

BANK OF SOUTH CAROLINA CORP  
Form 10-Q  
August 08, 2014

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, 2014

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)

-

256 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 8, 2014 there were 4,461,388 Common Shares outstanding.

BANK OF SOUTH CAROLINA CORPORATION

AND SUBSIDIARY

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## PART I - ITEM 1 - FINANCIAL STATEMENTS

## BANK OF SOUTH CAROLINA CORPORATION AND SUBSIDIARY

## CONSOLIDATED BALANCE SHEETS

Assets:	(Unaudited) June 30, 2014	(Audited) December 31, 2013
Cash and due from banks	\$7,848,685	\$6,043,375
Interest bearing deposits in other banks	20,894,035	16,080,721
Investment securities available for sale	93,165,764	94,648,221
Mortgage loans to be sold	5,003,930	4,739,343
Loans	230,596,294	218,320,304
Less: Allowance for loan losses	(3,379,808 )	(3,292,277 )
Net loans	227,216,486	215,028,027
Premises and equipment, net	2,442,254	2,454,861
Other real estate owned	521,943	
Accrued interest receivable	1,114,437	1,182,272
Other assets	870,670	716,883
<b>Total assets</b>	<b>\$359,078,204</b>	<b>\$340,893,703</b>
<b>Liabilities and Shareholders' Equity:</b>		
<b>Liabilities</b>		
<b>Deposits:</b>		
Non-interest bearing demand	101,024,740	90,574,330
Interest bearing demand	79,982,199	78,576,851
Money market accounts	51,489,810	47,190,365
Certificates of deposit \$100,000 and over	49,830,228	52,516,487
Other time deposits	15,805,539	15,730,187
Other savings deposits	23,720,158	20,654,435
<b>Total deposits</b>	<b>321,852,674</b>	<b>305,242,655</b>
Accrued interest payable and other liabilities	1,345,712	911,905
<b>Total liabilities</b>	<b>323,198,386</b>	<b>306,154,560</b>
<b>Common Stock - No par value;</b> 12,000,000 shares authorized; Shares issued 4,680,839 at June 30, 2014 and 4,678,339 at December 31, 2013; Shares outstanding 4,461,388 at June 30, 2014 and 4,458,888 shares at December 31, 2013	—	—
Additional paid in capital	28,740,980	28,678,150

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Retained earnings	7,913,296	7,007,532
Treasury stock: 219,451 shares at June 30, 2014 and December 31, 2013	(1,902,439 )	(1,902,439 )
Accumulated other comprehensive income, net of income taxes	1,127,981	955,900
Total shareholders' equity	35,879,818	34,739,143
Total liabilities and shareholders' equity	\$ 359,078,204	\$ 340,893,703

See accompanying notes to consolidated financial statements.

## BANK OF SOUTH CAROLINA CORPORATION AND SUBSIDIARY

## CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Three Months Ended June 30,	
	2014	2013
Interest and fee income		
Interest and fees on loans	\$2,814,009	\$2,885,100
Interest and dividends on investment securities	488,798	345,581
Other interest income	12,949	24,567
Total interest and fee income	3,315,756	3,255,248
Interest expense		
Interest on deposits	103,024	104,169
Total interest expense	103,024	104,169
Net interest income	3,212,732	3,151,079
Provision for loan losses	20,000	95,000
Net interest income after provision for loan losses	3,192,732	3,056,079
Other income		
Service charges, fees and commissions	233,921	234,536
Mortgage banking income	303,288	382,426
Other non-interest income	7,188	7,196
Gain on sale of securities	138,838	—
Total other income	683,235	624,158
Other expense		
Salaries and employee benefits	1,329,048	1,285,942
Net occupancy expense	368,057	340,873
Other operating expenses	555,835	534,863
Total other expense	2,252,940	2,161,678
Income before income tax expense	1,623,027	1,518,559
Income tax expense	513,100	474,485
Net income	\$1,109,927	\$1,044,074
Basic income per common share	\$0.25	\$0.23
Diluted income per common share	\$0.24	\$0.23
Weighted average shares outstanding		
Basic	4,461,388	4,451,333
Diluted	4,583,833	4,451,333

Cash Dividend Per Share	\$0.13	\$0.12
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See accompanying notes to consolidated financial statements.



## BANK OF SOUTH CAROLINA CORPORATION AND SUBSIDIARY

## CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Six Months Ended June 30,	
	2014	2013
Interest and fee income		
Interest and fees on loans	\$5,523,980	\$5,593,847
Interest and dividends on investment securities	980,205	678,874
Other interest income	18,556	44,613
Total interest and fee income	6,522,741	6,317,334
Interest expense		
Interest on deposits	204,646	205,595
Total interest expense	204,646	205,595
Net interest income	6,318,095	6,111,739
Provision for loan losses	50,000	170,000
Net interest income after provision for loan losses	6,268,095	5,941,739
Other income		
Service charges, fees and commissions	456,437	466,838
Mortgage banking income	530,342	876,438
Other non-interest income	12,054	12,301
Gain on sale of securities	223,735	—
Total other income	1,222,568	1,355,577
Other expense		
Salaries and employee benefits	2,658,959	2,568,026
Net occupancy expense	732,728	668,411
Other operating expenses	1,101,751	1,091,998
Total other expense	4,493,438	4,328,435
Income before income tax expense	2,997,225	2,968,881
Income tax expense	931,500	926,002
Net income	\$2,065,725	\$2,042,879
Basic income per common share	\$0.46	\$0.46
Diluted income per common share	\$0.45	\$0.46
Weighted average shares outstanding		
Basic	4,461,388	4,449,131
Diluted	4,584,308	4,449,131

Cash Dividend Per Share	\$0.26	\$0.24
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See accompanying notes to consolidated financial statements.

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

	THREE MONTHS ENDED JUNE 30,	
	2014	2013
Net income	\$1,109,927	\$1,044,074
Other comprehensive income (loss)		
Unrealized gain (loss) on securities (net of tax \$31,100 and \$243,620, respectively)	140,424	(414,812 )
Reclassification adjustment for gains included in income (net of tax \$51,370)	(87,468 )	—
Other comprehensive income (loss), net of tax	52,956	(414,812 )
Total comprehensive income	\$1,162,883	\$629,262

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

	SIX MONTHS ENDED JUNE 30,	
	2014	2013
Net income	\$2,065,725	\$2,042,879
Other comprehensive income (loss)		
Unrealized gain (loss) on securities (net of tax \$101,063 and \$339,286, respectively)	313,034	(577,705 )
Reclassification adjustment for gains included in income (net of tax \$82,782)	(140,953 )	—
Other comprehensive income (loss), net of tax	172,081	(577,705 )
Total comprehensive income	\$2,237,806	\$1,465,174

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, 2014  
AND 2013  
(UNAUDITED)

	ADDITIONAL PAID IN CAPITAL	RETAINED EARNINGS	TREASURY STOCK	ACCUMULATED OTHER COMPREHENSIVE INCOME	TOTAL
December 31, 2012	\$ 28,474,951	\$ 5,157,839	\$(1,902,439)	\$ 2,200,091	\$ 33,930,442
Net income	—	2,042,879	—	—	2,042,879
Other comprehensive loss	—	—	—	(577,705)	(577,705)
Exercise of stock options	62,248	—	—	—	62,248
Stock-based compensation expense	36,952	—	—	—	36,952
Cash dividends (\$0.24 per common share)	—	(1,068,292)	—	—	(1,068,292)
June 30, 2013	28,574,151	6,132,426	(1,902,439)	1,622,386	34,426,524
December 31, 2013	28,678,150	7,007,532	(1,902,439)	955,900	34,739,143
Net income	—	2,065,725	—	—	2,065,725
Other comprehensive income	—	—	—	172,081	172,081
Exercise of Stock options	26,050	—	—	—	26,050
Stock-based compensation expense	36,780	—	—	—	36,780
Cash dividends (\$0.26 per common share)	—	(1,159,961)	—	—	(1,159,961)
June 30, 2014	\$ 28,740,980	\$ 7,913,296	\$(1,902,439)	\$ 1,127,981	\$ 35,879,818

See accompanying notes to consolidated financial statements.

## BANK OF SOUTH CAROLINA CORPORATION AND SUBSIDIARY

## CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six months Ended June 30,	
	2014	2013
Cash flows from operating activities:		
Net income	\$2,065,725	\$2,042,879
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	101,208	93,729
Gain on sale of securities	(223,735 )	—
Provision for loan losses	50,000	170,000
Stock-based compensation expense	36,780	36,952
Net amortization of unearned discounts on investments	210,773	214,496
Origination of mortgage loans held for sale	(28,845,724)	(49,460,592)
Proceeds from sale of mortgage loans held for sale	28,581,137	57,691,303
Increase in accrued interest receivable and other assets	(187,015 )	(181,841 )
Increase in accrued interest payable and other liabilities	433,482	146,723
Net cash provided by operating activities	2,222,631	10,753,649
Cash flows from investing activities:		
Proceeds from maturities of investment securities available for sale	1,755,000	2,165,000
Proceeds from sale of available for sale securities	19,529,603	—
Purchase of investment securities available for sale	(19,516,040)	(16,715,236)
Net (increase) decrease in loans	(12,760,402)	2,547,593
Purchase of premises, equipment and leasehold Improvements, net	(88,601 )	(87,867 )
Net cash used by investing activities	(11,080,440)	(12,090,510)
Cash flows from financing activities:		
Net increase in deposit accounts	16,610,019	13,914,504
Dividends paid	(1,159,636 )	(533,869 )
Stock options exercised	26,050	62,248
Net cash provided by financing activities	15,476,433	13,442,883
Net increase in cash and cash equivalents	6,618,624	12,106,022
Cash and cash equivalents at beginning of period	22,124,096	31,041,848

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Cash and cash equivalents at end of period	\$28,742,720	\$43,147,870
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Supplemental disclosure of cash flow data:

Cash paid during the period for:

Interest	\$216,283	\$198,066
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Income taxes	\$661,000	\$494,725
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Supplemental disclosure for non-cash investing and financing activity:

Change in dividends payable	\$325	\$534,423
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Change in unrealized gain (loss) on available for sale securities	\$172,081	\$(577,705 )
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Transfer of loans to other real estate owned	\$521,943	\$—
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See accompanying notes to consolidated financial statements.

BANK OF SOUTH CAROLINA CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 1: Basis of Presentation**

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

The Bank operates as an independent, community oriented, commercial bank providing a broad range of financial services and products. We have four banking house locations: 256 Meeting Street, Charleston, SC, 100 North Main Street, Summerville, SC, 1337 Chuck Dawley Boulevard, Mt. Pleasant, SC and 2027 Sam Rittenberg Boulevard, Charleston, SC. We intend to open a banking office in North Charleston, SC on Highway 78 and Ingleside Boulevard in 2015.

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

The consolidated financial statements in this report are unaudited, except for the December 31, 2013 consolidated balance sheet. All adjustments consisting of normal recurring accruals which are, in the opinion of management, necessary for fair presentation of the interim consolidated financial statements have been included and fairly and accurately present the financial position, results of operations and cash flows of the Company. The results of operations for the three and six months ended June 30, 2014, are not necessarily indicative of the results which may be expected for the entire year.

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



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

**NOTE 2: Investment Securities**

We classify investments into three categories as follows: (1) Held to Maturity - debt securities that we have the positive intent and ability to hold to maturity, which are reported at amortized cost, adjusted for the amortization of any related premiums or the accretion of any related discounts into interest income using a methodology which approximates a level yield of interest over the estimated remaining period until maturity; (2) Trading - debt and equity securities that are bought and held principally for the purpose of selling them in the near term, which are reported at fair value, with unrealized gains and losses included in earnings; and (3) Available for Sale - debt and equity securities that may be sold under certain conditions, which are reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of shareholders' equity, net of income taxes. Unrealized losses on securities due to fluctuations in fair value are recognized when it is determined that an other than temporary decline in value has occurred. Realized gains or losses on the sale of investments are recognized on a specific identification, trade date basis. All securities were classified as available for sale for the three and six months ended June 30, 2014 and 2013. We do not have any mortgage-backed securities nor have we ever invested in mortgage-backed securities. (See "non-interest income" for discussion on the sale of investment securities.)

BANK OF SOUTH CAROLINA CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 3: Mortgage Loans to be Sold**

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated market value in the aggregate. Net unrealized losses are provided for in a valuation allowance by charges to operations as a component of mortgage banking income. At June 30, 2014 and December 31, 2013, we had approximately \$5.0 million and \$4.7 million in mortgage loans held for sale, respectively. Gains or losses on sales of loans are recognized when control over these assets has been surrendered and are included in mortgage banking income in the consolidated statements of income.

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

**NOTE 4: Loans and Allowance for Loan Losses**

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

We account for nonrefundable fees and costs associated with originating or acquiring loans by requiring that loan origination fees be recognized over the life of the related loan as an adjustment on the loan's yield. Certain direct loan origination costs shall be recognized over the life of the related loan as a reduction of the loan's yield.

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

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

The accrual of interest is generally discontinued on loans that become 90 days past due as to principal or interest. The accrual of interest on some loans, however, may continue even though they are 90 days past due if the loans are well secured or in the process of collection and management deems it appropriate. If non-accrual loans decrease their past due status to less than 30 days for a period of 6 to 9 months, they are reviewed individually by management to determine if they should be returned to accrual status.

BANK OF SOUTH CAROLINA CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

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

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

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

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

The following table is a summary of the non-accrual loans as of June 30, 2014 and December 31, 2013.

June 30, 2014

Loans Receivable on Non-Accrual

Commercial \$—

Commercial Real Estate:

Commercial Real Estate - Construction —

Commercial Real Estate - Other 724,667

Consumer:

Consumer Real Estate —

Consumer - Other —

Total \$724,667

## BANK OF SOUTH CAROLINA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

December 31, 2013

Loans Receivable on Non-Accrual

Commercial \$—

Commercial Real Estate:

Commercial Real Estate - Construction —

Commercial Real Estate - Other 1,507,209

Consumer:

Consumer Real Estate 68,231

Consumer - Other —

Total \$1,575,440

One loan receivable previously reported with a non-accrual status, in the amount of \$54,959, was returned to accrual status during the six months ended June 30, 2014. The borrower made payments consistently for the past six months and has had a documented change in income and employment. All principal and interest is current and repayment of the remaining contractual principal and interest is expected. In addition, a loan receivable in the amount of \$521,943 was moved to Other Real Estate Owned (OREO).

The following is a schedule of our delinquent loans, excluding mortgage loans held for sale, as of June 30, 2014 and December 31, 2013.

June 30, 2014

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Recorded Investment > 90 Days and Accruing
Commercial	\$—	—	—	—	52,687,696	52,687,696	—
Commercial Real Estate:							
Commercial Real Estate - Construction	—	—	—	—	1,551,147	1,551,147	—
Commercial Real Estate - Other	89,500	931,406	232,299	1,253,205	110,547,007	111,800,212	—

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Consumer:

Consumer - Real Estate	—	—	—	—	60,260,769	60,260,769	—
Consumer - Other	3,000	—	—	3,000	4,293,470	4,296,470	—
Total	\$92,500	931,406	232,299	1,256,205	229,340,089	230,596,294	—

## BANK OF SOUTH CAROLINA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

December 31, 2013

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Recorded Investment > 90 Days and Accruing
Commercial	\$230,848	78,200	—	309,048	52,994,521	53,303,569	—
Commercial Real Estate:							
Commercial Real Estate - Construction	—	—	—	—	1,516,545	1,516,545	—
Commercial Real Estate - Other	689,859	226,314	754,168	1,670,341	103,070,237	104,740,578	—
Consumer:							
Consumer - Real Estate	—	—	—	—	54,669,359	54,669,359	—
Consumer - Other	24,399	—	—	24,399	4,065,854	4,090,253	—
Total	\$945,106	304,514	754,168	2,003,788	216,316,516	218,320,304	—

As of June 30, 2014 and December 31, 2013, loans individually evaluated and considered impaired are presented in the following table:

## Impaired and Restructured Loans

As of June 30, 2014

	Unpaid	Recorded	Related
With no related allowance recorded:	Principal	Investments	Allowance
	Balance		
Commercial	\$997,712	\$997,712	\$—
Commercial Real Estate	1,613,393	1,613,393	—
Consumer Real Estate	272,963	272,963	—
Consumer Other	—	—	—
Total	\$2,884,068	\$2,884,068	\$—



With an allowance recorded:

Commercial	\$1,123,036	\$1,123,036	\$859,620
Commercial Real Estate	1,597,734	1,597,734	578,746
Consumer Real Estate	689,518	689,518	174,522
Consumer Other	38,319	38,319	38,319
Total	\$3,448,607	\$3,448,607	\$1,651,207
Grand Total	6,332,675	6,332,675	1,651,207

## BANK OF SOUTH CAROLINA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## Impaired and Restructured Loans

As of the Year Ended December 31, 2013

	Unpaid	Recorded	Related
With no related allowance recorded:	Principal	Investments	Allowance
	Balance		
Commercial	\$471,080	\$471,080	\$—
Commercial Real Estate	2,213,271	2,213,271	—
Consumer Real Estate	200,399	200,399	—
Consumer Other	—	—	—
Total	\$2,884,750	\$2,884,750	\$—
With an allowance recorded:			
Commercial	\$1,175,329	\$1,175,329	\$1,175,329
Commercial Real Estate	2,191,875	2,191,875	535,766
Consumer Real Estate	842,127	842,127	423,705
Consumer Other	42,826	42,826	42,826
Total	\$4,252,157	\$4,252,157	\$2,177,626
Grand Total	7,136,907	7,136,907	2,177,626

The following table presents by class, information related to the average recorded investment and interest income recognized on impaired loans for the three and six months ended June 30, 2014 and 2013, respectively.

## Average Recorded Investment and Interest Income

Impaired and Restructured Loans

For the Three Months Ended

	June 30, 2014		June 30, 2013	
	Average	Interest	Average	Interest
With no related allowance recorded:	Recorded	Income	Recorded	Income
	Investment	Recognized	Investment	Recognized
Commercial	\$350,828	\$ 13,259	\$458,260	\$ 3,307
Commercial Real Estate	2,210,822	38,263	3,820,467	35,421
	272,981	2,712	339,948	7,418

Consumer				
Real Estate				
Consumer				
Other	—	—	2,001	1,713
Total	\$2,834,631	\$ 54,234	\$4,620,676	\$ 47,859
With an allowance recorded:				
Commercial	\$1,144,263	\$ 14,423	\$1,282,037	\$ 15,153
Commercial				
Real Estate	1,600,710	20,468	744,505	8,918
Consumer				
Real Estate	691,458	7,000	877,942	10,517
Consumer				
Other	39,574	636	49,425	604
Total	\$3,476,005	\$ 42,527	\$2,953,909	\$ 35,192
Grand Total	6,310,636	96,761	7,574,585	83,051

## BANK OF SOUTH CAROLINA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

	June 30, 2014		June 30, 2013	
	Average	Interest	Average	Interest
With no related allowance recorded:	Recorded	Income	Recorded	Income
	Investment	Recognized	Investment	Recognized
Commercial	\$353,509	\$ 22,440	\$456,225	\$22,077
Commercial	2,228,199	63,794	3,751,096	1,326,406
Real Estate				
Consumer	273,015	5,526	339,691	72,557
Real Estate				
Consumer	—	—	2,001	1,713
Other				
Total	\$2,854,723	\$ 91,760	\$4,549,013	\$1,422,753
With an allowance recorded:				
Commercial	\$1,158,183	\$ 27,981	\$1,279,849	\$198,396
Commercial				
Real Estate	1,603,108	36,674	743,928	203,804
Consumer				
Real Estate	695,775	15,639	876,495	148,258
Consumer				
Other	40,428	1,109	49,303	7,073
Total	\$3,497,494	\$ 81,403	\$2,949,575	\$557,531
Grand Total	6,352,217	173,163	7,498,588	1,980,284

The following table illustrates credit risks by category and internally assigned grades at June 30, 2014 and December 31, 2013.

June 30, 2014

Commercial    Commercial    Commercial    Consumer    Consumer    Total

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		Real Estate	Real Estate	Real Estate	Other	
		Construction	Other			
Pass	\$48,135,050	\$1,096,630	\$104,674,715	\$57,234,387	\$4,015,267	\$215,156,049
Watch	1,794,084	—	1,664,461	1,431,329	182,535	5,072,409
OAEM	555,309	454,517	2,396,348	632,887	53,625	4,092,686
Sub-Standard	2,203,253	—	3,064,688	962,166	45,043	6,275,150
Doubtful	—	—	—	—	—	—
Loss	—	—	—	—	—	—
Total	\$52,687,696	\$1,551,147	\$111,800,212	\$60,260,769	\$4,296,470	\$230,596,294

## BANK OF SOUTH CAROLINA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

December 31, 2013

	Commercial	Commercial Real Estate Construction	Commercial Real Estate Other	Consumer Real Estate	Consumer Other	Total
Pass	\$48,383,912	\$1,516,545	\$95,942,918	\$50,846,709	\$3,703,400	\$200,393,484
Watch	1,962,292	—	1,902,129	1,933,566	191,081	5,989,068
OAEM	546,938	—	2,234,023	654,076	76,097	3,511,134
Sub-Standard	2,410,427	—	4,661,508	1,235,008	119,675	8,426,618
Doubtful	—	—	—	—	—	—
Loss	—	—	—	—	—	—
Total	\$53,303,569	\$1,516,545	\$104,740,578	\$54,669,359	\$4,090,253	\$218,320,304

The following table sets forth the changes in the allowance and an allocation of the allowance by loan category for the three and six months ended June 30, 2014 and 2013, respectively, and December 31, 2013. The allocation of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off. The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. The general component covers non-impaired loans and is based on historical loss experience adjusted for current economic factors described above.

For the Three Months Ended  
June 30, 2014

	Commercial	Commercial Real Estate	Consumer Real Estate	Consumer Other	Unallocated	Total
Allowance for Loan Losses						
Beginning Balance	\$1,395,087	\$958,270	\$405,361	\$83,318	\$481,529	\$3,323,565
Charge-offs	—	—	—	(2,064 )	—	(2,064 )
Recoveries	—	12,000	—	26,307	—	38,307
Provisions	(261,090 )	11,482	149,501	(31,120)	151,227	20,000
Ending Balance	\$1,133,997	\$981,752	\$554,862	\$76,441	\$632,756	\$3,379,808

## BANK OF SOUTH CAROLINA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

As of and for the Six Months Ended  
June 30, 2014

	Commercial	Commercial Real Estate	Consumer Real Estate	Consumer Other	Unallocated	Total
Allowance for Loan Losses						
Beginning Balance	\$ 1,398,184	\$ 966,781	\$ 641,194	\$ 80,214	\$ 205,904	\$ 3,292,277
Charge-offs	—	(3,953 )	—	(4,129 )	—	(8,082 )
Recoveries	—	19,100	—	26,513	—	45,613
Provisions	(264,187 )	(176 )	(86,332 )	(26,157 )	426,852	50,000
Ending Balance	1,133,997	981,752	554,862	76,441	632,756	3,379,808
Ending Balances:						
Individually evaluated for impairment	859,620	578,746	174,522	38,319	—	1,651,207
Collectively evaluated for impairment	274,377	403,006	380,340	38,122	632,756	1,728,601
Ending Balances:						
Individually evaluated for impairment	2,120,748	3,211,127	962,481	38,319	—	6,332,675
Collectively evaluated for impairment	\$ 50,566,948	\$ 110,140,232	\$ 59,298,288	\$ 4,258,151	\$ —	\$ 224,263,619

For the Three Months Ended  
June 30, 2013

	Commercial	Commercial Real Estate	Consumer Real Estate	Consumer Other	Unallocated	Total
Allowance for Loan Losses						
Beginning Balance	\$ 1,500,055	\$ 654,283	\$ 841,411	\$ 82,330	\$ 340,874	\$ 3,418,953
Charge-offs	(141,063 )	—	—	(17,831 )	—	(158,894 )
Recoveries	1,445	3,000	—	411	—	4,856
Provisions	103,204	42,478	4,921	21,811	(77,414 )	95,000
Ending Balance	\$ 1,463,641	\$ 699,761	\$ 846,332	\$ 86,721	\$ 263,460	\$ 3,359,915

## BANK OF SOUTH CAROLINA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

As of and for the Six Months Ended  
June 30, 2013

	Commercial	Commercial Real Estate	Consumer Real Estate	Consumer Other	Unallocated	Total
Allowance for Loan Losses						
Beginning Balance	\$ 1,478,450	\$ 584,646	\$ 890,728	\$ 102,953	\$ 376,067	\$ 3,432,844
Charge-offs	(235,016 )	—	—	(17,831 )	—	(252,847 )
Recoveries	2,934	6,000	—	984	—	9,918
Provisions	217,273	109,115	(44,396 )	615	(112,607 )	170,000
Ending Balance	1,463,641	699,761	846,332	86,721	263,460	3,359,915
Ending Balances:						
Individually evaluated for impairment	1,221,009	267,836	454,111	47,238	—	1,990,194
Collectively evaluated for impairment	242,632	431,925	392,221	39,483	263,460	1,369,721
Ending Balances:						
Individually evaluated for impairment	1,664,534	3,803,214	1,207,220	49,239	—	6,724,207
Collectively evaluated for impairment	\$ 51,269,459	\$ 100,436,505	\$ 51,663,145	\$ 4,244,786	\$ —	\$ 207,613,895

December 31, 2013

	Commercial	Commercial Real Estate	Consumer Real Estate	Consumer Other	Unallocated	Total
Allowance for Loan Losses						
Beginning Balance	\$ 1,478,450	\$ 584,646	\$ 890,728	\$ 102,953	\$ 376,067	\$ 3,432,844
Charge-offs	(245,599 )	—	—	(145,802 )	—	(391,401 )
Recoveries	23,004	15,348	—	4,982	—	43,334
Provisions	142,329	366,787	(249,534 )	118,081	(170,163 )	207,500
Ending Balance	1,398,184	966,781	641,194	80,214	205,904	3,292,277
Ending Balances:						
Individually evaluated for impairment	1,175,329	535,766	423,705	42,826	—	2,177,626
Collectively evaluated for impairment	222,855	431,015	217,489	37,388	205,904	1,114,651
Ending Balance:						
Individually evaluated for impairment	1,646,409	4,405,146	1,042,526	42,826	—	7,136,907
Collectively evaluated for impairment	\$ 51,657,160	\$ 101,851,977	\$ 53,626,833	\$ 4,047,427	\$ —	\$ 211,183,397





## BANK OF SOUTH CAROLINA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Restructured loans (loans, still accruing interest, which have been renegotiated at below-market interest rates or for which other concessions have been granted) were \$481,332 and \$1,196,341 at June 30, 2014 and December 31, 2013, respectively, and are illustrated in the following table. The following loans were renegotiated to interest only. At June 30, 2014 and December 31, 2013, all restructured loans were performing as agreed.

## Modification

As of June 30, 2014

	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Commercial	—	\$—	\$—
Commercial Real Estate	2	\$481,332	\$481,332
Commercial Real Estate Construction			
	—	\$—	\$—
Consumer Real Estate –Prime	—	\$—	\$—
Consumer Real Estate-Subprime			
	—	\$—	\$—
Consumer Other	—	\$—	\$—
Troubled Debt Restructurings That Subsequently Defaulted			
Commercial	—	\$—	\$—
Commercial Real Estate	—	\$—	\$—
Commercial Real Estate Construction			\$—
	—	\$—	
Consumer Real Estate -Prime	—	\$—	\$—
Consumer Real Estate-Subprime			\$—
	—	\$—	
Consumer Other	—	\$—	\$—
—			

## Modification

As of December 31, 2013

Number of

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	Contracts	Pre-Modification Outstanding	Post-Modification Outstanding
		Recorded Investment	Recorded Investment
Troubled Debt Restructurings			
Commercial	1	\$ 106,194	\$ 106,194
Commercial Real Estate	3	\$ 1,090,147	\$ 1,090,147
Commercial Real Estate Construction	—	\$ —	\$ —
Consumer Real Estate –Prime	—	\$ —	\$ —
Consumer Real Estate-Subprime	—	\$ —	\$ —
Consumer Other	—	\$ —	\$ —
Troubled Debt Restructurings That Subsequently Defaulted			
Commercial	—	\$ —	\$ —
Commercial Real Estate	—	\$ —	\$ —
Commercial Real Estate Construction	—	\$ —	\$ —
Consumer Real Estate -Prime	—	\$ —	\$ —
Consumer Real Estate-Subprime	—	\$ —	\$ —
Consumer Other	—	\$ —	\$ —

During the six months ended June 30, 2014 a loan receivable with a current balance of \$496,090, was removed from the Trouble Debt Restructuring (TDR) status. The borrower was paying as agreed and also made substantial reductions to principal. Refinance guidance ASC 310-20-35-9 allows for a loan to be removed from the TDR status if the terms of the loan reflect current market rates. Although we removed this loan receivable from a TDR status, it will remain classified as an impaired loan and will continue to be recorded, evaluated and disclosed as such. In addition, one loan receivable with a balance of \$106,194 at December 31, 2013, was paid off during the six months ended June 30, 2014. There were no additional loans identified as a TDR during the six months ended June 30, 2014.

## BANK OF SOUTH CAROLINA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 5: Premises, Equipment and Leasehold Improvements and Depreciation**

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

**NOTE 6: Other Real Estate Owned**

The following table summarizes the activity in the other real estate owned at June 30, 2014 and December 31, 2013.

	June 30, 2014	December 31, 2013
Balance, beginning of year	\$—	\$ —
Additions-foreclosure	521,943	—
Sales	—	—
Write-downs	—	—
Balance, end of year	\$521,943	\$ —

**NOTE 7: Income Taxes**

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

Accounting standards require the accounting for uncertainty in income taxes recognized in an enterprise's financial statements. These standards also prescribe a recognition threshold and measurement of a tax position taken or expected to be taken in an enterprise's tax return. We believe that we had no uncertain tax positions as of June 30, 2014, December 31, 2013, or June 30, 2013.

NOTE 8: Stock Based Compensation

Our shareholders voted at our Annual Meeting, April 13, 2010 to approve the 2010 Omnibus Stock Incentive Plan, including 330,000 shares (adjusted for a 10% stock dividend declared on August 26, 2010) reserved under the plan (copy of the plan was filed with 2010 Proxy Statement). This plan is intended to assist us in recruiting and retaining employees with ability and initiative by enabling them to participate in our future success and to associate their interest with those of the Company and our shareholders. Under the Omnibus Stock Incentive Plan, options are periodically granted to employees at a price not less than 100% of the fair market value of the shares at the date of the grant. All employees are eligible to participate in this plan if the Executive Committee, in its sole discretion, determines that such person has contributed or can be expected to contribute to our profits or growth. Options may be exercised in whole at any time or in part from time to time at such times and in compliance with such requirements as the Executive Committee shall determine. The maximum period in which an option may be exercised is determined at the date of grant and shall not exceed ten years from the date of grant. The options are not transferable except by will or by the laws of descent and distribution.

## BANK OF SOUTH CAROLINA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

There were no options granted during the three or six months ended June 30, 2014. The Executive Committee granted options to purchase an aggregate of 5,000 shares on June 27, 2013, to five employees. Fair value was estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions: dividend yield 3.98%, historical volatility 36.34%, risk free interest rate of 2.49% and an expected life of ten years.

On April 14, 1998 we adopted the 1998 Omnibus Stock Incentive Plan which expired on April 14, 2008. Although options can no longer be granted under this Plan, options granted before April 14, 2008, shall remain valid in accordance with their terms. There are currently options to purchase 24,915 shares outstanding under this plan with options to purchase 15,972 shares exercisable.

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

The following is a summary of the activity under the 1998 and 2010 Omnibus Stock Incentive Plans for the three and six months ended June 30, 2014 and for the three and six months ended June 30, 2013.

Three Months Ended June 30, 2014	Options	Weighted Average Exercise Price
Balance at April 1, 2014	156,665	\$ 11.04
Forfeited	(3,750)	11.46
Exercised	—	—
Balance at June 30, 2014	152,915	11.03
Six Months Ended June 30, 2014	Options	Weighted Average Exercise Price
Balance at January 1, 2014	159,165	\$ 11.03
Forfeited	(3,750)	11.46

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Exercised	(2,500)	10.42
Balance at June 30, 2014	152,915	11.03
Options exercisable at June 30, 2014	15,972	\$ 14.81
Three months Ended June 30, 2013	Options	Weighted Average Exercise Price
Balance at April 1, 2013	168,208	\$ 11.20
Granted	5,000	12.84
Forfeited	(2,500)	10.77
Exercised	(4,630)	8.54
Balance at June 30, 2013	166,078	11.35
Six months Ended June 30, 2013	Options	Weighted Average Exercise Price
Balance at January 1, 2013	174,467	\$ 11.20
Granted	5,000	12.84
Forfeited	(6,100)	11.55
Exercised	(7,292)	8.54
Balance at June 30, 2013	166,075	11.35
Options exercisable at June 30, 2013	13,915	\$ 14.79

## BANK OF SOUTH CAROLINA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**NOTE 9: Shareholders' Equity**

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

Regular quarterly cash dividends of \$.13 per share were declared on March 27, 2014 and June 26, 2014 for shareholders of record at April 8, 2014 and July 7, 2014. The dividends were payable on April 30, 2014 and July 31, 2014. Income per common share for the three and six months ended June 30, 2014 and for the three and six months ended June 30, 2013 were calculated as follows:

	FOR THE THREE MONTHS ENDED JUNE 30, 2014		
	INCOME (NUMERATOR)	SHARES (DENOMINATOR)	PER SHARE AMOUNT
Net income	\$1,109,927		
Basic income available to common shareholders	\$1,109,927	4,461,388	\$ .25
Effect of dilutive options		122,445	
Diluted income available to common shareholders	\$1,109,927	4,583,833	\$ .24

	FOR THE SIX MONTHS ENDED JUNE 30, 2014		
	INCOME (NUMERATOR)	SHARES (DENOMINATOR)	PER SHARE AMOUNT
Net income	\$2,065,725		
Basic income available to			



common shareholders	\$2,065,725	4,461,388	\$ .46
Effect of dilutive options		122,920	
Diluted income available to common shareholders	\$2,065,725	4,584,308	\$ .45

FOR THE THREE MONTHS ENDED JUNE  
30, 2013

	INCOME (NUMERATOR)	SHARES (DENOMINATOR)	PER SHARE AMOUNT
Net income	\$1,044,074		
Basic income available to common shareholders	\$1,044,074	4,451,333	\$ .23
Effect of dilutive options		—	
Diluted income available to common shareholders	\$1,044,074	4,451,333	\$ .23

## BANK OF SOUTH CAROLINA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

FOR THE SIX MONTHS ENDED JUNE 30,  
2013

	INCOME (NUMERATOR)	SHARES (DENOMINATOR)	PER SHARE AMOUNT
Net income	\$2,042,879		
Basic income available to common shareholders	\$2,042,879	4,449,131	\$ .46
Effect of dilutive options		—	
Diluted income available to common shareholders	\$2,042,879	4,449,131	\$ .46

The future payment of cash dividends is subject to the discretion of the Board of Directors and depends upon a number of factors, including future earnings, financial condition, cash requirements, and general business conditions. Cash dividends when declared, are paid by the Bank to the Company for distribution to shareholders of the Company. The Bank's ability to pay dividends to the Company is restricted by the laws and regulations of the State of South Carolina. Generally, these restrictions allow the Bank to pay dividends from current earnings without the prior written consent of the South Carolina Commissioner of Banking, if it received a satisfactory rating at its most recent examination.

NOTE 10: Comprehensive Income

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

Comprehensive income totaled \$1,162,883 and \$629,262 for the three months ended June 30, 2014 and June 30, 2013, respectively, and \$2,237,806 and \$1,465,174 for the six months ended June 30, 2014 and June 30, 2013, respectively.

NOTE 11: Fair Value Measurements

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

# BANK OF SOUTH CAROLINA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

- Level 1** Valuation is based upon quoted prices (unadjusted) in active markets for identical assets or liabilities that we have the ability to access. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as US Treasuries and money market funds.
- Level 2** Valuation is based upon quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability (other than quoted prices), such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments, mortgage-backed securities, municipal bonds, corporate debt securities and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes certain derivative contracts and impaired loans.
- Level 3** Valuation is generated from model-based techniques that use at least one significant assumption based on unobservable inputs for the asset or liability, which are typically based on an entity's own assumptions, as there is little, if any, related market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

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

### Investment Securities Available for Sale

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



## BANK OF SOUTH CAROLINA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Assets and liabilities measured at fair value on a recurring basis at June 30, 2014 and December 31, 2013 are as follows:

Balance  
at  
June 30, 2014

	Quoted	Significant		
	Market Price	Other	Significant	
	in active	Observable	Unobservable	Total
	markets	Inputs	Inputs	
	(Level 1)	(Level 2)	(Level 3)	
US Treasury Notes	\$19,142,422	\$—	\$—	\$19,142,422
Government Sponsored Enterprises	\$—	\$40,219,602	\$—	\$40,219,602
Municipal Securities	\$—	\$32,266,306	\$1,537,434	\$33,803,740
Total	\$19,142,422	\$72,485,908	\$1,537,434	\$93,165,764

Balance  
at  
December 31, 2013

	Quoted	Significant		
	Market Price	Other	Significant	
	in active	Observable	Unobservable	Total
	markets	Inputs	Inputs	
	(Level 1)	(Level 2)	(Level 3)	
US Treasury Notes	\$15,832,401	\$—	\$—	\$15,832,401
Government Sponsored Enterprises	\$—	\$43,635,038	\$—	\$43,635,038
Municipal Securities	\$—	\$33,655,445	\$1,525,337	\$35,180,782
Total	\$15,832,401	\$77,290,483	\$1,525,337	\$94,648,221

Other Real Estate Owned (OREO)

Loans, secured by real estate, are adjusted to fair value upon transfer to other real estate owned (OREO). Subsequently, OREO is carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or our estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraisal, we record the asset as nonrecurring Level 2. When an appraised value is not available or we determine the fair value of the collateral is further impaired below the appraised value and there is no observable market price, we record the asset as nonrecurring Level 3. We had one property valued at \$521,943 classified as Other Real Estate Owned at June 30, 2014 with no Other Real Estate Owned at December 31, 2013.

BANK OF SOUTH CAROLINA CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Impaired Loans

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

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

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

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

Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At June 30, 2014 and December 31, 2013, substantially all



of the total impaired loans were evaluated based on the fair value of the collateral. In accordance with ASC 820, impaired loans, where an allowance is established based on the fair value of collateral, require classification in the fair value hierarchy. We record the impaired loan as nonrecurring Level 3.

#### Mortgage Loans Held for Sale

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

## BANK OF SOUTH CAROLINA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets and liabilities carried on the balance sheet by caption and by level within the valuation hierarchy (as described above) as of June 30, 2014 and December 31, 2013, for which a nonrecurring change in fair value has been recorded during the six months ended June 30, 2014 and twelve months ended December 31, 2013.

June 30, 2014

	Quoted			
	Market Price	Significant Other	Significant Unobservable	
	in active markets (Level 1)	Observable Inputs (Level 2)	Inputs (Level 3)	Total
Impaired loans	\$ —	\$—	\$ 4,681,468	\$4,681,468
Mortgage loans held for sale	—	5,003,930	—	5,003,930
Other real estate owned	—	521,943	—	521,943
Total	\$ —	\$5,525,873	\$ 4,681,468	\$10,207,341

December 31, 2013

	Quoted			
	Market Price	Significant Other	Significant Unobservable	Balance at
	in active markets (Level 1)	Observable Inputs (Level 2)	Inputs (Level 3)	December 31, 2013
Impaired loans	\$ —	\$—	\$ 4,959,281	\$4,959,281
Mortgage loans held for sale	—	4,739,343	—	4,739,343

Other real estate owned	—	—	—	—
Total	\$ —	\$4,739,343	\$4,959,281	\$9,698,624

	Valuation Technique	Inputs Unobservable Input	General Range of Inputs
Nonrecurring measurements: Impaired Loans	Discounted Appraisals	Collateral Discounts	0-25%

BANK OF SOUTH CAROLINA CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

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

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

- a. Cash and due from banks, interest bearing deposits in other banks and federal funds sold  
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, 2014 and December 31, 2013, approximate market.  
  
The carrying value of mortgage loans held for sale approximates fair value.  
  
For lines of credit, the carrying value approximates fair value.

d.

Deposits

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

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## BANK OF SOUTH CAROLINA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following table presents the carrying amount, fair value, and placement in the fair value hierarchy of our financial instruments as of June 30, 2014 and December 31, 2013. This table excludes financial instruments for which the carrying amount approximates fair value. 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.

June 30, 2014

Fair Value Measurement

	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Instruments-Assets					
Loans	\$230,596,294	\$230,663,725	\$ —	\$—	\$230,663,725
Financial Instruments- Liabilities					
Deposits	\$321,852,674	\$321,851,739	\$ —	\$321,851,739	\$—

December 31, 2013

Fair Value Measurement

	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Instruments-Assets					
Loans	\$218,320,304	\$218,406,792	\$ —	\$—	\$218,406,792

Financial Instruments- Liabilities

Deposits	\$ 305,242,655	\$ 305,269,155	\$ —	\$ 305,269,155	\$ —
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## BANK OF SOUTH CAROLINA CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

	June 30, 2014	
	Notional	Fair
	Amount	Value
Off Balance Sheet Financial Instruments:		

Commitments to extend credit	\$55,110,403	\$ —
Standby letters of credit	557,593	—

	December 31, 2013	
	Notional	Fair
	Amount	Value
Off Balance Sheet Financial Instruments:		
Commitments to extend credit	\$64,830,461	\$ —
Standby letters of credit	557,593	—

NOTE 12: Recently Issued Accounting Pronouncements

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

On February 28, 2013, the FASB amended the liabilities topic to address obligations resulting from joint and several liability arrangements. The guidance addresses recognition of financial commitments arising from joint and several liability arrangements. Specifically, the amendments require recognition of financial commitments arising from loans, contracts, and legal rulings if we can be held liable for the entire claim. The amendments became effective for reporting periods beginning after December 15, 2013 and did not have a material effect on our financial statements.

In January 2014, the FASB amended the Receivables topic of the Accounting Standards Codification. The amendments are intended to resolve diversity in practice with respect to when a creditor should reclassify a collateralized consumer mortgage loan to other real estate owned (OREO). In addition, the amendments require a creditor reclassify a collateralized consumer mortgage loan to OREO upon obtaining legal title to the real estate collateral, or the borrower voluntarily conveying all interest in the real estate property to the lender to satisfy the loan through a deed in lieu of foreclosure or similar legal agreement. The amendments will be effective for interim and



annual reporting periods beginning after December 15, 2014, with early implementation of the guidance permitted. In implementing this guidance, assets that are reclassified from real estate to loans are measured at the carrying value of the real estate at the date of adoption. Assets reclassified from loans to real estate are measured at the lower of the net amount of the loan receivable or the fair value of the real estate less costs to sell at the date of adoption. We will apply the amendments prospectively using a modified retrospective approach. 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 (UNAUDITED)**

In May 2014, the FASB issued guidance to change the recognition of revenue from contracts with customers. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The guidance will be effective for reporting periods beginning after December 15, 2016. We will apply the guidance using a modified retrospective approach. We do not expect these amendments to have a material effect on our financial statements.

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

**NOTE 13: Subsequent Events**

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

**ITEM 2**

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**OR PLAN OF OPERATION**

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

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

advantage of the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1996 and are including this statement for the express purpose of availing the Company of protections of such safe harbor with respect to all “forward-looking statements” contained in this Form 10-Q. Forward looking statements may relate to, among other matters, the financial condition, results of operations, plans, objectives, future performance, and business of the Company. Forward-looking statements are based on many assumptions and estimates and are not guarantees of future performance. Actual results may differ materially from those anticipated in any forward-looking statements. The words “may”, “would”, “could”, “should”, “will”, “expect”, “anticipate”, “predict”, “project”, “potential”, “continue”, “assume”, “plan”, “forecast”, “goal”, and “estimate”, as well as similar expressions, are meant to identify such forward-looking statements. Potential risks and uncertainties that could cause our actual results to differ materially from those anticipated in our forward-looking statements include, without limitations, those described under the heading “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2013 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
- Current uncertainty in the financial service industry

These risks are exacerbated by the development over the last six years in national and international financial markets, and we are unable to predict what effect continued uncertainty in market conditions will have on us. There can be no assurance that the unprecedented developments experienced over the last six years will not materially and adversely affect our business, financial condition and results of operations.

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

## **Overview**

Bank of South Carolina Corporation (the Company) is a financial institution holding company headquartered in Charleston, South Carolina, with \$359,078,204 in assets as of June 30, 2014 and net income of \$2,065,725 for the six months ended June 30, 2014. The Company offers a broad range of financial services through its wholly-owned subsidiary, The Bank of South Carolina (the Bank). The Bank is a state-chartered commercial bank which operates primarily in the Charleston, Dorchester and Berkeley counties of South Carolina. The Bank's original and current concept is to be a full service financial institution specializing in personal service, responsiveness, and attention to detail to foster long standing relationships.

The following is a discussion of our financial condition as of June 30, 2014 as compared to December 31, 2013 and the results of operations for the three and six months ended June 30, 2014 as compared to the three and six months

ended June 30, 2013. The discussion and analysis identifies significant factors that have affected our financial position and operating results and should be read in conjunction with the financial statements and the related notes included in this report.

We derive most of our income from interest on loans and investments (interest earning 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, such as deposits. Another key measure is the spread between the yield we earn on these interest earning 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 and lease 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. The Allowance is increased or decreased through the provisioning process. For a detailed discussion on the allowance for loan losses see "Allowance for Loan Losses".

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

### **CRITICAL ACCOUNTING POLICIES**

We have adopted various accounting policies that govern the application of principles generally accepted in the United States and with general practices within the banking industry in the preparation of our financial statements. Our significant accounting policies are described in the footnotes to our unaudited consolidated financial statements as of June 30, 2014 and our notes included in the consolidated financial statements in our 2013 Annual Report on Form 10-K as filed with the SEC.

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

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

### **BALANCE SHEET**

#### **CASH AND CASH EQUIVALENTS**

Cash and cash equivalents include cash and noninterest-earning deposits, and interest-earning deposits. All amounts are readily convertible to cash and have maturities of less than 90 days. Total cash and cash equivalents increased 29.92% or \$6,618,624 to \$28,742,720 at June 30, 2014, from \$22,124,096 at December 31, 2013. This increase was primarily due to an increase in deposits.

Regulations set by the Federal Reserve require that we maintain certain average cash reserve balances. For the six months ended June 30, 2014 and 2013 our cash reserve requirement with the Federal Reserve was satisfied by vault cash.

## **LOANS**

We focus our lending activities on small and middle market businesses, professionals and individuals in our geographic markets. At June 30, 2014, outstanding loans (plus deferred loan fees of \$80,692) totaled \$230,596,294 which equaled 71.65% of total deposits and 64.22% of total assets. Substantially all loans were to borrowers located in our market area of Charleston, Dorchester and Berkeley counties of South Carolina.

The quality of our loan portfolio is contingent upon our risk selection and underwriting practices. Every credit with over \$100,000 in exposure is summarized by our Credit Department and reviewed by the Loan Committee on a monthly basis. The Board of Directors review credits over \$500,000 monthly with annual credit analyses conducted on these borrowers upon the receipt of updated financial information. Prior to any extension of credit, every loan request goes through sound credit underwriting. The Credit Department conducts detailed cash flow analysis on each proposal using the most current financial information. Relevant trends and ratios are evaluated.

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

	June 30, 2014	2013	December 31, 2013
Commercial loans	\$52,687,696	52,933,993	\$53,303,569
Commercial real estate:			
Commercial real estate construction	1,551,147	1,725,535	1,516,545
Commercial real estate other	111,800,212	102,514,184	104,740,578
Consumer:			
Consumer real estate	60,260,769	52,870,365	54,669,359
Consumer other	4,296,470	4,294,025	4,090,253
	230,596,294	214,338,102	218,320,304
Allowance for loan losses	(3,379,808 )	(3,359,915 )	(3,292,277 )
Loans, net	\$227,216,486	210,978,187	\$215,028,027

Percentage of Loans	June 30,		December 31,	
	2014	2013	2013	
Commercial loans	22.85 %	24.70 %	24.41 %	
Commercial real estate construction	.67 %	.80 %	.70 %	
Commercial real estate other	48.49 %	47.83 %	47.98 %	
Consumer real estate	26.13 %	24.67 %	25.04 %	
Consumer other	1.86 %	2.00 %	1.87 %	
Total	100.00 %	100.00 %	100.00 %	

### **INVESTMENT SECURITIES AVAILABLE FOR SALE**

We use the investment securities portfolio for several purposes. It serves as a vehicle to manage interest rate and prepayment risk, to generate interest and dividend income from investment of funds, to provide liquidity to meet funding requirements, and to provide collateral for pledges on public funds. Investments are classified into three categories (1) Held to Maturity (2) Trading and (3) Available for Sale. We believe that maintaining our securities in the Available for Sale category provides greater flexibility in the management of the overall investment portfolio. The average yield on investments at June 30, 2014 was 2.13% compared to 2.20% at December 31, 2013. The amortized



cost of the investments available for sale at June 30, 2014, June 30, 2013 and December 31, 2013 and percentage of each category to total investments are as follows:

## INVESTMENT PORTFOLIO

	June 30, 2014	June 30, 2013	December 31, 2013
US Treasury Notes	\$19,142,422	\$6,159,375	\$15,832,401
Government-Sponsored Enterprises	40,219,602	31,300,631	43,635,038
Municipal Securities	33,803,740	34,472,958	35,180,782
	\$93,165,764	\$71,932,964	\$94,648,221
US Treasury Notes	20.55	% 8.56	% 16.73
Government-Sponsored Enterprises	43.17	% 43.51	% 46.10
Municipal Securities	36.28	% 47.93	% 37.17
	100.00	% 100.00	% 100.00

All investment securities were classified as Available for Sale (debt and equity securities that may be sold under certain conditions), at June 30, 2014 and December 31, 2013. The securities were reported at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of shareholders' equity, net of income taxes. Unrealized losses on securities due to fluctuations in fair value are recognized when it is determined that an other than temporary decline in value has occurred. Gains or losses on the sale of securities are recognized on a specific identification, trade date basis. (See "non-interest income" for discussion on the sale of investment securities.)

The amortized cost and fair value of investment securities available for sale are summarized as follows as of June 30, 2014 and December 31, 2013:

	JUNE 30, 2014			
	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
U.S. Treasury Notes	\$19,258,500	\$ 2,559	\$ 118,637	\$19,142,422
Government-Sponsored Enterprises	40,207,462	145,804	133,664	40,219,602
Municipal Securities	31,909,356	1,933,533	39,149	33,803,740
Total	\$91,375,318	\$ 2,081,896	\$ 291,450	\$93,165,764
	DECEMBER 31, 2013			
	AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE

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U.S. Treasury Notes	\$15,841,901	\$ 58,429	\$ 67,929	\$15,832,401
Government-Sponsored Enterprises	43,582,119	363,981	311,062	43,635,038
Municipal Securities	33,706,898	1,599,638	125,754	35,180,782
Total	\$93,130,918	\$ 2,022,048	\$ 504,745	\$94,648,221

The amortized cost and fair value of investment securities available for sale at June 30, 2014, and December 31, 2013, by contractual maturity are as follows:

June 30, 2014

	AMORTIZED COST	ESTIMATED FAIR VALUE
Due in one year or less	\$8,339,600	\$8,435,710
Due in one year to five years	46,234,426	46,767,692
Due in five years to ten years	29,461,922	30,390,981
Due in ten years and over	7,339,370	7,571,381
Total	\$91,375,318	\$93,165,764

December 31, 2013

	AMORTIZED COST	ESTIMATED FAIR VALUE
Due in one year or less	\$11,048,145	\$11,147,251
Due in one year to five years	39,310,800	39,914,350
Due in five years to ten years	31,907,109	32,503,090
Due in ten years and over	10,864,864	11,083,530
Total	\$93,130,918	\$94,648,221

The fair value of investment securities available for sale with unrealized losses at June 30, 2014, and December 31, 2013, are as follows:

JUNE 30, 2014

Description of Securities	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury Notes	\$16,154,141	\$118,637	\$—	\$—	\$16,154,141	\$118,637
Government-Sponsored Enterprises	13,185,687	45,593	7,426,096	88,071	20,611,783	133,664
Municipal Securities	410,364	4,635	1,538,672	34,514	1,949,036	39,149
Total	\$29,750,192	\$168,865	\$8,964,768	\$122,585	\$38,714,960	\$291,450



## DECEMBER 31, 2013

Description of Securities	Less than 12 months		12 months or longer		Total	Unrealized
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Losses
U.S. Treasury Notes	\$9,713,619	\$67,929	\$—	\$ —	\$9,713,619	\$67,929
Government-Sponsored Enterprises	20,027,016	311,062	—	—	20,027,016	311,062
Municipal Securities	2,496,742	125,652	401,624	102	2,898,366	125,754
Total	\$32,237,377	\$504,643	\$401,624	\$ 102	\$32,639,001	\$504,745

At June 30, 2014, we had five US Treasury Notes with an unrealized loss of \$118,637, five Agency Notes with an unrealized loss of \$133,664 and three Municipal Securities with an unrealized loss of \$39,149. At December 31, 2013 we had three US Treasury Notes with an unrealized loss of \$67,929, five Agency Notes with an unrealized loss of \$311,062 and six Municipal Securities with an unrealized loss of \$125,754. The unrealized losses on investments were caused by interest rate increase. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the amortized cost of the investment. Therefore, these investments are not considered other-than-temporarily impaired. We have the ability to hold these investments until market price recovery or maturity.

DEPOSITS

Deposits remain our primary source of funding for loans and investments. Average interest bearing deposits provided funding for 63.54% of average earning assets for the six months ended June 30, 2014, and 66.07% for the twelve months ended December 31, 2013. There is strong competition from other financial institutions as well as consumer and commercial finance companies, insurance companies and brokerage firms located in our primary service area. 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, 2014	2013	December 31, 2013
Non-interest bearing demand	\$101,024,740	\$86,445,804	\$90,574,330
Interest bearing demand	79,982,199	84,876,741	78,576,851
Money market accounts	51,489,810	53,911,655	47,190,365
Certificates of deposit \$100,000 and over	49,830,228	45,171,414	52,516,487
Other time deposits	15,805,539	15,499,830	15,730,187
Other savings deposits	23,720,158	19,082,903	20,654,435
Total Deposits	\$321,852,674	\$304,988,347	\$305,242,655

Percentage of Deposits	June 30,	December 31,
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	2014		2013		2013	
Non-interest bearing demand	31.39	%	28.34	%	29.67	%
Interest bearing demand	24.85	%	27.83	%	25.74	%
Money market accounts	16.00	%	17.68	%	15.46	%
Certificates of deposit \$100,000 and over	15.48	%	14.81	%	17.21	%
Other time deposits	4.91	%	5.08	%	5.15	%
Other savings deposits	7.37	%	6.26	%	6.77	%
 Total Deposits	 100.00	 %	 100.00	 %	 100.00	 %

Deposits increased 5.53% or \$16,864,327 from June 30, 2013 to June 30, 2014 and increased 5.44% or \$16,610,019 from December 31, 2013 to June 30, 2014.

### **SHORT-TERM BORROWINGS**

At June 30, 2014 and December 31, 2013, we had no outstanding federal funds purchased with the option to borrow up to \$19,000,000 on short term lines of credit. In March 2012, we established a \$6 million REPO Line with Raymond James. There have been no borrowings under this agreement. We also established a Borrower-In-Custody arrangement with the Federal Reserve as a secondary source of liquidity. This arrangement permits us to retain possession of loans pledged as collateral to secure advances from the Federal Reserve Discount Window. Under this agreement we could borrow up to \$70 million and \$69 million at June 30, 2014 and December 31, 2013, respectively. There have been no borrowings under this arrangement.

### **Comparison of Three Months Ended June 30, 2014 to Three Months Ended June 30, 2013**

Net income increased \$65,853 or 6.31% to \$1,109,927, or basic and diluted earnings per share of \$.25 and \$.24, respectively, for the three months ended June 30, 2014, from \$1,044,074, or basic and diluted earnings per share of \$.23 and \$.23, respectively, for the three months ended June 30, 2013. Our return on average assets and average equity for the three months ended June 30, 2014 were 1.27% and 12.33%, respectively, compared with 1.27% and 11.98%, respectively, for the three months ended June 30, 2013.

### **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 \$61,653 or 1.96% to \$3,212,732 for the three months ended June 30, 2014 from \$3,151,079 for the three months ended June 30, 2013. The increase in net interest income was primarily due to an increase in interest and dividends from investment secu