

BANK OF SOUTH CAROLINA CORP  
Form 10-Q  
August 05, 2016

**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 June 30, 2016

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)

South Carolina                      57-1021355  
(State or other jurisdiction of    (IRS Employer  
incorporation or organization) 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 August 5, 2016 there were 4,942,229 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)<br/>June 30, 2016</b> | <b>(Audited)<br/>December 31,<br/>2015</b> |
|---|--------------------------------------|--|
| <b>ASSETS</b>                                       |                                      |  |
| Cash and due from banks                             | \$6,455,536                          | \$5,295,924                                |
| Interest-bearing deposits in other bank             | 35,256,752                           | 23,898,862                                 |
| Investment securities available for sale            | 105,358,942                          | 119,997,585                                |
| Mortgage loans to be sold                           | 6,500,452                            | 5,820,239                                  |
| Loans   | 270,300,089                          | 242,622,705                                |
| Less: Allowance for loan losses                     | (3,512,446 )                         | (3,417,827 )                               |
| Net loans   | 266,787,643                          | 239,204,878                                |
| Premises, equipment and leasehold improvements, net | 2,218,154                            | 2,289,228                                  |
| Other real estate owned                             | 521,943                              | 620,394                                    |
| Accrued interest receivable                         | 1,401,353                            | 1,284,063                                  |
| Other assets  | 444,082                              | 761,339                                    |
| <b>Total assets</b>                                 | <b>\$424,944,857</b>                 | <b>\$399,172,512</b>                       |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>         |                                      |  |
| <b>Liabilities</b>                                  |                                      |  |
| <b>Deposits:</b>                                    |                                      |  |
| Non-interest-bearing demand                         | \$128,132,432                        | \$122,073,396                              |
| Interest-bearing demand                             | 92,868,069                           | 84,977,640                                 |
| Money market accounts                               | 83,527,123                           | 70,233,422                                 |
| Time deposits over \$250,000                        | 24,095,180                           | 25,896,768                                 |
| Other time deposits                                 | 23,681,308                           | 28,871,044                                 |
| Other savings deposits                              | 29,918,168                           | 26,666,342                                 |
| <b>Total deposits</b>                               | <b>382,222,280</b>                   | <b>358,718,612</b>                         |
| Accrued interest payable and other liabilities      | 1,205,589                            | 1,302,188                                  |
| <b>Total Liabilities</b>                            | <b>383,427,869</b>                   | <b>360,020,800</b>                         |

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Shareholders' Equity

|  |               |               |
|--|---------------|---------------|
| Common Stock-No par value: 12,000,000 shares authorized; shares issued 5,183,185 at June 30, 2016 and 5,157,996 at December 31, 2015; shares outstanding 4,941,789 at June 30, 2016 and 4,916,600 at December 31, 2015 | —             | —             |
| Additional paid in capital   | 36,641,973    | 36,341,744    |
| Retained earnings  | 5,290,971     | 4,064,834     |
| Treasury stock; 241,396 shares at June 30, 2016 and December 31, 2015  | (2,247,415 )  | (2,247,415 )  |
| Accumulated other comprehensive income, net of income taxes  | 1,831,459     | 992,549       |
| Total shareholders' equity   | 41,516,988    | 39,151,712    |
| <br>   |               |               |
| Total liabilities and shareholders' equity   | \$424,944,857 | \$399,172,512 |

See accompanying notes to consolidated financial statements.

**BANK OF SOUTH CAROLINA CORPORATION AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

|  | <b>Three Months Ended</b> |             |
|--|---------------------------|-------------|
|  | <b>June 30,</b>           |             |
|  | 2016                      | 2015        |
| Interest and fee income                              |                           |             |
| Loans, including fees                                | \$3,208,836               | \$2,958,135 |
| Taxable securities                                   | 290,486                   | 333,111     |
| Tax-exempt securities                                | 240,171                   | 252,973     |
| Other  | 31,176                    | 6,444       |
| Total interest and fee income                        | 3,770,669                 | 3,550,663   |
| Interest expense                                     |                           |             |
| Deposits   | 92,981                    | 99,423      |
| Short-term borrowings                                | 7                         | 156         |
| Total interest expense                               | 92,988                    | 99,579      |
| Net interest income                                  | 3,677,681                 | 3,451,084   |
| Provision for loan losses                            | 140,000                   | 70,000      |
| Net interest income after provisions for loan losses | 3,537,681                 | 3,381,084   |
| Other income   |                           |             |
| Service charges, fees and commissions                | 265,736                   | 251,207     |
| Mortgage banking income                              | 296,891                   | 457,590     |
| Other non-interest income                            | 6,554                     | 6,607       |
| Gain on sale of securities                           | 160,391                   | 153,088     |
| Total other income                                   | 729,572                   | 868,492     |
| Other expense  |                           |             |
| Salaries and employee benefits                       | 1,480,420                 | 1,475,677   |
| Net occupancy expense                                | 380,311                   | 376,029     |
| Other operating expenses                             | 576,150                   | 547,752     |
| Total other expense                                  | 2,436,881                 | 2,399,458   |
| Income before income tax expense                     | 1,830,372                 | 1,850,118   |
| Income tax expense                                   | 518,262                   | 596,680     |
| Net income   | \$1,312,110               | \$1,253,438 |
| Weighted average shares outstanding                  |                           |             |
| Basic  | 4,929,722                 | 4,910,501   |
| Diluted  | 5,056,523                 | 5,024,167   |

|                                 |        |        |
|---------------------------------|--------|--------|
| Basic income per common share   | \$0.27 | \$0.26 |
| Diluted income per common share | \$0.26 | \$0.25 |

See accompanying notes to consolidated financial statements.

**BANK OF SOUTH CAROLINA CORPORATION AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

|  | Six Months Ended |             |
|--|------------------|-------------|
|  | June 30,         |             |
|  | 2016             | 2015        |
| Interest and fee income                              |                  |             |
| Loans, including fees                                | \$6,242,879      | \$5,822,901 |
| Taxable securities                                   | 613,619          | 672,891     |
| Tax-exempt securities                                | 479,485          | 516,154     |
| Other  | 66,750           | 13,318      |
| Total interest and fee income                        | 7,402,733        | 7,025,264   |
| Interest expense                                     |                  |             |
| Deposits   | 187,120          | 192,157     |
| Short-term borrowings                                | 7                | 893         |
| Total interest expense                               | 187,127          | 193,050     |
| Net interest income                                  | 7,215,606        | 6,832,214   |
| Provision for loan losses                            | 185,000          | 75,000      |
| Net interest income after provisions for loan losses | 7,030,606        | 6,757,214   |
| Other income   |                  |             |
| Service charges, fees and commissions                | 526,267          | 488,493     |
| Mortgage banking income                              | 648,764          | 834,736     |
| Other non-interest income                            | 12,243           | 11,520      |
| Loss on sale of other real estate                    | (13,450 )        | —           |
| Gain on sale of securities                           | 348,327          | 264,401     |
| Total other income                                   | 1,522,151        | 1,599,150   |
| Other expense  |                  |             |
| Salaries and employee benefits                       | 2,995,446        | 2,891,850   |
| Net occupancy expense                                | 756,710          | 739,627     |
| Other operating expenses                             | 1,207,422        | 1,107,035   |
| Total other expense                                  | 4,959,578        | 4,738,512   |
| Income before income tax expense                     | 3,593,179        | 3,617,852   |
| Income tax expense                                   | 1,085,333        | 1,159,455   |
| Net income   | \$2,507,846      | \$2,458,397 |
| Weighted average shares outstanding                  |                  |             |
| Basic  | 4,923,266        | 4,908,871   |



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|                                 |           |           |
|---------------------------------|-----------|-----------|
| Diluted                         | 5,047,601 | 5,025,554 |
| Basic income per common share   | \$0.51    | \$0.50    |
| Diluted income per common share | \$0.50    | \$0.49    |

See accompanying notes to consolidated financial statements.

**BANK OF SOUTH CAROLINA CORPORATION AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

|   | <b>Three Months Ended</b> |             |
|---|---------------------------|-------------|
|   | <b>June 30,</b>           |             |
|   | 2016                      | 2015        |
| Net income  | \$1,312,110               | \$1,253,438 |
| Other comprehensive income (loss):                                      |                           |             |
| Unrealized gain (loss) on securities arising during the period          | 553,433                   | (1,278,318) |
| Reclassification adjustment for securities gains realized in net income | (160,391 )                | (153,088 )  |
| Other comprehensive income (loss), before tax                           | 393,042                   | (1,431,406) |
| Income tax effect related to items of other comprehensive income (loss) | 145,426                   | (529,620 )  |
| Other comprehensive income (loss), after tax                            | 247,616                   | (901,786 )  |
| Total comprehensive income  | \$1,559,726               | \$351,652   |

|   | <b>Six Months Ended</b> |             |
|---|-------------------------|-------------|
|   | <b>June 30,</b>         |             |
|   | 2016                    | 2015        |
| Net income  | \$2,507,846             | \$2,458,397 |
| Other comprehensive income (loss):                                      |                         |             |
| Unrealized gain (loss) on securities arising during the period          | 1,679,929               | (195,744 )  |
| Reclassification adjustment for securities gains realized in net income | (348,327 )              | (264,401 )  |
| Other comprehensive income (loss), before tax                           | 1,331,602               | (460,145 )  |
| Income tax effect related to items of other comprehensive income (loss) | 492,692                 | (170,254 )  |
| Other comprehensive income (loss), after tax                            | 838,910                 | (289,891 )  |
| Total comprehensive income  | \$3,346,756             | \$2,168,506 |

See accompanying notes to consolidated financial statements.

**BANK OF SOUTH CAROLINA CORPORATION AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY****FOR THE SIX MONTHS ENDED JUNE 30, 2016 AND 2015 (UNAUDITED)**

|  | <b>ADDITIONAL<br/>PAID IN<br/>CAPITAL</b> | <b>RETAINED<br/>EARNINGS</b> | <b>TREASURY<br/>STOCK</b> | <b>ACCUMULATED<br/>OTHER<br/>COMPREHENSIVE<br/>INCOME</b> | <b>TOTAL</b> |
|--|---|------------------------------|---------------------------|---|--------------|
| December 31, 2014                        | \$ 28,779,108                             | \$ 8,640,291                 | \$(1,902,439)             | \$ 1,243,022  | \$36,759,982 |
| Net income                               | —   | 2,458,397                    | —                         | —   | 2,458,397    |
| Other comprehensive loss                 | —   | —                            | —                         | (289,891)   | (289,891)    |
| Exercise of stock options                | 113,254                                   | —                            | —                         | —   | 113,254      |
| Stock-based compensation expense         | 38,907                                    | —                            | —                         | —   | 38,907       |
| Cash dividends (\$0.26 per common share) | —   | (1,160,952)                  | —                         | —   | (1,160,952)  |
| June 30, 2015                            | \$ 28,931,269                             | \$ 9,937,736                 | \$(1,902,439)             | \$ 953,131  | \$37,919,697 |
| December 31, 2015                        | \$ 36,341,744                             | \$ 4,064,834                 | \$(2,247,415)             | \$ 992,549  | \$39,151,712 |
| Net income                               | —   | 2,507,846                    | —                         | —   | 2,507,846    |
| Other comprehensive income               | —   | —                            | —                         | 838,910   | 838,910      |
| Exercise of stock options                | 260,546                                   | —                            | —                         | —   | 260,546      |
| Stock-based compensation expense         | 39,683                                    | —                            | —                         | —   | 39,683       |
| Cash dividends (\$0.26 per common share) | —   | (1,281,709)                  | —                         | —   | (1,281,709)  |
| June 30, 2016                            | \$ 36,641,973                             | \$ 5,290,971                 | \$(2,247,415)             | \$ 1,831,459  | \$41,516,988 |

See accompanying notes to consolidated financial statements.

**BANK OF SOUTH CAROLINA CORPORATION AND SUBSIDIARY****CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

|   | <b>Six Months Ended</b> |              |
|---|-------------------------|--------------|
|   | <b>June 30,</b>         |              |
|   | 2016                    | 2015         |
| Cash flows from operating activities:   |                         |              |
| Net income  | \$2,507,846             | \$2,458,397  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                         |              |
| Depreciation  | 95,732                  | 99,451       |
| Gain on sale of securities  | (348,327 )              | (264,401 )   |
| Loss on sale of OREO  | 13,450                  | —            |
| Provision for loan losses   | 185,000                 | 75,000       |
| Stock-based compensation expense  | 39,683                  | 38,907       |
| Net amortization of unearned discounts on investments                             | 92,417                  | 48,540       |
| Origination of mortgage loans held for sale                                       | (36,412,202)            | (49,005,737) |
| Proceeds from sale of mortgage loans held for sale                                | 35,731,989              | 49,875,936   |
| (Increase) decrease in accrued interest receivable and other assets               | (292,725 )              | 209,283      |
| (Decrease) increase in accrued interest payable and other liabilities             | (99,874 )               | 227,098      |
| Net cash provided by operating activities   | 1,512,989               | 3,762,474    |
| Cash flows from investing activities:   |                         |              |
| Proceeds from maturities of investment securities available for sale              | 4,146,000               | 2,145,000    |
| Proceeds from sale of investment securities available for sale                    | 21,113,400              | 15,219,799   |
| Purchase of investment securities available for sale                              | (9,033,245 )            | (7,056,800 ) |
| Proceeds from sale of other real estate owned                                     | 85,001                  | —            |
| Net increase in loans   | (27,767,765)            | (6,340,644 ) |
| Purchase of premises, equipment, and leasehold improvements                       | (24,658 )               | (85,607 )    |
| Net cash (used) provided by investing activities                                  | (11,481,267)            | 3,881,748    |
| Cash flows from financing activities:   |                         |              |
| Net increase in deposit accounts  | 23,503,668              | 7,527,122    |
| Net decrease in short-term borrowings   | —                       | (6,499,571 ) |
| Dividends paid  | (1,278,434 )            | (1,159,960 ) |
| Stock options exercised   | 260,546                 | 113,254      |
| Net cash provided (used) by financing activities                                  | 22,485,780              | (19,155 )    |
| Net increase in cash and cash equivalents   | 12,517,502              | 7,625,067    |
| Cash and cash equivalents at beginning of period                                  | 29,194,786              | 10,379,048   |
| Cash and cash equivalents at end of period  | \$41,712,288            | \$18,004,115 |

## Supplemental disclosure of cash flow data:

Cash paid during the period for:

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|   |              |              |
|---|--------------|--------------|
| Interest  | \$ 190,343   | \$ 201,704   |
| Income taxes  | \$ 1,069,840 | \$ 972,252   |
| Supplemental disclosure for non-cash investing and financing activity:        |              |              |
| Change in unrealized gain (loss) on available for sale securities, net of tax | \$ 838,910   | \$(289,891 ) |
| Change in dividends payable   | \$ 3,275     | \$ 992       |

See accompanying notes to consolidated financial statements.

**BANK OF SOUTH CAROLINA CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1: Nature of Business and Basis of Presentation**

*Organization*

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.

*Principles of Consolidation*

The accompanying consolidated financial statements include the accounts of Bank of South Carolina Corporation (the “Company”) and its wholly-owned subsidiary, The Bank of South Carolina (the “Bank”). In consolidation, all significant intercompany balances and transactions have been eliminated.

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

*Basis of Presentation*

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles, or GAAP, for the interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, our interim consolidated financial statements do not include all of the information and footnotes required by GAAP for complete financial statements and should be read in conjunction with our Annual Report on Form 10-K, filed with the SEC on March 4, 2016. In the opinion of management, these interim financial statements present fairly, in all material respects, the Company’s consolidated

financial position and results of operations for each of the interim periods presented. Results of operations for interim periods are not necessarily indicative of the results of operations that may be expected for a full year or any future period.

#### *Accounting Estimates and Assumptions*

The preparation of the consolidated financial statements 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 reported periods. 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.

#### *Reclassification*

Certain amounts in the prior years' financial statements have been reclassified to conform to the current year's presentation. Such reclassifications had no effect on shareholders' equity or the net income as previously reported.

**BANK OF SOUTH CAROLINA CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

*Income per share*

Basic income per share represents income available to shareholders divided by the weighted-average number of common shares outstanding during the period. Dilutive income per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued. The only potential common share equivalents are those related to stock options. Stock options which are anti-dilutive are excluded from the calculation of diluted net income per share. The dilutive effect of options outstanding under our stock compensation plan is reflected in diluted earnings per share by the application of the treasury stock method. Retroactive recognition has been given for the effects of all stock dividends.

*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. Non recognized 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 available to be issued and no subsequent events occurred requiring accrual or disclosure.

*Recent 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 May 2014, the Financial Accounting Standards Board (“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 Accounting Standards Update (“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.

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.

**BANK OF SOUTH CAROLINA CORPORATION**

**NOTES TO CONSOLIDATED 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 Accounting Standards Codification (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. The amendments were 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 these amendments to have a material effect on our 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. We do not expect these amendments to have a material effect on our financial statements.

In January 2016, the FASB amended the Financial Instruments topic of Accounting Standards Codification to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments will be effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. We will apply the guidance by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values will be applied prospectively to equity investments that exist as of the date of adoption of the amendments. We do not expect this amendment to have a material effect on our financial statements.

In February 2016, the FASB amended the Leases topic of the Accounting Standards Codification to revise certain aspects of recognition, measurement, presentation, and disclosure of leasing transactions. The amendments will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. We are currently evaluating the effect that implementation of the new standard will have on our financial position, results of operations, and cash flows.

In March 2016, the FASB amended the Revenue from Contracts with Customers topic of the Accounting Standards Codification to clarify the implementation guidance on principal versus agent considerations and address how an entity should assess whether it is the principal or the agent in contracts that include three or more parties. The amendments will be effective for the Company for reporting periods beginning after December 15, 2017. We do not expect these amendments to have a material effect on our financial statements.

In March 2016, the FASB issued guidance to simplify several aspects of the accounting for share-based payment award transactions including the income tax consequences, the classification of awards as either equity or liabilities, and the classification on the statement of cash flows. Additionally, the guidance simplifies two areas specific to entities other than public business entities allowing them apply a practical expedient to estimate the expected term for all awards with performance or service conditions that have certain characteristics and also allowing them to make a one-time election to switch from measuring all liability-classified awards at fair value to measuring them at intrinsic value. The amendments will be effective for annual periods beginning after December 15, 2016 and interim periods within those annual periods. We do not expect these amendments to have a material effect on our financial statements.

In April 2016, the FASB amended the Revenue from Contracts with Customers topic of the ASC to clarify guidance related to identifying performance obligations and accounting for licenses of intellectual property. The amendments will be effective for reporting periods beginning after December 15, 2017. We do not expect these amendments to have a material effect on our financial statements.

**BANK OF SOUTH CAROLINA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

In May 2016, the FASB amended the Revenue from Contracts with Customers topic of the ASC to clarify guidance related to the collectability, noncash consideration, presentation of sales tax, and transition. The amendments will be effective for reporting periods beginning after December 15, 2017. We do not expect these amendments to have a material effect on our financial statements.

In June 2016, the FASB issued guidance to change the accounting for credit losses and modify the impairment model for certain debt securities. The amendments will be effective for the reporting periods beginning after December 15, 2019. We are currently evaluating the effect that implementation of the new standard will have on our financial position, results of operations, and cash flows.

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 2: Investment Securities**

The amortized cost and fair value of investment securities available for sale are summarized as follows:

|                                  | June 30, 2016     |                              |                               |                         |
|----------------------------------|-------------------|------------------------------|-------------------------------|-------------------------|
|                                  | AMORTIZED<br>COST | GROSS<br>UNREALIZED<br>GAINS | GROSS<br>UNREALIZED<br>LOSSES | ESTIMATED<br>FAIR VALUE |
| U.S. Treasury Notes              | \$23,993,169      | \$ 381,362                   | \$ —                          | \$24,374,531            |
| Government-Sponsored Enterprises | 40,866,456        | 1,050,975                    | —                             | 41,917,431              |
| Municipal Securities             | 37,592,246        | 1,487,186                    | 12,452                        | 39,066,980              |
| Total                            | \$102,451,871     | \$ 2,919,523                 | \$ 12,452                     | \$105,358,942           |

December 31, 2015

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|                                  | AMORTIZED<br>COST | GROSS<br>UNREALIZED<br>GAINS | GROSS<br>UNREALIZED<br>LOSSES | ESTIMATED<br>FAIR VALUE |
|----------------------------------|-------------------|------------------------------|-------------------------------|-------------------------|
| U.S. Treasury Notes              | \$34,517,996      | \$ 161,037                   | \$ 45,360                     | \$34,633,673            |
| Government-Sponsored Enterprises | 51,136,426        | 281,650                      | 133,744                       | 51,284,332              |
| Municipal Securities             | 32,767,694        | 1,340,610                    | 28,724                        | 34,079,580              |
| Total                            | \$118,422,116     | \$ 1,783,297                 | \$ 207,828                    | \$119,997,585           |

**BANK OF SOUTH CAROLINA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

The following table presents the amortized cost and estimated fair value of investment securities available for sale by contractual maturity for the periods indicated:

|                                | June 30, 2016     |                         | December 31, 2015 |                         |
|--------------------------------|-------------------|-------------------------|-------------------|-------------------------|
|                                | AMORTIZED<br>COST | ESTIMATED<br>FAIR VALUE | AMORTIZED<br>COST | ESTIMATED<br>FAIR VALUE |
| Due in one year or less        | \$2,206,397       | \$2,230,496             | \$3,311,346       | \$3,326,249             |
| Due in one year to five years  | 66,494,101        | 68,024,729              | 69,870,930        | 70,584,179              |
| Due in five years to ten years | 30,790,840        | 32,066,086              | 41,930,801        | 42,670,986              |
| Due in ten years and over      | 2,960,533         | 3,037,631               | 3,309,039         | 3,416,171               |
| Total                          | \$102,451,871     | \$105,358,942           | \$118,422,116     | \$119,997,585           |

Securities pledged to secure deposits at June 30, 2016 and December 31, 2015, had a carrying amount of \$47.1 million and \$48.0 million, respectively.

The tables below summarize gross unrealized losses on investment securities and the fair market value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2016 and December 31, 2015. We believe that all unrealized losses have resulted from temporary changes in the interest rate market and not as a result of credit deterioration. We do not intend to sell and it is not likely that we will be required to sell any of the securities referenced in the table below before recovery of their amortized cost.

|                                  | Less Than 12 months |               |                      | 12 months or longer |               |                      | Total |               |                      |
|----------------------------------|---------------------|---------------|----------------------|---------------------|---------------|----------------------|-------|---------------|----------------------|
|                                  | #                   | Fair<br>Value | Unrealized<br>Losses | #                   | Fair<br>Value | Unrealized<br>Losses | #     | Fair<br>Value | Unrealized<br>Losses |
| Available for sale               |                     |               |                      |                     |               |                      |       |               |                      |
| As of June 30, 2016              |                     |               |                      |                     |               |                      |       |               |                      |
| U.S. Treasury Notes              | —                   | \$—           | \$—                  | —                   | \$—           | —                    | —     | \$—           | \$—                  |
| Government Sponsored Enterprises | —                   | —             | —                    | —                   | —             | —                    | —     | —             | —                    |
| Municipal Securities             | 7                   | 3,192,676     | 12,452               | —                   | —             | —                    | 7     | 3,192,676     | 12,452               |
| Total                            | 7                   | \$3,192,676   | \$12,452             | —                   | \$—           | —                    | 7     | \$3,192,676   | \$12,452             |

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| Available for sale               | Less Than 12 months |               |                   | 12 months or longer |              |                   | Total |               |                   |
|----------------------------------|---------------------|---------------|-------------------|---------------------|--------------|-------------------|-------|---------------|-------------------|
|                                  | #                   | Fair Value    | Unrealized Losses | #                   | Fair Value   | Unrealized Losses | #     | Fair Value    | Unrealized Losses |
| As of December 31, 2015          |                     |               |                   |                     |              |                   |       |               |                   |
| U.S. Treasury Notes              | 2                   | \$ 10,064,063 | \$ 45,360         | —                   | \$ —         | \$ —              | 2     | \$ 10,064,063 | \$ 45,360         |
| Government Sponsored Enterprises | 2                   | 7,475,445     | 38,538            | 1                   | 5,002,335    | 95,206            | 3     | 12,477,780    | 133,744           |
| Municipal Securities             | 6                   | 4,361,149     | 28,724            | —                   | —            | —                 | 6     | 4,361,149     | 28,724            |
| Total                            | 10                  | \$ 21,900,657 | \$ 112,622        | 1                   | \$ 5,002,335 | \$ 95,206         | 11    | \$ 26,902,992 | \$ 207,828        |

**BANK OF SOUTH CAROLINA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

We received proceeds from sales of securities available for sale and gross realized gains and losses as follows:

|                       | <b>For the Three Months<br/>Ended<br/>June 30,</b> |             |
|-----------------------|--|-------------|
|                       | 2016   | 2015        |
| Gross proceeds        | \$5,135,609  | \$4,373,911 |
| Gross realized gains  | 160,391  | 153,088     |
| Gross realized losses | —  | —           |

|                       | <b>For the Six Months Ended<br/>June 30,</b> |              |
|-----------------------|--|--------------|
|                       | 2016   | 2015         |
| Gross proceeds        | \$21,113,400                                 | \$15,219,799 |
| Gross realized gains  | 348,327                                      | 264,401      |
| Gross realized losses | —  | —            |

The tax provision related to these gains was \$59,382 and \$56,643 for the three months ended June 30, 2016 and 2015, respectively and \$128,881 and \$97,829 for the six months ended June 30, 2016 and 2015, respectively.

**Note 3: Loans and Allowance for Loan Losses**

Major classifications of loans (net of deferred loan fees of \$133,721 at June 30, 2016, and \$118,188 at December 31, 2015) are as follows:

|                         | <b>June 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|-------------------------|--------------------------|------------------------------|
| Commercial Loans        | \$53,236,380             | \$50,938,265                 |
| Commercial real estate: |                          |                              |



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|                                     |               |               |
|-------------------------------------|---------------|---------------|
| Commercial real estate construction | 1,295,073     | 1,005,118     |
| Commercial real estate other        | 129,103,382   | 115,736,034   |
| Consumer                            |               |               |
| Consumer real estate                | 81,158,674    | 69,777,307    |
| Consumer other                      | 5,506,580     | 5,165,981     |
|                                     | 270,300,089   | 242,622,705   |
| Allowance for Loan losses           | (3,512,446 )  | (3,417,827 )  |
| Loans, net                          | \$266,787,643 | \$239,204,878 |

We had \$109.1 million and \$102.1 million of loans pledged as collateral to secure funding with the Federal Reserve Bank (“FRB”) Discount Window at June 30, 2016 and at December 31, 2015, respectively.

Our portfolio grading analysis estimates the capability of the borrower to repay the contractual obligations of the loan agreements as scheduled. Our internal credit risk grading system is based on experience with similarly graded loans, industry best practices, and regulatory guidance.

**BANK OF SOUTH CAROLINA CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Our internally assigned grades pursuant to the Board-approved lending policy are as follows:

**Excellent** (1) The borrowing entity has more than adequate cash flow, unquestionable strength, strong earnings and capital where applicable, and no overdrafts.

**Good** (2) The Borrowing entity has dependable cash flow, better than average financial condition, good capital and usually no overdrafts.

**Satisfactory** (3) The borrowing entity has adequate cash flow, satisfactory financial condition, explainable overdrafts (if any).

**Watch** (4) The borrowing entity has generally adequate, yet inconsistent cash flow, cyclical earnings, weak capital, loan to/from stockholders, and infrequent overdrafts. The borrower has consistent yet sometimes unpredictable sales and growth.

**OAEM** (5) The borrowing entity has marginal cash flow, occasional past dues, and frequent and unexpected working capital needs.

**Substandard** (6) The borrowing entity has a cash flow barely sufficient to service debt, deteriorated financial condition, bankruptcy possible. The borrowing entity has declining sales, rising costs, and may need to look for secondary source of repayment.

**Doubtful** (7) The borrowing entity has negative cash flow. Survival of the business is at risk, full repayment is unlikely, and there are frequent and unexplained overdrafts. The borrowing entity shows declining trends and no operating profits.

**Loss** (8) The borrowing entity has negative cash flow with no alternatives. Survival of the business is unlikely.

The following table illustrates credit risks by category and internally assigned grades at June 30, 2016 and December 31, 2015. "Pass" includes loans internally graded as excellent, good and satisfactory.

| June 30,2016 |   |                                    |                         |                   |       |
|--------------|---|------------------------------------|-------------------------|-------------------|-------|
| Commercial   | Commercial<br>Real Estate<br>Construction | Commercial<br>Real Estate<br>Other | Consumer<br>Real Estate | Consumer<br>Other | Total |

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|             |              |              |               |              |             |               |
|-------------|--------------|--------------|---------------|--------------|-------------|---------------|
| Pass        | \$49,359,963 | \$ 871,056   | \$123,622,814 | \$78,033,500 | \$5,253,174 | \$257,140,507 |
| Watch       | 1,168,350    | 424,017      | 917,792       | 1,158,622    | 127,090     | 3,795,871     |
| OAEM        | 1,134,582    | —            | 658,281       | 651,537      | 16,994      | 2,461,394     |
| Substandard | 1,573,485    | —            | 3,904,495     | 1,315,015    | 109,322     | 6,902,317     |
| Doubtful    | —            | —            | —             | —            | —           | —             |
| Loss        | —            | —            | —             | —            | —           | —             |
| Total       | \$53,236,380 | \$ 1,295,073 | \$129,103,382 | \$81,158,674 | \$5,506,580 | \$270,300,089 |

**BANK OF SOUTH CAROLINA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

|             | December 31, 2015 |   |                                    |                         |                   |               |
|-------------|-------------------|---|------------------------------------|-------------------------|-------------------|---------------|
|             | Commercial        | Commercial<br>Real Estate<br>Construction | Commercial<br>Real Estate<br>Other | Consumer<br>Real Estate | Consumer<br>Other | Total         |
| Pass        | \$46,865,088      | \$572,101                                 | \$110,040,948                      | \$65,941,806            | \$4,857,576       | \$228,277,519 |
| Watch       | 1,096,200         | 433,017                                   | 940,073                            | 2,490,339               | 175,489           | 5,135,118     |
| OAEM        | 1,337,002         | —   | 1,203,518                          | 99,743                  | 26,961            | 2,667,224     |
| Substandard | 1,639,975         | —   | 3,551,495                          | 1,245,419               | 105,955           | 6,542,844     |
| Doubtful    | —                 | —   | —                                  | —                       | —                 | —             |
| Loss        | —                 | —   | —                                  | —                       | —                 | —             |
| Total       | \$50,938,265      | \$1,005,118                               | \$115,736,034                      | \$69,777,307            | \$5,165,981       | \$242,622,705 |

The following tables include an aging analysis of the recorded investment of past-due financing receivable by class:

|  | June 30, 2016             |                        |                            |                   |               |                           |   |
|--|---------------------------|------------------------|----------------------------|-------------------|---------------|---------------------------|---|
|  | 30-59<br>Days Past<br>Due | 60-89 Days<br>Past Due | Greater<br>Than 90<br>Days | Total Past<br>Due | Current       | Total Loans<br>Receivable | Recorded<br>Investment<br>> 90<br>Days<br>and<br>Accruing<br>Interest |
| Commercial Loans                       | \$—                       | \$1,174,677            | \$2,685                    | \$1,177,362       | \$52,059,018  | \$53,236,380              | \$ —  |
| Commercial real estate:                |                           |                        |                            |                   |               |                           |   |
| Commercial real estate<br>construction | —                         | —                      | —                          | —                 | 1,295,073     | 1,295,073                 | —   |
| Commercial real estate<br>other        | 408,729                   | 547,814                | 2,162,237                  | 3,118,780         | 125,984,602   | 129,103,382               | —   |
| Consumer                               |                           |                        |                            |                   |               |                           |   |
| Consumer real estate                   | 43,173                    | 249,754                | —                          | 292,927           | 80,865,747    | 81,158,674                | —   |
| Consumer other                         | 4,523                     | 4,208                  | —                          | 8,731             | 5,497,849     | 5,506,580                 | —   |
| Total                                  | \$456,425                 | \$1,976,453            | \$2,164,922                | \$4,597,800       | \$265,702,289 | \$270,300,089             | \$ —  |

|  | December 31, 2015      |                        |                            |                   |         |                           |                                     |
|--|------------------------|------------------------|----------------------------|-------------------|---------|---------------------------|-------------------------------------|
|  | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | Greater<br>Than 90<br>Days | Total Past<br>Due | Current | Total Loans<br>Receivable | Recorded<br>Investment<br>> 90 Days |

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|                                     |              |              |              |              |                |                | and<br>Accruing<br>Interest |
|-------------------------------------|--------------|--------------|--------------|--------------|----------------|----------------|-----------------------------|
| Commercial Loans                    | \$ 1,162,676 | \$ 250,370   | \$ 4,317     | \$ 1,417,363 | \$ 49,520,902  | \$ 50,938,265  | \$ —                        |
| Commercial real estate:             |              |              |              |              |                |                |                             |
| Commercial real estate construction | —            | —            | —            | —            | 1,005,118      | 1,005,118      | —                           |
| Commercial real estate other        | 91,607       | 1,215,473    | 1,152,774    | 2,459,854    | 113,276,180    | 115,736,034    | —                           |
| Consumer                            |              |              |              |              |                |                |                             |
| Consumer real estate                | 68,240       | 249,754      | 82,015       | 400,009      | 69,377,298     | 69,777,307     | —                           |
| Consumer other                      | 69,333       | 58,116       | 6,056        | 133,505      | 5,032,476      | 5,165,981      | 1,606                       |
| Total                               | \$ 1,391,856 | \$ 1,773,713 | \$ 1,245,162 | \$ 4,410,731 | \$ 238,211,974 | \$ 242,622,705 | \$ 1,606                    |

**BANK OF SOUTH CAROLINA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

There were no loans at June 30, 2016 and one loan at December 31, 2015, over 90 days past due and still accruing interest.

The following table summarizes the balances of non-accrual loans:

|                                     | Loans Receivable on<br>Non-Accrual<br>For the Period Ending |                      |
|-------------------------------------|---|----------------------|
|                                     | June 30,<br>2016  | December<br>31, 2015 |
| Commercial Loans                    | \$2,685   | \$4,317              |
| Commercial real estate:             |   |                      |
| Commercial real estate construction | —   | —                    |
| Commercial real estate other        | 2,451,620   | 1,970,306            |
| Consumer                            |   |                      |
| Consumer real estate                | —   | 82,015               |
| Consumer other                      | 2,149   | 4,450                |
| Total                               | \$2,456,454   | \$2,061,088          |

The following tables set forth the changes in the allowance for loan losses and an allocation of the allowance by loan category for the three and six months ended June 30, 2016 and June 30, 2015. 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.

**Three Months Ended  
June 30, 2016**

|                   | Commercial                  | Commercial           | Consumer       | Consumer  | Total       |
|-------------------|-----------------------------|----------------------|----------------|-----------|-------------|
|                   | Real Estate<br>Construction | Real Estate<br>Other | Real<br>Estate | Other     |             |
| Beginning Balance | \$1,500,650                 | \$ 44,268            | \$1,108,703    | \$169,899 | \$3,436,762 |
| Charge-offs       | —                           | —                    | (82,015)       | (541)     | (82,556)    |
| Recoveries        | —                           | —                    | 18,000         | 240       | 18,240      |

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|                |             |           |             |           |           |             |
|----------------|-------------|-----------|-------------|-----------|-----------|-------------|
| Provision      | (10,323 )   | 13,106    | 59,821      | 98,546    | (21,150 ) | 140,000     |
| Ending Balance | \$1,490,327 | \$ 57,374 | \$1,186,524 | \$629,773 | \$148,448 | \$3,512,446 |

**Six Months Ended  
June 30, 2016**

|                   | Commercial  | Commercial<br>Real Estate<br>Construction | Commercial<br>Real Estate<br>Other | Consumer<br>Real Estate | Consumer<br>Other | Total       |
|-------------------|-------------|---|------------------------------------|-------------------------|-------------------|-------------|
| Beginning Balance | \$896,854   | \$ 59,861                                 | \$1,345,094                        | \$941,470               | \$174,548         | \$3,417,827 |
| Charge-offs       | (33,045 )   | —   | —                                  | (82,015 )               | (1,591 )          | (116,651 )  |
| Recoveries        | 1,284       | —   | 24,000                             | —                       | 986               | 26,270      |
| Provision         | 625,234     | (2,487 )                                  | (182,570 )                         | (229,682)               | (25,495 )         | 185,000     |
| Ending Balance    | \$1,490,327 | \$ 57,374                                 | \$1,186,524                        | \$629,773               | \$148,448         | \$3,512,446 |

## BANK OF SOUTH CAROLINA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**Three Months Ended  
June 30, 2015**

|                   | Commercial   | Commercial  | Commercial   | Consumer   | Consumer   | Total        |
|-------------------|--------------|-------------|--------------|------------|------------|--------------|
|                   | Real Estate  | Real Estate | Real Estate  | Real       | Other      |              |
|                   | Construction | Other       | Other        | Estate     |            |              |
| Beginning Balance | \$ 1,100,802 | \$ 44,696   | \$ 1,191,722 | \$ 851,258 | \$ 145,610 | \$ 3,334,088 |
| Charge-offs       | —            | —           | —            | —          | (20,734 )  | (20,734 )    |
| Recoveries        | —            | —           | 24,164       | —          | 240        | 24,404       |
| Provision         | (56,473 )    | (378 )      | (29,843 )    | 61,871     | 94,823     | 70,000       |
| Ending Balance    | \$ 1,044,329 | \$ 44,318   | \$ 1,186,043 | \$ 913,129 | \$ 219,939 | \$ 3,407,758 |

**Six Months Ended  
June 30, 2015**

|                   | Commercial   | Commercial  | Commercial   | Consumer   | Consumer   | Total        |
|-------------------|--------------|-------------|--------------|------------|------------|--------------|
|                   | Real Estate  | Real Estate | Real Estate  | Real       | Other      |              |
|                   | Construction | Other       | Other        | Estate     |            |              |
| Beginning Balance | \$ 1,211,130 | \$ 42,904   | \$ 1,112,387 | \$ 863,351 | \$ 105,076 | \$ 3,334,848 |
| Charge-offs       | —            | —           | (21,000 )    | —          | (20,734 )  | (41,734 )    |
| Recoveries        | —            | —           | 39,164       | —          | 480        | 39,644       |
| Provision         | (166,801 )   | 1,414       | 55,492       | 49,778     | 135,117    | 75,000       |
| Ending Balance    | \$ 1,044,329 | \$ 44,318   | \$ 1,186,043 | \$ 913,129 | \$ 219,939 | \$ 3,407,758 |

The following tables present, by portfolio segment and reserving methodology, the allocation of the allowance for loan losses and the gross investment in loans.

|   | June 30, 2016 |              |             |             |           | Total        |
|---|---------------|--------------|-------------|-------------|-----------|--------------|
|   | Commercial    | Commercial   | Commercial  | Consumer    | Consumer  |              |
|   |               | Real Estate  | Real Estate | Real Estate | Other     |              |
|   |               | Construction | Other       |             |           |              |
| Allowance for Loan Losses Individually evaluated for impairment | \$ 1,087,995  | \$ —         | \$ 303,466  | \$ 72,008   | \$ 97,279 | \$ 1,560,748 |
|   | 402,332       | 57,374       | 883,058     | 557,765     | 51,169    | 1,951,698    |



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|                                       |               |              |                |               |              |                |
|---------------------------------------|---------------|--------------|----------------|---------------|--------------|----------------|
| Collectively evaluated for impairment |               |              |                |               |              |                |
| Total Allowance for Loan Losses       | \$ 1,490,327  | \$ 57,374    | \$ 1,186,524   | \$ 629,773    | \$ 148,448   | \$ 3,512,446   |
| Loans Receivable                      |               |              |                |               |              |                |
| Individually evaluated for impairment | \$ 1,570,800  | \$ —         | \$ 3,904,494   | \$ 1,315,015  | \$ 97,279    | \$ 6,887,588   |
| Collectively evaluated for impairment | 51,665,580    | 1,295,073    | 125,198,888    | 79,843,659    | 5,409,301    | 263,412,501    |
| Total Loans Receivable                | \$ 53,236,380 | \$ 1,295,073 | \$ 129,103,382 | \$ 81,158,674 | \$ 5,506,580 | \$ 270,300,089 |

## BANK OF SOUTH CAROLINA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

|                                       | December 31, 2015 |                                     |                              |                      |                | Total         |
|---------------------------------------|-------------------|-------------------------------------|------------------------------|----------------------|----------------|---------------|
|                                       | Commercial        | Commercial Real Estate Construction | Commercial Real Estate Other | Consumer Real Estate | Consumer Other |               |
| Allowance for Loan Losses             |                   |                                     |                              |                      |                |               |
| Individually evaluated for impairment | \$387,979         | \$—                                 | \$253,105                    | \$342,320            | \$100,103      | \$1,083,507   |
| Collectively evaluated for impairment | 508,875           | 59,861                              | 1,091,989                    | 599,150              | 74,445         | 2,334,320     |
| Total Allowance for Loan Losses       | \$896,854         | \$59,861                            | \$1,345,094                  | \$941,470            | \$174,548      | \$3,417,827   |
| Loans Receivable                      |                   |                                     |                              |                      |                |               |
| Individually evaluated for impairment | \$1,639,974       | \$—                                 | \$3,551,495                  | \$1,245,419          | \$105,819      | \$6,542,707   |
| Collectively evaluated for impairment | 49,298,291        | 1,005,118                           | 112,184,539                  | 68,531,888           | 5,060,162      | 236,079,998   |
| Total Loans Receivable                | \$50,938,265      | \$1,005,118                         | \$115,736,034                | \$69,777,307         | \$5,165,981    | \$242,622,705 |

As of June 30, 2016 and December 31, 2015, loans individually evaluated and considered impaired are presented in the following table:

|  | Impaired and Restructured Loans |                     |                   |                          |                     |                   |
|--|---------------------------------|---------------------|-------------------|--------------------------|---------------------|-------------------|
|  | As of June 30, 2016             |                     |                   | December 31, 2015        |                     |                   |
|  | Unpaid Principal Balance        | Recorded Investment | Related Allowance | Unpaid Principal Balance | Recorded Investment | Related Allowance |
| <u>With no related allowance recorded:</u> |                                 |                     |                   |                          |                     |                   |
| Commercial                                 | \$482,805                       | 482,805             | \$—               | \$692,831                | \$692,831           | \$—               |
| Commercial Real Estate Construction        | —                               | —                   | —                 | —                        | —                   | —                 |
| Commercial Real Estate Other               | 2,873,160                       | 2,873,160           | —                 | 2,476,018                | 2,476,018           | —                 |
| Consumer Real Estate                       | 1,243,008                       | 1,243,008           | —                 | 450,402                  | 450,402             | —                 |
| Consumer Other                             | —                               | —                   | —                 | 5,715                    | 5,715               | —                 |
|  | \$4,598,973                     | \$4,598,973         | \$—               | \$3,624,966              | \$3,624,966         | \$—               |

With an allowance recorded:

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|                                     |             |             |             |             |             |             |
|-------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Commercial                          | \$1,087,995 | 1,087,995   | \$1,087,995 | \$947,143   | \$947,143   | \$387,979   |
| Commercial Real Estate Construction | —           | —           | —           | —           | —           | —           |
| Commercial Real Estate Other        | 1,031,334   | 1,031,334   | 303,466     | 1,075,477   | 1,075,477   | 253,105     |
| Consumer Real Estate                | 72,008      | 72,008      | 72,008      | 795,017     | 795,017     | 342,320     |
| Consumer Other                      | 97,279      | 97,279      | 97,279      | 100,104     | 100,104     | 100,103     |
|                                     | \$2,288,616 | \$2,288,616 | \$1,560,748 | \$2,917,741 | \$2,917,741 | \$1,083,507 |
| <b>Total</b>                        |             |             |             |             |             |             |
| Commercial                          | \$1,570,800 | \$1,570,800 | \$1,087,995 | \$1,639,974 | \$1,639,974 | \$387,979   |
| Commercial Real Estate Construction | —           | —           | —           | —           | —           | —           |
| Commercial Real Estate Other        | 3,904,494   | 3,904,494   | 303,466     | 3,551,495   | 3,551,495   | 253,105     |
| Consumer Real Estate                | 1,315,016   | 1,315,016   | 72,008      | 1,245,419   | 1,245,419   | 342,320     |
| Consumer Other                      | 97,279      | 97,279      | 97,279      | 105,819     | 105,819     | 100,103     |
|                                     | \$6,887,589 | \$6,887,589 | \$1,560,748 | \$6,542,707 | \$6,542,707 | \$1,083,507 |

**BANK OF SOUTH CAROLINA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

The following table presents average impaired loans and interest income recognized on those impaired loans, by class segment, for the periods indicated.

|  | Three Months Ended |            | June 30, 2015 |            |
|--|--------------------|------------|---------------|------------|
|  | June 30, 2016      |            | Average       | Interest   |
|  | Average            | Interest   | Recorded      | Income     |
|  | Recorded           | Income     | Investment    | Recognized |
|  | Investment         | Recognized | Investment    | Recognized |
| <u>With no related allowance recorded:</u> |                    |            |               |            |
| Commercial                                 | \$486,498          | \$ 4,221   | \$811,606     | \$ 11,026  |
| Commercial Real Estate Construction        | —                  | —          | —             | —          |
| Commercial Real Estate Other               | 2,883,625          | 20,215     | 3,303,936     | 42,405     |
| Consumer Real Estate                       | 1,242,703          | 14,334     | 522,399       | 5,133      |
| Consumer Other                             | —                  | —          | 7,658         | 34         |
|  | \$4,612,826        | \$ 38,770  | \$4,645,599   | \$ 58,598  |
| <u>With an allowance recorded:</u>         |                    |            |               |            |
| Commercial                                 | \$1,097,191        | \$ 13,912  | \$1,141,727   | \$ 13,551  |
| Commercial Real Estate Construction        | —                  | —          | —             | —          |
| Commercial Real Estate Other               | 1,065,261          | 10,949     | 1,013,311     | 12,885     |
| Consumer Real Estate                       | 72,034             | 387        | 1,200,173     | 7,862      |
| Consumer Other                             | 100,212            | 1,177      | 157,602       | 2,154      |
|  | \$2,334,698        | \$ 26,425  | \$3,512,813   | \$ 36,452  |
| Total                                      |                    |            |               |            |
| Commercial                                 | \$1,583,689        | \$ 18,133  | \$1,953,333   | \$ 24,577  |
| Commercial Real Estate Construction        | —                  | —          | —             | —          |
| Commercial Real Estate Other               | 3,948,886          | 31,164     | 4,317,247     | 55,290     |
| Consumer Real Estate                       | 1,314,737          | 14,721     | 1,722,572     | 12,995     |
| Consumer Other                             | 100,212            | 1,177      | 165,260       | 2,188      |
|  | \$6,947,524        | \$ 65,195  | \$8,158,412   | \$ 95,050  |

**BANK OF SOUTH CAROLINA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

|  | Six Months Ended                  |                                  |                                   |                                  |
|--|-----------------------------------|----------------------------------|-----------------------------------|----------------------------------|
|  | June 30, 2016                     |                                  | June 30, 2015                     |                                  |
|  | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized | Average<br>Recorded<br>Investment | Interest<br>Income<br>Recognized |
| <u>With no related allowance recorded:</u> |                                   |                                  |                                   |                                  |
| Commercial                                 | \$494,572                         | \$ 10,718                        | \$822,849                         | \$ 25,578                        |
| Commercial Real Estate Construction        | —                                 | —                                | —                                 | —                                |
| Commercial Real Estate Other               | 2,889,248                         | 42,855                           | 3,318,009                         | 88,205                           |
| Consumer Real Estate                       | 1,242,069                         | 27,781                           | 522,429                           | 10,518                           |
| Consumer Other                             | —                                 | —                                | 7,574                             | 84                               |
|  | \$4,625,889                       | \$ 81,354                        | \$4,670,861                       | \$ 124,385                       |
| With an allowance recorded:                |                                   |                                  |                                   |                                  |
| Commercial                                 | \$1,101,252                       | \$ 30,364                        | \$1,146,928                       | \$ 26,392                        |
| Commercial Real Estate Construction        | —                                 | —                                | —                                 | —                                |
| Commercial Real Estate Other               | 1,031,087                         | 18,265                           | 1,015,819                         | 25,029                           |
| Consumer Real Estate                       | 72,059                            | 1,006                            | 1,203,183                         | 23,396                           |
| Consumer Other                             | 102,264                           | 3,510                            | 159,093                           | 4,858                            |
|  | \$2,306,662                       | \$ 53,145                        | \$3,525,023                       | \$ 79,675                        |
| Total                                      |                                   |                                  |                                   |                                  |
| Commercial                                 | \$1,595,824                       | \$ 41,082                        | \$1,969,777                       | \$ 51,970                        |
| Commercial Real Estate Construction        | —                                 | —                                | —                                 | —                                |
| Commercial Real Estate Other               | 3,920,335                         | 61,120                           | 4,333,828                         | 113,234                          |
| Consumer Real Estate                       | 1,314,128                         | 28,787                           | 1,725,612                         | 33,914                           |
| Consumer Other                             | 102,264                           | 3,510                            | 166,667                           | 4,942                            |
|  | \$6,932,552                       | \$ 134,499                       | \$8,195,884                       | \$ 204,060                       |

Restructured loans were \$442,442 (3 loans) and \$458,268 (3 loans) at June 30, 2016 and December 31, 2015, respectively. Restructured loans were granted extended payment terms with no principal reduction. All restructured loans were performing as agreed as of June 30, 2016 and December 31, 2015, respectively. There were no additional loans identified as a troubled debt restructuring (“TDR”) during the three or six months ended June 30, 2016 or 2015. No TDRs defaulted during the three or six months ended June 30, 2016 and 2015, which were modified within the previous twelve months.

**Note 4: Disclosure Regarding Fair Value of Financial Statements**

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 the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants at the measurement date. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction. The fair value standard establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs. Observable inputs, which are developed based on market data we have obtained from independent sources, are ones that market participants would use in pricing an asset or liability. Unobservable inputs, which are developed based on the best information available in the circumstances, reflect our estimate of assumptions that market participants would use in pricing an asset or liability.

## **BANK OF SOUTH CAROLINA CORPORATION**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

The fair value hierarchy gives the highest priority to unadjusted quoted market prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). The fair value hierarchy is broken down into three levels based on the reliability of inputs as follows:

Level 1: valuation is based upon unadjusted quoted market prices for identical instruments traded in active markets.  
Level 2: valuation is based upon quoted market prices for similar instruments traded in active markets, quoted market prices for identical or similar instruments traded in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by market data.  
Level 3: valuation is derived from other valuation methodologies, including discounted cash flow models and similar techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in determining fair value.

Fair value estimates are made at a specific point of time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale our entire holdings of a particular financial instrument. Because no active market exists for a significant portion of our financial instruments, fair value estimates are based on judgements regarding future expected loss experience, current economic conditions, current interest rates and prepayment trends, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and therefore cannot be determined with precision. Changes in any of these assumptions used in calculating fair value also would affect significantly the estimates. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of these estimates.

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value on a recurring basis:

#### 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 value is 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.

### Derivative Instruments

Derivative instruments include interest rate lock commitments and forward sale commitments. These instruments are valued based on the change in the value of the underlying loan between the commitment date and the end of the period. We classify these instruments as Level 3. The fair value of these commitments was not significant at June 30, 2016 or December 31, 2015.

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 June 30, 2016 and December 31, 2015.



**BANK OF SOUTH CAROLINA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Assets and liabilities measured at fair value on a recurring basis at June 30, 2016 and December 31, 2015 are as follows:

|                                  | June 30, 2016   |   |  |               |
|----------------------------------|---|---|--|---------------|
|                                  | Quoted<br>Market Price<br>in active<br>markets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total         |
| U.S. Treasury Notes              | \$24,374,531  | \$—   | \$—  | \$24,374,531  |
| Government-Sponsored Enterprises | —   | 41,917,431  | —  | 41,917,431    |
| Municipal Securities             | —   | 31,362,166  | 7,704,814  | 39,066,980    |
| Total                            | \$24,374,531  | \$73,279,597  | \$7,704,814  | \$105,358,942 |

|                                  | December 31, 2015   |   |  |               |
|----------------------------------|---|---|--|---------------|
|                                  | Quoted<br>Market Price<br>in active<br>markets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total         |
| U.S. Treasury Notes              | \$34,633,673  | \$—   | \$—  | \$34,633,673  |
| Government-Sponsored Enterprises | —   | 51,284,332  | —  | 51,284,332    |
| Municipal Securities             | —   | 28,861,902  | 5,217,678  | 34,079,580    |
| Total                            | \$34,633,673  | \$80,146,234  | \$5,217,678  | \$119,997,585 |

There were no liabilities recorded at fair value on a recurring basis as of June 30, 2016 or December 31, 2015.

The following table reconciles the changes in assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and six months ended June 30, 2016 and June 30, 2015, respectively:

|  | <b>Three Months Ended</b> |             |
|--|---------------------------|-------------|
|  | <b>June 30,</b>           |             |
|  | 2016                      | 2015        |
| Beginning Balance  | \$5,249,351               | \$1,368,443 |
| Total gains or (losses) (realized/unrealized) included in earnings |                           |             |
| Included in other comprehensive income                             | (1,463 )                  | (24,129 )   |
| Purchases, issuances and settlements                               | 2,454,000                 | 1,945,000   |
| Transfers in and/or out of level 3                                 | —                         | —           |
| Ending balance   | \$7,704,814               | \$3,289,314 |

**BANK OF SOUTH CAROLINA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

|  | <b>Six Months Ended</b> |             |
|--|-------------------------|-------------|
|  | <b>June 30,</b>         |             |
|  | 2016                    | 2015        |
| Beginning Balance  | \$5,217,678             | \$1,377,089 |
| Total gains or (losses) (realized/unrealized) included in earnings |                         |             |
| Included in other comprehensive income                             | (33,136 )               | (32,775 )   |
| Purchases, issuances and settlements                               | 2,454,000               | 1,945,000   |
| Transfers in and/or out of level 3                                 | —                       | —           |
| Ending balance   | \$7,704,814             | \$3,289,314 |

There were no transfers between fair value levels during the three or six months ended June 30, 2016 or June 30, 2015.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value on a nonrecurring basis:

Other Real Estate Owned (OREO)

Loans, secured by real estate, are adjusted to the lower of the recorded investment in the loan or the fair value of the real estate 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.

Impaired Loans

Impaired loans are carried at the lower of recorded investment or fair value. 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 12 to 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 non-performing 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 non-performing or immediately following the determination that the loan is impaired. However, as a second example, on a non-performing 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.

In accordance with Accounting Standards Codification (“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. At June 30, 2016 and December 31, 2015, substantially all of the impaired loans were evaluated based on the fair value of the collateral. These impaired loans are classified as Level 3. Impaired loans measured using discounted future cash flows are not deemed to be measured at fair value.

## BANK OF SOUTH CAROLINA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Loans Held for Sale

Loans held for sale include mortgage loans and are carried at the lower of cost or market value. The fair values of mortgage loans held for sale are based on current market rates from investors within the secondary market for loans with similar characteristics. Carrying value approximates fair value. 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 information about certain assets and liabilities measured at fair value on a nonrecurring basis at June 30, 2016, and December 31, 2015:

|                         | June 30, 2016 |             |              |
|-------------------------|---------------|-------------|--------------|
|                         | Quoted        | Significant | Significant  |
|                         | Market        | Other       | Unobservable |
|                         | Prices        | Observable  | Inputs       |
|                         | in            | Markets     |              |
|                         | Active        | (Level 2)   | (Level 3)    |
|                         | Markets       | (Level 2)   | (Level 3)    |
|                         | (Level 1)     | (Level 2)   | Total        |
| Impaired loans          | \$—           | \$—         | \$ 5,326,841 |
| Other real estate owned | —             | —           | 521,943      |
| Loans held for sale     | —             | 6,500,452   | —            |
| Total                   | \$—           | \$6,500,452 | \$ 5,848,784 |

|                         | December 31, 2015 |             |              |
|-------------------------|-------------------|-------------|--------------|
|                         | Quoted            | Significant | Significant  |
|                         | Market            | Other       | Unobservable |
|                         | Prices            | Observable  | Inputs       |
|                         | in                | Markets     |              |
|                         | Active            | (Level 2)   | (Level 3)    |
|                         | Markets           | (Level 2)   | (Level 3)    |
|                         | (Level 1)         | (Level 2)   | Total        |
| Impaired loans          | \$—               | \$—         | \$ 5,326,841 |
| Other real estate owned | —                 | —           | 521,943      |
| Loans held for sale     | —                 | 6,500,452   | —            |
| Total                   | \$—               | \$6,500,452 | \$ 5,848,784 |

|                         | in Inputs<br>Active<br>Markets<br>(Level<br>1) (Level 2) | (Level 3)    | Total         |
|-------------------------|--|--------------|---------------|
| Impaired loans          | \$—\$—   | \$ 5,459,200 | \$5,459,200   |
| Other real estate owned | — —  | 620,394      | 620,394       |
| Loans held for sale     | — 5,820,239  | —            | 5,820,239     |
| Total                   | \$—\$5,820,239   | \$ 6,079,594 | \$ 11,899,833 |

There were no liabilities measured at fair value on a nonrecurring basis as of June 30, 2016 or December 31, 2015.

The following table provides information describing the unobservable inputs used in Level 3 fair value measurements at June 30, 2016:

|                            | Valuation Technique                                     | Inputs<br>Unobservable Input                        | General Range<br>of Inputs   |
|----------------------------|---|---|--|
| Impaired<br>Loans          | Discounted Appraisals                                   | Collateral Discounts                                | 0 – 35%  |
| Other Real<br>Estate Owned | Appraisal Value/<br>Comparison Sales/Other<br>Estimates | Appraisals and/or Sales of<br>Comparable Properties | Appraisals Discounted 10% to 20% for<br>Sales Commissions and Other Holding<br>Costs |

## **BANK OF SOUTH CAROLINA CORPORATION**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Accounting standards require disclosure of fair value information for all of our assets and liabilities that are considered 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 June 30, 2016 and December 31, 2015, 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, using 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).

e. Short-term borrowings

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

f. Accrued interest receivable and payable

Since these financial instruments will typically be received or paid within three months, the carrying amounts of such instruments are deemed to be a reasonable estimate of fair value.

g. Loan commitments

Estimates of the fair value of these off-balance sheet items are not made because of the short-term nature of these arrangements and the credit standing of the counterparties.



**BANK OF SOUTH CAROLINA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

The following tables present the carrying amount, fair value, and placement in the fair value hierarchy of our financial instruments as of June 30, 2016 and December 31, 2015. For short-term financial assets such as cash and cash equivalents, the carrying amount is a reasonable estimate of fair value due to the relatively short time between the origination of the instrument and its expected realization.

|  | <b>June 30, 2016</b>     |                      |             |             |             |
|--|--------------------------|----------------------|-------------|-------------|-------------|
|  | Carrying Amount          | Estimated Fair Value | Level 1     | Level 2     | Level 3     |
| <b>Financial Assets:</b>                 |                          |                      |             |             |             |
| Cash and due from banks                  | \$6,455,536              | \$6,455,536          | \$6,455,536 | \$          | \$          |
| Interest-bearing deposits in other banks | 35,256,752               | 35,256,752           | 35,256,752  |             |             |
| Investments available for sale           | 105,358,942              | 105,358,942          | 24,374,531  | 73,279,597  | 7,704,814   |
| Mortgage loans to be sold                | 6,500,452                | 6,500,452            |             | 6,500,452   |             |
| Loans                                    | 270,300,089              | 270,170,410          |             |             | 270,170,410 |
| Accrued interest receivable              | 1,401,353                | 1,401,353            |             | 1,401,353   |             |
| <b>Financial Liabilities:</b>            |                          |                      |             |             |             |
| Demand deposits                          | 334,445,792              | 334,445,792          |             | 334,445,792 |             |
| Time deposits                            | 47,776,488               | 47,790,915           |             | 47,790,915  |             |
| Accrued interest payable                 | 56,580                   | 56,580               |             | 56,580      |             |
| <br>                                     |                          |                      |             |             |             |
|  | <b>December 31, 2015</b> |                      |             |             |             |
|  | Carrying Amount          | Estimated Fair Value | Level 1     | Level 2     | Level 3     |
| <b>Financial Assets:</b>                 |                          |                      |             |             |             |
| Cash and due from banks                  | \$5,295,924              | \$5,295,924          | \$5,295,924 | \$          | \$          |
| Interest-bearing deposits in other banks | 23,898,862               | 23,898,862           | 23,898,862  |             |             |
| Investments available for sale           | 119,997,585              | 119,997,585          | 34,633,673  | 80,146,234  | 5,217,678   |
| Mortgage loans to be sold                | 5,820,239                | 5,820,239            |             | 5,820,239   |             |
| Loans                                    | 242,622,705              | 242,851,154          |             |             | 242,581,154 |
| Accrued interest receivable              | 1,284,063                | 1,284,063            |             | 1,284,063   |             |
| <b>Financial Liabilities:</b>            |                          |                      |             |             |             |
| Demand deposits                          | 303,950,800              | 303,950,800          |             | 303,950,800 |             |
| Time deposits                            | 54,767,812               | 54,780,915           |             | 54,780,915  |             |
| Accrued interest payable                 | 73,421                   | 73,421               |             | 73,421      |             |

**Note 5: 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 is 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.

**BANK OF SOUTH CAROLINA CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

|   | <b>Three Months Ended</b> |              |
|---|---------------------------|--------------|
|   | <b>June 30,</b>           |              |
|   | 2016                      | 2015         |
| Numerator:                                  |                           |              |
| Net Income                                  | \$ 1,312,110              | \$ 1,253,438 |
| Denominator:                                |                           |              |
| Weighted average shares outstanding         | 4,929,722                 | 4,910,501    |
| Effect of dilutive shares                   | 126,801                   | 113,666      |
| Weighted average shares outstanding-diluted | 5,056,523                 | 5,024,167    |
| Earnings per share                          |                           |              |
| Basic                                       | \$0.27                    | \$0.26       |
| Diluted                                     | \$0.26                    | \$0.25       |

|   | <b>Six Months Ended</b> |              |
|---|-------------------------|--------------|
|   | <b>June 30,</b>         |              |
|   | 2016                    | 2015         |
| Numerator:                                  |                         |              |
| Net Income                                  | \$ 2,507,846            | \$ 2,458,397 |
| Denominator:                                |                         |              |
| Weighted average shares outstanding         | 4,923,266               | 4,908,871    |
| Effect of dilutive shares                   | 124,335                 | 116,683      |
| Weighted average shares outstanding-diluted | 5,047,601               | 5,025,554    |
| Earnings per share                          |                         |              |
| Basic                                       | \$0.51                  | \$0.50       |
| Diluted                                     | \$0.50                  | \$0.49       |

On August 27, 2015, the Company's Board of Directors declared a ten percent stock dividend to our shareholders. The record date was September 8, 2015 and the distribution date was September 28, 2015. Earnings per share and average shares outstanding have been adjusted to reflect the stock dividend in our consolidated financial statements.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

## **CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q, including information included or incorporated by reference in this document, contains statements which constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1934. 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 our Company. Forward-looking statements are based on many assumptions and estimates and are not guarantees of future performance. Our actual results may differ materially from those anticipated in any forward-looking statements, as they will depend on many factors about which we are unsure, including many factors that are beyond our control. The words “may,” “would,” “could,” “should,” “will,” “expect,” “anticipate,” “predict,” “project,” “continue,” “assume,” “believe,” “intend,” “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, 2015 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

These risks are exacerbated by the developments over the last ten 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.

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 future filings with the SEC, in our press releases, and in 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 \$424.9 million in assets as of June 30, 2016 and net income of \$1.3 million and \$2.5 million for the three and six months ended June 30, 2016, 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.

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 success 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 consequence of lending activities 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 probable and estimable losses inherent in our loan and lease portfolio.

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. The discussion and analysis also identifies significant factors that have affected our financial position and operating results as of June 30, 2016 and December 31, 2015, and should be read in conjunction with the financial statements and the related notes included in this report. In addition, a number of tables have been included to assist in the discussion.

### **Critical Accounting Policies**

Our critical accounting policies which involve significant judgements and assumptions that have a material impact on the carrying value of certain assets and liabilities, and used in the preparation of the Consolidated Financial Statements as of June 30, 2016, have remained unchanged from the disclosures presented in our Annual Report on Form 10-K.

### **Balance Sheet**

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

Total cash and cash equivalents increased 42.88% or \$12.5 million to \$41.7 million at June 30, 2016, from \$29.2 million at December 31, 2015. This increase reflects the strength of our local economy as we continue to experience solid deposit growth both in existing customer account balances as well as through the acquisition of new customers. Additionally, we sold investment securities and had investment securities mature during the period but chose not to reinvest all of those funds in the investment portfolio.

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

Our primary objective in managing the investment portfolio is to maintain a portfolio of high quality, highly liquid investments yielding competitive returns. We are required under federal regulations to maintain adequate liquidity to ensure safe and sound operations. We maintain investment balances based on the continuing assessment of cash flows, the level of current and expected loan production, the current interest rate risk strategies and the assessment of potential future direction of market interest rate changes. Investment securities differ in terms of default, interest rate, liquidity and expected rate of return risk.

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.

At June 30, 2016, our available for sale investment portfolio included U. S. Treasury Notes, Government-Sponsored Enterprises and Municipal Securities with a fair market value of \$105.4 million and an amortized cost of \$102.5 million for a net unrealized gain of \$2.9 million. At June 30, 2016 and December 31, 2015, our investment securities portfolio represented approximately 24.79% and 30.06% of our total assets, respectively. The average yield on our investment securities was 2.05% and 2.16% at June 30, 2016 and December 31, 2015, respectively.

We had ten Municipal Securities totaling \$4.1 million that matured in the six months ended June 30, 2016. In addition, we sold three U.S. Treasury Notes and two Government Sponsored Enterprises totaling \$20.8 million during the same period. We purchased twenty-one Municipal Securities with a face value of \$8.5 million during the six months ended June 30, 2016.

### **Loans**

We focus our lending activities on small and middle market businesses, professionals and individuals in our geographic markets and typically require a personal guarantee. Substantially all of our loans are to borrowers located in our market area of Charleston, Dorchester and Berkeley Counties of South Carolina.

Net loans increased \$27.6 million, or 11.53%, to \$266.8 million at June 30, 2016 from \$239.2 million at December 31, 2015. We believe that economic conditions in our primary market area are continuing to improve, and that these improving conditions are contributing to an increase in loan demand. The amount of commercial real estate loans as a percentage of total loans continues to increase as a result of strong real estate demand in our markets.



The following is a summary of our loan portfolio composition (net of deferred fees of \$133,721 at June 30, 2016 and \$118,188 at December 31, 2015) and the corresponding percentage of total loans as of the dates indicated. Our commercial real estate experienced the largest growth of \$13.4 million or 11.55%.

|                                     | June 30,<br>2016 | Percent  | December 31,<br>2015 | Percent  |
|-------------------------------------|------------------|----------|----------------------|----------|
| Commercial Loans                    | \$53,236,380     | 19.70 %  | \$50,938,265         | 20.99 %  |
| Commercial real estate:             |                  |          |                      |          |
| Commercial real estate construction | 1,295,073        | 0.48 %   | 1,005,118            | 0.41 %   |
| Commercial real estate other        | 129,103,382      | 47.76 %  | 115,736,034          | 47.70 %  |
| Consumer                            |                  |          |                      |          |
| Consumer real estate                | 81,158,674       | 30.03 %  | 69,777,307           | 28.76 %  |
| Consumer other                      | 5,506,580        | 2.04 %   | 5,165,981            | 2.13 %   |
|                                     | 270,300,089      | 100.00 % | 242,622,705          | 100.00 % |
| Allowance for Loan losses           | (3,512,446 )     |          | (3,417,827 )         |          |
| Loans, net                          | \$266,787,643    |          | \$239,204,878        |          |

### Non-performing Assets

Non-performing Assets include real estate acquired through foreclosure or deed taken in lieu of foreclosure, loans on nonaccrual status and TDRs. Generally, a loan is placed on nonaccrual status when it becomes 90 days past due as to principal or interest, or when we believe, after considering economic and business conditions and collection efforts, that the borrower's financial condition is such that collection of the contractual principal or interest on the loan is doubtful. A payment of interest on a loan that is classified as nonaccrual is recognized as a reduction in principal when received. Our policy with respect to non-performing loans requires the borrower to make a minimum of six consecutive payments in accordance with the loan terms and to show capacity to continue performing into the future before that loan can be placed back on accrual status. As of June 30, 2016 we had no loans 90 days past due still accruing interest.

We consider a loan to be a TDR when the debtor experiences financial difficulties and we provide concessions such that we will not collect all principal and interest in accordance with the original terms of the agreement. Concessions can relate to the contractual interest rate, maturity date, or payment structure of the note. As part of our workout plan for individual loan relationships, we may restructure loan terms to assist borrowers facing challenges in the current economic environment. As of June 30, 2016, we determined that we had loans totaling \$442,442, that we considered TDRs. As of December 31, 2015, we had loans totaling \$458,268, that we considered TDRs.

Non-performing loans include all loans past due 90 days and over, certain impaired loans (some of which may be contractually current), and TDR loans that have not yet established a satisfactory period of payment performance (some of which may be contractually current). Non-performing assets include other real estate owned, which decreased by \$98,451 from December 31, 2015 due to the sale of one property. We recorded a loss of \$13,450 on this sale. The balance at June 30, 2016 of \$521,943 represents one commercial property.

The following table is a summary of our non-performing assets, including accruing TDRs.

|                                      | <b>June 30,<br/>2016</b> | <b>December<br/>31,<br/>2015</b> |
|--------------------------------------|--------------------------|----------------------------------|
| Commercial                           | \$2,685                  | \$4,317                          |
| Commercial real estate               | 2,451,620                | 1,970,306                        |
| Consumer real estate                 | —                        | 82,015                           |
| Consumer other                       | 2,149                    | 4,450                            |
| Total nonaccrual loans               | 2,456,454                | 2,061,088                        |
| Accruing troubled debt restructuring | 442,442                  | 458,268                          |
| Other real estate owned              | 521,943                  | 620,394                          |
| Total nonperforming assets           | 3,420,839                | 3,139,750                        |

#### **Allowance for Loan Losses**

The allowance for loan losses was \$3.5 million and \$3.4 million at June 30, 2016 and December 31, 2015, respectively, or 1.30% and 1.41% of outstanding loans, respectively. At June 30, 2016 and December 31, 2015, the allowance for loan losses represented 102.76% and 108.84% of the total amount of non-performing loans. Based on the level of coverage on non-performing loans and analysis of our loan portfolio, we believe the allowance for loan losses at June 30, 2016 is adequate.

At June 30, 2016, impaired loans totaled \$6.9 million, for which \$2.3 million of these loans had a reserve of approximately \$1.6 million allocated in the allowance. Comparatively, impaired loans totaled \$6.5 million at December 31, 2015, and \$2.9 million of these loans had a reserve of approximately \$1.1 million allocated in the allowance.

During the three and six months ended June 30, 2016, we charged-off \$82,556 and \$116,651 of loans and recorded \$18,240 and \$26,270 of recoveries on loans previously charged-off, for net charge-offs of \$64,316 and \$90,381, respectively. Comparatively, we charged-off \$20,734 and \$41,734 of loans and recorded \$24,404 and \$39,644 of recoveries on loans previously charged-off, resulting in net recoveries of \$3,670 and net charge-offs of \$2,090 for the three and six months ended June 30, 2015, respectively.

#### **Deposits**

Deposits remain our primary source of funding for loans and investments. Average interest bearing deposits provided funding for 60.13% of average earning assets for the six months ended June 30, 2016, respectively and 60.55% for the

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twelve months ended December 31, 2015. 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:

|                              | June 30, 2016  | Percentage | December 31,<br>2015 | Percentage |
|------------------------------|----------------|------------|----------------------|------------|
| Deposits:                    |                |            |                      |            |
| Non-interest-bearing demand  | \$ 128,132,432 | 33.52 %    | \$ 122,073,396       | 34.03 %    |
| Interest-bearing demand      | 92,868,069     | 24.30 %    | 84,977,640           | 23.69 %    |
| Money market accounts        | 83,527,123     | 21.85 %    | 70,233,422           | 19.58 %    |
| Time deposits over \$250,000 | 24,095,180     | 6.30 %     | 25,896,768           | 7.22 %     |
| Other time deposits          | 23,681,308     | 6.20 %     | 28,871,044           | 8.05 %     |
| Other savings deposits       | 29,918,168     | 7.83 %     | 26,666,342           | 7.43 %     |
| Total Deposits               | \$ 382,222,280 | 100.00 %   | \$ 358,718,612       | 100.00 %   |

Deposits increased 6.55% or \$23.5 million from December 31, 2015 to June 30, 2016. 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 \$24.1 million and \$25.9 million at June 30, 2016 and December 31, 2015, respectively.

At June 30, 2016 and December 31, 2015, deposits with an aggregate deficit balance of \$27,117 and \$121,331, respectively were re-classified as other loans.

### **Comparison of Three Months Ended June 30, 2016 to Three Months Ended June 30, 2015**

Net income increased \$58,672 or 4.68% to \$1.31 million, or basic and diluted earnings per share of \$.27 and \$.26, respectively, for the three months ended June 30, 2016, from \$1.25 million, or basic and diluted earnings per share of \$.26 and \$.25, respectively, for the three months ended June 30, 2015. Our return on average assets and average equity for the three months ended June 30, 2016 were 1.30% and 12.82%, respectively, compared with 1.36% and 13.08%, respectively, for the three months ended June 30, 2015.

### **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 \$226,597 or 6.57% to \$3.7 million for the three months ended June 30, 2016 from \$3.5 million for the three months ended June 30, 2015. This increase was primarily due to an increase in interest and fee income from loans and interest bearing deposits in other banks (Federal Reserve). Average loans increased \$21.5 million or 8.75% to \$266.8 million for the three months ended June 30, 2016, compared to \$245.3 million for the three months ended June 30, 2015. The yield on average loans (including fees) remained unchanged at 4.84% for the three months ended June 30, 2016 and 2015, respectively. Interest income on loans increased \$250,701 for the three months ended June 30, 2016 to \$3.2 million from \$3.0 million for the three months ended June 30, 2015.

The average balance of interest bearing deposits in other banks increased \$14.5 million or 137.25% to \$25.1 million for the three months ended June 30, 2016, with a rate of 0.50% as compared to \$10.6 million for the three months ended June 30, 2015, with a rate of 0.24%.

### **Provision for Loan Losses**

We have established an allowance for loan losses through a provision for loan losses charged as an expense on our consolidated statements of income. We review our loan portfolio periodically to evaluate our outstanding loans and to measure both the performance of the portfolio and the adequacy for loan losses. For the three months ended June 30,

2016, we had a provision of \$140,000 compared to a provision of \$70,000 for the same period in the prior year. The increase in the provision for loan losses was based on our analysis of the adequacy of the allowance.

#### Non-Interest Income

Other income decreased \$138,920 or 16.00% to \$729,572 for the three months ended June 30, 2016, from \$868,492 for the three months ended June 30, 2015. This decrease was primarily due to a decrease of \$160,699 or 35.12% in mortgage banking income. Mortgage loan originations decreased \$3.2 million resulting in decreases of \$241,788 in discount fees and \$51,880 in service release premiums during the three months ended June 30, 2016. Service charge fees and commissions increased \$14,529 or 5.78% to \$265,736 primarily due to increases of \$18,191 in debit card fees and \$16,590 in wire transfer fees offset by a decrease of \$23,654 in business service charge fees and overdraft fees.

#### Non-Interest Expense

Non-interest expense increased \$37,423 or 1.56% to \$2,436,881 for the three months ended June 30, 2016, from \$2,399,458 for the three months ended June 30, 2015. This increase was primarily due to an increase of \$28,398 in other operating expenses from \$547,752 for the three months ended June 30, 2015, to \$576,150 for the three months ended June 30, 2016. Our professional legal fees increased \$21,405 due to costs associated with new compliance rules as well as our investment in a South Carolina Historical Rehabilitation Tax Credit. Our data processing fees increased \$18,372 for the three months ended June 30, 2016 due to increased usage of electronic banking by our business and personal customers.

### Income Tax Expense

We incurred income tax expense of \$518,262 for the three months ended June 30, 2016 as compared to \$596,680 during the same period in 2015. Our effective tax rate was 28.31% and 32.25% for the three months ended June 30, 2016 and 2015, respectively. The decrease in the effective tax rate during the three months ended June 30, 2016 was primarily due to an investment in a South Carolina Historic Rehabilitation Tax Credit generated from the extensive renovation of a local historic building. This transaction closed on June 24, 2016.

### Comparison of Six Months Ended June 30, 2016 to Six Months Ended June 30, 2015

Net income increased \$49,449 or 2.01% to \$2.51 million, or basic and diluted earnings per share of \$.51 and \$.50, respectively, for the six months ended June 30, 2016, from \$2.46 million, or basic and diluted earnings per share of \$.50 and \$.49, respectively, for the six months ended June 30, 2015. Our return on average assets and average equity for the six months ended June 30, 2016 was 1.26% and 12.37%, respectively, compared with 1.34% and 13.00%, respectively, for the six months ended June 30, 2015.

### Net Interest Income

Net interest income increased \$383,392 or 5.61% to \$7.2 million for the six months ended June 30, 2016 from \$6.8 million for the six months ended June 30, 2015. This increase was primarily due to an increase in interest and fee income from loans and interest bearing deposits in other banks (Federal Reserve). Average loans increased \$16.7 million or 6.90% to \$259.4 million for the six months ended June 30, 2016, compared to \$242.6 million for the six months ended June 30, 2015. The yield on average loans (including fees) remained unchanged at 4.84% for the six months ended June 30, 2016 and 2015, respectively. Interest income on loans increased \$419,978 for the six months ended June 30, 2016 to \$6.2 million from \$5.8 million for the six months ended June 30, 2015.

The average balance of interest bearing deposits in other banks increased \$15.0 million or 135.52% to \$26.1 million for the six months ended June 30, 2016, with a rate of 0.50% as compared to \$11.1 million for the six months ended June 30, 2015, with a rate of 0.25%.

### Provision for Loan Losses

We have established an allowance for loan losses through a provision for loan losses charged as an expense on our consolidated statements of income. We review our loan portfolio periodically to evaluate our outstanding loans and to measure both the performance of the portfolio and the adequacy for loan losses. For the six months ended June 30, 2016, we had a provision of \$185,000 compared to a provision of \$75,000 for the same period in the prior year. The increase in the provision for loan losses was based on our analysis of the adequacy of the allowance.

**Non-Interest Income**

Other income decreased \$76,999 or 4.81% to \$1.5 million for the six months ended June 30, 2016, from \$1.6 million for the six months ended June 30, 2015. This decrease was primarily due to a decrease of \$185,972 or 22.28% in mortgage banking income. Mortgage loan originations decreased \$12.6 million resulting in a decrease of \$292,670 in discount fees and \$75,650 in service release premiums during the six months ended June 30, 2016. Service charge fees and commissions increased \$37,774 or 7.73% to \$526,267 for the six months ended June 30, 2016, primarily due to an increase of \$34,758 in debit card fees. We also realized gains of \$348,327 on the sale of investment securities for the six months ended June 30, 2016 as compared to gains of \$264,401 for the same period in 2015.

**Non-Interest Expense**

Non-interest expense increased \$221,066 or 4.67% to \$4.9 million for the six months ended June 30, 2016, from \$4.7 million for the six months ended June 30, 2015. This increase was primarily due to increases in salaries and employee benefits of \$103,596 or 3.58% from \$2.9 million for the six months ended June 30, 2015 to \$3.0 million for the six months ended June 30, 2016. Base wages increased \$85,829 to \$2.4 million for the six months ended June 30, 2016, as a result of annual merit increases. Our Employee Stock Ownership Plan (“ESOP”) contribution increased \$15,000 for the six months ended June 30, 2016, as our monthly contribution increased from \$25,000 in 2015 to \$27,500 in 2016. We also saw an increase of \$100,387 in other operating expenses from \$1.1 million for the six months ended June 30, 2015, to \$1.2 million for the six months ended June 30, 2016. This increase was primarily due to increases in professional fees, employee training and the FDIC assessment.



### **Income Tax Expense**

We incurred income tax expense of \$1.1 million for the six months ended June 30, 2016 as compared to \$1.2 million during the same period in 2015. Our effective tax rate was 30.21% and 32.05% for the six months ended June 30, 2016 and 2015, respectively. The decrease in the effective tax rate during the six months ended June 30, 2016 was primarily due to an investment in a South Carolina Historic Rehabilitation Tax Credit generated from the extensive renovation of a local historic building. This transaction closed on June 24, 2016.

### **Off Balance Sheet Arrangements**

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained if deemed necessary by the Company upon extension of credit is based on our credit evaluation of the borrower. Collateral held varies but may include accounts receivable, negotiable instruments, inventory, property, plant and equipment, and real estate. Commitments to extend credit, including unused lines of credit, amounted to \$85.6 million and \$87.6 million at June 30, 2016 and December 31, 2015, respectively.

Standby letters of credit represent our obligation to a third party contingent upon the failure of our customer to perform under the terms of an underlying contract with the third party or obligates us to guarantee or stand as surety for the benefit of the third party. The underlying contract may entail either financial or nonfinancial obligations and may involve such things as the shipment of goods, performance of a contract, or repayment of an obligation. Under the terms of a standby letter, generally drafts will be drawn only when the underlying event fails to occur as intended. We can seek recovery of the amounts paid from the borrower. The majority of these standby letters of credit are unsecured. Commitments under standby letters of credit are usually for one year or less. The maximum potential amount of undiscounted future payments related to standby letters of credit at June 30, 2016 and December 31, 2015 was \$703,237 and \$745,187, respectively.

We originate certain fixed rate residential loans and commit these loans for sale. The commitments to originate fixed rate residential loans and the sales commitments are freestanding derivative instruments. We had forward sales commitments, totaling \$6.5 million at June 30, 2016, to sell loans held for sale of \$6.5 million, compared to forward sales commitments of \$5.8 million at December 31, 2015, to sell loans held for sale of \$5.8 million. The fair value of these commitments was not significant at June 30, 2016 or December 31, 2015. We had no embedded derivative instruments requiring separate accounting treatment.

Once we sell certain fixed rate residential loans, the loans are no longer reportable on our balance sheet. With most of these sales, we have an obligation to repurchase the loan in the event of a default of principal or interest on the loan. This recourse period ranges from three to nine months. Misrepresentation or fraud carries unlimited time for recourse.

The unpaid principal balance of loans sold with recourse was \$12.9 million at June 30, 2016 and \$13.1 million at December 31, 2015. For the three and six months ended June 30, 2016 and June 30, 2015, there were no loans repurchased.

### Liquidity

Historically, we have maintained our liquidity at levels believed by management to be adequate to meet requirements of normal operations, potential deposit outflows and strong loan demand and still allow for optimal investment of funds and return on assets.

We manage our assets and liabilities to ensure there is sufficient liquidity to enable management to fund deposit withdrawals, loan demand, capital expenditures, reserve requirements, operating expenses, dividends and to manage daily operations on an ongoing basis. Funds are primarily provided by the Bank through customer deposits, principal and interest payments on loans, mortgage loan sales, the sale or maturity of securities, temporary investments and earnings.

Proper liquidity management is crucial to ensure that we are able to take advantage of new business opportunities as well as meet the credit needs of our existing customers. Investment securities are an important tool in our liquidity management. Our primary liquid assets are cash and due from banks, federal funds sold, investments available for sale, other short-term investments and mortgage loans held for sale. Our primary liquid assets accounted for 36.14% and 38.83% of total assets at June 30, 2016 and December 31, 2015, respectively. Securities classified as available for sale, which are not pledged, may be sold in response to changes in interest rates and liquidity needs. All of the securities presently owned are classified as Available for Sale. Net cash provided by operations and deposits from customers have been the primary sources of liquidity. At June 30, 2016, we had unused short-term lines of credit totaling approximately \$18 million (which can be withdrawn at the lender's option). Additional sources of funds available to us for additional liquidity needs include borrowing on a short-term basis from the Federal Reserve System, increasing deposits by raising interest rates paid and selling mortgage loans held for sale. We established a Borrower-In-Custody arrangement with the Federal Reserve. This arrangement permits us to retain possession of assets pledged as collateral to secure advances from the Federal Reserve Discount Window. At June 30, 2016 we could borrow up to \$81 million. There have been no borrowings under this arrangement.

Our core deposits consist of non-interest bearing accounts, NOW accounts, money market accounts, time deposits and savings accounts. We closely monitor our level of certificates of deposit greater than \$100,000 and other large deposits. We maintain a Contingency Funding Plan ("CFP") that identifies liquidity needs and weighs alternate courses of action designed to address these needs in emergency situations. We perform a quarterly cash flow analysis and stress test the CFP to evaluate the expected funding needs and funding capacity during a liquidity stress event. We believe our liquidity sources are adequate to meet our operating needs and do not know of any trends, events or uncertainties that may result in a significant adverse effect on our liquidity position. At June 30, 2016 and December 31, 2015, our liquidity ratio was 33.72% and 37.27%, respectively.

### Capital Resources

Our capital needs have been met to date through the \$10.6 million in capital raised in our initial offering, the retention of earnings less dividends paid and the exercise of stock options to purchase. Total shareholders' equity at June 30, 2016 was \$41.5 million. The rate of asset growth since our inception has not negatively impacted this capital base.

On July 2, 2013, the Federal Reserve Board approved the final rules implementing the Basel Committee on Banking Supervision's ("BCBS") capital guidelines for US banks ("Basel III"). Following the actions by the Federal Reserve, the FDIC also approved regulatory capital requirements on July 9, 2013. The FDIC's rule is identical in substance to the final rules issued by the Federal Reserve Bank.

Basel III became effective on January 1, 2015. The purpose is to improve the quality and increase the quantity of capital for all banking organizations. The minimum requirements for the quantity and quality of capital were increased. The rule includes a new common equity Tier 1 capital to risk-weighted assets ratio of 4.5% and a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets. The rule also raises the minimum ratio of

Tier 1 capital to risk-weighted assets from 4% to 6% and requires a minimum leverage ratio of 4%. In addition, the rule also implements strict eligibility criteria for regulatory capital instruments and improves the methodology for calculating risk-weighted assets to enhance risk sensitivity. Full compliance with all of the final rule requirements will be phased in over a multi-year schedule. The Bank's total risk-based capital ratio at June 30, 2016 and December 31, 2015 was 14.38% and 15.42%, respectively.

At June 30, 2016, the Company and the Bank were categorized as "well capitalized" under Basel III. To be categorized as "well capitalized" the Company and the Bank must maintain minimum total risk based, Tier 1 risk based, common equity Tier 1 risk based capital and Tier 1 leverage ratios of 10%, 8%, 6.5% and 5%, respectively, and to be categorized as "adequately capitalized," the Company and the Bank must maintain minimum total risk based, Tier 1 risk based, common equity Tier 1 risk based capital, and Tier 1 leverage ratios of 8%, 6%, 4.5%, and 4%, respectively.

We are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory – and possibly additional discretionary – actions by regulators that, if undertaken, could have a material effect on the financial statements. We must meet specific capital guidelines that involve quantitative measures of our assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. Our capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. Current and previous quantitative measures established by regulation to ensure capital adequacy require that we maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets and to average assets. Management expects that the capital ratios for the Company and the Bank under Basel III will continue to exceed the well-capitalized minimum capital requirements.

The Company had no material commitments for capital expenditures as of June 30, 2016 and December 31, 2015, respectively.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Not required.

### **Item 4. Controls and Procedures**

#### Evaluation of disclosure controls and procedures and internal controls and procedures for financial reporting

An evaluation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) promulgated under the Securities and Exchange Act of 1934 as amended (the "Act") was carried out as of June 30, 2016 under the supervision and with the participation of the Bank of South Carolina Corporation's management, including its President/Chief Executive Officer and the Chief Financial Officer/Senior Vice President and several other members of the Company's senior management. Based upon that evaluation, Bank of South Carolina Corporation's management, including the President/Chief Executive Officer and the Chief Financial Officer/Senior Vice President concluded that, as of June 30, 2016, the Company's disclosure controls and procedures were effective in ensuring that the information the Company is required to disclose in the reports filed or submitted under the Act has been (i) accumulated and communicated to management (including the President/Chief Executive Officer and Chief Financial Officer/Senior Vice President) to allow timely decisions regarding required disclosure, and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

The Company's management is responsible for establishing and maintaining adequate internal controls over financial reporting, as such term is defined in Rule 13a-15(f) of the Exchange Act. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of published financial statements in accordance with generally accepted accounting principles.

Under the supervision and with the participation of management, including the President/Chief Executive Officer and the Chief Financial Officer/Senior Vice President, the Company's management has evaluated the effectiveness of its internal control over financial reporting as of June 30, 2016, based on the 2013 framework established in a report entitled "*Internal Control-Integrated Framework*" issued by the Committee of Sponsoring Organizations of the Treadway Commission.

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

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of June 30, 2016. Based on this assessment, management believes that as of June 30, 2016, the Company's internal control over financial reporting was effective. There were no changes in the Company's internal control over financial reporting that occurred during the quarter ended June 30, 2016, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

The Audit and Compliance Committee, composed entirely of independent Directors, meets periodically with management, the Company's Compliance Officer, Risk Management Officer and Elliott Davis Decosimo, LLC (separately and jointly) to discuss audit, financial and related matters. Elliott Davis Decosimo, LLC, the Compliance Officer, and the Risk Management Officer have direct access to the Audit and Compliance Committee.

**Part II. Other Information**

**Item 1. Legal Proceedings**

In our opinion, there are no other legal proceedings pending other than routine litigation incidental to our business involving amounts which are not material to our financial condition.

**Item 1A. Risk Factors**

Not required.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosure**

None.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

1. The Consolidated Financial Statements are included in this Form 10-Q and listed on pages as indicated.

|   | Page |
|---|------|
| (1) Consolidated Balance Sheets                     | 3    |
| (2) Consolidated Statements of Income               | 4    |
| (3) Consolidated Statements of Comprehensive Income | 5-6  |
| (4) Consolidated Statements of Shareholders' Equity | 7    |
| (4) Consolidated Statements of Cash Flows           | 8    |
| (5) Notes to Consolidated Financial Statements      | 9-28 |

2. Exhibits

|         |  |
|---------|--|
| 2.0     | Plan of Reorganization (Filed with 1995 10-KSB)  |
| 3.0     | Articles of Incorporation of the Registrant (Filed with 1995 10-KSB)   |
| 3.1     | By-laws of the Registrant (Filed with 1995 10-KSB)   |
| 3.2     | Amendments to the Articles of Incorporation of the Registrant (Filed with Form S on June 23, 2011)   |
| 4.0     | 2016 Proxy Statement (Filed with 2015 10-K)  |
| 10.0    | Lease Agreement for 256 Meeting Street (Filed with 1995 10-KSB)  |
| 10.1    | Sublease Agreement for Parking Facilities at 256 Meeting Street (Filed with 1995 10-KSB)   |
| 10.2    | Lease Agreement for 100 N. Main Street, Summerville, SC (Filed with 1995 10-KSB)   |
| 10.3    | Lease Agreement for 1337 Chuck Dawley Blvd., Mt. Pleasant, SC (Filed with 1995 10-KSB)   |
| 10.4    | Lease Agreement for 1071 Morrison Drive, Charleston, SC (Filed With 2010 10-K)<br>Lease Agreement for 1071 Morrison Drive, Charleston, SC (Filed with September 30, 2014 10-Q) |
| 10.5    | 1998 Omnibus Stock Incentive Plan (Filed with 2008 10-K/A)   |
| 10.6    | Employee Stock Ownership Plan (Filed with 2008 10-K/A)<br>Employee Stock Ownership Plan, Restated (Filed with 2011 Proxy Statement)  |
| 10.7    | 2010 Omnibus Incentive Stock Option Plan (Filed with 2010 Proxy Statement)   |
| 10.8    | Lease Agreement for Highway 78 Ingleside Boulevard North Charleston, SC (Filed with 2013 10-K)   |
| 10.9    | Assignment and Assumption of Lease Agreement for Highway 78 Ingleside Boulevard North Charleston, SC (Filed with 2015 10-K)  |
| 10.10   | First Amendment to Lease Agreement for Highway 78 Ingleside Boulevard North Charleston, SC (Filed with 2015 10-K)  |
| 10.11   | Second Amendment to Lease Agreement for Highway 78 Ingleside Boulevard North Charleston, SC (Filed with 2015 10-K)   |
| 14.0    | Code of Ethics (Filed with 2004 10-KSB)  |
| 21.0    | List of Subsidiaries of the Registrant (Filed with 1995 10-KSB)<br>The Registrant's only subsidiary is The Bank of South Carolina (Filed with 1995 10-KSB)                     |
| 31.1    | <u>Certification pursuant to Rule 13a-14(a)/15d-14(a) by Chief Executive Officer</u>   |
| 31.2    | <u>Certification pursuant to Rule 13a-14(a)/15d-14(a) by Chief Financial Officer</u>   |
| 32.1    | <u>Certification pursuant to Section 1350</u>  |
| 32.2    | <u>Certification pursuant to Section 1350</u>  |
| 101.INS | XBRL Instance Document   |
| 101.SCH | XBRL Taxonomy Extension Schema Document  |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document  |



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101.DEF XBRL Taxonomy Extension Definition Linkbase Document  
101.LAB XBRL Taxonomy Extension Label Linkbase Document  
101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

**Signatures**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Bank of South Carolina Corporation

August 5, 2016

By:/s/Fleetwood S. Hassell  
Fleetwood S. Hassell  
President/Chief Executive Officer

By:/s/Eugene H. Walpole, IV  
Eugene H. Walpole, IV  
Chief Financial Officer/  
Senior Vice President