,975,653	\$2,868,904
Interest and dividends on investment securities	581,708	536,034
Other interest income	12,311	14,927
Total interest and fee income	3,569,672	3,419,865
Interest expense		
Interest on deposits	101,199	104,009
Interest on short-term borrowings	31	244
Total interest expense	101,230	104,253
Net interest income	3,468,442	3,315,612
Provision for loan losses	7,500	12,500
Net interest income after provision for loan losses	3,460,942	3,303,112
Other income		
Service charges, fees and commissions	240,306	223,369
Mortgage banking income	413,077	383,304
Other non-interest income	8,655	8,330
Gain on sale of other real estate owned	—	2,382
Total other income	662,038	617,385
Other expense		
Salaries and employee benefits	1,450,852	1,349,779
Net occupancy expense	372,727	369,201
Other operating expenses	549,163	522,998
Total other expense	2,372,742	2,241,978
Income before income tax expense	1,750,238	1,678,519
Income tax expense	551,319	536,806
Net income	\$1,198,919	\$1,141,713
Basic income per common share	\$0.24	\$0.23
Diluted income per common share	\$0.24	\$0.23
Weighted average shares outstanding		
Basic	4,915,610	4,907,203
Diluted	5,061,685	5,020,082

Cash Dividend Per Share	\$0.13	\$0.23
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All share and per share data have been restated to reflect a 10% stock dividend declared August 27, 2015.

See accompanying notes to consolidated financial statements



**Bank of South Carolina Corporation and Subsidiary****Consolidated Statements of Income (Unaudited)**

	Nine Months Ended September 30,	
	2015	2014
Interest and fee income		
Interest and fees on loans	\$8,798,553	\$8,392,884
Interest and dividends on investment securities	1,770,754	1,516,239
Other interest income	25,629	33,483
Total interest and fee income	10,594,936	9,942,606
Interest expense		
Interest on deposits	293,356	308,655
Interest on short-term borrowings	924	244
Total interest expense	294,280	308,899
Net interest income	10,300,656	9,633,707
Provision for loan losses	82,500	62,500
Net interest income after provision for loan losses	10,218,156	9,571,207
Other income		
Service charges, fees and commissions	728,799	679,806
Mortgage banking income	1,247,813	913,646
Other non-interest income	20,175	20,384
Gain on sale of other real estate owned	—	2,382
Gain on sale of securities	264,401	223,735
Total other income	2,261,188	1,839,953
Other expense		
Salaries and employee benefits	4,342,702	4,008,738
Net occupancy expense	1,112,354	1,101,929
Other operating expenses	1,656,198	1,624,749
Total other expense	7,111,254	6,735,416
Income before income tax expense	5,368,090	4,675,744
Income tax expense	1,710,774	1,468,306
Net income	\$3,657,316	\$3,207,438
Basic income per common share	\$0.74	\$0.65
Diluted income per common share	\$0.72	\$0.64
Weighted average shares outstanding		
Basic	4,911,142	4,907,203

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Diluted	5,062,695	5,019,905
Cash Dividend Per Share	\$0.39	\$0.49

All share and per share data have been restated to reflect a 10% stock dividend declared August 27, 2015.

See accompanying notes to consolidated financial statements

**Bank of South  
Carolina  
Corporation  
and Subsidiary  
Consolidated  
Statements of  
Comprehensive  
Income**

**(Unaudited)**

	Three Months Ended September 30,	
	2015	2014
Net income	\$1,198,919	\$1,141,713
Other comprehensive income		
Unrealized gain (loss) on securities (net of tax \$295,129 and \$47,757, respectively)	502,516	(81,316 )
Other comprehensive income (loss), net of tax	502,516	(81,316 )
Total Comprehensive income	\$1,701,435	\$1,060,397

	Nine Months Ended September 30,	
	2015	2014
Net income	\$3,657,316	\$3,207,438
Other comprehensive income		
Unrealized gain on securities (net of tax \$27,046 and \$53,306, respectively)	379,197	231,718
Reclassification adjustment for gains included in income (net of tax \$97,829 and \$82,782, respectively)	(166,572 )	(140,953 )
Other comprehensive income, net of tax	212,625	90,765
Total Comprehensive income	\$3,869,941	\$3,298,203

See accompanying notes to consolidated financial statements.

**Bank of  
South  
Carolina  
Corporation  
and  
Subsidiary  
Consolidated  
Statements of  
Shareholders'  
Equity  
For the Nine  
Months  
Ended  
September  
30, 2015 and  
2014  
(Unaudited)**

	Additional Paid in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income	Total
December 31, 2013	\$28,678,150	\$7,007,532	\$(1,902,439)	\$ 955,900	\$34,739,143
Net income	—	3,207,438	—	—	3,207,438
Other comprehensive income	—	—	—	90,765	90,765
Exercise of stock options	26,050	—	—	—	26,050
Stock-based compensation expense	55,709	—	—	—	55,709
Cash dividends (\$0.49 per common share)	—	(2,186,080)	—	—	(2,186,080 )
September 30, 2014	\$28,759,909	\$8,028,890	\$(1,902,439)	\$ 1,046,665	\$35,933,025
December 31, 2014	\$28,779,108	\$8,640,291	\$(1,902,439)	\$ 1,243,022	\$36,759,982
Net income	—	3,657,316	—	—	3,657,316
Other comprehensive income	—	—	—	212,625	212,625
Exercise of stock options	113,254	—	—	—	113,254
10% Stock dividend 446,597 common 21,945 treasury at \$15.72	7,360,703	(7,020,505)	(344,976 )	—	(4,778 )
Stock-based					

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compensation expense	58,943	—	—	—	58,943
Cash dividends (\$0.39 per common share)	—	(1,799,981)	—	—	(1,799,981)
September 30, 2015	\$36,312,008	\$3,477,121	\$(2,247,415)	\$ 1,455,647	\$38,997,361

See accompanying notes to consolidated financial statements.

**Bank of South Carolina Corporation and Subsidiary****Consolidated Statements of Cash Flows (Unaudited)**

	Nine Months Ended September 30,	
	2015	2014
Cash flows from operating activities:		
Net income	\$3,657,316	\$3,207,438
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	148,425	152,869
Gain on sale of securities	(264,401 )	(223,735 )
Gain on sale of other real estate owned	—	(2,382 )
Provision for loan losses	82,500	62,500
Stock-based compensation expense	58,943	55,709
Net amortization of unearned discounts on investments	73,622	256,679
Origination of mortgage loans held for sale	(74,776,964)	(50,265,314)
Proceeds from sale of mortgage loans held for sale	75,083,908	48,374,207
Decrease (increase) in accrued interest receivable and other assets	334,841	(161,354 )
Increase in accrued interest payable and other liabilities	202,926	358,805
Net cash provided by operating activities	4,601,116	1,815,422
Cash flows from investing activities:		
Proceeds from maturities of investment securities available for sale	2,315,000	1,920,000
Proceeds from sale of investment securities available for sale	15,219,799	19,529,603
Proceeds from sale of other real estate owned	—	37,855
Purchase of investment securities available for sale	(19,278,675)	(33,418,244)
Net increase in loans	(7,358,989 )	(11,879,322)
Purchase of premises, equipment and leasehold improvements, net	(93,833 )	(98,424 )
Net cash used by investing activities	(9,196,698 )	(23,908,532)
Cash flows from financing activities:		
Net increase in deposit accounts	21,333,477	24,032,780
Net (decrease) increase in short-term borrowings	(6,499,540 )	9,680,244
Dividends paid	(1,740,932 )	(1,739,616 )
Cash paid for fractional shares	(4,778 )	—
Stock options exercised	113,254	26,050

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Net cash provided by financing activities	13,201,481	31,999,458
Net increase in cash and cash equivalents	8,605,899	9,906,348
Cash and cash equivalents at beginning of period	10,379,048	22,124,096
Cash and cash equivalents at end of period	\$18,984,947	\$32,030,444
Supplemental disclosure of cash flow data:		
Cash paid during the period for:		
Interest	\$313,689	\$329,710
Income taxes	\$1,631,252	\$1,232,000
Supplemental disclosure for non-cash investing and financing activity:		
Change in dividends payable	\$59,049	\$446,464
Change in unrealized gain on available for sale securities, net of tax	\$212,625	\$90,765
Transfer of loans to other real estate owned	\$98,451	\$557,416

See accompanying notes to consolidated financial statements.

Bank of South Carolina Notes to Consolidated Financial Statements

**Note 1: Basis of Presentation**

The Bank of South Carolina (the “Bank”) was organized on October 22, 1986 and opened for business as a state-chartered financial institution on February 26, 1987, in Charleston, South Carolina. The Bank was reorganized into a wholly-owned subsidiary of Bank of South Carolina Corporation (the “Company”), effective April 17, 1995. At the time of the reorganization, each outstanding share of the Bank was exchanged for two shares of Bank of South Carolina Corporation Stock.

The Bank operates as an independent, community oriented, commercial bank providing a broad range of financial services and products. We have four banking house locations: 256 Meeting Street, Charleston, SC, 100 North Main Street, Summerville, SC, 1337 Chuck Dawley Boulevard, Mt. Pleasant, SC and 2027 Sam Rittenberg Boulevard, Charleston, SC. We intend to open a banking office in North Charleston, SC on Highway 78 and Ingleside Boulevard in the future.

References to “we,” “us,” “our,” “the Bank,” or “the Company” refer to the parent and its subsidiary, that are consolidated for financial purposes.

The consolidated financial statements in this report are unaudited, except for the December 31, 2014 consolidated balance sheet. All adjustments consisting of normal recurring accruals which are, in the opinion of management, necessary for fair presentation of the interim consolidated financial statements have been included and fairly and accurately present the financial position, results of operations and cash flows of the Company. The results of operations for the three and nine months ended September 30, 2015, are not necessarily indicative of the results which may be expected for the entire year.

The preparation of the consolidated financial statements are in conformity with accounting principles generally accepted in the United States of America (“GAAP”) which requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from these estimates and assumptions. Material estimates generally susceptible to significant change are related to the determination of the allowance for loan losses, impaired loans, other real estate owned, asset prepayment rates and other-than-temporary impairment of investment securities.



In preparing these financial statements, we evaluated events and transactions for potential recognition or disclosure through the date the financial statements were available to be issued.

**Note 2: Cash and Cash Equivalents**

Cash and cash equivalents include working cash funds, due from banks, interest-bearing deposits in other banks, items in process of collection and federal funds sold. All cash equivalents are readily convertible to cash and have maturities of less than 90 days.

To comply with Federal Reserve regulations, we are required to maintain certain average cash reserve balances. Our daily reserve requirement for the three and nine month periods ending September 30, 2015 and the three and nine month periods ending September 30, 2014 was satisfied by vault cash.

**Note 3: Investment Securities**

We classify investments into three categories as follows: (1) Held to Maturity - debt securities that we have the positive intent and ability to hold to maturity, which are reported at amortized cost, adjusted for the amortization of any related premiums or the accretion of any related discounts into interest income using a methodology which approximates a level yield of interest over the estimated remaining period until maturity; (2) Trading - debt and equity securities that are bought and held principally for the purpose of selling them in the near term, which are reported at fair value, with unrealized gains and losses included in earnings; and (3) Available for Sale - debt and equity securities that may be sold under certain conditions, which are reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of shareholders' equity, net of income taxes. Unrealized losses on securities due to fluctuations in fair value are recognized when it is determined that an other than temporary decline in value has occurred. Realized gains or losses on the sale of investments are recognized on a specific identification, trade date basis. All securities were classified as available for sale for the three and nine months ended September 30, 2015 and at December 31, 2014. We do not have any mortgage-backed securities nor have we ever invested in mortgage-backed securities. (See "non-interest income" for discussion on the sale of investment securities.)

Bank of South Carolina Notes to Consolidated Financial Statements

**Note 4: Mortgage Loans to be Sold**

We originate fixed and variable rate residential mortgage loans on a service release basis in the secondary market. Loans closed but not yet settled with an investor are carried in our loans held for sale portfolio. These loans are fixed and variable rate residential mortgage loans that have been originated in our name and have closed. Virtually all of these loans have commitments to be purchased by investors and the majority of these loans were locked in by price with the investors on the same day or shortly thereafter that the loan was locked in with our customers. Therefore, these loans present very little market risk. We usually deliver to, and receive funding from, the investor within 30 to 60 days. Commitments to sell these loans to the investor are considered derivative contracts and are sold to investors on a "best efforts" basis. We are not obligated to deliver a loan or pay a penalty if a loan is not delivered to the investor. As a result of the short-term nature of these derivative contracts, the fair value of the mortgage loans held for sale in most cases is the same as the value of the loan amount at its origination.

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated market value in the aggregate. Net unrealized losses are provided for in a valuation allowance by charges to operations as a component of mortgage banking income. At September 30, 2015 and December 31, 2014, we had approximately \$7.0 million and \$7.3 million in mortgage loans held for sale, respectively. Gains or losses on sales of loans are recognized when control over these assets has been surrendered and are included in mortgage banking income in the consolidated statements of income.

**Note 5: Loans and Allowance for Loan Losses**

Loans are carried at principal amounts outstanding. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment to yield. Interest income on all loans is recorded on an accrual basis. The accrual of interest and the amortization of net loan fees are generally discontinued and accrued interest amounts are reversed against interest income on loans which 1) are maintained on a cash basis because of deterioration in the financial condition of the borrower; 2) for which payment of full principal is not expected; or 3) upon which principal or interest has been in default for a period of 90 days or more. The accrual of interest, however, may continue on these loans if they are well secured, in the process of collection, and management deems it appropriate. If non-accrual loans decrease their past due status to less than 30 days for a period of six to nine months, they are reviewed individually by management to determine if they should be returned to accrual status. We define past due loans based on contractual payment and maturity dates.

We account for nonrefundable fees and costs associated with originating or acquiring loans by requiring that loan origination fees be recognized over the life of the related loan as an adjustment on the loan's yield. Deferred loan fees were \$108,939 at September 30, 2015 and \$89,441 at December 31, 2014. Certain direct loan origination costs shall be recognized over the life of the related loan as a reduction of the loan's yield.

We account for impaired loans by requiring that all loans for which it is estimated that we will be unable to collect all amounts due according to the terms of the loan agreement be recorded at the loan's fair value. Fair value may be determined based upon the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral less cost to sell, if the loan is collateral dependent.

Additional accounting guidance allows us to use existing methods for recognizing interest income on an impaired loan. The guidance also requires additional disclosures about how we estimate interest income related to our impaired loans.

Bank of South Carolina Notes to Consolidated Financial Statements

When the ultimate collectability of an impaired loan's principal is in doubt, wholly or partially, all cash receipts are applied to principal. Once the recorded principal balance has been reduced to zero, future cash receipts are applied to interest income, to the extent that any interest has been foregone. Further cash receipts are recorded as recoveries of any amounts previously charged off. When this doubt does not exist, cash receipts are applied under the contractual terms of the loan agreement first to interest income and then to principal.

A loan is also considered impaired if its terms are modified in a troubled debt restructuring (“TDR”). For this type of impaired loan, cash receipts are typically applied to principal and interest receivable in accordance with the terms of the restructured loan agreement. Interest income is recognized on these loans using the accrual method of accounting, provided they are performing in accordance with their restructured terms.

We believe that the allowance is adequate to absorb inherent losses in the loan portfolio; however, assessing the adequacy of the allowance is a process that requires considerable judgment. Our judgments are based on numerous assumptions about current events which we believe to be reasonable, but which may or may not be valid. Thus there can be no assurance that loan losses in future periods will not exceed the current allowance amount or that future increases in the allowance will not be required. No assurance can be given that our ongoing evaluation of the loan portfolio, in light of changing economic conditions and other relevant circumstances, will not require significant future additions to the allowance, thus adversely affecting our operating results.

The allowance is also subject to examination by regulatory agencies, which may consider such factors as the methodology used to determine adequacy and the size of the allowance relative to that of peer institutions and other adequacy tests. In addition, such regulatory agencies could require us to adjust our allowance based on information available to us at the time of our examination.

The methodology used to determine the reserve for unfunded lending commitments, which is included in other liabilities, is inherently similar to the methodology used to determine the allowance for loan losses adjusted for factors specific to binding commitments, including the probability of funding and historical loss ratio.

The following is a summary of the non-accrual loans as of September 30, 2015 and December 31, 2014.

**September 30, 2015**  
**Loans Receivable on Non-Accrual**

Commercial	\$—
Commercial Real Estate:	
Commercial Real Estate - Construction	—
Commercial Real Estate - Other	1,400,600
Consumer:	
Consumer Real Estate	82,015
Consumer - Other	—
Total	\$1,482,615

**December 31, 2014**

**Loans Receivable on Non-Accrual**

Commercial	\$—
Commercial Real Estate:	
Commercial Real Estate - Construction	—
Commercial Real Estate - Other	882,413
Consumer:	
Consumer Real Estate	—
Consumer - Other	—
Total	\$882,413

## Bank of South Carolina Notes to Consolidated Financial Statements

The following is a schedule of our delinquent loans, excluding mortgage loans held for sale, as of September 30, 2015 and December 31, 2014.

**September 30, 2015**

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Recorded Investment > 90 Days and Accruing
Commercial	\$4,640	1,065,264	—	1,069,904	47,010,005	48,079,909	—
Commercial Real Estate:							
Commercial Real Estate	—	—	—	—	1,371,523	1,371,523	—
-Construction							
Commercial Real Estate	187,359	696,206	685,271	1,568,836	118,209,088	119,777,924	89,500
-Other							
Consumer:							
Consumer- Real Estate	53,989	—	82,015	136,004	67,184,285	67,320,289	—
Consumer-Other	7,803	1,735	—	9,538	4,691,070	4,700,608	—
Total	\$253,792	1,763,204	767,286	2,784,282	238,465,971	241,250,253	89,500

**December 31, 2014**

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Recorded Investment > 90 Days and Accruing
Commercial	\$557,608	2,474	—	560,082	49,339,495	49,899,577	—
Commercial Real Estate:							
Commercial Real Estate	—	—	—	—	1,511,702	1,511,702	—
-Construction							
Commercial Real Estate	229,607	589,705	1,665,673	2,484,985	113,254,697	115,739,682	1,274,119
-Other							
Consumer:							
Consumer- Real Estate	—	—	—	—	62,054,983	62,054,983	—
Consumer-Other	17,468	—	—	17,468	4,894,380	4,911,848	—
Total	\$804,683	592,179	1,665,673	3,062,535	231,055,257	234,117,792	1,274,119

We grant short to intermediate term commercial and consumer loans to customers throughout our primary market area of Charleston, Berkeley and Dorchester Counties of South Carolina. Our primary market area is heavily dependent on tourism and medical services. Although we have a diversified loan portfolio, a substantial portion of our debtors' ability to honor their contracts is dependent upon the stability of the economic environment in their primary markets including the government, tourism and medical industries. The majority of the loan portfolio is located in our immediate market area with a concentration in Real Estate Related, Offices and Clinics of Medical Doctors, Real Estate Agents and Managers, and Legal Services.

## Bank of South Carolina Notes to Consolidated Financial Statements

As of September 30, 2015 and December 31, 2014, loans individually evaluated and considered impaired are presented in the following table:

**Impaired and Restructured Loans****For September 30, 2015**

With no related allowance recorded:	Unpaid Principal Balance	Recorded Investment	Related Allowance
Commercial	\$719,343	\$719,343	\$—
Commercial Real Estate	2,670,690	2,670,690	—
Consumer Real Estate	450,053	450,053	—
Consumer Other	6,613	6,613	—
<b>Total</b>	<b>3,846,699</b>	<b>3,846,699</b>	<b>—</b>
With an allowance recorded:			
Commercial	956,983	956,983	507,152
Commercial Real Estate	1,249,419	1,249,419	198,681
Consumer Real Estate	911,450	911,450	392,618
Consumer Other	97,171	97,171	97,171
<b>Total</b>	<b>3,215,023</b>	<b>3,215,023</b>	<b>1,195,622</b>
<b>Grand Total</b>	<b>\$7,061,722</b>	<b>\$7,061,722</b>	<b>\$1,195,622</b>

**Impaired and Restructured Loans****As of December 31, 2014**

With no related allowance recorded:	Unpaid Principal Balance	Recorded Investment	Related Allowance
Commercial	\$634,865	\$634,865	\$—
Commercial Real Estate	3,349,844	3,349,844	—
Consumer Real Estate	351,140	351,140	—
Consumer Other	—	—	—
<b>Total</b>	<b>4,335,849</b>	<b>4,335,849</b>	<b>—</b>
With an allowance recorded:			
Commercial	1,157,560	1,157,560	784,561
Commercial Real Estate	846,008	846,008	209,189



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Consumer Real Estate	672,163	672,163	250,590
Consumer Other	39,547	39,547	39,547
Total	2,715,278	2,715,278	1,283,887
Grand Total	\$7,051,127	\$7,051,127	\$1,283,887

## Bank of South Carolina Notes to Consolidated Financial Statements

The following table presents by class, information related to the average recorded investment and interest income recognized on impaired loans for the three and nine months ended September 30, 2015 and 2014, respectively.

**Average Recorded Investment and Interest Income****Impaired and Restructured Loans****For the Three Months Ended**

	September 30, 2015		September 30, 2014	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Commercial	\$736,376	\$ 11,289	\$591,490	\$ 12,344
Commercial Real Estate	2,689,602	37,625	3,212,538	40,197
Consumer Real Estate	450,053	4,559	351,712	2,576
Consumer Other	6,930	146	—	—
Total	3,882,961	53,619	4,155,740	55,117
With an allowance recorded:				
Commercial	989,914	11,865	1,270,229	14,578
Commercial Real Estate	1,253,113	14,333	1,794,000	21,349
Consumer Real Estate	914,480	10,495	681,958	10,726
Consumer Other	98,486	1,415	39,996	419
Total	3,255,993	38,108	3,786,183	47,072
Grand Total	\$7,138,954	\$ 91,727	\$7,941,923	\$ 102,189

## Bank of South Carolina Notes to Consolidated Financial Statements

**Average Recorded Investment and Interest Income****Impaired and Restructured Loans****For the Nine months Ended**

	September 30, 2015		September 30, 2014	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Commercial	\$763,464	\$ 33,861	\$603,268	\$ 34,784
Commercial Real Estate	2,646,960	111,164	3,298,665	100,952
Consumer Real Estate	450,053	14,009	351,775	8,102
Consumer Other	7,139	224	—	—
Total	3,867,616	159,258	4,253,708	143,838
With an allowance recorded:				
Commercial	1,026,875	37,673	1,320,051	42,558
Commercial Real Estate	1,254,696	43,702	1,803,242	61,062
Consumer Real Estate	920,347	29,772	691,169	26,365
Consumer Other	100,889	4,462	42,114	1,528
Total	3,302,807	115,609	3,856,576	131,513
Grand Total	\$7,170,423	\$ 274,867	\$8,110,284	\$ 275,351

The following table illustrates credit risks by category and internally assigned grades at September 30, 2015 and December 31, 2014.

**September 30, 2015**

	Commercial	Commercial Real Estate Construction	Commercial Real Estate Other	Consumer Real Estate	Consumer Other	Total
Pass	\$43,993,347	\$ 935,506	\$113,436,081	\$63,862,429	\$4,313,261	\$226,540,624
Watch	1,033,532	436,017	1,221,544	1,992,556	254,295	4,937,944
OAEM	1,376,704	—	1,200,190	103,801	29,268	2,709,963
Sub-Standard	1,676,326	—	3,920,109	1,361,503	103,784	7,061,722

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Doubtful	—	—	—	—	—	—
Loss	—	—	—	—	—	—
Total	\$48,079,909	\$ 1,371,523	\$119,777,924	\$67,320,289	\$4,700,608	\$241,250,253

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## Bank of South Carolina Notes to Consolidated Financial Statements

**December 31, 2014**

	Commercial	Commercial Real Estate Construction	Commercial Real Estate Other	Consumer Real Estate	Consumer Other	Total
Pass	\$45,154,058	\$ 1,062,185	\$ 108,568,274	\$58,744,677	\$4,512,912	\$218,042,106
Watch	2,401,715	—	1,697,883	1,818,923	276,557	6,195,078
OAEM	551,380	449,517	1,378,436	467,482	82,832	2,929,647
Sub-Standard	1,792,424	—	4,095,089	1,023,901	39,547	6,950,961
Doubtful	—	—	—	—	—	—
Loss	—	—	—	—	—	—
<b>Total</b>	<b>\$49,899,577</b>	<b>\$ 1,511,702</b>	<b>\$ 115,739,682</b>	<b>\$62,054,983</b>	<b>\$4,911,848</b>	<b>\$234,117,792</b>

The following table sets forth the changes in the allowance and an allocation of the allowance by loan category for the three and nine months ended September 30, 2015 and for the three and nine months ended September 30, 2014 and at December 31, 2014. The allocation of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in our judgment, should be charged-off. The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. The general component covers non-impaired loans and is based on historical loss experience adjusted for current economic factors described above.

**For the Three Months Ended  
September 30, 2015**

	Commercial	Commercial Real Estate	Consumer Real Estate	Consumer Other	Total
Allowance for Loan Losses					
Beginning Balance June 30, 2015	\$ 1,044,329	1,186,043	957,447	219,939	3,407,758
Charge-offs	(99,737 )	(34,252 )	(6,075 )	(19,274 )	(159,338 )
Recoveries	—	17,000	6,075	10,276	33,351
Provisions	3,450	100,935	(46,204 )	(50,681 )	7,500
Ending Balance	948,042	1,269,726	911,243	160,260	3,289,271

## Bank of South Carolina Notes to Consolidated Financial Statements

**As of and for the Nine Months Ended  
September 30, 2015**

	Commercial	Commercial Real Estate	Consumer Real Estate	Consumer Other	Total
Allowance for Loan Losses					
Beginning Balance December 31, 2014	\$ 1,211,130	\$ 1,112,387	\$ 906,255	\$ 105,076	\$ 3,334,848
Charge-offs	(99,737 )	(55,252 )	(6,075 )	(40,007 )	(201,071 )
Recoveries	9,164	47,000	6,075	10,755	72,994
Provisions	(172,515 )	165,591	4,988	84,436	82,500
Ending Balance	948,042	1,269,726	911,243	160,260	3,289,271
Allowance for Loan Losses Ending Balances:					
Individually evaluated for impairment	507,152	198,681	392,618	97,171	1,195,622
Collectively evaluated for impairment	440,890	1,071,045	518,625	63,089	2,093,649
Investment in Loans Ending Balance:					
Individually evaluated for impairment	1,676,326	3,920,109	1,361,503	103,784	7,061,722
Collectively evaluated for impairment	\$ 46,403,583	\$ 117,229,338	\$ 65,958,786	\$ 4,596,824	\$ 234,188,531

**For the Three Months Ended  
September 30, 2014**

	Commercial	Commercial Real Estate	Consumer Real Estate	Consumer Other	Total
Allowance for Loan Losses					
Beginning Balance June 30, 2014	\$ 1,277,246	\$ 1,317,450	\$ 696,661	\$ 88,451	\$ 3,379,808
Charge-offs	—	(15,834 )	—	(3,004 )	(18,838 )
Recoveries	—	12,000	—	206	12,206
Provisions	(23,077 )	(25,135 )	44,219	16,493	12,500
Ending Balance	1,254,169	1,288,481	740,880	102,146	3,385,676

## Bank of South Carolina Notes to Consolidated Financial Statements

**As of and for the Nine Months Ended  
September 30, 2014**

	Commercial	Commercial Real Estate	Consumer Real Estate	Consumer Other	Total
Allowance for Loan Losses					
Beginning Balance December 31, 2013	\$1,448,804	\$1,064,363	\$694,950	\$84,160	\$3,292,277
Charge-offs	—	(19,787 )	—	(7,133 )	(26,920 )
Recoveries	—	31,100	—	26,719	57,819
Provisions	(194,635 )	212,805	45,930	(1,600 )	62,500
Ending Balance	1,254,169	1,288,451	740,880	102,146	3,385,676
Allowance for Loan Losses Ending Balances:					
Individually evaluated for impairment	872,728	470,189	151,431	39,547	1,533,895
Collectively evaluated for impairment	381,441	738,704	589,449	62,599	1,851,781
Investment in Loans Ending Balance:					
Individually evaluated for impairment	2,224,613	4,600,806	1,031,280	39,547	7,896,246
Collectively evaluated for impairment	\$46,495,983	\$110,560,553	\$59,724,271	\$4,996,056	\$221,776,863

Bank of South Carolina Notes to Consolidated Financial Statements

TDR's (loans, still accruing interest, which have been renegotiated at below-market interest rates or for which other concessions have been granted) were \$433,743 and \$466,541 at September 30, 2015 and December 31, 2014, respectively. All restructured loans were renegotiated to allow multiple principal extensions and were performing as agreed as of September 30, 2015 and December 31, 2014, respectively.

There were no additional loans identified as a TDR during the nine months ended September 30, 2015. There were no loans identified as a TDR that were in default as of September 30, 2015 or as of December 31, 2014.

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**Note 6: Premises, Equipment and Leasehold Improvements and Depreciation**

Buildings and equipment are carried at cost less accumulated depreciation, calculated on the straight-line method over the estimated useful life of the related assets - 40 years for buildings and 3 to 15 years for equipment. Amortization of leasehold improvements is recorded using the straight-line method over the lesser of the estimated useful life of the asset or the term of the lease. Maintenance and repairs are charged to operating expenses as incurred.

**Note 7: Concentration of Credit Risk**

Our primary market consists of the Counties of Berkeley, Charleston and Dorchester, South Carolina. At September 30, 2015 and December 31, 2014, the majority of the total loan portfolio, as well as a substantial portion of the commercial and real estate loan portfolios, were to borrowers within this region. No other areas of significant concentration of credit risk have been identified.



## Bank of South Carolina Notes to Consolidated Financial Statements

**Note 8: Other Real Estate Owned**

Other real estate owned (“OREO”) is carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral, or our estimation of the value of the collateral. Gains and losses on the sale of OREO and subsequent write-downs from periodic re-evaluation are charged to Other Operating Income. We had two properties valued at \$620,394 classified as OREO at September 30, 2015 and one property valued at \$521,943 at December 31, 2014. A property valued at \$35,473 classified as OREO sold at a gain of \$2,382 during the year ended December 31, 2014.

The following table summarizes the activity in OREO at September 30, 2015 and December 31, 2014.

	<b>September 30, 2015</b>	<b>December 31, 2014</b>
Balance, beginning of period	\$ 521,943	\$—
Additions-foreclosure	98,451	557,416
Sales	—	35,473
Write-downs	—	—
Balance, end of period	\$ 620,394	\$ 521,943

**Note 9: Income Taxes**

We account for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Net deferred tax assets are included in other assets in the consolidated balance sheet.

Accounting standards require the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements. These standards also prescribe a recognition threshold and measurement of a tax position taken or expected to be taken in an enterprise’s tax return. We believe that we had no uncertain tax positions as of September 30, 2015 or December 31, 2014.

**Note 10: Stock Based Compensation**

The shareholders of the Company voted at the Company's Annual Meeting, April 13, 2010 to approve the 2010 Omnibus Stock Incentive Plan, including 363,000 shares (adjusted for a 10% stock dividend declared on August 26, 2010 and a 10% stock dividend declared on August 27, 2015) reserved under the plan (copy of the plan was filed with 2010 Proxy Statement). This plan is intended to assist the Company in recruiting and retaining employees with ability and initiative by enabling employees to participate in its future success and to align their interest with those of the Company and its shareholders. Under the Omnibus Stock Incentive Plan, options are periodically granted to employees at a price not less than 100% of the fair market value of the shares at the date of the grant. All employees are eligible to participate in this plan if the Executive Committee, in its sole discretion, determines that such person has contributed or can be expected to contribute to the profits or growth of the Company or its subsidiary. Options may be exercised in whole at any time or in part from time to time at such times and in compliance with such requirements as the Executive Committee shall determine. The maximum period in which an option may be exercised is determined at the date of grant and shall not exceed 10 years from the date of grant.

The options are not transferable except by will or by the laws of descent and distribution.

On April 23, 2015, the Executive Committee granted options to purchase an aggregate of 20,350 shares to nine employees. Fair value was estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions: dividend yield 4.13%, historical volatility 19.62%, risk free interest rate of 1.96%. In addition, the Executive Committee granted options to purchase 3,300 shares to an employee on June 29, 2015. Fair value was estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions: dividend yield 4.13%, historical volatility 19.62%, risk free interest rate of 1.96%.

Bank of South Carolina Notes to Consolidated Financial Statements

On July 24, 2014, the Executive Committee granted options to purchase an aggregate of 11,000 shares to twelve employees. Fair value was estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions: dividend yield 3.74%, historical volatility 31.69%, risk free interest rate of 2.52% and an expected life of 10 years.

On April 14, 1998, the Company adopted the 1998 Omnibus Stock Incentive Plan which expired on April 14, 2008. Options can no longer be granted under the 1998 Plan. Options granted before April 14, 2008, shall remain valid in accordance with their terms. There are currently options to purchase 19,017 shares outstanding under this plan with options to purchase 13,209 shares exercisable.

All of the above shares subject to options have been adjusted to reflect a 10% stock dividend declared on August 27, 2015.

Under both plans, employees become 20% vested after five years and vest 20% each year until fully vested. The right to exercise each such 20% of the options is cumulative and will not expire until the tenth anniversary of the date of the grant.

The following is a summary of the activity under the 1998 and 2010 Omnibus Stock Incentive Plan for the three and nine months ended September 30, 2015 and for the three and nine months ended September 30, 2014.

Three Months Ended September 30, 2015	Options	Weighted Average Exercise Price
Balance at July 1, 2015	187,042	\$ 10.84
Forfeited	(1,925 )	13.49
Balance at September 30, 2015	185,117	10.81
Nine months Ended September 30, 2015	Options	Weighted Average Exercise Price
Balance at January 1, 2015	176,181	\$ 10.48
Forfeited	(6,326 )	11.88
Exercised	(8,388 )	13.51
Granted	23,650	14.48
Balance at September 30, 2015	185,117	10.81

Three months Ended September 30, 2014      Options      Weighted Average Exercise Price

Balance at July 1, 2014	168,206	\$ 10.03
Granted	11,000	13.49
Forfeited	(1,375 )	11.67
Balance at September 30, 2014	177,831	10.23

Nine months Ended September 30, 2014      Options      Weighted Average Exercise Price

Balance at January 1, 2014	175,081	\$ 10.03
Granted	11,000	13.49
Forfeited	(5,500 )	10.73
Exercised	(2,750 )	9.47
Balance at September 30, 2014	177,831	10.23

Options exercisable at September 30, 2015      13,209      \$ 13.41

All shares and exercise prices per share have been adjusted to reflect a 10% stock dividend declared on August 27, 2015.

## Bank of South Carolina Notes to Consolidated Financial Statements

**Note 11: Income Per Common Share**

Basic income per share is computed by dividing net income by the weighted-average number of common shares outstanding. Diluted earnings per share are computed by dividing net income by the weighted-average number of common shares and potential common shares outstanding. Potential common shares consist of dilutive stock options determined using the treasury stock method and the average market price of common stock.

The following table is a summary of dividends declared during the nine months ended September 30, 2015 and the nine months ended September 30, 2014.

<b>Quarterly Dividend</b>	<b>Date Declared</b>	<b>Date of Record</b>	<b>Date Payable</b>
\$ .13	March 26, 2015	April 7, 2015	April 30, 2015
\$ .13	June 25, 2015	July 6, 2015	July 31, 2015
\$ .13	September 24, 2015	October 5, 2015	October 30, 2015

<b>Quarterly Dividend</b>	<b>Date Declared</b>	<b>Date of Record</b>	<b>Date Payable</b>
\$ .13	March 27, 2014	April 8, 2014	April 30, 2014
\$ .13	June 26, 2014	July 7, 2014	July 31, 2014
\$ .13	September 25, 2014	October 8, 2014	October 31, 2014
Special \$ .10	September 25, 2014	October 8, 2014	October 31, 2014

Income per common share for the three and nine months ended September 30, 2015 and for the three and nine months ended September 30, 2014 was calculated as follows:

All shares have been adjusted to reflect a 10% stock dividend declared August 27, 2015.

**For The Three Months Ended  
September 30, 2015**

Income (Numerator)	Shares Weighted Average (Denominator)	Per Share Amount
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Net income	\$1,198,919	
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Basic income available to common shareholders	\$1,198,919	4,915,610	\$ .24
Effect of dilutive options		146,075	
Diluted income available to common shareholders	\$1,198,919	5,061,685	\$ .24

**For The Nine Months Ended  
September 30, 2015**

	Income (Numerator)	Shares Weighted Average (Denominator)	Per Share Amount
Net income	\$3,657,316		
Basic income available to common shareholders	\$3,657,316	4,911,142	\$ .74
Effect of dilutive options		151,553	
Diluted income available to common shareholders	\$3,657,316	5,062,695	\$ .72

## Bank of South Carolina Notes to Consolidated Financial Statements

**For The Three Months Ended  
September 30, 2014**

	Income (Numerator)	Shares Weighted Average (Denominator)	Per Share Amount
Net income	\$1,141,713		
Basic income available to common shareholders	\$1,141,713	4,907,203	\$ .23
Effect of dilutive options		112,879	
Diluted income available to common shareholders	\$1,141,713	5,020,082	\$ .23

**For The Nine Months Ended  
September 30, 2014**

	Income (Numerator)	Shares Weighted Average (Denominator)	Per Share Amount
Net income	\$3,207,438		
Basic income available to common shareholders	\$3,207,438	4,907,203	\$ .65
Effect of dilutive options		112,702	
Diluted income available to common shareholders	\$3,207,438	5,019,905	\$ .64

The future payment of cash dividends is subject to the discretion of the Board of Directors and depends upon a number of factors, including future earnings, financial condition, cash requirements, and general business conditions.

Cash dividends when declared, are paid by the Bank to the Company for distribution to shareholders of the Company. The Bank's ability to pay dividends to the Company is restricted by the laws and regulations of the State of South Carolina. Generally, these restrictions allow the Bank to pay dividends from current earnings without the prior written consent of the South Carolina Commissioner of Banking, if it received a satisfactory rating at its most recent examination.

Note 12: Comprehensive Income

We apply accounting standards which establish guidance for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income consists of net income and net unrealized gains or losses on available for sale securities.

Comprehensive income totaled \$1,701,435 and \$1,060,397 for the three months ended September 30, 2015 and 2014, respectively and \$3,869,941 and \$3,298,203 for the nine months ended September 30, 2015 and 2014, respectively.

Note 13: Segment Information

We report operating segments in accordance with accounting standards. Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the Chief Financial Officer/Executive Vice President in deciding how to allocate resources and assess performance. Accounting standards require that a public enterprise report a measure of segment profit or loss, certain specific revenue and expense items, segment assets, information about the way that the operating segments were determined and other items. The Company has one reporting segment, The Bank of South Carolina.



Bank of South Carolina Notes to Consolidated Financial Statements

Note 14: Derivative Instruments

Accounting standards require that all derivative instruments be recorded on the balance sheet at fair value. The accounting for the gain or loss due to change in fair value of the derivative instrument depends on whether the derivative instrument qualifies as a hedge. If the derivative does not qualify as a hedge, the gains or losses are reported in earnings when they occur. However, if the derivative instrument qualifies as a hedge, the accounting varies based on the type of risk being hedged.

We had no embedded derivative instruments requiring separate accounting treatment. We had freestanding derivative instruments consisting of fixed rate conforming loan commitments as interest rate locks and commitments to sell fixed rate conforming loans on a best efforts basis. We do not currently engage in hedging activities. Based on short term fair value of the mortgage loans held for sale (derivative contract), our derivative instruments were immaterial to our consolidated financial statements as of September 30, 2015 and September 30, 2014.

Note 15: Fair Value Measurements

Fair value measurements apply whenever GAAP requires or permits assets or liabilities to be measured at fair value either on a recurring or nonrecurring basis. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for an asset or liability in an orderly transaction between market participants at the measurement date. Fair value is based on the assumptions that we believe market participants would use when pricing an asset or liability. Fair value measurement and disclosure guidance establishes a three-level fair value hierarchy that prioritizes the use of inputs used in valuation methodologies.

The three levels of input that may be used to measure fair value are the following:

- Level 1 Valuation is based upon quoted prices (unadjusted) in active markets for identical assets or liabilities that we have the ability to access. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as US Treasuries and money market funds.
- Level 2 Valuation is based upon quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability (other than quoted prices), such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments, mortgage-backed securities, municipal bonds, corporate debt securities and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes certain derivative contracts and impaired loans.

Level  
3 Valuation is generated from model-based techniques that use at least one significant assumption based on unobservable inputs for the asset or liability, which are typically based on an entity's own assumptions, as there is little, if any, related market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

## Bank of South Carolina Notes to Consolidated Financial Statements

The guidance requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available for sale investment securities) or on a nonrecurring basis (for example, impaired loans). Fair value estimates, methods, and assumptions are set forth below.

### Investment Securities Available for Sale

Securities available for sale are recorded at fair value on a recurring basis and are based upon quoted prices if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange such as the New York Stock Exchange, or by dealers or brokers in active over-the-counter markets. Level 2 securities include mortgage backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

### Other Real Estate Owned (OREO)

Loans, secured by real estate, are adjusted to fair value upon transfer to OREO. Subsequently, OREO is carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or our estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraisal, we record the asset as nonrecurring Level 2. When an appraised value is not available or we determine the fair value of the collateral is further impaired below the appraised value and there is no observable market price, we record the asset as nonrecurring Level 3. We had two properties valued at \$620,394 and one property valued at \$521,943 classified as OREO at September 30, 2015 and December 31, 2014, respectively.

### Impaired Loans

We do not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans are reviewed for impairment on a quarterly basis if any of the following criteria are met:

- 1) Any loan on non-accrual
- 2) Any loan that is a troubled debt restructuring

- 3) Any loan over 60 days past due
- 4) Any loan rated sub-standard, doubtful, or loss
- 5) Excessive principal extensions are executed
- 6) If we are provided information that indicates that we will not collect all principal and interest as scheduled

Once a loan is identified as individually impaired, we measure the impairment in accordance with Accounting Standards Codification (“ASC”) 310-10, “Accounting by Creditors for Impairment of a Loan”.

In accordance with this standard, the fair value is estimated using one of the following methods: fair value of the collateral less estimated costs to sell, discounted cash flows, or market value of the loan based on similar debt. The fair value of the collateral less estimated costs to sell is the most frequently used method. Typically, we review the most recent appraisal and if it is over 18 months old we may request a new third party appraisal. Depending on the particular circumstances surrounding the loan, including the location of the collateral, the date of the most recent appraisal and the value of the collateral relative to the recorded investment in the loan, we may order an independent appraisal immediately or, in some instances, may elect to perform an internal analysis. Specifically as an example, in situations where the collateral on a nonperforming commercial real estate loan is out of our primary market area, we would typically order an independent appraisal immediately, at the earlier of the date the loan becomes nonperforming or immediately following the determination that the loan is impaired. However, as a second example, on a nonperforming commercial real estate loan where we are familiar with the property and surrounding areas and where the original appraisal value far exceeds the recorded investment in the loan, we may perform an internal analysis whereby the previous appraisal value would be reviewed considering recent current conditions, and known recent sales or listings of similar properties in the area, and any other relevant economic trends. This analysis may result in the call for a new appraisal. These valuations are reviewed and updated on a quarterly basis.

## Bank of South Carolina Notes to Consolidated Financial Statements

Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At September 30, 2015 and December 31, 2014, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. In accordance with topic ASC 820 "Fair Value Measurement", impaired loans, where an allowance is established based on the fair value of collateral, require classification in the fair value hierarchy. We record the impaired loan as nonrecurring Level 3.

Assets and liabilities measured at fair value on a recurring basis at September 30, 2015 and December 31, 2014 are as follows:

**Balance at****September 30, 2015**

	Quoted Market Price in active markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
US Treasury Notes	\$29,908,712	\$—	\$—	\$29,908,712
Government Sponsored Enterprises	—	51,653,088	—	51,653,088
Municipal Securities	—	29,240,720	5,199,347	34,440,067
Total	\$29,908,712	\$80,893,808	\$5,199,347	\$116,001,867

**Balance at****December 31, 2014**

	Quoted Market Price in active markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
US Treasury Notes	\$29,248,281	\$—	\$—	\$29,248,281
Government Sponsored Enterprises	—	50,142,649	—	50,142,649
Municipal Securities	—	33,226,093	1,377,089	34,603,182
Total	\$29,248,281	\$83,368,742	\$1,377,089	\$113,994,112

There were no liabilities carried at fair value on a recurring basis as of September 30, 2015 or December 31, 2014.

## Bank of South Carolina Notes to Consolidated Financial Statements

Mortgage Loans Held for Sale

We originate fixed and variable rate residential mortgage loans on a service release basis in the secondary market. Loans closed but not yet settled with an investor are carried in our loans held for sale portfolio. These loans are fixed and variable rate residential mortgage loans that have been originated in our name and have closed. Virtually all of these loans have commitments to be purchased by investors and the majority of these loans were locked in by price with the investors on the same day or shortly thereafter that the loan was locked in with our customers. Therefore, these loans present very little market risk. We usually deliver to, and receive funding from, the investor within 30 to 60 days. Commitments to sell these loans to the investor are considered derivative contracts and are sold to investors on a "best efforts" basis. We are not obligated to deliver a loan or pay a penalty if a loan is not delivered to the investor. As a result of the short-term nature of these derivative contracts, the fair value of the mortgage loans held for sale in most cases is the same as the value of the loan amount at its origination. These loans are classified as Level 2.

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the collaterally dependent assets and liabilities carried on the balance sheet by caption and by level within the valuation hierarchy (as described above) as of September 30, 2015, and December 31, 2014, for which a nonrecurring change in fair value has been recorded as of September 30, 2015 and December 31, 2014.

**September 30, 2015**

	Quoted Market Price in active markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Impaired loans	\$ —	\$ —	\$ 5,866,100	\$5,866,100
Other real estate owned	—	—	620,394	620,394
Total	\$ —	\$ —	\$ 6,486,494	\$6,486,494

**December 31, 2014**

	Quoted Market Price in active markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
--	---	---	--	-------

	1)				
Impaired loans	\$	—	\$	—	\$ 5,767,240
Other real estate owned		—		—	521,943
Total	\$	—	\$	—	\$ 6,289,183

There were no liabilities carried at fair value on nonrecurring basis as of September 30, 2015 or December 31, 2014.

The following table provides information describing the unobservable inputs used in Level 3 fair value measurement at September 30, 2015 and December 31, 2014.



Bank of South Carolina Notes to Consolidated Financial Statements

	Valuation Technique	Inputs Unobservable Input	General Range of Inputs
Nonrecurring measurements: Impaired Loans	Discounted Appraisals	Collateral Discounts	0-25%
Other Real Estate Owned	Appraisal Value/ Comparison Sales/Other Estimates	Appraisals and/or Sales of Comparable Properties	Appraisals Discounted 10% to 20% for Sales Commissions and Other Holding Costs

Accounting standards require disclosure of fair value information about financial instruments whether or not recognized on the balance sheet, for which it is practicable to estimate fair value. Fair value estimates are made as of a specific point in time based on the characteristics of the financial instruments and the relevant market information. When available, quoted market prices are used. In other cases, fair values are based on estimates using present value or other valuation techniques. These techniques involve uncertainties and are significantly affected by the assumptions used and the judgments made regarding risk characteristics of various financial instruments, discount rates, prepayments, and estimates of future cash flows, future expected loss experience and other factors. Changes in assumptions could significantly affect these estimates. Derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, may or may not be realized in an immediate sale of the instrument.

Under the accounting standard, fair value estimates are based on existing financial instruments without attempting to estimate the value of anticipated future business and the value of the assets and liabilities that are not financial instruments. Accordingly, the aggregate fair value amounts of existing financial instruments do not represent the underlying value of those instruments on our books.

The following describes the methods and assumptions we use in estimating the fair values of financial instruments:

a. Cash and due from banks, interest-bearing deposits in other banks

The carrying value approximates fair value. All mature within 90 days and do not present unanticipated credit concerns.

b. Investment securities available for sale

The fair value of investment securities is derived from quoted market prices.

c. Loans

The carrying values of variable rate consumer and commercial loans and consumer and commercial loans with remaining maturities of three months or less, approximate fair value. The fair values of fixed rate consumer and commercial loans with maturities greater than three months are determined using a discounted cash flow analysis and assume the rate being offered on these types of loans at September 30, 2015 and December 31, 2014, approximate market.

The carrying value of mortgage loans held for sale approximates fair value.

For lines of credit, the carrying value approximates fair value.

d. Deposits

The estimated fair value of deposits with no stated maturity is equal to the carrying amount. The fair value of time deposits is estimated by discounting contractual cash flows, by applying interest rates currently being offered on the deposit products. The fair value estimates for deposits do not include the benefit that results from the low cost funding provided by the deposit liabilities as compared to the cost of alternative forms of funding (deposit base intangibles).

## Bank of South Carolina Notes to Consolidated Financial Statements

e. Short-term borrowings

The carrying amount approximates fair value due to the short-term nature of these instruments.

The following table is a summary of the carrying value and estimated fair value of the Company's financial instruments as of September 30, 2015 and December 31, 2014:

September 30, 2015

	Carrying Amount	Estimated Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Cash and due from banks	\$6,516,874	\$6,516,874	6,516,874	—	—
Interest-bearing deposits in other banks	12,468,073	12,468,073	12,468,073	—	—
Investments available for sale	116,001,867	116,001,867	29,908,712	80,893,808	5,199,347
Mortgage loans to be sold	7,018,137	7,018,137	—	7,018,137	—
Loans	241,250,253	241,286,861	—	—	241,286,861
Financial Liabilities:					
Deposits	343,752,504	344,467,342	—	344,467,342	—
	Notional Amount	Fair Value			
Off-Balance Sheet Financial Instruments:					
Commitments to extend credit	\$82,753,090	\$ —	\$ —	\$ —	\$ —
Standby letters of credit	567,427	—	—	—	—

## Bank of South Carolina Notes to Consolidated Financial Statements

December 31, 2014

	Carrying Amount	Estimated Fair Value	Level 1	Level 2	Level 3
<b>Financial Assets:</b>					
Cash and due from banks	\$4,698,435	\$4,698,435	4,698,435	—	—
Interest-bearing deposits in other banks	5,680,613	5,680,613	5,680,613	—	—
Investments available for sale	113,994,112	113,994,112	29,248,281	83,368,742	1,377,089
Mortgage loans to be sold	7,325,081	7,325,081	—	7,325,081	—
Loans	234,117,792	234,204,303	—	—	234,204,303
<b>Financial Liabilities:</b>					
Deposits	322,419,027	322,435,308	—	322,435,308	—

	Notional Amount	Fair Value
<b>Off-Balance Sheet Financial Instruments:</b>		
Commitments to extend credit	\$62,597,548	\$ — \$ — — \$ —
Standby letters of credit	577,943	— — — —

Note 16: Recently Issued Accounting Pronouncements

The following is a summary of recent authoritative pronouncements that could impact the accounting, reporting and/or disclosure of financial information by the Company.

In January 2014, the Financial Accounting Standards Board (“FASB”) amended the Receivables topic of the Accounting Standards Codification. The amendments are intended to resolve diversity in practice with respect to when a creditor should reclassify a collateralized consumer mortgage loan to OREO. In addition, the amendments require a creditor reclassify a collateralized consumer mortgage loan to OREO upon obtaining legal title to the real estate collateral, or the borrower voluntarily conveying all interest in the real estate property to the lender to satisfy the loan through a deed in lieu of foreclosure or similar legal agreement. The amendments became effective for interim and annual reporting periods beginning after December 15, 2014, with early implementation of the guidance permitted. In implementing this guidance, assets that are reclassified from real estate to loans are measured at the carrying value of the real estate at the date of adoption. Assets reclassified from loans to real estate are measured at the lower of the net amount of the loan receivable or the fair value of the real estate less costs to sell at the date of adoption. We applied the amendments prospectively using the modified retrospective approach. These amendments did not have a material effect on our financial statements.

In May 2014, the FASB issued guidance to change the recognition of revenue from contracts with customers. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The guidance will be effective for reporting periods beginning after December 15, 2017. We will apply this guidance using a modified retrospective approach. We do not expect this amendment to have a material effect on our consolidated financial statements.

In August 2015, the FASB deferred the effective date of ASU 2014-09, Revenue from Contracts with Customers. As a result of the deferral, the guidance in ASU 2014-09 will be effective for reporting periods beginning after December 15, 2017. We will apply this guidance using the modified retrospective approach. We do not expect this amendment to have a material effect on our financial statements.

Bank of South Carolina Notes to Consolidated Financial Statements

In June 2014, the FASB issued guidance which makes limited amendments to the guidance on accounting for certain repurchase agreements. The guidance (1) requires entities to account for repurchase-to-maturity transactions as secured borrowings (rather than as sales with forward repurchase agreements), (2) eliminates accounting guidance on linked repurchase financing transactions, and (3) expands disclosure requirements related to certain transfers of financial assets that are accounted for as sales and certain transfers (specifically repos, securities lending transactions, and repurchase-to-maturity transactions) accounted for as secured borrowings. The amendments became effective for the Company for the first interim or annual period beginning after December 31, 2014. We applied the guidance by making a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. This adjustment did not have a material effect on our financial statements.

In August 2014, the FASB issued guidance that is intended to define management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures. In connection with preparing financial statements, management will need to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the organization's ability to continue as a going concern within one year after the date that the financial statements are issued. This amendment will be effective for annual periods ending after December 31, 2016, and for annual and interim periods thereafter. We do not expect this amendment to have a material effect on our financial statements.

In January 2015, the FASB issued guidance to eliminate from U.S. GAAP the concept of an extraordinary item, which is an event or transaction that is both (1) unusual in nature and (2) infrequently occurring. Under the new guidance, an entity will no longer (1) segregate an extraordinary item from the results of ordinary operations; (2) separately present an extraordinary item on its income statement, net of tax, after income from continuing operations; or (3) disclose income taxes and earnings-per-share data applicable to an extraordinary item. The amendment will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015, with early adoption permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. We will apply the guidance prospectively. We do not expect this amendment to have a material effect on our financial statements.

In February 2015, the FASB issued guidance which amends the consolidation requirements and significantly changes the consolidation analysis required under U.S. GAAP. Although the amendments are expected to result in the deconsolidation of many entities, the Company will need to reevaluate all its previous consolidation conclusions. The amendment will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015, with early adoption permitted (including during an interim period), provided that the guidance is applied as of the beginning of the annual period containing the adoption date. We do not expect this amendment to have a material effect on our financial statements.

In April 2015, the FASB issued guidance that will require debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. This update affects disclosures related to debt issuance costs but does not affect existing recognition and measurement guidance for these items. The amendment will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015, with early adoption permitted. We do not expect this amendment to have a material effect on our financial statements.

In June 2015, the FASB issued amendments to clarify the ASC, correct unintended application of guidance, and make minor improvements to the ASC that are not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities. This amendment was effective upon issuance (June 12, 2015) for amendments that do not have transition guidance. Amendments that are subject to transition guidance will be effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. We do not expect this amendment to have a material effect on our financial statements.

Bank of South Carolina Notes to Consolidated Financial Statements

In August 2015, the FASB issued amendments to the interest topic of the Accounting Standards Codification to clarify the SEC staff's position on presenting and measuring debt issuance costs incurred in connection with line-of-credit arrangements. The amendments were effective upon issuance. These amendments did not have a material effect on our financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on our financial position, results of operations or cash flows.

**Note 17: Reclassification**

Certain reclassifications of accounts reported for previous periods have been made in these consolidated financial statements. Such reclassifications had no effect on shareholders' equity or net income as previously reported.

**Note 18: Subsequent Events**

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. We have reviewed events occurring through the date the financial statements were issued and noted no subsequent event requiring accrual or disclosure.

**Item 2. Management's Discussion and Analysis or Plan of Operation**

Management's discussion and analysis is included to assist shareholders in understanding our financial condition, results of operations, and cash flow. This discussion should be reviewed in conjunction with the consolidated financial statements (unaudited) and notes presented in this report and the supplemental financial data appearing throughout this report. Since the primary asset of the Company is its wholly-owned subsidiary, most of the discussion and analysis relates to the Bank.

Management's Discussion and Analysis of Financial Condition and Results of Operations and other portions of this quarterly report contain certain "forward-looking statements" concerning the future operations. We desire to take



advantage of the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1996 and are including this statement for the express purpose of availing the Company of protections of such safe harbor with respect to all “forward-looking statements” contained in this Form 10-Q. Forward looking statements may relate to, among other matters, the financial condition, results of operations, plans, objectives, future performance, and business of the Company. Forward-looking statements are based on many assumptions and estimates and are not guarantees of future performance. Actual results may differ materially from those anticipated in any forward-looking statements. The words “may”, “would”, “could”, “should”, “will”, “expect”, “anticipate”, “predict”, “project”, “potential”, “continue”, “assume”, “plan”, “forecast”, “goal”, and “estimate”, as well as similar expressions, are meant to identify such forward-looking statements. Potential risks and uncertainties that could cause our actual results to differ materially from those anticipated in our forward-looking statements include, without limitations, those described under the heading “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2014 as filed with the Securities and Exchange Commission (the “SEC”) and the following:

- Risk from changes in economic, monetary policy, and industry conditions
- Changes in interest rates, shape of the yield curve, deposit rates, the net interest margin and funding sources
- Market risk (including net income at risk analysis and economic value of equity risk analysis) and inflation
- Risk inherent in making loans including repayment risks and changes in the value of collateral
- Loan growth, the adequacy of the allowance for loan losses, provisions for loan losses, and the assessment of problem loans
- Level, composition, and re-pricing characteristics of the securities portfolio
- Deposit growth, change in the mix or type of deposit products and services
- Continued availability of senior management
- Technological changes
- Ability to control expenses
- Changes in compensation
- Risks associated with income taxes including potential for adverse adjustments
- Changes in accounting policies and practices
- Changes in regulatory actions, including the potential for adverse adjustments
- Recently enacted or proposed legislation

Much has been done to eliminate or mitigate these risks that have been exacerbated by the developments over the last eight years in national and international markets. Sweeping reform has entered our industry yet we are unable to fully predict its impact and perhaps its unintentional consequences for some time. There can be no assurance that these changes will not materially and adversely affect our business, financial condition and results of operation.

All forward-looking statements in this report are based on information available to us as of the date of this report. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee that these expectations will be achieved. We will undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made to reflect the occurrence of unanticipated events. In addition, certain statements in our future filings with the SEC, in our press releases, and in our oral and written statements, which are not statements of historical fact, constitute forward looking statements.

## Overview

Bank of South Carolina Corporation (the “Company”) is a financial institution holding company headquartered in Charleston, South Carolina, with \$384,559,093 in assets as of September 30, 2015 and net income of \$1,198,919 and \$3,657,316 for the three and nine months ended September 30, 2015, respectively. The Company offers a broad range of financial services through its wholly-owned subsidiary, The Bank of South Carolina (the “Bank”). The Bank is a state-chartered commercial bank which operates primarily in the Charleston, Dorchester and Berkeley counties of South Carolina. The Bank’s original and current concept is to be a full service financial institution specializing in personal service, responsiveness, and attention to detail to foster long standing relationships.

The following is a discussion of our financial condition as of September 30, 2015 as compared to December 31, 2014 and the results of operations for the three and nine months ended September 30, 2015 as compared to the three and nine months ended September 30, 2014. The discussion and analysis identifies significant factors that have affected our financial position and operating results and should be read in conjunction with the financial statements and the related notes included in this report.

We derive most of our income from interest on loans and investments (interest bearing assets). The primary source of funding for making these loans and investments is our interest and non-interest bearing deposits. Consequently, one of the key measures of our profitability is the amount of net interest income, or the difference between the income on our interest earning assets, such as loans and investments, and the expense on our interest bearing liabilities, primarily deposits. Another key measure is the spread between the yield we earn on these interest bearing assets and the rate we pay on our interest bearing liabilities.

A primary risk of lending is that we may incur credit losses. The amount of such losses will vary depending upon the risk characteristics of the loan and lease portfolio as affected by economic conditions such as rising interest rates and the financial performance of borrowers. The reserve for credit losses consists of the allowance for loan losses (the

"Allowance") and a reserve for unfunded commitments (the "Unfunded Reserve"). The Allowance provides for estimable losses inherent in our loan and lease portfolio. The Allowance is increased or decreased through the provisioning process. For a detailed discussion on the allowance for loan losses see "Allowance for Loan Losses".

In addition to earning interest on loans and investments, we earn income through fees and other expenses we charge to the customer. The various components of non-interest income as well as non-interest expense are described in the following discussion.

### **Critical Accounting Policies**

We have adopted various accounting policies that govern the application of principles generally accepted in the United States and with general practices within the banking industry in the preparation of our financial statements. Our significant accounting policies are described in the footnotes to our unaudited consolidated financial statements as of September 30, 2015 and our notes included in the consolidated financial statements in our 2014 Annual Report on Form 10-K as filed with the SEC.

Certain accounting policies involve significant judgments and assumptions by the Company that have a material impact on the carrying value of certain assets and liabilities. We consider these accounting policies to be critical accounting policies. The judgment and assumptions we use are based on historical experience and other factors, which we believe to be reasonable under the circumstances. Because of the number of the judgments and assumptions that we make, actual results could differ from these judgments and estimates that could have a material impact on the carrying values of our assets and liabilities and our results of operations.

We consider our policies regarding the allowance for loan losses to be our most subjective accounting policy due to the significant degree of judgment. We have developed what we believe to be appropriate policies and procedures for assessing the adequacy of the allowance for loan losses, recognizing that this process requires a number of assumptions and estimates with respect to our loan portfolio. Our assessments may be impacted in future periods by changes in economic conditions, the impact of regulatory examinations and the discovery of information with respect to borrowers which were not known at the time of the issuance of the consolidated financial statements. For additional discussion concerning our allowance for loan losses and related matters, see "Allowance for Loan Losses."

### **Balance Sheet**

#### **Cash and Cash Equivalents**

Cash and cash equivalents include working cash funds, due from banks, interest-bearing deposits in other banks, items in process of collection and federal funds sold. All amounts are readily convertible to cash and have maturities of less than 90 days. Total cash and cash equivalents increased 82.92% or \$8,605,899 to \$18,984,947 at September 30, 2015, from \$10,379,048 at December 31, 2014. This increase was primarily due to an increase in deposits resulting in an increase in cash and interest bearing deposits in other banks.

Regulations set by the Federal Reserve require that we maintain certain average cash reserve balances. At September 30, 2015 and 2014 our cash reserve requirement with the Federal Reserve was satisfied by vault cash.

### **Loans**

We focus our lending activities on small and middle market businesses, professionals and individuals in our geographic markets. At September 30, 2015, outstanding loans (plus deferred loan fees of \$108,939) totaled \$241,250,253 which equaled 70.18% of total deposits and 62.73% of total assets. Most loans were to borrowers located in our market area of Charleston, Dorchester and Berkeley Counties of South Carolina.

The quality of our loan portfolio is contingent upon our risk selection and underwriting practices. All new credit (except for mortgage loans in the process of being sold to investors and loans secured by properly margined negotiable securities traded on an established market or other cash collateral) with over \$200,000 in exposure is summarized by our Credit Department and reviewed by the Loan Committee on a monthly basis. The Board of Directors reviews credits over \$500,000 monthly with annual credit analyses conducted on these borrowers upon the receipt of updated financial information. Prior to any extension of credit, every loan request goes through sound credit underwriting. The Credit Department conducts detailed cash flow analysis on each proposal using the most current financial information. Relevant trends and ratios are evaluated.

The breakdown of total loans by type and the respective percentage of total loans are as follows:

	<b>September 30,</b>		<b>December 31,</b>
	<b>2015</b>	<b>2014</b>	<b>2014</b>
Commercial loans	\$48,079,909	48,720,596	\$49,899,577
Commercial real estate:			
Commercial real estate construction	1,371,523	1,529,534	1,511,702
Commercial real estate other	119,777,924	115,161,359	115,739,682
Consumer:			
Consumer real estate	67,320,289	59,226,017	62,054,983
Consumer other	4,700,608	5,035,603	4,911,848
	241,250,253	229,673,109	234,117,792
Allowance for loan losses	(3,289,271 )	(3,385,676 )	(3,334,848 )
Loans, net	\$237,960,982	226,287,433	\$230,782,944

<b>Percentage of Loans</b>	<b>September 30,</b>		<b>December 31,</b>	
	<b>2015</b>	<b>2014</b>	<b>2014</b>	
Commercial loans	19.93 %	21.21 %	21.31 %	%
Commercial real estate construction	.57 %	.67 %	.64 %	%
Commercial real estate other	49.65 %	50.14 %	49.44 %	%
Consumer real estate	27.90 %	25.79 %	26.51 %	%
Consumer other	1.95 %	2.19 %	2.10 %	%
Total	100.00%	100.00%	100.00 %	

### **Investment Securities Available for Sale**

We use the investment securities portfolio for several purposes. It serves as a vehicle to manage interest rate and prepayment risk, to generate interest and dividend income from investment of funds, to provide liquidity to meet funding requirements, and to provide collateral for pledging of public funds. Investments are classified into three categories (1) Held to Maturity (2) Trading and (3) Available for Sale. We believe that maintaining our securities in the Available for Sale category provides greater flexibility in the management of the overall investment portfolio. The average yield on investments at September 30, 2015 was 2.19% compared to 2.15% at September 30, 2014 and 2.12% at December 31, 2014. The amortized cost of the investments available for sale at September 30, 2015, September 30, 2014 and December 31, 2014 and percentage of each category to total investments are as follows:

<b><u>Investment Portfolio</u></b>		
<b>September 30,</b>	<b>September 30,</b>	<b>December 31,</b>
<b>2015</b>	<b>2014</b>	

	<b>2014</b>					
US Treasury Notes	\$29,908,712		\$29,922,266		\$29,248,281	
Government-Sponsored Enterprises	51,653,088		42,163,057		50,142,649	
Municipal Securities	34,440,067		34,642,666		34,603,182	
	\$116,001,867		\$106,727,989		\$113,994,112	
US Treasury Notes	25.78	%	28.04	%	25.66	%
Government-Sponsored Enterprises	44.53	%	39.50	%	43.99	%
Municipal Securities	29.69	%	32.46	%	30.35	%
	100.00	%	100.00	%	100.00	%

All investment securities were classified as Available for Sale (debt and equity securities that may be sold under certain conditions) at September 30, 2015 and December 31, 2014. The securities were reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of shareholders' equity, net of income taxes. Unrealized losses on securities due to fluctuations in fair value are recognized when it is determined that an other than temporary decline in value has occurred. Gains or losses on the sale of securities are recognized on a specific identification, trade date basis. (See "non-interest income" for discussion on the sale of investment securities.)

The amortized cost and fair value of investment securities available for sale are summarized as follows as of September 30, 2015 and December 31, 2014:

	<b>September 30, 2015</b>			
	Amortized	Gross	Gross	Estimated
	Cost	Unrealized	Unrealized	Fair
		Gains	Losses	Value
U.S. Treasury Notes	\$29,506,783	\$401,929	\$—	\$29,908,712
Government-Sponsored Enterprises	51,160,342	576,093	83,347	51,653,088
Municipal Securities	33,024,189	1,477,855	61,977	34,440,067
Total	\$113,691,315	\$2,455,877	\$145,324	\$116,001,867

	<b>December 31, 2014</b>			
	Amortized	Gross	Gross	Estimated
	Cost	Unrealized	Unrealized	Fair
		Gains	Losses	Value
U.S. Treasury Notes	\$29,162,412	\$105,627	\$19,758	\$29,248,281
Government-Sponsored Enterprises	50,194,951	95,961	148,263	50,142,649
Municipal Securities	32,663,698	1,973,743	34,259	34,603,182
Total	\$112,021,061	\$2,175,331	\$202,280	\$113,994,112

The amortized cost and fair value of investment securities available for sale at September 30, 2015, and December 31, 2014, by contractual maturity are as follows:

**September 30, 2015**



	Amortized Cost	Estimated Fair Value
Due in one year or less	\$3,319,312	\$3,348,511
Due in one year to five years	60,758,549	61,922,337
Due in five years to ten years	46,302,046	47,324,190
Due in ten years and over	3,311,408	3,406,829
Total	\$113,691,315	\$116,001,867

**December 31, 2014**

	Amortized Cost	Estimated Fair Value
Due in one year or less	\$8,324,400	\$8,362,398
Due in one year to five years	43,301,670	43,851,426
Due in five years to ten years	52,566,597	53,671,067
Due in ten years and over	7,828,394	8,109,221
Total	\$112,021,061	\$113,994,112

The fair value of investment securities available for sale with unrealized losses at September 30, 2015, and December 31, 2014, are as follows:

## September 30, 2014

Description of Securities	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury Notes	\$—	\$—	\$—	\$—	\$—	\$—
Government-Sponsored Enterprises	5,017,980	83,347	—	—	5,017,980	83,347
Municipal Securities	6,138,841	61,977	—	—	6,138,841	61,977
Total	\$11,156,821	\$145,324	\$—	\$—	\$11,156,821	\$145,324

## December 31, 2014

Description of Securities	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury Notes	\$4,948,438	\$19,758	\$—	\$—	\$4,948,438	\$19,758
Government-Sponsored Enterprises	28,850,132	148,263	—	—	28,850,132	148,263
Municipal Securities	931,428	27,182	1,557,833	7,077	2,489,261	34,259
Total	\$34,729,998	\$195,203	\$1,557,833	\$7,077	\$36,287,831	\$202,280

At September 30, 2015, we had one Government Sponsored Enterprise with an unrealized loss of \$83,347 and eight Municipal Securities with an unrealized loss of \$61,977. At December 31, 2014 we had two U.S. Treasury Notes with an unrealized loss of \$19,758, seven Government Sponsored Enterprises with an unrealized loss of \$148,263 and three

Municipal Securities with an unrealized loss of \$34,259. The unrealized losses on investments were caused by interest rate increases. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the amortized cost of the investment. Therefore, these investments are not considered other-than-temporarily impaired. We have the ability to hold these investments until market price recovery or maturity.

Deposits

Deposits remain our primary source of funding for loans and investments. Average interest bearing deposits provided funding for 59.02% of average earning assets for the nine months ended September 30, 2015, and 61.88% for the twelve months ended December 31, 2014. The Company encounters strong competition from other financial institutions as well as consumer and commercial finance companies, insurance companies and brokerage firms located in the primary service area of the Bank. However, the percentage of funding provided by deposits has remained stable. The breakdown of total deposits by type and the respective percentage of total deposits are as follows:

	<b>September 30,</b>		<b>December 31,</b>
	2015	2014	2014
Non-interest bearing demand	\$ 116,488,824	\$ 109,354,662	\$ 107,072,271
Interest bearing demand	79,865,760	76,901,044	79,397,647
Money market accounts	56,659,892	52,443,674	47,450,210
Time deposits over \$250,000	34,121,413	35,185,310	32,363,615
Other time deposits	30,297,705	30,804,764	29,457,720
Other savings deposits	26,318,910	24,585,981	26,677,564
<b>Total Deposits</b>	<b>\$ 343,752,504</b>	<b>\$ 329,275,435</b>	<b>\$ 322,419,027</b>

Percentage of Deposits	<b>September 30,</b>		<b>December 31,</b>	
	2015	2014	2014	
Non-interest bearing demand	33.89 %	33.21 %	33.21 %	
Interest bearing demand	23.23 %	23.35 %	24.62 %	
Money Market accounts	16.48 %	15.93 %	14.72 %	
Time deposit over \$250,000	9.93 %	10.69 %	10.04 %	
Other time deposits	8.81 %	9.35 %	9.14 %	
Other savings deposits	7.66 %	7.47 %	8.27 %	
<b>Total Deposits</b>	<b>100.00 %</b>	<b>100.00 %</b>	<b>100.00 %</b>	

Deposits increased 4.40% or \$14,477,069 from September 30, 2014 to September 30, 2015 and increased 6.62% or \$21,333,477 from December 31, 2014 to September 30, 2015. These increases were primarily due to larger balances in existing customer accounts as well as new accounts. Certificates of Deposit and other time deposits over \$250,000 totaled \$34,121,413, \$35,185,310 and \$32,363,615 at September 30, 2015, September 30, 2014 and December 31, 2014, respectively.

At September 30, 2015 and September 30, 2014, deposits with an aggregate deficit balance of \$37,246 and \$27,771, respectively were re-classified as other loans. At December 31, 2014 deposits with an aggregate deficit balance of \$58,364 were reclassified as other loans.

Short-Term Borrowings

Short term borrowings are summarized as follows:

	<b>September 30, 2015</b>	<b>December 31, 2014</b>
Securities sold under agreement to repurchase	\$ 481,141	\$ 6,980,681
Total	\$ 481,141	\$ 6,980,681

Securities sold under agreements to repurchase with customers mature on demand. These borrowings were collateralized by two U.S. Treasury Notes with an amortized cost of \$2,664,912 and a fair value of \$2,717,774 at September 30, 2015. At December 31, 2014, the borrowings were collateralized by five U.S. Treasury Notes with an amortized cost of \$8,502,891 and a fair value of \$8,553,484. The agreements to repurchase had a weighted average interest rate of .018% at September 30, 2015 and .025% at December 31, 2014, respectively. The average amount of outstanding agreements to repurchase was \$2,459,048 for the nine months ended September 30, 2015 and \$2,426,044 for the twelve months ended December 31, 2014. The securities underlying the repurchase agreements were held in safekeeping by an authorized broker. At the maturity date of this agreement the securities will be returned to our account.

At September 30, 2015 and December 31, 2014, we had no outstanding federal funds purchased with the option to borrow up to \$18,000,000 on short term lines of credit. We established a Borrower-In-Custody arrangement with the Federal Reserve as a secondary source of liquidity. This arrangement permits us to retain possession of loans pledged as collateral to secure advances from the Federal Reserve Discount Window. Under this agreement we could borrow up to \$74 million and \$71 million at September 30, 2015 and December 31, 2014, respectively. There have been no borrowings under this arrangement.

#### Comparison of Three Months Ended September 30, 2015 to Three Months Ended September 30, 2014

Net income increased \$57,206 or 5.01% to \$1,198,919, or basic and diluted earnings per share of \$.24 and \$.24, respectively, for the three months ended September 30, 2015, from \$1,141,713, or basic and diluted earnings per share of \$.23 and \$.23, respectively, for the three months ended September 30, 2014. Our return on average assets and average equity for the three months ended September 30, 2015 were 1.25% and 12.27%, respectively, compared with 1.23% and 12.36%, respectively, for the three months ended September 30, 2014.

#### Net Interest Income

Net interest income is affected by the size and mix of our balance sheet components as well as the spread between interest earned on assets and interest paid on liabilities. Net interest margin is a measure of the difference between interest income on earning assets and interest paid on interest bearing liabilities relative to the amount of interest bearing assets. Net interest income increased \$152,830 or 4.61% to \$3,468,442 for the three months ended September 30, 2015 from \$3,315,612 for the three months ended September 30, 2014. This increase was primarily due to increases in interest and fees on loans and interest and dividends from investment securities. Our local economy continues to improve which is giving our customers confidence to borrow for business and personal needs. Our average loans increased \$9,553,253 or 4.08% to \$243,617,106 for the three months ended September 30, 2015, compared to \$234,063,853 for the three months ended September 30, 2014. The yield on average loans remained relatively unchanged from 4.85% for the three months ended September 30, 2014, to 4.86% for the three months ended September 30, 2015. Interest income on loans increased \$106,749 for the three months ended September 30, 2015 to \$2,975,653 from \$2,868,904 for the three months ended September 30, 2014.

Average investment securities increased \$6,092,447 or 6.04% to \$106,900,893 for the three months ended September 30, 2015, with a yield of 2.16% as compared to \$100,808,446 for the three months ended September 30, 2014, with a yield of 2.11%. Interest and dividends on investment securities increased \$45,674 to \$581,708 for the three months ended September 30, 2015. This was an increase of 8.52% from \$536,034 for the three months ended September 30, 2014. An increase in deposits gave us the opportunity to invest our excess cash in investment securities to improve our earnings yield.

#### Allowance for Loan Losses

The allowance for loan losses represents our estimate of probable losses inherent in our loan portfolio. The adequacy of the allowance for loan losses (the “allowance”) is reviewed monthly by the Loan Committee and on a quarterly basis by the Board of Directors. For purposes of this analysis, adequacy is defined at a level sufficient to absorb estimated losses in the loan portfolio as of the balance sheet date presented. To remain Generally Accepted Accounting Principals (“GAAP”) compliant, the methodology employed for this analysis has been modified over the years to reflect our economic environment. This allowance is reviewed on a monthly basis by Credit Personnel. In addition, the allowance is validated on a periodic basis by the Company’s Risk Management Officer. The methodology is based on a Reserve Model that is comprised of the three components listed below:

- 1) Specific Reserve analysis for impaired loans based on Financial Accounting Standards Board (“FASB”) “receivables” topic ASC 310-10-35.
- 2) General reserve analysis applying historical loss rates based on FASB “contingencies” topic ASC 450-20.
- 3) Qualitative or environmental factors.

Loans are reviewed for impairment on a quarterly basis if any of the following criteria are met:

- 1) Any loan on non-accrual
- 2) Any loan that is a troubled debt restructuring
- 3) Any loan over 60 days past due
- 4) Any loan rated sub-standard, doubtful, or loss
- 5) Excessive principal extensions are executed
- 6) If we are provided information that indicates we will not collect all principal and interest as scheduled

The aforementioned methodology applies to both secured and unsecured loans, yet it does not apply to large groups of smaller balance loans that are collectively evaluated. Impairment is measured by the present value of the future cash flow discounted at the loan’s effective interest rate, or, alternatively the fair value of the collateral if the loan is collateral dependent. An impaired loan may not represent an expected loss.

A general reserve analysis is performed on all loans, excluding impaired loans. This analysis includes a pool of loans that are reviewed for impairment but are not found to be impaired. Historical losses are segregated into risk-similar groups and a loss ratio is determined for each group over a five-year period. The five-year average loss ratio by type is then used to calculate the estimated loss based on the current balance of each group.

Qualitative and environmental factors include external risk factors that we believe are representative of our overall lending environment. We believe that the following factors create a more comprehensive system of controls in which we can monitor the quality of the loan portfolio.

- 1) Portfolio risk
  - a. Levels and trends in delinquencies, impaired loans and changes in loan rating matrix
  - b. Trends in volume and terms of loans
  - c. Over-margined real estate lending risk
- 2) National and local economic trends and conditions
- 3) Effects of changes in risk selection and underwriting practices



- 4) Experience, ability and depth of lending management staff
- 5) Industry conditions
- 6) Effects of changes in credit concentrations
  - a. Loan concentration
  - b. Geographic concentration
  - c. Regulatory concentration
- 7) Loan and credit administration risk
  - a. Collateral documentation
  - b. Insurance Risk
  - c. Maintenance of financial information risk

The sum of each component's analysis results represents the "estimated loss" within our total portfolio.

Portfolio risk includes the levels and trends in delinquencies, impaired loans and changes in the loan rating matrix, trends in volume and terms of loans and overmargined real estate lending. We are satisfied with the stability of the past due and non-performing loans and believe there has been no decline in the quality of our loan portfolio due to any trend in delinquent or adversely classified loans. Sizable unsecured principal balances on a non-amortizing basis are monitored. Although the vast majority of our real estate loans are underwritten on a cash flow basis, the secondary source of repayment is typically tied to our ability to realize on the collateral. Accordingly, we closely monitor loan to value ratios. The maximum collateral advance rate is 80% on all real estate transactions, with the exception of raw land at 65% and land development at 70%.

Occasionally, we extend credit beyond our normal collateral advance margins in real estate lending. Although infrequent, the aggregate of these loans represent a notable part of our portfolio. Accordingly, these loans are monitored and the balances reported to the Board every quarter. An excessive level of this practice (as a percentage of capital) could result in additional regulatory scrutiny, competitive disadvantages and potential losses if forced to convert the collateral. The consideration of overmargined real estate loans directly relates to the capacity of the borrower to repay. We often request additional collateral to bring the loan to value ratio within the policy guidelines and also require a strong secondary source of repayment in addition to the primary source of repayment.

Although significantly under the threshold of 100% of capital (currently approximately \$39 million), the number of overmargined real estate loans currently totals approximately \$11.7 million or approximately 4.84% of our loan portfolio at September 30, 2015 compared to \$16.1 million or approximately 9.09% of the loan portfolio at September 30, 2014.

A credit rating matrix is used to rate all extensions of credit and to provide a more specified picture of the risk each loan poses to the quality of the loan portfolio. There are nine possible ratings used to determine the quality of each loan based on the following characteristics: cash flow, collateral quality, guarantor strength, financial condition, management quality, operating performance, the relevancy of the financial statements, historical loan performance, and the borrower's leverage position. The matrix is designed to meet our standards and expectations of loan quality. One hundred percent of our loans are graded.

National and local economic trends and conditions are constantly changing and result in both positive and negative impact on borrowers. Most macroeconomic conditions are not controllable by us and are incorporated into the qualitative risk factors. Natural and environmental disasters, political uncertainty, international instability, as well as problems in the traditional mortgage market are a few of the trends and conditions that are currently affecting the national and local economies. These changes have impacted borrowers' ability, in many cases, to repay loans in a timely manner. On occasion, a loan's primary source of repayment (i.e., personal income, cash flow, or lease income) may be eroded as a result of unemployment, lack of revenues, or the inability of a tenant to make rent payments.

The quality of our loan portfolio is contingent upon our risk selection and underwriting practices. Every credit with over \$200,000 in exposure is summarized by our Credit Department and reviewed by the Loan Committee on a monthly basis. The Board of Directors reviews credits over \$500,000 monthly with annual credit analyses conducted on these borrower upon the receipt of updated financial information. Prior to any extension of credit, every significant commercial loan goes through sound credit underwriting. The Credit Department conducts a detailed cash flow on each proposal using the most current financial information.

We have over 350 years of lending experience among our lending staff. In addition to the lending staff, we have an Advisory Board for each office comprised of business and community leaders from the specific office market area. An

additional Advisory Board was created during 2012 to support our business efforts in the North Charleston area of South Carolina. As noted previously, the Bank recently announced its intention to open an office in North Charleston, South Carolina on Highway 78 and Ingleside Boulevard. We have signed a lease with an anticipated opening in the future. We meet with these advisory boards quarterly to discuss the trends and conditions in each respective market. We are aware of the many challenges currently facing the banking industry. As other banks look to increase earnings in the short term, we will continue to emphasize the need to maintain safe and sound lending practices and core deposit growth managed with a long term objective.

There continues to be an influx of new banks in our geographic area. This increase has decreased the local industry's overall margins as a result of pricing competition. We believe that our borrowing base is well established and therefore unsound price competition is not necessary.

The risks associated with the effects of changes in credit concentration include loan concentration, geographic concentration and regulatory concentration.

