BANK OF SOUTH CAROLINA CORP
Form 10-K
March 04, 2019

UNITED STATES

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, 2018

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

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 10-K 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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

Emerging Growth Company

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

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

Aggregate market value of the voting stock held by non-affiliates, computed by reference to the closing price of such stock on June 30, 2018 was $74,908,192.

As of February 14, 2019, the Registrant has outstanding 5,514,305 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 that 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 Bank of South Carolina Corporation (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 the 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," "anticipat "predict," "project," "potential," "continue," "assume," "believe," "intend," "plan," "forecast," "goal," and "estimate," as well 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, 2018 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 and changes in the mix or type of deposit products and services
Continued availability of senior management and ability to attract and retain key personnel
Technological changes
Increased cybersecurity risk, including potential business disruptions or financial losses
Ability to control expenses
Changes in compensation
Risks associated with income taxes including potential for adverse adjustments
Changes in accounting policies and practices
Changes in regulatory actions, including the potential for adverse adjustments
Recently enacted or proposed legislation and changes in political conditions
Reputational risk

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

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 the Company, effective April 17, 1995. At the time of the reorganization, each outstanding share of the Bank was exchanged for two shares of Company stock.

Market Area

The Bank operates as an independent, community oriented, commercial bank providing a broad range of financial services and products to the Charleston – North Charleston metro area, which includes Charleston, Berkeley, and Dorchester county. 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 at 9403 Highway 78, North Charleston, SC in 2019 (copy of the lease incorporated as Exhibit 10.13 in the June 30, 2017 Form 10-Q).

The Charleston – North Charleston metro area grew 33.11% between 2012 and 2017 according to the U.S. Bureau of Economic Analysis. The primary economic drivers of our market area are manufacturing, hospitality, technology, and the healthcare industry. This includes manufacturing campuses for Boeing, Volvo Cars, and Mercedes-Benz Vans in the area. Hospitality has also contributed to the economic growth as both Conde Nast Traveler and Travel Leisure Magazine have recognized the area as a top tourism destination. Additionally, Charleston is considered the number one mid-sized U.S. metro area for IT growth according to the U.S. Bureau of Labor Statistics.

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 (ticker symbol: 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
relative lending limits in the case of loans
increase in non-banking financial institutions providing similar services
continued consolidation, and
legislative, regulatory, economic, and technological changes

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 by emphasizing exceptional service 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 personal guarantees. Our primary lending activities are for commercial,

commercial real estate, and consumer purposes, with the largest category being commercial real estate. Most of our lending activity is to borrowers within our market area.

Commercial Loans

As of December 31, 2018, $54.8 million, or 19.96%, of our loan portfolio consisted of commercial loans. We originate various types of secured and unsecured commercial loans to customers in our market area in order to provide customers with working capital and funds for other general business purposes. The term of these loans generally range from less than one year to 10 years. These loans bear either a fixed interest rate or an interest rate linked to a variable market index, depending on the individual loan, its purpose, and underwriting of that loan.

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 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 adequacy of any collateral.

Commercial Real Estate Loans

As of December 31, 2018, commercial real estate construction loans comprised $7.3 million, or 2.66%, of our loan portfolio. We make construction loans for commercial properties to businesses. Advances on construction loans are made in accordance with a schedule reflecting the cost of construction. Loans are typically underwritten with a maximum loan to value ratio of 80% based on current appraisals with value defined as the purchase price, appraised value, or cost of construction, whichever is lower. Repayment of construction loans on non-residential and income-producing properties is normally attributable to rental income, income from the borrower's operating entity, or the sale of the property. Construction loans are interest-only during the construction period, which typically does not exceed twelve 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.

As of December 31, 2018, $143.7 million, or 52.32%, of our loan portfolio consisted of other 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.

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 a deduction for an appropriate vacancy factor and reasonable expenses. We typically require property casualty insurance, title insurance, earthquake insurance, wind and hail coverage, 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.

Consumer Loans

Consumer real estate loans were $63.8 million, or 23.22%, of the loan portfolio as of December 31, 2018. Consumer real estate loans consist of consumer construction loans, consumer real estate loans, HELOCs, and mortgage originations. We make construction loans for owner-occupied residential properties. Advances on construction loans are in accordance with a schedule reflecting the cost of construction, but are limited to a maximum loan-to-value ratio of 80%. 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. Similar to commercial real estate construction financing, consumer 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 real estate loans consist of loans secured by first or second mortgages on primary residences, and originate as adjustable-rate or fixed-rate loans. Owner-occupied properties located in the Company's market area serve as the collateral for these loans. The Company currently originates residential mortgage loans for our portfolio with a maximum loan-to-value ratio of 80% for traditional owner-occupied homes.

In addition to consumer real estate loans, we offer home equity loans and lines of credit secured by the borrower's primary or secondary residence. Our home equity loans and lines of credit currently originate with adjustable- rate with a floor. We generally underwrite home equity loans and lines of credit with the same criteria that we use to underwrite mortgage loans to be sold. For a borrower's primary and secondary residences, home equity loans and lines of credit are typically underwritten with a maximum loan-to-value ratio of 80% 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.

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

Other consumer loans totaled $5.0 million and were 1.83% of the loan portfolio as of December 31, 2018. These loans are originated for various purposes, including the purchase of automobiles, boats, and other personal purposes.

Consumer loans may entail greater credit risk than mortgage loans to be sold, 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.

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 the 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 underwriting standards and loan origination procedures include officer lending limits, which are approved by the Board of Directors. The individual secured/unsecured lending authority of the President/Chief Executive Officer of the Bank is set at $1,500,000 and the individual secured/unsecured lending authority of the Senior Lender/Executive Vice President is set at $750,000. 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. 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, a majority of the Loan Committee or two-thirds of the Board of Directors.

All new credit which results in aggregate direct, indirect, and related credit, not under an approved line of credit of a threshold set forth in our loan policy, 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. Certain new credits that meet a higher threshold than required for the Loan Committee are reviewed by the Board of Directors of the Bank at its regular monthly meeting.

Employees

At December 31, 2018, we employed 79 people, with four individuals considered part time and one individual considered hourly, 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, 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.

The Dodd-Frank Act created the Consumer Financial Protection Bureau (the "CFPB") to centralize responsibility for consumer financial protection, including implementing, examining and enforcing compliance with federal consumer financial laws. The CFPB exercises supervisory review of banks under its jurisdiction. The CFPB focuses 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. 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. Governmental intervention and new regulations could materially and adversely affect our business, financial condition and results of operations.

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, 2018, the Company has evaluated our securities portfolio and has determined that we do not hold any covered funds.

Bank Holding Company Act

The Company is a one-bank holding company under the Federal Bank Holding Company Act of 1956, as amended. As a result, the Company is primarily subject to the supervision, examination and reporting requirements of the Board of Governors (the "Federal Reserve Board") of the Federal Reserve Bank (the "Federal Reserve") under the 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 (see Note 18). The ability of the Company to pay dividends to shareholders 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 to, among other things, 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 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 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, which governs disclosures of credit terms to consumer borrowers
- The Home Mortgage Disclosure Act of 1975, which requires 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
- The Fair Lending Act, which requires 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, which governs the use and provision of information to credit reporting agencies
- The Fair Debt Collection Act, which governs 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 the Federal Reserve Board issued Regulation E to implement the 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.

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 ("USA Patriot Act"). We must maintain a Bank Secrecy Act Program that includes established internal policies, procedures, and controls; a designated compliance officer; an ongoing employee-training program; and testing of the program by an independent audit function. The enactment of the USA Patriot Act amended and expanded the focus of the Bank Secrecy Act to facilitate information sharing among governmental entities and the Company for the purpose of combating terrorism and money laundering. It improves anti-money laundering and financial transparency laws, information collection tools and the enforcement mechanics for the U.S. 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.

Similar in purpose to the Bank Secrecy Act, the Office of Foreign Assets Control ("OFAC"), a division of the U.S. Department of Treasury, controls and imposes economic and trade sanctions based on U.S. foreign policy and national security goals against targeted countries and individuals based on threats to foreign policy, national security, or the U.S. economy. OFAC has and will send banking regulatory agencies lists of names of individuals and organizations suspected of aiding, concealing, or engaging in terrorist acts. Among other things, the Bank must block transactions with or accounts of sanctioned persons and report those transactions after their occurrence.

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"). 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." 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.

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 the Bank. The Bank also 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. A fifth office at 9403 Highway 78 in North Charleston, SC is under construction and will open in 2019. The Company owns the 2027 Sam Rittenberg Boulevard location, which houses the Operations Department of the Bank as well as operating as a banking office. The Company leases all other locations. 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 legal proceedings pending other than routine litigation incidental to the Company's business involving amounts that are not material to our financial condition.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

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

At December 31, 2018, there were 5,777,474 shares issued and 5,510,917 shares outstanding of the 12,000,000 authorized shares of common stock of the Company. Our common stock is traded on the NASDAQ under the trading symbol "BKSC".

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

	High	Low	Dividends
2018			
Quarter ended March 31, 2018	$21.45	$18.90	$ 0.15
Quarter ended June 30, 2018	$21.90	$17.55	$ 0.15
Quarter ended September 30, 2018	$21.15	$19.50	$ 0.25
Quarter ended December 31, 2018	$20.90	$17.89	$ 0.15
2017			
Quarter ended March 31, 2017	$21.85	$19.28	$ 0.14
Quarter ended June 30, 2017	$21.15	$18.80	$ 0.14
Quarter ended September 30, 2017	$19.95	$17.47	$ 0.15
Quarter ended December 31, 2017	$19.35	$18.00	$ 0.15
2016			
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

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.

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 266,557 shares, adjusted for five 10% stock dividends and a 25% stock dividend. At the Annual Meeting in April 2007, the shareholders voted to increase the number of authorized shares from 6,000,000 to 12,000,000.

As of February 14, 2019, there were approximately 1,853 shareholders of record with shares held by individuals and in nominee names. The market price for our common stock as of February 14, 2019, was $18.51. As of February 14, 2019, there were 5,780,862 shares of common stock issued and 5,514,305 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) and submitted the plan to the IRS for approval. The IRS issued a determination letter on September 26, 2013, stating that the plan satisfied 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 restated Plan was submitted to the IRS for approval and a determination letter was issued November 17, 2017, stating that the plan satisfies the requirements of Code Section 4975 (e) (7).

The Board of Directors of the Bank approved a cash contribution of $420,000 to the ESOP for the fiscal year ended December 31, 2018. The Board of Directors of the Bank approved cash contributions of $375,000 and $345,000 for the fiscal years ended December 31, 2017 and 2016, 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.

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 H. Walpole, IV, Fleetwood S. Hassell, Sheryl G. Sharry and Douglas H. Sass, currently serve as the Plan Administrative Committee and Trustees for the Plan. At December 31, 2018, the Plan owned 308,613 shares of common stock of the Company.

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 four 10% stock dividends, and a 25% stock dividend) shares reserved, and a Stock Incentive Plan, which was approved in 2010, with 300,000 (363,000 adjusted for two 10% stock dividends) 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/Long-Range Planning 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.

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.

	2018	2017	2016	2015	2014
For December 31:					
Net income	$6,922,934	$4,901,825	$5,247,063	$4,884,288	$4,398,820
Selected Year End Balances:					
Total assets	429,135,198	446,566,498	413,949,636	399,172,512	367,225,802
Total loans[(1)]	275,863,705	272,274,363	264,962,325	248,442,944	241,442,873
Investment securities available for sale	119,668,874	139,250,250	119,978,944	119,997,585	113,994,112
Interest-bearing deposits at the Federal Reserve	25,506,784	24,034,194	18,101,300	23,898,862	5,680,613
Earning assets	421,039,363	435,558,807	403,042,569	392,339,391	361,117,598
Total deposits	382,378,388	402,888,300	372,522,851	358,718,612	322,419,027
Total shareholders' equity	45,462,561	42,764,635	40,612,974	39,151,712	36,759,982
Weighted average shares outstanding - basic	5,500,027	5,471,001	5,428,884	5,403,749	5,397,929
Weighted average shares outstanding - diluted	5,589,012	5,568,493	5,561,739	5,573,794	5,535,432
For the Year:					
Selected Average Balances:					
Total assets	430,495,412	428,174,359	410,581,560	379,527,104	358,774,284
Total loans[(1)]	277,223,600	264,881,222	265,151,258	243,729,630	232,281,473
Investment securities available for sale	123,347,669	130,161,937	110,762,289	110,633,399	99,488,314
Interest-bearing deposits at the Federal Reserve	20,151,823	23,558,893	26,474,258	17,549,903	19,588,597
Earning assets	420,723,092	418,602,052	402,387,805	371,912,932	351,358,384
Total deposits	386,025,147	384,524,305	367,822,900	337,969,217	319,131,466
Total shareholders' equity	43,691,359	43,121,778	41,479,755	38,631,718	36,283,441
Performance Ratios:					
Return on average equity	15.85 %	11.37 %	12.65 %	12.64 %	12.12 %
Return on average assets	1.61 %	1.14 %	1.28 %	1.29 %	1.23 %
Average equity to average assets	10.15 %	10.07 %	10.10 %	10.18 %	10.11 %
Net interest margin	4.15 %	3.76 %	3.71 %	3.72 %	3.70 %

Net (recoveries) charge-offs to average loans	(0.01)%	0.01%	0.05%	0.04%	0.02%
Allowance for loan losses as a percentage of total loans[2]	1.53%	1.43%	1.48%	1.41%	1.42%
Per Share:					
Basic income per common share[3]	$1.26	$0.90	$0.97	$0.90	$0.81
Diluted income per common share[3]	$1.24	$0.88	$0.94	$0.88	$0.79
Year end book value[3]	$8.25	$7.79	$7.45	$7.24	$7.49
Dividends per common share	$0.58	$0.58	$0.54	$0.52	$0.62
Dividend payout ratio	54.68%	58.87%	50.86%	49.94%	62.88%
Full time employee equivalents	79	77	74	81	77

(1) Including mortgage loans to be sold.
(2) Excluding mortgage loans to be sold.
(3) Adjusted to retroactively reflect 10% stock dividend.

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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

The Company is a bank holding company headquartered in Charleston, South Carolina, with $429.1 million in assets as of December 31, 2018 and net income of $6.9 million for the year ended December 31, 2018. The Company offers a broad range of financial services through its wholly owned subsidiary, 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 investment securities. The primary source of funding for making these loans and investment securities is our interest and non-interest-bearing deposits. Consequently, one of the key measures of our success is the amount of net interest income, or the difference between the income on our interest-earning assets, such as loans and investments, and the expense on our interest-bearing liabilities, such as deposits. Another key measure is the spread between the yield we earn on these interest-earning assets and the rate we pay on our interest-bearing liabilities.

A consequence of lending activities is that we may incur credit losses. The amount of such losses will vary depending upon the risk characteristics of the loan portfolio as affected by economic conditions such as rising interest rates and the financial performance of borrowers. The reserve for credit losses consists of the allowance for loan losses (the “allowance”) and a reserve for unfunded commitments (the “unfunded reserve”). The allowance provides for probable and estimable losses inherent in our loan portfolio while the unfunded reserve provides for potential losses related to unfunded lending commitments. For a detailed discussion on the allowance for loan losses, see “Allowance for Loan Losses”.

In addition to earning interest on loans and investment securities, 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, 2018 as compared to December 31, 2017 and our operating results for 2018 compared to 2017 and 2017 compared to 2016, 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 accounting principles generally accepted in the United States ("GAAP") 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 of this report.

Certain accounting policies involve significant judgments and assumptions made 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 factors that we believe to be reasonable under the circumstances. Because of the number of judgments and assumptions that we make, actual results could differ and 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, 2018 TO DECEMBER 31, 2017

Net income increased $2.0 million or 41.23% to $6.9 million, or basic and diluted income per share of $1.26 and $1.24, respectively, for the year ended December 31, 2018 from $4.9 million or basic and diluted income per share of $0.90 and $0.88, respectively, for the year ended December 31, 2017. The increase in net income was primarily due to improved margins resulting from a lower corporate tax rate due to the enactment of the Tax Cuts and Jobs Act and rising interest rates on interest-earning assets. Our returns on average assets and average equity for the year ended December 31, 2018 were 1.61% and 15.85%, respectively, compared with 1.14% and 11.37%, respectively, for the year ended December 31, 2017.

Net interest income increased $1.7 million or 10.78% to $17.4 million for the year ended December 31, 2018 from $15.7 million for the year ended December 31, 2017. This increase was primarily due to increases in interest and fees on loans and investment securities. Interest and fees on loans increased $1.8 million or 13.84% to $15.1 million for the year ended December 31, 2018 from $13.3 million for the year ended December 31, 2017, as the result of the increases in the Federal Funds target rate set by the Federal Reserve. Interest income on investment securities increased $4,980 or 0.31% to $2.6 million for the year ended December 31, 2018.

Average earning assets increased $2.1 million or 0.51% to $420.7 million for the year ended December 31, 2018 from $418.6 million for the year ended December 31, 2017. This is primarily related to the increase in the average balance of loans offset by decreases in average investment securities and interest-bearing deposits at the Federal Reserve.

The provision to the allowance for loan losses for the year ended December 31, 2018 was $325,000 compared to $55,000 for the year ended December 31, 2017. The increase was primarily driven by the growth of our loan portfolio in accordance with our allowance for loan loss methodology. The Board of Directors determined that this provision was appropriate based upon the adequacy of our reserve. Charge-offs of $115,887 and recoveries of $129,820, together with the provision to the allowance, resulted in an allowance for loan losses of $4,214,331 or 1.53% of total loans at December 31, 2018.

Other income decreased $273,846 or 12.07% to $2.0 million for the year ended December 31, 2018, from $2.3 million for the year ended December 31, 2017. Our mortgage banking income decreased $270,564 or 25.59% to $786,893 for the year ended December 31, 2018 from $1.1 million for the year ended December 31, 2017 due to decreased volume. We were also impacted by an increase in competition as new banks entered the market area. Mortgage banking income is highly influenced by mortgage interest rates and the housing market.

Other expense increased $837,938 or 8.18% to $11.1 million for the year ended December 31, 2018, from $10.2 million for the year ended December 31, 2017. Salaries and employee benefits increased $427,398 or 7.05% from $6.1 million for the year ended December 31, 2017 to $6.5 million for the year ended December 31, 2018. Other operating expenses increased $435,726 to $3.0 million during the year ended December 31, 2018 from $2.5 million during the year ended December 31, 2017. This increase is directly related to the amortization expense of $354,888 for our investment in a Federal Rehabilitation Tax Credit.

For the year ended December 31, 2018, the Company’s effective tax rate was 13.81% compared to 36.48% during the year ended December 31, 2017. The decrease in the effective tax rate is directly related to the income tax expense recorded due to the revaluation of the deferred tax asset in 2017, as well as our investment in a Federal Rehabilitation Tax Credit in 2018. As a result of the enactment of the Tax Cuts and Jobs Act, which changed the corporate tax rate to 21% from 34%, the deferred tax asset was revalued on December 22, 2017. This revaluation resulted in additional income tax expense of $666,674 in 2017.

COMPARISON OF THE YEAR ENDED DECEMBER 31, 2017 TO DECEMBER 31, 2016

Net income decreased $345,238 or 6.58% to $4.9 million, or basic and diluted income per share of $0.90 and $0.88, respectively for the year ended December 31, 2017 from $5.2 million or basic and diluted income per share of $0.97 and $0.94, respectively for the year ended December 31, 2016. The decrease in net income was primarily due to the enactment of the Tax Cuts and Jobs Act on December 22, 2017 and the related revaluation of the deferred tax asset. Deferred tax assets and liabilities must be adjusted to legislation based on the enactment date not the effective date; therefore, the deferred tax asset was revalued at a corporate tax rate of 21% instead of 34% in accordance with GAAP at December 22, 2017. This revaluation resulted in additional income tax expense of $666,674. Our returns on average assets and average equity for the year ended December 31, 2017 were 1.14% and 11.37%, respectively, compared with 1.28% and 12.65%, respectively, for the year ended December 31, 2016.

Net interest income increased $828,427 or 5.55% to $15.7 million for the year ended December 31, 2017 from $14.9 million for the year ended December 31, 2016. This increase was primarily due to increases in interest and fees on loans and investment securities. Interest and fees on loans increased $435,418 or 3.89% to $13.3 million for the year ended December 31, 2017 from $12.9 million for the year ended December 31, 2016, as the result of the increases in the Federal Funds rate set by the Federal Reserve. Interest income on investment securities increased $306,944 or 13.32% to $2.6 million for the year ended December 31, 2017 from $2.3 million for the year ended December 31, 2016 a result of the increase in the average balance of investment securities from $110.8 million for the year ended December 31, 2016 to $130.2 million for the year ended December 31, 2017.

Average earning assets increased $16.2 million or 4.03% to $418.6 million for the year ended December 31, 2017 from $402.4 million for the year ended December 31, 2016. This is primarily related to the increase in the average balance of investment securities as stated in the previous paragraph.

The provision to the allowance for loan losses for the year ended December 31, 2017 was $55,000 compared to $570,000 for the year ended December 31, 2016. The decrease was primarily a result of slower loan growth in the first three quarters of the year and lower net charge-offs. The Board of Directors determined that this provision was appropriate based upon the adequacy of our reserve and the anticipation of continued loan growth and an improving economy. Charge-offs of $185,449 and recoveries of $154,230, together with the provision to the allowance, resulted in an allowance for loan losses of $3.9 million or 1.43% of total loans at December 31, 2017.

Other income decreased $592,612 or 20.71% to $2.3 million for the year ended December 31, 2017. Our mortgage banking income decreased $330,283 or 23.80% to $1.1 million for the year ended December 31, 2017 from $1.4 million for the year ended December 31, 2016 due to decreased volume. We were also impacted by an increase in competition as new banks enter the market area. Mortgage banking income is highly influenced by mortgage interest rates and the housing market. Mortgage loan originations decreased $20.2 million or 26.62% to $55.8 million for the year ended December 31, 2017 from $76.0 million for the year ended December 31, 2016. We also had gains of $380,904 on the sales of investment securities during the year ended December 31, 2016 compared to gains of $45,820 during the year ended December 31, 2017, a decrease of $335,084 or 87.97%. The decrease in gains was due to the little difference between short-term and long-term rates for bonds of the same credit quality in the current market.

Other expense decreased $30,148 or 0.29% to $10.2 million for the year ended December 31, 2017, from $10.3 million for the year ended December 31, 2016. Salaries and employee benefits decreased $27,098 or 0.45% from $6.1 million for the year ended December 31, 2016 to $6.1 million for the year ended December 31, 2017. Other operating expenses decreased $122,039 to $2.5 million during the year ended December 31, 2017 from $2.6 million during the year ended December 31, 2016. This decrease was primarily attributable to a decrease in state and FDIC insurance and fees. Our net occupancy expense increased $43,028 or 2.82% to $1.6 million for the year ended December 31, 2017, from $1.5 million for the year ended December 31, 2016. 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, 2017, the Company's effective tax rate was 36.48% compared to 24.34% during the year ended December 31, 2016. The increase in the effective tax rate is directly related to the income tax expense recorded due to the revaluation of the deferred tax asset. As a result of the enactment of the Tax Cuts and Jobs Act changing the corporate tax rate to 21% from 34%, the deferred tax asset was revalued on December 22, 2017. This revaluation resulted in additional income tax expense of $666,674.

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, and 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 Asset Liability/Investment Committee ("ALCO") manages asset and liability procedures though the ultimate responsibility rests with the President/Chief Executive Officer. At December 31, 2018, total assets decreased 3.90% to $429.1 million from $446.6 million as of December 31, 2017 and total deposits decreased 5.09% to $382.4 million from $402.9 million as of December 31, 2017.

As of December 31, 2018, earning assets, which are composed of U.S. Treasury, Government Sponsored Enterprises and Municipal Securities in the amount of $119.7 million, interest-bearing deposits at the Federal Reserve in the amount of $25.5 million and total loans, including mortgage loans held for sale, in the amount of $275.9 million, constituted approximately 98.11% of our total assets.

The yield on a majority of our earning assets adjusts in tandem 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 the funding by deposit and borrowing activities.

Our policy is to minimize interest rate risk between interest-earning assets and interest-bearing 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 and or precipitous change in interest rates. The average net interest rate margin for 2018 increased to 4.15% from 3.76% for 2017. The average net interest margin for 2017 increased to 3.76% from 3.71% for 2016. At December 31, 2018 and 2017, 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, 2018, the average maturity of the investment portfolio was 3.69 years with an average yield of 2.08% compared to 3.90 years with an average yield of 2.04% at December 31, 2017.

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.