BANK OF SOUTH CAROLINA CORP
Form 10-Q
November 09, 2018

United States
Securities and Exchange Commission

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended **September 30, 2018**

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 incorporation or organization)	(IRS Employer 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 registrant (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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 October 31, 2018, there were 5,510,917 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

	(Unaudited) September 30, 2018	(Audited) December 31, 2017
ASSETS		
Cash and due from banks	$8,187,758	$8,486,025
Interest-bearing deposits at the Federal Reserve	21,573,263	24,034,194
Investment securities available for sale	118,603,201	139,250,250
Mortgage loans to be sold	2,861,227	2,093,723
Loans	274,627,803	270,180,640
Less: Allowance for loan losses	(4,105,930)	(3,875,398)
Net loans	270,521,873	266,305,242
Premises, and equipment and leasehold improvements, net	2,314,004	2,244,525
Other real estate owned	—	435,479
Accrued interest receivable	1,471,368	1,720,920
Other assets	2,844,688	1,996,140
Total assets	$428,377,382	$446,566,498
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Non-interest bearing demand	$131,015,152	$139,256,748
Interest bearing demand	96,573,047	108,967,196
Money market accounts	78,552,052	77,833,728
Time deposits over $250,000	21,861,748	18,624,924
Other time deposits	21,460,316	23,295,492
Other savings deposits	33,578,943	34,910,212
Total deposits	383,041,258	402,888,300
Accrued interest payable and other liabilities	2,036,590	913,563
Total liabilities	385,077,848	403,801,863

Shareholders' equity		
Common stock - no par 12,000,000 shares authorized; Issued 5,776,869 shares at September 30, 2018 and 5,753,743 shares at December 31, 2017. Shares outstanding 5,510,312 and 5,488,207 at September 30, 2018 and December 31, 2017, respectively		
Additional paid in capital	46,838,852	37,236,566
Retained earnings	1,295,509	8,471,780
Treasury stock: 266,557 shares as of September 30, 2018 and 265,536 shares as of December 31, 2017	(2,268,264)	(2,247,415)
Accumulated other comprehensive loss, net of income taxes	(2,566,563)	(696,296)
Total shareholders' equity	43,299,534	42,764,635
Total liabilities and shareholders' equity	$428,377,382	$446,566,498

See accompanying notes to consolidated financial statements.

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BANK OF SOUTH CAROLINA CORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Three Months Ended September 30,	
	2018	2017
Interest and fee income		
Loans, including fees	$3,905,954	$3,364,293
Taxable securites	465,180	409,055
Tax-exempt securities	171,916	251,172
Other	122,536	92,512
Total interest and fee income	4,665,586	4,117,032
Interest expense		
Deposits	195,434	110,625
Total interest expense	195,434	110,625
Net interest income	4,470,152	4,006,407
Provision for loan losses	100,000	20,000
Net interest income after provision for loan losses	4,370,152	3,986,407
Other income		
Service charges and fees	284,046	278,204
Mortgage banking income	168,004	149,379
Gain on sales of securities	—	45,820
Other non-interest income	6,643	8,479
Total other income	458,693	481,882
Other expense		
Salaries and employee benefits	1,595,706	1,487,207
Net occupancy expense	389,973	399,534
Other operating expenses	797,319	597,797
Net other real estate owned expenses	33,476	—
Total other expense	2,816,474	2,484,538
Income before income tax expense	2,012,371	1,983,751
Income tax expense	234,218	543,098
Net Income	$1,778,153	$1,440,653
Weighted average shares outstanding		
Basic	5,506,649	5,475,504

Diluted	5,589,549	5,588,410
Basic income per common share	$0.32	$0.26
Diluted income per common share	$0.32	$0.26

See accompanying notes to consolidated financial statements.

BANK OF SOUTH CAROLINA CORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Nine Months Ended September 30,	
	2018	2017
Interest and fee income		
Loans, including fees	$11,169,692	$9,727,886
Taxable securites	1,406,094	1,147,811
Tax-exempt securities	575,657	778,259
Other	258,019	187,782
Total interest and fee income	13,409,462	11,841,738
Interest expense		
Deposits	444,961	313,929
Total interest expense	444,961	313,929
Net interest income	12,964,501	11,527,809
Provision for loan losses	230,000	52,500
Net interest income after provision for loan losses	12,734,501	11,475,309
Other income		
Service charges and fees	875,709	835,643
Mortgage banking income	558,473	825,003
Gain on sales of securities	4,735	45,820
Other non-interest income	22,817	23,769
Total other income	1,461,734	1,730,235
Other expense		
Salaries and employee benefits	4,744,878	4,457,778
Net occupancy expense	1,195,364	1,157,442
Other operating expenses	2,111,968	1,884,928
Net other real estate owned expenses	57,613	46,143
Total other expense	8,109,823	7,546,291
Income before income tax expense	6,086,412	5,659,253
Income tax expense	969,672	1,606,127
Net Income	$5,116,740	$4,053,126
Weighted average shares outstanding		
Basic	5,496,346	5,459,006
Diluted	5,579,989	5,568,799

Basic income per common share	$0.93	$0.74
Diluted income per common share	$0.92	$0.73

See accompanying notes to consolidated financial statements.

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BANK OF SOUTH CAROLINA CORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Three Months Ended September 30,	
	2018	2017
Net Income	$1,778,153	$1,440,653
Other comprehensive loss		
Unrealized loss on securities arising during the period	(548,497)	(339,956)
Reclassification adjustment for securities gains realized in net income	—	45,820
Other comprehensive loss before tax	(548,497)	(294,136)
Income tax effect related to items of other comprehensive loss before tax	115,052	100,006
Other comprehensive loss after tax	(433,445)	(194,130)
Total comprehensive income	$1,344,708	$1,246,523

	Nine Months Ended September 30,	
	2018	2017
Net Income	$ 5,116,740	$ 4,053,126
Other comprehensive (loss) income		
Unrealized (loss) gain on securities arising during the period	(2,362,691)	1,242,599
Reclassification adjustment for securities gains realized in net income	(4,735)	45,820
Other comprehensive (loss) income before tax	(2,367,426)	1,288,419
Income tax effect related to items of other comprehensive (loss) income before tax	497,159	(455,637)
Other comprehensive (loss) income after tax	(1,870,267)	832,782
Total comprehensive income	$ 3,246,473	$ 4,885,908

See accompanying notes to consolidated financial statements.

BANK OF SOUTH CAROLINA CORPORATION AND SUBSIDIARY CONSOLIDATED STATEMENTS OF

SHAREHOLDERS' EQUITY FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2018 AND 2017 (UNAUDITED)

	Additional Paid in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
December 31, 2017	$37,236,566	$8,471,780	$(2,247,415)	$(696,296)	$42,764,635
Net income	—	5,116,740	—	—	5,116,740
Other comprehensive loss	—	—	—	(1,870,267)	(1,870,267)
Stock option exercises	214,418	—	(20,849)	—	193,569
Stock-based comp expense	53,526	—	—	—	53,526
Cash dividends ($0.45 per common share)	—	(2,958,669)	—	—	(2,958,669)
Common stock dividend, 10%	9,334,342	(9,334,342)	—	—	—
September 30, 2018	$46,838,852	$1,295,509	$(2,268,264)	$(2,566,563)	$43,299,534

	Additional Paid in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
December 31, 2016	$36,824,022	$6,643,476	$(2,247,415)	$(607,109)	$40,612,974
Net income	—	4,053,126	—	—	4,053,126
Other comprehensive loss	—	—	—	832,782	832,782
Stock option exercises	294,342	—	—	—	294,342
Stock-based comp expense	54,404	—	—	—	54,404
Cash dividends ($0.43 per common share)	—	(2,138,160)	—	—	(2,138,160)
September 30, 2017	$37,172,768	$8,558,442	$(2,247,415)	$225,673	$43,709,468

See accompanying notes to consolidated financial statements.

BANK OF SOUTH CAROLINA CORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine Months Ended September 30, 2018	2017
Cash flows from operating activities:		
Net income	$5,116,740	$4,053,126
Adjustments to reconcile net income net cash provided by operating activities:		
Depreciation	144,158	142,859
Gain on sale of investment securities	(4,735)	(45,820)
Loss on sale of other real estate owned	33,476	—
Loss on disposal of premises, equipment, and leasehouse improvements, net	428	—
Valuation and other adjustments to other real estate owned	23,637	46,143
Provision for loan losses	230,000	52,500
Stock-based compensation expense	53,526	54,404
Deferred income taxes	(166,739)	(567,272)
Net amortization of unearned discounts on investment securities available for sale	227,847	293,080
Origination of mortgage loans held for sale	(43,444,865)	(43,420,076)
Proceeds from sale of mortgage loans held for sale	42,677,361	44,688,456
Decrease in accrued interest receivable and other assets	64,902	285,460
Increase in accrued interest payable and other liabilities	486,474	350,649
Net cash provided by operating activities	5,442,210	5,933,509
Cash flows from investing activities:		
Proceeds from calls and maturities of investment securities available for sale	6,599,927	4,380,870
Proceeds from sale of investment securities available for sale	21,434,634	20,231,265
Purchase of investment securities available for sale	(9,978,050)	(30,088,916)
Proceeds from sale of other real estate owned	378,366	—
Net decrease in loans	(4,446,631)	(8,664,506)
Purchase of premises, equipment, and leasehold improvements, net	(214,065)	(99,067)
Net cash provided by (used in) investing activities	13,774,181	(14,240,354)
Cash flows from financing activities:		
Net (decrease) increase in deposit accounts	(19,847,042)	14,024,187
Dividends paid	(2,322,116)	(2,084,817)
Stock options exercised	193,569	294,342
Net cash (used in) provided by financing activities	(21,975,589)	12,233,712
Net (decrease) increase in cash and cash equivalents	(2,759,198)	3,926,867
Cash and cash equivalents at the beginning of the period	32,520,219	26,242,330
Cash and cash equivalents at the end of the period	$29,761,021	$30,169,197
Cash paid during the period for:		
Interest	$391,972	$365,558
Income Taxes	$963,571	$2,055,063

Supplemental disclosures for non-cash investing and financing activity:		
Change in unrealized gain on securities available for sale, net of income taxes	$1,870,267	$832,782
Change in dividends payable	$636,553	$53,343
Transfer of loans to other real estate owned	$—	$90,832

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 the Company and its wholly-owned subsidiary, 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 ("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 Securities and Exchange Commission ("SEC") on March 3, 2018. 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, deferred tax assets, the fair value of financial instruments 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 period's presentation. Such reclassifications had no effect on shareholders' equity or the net income as previously reported.

Income per share

Basic income per share is computed by dividing net income by the weighted-average number of common shares outstanding during the period. Dilutive income 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. Retroactive recognition has been given for the effects of all stock dividends.

On March 22, 2018, the Company approved a 10% stock dividend payable May 31, 2018 to shareholders of record as of April 30, 2018. Shares and share data have been adjusted retroactively to reflect the stock dividend. In recognition of the Company's 2018 performance to-date, on September 27, 2018, we declared a special cash dividend of $0.10 per share to shareholders of record October 9, 2018, payable October 31, 2018, to reward our shareholders.

BANK OF SOUTH CAROLINA CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers, Topic 606.* The core principle of the new standard 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. This guidance also includes expanded disclosure requirements that result in an entity providing users of financial statements with comprehensive information about the nature, amount, timing, and uncertainty of revenue and cash flows arising from the entity's contracts with customers. The guidance became effective January 1, 2018. The amendment does not apply to revenue associated with financial instruments, such as loans and investment securities available for sale, and therefore had no material effect on our consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10); Recognition and Measurement of Financial Instruments and Financial Liabilities.* This update addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments became effective on January 1, 2018 and did not have a material effect on the financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842),* which revises 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 results of operations and cash flows, and financial position.

In March 2016, the FASB issued ASU 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net),* 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 guidance became effective January 1, 2018. The Company completed an assessment of revenue streams and a review of related contracts potentially affected by the ASU and, based on this assessment, the Company concluded that the ASU did not materially change the method in which the Company currently recognizes revenue for these revenue streams. As such, a cumulative effect adjustment to opening retained earnings was not deemed necessary.

In April 2016, the FASB issued ASU 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*, to clarify guidance related to identifying performance obligations and accounting for licenses of intellectual property. The amendment became effective for the Company January 1, 2018 and did not have a material effect on the financial statements.

In May 2016, the FASB issued ASU 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow- Scope Improvements and Practical Expedients*, to clarify guidance related to collectability, noncash consideration, presentation of sales tax, and transition. The amendment became effective on January 1, 2018 and did not have a material effect on the financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,* to change the accounting for credit losses and modify the impairment model for certain debt securities. The amendments will be effective for the Company for reporting periods beginning after December 15, 2019. Early adoption is permitted for all organizations for periods beginning after December 15, 2018. The Company is currently evaluating the effect that implementation of the new standard will have on its financial position, results of operations, and cash flows.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments,* to clarify how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendment became effective on January 1, 2018 and did not have a material effect on the financial statements.

BANK OF SOUTH CAROLINA CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In December 2016, the FASB issued ASU 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*. These corrections make a limited number of revisions to several pieces of the revenue recognition standard issued in 2014. The amendment became effective on January 1, 2018 and did not have a material effect on the financial statements.

In January 2017, the FASB issued ASU 2017-01, *Clarifying the Definition of a Business*, which provided guidance to assist with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The update is intended to address concerns that the existing definition of a business has been applied too broadly and has resulted in many transactions being recorded as business acquisitions that in substance are more akin to asset acquisitions. The amendments became effective on January 1, 2018 and did not have a material effect on the financial statements.

In February 2017, the FASB issued ASU 2017-05, *Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*, to clarify the scope of established guidance on nonfinancial asset derecognition, issued as part of ASU 2014-09, *Revenue from Contracts with Customers*, as well as accounting for partial sales of nonfinancial assets. The amendments conform the derecognition guidance on nonfinancial assets with the model for transactions in the new revenue standard. The amendments became effective on January 1, 2018 and did not have a material effect on the financial statements.

In March 2017, the FASB issued ASU 2017-08, *Receivables – Nonrefundable Fees and Other Costs* (Subtopic 310-20): *Premium Amortization of Purchased Callable Debt Securities*, which shortens the amortization period for the premium to the earliest call date. The amendment will be effective for the Company for interim and annual periods beginning after December 15, 2018. Early adoption is permitted. The Company does not expect this amendment to have a material effect on its financial statements.

In February 2018, the FASB issued ASU 2018-02, *Income Statement – Reporting Comprehensive Income* (Topic 220): *Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*, which requires companies to reclassify the stranded effects in other comprehensive income to retained earnings as a result of the change in the tax rates under the Tax Cuts and Jobs Act (the 2017 Tax Act"). The Company adopted this pronouncement early by retrospective application to each period in which the effect of the change in the tax rate under the 2017 Tax Act is recognized. The impact of the reclassification from other comprehensive income to retained earnings was included in the Statement of Changes in Shareholders' Equity for the year ended December 31, 2017.

In February 2018, the FASB issued ASU 2018-03, *Technical Corrections and Improvements to Financial Instruments—Overall* (Subtopic 825-10): *Recognition and Measurement of Financial Assets and Financial Liabilities* to clarify certain aspects of the guidance issued in ASU 2016-01. The amendments will be effective for the third quarter of 2018 subsequent to adopting the amendments in ASU 2016-01. All entities may early adopt these amendments for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, as long as they have adopted ASU 2016-01. The Company does not expect these amendments to have a material effect on its financial statements.

In March 2018, the FASB issued ASU 2018-4, *Investments—Debt Securities* (Topic 320) *and Regulated Operations* (Topic 980): *Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 117 and SEC Release No. 33-9273* which incorporate into the Accounting Standards Codification recent SEC guidance which was issued in order to make the relevant interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The amendments were effective upon issuance. The Company does not expect these amendments to have a material effect on its financial statements.

In March 2018, the FASB issued ASU 2018-05, *Income Taxes* (Topic 740): *Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118*. The amendments incorporate into the Accounting Standards Codification recent SEC guidance related to the income tax accounting implications of the Tax Cuts and Jobs Act. The amendments were effective upon issuance. The Company does not expect these amendments to have a material effect on its financial statements.

In May 2018, the FASB amended the Financial Services – Depository and Lending Topic of the ASC to remove outdated guidance related to Circular 202. The amendments were effective upon issuance and did not have a material effect on the financial statements.

In July 2018, the FASB issued ASU 2018-10, *Codification Improvements to Topic 842 – Leases.* This update clarifies how to apply certain aspects of the new leases standard. The amendments are effective for reporting periods beginning after December 15, 2018. The Company does not expect these amendments to have a material effect on its financial statements.

In July 2018, the FASB issued ASU 2018-11, *Leases (Topic 842): Targeted Improvements,* which gives entities another option for transition and to provide lessors with a practical expedient. The amendments are effective for reporting periods beginning after December 15, 2018. The Company does not expect these amendments to have a material effect on its financial statements.

In August 2018, the FASB amended the Fair Value Measurement Topic of the ASC. The amendments remove, modify, and add certain fair value disclosure requirements based on the concepts in the FASB Concepts Statement, Conceptual Framework for Financial Reporting—Chapter 8: Notes to Financial Statements. The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted. An entity is permitted to early adopt any removed or modified disclosures upon issuance of this ASU and delay adoption of the additional disclosures until their effective date. The Company does not expect these amendments to have a material effect on its financial statements.

In August 2018, the FASB amended the Intangibles—Goodwill and Other Topic of the ASC to align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The amendments will be effective for the Company for fiscal years beginning after December 15, 2019. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its 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.

BANK OF SOUTH CAROLINA CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2: Investment Securities

The amortized cost, gross unrealized gains and losses, and estimated fair value of investment securities available for sale are summarized as follows:

	September 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasury Notes	$32,967,828	$—	$(1,128,095)	$31,839,733
Government-Sponsored Enterprises	60,727,011	—	(2,156,361)	58,570,650
Municipal Securities	28,632,346	115,836	(555,364)	28,192,818
Total	$122,327,185	$115,836	$(3,839,820)	$118,603,201

	December 31, 2017			
	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
U.S. Treasury Notes	$35,970,990	$—	$(411,145)	$35,559,845
Government-Sponsored Enterprises	64,444,315	—	(887,811)	63,556,504
Municipal Securities	40,191,502	487,545	(545,146)	40,133,901
Total	$140,606,807	$487,545	$(1,844,102)	$139,250,250

The amortized cost and estimated fair value of investment securities available for sale as of September 30, 2018 and December 31, 2017, by contractual maturity are as follows:

	September 30, 2018		December 31, 2017	
		Estimated		**Estimated**

	Amortized Cost	**Fair Value**	**Amortized Cost**	**Fair Value**
Due in one year or less	$4,251,445	$4,259,579	$11,554,040	$11,546,968
Due in one year to five years	99,801,938	96,746,338	72,622,056	72,124,395
Due in five years to ten years	17,858,947	17,228,111	53,290,088	52,576,036
Due in ten years and over	414,855	369,173	3,140,623	3,002,851
Total	$122,327,185	$118,603,201	$140,606,807	$139,250,250

Investment securities pledged to secure deposits had a fair value of $40.5 million and $49.4 million as of September 30, 2018 and December 31, 2017, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, as of September 30, 2018 and December 31, 2017. We believe that all unrealized losses have resulted from temporary changes in the interest rates and current market conditions 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 Value	Gross Unrealized Loss	#	Fair Value	Gross Unrealized Loss	#	Fair Value	Gross Unrealized Loss
September 30, 2018									
Available for sale									
U.S. Treasury Notes	7	$31,839,733	$(1,128,095)	—	$—	$—	7	$31,839,733	$(1,128,095
Government-Sponsored Enterprises	9	43,775,540	(1,322,126)	4	14,795,110	(834,235)	13	58,570,650	(2,156,361
Municipal Securities	19	8,143,784	(200,329)	19	7,387,750	(355,035)	38	15,531,534	(555,364
Total	35	$83,759,057	$(2,650,550)	23	$22,182,860	$(1,189,270)	58	$105,941,917	$(3,839,820
December 31, 2017									
Available for sale									
U.S. Treasury Notes	8	$35,559,845	$(411,145)	—	$—	$—	8	$35,559,845	$(411,145)
Government-Sponsored Enterprises	12	53,275,064	(462,174)	3	10,281,440	(425,637)	15	63,556,504	(887,811)
Municipal Securities	20	7,815,221	(134,998)	29	11,056,185	(410,148)	49	18,871,406	(545,146)
Total	40	$96,650,130	$(1,008,317)	32	$21,337,625	$(835,785)	72	$117,987,755	$(1,844,102)

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

	Three Months Ended September 30, 2018	2017
Gross proceeds	$—	$20,231,265
Gross realized gains	—	154,692
Gross realized losses	—	(108,872)

	Nine Months Ended September 30, 2018	2017
Gross proceeds	$21,434,634	$20,231,265
Gross realized gains	104,634	154,692
Gross realized losses	(99,899)	(108,872)

For the nine months ended September 30, 2018, the tax provision related to these gains was $994.

<u>Note 3: Loans and Allowance for Loan Losses</u>

Major classifications of loans (net of deferred loan fees of $159,418 as of September 30, 2018 and $152,047 as of December 31, 2017) are as follows:

	September 30, 2018	December 31, 2017
Commercial loans	$55,372,741	$51,723,237
Commercial real estate:		
Construction	4,997,437	2,317,857
Other	140,978,428	140,186,324
Consumer:		
Real estate	68,179,290	70,797,973
Other	5,099,907	5,155,249
	274,627,803	270,180,640

Allowance for loan losses	(4,105,930)	(3,875,398)
Loans, net	$ 270,521,873	$ 266,305,242

We had $99.9 million and $113.4 million of loans pledged as collateral to secure funding with the Federal Reserve Bank ("FRB") Discount Window as of September 30, 2018 and as of December 31, 2017, 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. Our portfolio is graded in its entirety.

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, and where applicable, 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, and 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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, and bankruptcy is a possibility. 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 tables illustrate credit quality by class and internally assigned grades as of September 30, 2018 and December 31, 2017. “Pass” includes loans internally graded as excellent, good and satisfactory.

September 30, 2018

	Commercial	Commercial Real Estate - Construction	Commercial Real Estate - Other	Consumer Real Estate	Consumer Other	Total
Pass	$52,477,930	$4,997,437	$136,098,726	$65,689,519	$4,796,814	$264,060,426
Watch	1,047,571	—	2,907,641	1,610,019	212,117	5,777,348
OAEM	—	—	593,359	—	—	593,359
Substandard	1,847,240	—	1,378,702	879,752	90,976	4,196,670
Doubtful	—	—	—	—	—	—
Loss	—	—	—	—	—	—
Total	$55,372,741	$4,997,437	$140,978,428	$68,179,290	$5,099,907	$274,627,803

December 31, 2017

	Commercial	**Commercial Real Estate - Construction**	**Commercial Real Estate - Other**	**Consumer Real Estate**	Consumer Other	Total
Pass	$47,456,205	$ 1,936,335	$134,401,977	$68,570,298	$4,933,696	$257,298,511

Watch	2,403,978	381,522	3,605,621	1,934,802	185,746	8,511,669
OAEM	—	—	610,806	—	—	610,806
Substandard	1,863,054	—	1,567,920	292,873	35,807	3,759,654
Doubtful	—	—	—	—	—	—
Loss	—	—	—	—	—	—
Total	$51,723,237	$2,317,857	$140,186,324	$70,797,973	$5,155,249	$270,180,640

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following tables include an aging analysis of the recorded investment in loans segregated by class:

	September 30, 2018						
	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	$284,995	$229,396	$—	$514,391	$54,858,350	$55,372,741	$ —
Commercial Real Estate - Construction	—	—	—	—	4,997,437	4,997,437	—
Commercial Real Estate - Other	209,806	—	571,292	781,098	140,197,330	140,978,428	—
Consumer Real Estate	—	—	—	—	68,179,290	68,179,290	—
Consumer Other	13,622	—	—	13,622	5,086,285	5,099,907	—
Total	$508,423	$229,396	$571,292	$1,309,111	$273,318,692	$274,627,803	$ —

	December 31, 2017						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total	Recorded Investment ≥ 90 Days and Accruing
Commercial	$3,531	$192,846	$—	$196,377	$51,526,860	$51,723,237	$ —
Commercial Real Estate - Construction	—	—	—	—	2,317,857	2,317,857	—
Commercial Real Estate - Other	—	—	651,578	651,578	139,534,746	140,186,324	—
Consumer Real Estate	—	—	—	—	70,797,973	70,797,973	—
Consumer Other	10,302	—	34,107	44,409	5,110,840	5,155,249	34,107
Total	$13,833	$192,846	$685,685	$892,364	$269,288,276	$270,180,640	$ 34,107

There were no loans as of September 30, 2018 and two loans as of December 31, 2017 over 90 days past due and still accruing.

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

	Loans Receivable on Non-Accrual	
	September 30, 2018	**December 31, 2017**
Commercial	$27,230	$41,651
Commercial Real Estate - Construction	—	—
Commercial Real Estate - Other	571,292	790,208
Consumer Real Estate	—	—
Consumer Other	3,405	—
Total	$601,927	$831,859

The following tables set forth the changes in the allowance for loan losses and an allocation of the allowance for loan losses by class for the three and nine months ended September 30, 2018 and September 30, 2017. The allowance for loan losses 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 September 30, 2018

	Commercial	Commercial Real Estate - Construction	Commercial Real Estate - Other	Consumer Real Estate	Consumer Other	Total
Allowance for Loan Losses:						
Beginning Balance	$1,343,760	$ 29,091	$ 972,038	$589,051	$1,073,524	$4,007,464
Charge-offs	—	—	—	—	(12,794)	(12,794)
Recoveries	11,000	—	—	—	260	11,260
Provisions	146,752	4,404	10,334	(84,365)	22,875	100,000
Ending Balance	$1,501,512	$ 33,495	$ 982,372	$504,686	$1,083,865	$4,105,930

Nine Months Ended September 30, 2018

	Commercial	Commercial Real Estate - Construction	Commercial Real Estate - Other	Consumer Real Estate	Consumer Other	Total
Allowance for Loan Losses:						
Beginning Balance	$1,403,588	$ 23,638	$1,549,755	$796,918	$101,499	$3,875,398

Charge-offs	(31,250)	—	—	—	(84,637)	(115,887)
Recoveries	13,500	—	56,827	45,412	680	116,419
Provisions	115,674	9,857	(624,210)	(337,644)	1,066,323	230,000
Ending Balance	$1,501,512	$ 33,495	$982,372	$504,686	$1,083,865	$4,105,930

Three Months Ended September 30, 2017

	Commercial	Commercial Real Estate - Construction	Commercial Real Estate - Other	Consumer Real Estate	Consumer Other	Total
Allowance for Loan Losses:						
Beginning Balance	$1,628,672	$ 52,763	$1,382,919	$771,853	$91,308	$3,927,515
Charge-offs	—	—	—	(80,787)	(2,489)	(83,276)
Recoveries	—	—	—	21,000	1,720	22,720
Provisions	403,920	(7,235)	(209,108)	(150,697)	(16,880)	20,000
Ending Balance	$2,032,592	$ 45,528	$1,173,811	$561,369	$73,659	$3,886,959

Nine Months Ended September 30, 2017

	Commercial	Commercial Real Estate - Construction	Commercial Real Estate - Other	Consumer Real Estate	Consumer Other	Total
Allowance for Loan Losses:						
Beginning Balance	$1,545,188	$ 51,469	$1,374,706	$726,391	$153,863	$3,851,617
Charge-offs	—	—	—	(80,786)	(4,863)	(85,649)
Recoveries	—	—	—	63,000	5,491	68,491
Provisions	487,404	(5,941)	(200,895)	(147,236)	(80,832)	52,500
Ending Balance	$2,032,592	$ 45,528	$1,173,811	$561,369	$73,659	$3,886,959

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

September 30, 2018

	Commercial	Commercial Real Estate - Construction	Commercial Real Estate - Other	Consumer Real Estate	Consumer Other	Total
Allowance for Loan Losses						
Individually evaluated for impairment	$918,694	$—	$40,614	$—	$23,046	$982,354
Collectively evaluated for impairment	582,818	33,495	941,758	504,686	1,060,819	3,123,576
Total Allowance for Loan Losses	$1,501,512	$33,495	$982,372	$504,686	$1,083,865	$4,105,930
Loans Receivable						
Individually evaluated for impairment	$1,807,958	$—	$1,390,661	$879,753	$23,046	$4,101,418
Collectively evaluated for impairment	53,564,783	4,997,437	139,587,767	67,299,537	5,076,861	270,526,385
Total Loans Receivable	$55,372,741	$4,997,437	$140,978,428	$68,179,290	$5,099,907	$274,627,803

December 31, 2017

	Commercial	Commercial Real Estate - Construction	**Commercial Real Estate - Other**	Consumer Real Estate	**Consumer Other**	Total
Allowance for Loan Losses						
Individually evaluated for impairment	$832,571	$—	$99,523	$43,042	$34,107	$1,009,243
Collectively evaluated for impairment	571,017	23,638	1,450,232	753,876	67,392	2,866,155
Total Allowance for Losses	$1,403,588	$23,638	$1,549,755	$796,918	$101,499	$3,875,398
Loans Receivable						
Individually evaluated for impairment	$1,812,461	$—	$1,584,821	$292,873	$34,107	$3,724,262
Collectively evaluated for impairment	49,910,776	2,317,857	138,601,503	70,505,100	5,121,142	266,456,378
Total Loans Receivable	$51,723,237	$2,317,857	$140,186,324	$70,797,973	$5,155,249	$270,180,640

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of September 30, 2018 and December 31, 2017, loans individually evaluated for impairment and the corresponding allowance for loan losses are presented in the following table:

	Impaired and Restructured Loans As of September 30, 2018			December 31, 2017		
	Unpaid Principal Balance	Recorded Investment	Related Allowance	**Unpaid Principal Balance**	**Recorded Investment**	**Related Allowance**
With no related allowance recorded:						
Commercial	$124,983	$124,983	—	$152,490	$152,490	$—
Commercial Real Estate - Construction	—	—	—	—	—	—
Commercial Real Estate - Other	981,021	981,021	—	1,058,601	1,058,601	—
Consumer Real Estate	879,753	879,753	—	249,754	249,754	—
Consumer Other	—	—	—	—	—	—
Total	1,985,757	1,985,757	—	1,460,845	1,460,845	—
With an allowance recorded:						
Commercial	1,682,975	1,682,975	918,694	1,659,971	1,659,971	832,571
Commercial Real Estate - Construction	—	—	—	—	—	—
Commercial Real Estate - Other	409,640	309,839	40,614	626,021	526,220	99,523
Consumer Real Estate	—	—	—	43,119	43,119	43,042
Consumer Other	23,046	23,046	23,046	34,107	34,107	34,107
Total	2,115,661	2,015,860	982,354	2,363,218	2,263,417	1,009,243
Total						
Commercial	1,807,958	1,807,958	918,694	1,812,461	1,812,461	832,571
Commercial Real Estate - Construction	—	—	—	—	—	—
Commercial Real Estate - Other	1,390,661	1,290,860	40,614	1,684,622	1,584,821	99,523
Consumer Real Estate	879,753	879,753	—	292,873	292,873	43,042

Consumer Other	23,046	23,046	23,046	34,107	34,107	34,107
Total	$4,101,418	$4,001,617	$982,354	$3,824,063	$3,724,262	$1,009,243

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

	Three Months Ended September 30,			
	2018		2017	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Commercial	$128,953	$ 2,178	$165,274	$ 2,429
Commercial Real Estate - Construction	—	—	—	—
Commercial Real Estate - Other	984,499	10,378	1,276,906	9,999
Consumer Real Estate	879,753	8,562	451,318	5,972
Consumer Other	—	—	—	—
Total	1,993,205	21,118	1,893,498	18,400
With an allowance recorded:				
Commercial	1,702,976	26,195	1,685,930	26,484
Commercial Real Estate - Construction	—	—	—	—
Commercial Real Estate - Other	411,107	2,739	933,243	2,792
Consumer Real Estate	—	—	43,119	462
Consumer Other	24,518	329	34,579	463
Total	2,138,601	29,263	2,696,871	30,201
Commercial	1,831,929	28,373	1,851,204	28,913
Commercial Real Estate - Construction	—	—	—	—
Commercial Real Estate - Other	1,395,606	13,117	2,210,149	12,791
Consumer Real Estate	879,753	8,562	494,437	6,434
Consumer Other	24,518	329	34,579	463
Total	$4,131,806	$ 50,381	$4,590,369	$ 48,601

	Nine Months Ended September 30,			
	2018		2017	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:				
Commercial	$137,445	$ 6,551	$173,964	$ 7,416
Commercial Real Estate - Construction	—	—	—	—

Commercial Real Estate - Other	983,516	29,724	1,275,402	23,084
Consumer Real Estate	879,753	37,847	451,025	16,938
Consumer Other	—	—	—	—
Total	2,000,714	74,122	1,900,391	47,438
With an allowance recorded:				
Commercial	1,742,743	81,553	1,711,259	76,544
Commercial Real Estate - Construction	—	—	—	—
Commercial Real Estate - Other	419,231	8,209	930,420	5,367
Consumer Real Estate	—	—	43,119	1,296
Consumer Other	27,469	1,084	36,056	1,419
Total	2,189,443	90,846	2,720,854	84,626
Commercial	1,880,188	88,104	1,885,223	83,960
Commercial Real Estate - Construction	—	—	—	—
Commercial Real Estate - Other	1,402,747	37,933	2,205,822	28,451
Consumer Real Estate	879,753	37,847	494,144	18,234
Consumer Other	27,469	1,084	36,056	1,419
Total	$4,190,157	$ 164,968	$4,621,245	$ 132,064

In general, the modification or restructuring of a debt is considered a troubled debt restructuring (“TDR”) if we, for economic or legal reasons related to a borrower’s financial difficulties, grant a concession to the borrower that we would not otherwise consider. As of September 30, 2018, there was one TDR with a balance of $23,046, compared to one TDR with a total balance of $33,300 as of December 31, 2017. These TDRs were granted extended payment terms with no principal reduction. All TDRs were performing as agreed as of September 30, 2018 and December 31, 2017, respectively. No TDRs defaulted during the nine months ended September 30, 2018 and 2017, which were modified within the previous twelve months.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 the 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. GAAP 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.

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 paragraphs describe the valuation methodologies used for assets and liabilities recorded at fair value on a recurring basis:

Investment Securities Available for Sale

Investment Securities 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.

We had no embedded derivative instruments requiring separate accounting treatment. We had freestanding derivative instruments consisting of fixed rate conforming loan commitments as interest rate locks and commitments to sell fixed rate conforming loans on a best efforts basis. We do not currently engage in hedging activities. Based on short term fair value of the mortgage loans held for sale (derivative contract), our derivative instruments were immaterial to our consolidated financial statements as of September 30, 2018 and December 31, 2017.

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Assets and liabilities measured at fair value on a recurring basis as of September 30, 2018 and December 31, 2017 are as follows:

	Balance as of September 30, 2018			
	Level 1	Level 2	Level 3	Total
U.S. Treasury Notes	$31,839,733	$—	$—	$31,839,733
Government-Sponsored Enterprises	—	58,570,650	—	58,570,650
Municipal Securities	—	21,649,135	6,543,683	28,192,818
Total	$31,839,733	$80,219,785	$6,543,683	$118,603,201

	Balance as of December 31, 2017			
	Level 1	Level 2	Level 3	Total
U.S. Treasury Notes	$35,559,845	$—	$—	$35,559,845
Government-Sponsored Enterprises	—	63,556,504	—	63,556,504
Municipal Securities	—	28,675,012	11,458,889	40,133,901
Total	$35,559,845	$92,231,516	$11,458,889	$139,250,250

There were no liabilities recorded at fair value on a recurring basis as of September 30, 2018 or December 31, 2017.

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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 months and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Beginning Balance	$7,096,356	$12,488,995	$11,458,889	$13,977,857
Total realized/unrealized gains (losses)				
Included in earnings	—	—	—	—
Included in other comprehensive income	52,254	13,852	119,721	254,940
Purchases, issuances, and settlements net of maturities	(604,927)	(593,719)	(5,034,927)	(2,323,719)
Transfers in and/or out of Level 3	—	—	—	—
Ending Balance	$6,543,683	$11,909,128	$6,543,683	$11,909,078

There were no transfers between fair value levels during the nine months ended September 30, 2018 or September 30, 2017.

The following paragraphs describe the 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. 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.

In accordance with 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. 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

Mortgage Loans to be Sold

Mortgage loans to be sold are carried at the lower of cost or market value. The fair values of mortgage loans to be sold 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 tables present information about certain assets and liabilities measured at fair value on a nonrecurring basis as of September 30, 2018 and December 31, 2017:

	September 30, 2018			
	Quoted Market Price in active markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Impaired loans	$ —	$—	$ 2,229,800	$ 2,229,800
Other real estate owned	—	—	—	—
Loans held for sale	—	2,861,227	—	2,861,227
Total	$ —	$ 2,861,227	$ 2,229,800	$ 5,091,027

	December 31, 2017			
	Quoted Market Price in active markets (Level 1)	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**

Impaired loans	$—	$—	$1,735,051	$1,735,051
Other real estate owned	—	—	435,479	435,479
Loans held for sale	—	2,093,723	—	2,093,723
Total	$—	$2,093,723	$2,170,530	$4,264,253

There were no liabilities measured at fair value on a nonrecurring basis as of September 30, 2018 or December 31, 2017.

BANK OF SOUTH CAROLINA CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table provides information describing the unobservable inputs used in Level 3 fair value measurements as of September 30, 2018 and 2017:

	Valuation Technique	**Inputs Unobservable Input**	**General Range of Inputs**
Impaired Loans	Appraisal Value/Comparison Sales/Other Estimates	Appraisals and/or Sales of Comparable Properties	Appraisals Discounted 10% to 20% for Sales Commissions and Other Holding Costs
Other Real Estate Owned	Appraisal Value/Comparison Sales/Other Estimates	Appraisals and/or Sales of Comparable Properties	Appraisals Discounted 10% to 20% for Sales Commissions and Other Holding Costs

Accounting standards require disclosure of fair value information 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.

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 paragraphs describe the methods and assumptions we use in estimating the fair values of financial instruments:

a. Cash and due from banks, interest-bearing deposits at the Federal Reserve

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

b. Investment securities available for sale

Investment securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is 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.

c. Loans, net

During the first quarter of 2018, the Company adopted ASU 2016-01, *Recognition and Measurement of Financial Assets and Liabilities*. The amendments included within this standard, which are applied prospectively, require the Company to measure and disclose fair value of balance sheet financial instruments using an exit price notion. Prior to adopting the amendments included in the standard, the Company measured fair value under an entry price notion. The entry price notion previously applied by the Company used a discounted cash flows technique to calculate the present value of expected future cash flows for a financial instrument. The exit price notion uses the same approach, but also incorporates other factors, such as enhanced credit risk, illiquidity risk, and market factors that sometimes exist in exit prices in dislocated markets.

As of September 30, 2018, the technique used by the Company to estimate the exit price of the loan portfolio consists of similar procedures to those used as of December 31, 2017, but with added emphasis on both illiquidity risk and credit risk not captured by the previously applied entry price notion. The fair value of the Company’s loan portfolio has always included a credit risk assumption in the determination of the fair value of its loans. This credit risk assumption is intended to approximate the fair value that a market participant would realize in a hypothetical orderly transaction. The Company’s loan portfolio is initially fair valued using a segmented approach. The Company divides its loan portfolio into the following categories: variable rate loans, impaired loans and all other loans. The results are then adjusted to account for credit risk as described above. However, under the new guidance, the Company believes a further credit risk discount must be applied through the use of a discounted cash flow model to compensate for illiquidity risk, based on certain assumptions included within the discounted cash flow model, primarily the use of discount rates that better capture inherent credit risk over the lifetime of a loan. This consideration of enhanced credit risk provides an estimated exit price for the Company’s loan portfolio.

For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values approximate carrying values. Fair values for impaired loans are estimated using discounted cash flow models or based on the fair value of the underlying collateral.

BANK OF SOUTH CAROLINA CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of December 31, 2017, the fair value of the Company’s loan portfolio included a credit risk assumption in the determination of the fair value of its loans. This credit risk assumption was intended to approximate the fair value that a market participant would realize in a hypothetical orderly transaction. The Company’s loan portfolio is initially fair valued using a segmented approach. The Company divides its loan portfolio into the following categories: variable rate loans, impaired loans and all other loans. The results are then adjusted to account for credit risk. For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values approximate carrying values. Fair values for impaired loans are estimated using discounted cash flow models or based on the fair value of the underlying collateral. For other loans, fair values are estimated using discounted cash flow models, using current market interest rates offered for loans with similar terms to borrowers of similar credit quality. The values derived from the discounted cash flow approach for each of the above portfolios are then further discounted to incorporate credit risk. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price as of December 31, 2017.

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. 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.

f. 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 September 30, 2018 and December 31, 2017.

Fair Value Measurements at September 30, 2018

	Carrying Amount	Estimated Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Cash and due from banks	$8,187,758	$8,187,758	$8,187,758	$—	$—
Interest-bearing deposits at the Federal Reserve	21,573,263	21,573,263	21,573,263	—	—
Investment securities available for sale	118,603,201	118,603,201	31,839,733	80,219,785	6,543,683
Mortgage loans to be sold	2,861,227	2,861,227	—	2,861,227	—
Loans, net	270,521,873	264,323,028	—	—	264,323,028
Accrued interest receivable	1,471,368	1,471,368	—	1,471,368	—
Financial Liabilities:					
Demand deposits	339,719,194	339,719,194	—	339,719,194	—
Time deposits	43,322,064	44,653,911	—	44,653,911	—
Accrued interest payable	149,179	149,179	—	149,179	—

Fair Value Measurements at December 31, 2017

	Carrying Amount	Estimated Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Cash and due from banks	$8,486,025	$8,486,025	$8,486,025	$—	$—
Interest-bearing deposits at the Federal Reserve	24,034,194	24,034,194	24,034,194	—	—
Investment securities available for sale	139,250,250	139,250,250	35,559,845	92,231,516	11,458,889
Mortgage loans to be sold	2,093,723	2,093,723	—	2,093,723	—
Loans, net	266,305,242	265,277,204	—	—	265,277,204
Accrued interest receivable	1,720,920	1,720,920	—	1,720,920	—
Financial Liabilities:					
Demand deposits	360,967,884	360,967,884	—	360,967,884	—
Time deposits	41,920,416	40,722,870	—	40,722,870	—
Accrued interest payable	96,190	96,190	—	96,190	—

BANK OF SOUTH CAROLINA CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, after giving retroactive effect to a stock dividend paid on May 31, 2018. 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.

The following table is a summary of the reconciliation of average shares outstanding for the three months ended September 30:

	2018	2017
Net income	$1,778,153	$1,440,653
Weighted average shares outstanding	5,506,649	5,475,504
Effect of dilutive shares	82,900	112,906
Weighted average shares outstanding - diluted	5,589,549	5,588,410
Earnings per share - basic	$0.32	$0.26
Earnings per share - diluted	$0.32	$0.26

The following table is a summary of the reconciliation of average shares outstanding for the nine months ended September 30:

	2018	2017
Net income	$5,116,740	$4,053,126
Weighted average shares outstanding	5,496,346	5,459,006
Effect of dilutive shares	83,643	109,793
Weighted average shares outstanding - diluted	5,579,989	5,568,799
Earnings per share - basic	$0.93	$0.74
Earnings per share - diluted	$0.92	$0.73

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

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 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, 2017 as filed with 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 and ability to attract and retain key personnel

Technological changes

Increased cybersecurity risk, including potential business disruptions or financial losses

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 and changes in political conditions

Reputational risk

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 $428.4 million in assets as of September 30, 2018, and net income of $1.8 million and $5.1 million for the three and nine months ended September 30, 2018, 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-bearing assets 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-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 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 portfolio while the unfunded reserve provides for potential losses related to unfunded lending commitments.

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 identify significant factors that have affected our financial position and operating results as of and for the periods ending September 30, 2018 and December 31, 2017, 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 judgments 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 September 30, 2018, have remained unchanged from the disclosures presented in our Annual Report on Form 10-K for the year ended December 31, 2017, except with respect to calculations of the fair value of our loan portfolio as described in Note 4 to our Financial Statements above.

Balance Sheet

Cash and Cash Equivalents

Total cash and cash equivalents decreased 8.48% or $2.7 million to $29.8 million as of September 30, 2018, from $32.5 million as of December 31, 2017. Funds are placed in interest-bearing deposit accounts at the Federal Reserve until opportunities arise for investment in higher yielding assets.

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 continuing assessment of cash flows, the level of current and expected loan production, 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.

As of September 30, 2018, our available for sale investment portfolio included U. S. Treasury Notes, Government-Sponsored Enterprises and Municipal Securities with a fair market value of $118.6 million and an amortized cost of $122.3 million for a net unrealized loss of approximately $3.7 million. As of September 30, 2018 and December 31, 2017, our investment securities portfolio represented approximately 27.69% and 31.18% of our total assets, respectively. The average yield on our investment securities was 2.08% and 2.01% as of September 30, 2018 and December 31, 2017, respectively.

During the nine months ended September 30, 2018, seven Municipal Securities totaling $2.7 million matured and thirteen Municipal Securities in the amount of $3.5 million were called. We sold four Government Sponsored Enterprise securities, eight Municipal Securities, and one U.S. Treasury Note during the nine months ended September 30, 2018 for gross proceeds of $21.4 million. We also purchased two Government Sponsored Enterprise securities with a face value of $10.0 million during the nine months ended September 30, 2018. The remaining proceeds from the sale of investment securities were used to fund daily liquidity needs as well as loan growth.

Loans

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

Net loans increased $4.2 million, or 1.58%, to $270.5 million as of September 30, 2018 from $266.3 million as of December 31, 2017. The increase in loans is due to improved loan demand.

The following table is a summary of our loan portfolio composition (net of deferred fees of $159,418 as of September 30, 2018 and $152,047 as of December 31, 2017) and the corresponding percentage of total loans as of the dates indicated.

	September 30, 2018		December 31, 2017	
	Amount	Percent	Amount	Percent
Commercial	$ 55,372,741	20.16 %	$ 51,723,237	19.14 %
Commercial Real Estate - Construction	4,997,437	1.82 %	2,317,857	0.86 %
Commercial Real Estate - Other	140,978,428	51.33 %	140,186,324	51.89 %
Consumer Real Estate	68,179,290	24.83 %	70,797,973	26.20 %
Consumer Other	5,099,907	1.86 %	5,155,249	1.91 %
Total	274,627,803	100.00 %	270,180,640	100.00 %
Allowance for loan losses	(4,105,930)		(3,875,398)	
Total loans, net	$ 270,521,873		$ 266,305,242	

Nonperforming Assets

Nonperforming 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 nonperforming 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 September 30, 2018, 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. As of September 30, 2018, we determined that we had one loan totaling $23,046 that we considered a TDR. As of December 31, 2017, we had one loan totaling $33,300 that we considered a TDR.

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Nonperforming 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). Nonperforming assets include other real estate owned.

The following table is a summary of our nonperforming assets:

	September 30, 2018	December 31, 2017
Commercial	$27,230	$41,651
Commercial Real Estate - Other	571,292	790,208
Consumer Other	3,405	—
Total nonaccruing loans	601,927	831,859
Other real estate owned	—	435,479
Total nonperforming assets	$601,927	$1,267,338

The decrease in total nonperforming assets is related to the sale of other real estate owned and improving real estate market.

Allowance for Loan Losses

The allowance for loan losses was $4.1 million as of September 30, 2018 and $3.9 million as of December 31, 2017, or 1.50% and 1.43% of outstanding loans, respectively. As of September 30, 2018 and December 31, 2017, the allowance for loan losses represented 656.98% and 305.79% of the total amount of nonperforming loans, respectively. Based on the level of coverage on nonperforming loans and analysis of our loan portfolio, we believe the allowance for loan losses as of September 30, 2018 is adequate.

As of September 30, 2018, impaired loans totaled $4.1 million, for which $2.1 million of these loans had a reserve of approximately $1.0 million allocated in the allowance for loan losses. Comparatively, impaired loans totaled $3.7 million at December 31, 2017, and $2.3 million of these loans had a reserve of approximately $1.0 million allocated in the allowance for loan losses.

During the three months ended September 30, 2018, we recorded $12,794 in charge-offs and $11,260 in recoveries on loans previously charged-off, resulting in net charge-offs of $1,534. During the same period in 2017, we recorded $83,276 of charge-offs and $22,720 of recoveries on loans previously charged-off, resulting in net recoveries of $60,556. During the nine months ended September 30, 2018, we recorded $115,887 of charge-offs and $116,419 of recoveries on loans previously charged-off, for net recoveries of $532. Comparatively, we recorded $85,649 of charge-offs and $68,491 of recoveries on loans previously charged-off, resulting in net charge-offs of $17,158 for the nine months ended September 30, 2017.

Deposits

Deposits remain our primary source of funding for loans and investments. Average interest bearing deposits provided funding for 60.52% of average earning assets for the nine months ended September 30, 2018, and 61.14% for the twelve months ended December 31, 2017. 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:

	September 30, 2018		December 31, 2017	
	Amount	Percent	Amount	Percent
Deposits				
Non-interest bearing demand	$131,015,152	34.20 %	$139,256,748	34.56 %
Interest bearing demand	96,573,047	25.21 %	108,967,196	27.05 %
Money market accounts	78,552,052	20.51 %	77,833,728	19.32 %
Time deposits over $250,000	21,861,748	5.71 %	18,624,924	4.62 %
Other time deposits	21,460,316	5.60 %	23,295,492	5.78 %
Other savings deposits	33,578,943	8.77 %	34,910,212	8.66 %
Total deposits	$383,041,258	100.00%	$402,888,300	100.00%

Deposits decreased 4.93% or $19.8 million from December 31, 2017 to September 30, 2018. These decreases were primarily due to normal, seasonal fluctuations and the anticipated loss of temporary deposits.

As of September 30, 2018 and December 31, 2017, deposits with an aggregate deficit balance of $31,616 and $66,479, respectively were re-classified as other loans.

Comparison of Three Months Ended September 30, 2018 to Three Months Ended September 30, 2017

Net income increased $337,500 or 23.43% to $1.8 million, or basic and diluted earnings per share of $0.32, for the three months ended September 30, 2018, from $1.4 million, or basic and diluted earnings per share of $0.26, for the three months ended September 30, 2017. Our annualized return on average assets and average equity for the three months ended September 30, 2018 were 1.63% and 16.19%, respectively, compared with 1.32% and 13.01%, respectively, for the three months ended September 30, 2017.

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 $463,745 or 11.58% to $4.5 million for the three months ended September 30, 2018 from $4.0 million for the three months ended September 30, 2017. This increase was primarily due to interest and fee income on loans related to increases in market interest rates. Average loans increased $17.1 million or 6.46% to $281.1 million for the three months ended September 30, 2018, compared to $264.0 million for the three months ended September 30, 2017. The yield on average loans (including fees) was 5.83% and 5.29% for the three months ended September 30, 2018 and September 30, 2017, respectively. Interest income on loans increased $541,661 for the three months ended September 30, 2018 to $3.7 million from $3.2 million for the three months ended September 30, 2017.

The average balance of interest bearing deposits at the Federal Reserve decreased $4.9 million or 17.43% to $23.6 million for the three months ended September 30, 2018, with a yield of 2.09% as compared to $28.5 million for the three months ended September 30, 2017, with a yield of 1.97%.

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 September 30, 2018, we had a provision of $100,000 compared to a provision of $20,000 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 for loan losses.

Non-Interest Income

Other income decreased $23,189 or 4.81% to $458,693 for the three months ended September 30, 2018, from $481,882 for the three months ended September 30, 2017. We had realized gains of $45,820 from the sales of investment securities during the three months ended September 30, 2017. However, there were no gains on sale of investment securities during the three months ended September 30, 2018. The decrease in gains on sales of investment securities was offset by an increase of $18,625 in mortgage banking income, which is the result of increased mortgage-related activity occurring in the current period.

Non-Interest Expense

Non-interest expense increased $331,936 or 13.36% to $2.8 million for the three months ended September 30, 2018 from $2.5 million for the three months ended September 30, 2017. This increase was primarily due to an increase in salaries and employee benefits of $108,499, loss on sale of other real estate owned of $33,476, and amortization expense of $141,995 related to our investment in a 2018 Federal Historic Renovation Tax Credit.

Income Tax Expense

We incurred income tax expense of $234,218 for the three months ended September 30, 2018 as compared to $543,098 during the same period in 2017. Our effective tax rate was 11.64% and 27.38% for the three months ended September 30, 2018 and 2017, respectively. The decrease in the effective tax rate during the 2018 period is a result of the 2017 Tax Act that reduced the U.S. corporate income tax rate from 34% to 21% for tax years beginning after December 31, 2017, as well as our investment in a 2018 Federal Historic Renovation Tax Credit generated from the extensive renovation of a historic building located in Union, South Carolina. This transaction closed on August 31, 2018.

Comparison of Nine Months Ended September 30, 2018 to Nine Months Ended September 30, 2017

Net income increased $1,063,614 or 26.24% to $5.1 million, or basic and diluted earnings per share of $0.93 and $0.92, respectively, for the nine months ended September 30, 2018, from $4.1 million, or basic and diluted earnings per share of $0.74 and $0.73, respectively, for the nine months ended September 30, 2017. Our annualized return on average assets and average equity for the nine months ended September 30, 2018 were 1.59% and 15.72%, respectively, compared with 1.28% and 12.66%, respectively, for the nine months ended September 30, 2017.

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 $1.5 million or 12.46% to $13.0 million for the nine months ended September 30, 2018 from $11.5 million for the nine months ended September 30, 2017. This increase was primarily due to increases in market interest rates. Average loans increased $14.4 million or 5.50% to $276.5 million for the nine months ended September 30, 2018, compared to $262.0 million for the nine months ended September 30, 2017. The yield on average loans was 5.66% and 5.33% for the nine months ended September 30, 2018 and 2017, respectively. Interest income on loans increased $1.4 million for the nine months ended September 30, 2018 to $11.2 million from $9.7 million for the nine months ended September 30, 2017.

The average balance of interest bearing deposits at the Federal Reserve decreased $4.3 million or 18.99% to $18.7 million for the nine months ended September 30, 2018, with a yield of 1.35% as compared to $23.0 million for the nine months ended September 30, 2017, with a yield of 1.09%.

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 nine months ended September 30, 2018, we had a provision of $230,000 compared to a provision of $52,500 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 for loan losses.

Non-Interest Income

Other income decreased $268,501 or 15.52% to $1.5 million for the nine months ended September 30, 2018, from $1.7 million for the nine months ended September 30, 2017. This reduction was primarily due to a reduction in mortgage banking income, which decreased $266,530 or 32.31% due to a decrease in originations. For the nine months ended September 30, 2017, we had realized gains of $45,820 from the sale of investment securities compared to $4,735 in realized gains during the nine months ended September 30, 2018.

Non-Interest Expense

Non-interest expense increased $563,532 or 7.47% to $8.1 million for the nine months ended September 30, 2018 from $7.5 million for the nine months ended September 30, 2017. The increase was primarily due to an increase in salaries and employee benefits of $287,100 or 6.44% from $4.7 million for the nine months ended September 30, 2017 to $4.5 million for the nine months ended September 30, 2018 in addition to amortization expense of $141,995 related to our investment in a 2018 Federal Historic Renovation Tax Credit.

Income Tax Expense

We incurred income tax expense of $735,454 for the nine months ended September 30, 2018 as compared to $1,063,029 during the same period in 2017. Our effective tax rate was 15.93% and 28.38% for the nine months ended September 30, 2018 and 2017, respectively. The decrease in the effective tax rate during the 2018 period is a result of the 2017 Tax Act that reduced the U.S. corporate income tax rate from 34% to 21% for tax years beginning after December 31, 2017, as well as our investment in a 2018 Federal Historic Renovation Tax Credit generated from the extensive renovation of a historic building located in Union, South Carolina. This transaction closed on August 31, 2018.

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 $95.9 million and $92.9 million as of September 30, 2018 and December 31, 2017, respectively.

Standby letters of credit represent either 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 our obligation 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 as of September 30, 2018 and December 31, 2017 was $1.2 million.

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 $2.9 million as of September 30, 2018, to sell loans held for sale of $2.9 million, compared to forward sales commitments of $2.1 million at December 31, 2017, to sell loans held for sale of $2.1 million. The fair value of these commitments was not significant as of September 30, 2018 or December 31, 2017. 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 $15.2 million as of September 30, 2018 and $13.4 million at December 31, 2017. For the nine months ended September 30, 2018 and September 30, 2017, 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, interest-bearing deposits in other banks, federal funds sold, investments available for sale, other short-term investments and mortgage loans held for sale. Our primary liquid assets accounted for 34.15% and 38.93% of total assets as of September 30, 2018 and December 31, 2017, 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. As of September 30, 2018, we had unused short-term lines of credit totaling approximately $23.0 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 liquidation of 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. As of September 30, 2018, we could borrow up to $104.7 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 $250,000 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. As of September 30, 2018 and December 31, 2017, our liquidity ratio was 34.98% and 37.68%, 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 stock. Total shareholders’ equity as of September 30, 2018 was $43.2 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 as of September 30, 2018 and December 31, 2017 was 17.11% and 15.69%, respectively.

As of September 30, 2018, 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 10.00%, 8.00%, 6.50% and 5.00%, 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 8.00%, 6.00%, 4.50%, and 4.00%, 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 intends to open a North Charleston office in 2019. The Bank of South Carolina will be the anchor tenant in a two-story building at the corner of Highway 78 and Ingleside Drive, occupying the entire first floor. At this time, the commitments for capital expenditures related to this office are not yet determined.

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 September 30, 2018 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/Executive 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/Executive Vice President concluded that, as of September 30, 2018, 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/Executive 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/Executive Vice President, the Company's management has evaluated the effectiveness of its internal control over financial reporting as of September 30, 2018, 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 September 30, 2018. Based on this assessment, management believes that as of September 30, 2018, 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 September 30, 2018, 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 Bank's Compliance Officer, Risk Management Officer and Elliott Davis, LLC (separately and jointly) to discuss audit, financial and related matters. Elliott Davis, LLC, the Compliance Officer, and the Risk Management Officer have direct access to the Audit and Compliance Committee.

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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.

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	2018 Proxy Statement (Filed with 2017 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)
	Lease Agreement for 1071 Morrison Drive, Charleston, SC (Filed with March 31, 2013 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)
	Employee Stock Ownership Plan, Restated (Filed with 2011 Proxy Statement)
	Employee Stock Ownership Plan, Restated (Filed with 2016 10-K)
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)
10.12	Extension to Lease Agreement for 256 Meeting Street (Filed with September 30, 2017 10-Q)
10.13	North Charleston Lease Agreement (Filed with June 30, 2017 10-Q)
10.14	Sublease Amendment for Parking Facilities at 256 Meeting Street (Filed with September 30, 2017 10-Q)
14.0	Code of Ethics (Filed with 2004 10-KSB)
21.0	List of Subsidiaries of the Registrant (Filed with 1995 10-KSB)
	The Registrant's only subsidiary is The Bank of South Carolina (Filed with 1995 10-KSB)
31.1	Certification pursuant to Rule 13a-14(a)/15d-14(a) by Chief Executive Officer
31.2	Certification pursuant to Rule 13a-14(a)/15d-14(a) by Chief Financial Officer
32.1	Certification pursuant to Section 1350
32.2	Certification pursuant to Section 1350
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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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
November 9, 2018	
	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/Executive Vice President