BANK OF SOUTH CAROLINA CORP
Form 10-K
March 03, 2017

U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2016

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________ to __________

Commission file number: 0-27702

BANK OF SOUTH CAROLINA CORPORATION
(Exact name of registrant 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)	(Zip Code)

Issuer’s telephone number: (843) 724-1500

Securities registered under Section 12(b) of the Exchange Act:

Common Stock
(Title of Class)

Securities registered under Section 12(g) of the Exchange Act: NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

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 and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for a shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10K or any amendment to this Form 10-K.

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

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

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

Aggregate market value of the voting stock held by non-affiliates, computed by reference to the closing price of such stock on June 30, 2016 was: $51,069,297

As of February 23, 2017, the Registrant has outstanding 4,962,189 shares of common stock.

BANK OF SOUTH CAROLINA CORPORATION

AND SUBSIDIARY

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PART I

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This report, 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-K. 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,”, “potential,” “continue,” “assum “intend,” “plan,” “forecast,” “goal,” and “estimate,” as well as similar expressions, are meant to identify such forward-looking statements. Potential risks and uncertainties that could cause our actual results to differ materially from those anticipated in our forward-looking statements include, without limitations, those described under the heading “Risk Factors” in this Annual Report on Form 10-K for the year ended December 31, 2016 as filed with the Securities and Exchange Commission (the “SEC”) and the following:

Risk from changes in economic, monetary policy, and industry conditions

Changes in interest rates, shape of the yield curve, deposit rates, the net interest margin and funding sources

Market risk (including net income at risk analysis and economic value of equity risk analysis) and inflation

Risk inherent in making loans including repayment risks and changes in the value of collateral

Loan growth, the adequacy of the allowance for loan losses, provisions for loan losses, and the assessment of problem loans

Level, composition, and re-pricing characteristics of the securities portfolio

Deposit growth, change in the mix or type of deposit products and services

Continued availability of senior management

Technological changes

Ability to control expenses

Changes in compensation

Risks associated with income taxes including potential for adverse adjustments

Changes in accounting policies and practices

Changes in regulatory actions, including the potential for adverse adjustments

Recently enacted or proposed legislation

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

We will undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made to reflect the occurrence of unanticipated events. In addition, certain statements in future filings with the SEC, in our press releases, and in oral and written statements, which are not statements of historical fact, constitute forward-looking statements.

Item 1. **Business**

General

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.

Market Area

The Bank operates as an independent, community oriented, commercial bank providing a broad range of financial services and products. We have four banking house locations: 256 Meeting Street, Charleston, SC, 100 North Main Street, Summerville, SC, 1337 Chuck Dawley Boulevard, Mt. Pleasant, SC and 2027 Sam Rittenberg Boulevard, Charleston, SC. We intend to open a banking office in North Charleston, SC on Highway 78 and Ingleside Boulevard in the future (copy of the lease incorporated as Exhibit 10.8 in the 2013 10-K and copy of the Assignment and Assumption of Lease incorporated as Exhibit 10.9, First Amendment to the Lease incorporated as Exhibit 10.10 and Second Amendment to the Lease incorporated as Exhibit 10.11 in the 2015 10-K).

The primary economic drivers of our market area are tourism, manufacturing and medical services. In addition, we have one of the busiest container ports in the United States as well as a Boeing plant in North Charleston, SC. In October 2009, Boeing selected a site in North Charleston SC, for a 787 Dreamliner final assembly and delivery line. Boeing South Carolina has added the IT Centers of Excellence, Engineering Design Center, Boeing Research & Technology Center and Propulsion South Carolina to its North Charleston campus and added a painting facility in 2016. Future development in our market area includes both a Volvo and Mercedes plant.

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

The Company ("BKSC") is publicly traded on the National Association of Securities Dealers Automated Quotations ("NASDAQ"), and is under the reporting authority of the SEC. All of our electronic filings with the SEC, including our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and other documents filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, are accessible at no cost on our website, http://www.banksc.com, through the “Investor Relations” link. Our filings are also available through the SEC’s web site at http://www.sec.gov or by calling 1-800-SEC-0330.

Competition

The financial services industry is highly competitive. We face competition in attracting deposits and originating loans based upon a variety of factors including:

interest rates offered on deposit accounts

interest rates charged on loans

credit and service charges

the quality of services rendered

the convenience of banking facilities and other delivery channels

in the case of loans, relative lending limits and

technology

We compete with commercial banks, savings institutions, finance companies, credit unions and other financial services companies. Many of our larger commercial bank competitors have greater name recognition and offer certain services that we do not. However, we believe that we have developed an effective competitive advantage in our market area that includes Charleston, Berkeley and Dorchester counties of South Carolina by emphasizing our exceptional service levels, and knowledge of local trends and conditions.

Lending Activities

We focus our lending activities on small and middle market businesses, professionals and individuals in our geographic markets and typically require a personal guarantee. Our primary lending activities are commercial real estate, one-to-four-family residential mortgage loans, commercial business loans and home equity loans and lines of credit. Our largest category of loans is commercial real estate. Most loans are to borrowers located in our market area of Charleston, Dorchester and Berkeley Counties of South Carolina.

Commercial Real Estate Loans

At December 31, 2016, $123.0 million, or 47.19%, of our loan portfolio consisted of commercial real estate loans, excluding commercial construction loans. Properties securing our commercial real estate loans are primarily comprised of business owner-occupied properties, small office buildings and office suites, and income-producing real estate.

In the underwriting of commercial real estate loans, we generally lend up to the lesser of 80% of the appraised value or the purchase price of the property. We base our decision to lend primarily on the economic viability of the property and the creditworthiness of the borrower. In evaluating a proposed commercial real estate loan, we emphasize the ratio of the property’s projected net cash flow to the loan’s debt service requirement computed after deduction for an appropriate vacancy factor and reasonable expenses. We typically require property casualty insurance, title insurance, earthquake insurance, casualty insurance, and, if appropriate, flood insurance, in order to protect our security interest in the underlying property.

Commercial real estate loans generally carry higher credit risks, as they typically involve larger loan balances concentrated with single borrowers or groups of related borrowers. In addition, the payment of loans secured by income-producing properties typically depends on the successful operation of the property, as repayment of the loan generally is dependent, in large part, on sufficient income from the property to cover operating expenses and debt service. Changes in economic conditions not within the control of the borrower or lender could affect the value of the underlying collateral or the future cash flow of the property.

Commercial Loans

At December 31, 2016, $52.3 million, or 20.06%, of our loan portfolio consisted of commercial loans. We originate various types of secured and unsecured commercial loans to customers in our market areas in order to provide customers with working capital and for other general business purposes. The terms of these loans generally range from less than one year to a maximum of 10 years. These loans bear either a fixed interest rate or an interest rate linked to a variable market index.

Commercial credit decisions are based upon our credit assessment of each applicant. We evaluate the applicant’s ability to repay in accordance with the proposed terms of the loan and we assess the risks involved. In addition to evaluating the applicant’s financial statements, we consider the adequacy of the primary and secondary sources of repayment for the loan. Credit agency reports of the applicant’s personal credit history supplement our analysis of the applicant’s creditworthiness. In addition, collateral supporting a secured transaction is analyzed to determine its marketability. Commercial business loans generally have higher interest rates than residential loans of similar duration because they have a higher risk of default with repayment generally depending on the successful operation of the borrower’s business and the sufficiency of any collateral.

One-to-Four-Family Residential Loans

One-to-four family residential loans were $30.7 million, or 11.78% of the loan portfolio at December 31, 2016. One-to-four family residential loans consist primarily of loans secured by first or second mortgages on primary residences, and are originated as adjustable-rate or fixed-rate loans for the purchase or refinancing of a mortgage. These loans are collateralized by owner-occupied properties located in the Company’s market area. The Company currently originates residential mortgage loans for our portfolio with loan-to-value ratios of up to 80% for traditional owner-occupied homes.

Home Equity Loans and Lines of Credit

At December 31, 2016, $41.6 million, or 15.99% of our loan portfolio consisted of home equity loans and lines of credit. In addition to traditional one-to-four-family residential mortgage loans, we offer home equity loans and lines of credit that are secured by the borrower's primary or secondary residence. Our home equity loans and lines of credit are currently originated with adjustable rates of interest, with a floor. Home equity loans and lines of credit are generally underwritten with the same criteria that we use to underwrite one-to-four-family residential mortgage loans. For a borrower's primary residence, home equity loans and lines of credit are typically underwritten with a loan-to-value ratio of 80% when combined with the principal balance of the existing mortgage loan, while the maximum loan-to-value ratio on secondary residences is 70% when combined with the principal balance of the existing mortgage loan. We require a current appraisal or internally prepared real estate evaluations on home equity loans and lines of credit. At the time we close a home equity loan or line of credit, we record a mortgage to perfect our security interest in the underlying collateral.

Construction Loans

At December 31, 2016, our portfolio included $4.8 million of one-to-four-family residential construction loans or 1.83% of our loan portfolio. Other construction loans comprised $1.2 million, or 0.46% of our loan portfolio. We make construction loans to owner-occupiers of residential properties, and to businesses for commercial properties. Advances on construction loans are made in accordance with a schedule reflecting the cost of construction, but are generally limited to 80% loan-to-value ratio based on the appraised value upon completion. Repayment of construction loans on non-residential properties is normally attributable to rental income, income from the borrower's operating entity or the sale of the property. Repayment of loans on income-producing property is normally scheduled following completion of construction, when permanent financing is obtained. Construction loans are interest-only during the construction period, which typically does not exceed 12 months and are often paid-off with permanent financing.

Before making a commitment to fund a construction loan, we require an appraisal of the property by a state-certified or state-licensed appraiser. We review and inspect properties before disbursement of funds during the term of the construction loan.

Construction financing generally involves greater credit risk than long-term financing on improved, owner-occupied real estate. Risk of loss on a construction loan depends largely upon the accuracy of the initial estimate of the value of the property at completion of construction compared to the estimated cost (including interest) of construction and other assumptions. Construction loans also expose us to risk that improvements will not be completed on time in accordance with specifications and projected costs.

Consumer Loans

Consumer loans totaled $7.0 million and were 2.69% of the loan portfolio at December 31, 2016. These loans are originated for various consumer purposes, including the purchase of automobiles, boats, and for other legitimate personal purposes. These loans generally have relatively low balances.

Consumer loans may entail greater credit risk than residential mortgage loans, particularly in the case of consumer loans that are unsecured or are secured by rapidly depreciable assets, such as automobiles. In addition, consumer loan collections are dependent on the borrower’s continuing financial stability, and thus are more likely to be affected by adverse personal circumstances. The application of various federal and state laws, including bankruptcy and insolvency laws, may also limit the amount which can be recovered on such loans.

Mortgage Loan Originations

All residential loans that we originate are underwritten pursuant to our policies and procedures. We originate both adjustable-rate and fixed-rate loans. Our loan origination and sales activity may be adversely affected by a rising interest rate environment that typically results in decreased loan demand.

Loan Approval Procedures and Authority

Our lending activities follow written, non-discriminatory underwriting standards and loan origination procedures established by the Board of Directors of the Bank. The loan approval process is intended to assess the borrower's ability to repay the loan and value of the collateral that will secure the loan. To assess the borrower's ability to repay, we review the borrower's employment, credit history, and information on the historical and projected income and expenses of the borrower.

The objectives of our lending program are to:

1. Establish a sound asset structure.
2. Provide a sound and profitable loan portfolio to:
   a) Protect the depositor's funds
   b) Maximize the shareholders' return on their investment
3. Promote the stable economic growth and development of the market area served by the Bank.
4. Comply with all Regulatory Agency requirements and applicable law.

The individual secured/unsecured lending authority of the President/Chief Executive Officer of the Bank is set at $1,000,000 and the individual secured/unsecured lending authority of the Senior Lender/Executive Vice President is set at $500,000. The President/Chief Executive Officer of the Bank and the Senior Lender/Executive Vice President may jointly lend up to 10% of the Bank's unimpaired capital for the previous quarter end. In the absence of either of the above, the other may, jointly with the approval of either the Chairman of the Board of Directors or a majority of the Loan Committee of the Board of Directors, lend up to 10% of the Bank's unimpaired capital for the previous quarter end. The Board of Directors, with two-thirds vote, may approve the aggregate credit in excess of this limit but may not exceed 15% of the Bank's unimpaired capital.

The Senior Lender/Executive Vice President may establish the unsecured loan authority of the individual loan officers of the Bank not to exceed $100,000 and secured loan authority not to exceed $250,000. With the concurrence of the President/Chief Executive Officer, the Senior Lender/Executive Vice President may approve unsecured lending authority of individual lending officers up to $250,000. Loan limits apply to the total direct and indirect liability of the borrower. All loans above the loan officer's authority must have the approval of a loan officer with the authority to approve a loan of that amount. Pooling of loan authority is not allowed except as outlined above for the President/Chief Executive Officer, Senior Lender/Executive Vice President and a majority of the Loan Committee or two-thirds of the Board of Directors.

Every new and renewed loan is graded according to a loan rating matrix and assigned a risk rating of excellent, good, satisfactory, watch, OAEM, substandard, doubtful, or loss based on cash flow, collateral, guarantor, financial condition, management, operating performance, financial statements, loan performance, leverage, and debt service coverage. A weighted average method is used to compute the rating with cash flow, financial condition, and debt service being weighted three times, and financial statements being weighted two times the amount of the other factors. When a loan rating is between (and including) 3.5 and 4.4, it is placed on the watch list. When the rating is 4.5 or higher, it is placed on the classified loan list in the appropriate risk grade. The ratings are included on the loan summary, when applicable, and are reviewed by the President/Chief Executive Officer and Senior Loan Officer/Executive Vice President.

All new credit which results in aggregate direct, indirect, and related credit, not under an approved line of credit, of $200,000 or more, with the exceptions of mortgage loans in the process of being sold to investors and loans secured by properly margined negotiable securities traded on an established market or other cash collateral, are reviewed in detail on a monthly basis by the Loan Committee. Those new credits which result in aggregate direct, indirect and related credit, not under an approved line of credit, of $500,000 or more are reported to the Board of Directors at its regular monthly meeting.

Employees

At December 31, 2016, we employed 74 people, with two individuals considered part time, none of whom are subject to a collective bargaining agreement. We provide a variety of benefit programs including an Employee Stock Ownership Plan and Trust, Stock Incentive Plan, health, life, disability and other insurance. We believe our relationship with our employees is excellent.

Supervision and Regulation

We are subject to extensive state and federal banking laws and regulations that impose specific requirements or restrictions and provide for general regulatory oversight of virtually all aspects of operations. The regulations are primarily intended to protect depositors, customers, and the integrity of the U.S. banking system and capital markets. The following information describes some of the more significant laws and regulations applicable to us. The description is qualified in its entirety by reference to the applicable laws and regulations. Proposals to change the laws and regulations governing the banking industry are frequently raised in Congress, in state legislatures, and with the various bank regulatory agencies. Changes in applicable laws or regulations, or a change in the way such laws or regulations are interpreted by regulatory agencies or courts, may have a material impact on our business operations and earnings.

Dodd-Frank Act

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) became effective. This law has broadly affected the financial services industry by implementing changes to the financial regulatory landscape aimed at strengthening the sound operation of the financial services industry, and will continue to significantly change the current bank regulatory structure and affect the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies, including the Company and the Bank. Under the Dodd-Frank Act a broad range of new rules and regulations by various federal agencies have been implemented, and further rulemaking must be proposed and adopted which will take effect over several years. Although we have already experienced some decrease in revenue because of the rules implemented under the Dodd-Frank Act, the overall financial impact the Act will have on the Company, our customers, or the financial industry in general remains difficult to anticipate.

The Dodd-Frank Act created the Consumer Financial Protection Bureau (the “CFPB”) as an agency to centralize responsibility for consumer financial protection, including implementing, examining and enforcing compliance with federal consumer financial laws. The CFPB has begun exercising supervisory review of banks under its jurisdiction. The CFPB is expected to focus its rulemaking in several areas, particularly in the areas of mortgage reform involving the Real Estate Settlement Procedures Act, the Truth in Lending Act, the Equal Credit Opportunity Act, and the Fair Debt Collection Practices Act; however, the content of the final rules and impact to our businesses are uncertain at this time. There are many provisions in the Dodd-Frank Act mandating regulators to adopt new regulations and conduct studies upon which future regulation may be based. While some have been issued, many remain to be issued. Governmental intervention and new regulations could materially and adversely affect our business, financial condition and results of operations.

Bank Holding Company Act

The Company is a one-bank holding company under the federal Bank Holding Company Act of 1956, as amended (the “Bank Holding Company Act”). As a result, the Company is primarily subject to the supervision, examination and reporting requirements of the Board of Governors of the Federal Reserve (the “Federal Reserve”) under the Bank Holding Company Act and its regulations promulgated thereunder. Moreover, as a bank holding company located in South Carolina, the Company is also subject to the regulations of the South Carolina State Board of Financial Institutions.

Capital Requirements

The Federal Reserve Board imposes certain capital requirements on the Company under the Bank Holding Company Act, including a minimum leverage ratio and minimum ratio of “qualifying” capital to risk-weighted assets. These requirements are essentially the same as those that apply to the Bank and are described under “Regulatory Capital Requirements” in the notes to the financial statements. The ability of the Company to pay dividends depends on the Bank’s ability to pay dividends to the Company, which is subject to regulatory restrictions as described below in “Dividends”.

Standards for Safety and Soundness

The Federal Deposit Insurance Act requires the federal banking regulatory agencies to prescribe, by regulation or guideline, operational and managerial standards for all insured depository institutions relating to (1) internal controls, information systems and internal audit systems, (2) loan documentation, (3) credit underwriting, (4) interest rate risk exposure, and (5) asset growth. The agencies also must prescribe standards for asset quality, earnings, and stock valuation, as well as standards for compensation, fees, and benefits. The federal banking agencies have adopted regulations and “Interagency Guidelines Establishing Standards for Safety and Soundness” to implement these required standards. These guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired.

Regulatory Examination

All insured institutions must undergo regular on-site examinations by their appropriate banking agency. The cost of examinations of insured depository institutions and any affiliates may be assessed by the appropriate banking agency against each institution or affiliate, as it deems necessary or appropriate. Insured institutions are required to submit annual reports to the Federal Deposit Insurance Corporation (“FDIC”), their federal regulatory agency, and state supervisor when applicable.

The federal banking regulatory agencies prescribe, by regulation, standards for all insured depository institutions and depository institution holding companies relating, among other things, to the following:

- Internal controls
- Information systems and audit systems
- Loan documentation
- Credit underwriting
- Interest rate risk exposure
- Asset quality
- Liquidity
- Capital adequacy

Bank Secrecy Act

Sensitivity to market risk

Transactions with Affiliates and Insiders

We are subject to certain restrictions on extensions of credit to executive officers, directors, certain principal shareholders, and their related interests. Such extensions of credit (1) must be made on substantially the same terms, including interest rates, and collateral, as those prevailing at the time for comparable transactions with third parties and (2) must not involve more than the normal risk of repayment or present other unfavorable features.

Dividends

The Company's principal source of cash flow, including cash flow to pay dividends to its shareholders, is dividends it receives from the Bank. Statutory and regulatory limitations apply to the Bank's payment of dividends to the Company. As a general rule, the amount of a dividend may not exceed, without prior regulatory approval, the sum of net income in the calendar year to date and the retained net earnings of the immediately preceding two calendar years. A depository institution may not pay any dividend if payment would cause the institution to become undercapitalized or if it already is undercapitalized.

Consumer Protection Regulations

Activities of the Bank are subject to a variety of statutes and regulations designed to protect consumers. Interest and other charges collected by the Bank are subject to state usury laws and federal laws concerning interest rates. Our loan operations are also subject to federal laws applicable to credit transactions such as:

The federal Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers

The Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves

Fair Lending Act, fair equitable, and nondiscriminatory access to credit for consumers

The Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit

The Fair Credit Reporting Act of 1978, governing the use and provision of information to credit reporting agencies

The Fair Debt Collection Act, governing the manner in which consumer debt may be collected by collection agencies

The rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws.

The deposit operations of the Bank also are subject to:

The Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records

The Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve Board to implement that Act, which governs automatic deposits to and withdrawals from deposit and customer’s rights and liabilities arising from the use of automated teller machines and other electronic banking services

Regulation DD which implements the Truth in Savings Act to enable consumers to make informed decisions about deposit accounts at depository institutions. Regulation DD requires depository institutions to provide disclosures so that consumers can make meaningful comparisons among depository institutions.

Enforcement Powers

The Company is subject to supervision and examination by the Federal Reserve and the South Carolina State Board of Financial Institutions. The Bank is subject to extensive federal and state regulations that significantly affect business and activities. These regulatory bodies have broad authority to implement standards and to initiate proceedings designed to prohibit depository institutions from engaging in activities that represent unsafe or unsound banking practices or constitute violations of applicable laws, rules, regulations, administrative orders, or written agreements with regulators. These regulatory bodies are authorized to take action against institutions that fail to meet such standards, including the assessment of civil monetary penalties, the issuance of cease-and-desist orders, and other actions.

Bank Secrecy Act/Anti-Money Laundering

We are subject to the Bank Secrecy Act and other anti-money laundering laws and regulations, including the USA Patriot Act of 2001. We must maintain a Bank Secrecy Act Program that includes (1) established internal policies, procedures, and controls, (2) a designated compliance officer, (3) an ongoing employee training program and, (4) testing of the program by an independent audit function. The USA Patriot Act, amended, in part, the Bank Secrecy Act and provides for the facilitation of information sharing among governmental entities and the Company for the purpose of combating terrorism and money laundering by enhancing anti-money laundering and financial transparency laws, as well as enhanced information collection tools and enforcement mechanics for the US government. These provisions include (a) standards for verifying customer identification at account opening; (b) rules to promote cooperation among financial institutions, regulators, and law enforcement entities in identifying parties that may be involved in terrorism or money laundering; (c) reports by nonfinancial trades and businesses filed with the U.S. Treasury's Financial Crimes Enforcement Network for transactions exceeding $10,000; (d) suspicious activities reports by brokers and dealers if they believe a customer may be violating U.S. laws; and (e) regulations and enhanced due diligence requirements for financial institutions that administer, maintain, or manage private bank accounts or correspondent accounts for non-U.S. persons. Bank regulators routinely examine institutions for compliance with these obligations and are required to consider compliance in connection with the regulatory review of applications.

Privacy and Credit Reporting

In connection with our lending activities, we are subject to a number of federal laws designed to protect borrowers and promote lending to various sectors of the economy and population. These include the Equal Credit Opportunity Act, the Truth-in-Lending Act, the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, and the Community Reinvestment Act (the "CRA"). In addition, federal banking regulators, pursuant to the Gramm-Leach-Bliley Act, have enacted regulations limiting the ability of banks and other financial institutions to disclose nonpublic consumer information to non-affiliated third parties. The regulations require disclosure of privacy policies and allow consumers to prevent certain personal information from being shared with nonaffiliated third parties. The CRA requires the appropriate federal banking agency, in connection with its examination of a bank, to assess the bank's record in meeting the credit needs of the communities served by the bank, including low and moderate income neighborhoods. Under the CRA, institutions are assigned a rating of "outstanding," "satisfactory," "needs to improve," or "substantial non-compliance."

Volcker Rule

Section 619 of the Dodd-Frank Act, known as the "Volcker Rule," prohibits any bank, bank holding company, or affiliate (referred to collectively as "banking entities") from engaging in two types of activities: "proprietary trading" and the ownership or sponsorship of private equity or hedge funds that are referred to as "covered funds." Proprietary trading, in general, is trading in securities on a short-term basis for a banking entity's own account. In December 2013, federal banking agencies, the SEC and the Commodity Futures Trading Commission, finalized a regulation to implement the Volcker Rule. At December 31, 2016, the Company has evaluated our securities portfolio and has determined that we do not hold any covered funds.

Item 1A. Risk Factors

Under the filer category of "smaller reporting company", as defined in Rule 12b-2 of the Exchange Act, the Company is not required to provide information requested by Part I, Item 1A of its Form 10-K.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The Company's headquarters is located at 256 Meeting Street in downtown Charleston, South Carolina. This site is also the location of the main office of its subsidiary, The Bank of South Carolina. In addition to the Meeting Street location, the Bank currently operates from three additional locations: 100 North Main Street, Summerville, SC, 1337 Chuck Dawley Boulevard, Mount Pleasant, SC, and 2027 Sam Rittenberg Boulevard, Charleston, SC. The Bank's mortgage department is located at 1071 Morrison Drive, Charleston, SC. On January 28, 2014, we signed a lease to open a banking office on Highway 78 and Ingleside Boulevard, North Charleston, SC in the future (copy of the lease incorporated as Exhibit 10.8 in the 2013 10-K and copy of the Assignment and Assumption of Lease incorporated as Exhibit 10.9, First Amendment to the Lease incorporated as Exhibit 10.10 and Second Amendment to the Lease incorporated as Exhibit 10.11 in the 2015 10-K). The Company owns the 2027 Sam Rittenberg Boulevard location which also houses the Operations Department of the Bank. All other locations are leased. The owned location is not encumbered and all of the leases have renewal options. Each banking location is suitable and adequate for banking operations.

Item 3. Legal Proceedings

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

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

There were issued and outstanding 4,956,139 shares of the 12,000,000 authorized shares of common stock of the Company at the close of our fiscal year ended December 31, 2016. Our common stock is traded on The NASDAQ Capital Market under the trading symbol "BKSC".

Information regarding the historical market prices of our common stock and dividends declared on that stock is shown below.

2016	High	Low	Dividends
Quarter ended March 31, 2016	$16.75	$14.91	$ 0.13
Quarter ended June 30, 2016	$16.25	$15.51	$ 0.13
Quarter ended September 30, 2016	$18.63	$15.95	$ 0.14
Quarter ended December 31, 2016	$23.47	$18.39	$ 0.14
2015			
Quarter ended March 31, 2015	$13.72	$13.35	$ 0.13
Quarter ended June 30, 2015	$15.92	$13.59	$ 0.13
Quarter ended September 30, 2015	$16.86	$13.48	$ 0.13
Quarter ended December 31, 2015	$16.87	$16.00	$ 0.13
2014			
Quarter ended March 31, 2014	$14.46	$13.29	$ 0.13
Quarter ended June 30, 2014	$14.11	$13.46	$ 0.13
Quarter ended September 30, 2014	$14.09	$13.32	$ 0.23
Quarter ended December 31, 2014	$13.87	$12.96	$ 0.13

As of February 23, 2017, there were approximately 1,769 shareholders of record with shares held by individuals and in nominee names. The market price for our common stock as of February 23, 2017, was $20.68.

The future payment of cash dividends is subject to the discretion of the Board of Directors and depends upon a number of factors, including future earnings, financial condition, cash requirements, and general business conditions. Cash dividends, when declared, are paid by the Bank to the Company for distribution to shareholders of the Company. Certain regulatory requirements restrict the amount of dividends that the Bank can pay to the Company.

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At our December, 1995 Board Meeting, the Board of Directors authorized the repurchase of up to 140,918 shares of its common stock on the open market. At our October, 1999 Board Meeting, the Board of Directors authorized the repurchase of up to 45,752 shares of its common stock on the open market and again at our September, 2001 Board meeting, the Board of Directors authorized the repurchase of up to 54,903 shares of its common stock on the open market. As of the date of this report, the Company owns 241,396 shares. Shares have been adjusted for three 10% stock dividends, a 10% stock distribution, and a 25% stock dividend. At the Annual Meeting April, 2007, the shareholders' voted to increase the number of authorized shares from 6,000,000 to 12,000,000. As of February 23, 2017, there were 5,203,585 shares of common stock issued and 4,962,189 shares of common stock outstanding.

THE BANK OF SOUTH CAROLINA EMPLOYEE STOCK OWNERSHIP PLAN AND TRUST

During 1989, the Board of Directors of the Bank adopted an Employee Stock Ownership Plan and Trust Agreement ("ESOP") to provide retirement benefits to eligible employees of the Bank for long and faithful service. An amendment and restatement was made to the ESOP effective January 1, 2007 and approved by the Board of Directors January 18, 2007. Periodically, the Internal Revenue Service ("IRS") requires a restatement of a qualified retirement plan to ensure that the plan document includes provisions required by legislative and regulatory changes made since the last restatement. There have been no substantive changes to the plan, however, to comply with the IRS rules, the Board of Directors approved a restated plan, on January 26, 2012 (incorporated as Exhibit 10.5 in the 2011 10-K). The Plan was submitted to the IRS for approval and a determination letter was issued September 26, 2013, stating that the plan satisfies the requirements of Code Section 4975 (e) (7). On January 26, 2017, the Board of Directors approved a restated plan (incorporated as Exhibit 10.6 in the 2016 10-K).

The Board of Directors of the Bank approved a cash contribution of $345,000 to The Bank of South Carolina ESOP for the fiscal year ended December 31, 2016. The Board of Directors of the Bank approved cash contributions of $315,000 and $280,000 for the fiscal years ended December 31, 2015 and 2014, respectively. The contributions were made during the respective fiscal years.

An employee of the Bank who is not a member of an ineligible class of employees is eligible to participate in the plan upon reaching 21 years of age and being credited with one year of service (1,000 hours of service). All employees are eligible employees except for the following ineligible classes of employees:

Employees whose employment is governed by a collective bargaining agreement between employee representatives and the Company in which retirement benefits were the subject of good faith bargaining unless the collective bargaining agreement expressly provides for the inclusion of such employees in the plan

Employees who are non-resident aliens who do not receive earned income from the Company which constitutes income from sources within the United States

Any person who becomes an employee as the result of certain asset or stock acquisitions, mergers, or similar transactions (but only during a transitional period)

Certain leased employees

Employees who are employed by an affiliated Company that does not adopt the plan

Any person who is deemed by the Company to be an independent contractor on his or her employment commencement date and on the first day of each subsequent plan year, even if such person is later determined by a court or a governmental agency to be or to have been an employee.

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The employee may enter the Plan on the January 1st that occurs nearest the date on which the employee first satisfies the age and service requirements described above. No contributions by employees are permitted. The amount and time of contributions are at the sole discretion of the Board of Directors of the Bank. The contribution for all participants is based solely on each participant's respective regular or base salary and wages paid by the Bank including commissions, bonuses and overtime, if any.

A participant becomes vested in the ESOP based upon the employee's credited years of service. The vesting schedule is as follows:

1 Year of Service	0% Vested
2 Years of Service	25% Vested
3 Years of Service	50% Vested
4 Years of Service	75% Vested
5 Years of Service	100% Vested

The Bank is the Plan Administrator. Eugene W. Walpole, IV, Fleetwood S. Hassell, Sheryl G. Sharry and Douglas H. Sass, currently serve as the Plan Administrative Committee and as Trustees for the Plan. The Plan currently owns 335,604 shares of common stock of Bank of South Carolina Corporation.

THE BANK OF SOUTH CAROLINA STOCK INCENTIVE PLAN

We have a Stock Incentive Plan which was approved in 1998 with 180,000 (329,422 adjusted for three 10% stock dividends, a 10% stock distribution, and a 25% stock dividend) shares reserved and a Stock Incentive Plan which was approved in 2010 with 300,000 (330,000 adjusted for a 10% stock dividend) shares reserved. Under both Plans, options are periodically granted to employees at a price not less than the fair market value of the shares at the date of grant. Participating employees become 20% vested after five years and then vest 20% each year until fully vested. The right to exercise each such 20% of the options is cumulative and will not expire until the tenth anniversary of the date of the grant. Employees are eligible to participate in this plan if the Executive Committee, in its sole discretion, determines that an employee has contributed or can be expected to contribute to our profits or growth.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model. Expected volatilities are based on historical volatilities of our common stock. The expected term of the options granted will not exceed ten years from the date of grant (the amount of time options granted are expected to be outstanding). The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant.

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Item 6. Selected Financial Data

The following table sets forth certain selected financial information concerning the Company and its wholly-owned subsidiary. The information was derived from audited consolidated financial statements. The information should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations", which follows, and the audited consolidated financial statements and notes which are presented elsewhere in this report.

	2016	2015	2014	2013	2012
For December 31:					
Net Income	$5,247,063	$4,884,288	$4,398,820	$4,076,924	$3,666,828
Selected Year End Balances:					
Total Assets	413,949,636	399,172,512	367,225,802	340,893,703	325,410,646
Total Loans (1)	264,962,325	248,442,944	241,442,873	223,059,647	235,608,502
Investment Securities Available for Sale	119,978,944	119,997,585	113,994,112	94,648,221	58,514,216
Interest-bearing Deposits in Other Banks	18,101,300	23,898,862	5,680,613	16,080,721	25,903,960
Earning Assets	403,042,569	392,339,391	361,117,598	333,788,589	320,026,678
Deposits	372,522,851	358,718,612	322,419,027	305,242,655	291,073,843
Shareholders' Equity	40,612,974	39,151,712	36,759,982	34,739,143	33,930,442
Weighted Average Shares Outstanding-Basic	4,935,349	4,912,499	4,907,208	4,897,902	4,890,310
Weighted Average Shares Outstanding-Diluted	5,054,114	5,067,085	5,032,211	4,906,234	4,890,310
For the Year:					
Selected Average Balances:					
Total Assets	410,581,560	379,527,104	358,774,284	332,092,490	317,438,538
Total Loans (1)	265,151,258	243,729,630	232,281,473	226,267,071	220,780,471
Investment Securities Available for Sale	110,762,289	110,633,399	99,488,314	67,484,036	57,982,652
Federal Funds Sold and Resale Agreements	—	—	—	—	7,578,169
Interest-bearing Deposits in Other Banks	26,474,258	17,549,903	19,588,597	31,524,293	32,386,509
Earning Assets	402,387,805	371,912,932	351,358,384	325,275,400	311,149,632
Deposits	367,822,900	337,969,217	319,131,466	296,482,622	283,365,379
Shareholders' Equity	41,479,755	38,631,718	36,283,441	34,800,116	33,415,008
Performance Ratios:					
Return on Average Equity	12.65 %	12.64 %	12.12 %	11.72 %	10.97 %
Return on Average Assets	1.28 %	1.29 %	1.23 %	1.23 %	1.16 %
	10.10 %	10.18 %	10.11 %	10.48 %	10.53 %

Average Equity to Average Assets					
Net Interest Margin	3.71 %	3.72 %	3.70 %	3.79 %	3.86 %
Net Charge-offs to Average Loans	.05 %	.04 %	.02 %	.15 %	.01 %
Allowance for Loan Losses as a Percentage of Total Loans (excluding mortgage loans to be sold)	1.48 %	1.41 %	1.42 %	1.51 %	1.58 %
<u>Per Share:</u>					
Basic Income	$1.06	$0.99	$0.90	$0.83	$0.75
Diluted Income	1.04	0.96	0.87	0.83	0.75
Year End Book Value	8.19	7.96	7.49	7.79	7.63
Cash Dividends Declared	0.54	0.52	0.62	0.50	0.45
Dividend Payout Ratio	50.86 %	49.94 %	62.88 %	54.63 %	54.56 %
Full Time Employee Equivalents	74	81	77	77	76

(1) Including mortgage loans to be sold

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's discussion and analysis is included to assist the shareholder in understanding our financial condition, results of operations, and cash flow. This discussion should be reviewed in conjunction with the audited consolidated financial statements and accompanying notes presented in Item 8 of this report and the supplemental financial data appearing throughout this report. Since the primary asset of the Company is its wholly-owned subsidiary, most of the discussion and analysis relates to the Bank.

OVERVIEW

Bank of South Carolina Corporation (the "Company") is a financial institution holding company headquartered in Charleston, South Carolina, with $413,949,636 in assets as of December 31, 2016 and net income of $1,312,879 and $5,247,063, respectively, for the three and twelve months ended December 31, 2016. 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 principally in the Charleston, Dorchester, and Berkeley counties of South Carolina. The Bank's original and current concept is to be a full service financial institution specializing in personal service, responsiveness, and attention to detail to foster long-standing relationships.

We derive most of our income from interest on loans and investments (interest-bearing assets). The primary source of funding for making these loans and investments is our interest and non-interest-bearing deposits. Consequently, one of the key measures of our success is the amount of net interest income, or the difference between the income on our interest earning assets, such as loans and investments, and the expense on our interest-bearing liabilities, 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 and lease portfolio as affected by economic conditions such as rising interest rates and the financial performance of borrowers. The reserve for credit losses consists of the allowance for loan and lease losses (the "allowance") and a reserve for unfunded commitments (the "unfunded reserve"). The allowance provides for probable and estimable losses inherent in our loan and lease portfolio while the unfunded reserve provides for potential losses related to unfunded lending commitments. The Allowance is increased or decreased through the provisioning process. For a detailed discussion on the allowance for loan losses see "Allowance for Loan Losses".

In addition to earning interest on loans and investments, we earn income through fees and other expenses we charge to the customer. The various components of other income and other expenses are described in the following discussion. The discussion and analysis also identifies significant factors that have affected our financial position as of December

31, 2016 as compared to December 31, 2015 and our operating results for 2016 as compared to 2015 and 2015 as compared to 2014, and should be read in conjunction with the consolidated 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

We have adopted various accounting policies that govern the application of principles generally accepted in the United States and with general practices within the banking industry in the preparation of our consolidated financial statements. Our significant accounting policies are set forth in the notes to the consolidated financial statements in this report.

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

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

COMPARISON OF THE YEAR ENDED DECEMBER 31, 2016 TO DECEMBER 31, 2015

Net income increased $362,775 or 7.43% to $5,247,063, or basic and diluted income per share of $1.06 and $1.04, respectively for the year ended December 31, 2016 from $4,884,288 or basic and diluted income per share of $0.99 and $0.96, respectively for the year ended December 31, 2015. This increase is primarily due to increases in interest and fees on loans offset by higher provision for loan losses expense and lower mortgage banking income. Our returns on average assets and average equity for the year ended December 31, 2016 were 1.28% and 12.65%, respectively, compared with 1.29% and 12.64%, respectively, for the year ended December 31, 2015.

Net interest income increased $1,089,304 or 7.88% to $14,916,857 for the year ended December 31, 2016 from $13,827,553 for the year ended December 31, 2015. This increase was primarily due to increases in interest and fees on loans and other interest income. Interest and fees on loans increased $1,056,597 or 8.96% to $12,851,900 for the year ended December 31, 2016 from $11,795,303 for the year ended December 31, 2015, as the result of higher average loan balances, an improving local economy, and consumer confidence. Other interest income, earned mostly on interest-bearing deposits in other banks, increased $93,057 or 204.22% to $138,623 for the year ended December 31, 2016 from $45,566 for the year ended December 31, 2015.

Average earning assets increased $30,474,873 or 8.19% to $402,387,805 for the year ended December 31, 2016 from $371,912,932 for the year ended December 31, 2015. Average loans increased $21,421,628 or 8.79% for the year ended December 31, 2016. Average interest-bearing deposits in other banks increased $8,924,355 or 50.85% to $26,474,258 for the year ended December 31, 2016 from $17,549,903 for the year ended December 31, 2015.

The provision to the allowance for loan losses for the year ended December 31, 2016 was $570,000 compared to $192,500 for the year ended December 31, 2015. The increase was primarily a result of loan growth. The Board of Directors determined that this provision was appropriate based upon the strength of our reserve and the anticipation of continued loan growth and an improving economy. Charge-offs of $208,295, recoveries of $72,085, together with the provision to the allowance, resulted in an allowance for loan losses of $3,851,617 or 1.48% of total loans at December 31, 2016.

Non-interest income decreased $188,875 or 6.19% to $2,861,083 for the year ended December 31, 2016. Our mortgage banking income decreased $217,936 or 13.57% to $1,387,740 for the year ended December 31, 2016 from $1,605,676 for the year ended December 31, 2015 due to the loss of two loan originators during 2016. Mortgage banking income is highly influenced by mortgage interest rates and the housing market. According to local real estate market reports, the sales volume in the Charleston market increased 10% for the year ended December 31, 2016 compared to the year ended December 31, 2015. The Charleston market had 17,114 home sales during 2016 with a median sales price of $245,000 compared to 16,202 home sales in 2015 at a median price of $229,000. Mortgage loan originations decreased $15,021,252 or 16.50% to $76,032,671 for the year ended December 31, 2016 from $91,053,923 for the year ended December 31, 2015. Service charges, fees and commissions increased $70,342 to $1,061,349 for the year ended December 31, 2016 from $991,007 for the year ended December 31, 2015. This increase was primarily due to an increase of $52,416 in debit card fees resulting from increased usage particularly by our business customers. We also had gains of $380,904 on the sales of investment securities during the year ended December 31, 2016 compared to gains of $423,832 during the year ended December 31, 2015.

Other expense increased $758,969 or 7.98% to $10,272,444 for the year ended December 31, 2016, from $9,513,475 for the year ended December 31, 2015. Salaries and employee benefits increased $228,726 or 3.90% from $5,859,203 for the year ended December 31, 2015 to $6,087,929 for the year ended December 31, 2016. Base wages increased $134,013 to $4,768,176 for the year ended December 31, 2016. This increase was primarily due to annual merit increases. Our contribution to the ESOP increased from $315,000 in 2015 to $345,000 for 2016.

Other operating expenses increased $471,394. During 2016, the Company invested in a South Carolina Historic Rehabilitation Tax Credit of $937,211. The credit will be amortized over three years. For the year ended December 31, 2016, the Company amortized $325,000 of the credit.

Our net occupancy expense increased $47,442 or 3.20% to $1,528,048 for the year ended December 31, 2016, from $1,480,606 for the year ended December 31, 2015. Our net occupancy expense includes rent and insurance on our banking locations as well as the cost of repairs and maintenance on these facilities. Occupancy expense increased primarily due to annual rent increases at our Meeting Street and Summerville banking locations as well as an increase in insurance on banking locations, offset by a decrease in the cost of maintenance and repairs and depreciation on furniture, fixtures and equipment.

For the year ended December 31, 2016, the Company's effective tax rate was 24.34% compared to 31.89% during the year ended December 31, 2015. The Company invested in a South Carolina Historic Rehabilitation Tax Credit during 2016 which resulted in a decrease to the effective rate.

COMPARISON OF THE YEAR ENDED DECEMBER 31, 2015 TO DECEMBER 31, 2014

Net income increased $485,468 or 11.04% to $4,884,288, or basic and diluted income per share of $.99 and $.96, respectively for the year ended December 31, 2015 from $4,398,820 or basic and diluted income per share of $.90 and $.87, respectively for the year ended December 31, 2014. This increase is primarily due to increases in interest and fees on loans, interest and dividends earned on investment securities, and mortgage banking income as well as gains recognized on the sale of investment securities available for sale. Our returns on average assets and average equity for the year ended December 31, 2015 were 1.29% and 12.64%, respectively, compared with 1.23% and 12.12%, respectively, for the year ended December 31, 2014.

Net interest income increased $818,246 or 6.29% to $13,827,553 for the year ended December 31, 2015 from $13,009,307 for the year ended December 31, 2014. This increase was primarily due to increases in interest and fees on loans and interest and dividends on investment securities. Interest and fees on loans increased $532,255 or 4.73% to $11,795,303 for the year ended December 31, 2015 from $11,263,048 for the year ended December 31, 2014, as the result of an improving local economy and consumer confidence. Interest and dividends on investment securities increased $283,604 or 13.47% to $2,389,079 for the year ended December 31, 2015 from $2,105,475 for the year ended December 31, 2014.

Average earning assets increased $20,554,548 or 5.85% to $371,912,932 for the year ended December 31, 2015 from $351,358,384 for the year ended December 31, 2014. Average loans increased $11,448,157 or 4.93% for the year ended December 31, 2015. Average investments increased $11,145,085 or 11.20% to $110,633,399 for the year ended December 31, 2015 from $99,488,314 for the year ended December 31, 2014.

The provision to the allowance for loan losses for the year ended December 31, 2015 was $192,500 compared to $82,500 for the year ended December 31, 2014. The Board of Directors determined that this provision was appropriate based upon the strength of our reserve and the anticipation of continued loan growth and an improving economy. Charge-offs of $201,071, recoveries of $91,550, together with the provision to the allowance, resulted in an allowance for loan losses of $3,417,827 or 1.41% of total loans at December 31, 2015.

Non-interest income increased $471,257 or 18.27% to $3,049,958 for the year ended December 31, 2015. Our mortgage banking income increased $290,656 or 22.10% to $1,605,676 for the year ended December 31, 2015 from $1,315,020 for the year ended December 31, 2014. Mortgage banking income is highly influenced by mortgage interest rates and the housing market. According to local real estate market reports, the sales volume in the Charleston market increased 14% for the year ended December 31, 2015 compared to the year ended December 31, 2014. The Charleston market had 16,202 home sales during 2015 with a median sales price of $229,000 compared to 14,256 home sales in 2014 at a median price of $215,000. Mortgage loan originations increased $19,286,123 or 26.87% to $91,053,923 for the year ended December 31, 2015 from $71,767,800 for the year ended December 31, 2014. Service charges, fees and commissions increased $69,369 to $991,007 for the year ended December 31, 2015 from $921,638 for the year ended December 31, 2014. This increase was primarily due to an increase of $71,267 in debit card fees resulting from increased usage particularly by our business customers. We also had a gain of $423,832 on the sales of investment securities during the year ended December 31, 2015 compared to a gain of $312,577 on the sales of investment securities during the year ended December 31, 2014.

Other expense increased $404,653 or 4.44% to $9,513,475 for the year ended December 31, 2015, from $9,108,822 for the year ended December 31, 2014. Salaries and employee benefits increased $392,757 or 7.18% from $5,466,446 for the year ended December 31, 2014 to $5,859,203 for the year ended December 31, 2015. Base wages increased $290,826 to $4,634,163 for the year ended December 31, 2015. This increase was primarily due to annual merit increases and the addition of new positions in our Credit and Technology Departments. The cost of providing insurance for employees including workers compensation increased $44,308 from $576,305 for the year ended December 31, 2014 to $620,613 for the year ended December 31, 2015. Our monthly contribution to the ESOP increased from $22,500 in 2014 to $25,000 for the first six months of 2015 with an additional increase in July 2015 to $27,500. Total contributions for the year ended December 31, 2015 increased 12.50% to $315,000 compared to $280,000 for the year ended December 31, 2014.

Our net occupancy expense increased $6,906 or .47% to $1,480,606 for the year ended December 31, 2015, from $1,473,700 for the year ended December 31, 2014. Our net occupancy expense includes rent and insurance on our banking locations as well as the cost of repairs and maintenance on these facilities. Occupancy expense increased primarily due to annual rent increases at our Meeting Street and Summerville banking locations as well as an increase in insurance on banking locations, offset by a decrease in the cost of maintenance and repairs and depreciation on furniture, fixtures and equipment.

For the year ended December 31, 2015, the Company's effective tax rate was 31.89% compared to 31.23% during the year ended December 31, 2014.

ASSET AND LIABILITY MANAGEMENT

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. The responsibility of managing asset and liability procedures is directed by the Asset and Liability/Investment Committee ("ALCO") with the ultimate responsibility resting with the Chief Executive Officer. At December 31, 2016, total assets were $413,949,636, an increase of 3.70% from December 31 2015; total deposits were $372,522,851, an increase of 3.85% from the end of the previous year.

At December 31, 2016, approximately 97.37% of our assets were earning assets composed of U.S. Treasury, Government Sponsored Enterprises and Municipal Securities in the amount of $119,978,944, interest-bearing deposits in other banks in the amount of $18,101,300 and total loans including mortgage loans held for sale in the amount of $264,962,325.

The yield on a majority of our earning assets adjusts simultaneously with changes in the general level of interest rates. Some of the Company's liabilities are issued with fixed terms and can be repriced only at maturity.

MARKET RISK

Market risk is the risk of loss from adverse changes in market prices and interest rates. Our risk consists primarily of interest rate risk in our lending and investing activities as they relate to their funding by deposit and borrowing activities.

Our policy is to minimize interest rate risk between interest-bearing assets and liabilities at various maturities and to attempt to maintain an asset sensitive position over a six-month period. By adhering to this policy, we anticipate that our net interest margins will not be materially affected, unless there is an extraordinary precipitous change in interest rates. The average net interest rate spread for 2016 decreased to 3.64% from 3.65% for 2015 and the average net interest margin for 2016 decreased to 3.71% from 3.72% for 2015. At December 31, 2016 and 2015, our net cumulative gap was liability sensitive for periods less than one year and asset sensitive for periods of one year or more. The reason for the shift in sensitivity is the direct result of management's strategic decision to invest excess funds held at the Federal Reserve into fixed rate investment securities that match our investment policy objectives. Management is aware of this departure from policy and will continue to closely monitor our sensitivity position going forward.

Since the rates on most of our interest-bearing liabilities can vary on a daily basis, we continue to maintain a loan portfolio priced predominately on a variable rate basis. However, in an effort to protect future earnings in a declining rate environment, we offer certain fixed rates, interest rate floors, and terms primarily associated with real estate transactions. We seek stable, long-term deposit relationships to fund our loan portfolio. Furthermore, we do not have any brokered deposits or internet deposits.

At December 31, 2016, the average maturity of the investment portfolio was 4.13 years with an average yield of 1.99% compared to 4.28 years with an average yield of 2.16% at December 31, 2015.

We do not take foreign exchange or commodity risks. In addition, we do not own mortgage-backed securities nor do we have any exposure to the sub-prime market or any other distressed debt instruments.

The following table summarizes our interest sensitivity position as of December 31, 2016:

Earning Assets (in 000's)	1 Day	Less Than 3 Months	3 Months to Less Than 6 Months	6 Months to Less Than 1 Year	1 Year to Less Than 5 Years	5 years or More	Total	Estimated Fair Value
Loans (1)	$143,900	$22,783	$17,725	$22,830	$57,046	$678	$264,962	$264,793
Investment securities (2)	—	995	1,835	513	82,849	34,750	120,942	119,979
Interest-bearing deposits	18,101	—	—	—	—	—	18,101	18,101
Total	$162,001	$23,778	$19,560	$23,343	$139,895	$35,428	$404,005	$402,873
Interest-bearing Liabilities (in 000's)								
CD's and other time deposits 100,000 and over	$225	$13,280	$8,419	$8,236	$1,297	$—	$31,457	$31,470
CD's and other time deposits under 100,000	17	3,904	3,401	3,539	1,520	3	12,384	12,386
Money market and interest bearing demand accounts	173,569	—	—	—	—	—	173,569	173,569
Savings	29,079	—	—	—	—	—	29,079	29,079
Total	$202,890	$17,184	$11,820	$11,775	$2,817	$3	$246,489	$246,504
Net	$(40,889)	$6,594	$7,740	$11,568	$137,078	$35,425	$157,516	
Cumulative		$(34,295)	$(26,555)	$(14,987)	$122,091	$157,516		

(1) Including mortgage loans to be sold and deferred fees.

(2) At amortized cost

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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.

The following table summarizes future contractual obligations as of December 31, 2016:

	Payment Due by Period			
	Total	Less than 1 Year	1-5 Years	After 5 Years
Contractual Obligations (in 000's)				
Time deposits	$43,841	$41,021	$2,817	$3
Operating leases	7,760	615	2,436	4,709
Total contractual cash obligations	$51,601	$41,636	$5,253	$4,712

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, investments available for sale, interest-bearing deposits in other banks, and mortgage loans held for sale. Our primary liquid assets accounted for 36.38% and 38.83% of total assets at December 31, 2016 and 2015, respectively. Securities classified as available for sale, which are not pledged, may be sold in response to changes in interest rates and liquidity needs. All of the securities presently owned are classified as Available for Sale. Net cash provided by operations and deposits from customers have been the primary sources of liquidity. At December 31, 2016, we had unused short-term lines of credit totaling approximately $21 million (which can be withdrawn at the lender's option). Additional sources of funds available to us for additional liquidity needs include borrowing on a short-term basis from the Federal Reserve System, increasing deposits by raising interest rates paid and selling mortgage loans held for sale. We also established a Borrower-In-Custody arrangement with the Federal Reserve. This arrangement permits us to retain possession of assets pledged as collateral to secure advances from the Federal Reserve Discount Window. At December 31, 2016 we could borrow up to $75 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 reliance on certificates of deposit greater than $100,000 and other large deposits. We maintain a Contingency Funding Plan ("CFP") that identifies liquidity needs and weighs alternate courses of action designed to address these needs in emergency situations. We perform a quarterly cash flow analysis and stress test the CFP to evaluate the expected funding needs and funding capacity during a liquidity stress event. We believe our liquidity sources are adequate to meet our operating needs and do not know of any trends, events or uncertainties that may result in a significant adverse effect on our liquidity position. At December 31, 2016 and 2015, our liquidity ratio was 38.27% and 37.27%, respectively.

Composition of Average Assets

	2016	2015	2014	2013	2012
Loans (1)	$265,151,258	$243,729,630	$232,281,473	$226,267,071	$220,780,471
Investment securities available for sale	110,762,289	110,633,399	99,488,314	67,484,036	57,982,652
Federal funds sold and other investments including interest-bearing deposits in other banks	26,474,258	17,549,903	19,588,597	31,524,293	32,386,509
Non-earning assets	8,193,755	7,614,172	7,415,900	6,817,090	6,288,906
Total average assets	$410,581,560	$379,527,104	$358,774,284	$332,092,490	$317,438,538

(1) Including mortgage loans to be sold and deferred fees.

Average earning assets increased by $30,474,873 from 2015 to 2016. This increase was primarily due to a $21,421,628 increase in average loans and an $8,924,355 increase in average interest-bearing deposits in other banks. We have seen an increase in loan demand primarily due to our business development efforts coupled with an improving economy.

ANALYSIS OF CHANGES IN NET INTEREST INCOME

The following table shows changes in interest income and expense based upon changes in volume and changes in rates:

	2016 vs. 2015			2015 vs. 2014			2014 vs. 2013		
	Volume	Rate	Net Dollar Change (1)	Volume	Rate	Net Dollar Change (1)	Volume	Rate	Net Dollar Change (1)
Loans (2)	$1,038,280	$18,317	$1,056,597	$554,074	$(21,819)	$532,255	$294,070	$(219,770)	$74,300
Investment securities available for sale	2,780	(86,785)	(84,005)	239,933	43,671	283,604	679,162	(56,281)	622,881
Interest-bearing deposits in other banks	31,025	62,032	93,057	(5,272)	1,107	(4,165)	(30,304)	(415)	(30,719)
Interest Income	$1,072,085	$(6,436)	$1,065,649	$788,735	$22,959	$811,694	$942,928	$(276,466)	$666,462
Interest-bearing transaction accounts	$28,628	$1,050	$29,678	$9,146	$215	$9,361	$(203)	$68	$(135)
Savings	3,061	295	3,356	3,474	(268)	3,206	4,584	107	4,691
Time deposits	(48,234)	(7,529)	(55,763)	(17,738)	(1,633)	(19,371)	15,375	(27,793)	(12,418)
Securities sold under agreement to repurchase	(1,817)	891	(926)	(160)	412	252	681	—	681
Interest expense	$(18,362)	$(5,293)	$(23,655)	$(5,278)	$(1,274)	$(6,552)	$20,437	$(27,618)	$(7,181)
Increase in net interest income			$1,089,304			$818,246			$673,643

(1) Volume/Rate changes have been allocated to each category based on the percentage of each to the total change.

(2) Including mortgage loans to be sold

YIELDS ON AVERAGE EARNING ASSETS AND RATES ON AVERAGE INTEREST-BEARING LIABILITIES

	2016			2015			2014	
	Average Balance	Interest Paid/ Earned	Average Yield/ Rate (1)	Average Balance	Interest Paid/Earned	Average Yield/Rate (1)	Average Balance	Interest Paid/Earned
Interest-Earning Assets								
Loans (2)	$265,151,258	$12,851,900	4.85%	$243,729,630	$11,795,303	4.84%	$232,281,473	$11,263,048
Investment securities available for sale	110,762,289	2,305,074	2.08%	110,633,399	2,389,079	2.16%	99,488,314	2,105,475
Interest-bearing deposits in other banks	26,474,258	138,623	0.52%	17,549,903	45,566	0.26%	19,588,597	49,731
Total earning assets	$402,387,805	$15,295,597	3.80%	$371,912,932	$14,229,948	3.83%	$351,358,384	$13,418,254
Interest-Bearing Liabilities:								
Interest-bearing transaction accounts	$167,534,223	$164,286	0.10%	$138,332,181	$134,608	0.10%	$128,932,314	$125,247
Savings	28,687,719	34,271	0.12%	26,123,223	30,915	0.12%	23,189,946	27,709
Time deposits	47,930,721	180,176	0.38%	60,726,160	235,939	0.39%	65,289,165	255,310
Securities sold under agreement to repurchase	751	7	0.93%	1,934,493	933	0.05%	2,426,044	681
Total interest-bearing liabilities	$244,153,414	$378,740	0.16%	$227,116,057	$402,395	0.18%	$219,837,469	$408,947
Net interest spread			3.64%			3.65%		
Net interest margin			3.71%			3.72%		
Net interest income		$14,916,857			$13,827,553			$13,009,307

(1) The effect of forgone interest income as a result of non-accrual loans was not considered in the above analysis.

(2) Average loan balances include non-accrual loans and mortgage loans to be sold.

INVESTMENT PORTFOLIO

The following tables summarize the carrying value of investment securities as of the indicated dates and the weighted-average yields of those securities at December 31, 2016.

December 31, 2016 *(in thousands)*	Amortized Cost Due					
	Due Within One Year	After One Through Five Years	After Five Through Ten Years	After Ten Years	Total	Market Value
Investment securities						
U.S. Treasury Notes	$—	$24,148	$—	$—	$24,148	$23,939
Government-sponsored Enterprises	—	40,897	10,841	—	51,738	51,034
Municipal securities	3,343	17,804	18,821	5,089	45,057	45,006
Total	$3,343	$82,849	$29,662	$5,089	$120,943	$119,979
Weighted average yields						
U.S. Treasury Notes	— %	1.70 %	— %	— %		
Government-sponsored Enterprises	— %	1.81 %	1.46 %	— %		
Municipal securities	1.92 %	2.43 %	2.64 %	2.11 %		
Total	1.92 %	1.91 %	2.21 %	2.11 %	1.99 %	

December 31, 2015 *(in thousands)*	Book Value	Market Value
Investment securities		
U.S. Treasury Notes	$34,518	$34,634
Government-sponsored Enterprises	51,136	51,284
Municipal securities	32,768	34,080
Total	$118,422	$119,998

December 31, 2014 *(in thousands)*	**Book Value**	**Market Value**
Investment securities		
U.S. Treasury Notes	$29,162	$29,248
Government-sponsored Enterprises	50,195	50,143
Municipal securities	32,664	34,603
Total	$112,021	$113,994

At December 31, 2016, we had four US Treasury Notes with an unrealized loss of $250,385, eight Agency Notes with an unrealized loss of $833,321 and fifty-four Municipal Securities with an unrealized loss of $816,413 compared to two US Treasury Notes with an unrealized loss of $45,360, three Agency Notes with an unrealized loss of $133,744 and six Municipal Securities with an unrealized loss of $28,724 at December 31, 2015. The unrealized losses on these investments were caused by interest rate increases. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the amortized cost of the investment. Therefore, these investments are not considered other-than-temporarily impaired. We have the ability to hold these investments until market price recovery or maturity.

The primary purpose of the investment portfolio is to fund loan demand, to help manage fluctuations in deposits and liquidity, to satisfy pledging requirements and, at the same time, to generate a favorable return on investment. In doing these things, our main objective is to adhere to sound investment practices. To that end, all purchases and sales of investment securities are made through reputable securities dealers that have been approved by the Board of Directors, who also review the entire investment portfolio at each regular monthly meeting. In addition, we report to the Board on a monthly basis any purchases, sales, calls, and maturities during the previous month. Furthermore, a financial underwriting review of all municipal securities and their corresponding municipalities is conducted annually by Credit Personnel and reviewed by management.

LOAN PORTFOLIO COMPOSITION

We focus our lending activities on small and middle market businesses, professionals and individuals in our geographic markets. At December 31, 2016, outstanding loans (including mortgage loans and deferred loan fees of $136,446) totaled $264,959,325, which equaled 71.13% of total deposits and 64.01% of total assets. Substantially all loans were to borrowers located in our market area of Charleston, Dorchester and Berkeley counties of South Carolina.

The following is a schedule of our loan portfolio, excluding both mortgage loans to be sold and deferred loan fees, as of December 31, 2016, as compared to the prior four years:

	Book Value (in 000's)				
	As of December 31,				
Type	2016	2015	2014	2013	2012
Commercial and industrial loans	$52,393	$50,871	$49,643	$53,183	$54,959
Real estate loans	200,016	185,453	179,238	160,819	157,525
Loans to individuals for household, family and other personal expenditures	6,976	4,985	4,989	4,029	4,365
All other loans (including overdrafts)	1,055	1,196	158	223	159
Total Loans (excluding unearned income)	$260,440	$242,505	$234,028	$218,254	$217,008

We had no foreign loans or loans to fund leveraged buyouts ("LBO's") at any time during the years ended December 31, 2012 through December 31, 2016.

The following table presents the contractual terms to maturity for loans outstanding at December 31, 2016. Demand loans, loans having no stated schedule of repayment or stated maturity, and overdrafts are reported as due in one year or less. The table does not include an estimate of prepayments, which can significantly affect the average life of loans and may cause our actual principal experience to differ from that shown.

SELECTED LOAN MATURITY (in 000's)

AT DECEMBER 31, 2016

	One year or less	Over one but less than five years	Over five years	**Total**
Type				
Commercial and industrial loans	$42,117	$10,216	$60	$52,393
Real estate loans	133,339	54,411	12,266	200,016
Loans to individuals for household, family and other personal expenditures	4,341	2,600	35	6,976
All other loans (including overdrafts)	25	1,030	—	1,055
Total Loans (excluding unearned income)	$179,822	$68,257	$12,361	$260,440

Loans maturing after one year with:	
Fixed interest rates	$57,458
Floating interest rates	23,160
	$80,618

IMPAIRED LOANS

A loan is impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans placed on non-accrual status are classified as impaired. However, not all impaired loans are on non-accrual status nor do they all represent a loss.

Impairment loss is measured by:

a. The present value of the future cash flow discounted at the loan's effective interest rate, or, alternatively,

b. The fair value of the collateral if the loan is collateral dependent.

The following is a schedule of our impaired loans (non-accrual loans included) and non-accrual loans.

Impaired Loans

At December 31,

2016	2015	2014	2013	2012
$5,901,784	$6,542,707	$7,051,127	$7,136,907	$11,498,279

Non-Accrual Loans

At December 31,

2016	2015	2014	2013	2012
$1,741,621	$2,061,088	$882,413	$1,575,440	$3,993,816

TROUBLED DEBT RESTRUCTURINGS

According to GAAP, we are required to account for certain loan modifications or restructuring as a troubled debt restructuring ("TDR"), when appropriate. In general, the modification or restructuring of a debt is considered a 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. Three factors must always be present:

1. An existing credit must formally be renewed, extended, or modified.

2. The borrower is experiencing financial difficulties.

3. We grant a concession that we would not otherwise consider.

The following is a schedule of our TDR’s including the number of loans represented.

Troubled Debt Restructurings

At December 31,									
2016		**2015**		**2014**		**2013**		**2012**	
#		**#**		**#**		**#**		**#**	
2	$ 378,382	3	$ 458,268	2	$ 466,541	4	$ 1,196,341	5	$ 1,618,278

One TDR with a balance of $72,919 at December 31, 2015, paid out during 2016. During the year ended December 31, 2014 a loan receivable with a balance of $496,090, was removed from TDR status. The borrower consistently paid as agreed and made substantial reductions to principal. Refinance guidance Financial Accounting Standards Board Accounting Standards Codification (“ASC”) 310-20-35-9 allows for a loan to be removed from TDR status if the terms of the loan reflect current market rates and the loan has been performing under modified terms for an extended period of time or under certain circumstances. In addition, one loan receivable with a balance of $106,194 at December 31, 2013, was paid off during the year ended December 31, 2014. We do not know of any potential problem loans which will not meet their contractual obligations that are not otherwise discussed herein.

ALLOWANCE FOR LOAN LOSSES

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

1) Specific reserve analysis for impaired loans based on Financial Accounting Standards Board ("FASB") "receivables" topic ASC 310-10-35.

2) General reserve analysis applying historical loss rates based on FASB "contingencies" topic ASC 450-20.

3) Qualitative or environmental factors.

Loans greater than $50,000 are reviewed for impairment on a quarterly basis if any of the following criteria are met:

1) Any loan on non-accrual

2) Any loan that is a troubled debt restructuring

3) Any loan over 60 days past due

4) Any loan rated sub-standard, doubtful, or loss

5) Excessive principal extensions are executed

6) If we are provided information that indicates we will not collect all principal and interest as scheduled

Impairment is measured by the present value of the future cash flow discounted at the loan's effective interest rate, or, alternatively the fair value of the collateral if the loan is collateral dependent. An impaired loan may not represent an expected loss.

A general reserve analysis is performed on all loans, excluding impaired loans. This analysis includes a pool of loans that are reviewed for impairment but are not found to be impaired. Historical losses are segregated into risk-similar groups and a loss ratio is determined for each group over a five-year period. The five-year average loss ratio by type is then used to calculate the estimated loss based on the current balance of each group. The five-year historical loss percentage was .058% and .115% at December 31, 2016 and 2015, respectively.

Qualitative and environmental loss factors are also applied against the portfolio, excluding impaired loans. These factors include external risk factors that we believe are representative of our overall lending environment. We believe that the following factors create a more comprehensive loss projection which we can use to monitor the quality of the loan portfolio.

1) Portfolio risk

a) Levels and trends in delinquencies and impaired loans and changes in loan rating matrix

b) Trends in volume and terms of loans

c) Over-margined real estate lending risk

2) National and local economic trends and conditions

3) Effects of changes in risk selection and underwriting practices

4) Experience, ability and depth of lending management staff

5) Industry conditions

6) Effects of changes in credit concentrations

a) Loan concentration

b) Geographic concentration

c) Regulatory concentration

7) Loan and credit administration risk

a) Collateral documentation

b) Insurance risk

c) Maintenance of financial information risk

The sum of each component’s analysis contributes to the “estimated loss” within our total portfolio.

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

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

Although significantly under the threshold of 100% of capital (currently approximately $41 million), the number of overmargined real estate loans currently totals approximately $10,015,945 or approximately 3.84% of our loan portfolio at December 31, 2016 compared to $11,441,700 or approximately 4.61% of the loan portfolio at December 31, 2015.

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

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

The quality of our loan portfolio is contingent upon our risk selection and underwriting practices. All new credits (except for mortgage loans in the process of being sold to investors and loans secured by properly margined negotiable securities traded on an established market or other cash collateral) with over $200,000 in exposure are reviewed by the Loan Committee on a monthly basis. The Board of Directors review credits over $500,000 monthly. Annual credit analyses are conducted on credits over $350,000 upon the receipt of updated financial information. Prior to any extension of credit, every significant commercial loan goes through sound credit underwriting. The Credit Department conducts a detailed cash flow on each proposal using the most current financial information.

We have over 350 years of lending experience among our lending staff. In addition to the lending staff, we have an Advisory Board for each office comprised of business and community leaders from the specific office market area. An additional Advisory Board was created during the year ended December 31, 2012, to support our business efforts in the North Charleston area of South Carolina. We meet with these advisory boards quarterly to discuss the trends and conditions in each respective market. We are aware of the many challenges currently facing the banking industry. As other banks look to increase earnings in the short term, we will continue to emphasize the need to maintain safe and sound lending practices and core deposit growth managed with a long term objective.

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

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

As of December 31, 2016, there were only two Standard Industrial Code groups that comprised more than 2% of our total outstanding loans. The two groups are activities related to real estate and offices and clinics of doctors.

We are located along the coast and on an earthquake fault, increasing the chances that a natural disaster may impact us and our borrowers. We have a Disaster Recovery Plan in place; however, the amount of time it would take for our customers to return to normal operations is unknown. Our plan is reviewed and tested annually.

Loan and credit administration risk includes collateral documentation, insurance risk and maintaining financial information risk.

The majority of our loan portfolio is collateralized with a variety of our borrowers' assets. The execution and monitoring of the documentation to properly secure the loan is the responsibility of our lenders and Loan Department. We require insurance coverage naming us as the mortgagee or loss payee. Although insurance risk is also considered collateral documentation risk, the actual coverage, amounts of coverage and increased deductibles are important to management. Recent legislation passed by Congress addresses the need for reform to the National Flood Insurance Program. This legislation, known as the Biggert Waters Flood Insurance Reform and Modernization Act of 2012, resulted in significant unintended consequences causing dramatic increases in the cost of flood insurance coverage and its potential unaffordability. However, on March 14, 2014 the Office of the President signed the 2014 Homeowner Flood Insurance Affordability Act. This law allows most properties to retain their subsidized premiums. Annual rate increases are also limited to 18% per year and the grandfather plan has been reinstated. In addition, the law requires the Federal Emergency Management Agency ("FEMA") to refund policy holders who overpaid for premiums under the Biggert Waters Flood Insurance Reform and Modernization Act of 2012.

Risk includes a function of time during which the borrower's financial condition may change; therefore, keeping financial information up to date is important to us. Our policy requires all new loans (with a credit exposure of $10,000 or more), regardless of the customer's history with us, to have updated financial information. In addition, we monitor appraisals closely as real estate values are improving.

Based on our allowance for loan loss model, we recorded a provision for loan loss of $570,000 for the year ended December 31, 2016 primarily based on loan growth, compared to $192,500 for the year ended December 31, 2015. At December 31, 2016, the five-year average loss ratios were: 0.110% Commercial, 0.059% Consumer, 0.102% 1-4 Residential, 0.000% Real Estate Construction and 0.018% Real Estate Mortgage.

During the year ended December 31, 2016, charge-offs of $208,295 and recoveries of $72,085 were recorded to the allowance for loan losses, resulting in an allowance for loan losses of $3,851,617 or 1.48% of total loans, compared to charge-offs of $201,071 and recoveries of $91,550 resulting in an allowance for loan losses of $3,417,827 or 1.41% of total loans at December 31, 2015.

We had impaired loans totaling $5,901,784 as of December 31, 2016 compared to $6,542,707 at December 31, 2015. Impaired loans include non-accrual loans with balances at December 31, 2016, and 2015, of $1,741,621 and $2,061,088, respectively and TDRs with balances at December 31, 2016 and 2015 of $378,392 and $458,268, respectively. We had two restructured loans at December 31, 2016 and three restructured loans at December 31, 2015. According to GAAP, we are required to account for certain loan modifications or restructuring as a troubled debt restructuring, when appropriate. In general, the modification or restructuring of a debt is considered a 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. We do not know of any loans which will not meet their contractual obligations that are not otherwise discussed herein.

The accrual of interest is generally discontinued on loans which become 90 days past due as to principal or interest. The accrual of interest on some loans, however, may continue even though they are 90 days past due if the loans are well secured or in the process of collection and we deem it appropriate. If non-accrual loans decrease their past due status to less than 30 days for a period of 6 to 9 months, they are reviewed individually to determine if they should be returned to accrual status. At December 31, 2016 there were two loans over 90 days past due still accruing interest compared to one loan over 90 days past due still accruing interest at December 31, 2015. The loans at December 31, 2016 were both considered impaired. One loan subsequently renewed and payments were brought current. The other loan was put on nonaccrual status subsequent to year-end.

Net charge-offs for the year ended December 31, 2016, were $136,210 as compared to net charge-offs of $109,521 for the year ended December 31, 2015. Although uncertainty in the national and international economic outlook still exists, we believe loss exposure in the portfolio is identified, reserved against, and closely monitored, to ensure that changes are promptly addressed in the analysis of reserve adequacy.

The following table represents a summary of loan loss experience for the past five years.

Summary of Loan Loss Experience

(Dollars in thousands)	**2016**	**2015**	**2014**	**2013**	**2012**
Balance of allowance for loan losses at beginning of period	$3,418	$3,335	$3,292	$3,433	$3,107
Charge offs:					
Commercial	(33)	(100)	(83)	(245)	(60)
Commercial real estate - construction	—	—	—	—	—
Commercial real estate - other	(78)	(55)	(16)	—	(44)
Consumer real estate	(82)	(6)	—	—	(56)
Consumer other	(15)	(40)	(14)	(146)	(12)
Total charge-offs	**(208)**	**(201)**	**(113)**	**(391)**	**(172)**
Recoveries:					
Commercial	—	9	—	23	110
Commercial real estate - construction	—	—	—	—	—
Commercial real estate - other	65	54	46	15	13
Consumer real estate	—	6	—	—	10
Consumer other	7	22	27	5	15
Total recoveries	**72**	**91**	**73**	**43**	**148**
Net charge-offs	**(136)**	**(110)**	**(40)**	**(348)**	**(24)**
Provision charged to operations	570	193	83	207	350
Balance of allowance for loan losses at end of period	$3,852	$3,418	$3,335	$3,292	$3,433

We believe the allowance for loan losses at December 31, 2016, is adequate to cover estimated losses in the loan portfolio; however, assessing the adequacy of the allowance is a process that requires considerable judgment. Our judgments are based on numerous assumptions about current events that we believe to be reasonable, but may or may not be valid. Thus, there can be no assurance that loan losses in future periods will not exceed the current allowance amount or that future increases in the allowance will not be required. No assurance can be given that our ongoing evaluation of the loan portfolio in light of changing economic conditions and other relevant circumstances will not require significant future additions to the allowance, thus adversely affecting our operating results.

The following table presents a breakdown of the allowance for loan losses for the past five years.

	December 31,									
	2016		2015		2014		2013		2012	
(in thousands)	**$**	%(1)	**$**	%(1)	**$**	%(1)	**$**	%(1)	**$**	%(1)
Commercial	$1,545	20 %	$897	21 %	$1,211	21 %	$1,449	24 %	$1,576	25 %
Commercial:										
Real Estate - Construction	52	1 %	60	1 %	43	1 %	22	1 %	31	1 %
Real Estate - Other	1,375	47 %	1,345	47 %	1,112	49 %	1,064	49 %	767	50 %
Consumer:										
Real Estate	726	29 %	941	29 %	863	27 %	673	25 %	947	22 %
Other	154	3 %	175	2 %	105	2 %	84	2 %	112	2 %
	$3,852	100%	$3,418	100%	$3,335	100%	$3,292	100%	$3,433	100%

(1) Loan category as a percentage of total loans.

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

The methodology used to determine the reserve for unfunded lending commitments, which is included in other liabilities, is inherently similar to the methodology used to determine the allowance for loan losses described above, adjusted for factors specific to binding commitments, including the probability of funding and historical loss ratio. A provision of $4,001 was recorded during the year ended December 31, 2016. No provision was considered necessary for the year ended December 31, 2015. The balance for the reserve for unfunded lending commitments was $24,826 and $20,825 as of December 31, 2016 and 2015, respectively.

OTHER REAL ESTATE OWNED

Real estate acquired as a result of foreclosure or by deed-in-lieu of foreclosure is classified as other real estate owned (“OREO”) until it is sold. When the property is acquired, it is recorded at the lesser of fair value of the property less estimated selling costs or the total loan balance. It is in our best interest to determine the fair market value by engaging an independent appraisal within 30 days of property being acquired into OREO. We cannot hold the property for a period of more than five years unless we have prior approval from the Commissioner of Banking of the State Board of Financial Institutions. The Bank will pay property taxes along with insurance expenses until the property is sold. OREO at December 31, 2016 consisted of one property in the amount of $521,943 compared to two properties in the total amount of $620,394 at December 31, 2015. One property was sold during the year ended

December 31, 2016 for a loss of $13,450. One loan receivable valued at $35,473 was moved to OREO during the year ended December 31, 2014, and ultimately sold at a gain of $2,382. We had no OREO during the years ended December 31, 2012 and December 31, 2013.

NONPERFORMING ASSETS

Nonperforming assets include OREO, nonaccrual loans and loans past due 90 days or more and still accruing interest. The following table summarizes nonperforming assets for the five years ended December 31, 2016:

Nonperforming Assets	**2016**	**2015**	**2014**	**2013**	**2012**
(Dollars in thousands)					
Nonaccrual loans	$1,742	$2,061	$882	$1,575	$3,994
Loans past due 90 days or more and still accruing interest	123	2	1,274	—	—
Total nonperforming loans	1,865	2,063	2,156	1,575	3,994
Other real estate owned	522	620	522	—	—
Total nonperforming assets	$2,387	$2,683	$2,678	$1,575	$3,994
Nonperforming assets to total assets	0.58 %	0.67 %	0.73 %	0.46 %	1.23 %
Nonperforming loans to total loans	0.72 %	0.85 %	0.92 %	0.72 %	1.84 %

DEPOSITS

(in 000's)	1 Day	Less Than 3 Months	3 Months to Less Than 6 Months	6 Months to Less Than 1 Year	1 Year to Less Than 5 Years	5 years or More	Total
CD's and other time deposits 100,000 and over	$225	$13,280	$8,419	$8,236	$1,297	$ —	$31,457
CD's and other time deposits under 100,000	$17	$3,904	$3,401	$3,539	$1,520	$ 3	$12,384

Certificates of Deposit $100,000 and over decreased $9,816,652 or 23.78% for the year ended December 31, 2016, from $41,273,428 at December 31, 2015. This decrease was primarily due to the maturity of Public Funds that were used for construction projects.

The following table presents average deposits by category:

	2016		**2015**		**2014**	
(Dollars in thousands)	**Average Amount**	**Average Rate Paid**	**Average Amount**	**Average Rate Paid**	**Average Amount**	**Average Rate Paid**

Non-interest-bearing demand	$123,670	n/a		$112,788	n/a		$101,720	n/a
Interest-bearing transaction accounts	167,534	0.10	%	138,332	0.10	%	128,932	0.10 %
Savings	28,688	0.12	%	26,123	0.12	%	23,190	0.12 %
Time deposits	47,931	0.38	%	60,726	0.39	%	65,289	0.39 %
Total average deposits	**$367,823**			**$337,969**			**$319,131**	

Deposits increased $13,804,239 or 3.85% to $372,522,851 at December 31, 2016, from $358,718,612 at December 31, 2015. Non-interest bearing deposits increased $3,961,082 to $126,034,478 at December 31, 2016, primarily from new account growth and an improved economy. We also experienced larger balances in existing customer accounts as well as large escrow deposits resulting in an increase in our interest-bearing demand deposit accounts.

We fund growth through core deposits and do not have and therefore do not rely on Brokered Deposits or Internet Deposits as a source to do so.

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SHORT-TERM BORROWINGS

Securities sold under agreements to repurchase with customers mature on demand. At December 31, 2016 and 2015, there were no securities sold under agreements to repurchase. There was no amount outstanding at any month end during 2016. The maximum amount of securities sold under agreements to repurchase outstanding at any month end was $5,480,927 for the year ended December 31, 2015. The average amount of outstanding securities sold under agreements to repurchase was $751 and $1,873,507 during the years ended December 31, 2016 and 2015, respectively. The securities underlying repurchase agreements are held in safekeeping by an authorized broker. At the maturity date of the agreement, the securities are returned to our account.

At December 31, 2016 and 2015, we had no outstanding federal funds purchased. We have a Borrower-In-Custody arrangement with the Federal Reserve. This arrangement permits the Company to retain possession of loans pledged as collateral to secure advances from the Federal Reserve Discount Window. Under this agreement, we may borrow up to $75 million. We established this arrangement as an additional source of liquidity. There have been no borrowings under this arrangement.

At December 31, 2016 and 2015, the Bank had unused short-term lines of credit totaling approximately $21,000,000 and $18,000,000, respectively (which are withdrawable at the lender’s option).

OFF-BALANCE SHEET ARRANGEMENTS

In the normal course of operations, we engage in a variety of financial transactions that, in accordance with generally accepted accounting principles, are not recorded in the financial statements, or are recorded in amounts that differ from the notional amounts. These transactions involve, to varying degrees, elements of credit, interest rate, and liquidity risk. We use such transactions for general corporate purposes or for customer needs. Corporate purpose transactions are used to help manage credit, interest rate and liquidity risk or to optimize capital. Customer transactions are used to manage customer requests for funding.

Our off-balance sheet arrangements consist principally of commitments to extend credit described below. We estimate probable losses related to binding unfunded lending commitments and record a reserve for unfunded lending commitments in other liabilities on the consolidated balance sheet. At December 31, 2016 and 2015, the balance of this reserve was $24,827 and $20,825, respectively. At December 31, 2016 and 2015, we had no interests in non-consolidated special purpose entities.

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 $81,234,269 and $87,622,437 at December 31, 2016 and 2015, respectively.

Standby letters of credit represent our obligation to a third party contingent upon the failure of our customer to perform under the terms of an underlying contract with the third party or obligates us to guarantee or stand as surety for the benefit of the third party. The underlying contract may entail either financial or nonfinancial obligations and may involve such things as the shipment of goods, performance of a contract, or repayment of an obligation. Under the terms of a standby letter, generally drafts will be drawn only when the underlying event fails to occur as intended. We can seek recovery of the amounts paid from the borrower. The majority of these standby letters of credit are unsecured. Commitments under standby letters of credit are usually for one year or less. The maximum potential amount of undiscounted future payments related to standby letters of credit at December 31, 2016 and 2015 was $793,992 and $745,187, respectively.

We originate certain fixed rate residential loans and commit these loans for sale. The commitments to originate fixed rate residential loans and the sales commitments are freestanding derivative instruments. We had forward sales commitments, totaling $4,386,210 at December 31, 2016, to sell loans held for sale of $4,386,210, compared to forward sales commitments of $5,820,239 at December 31, 2015, to sell loans held for sale of $5,820,239. The fair value of these commitments was not significant at December 31, 2016 or 2015. We had no embedded derivative instruments requiring separate accounting treatment.

Once we sell certain fixed rate residential loans, the loans are no longer reportable on our balance sheet. With most of these sales, we have an obligation to repurchase the loan in the event of a default of principal or interest on the loan. This recourse period ranges from three to nine months. Misrepresentation or fraud carries unlimited time for recourse. The unpaid principal balance of loans sold with recourse was $18.1 million at December 31, 2016 and $13.1 million at December 31, 2015. For the twelve months ended December 31, 2016 and December 31, 2015, there were no loans repurchased.

EFFECT OF INFLATION AND CHANGING PRICES

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles (“GAAP”) which require the measurement of financial position and results of operations in terms of historical dollars without consideration of changes in the relative purchasing power over time due to inflation.

Unlike most other industries, the assets and liabilities of financial institutions such as the Company are primarily monetary in nature. As a result, interest rates generally have a more significant impact on our performance than do the effects of general levels of inflation and changes in prices. In addition, interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. We strive to manage the relationship between interest-sensitive assets and liabilities in order to protect against wide interest rate fluctuations, including those resulting from inflation.

CAPITAL RESOURCES

Our capital needs have been met to date through the $10,600,000 in capital raised in our initial offering, the retention of earnings less dividends paid and the exercise of options to purchase stock. Total shareholders’ equity at December 31, 2016 was $40,612,974. 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.

At December 31, 2016, the Bank was categorized as "well capitalized". To be categorized as "well capitalized" the Bank must maintain minimum total risk based, Tier 1 risk based, common equity Tier 1 risk based capital and Tier 1 leverage ratios of 10%, 8.0%, 6.5% and 5%, respectively, and to be categorized as "adequately capitalized," the Bank must maintain minimum total risk based, Tier 1 risk based, common equity Tier 1 risk based capital, and Tier 1 leverage ratios of 8%, 6%, 4.5%, and 4.0%, 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. We believe, as of December 31, 2016, that the Company and the Bank meet all capital adequacy requirements to which we are subject.

There are no current conditions or events that we are aware of that would change the Company’s or the Bank’s category.

Please see “Notes to Consolidated Financial Statements” for the Company’s and the Bank’s various capital ratios at December 31, 2016.

Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>

See the Market Risk section in “Management’s Discussion and Analysis of Financial Condition and Results of Operation” included in Item 7 of this report.

Item 8. Financial Statements and Supplementary Data

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors

Bank of South Carolina Corporation and Subsidiary

Charleston, South Carolina

We have audited the accompanying consolidated balance sheets of Bank of South Carolina Corporation and Subsidiary as of December 31, 2016 and 2015, and the related consolidated statements of operations, comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2016. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Bank of South Carolina Corporation and Subsidiary as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

/s/ Elliott Davis Decosimo, LLC

Columbia, South Carolina

March 3, 2017

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BANK OF SOUTH CAROLINA CORPORATION AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

	DECEMBER 31, 2016	2015
ASSETS		
Cash and due from banks	$8,141,030	$5,295,924
Interest-bearing deposits in other banks	18,101,300	23,898,862
Investment securities available for sale (amortized cost of $120,942,615 and $118,422,116 in 2016 and 2015, respectively)	119,978,944	119,997,585
Mortgage loans to be sold	4,386,210	5,820,239
Loans	260,576,115	242,622,705
Less: Allowance for loan losses	(3,851,617)	(3,417,827)
Net loans	256,724,498	239,204,878
Premises, equipment and leasehold improvements, net	2,296,624	2,289,228
Other real estate owned	521,943	620,394
Accrued interest receivable	1,614,002	1,284,063
Other assets	2,185,085	761,339
Total assets	$413,949,636	$399,172,512
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Deposits:		
Non-interest-bearing demand	$126,034,478	$122,073,396
Interest-bearing demand	96,260,589	84,977,640
Money market accounts	77,307,662	70,233,422
Time deposits over $250,000	17,822,136	25,896,768
Other time deposits	26,019,121	28,871,044
Other savings deposits	29,078,865	26,666,342
Total deposits	372,522,851	358,718,612
Accrued interest payable and other liabilities	813,811	1,302,188
Total liabilities	373,336,662	360,020,800
Commitments and contingencies Notes 6 and 11		
Shareholders' equity		
Common stock-no par, 12,000,000 shares authorized; 5,197,535 and 5,157,996 shares issued at December 31, 2016 and 2015, respectively; 4,956,139 and 4,916,600 shares outstanding at December 31, 2016 and 2015, respectively	—	—
Additional paid in capital	36,824,022	36,341,744
Retained earnings	6,643,476	4,064,834
Treasury stock: 241,396 shares at December 31, 2016 and 2015	(2,247,415)	(2,247,415)
Accumulated other comprehensive income (loss), net of income taxes	(607,109)	992,549
Total shareholders' equity	40,612,974	39,151,712
Total liabilities and shareholders' equity	$413,949,636	$399,172,512

See accompanying notes to consolidated financial statements.

BANK OF SOUTH CAROLINA CORPORATION AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS

	YEARS ENDED DECEMBER 31,		
	2016	2015	2014
Interest and fee income			
Loans, including fees	$12,851,900	$11,795,303	$11,263,048
Taxable securities	1,297,636	1,376,441	1,045,592
Tax-exempt securities	1,007,438		