

Board of Governors of the Federal Reserve System



Annual Report of Holding Companies—FR Y-6

Report at the close of business as of the end of fiscal year

This Report is required by law: Section 5(c)(1)(A) of the Bank Holding Company Act (12 U.S.C. § 1844(c)(1)(A)); sections 8(a) and 13(a) of the International Banking Act (12 U.S.C. §§ 3106(a) and 3108(a)); sections 11(a)(1), 25, and 25A of the Federal Reserve Act (12 U.S.C. §§ 248(a)(1), 602, and 611a); and sections 113, 165, 312, 618, and 809 of the Dodd-Frank Act (12 U.S.C. §§ 5361, 5365, 5412, 1850a(c)(1), and 5468(b)(1)). Return to the appropriate Federal Reserve Bank the original and the number of copies specified.

NOTE: The *Annual Report of Holding Companies* must be signed by one director of the top-tier holding company. This individual should also be a senior official of the top-tier holding company. In the event that the top-tier holding company does not have an individual who is a senior official and is also a director, the chairman of the board must sign the report. If the holding company is an ESOP/ESOT formed as a corporation or is an LLC, see the General Instructions for the authorized individual who must sign the report.

I, James B Schwiers

Name of the Holding Company Director and Official

President

Title of the Holding Company Director and Official

attest that the *Annual Report of Holding Companies* (including the supporting attachments) for this report date has been prepared in conformance with the instructions issued by the Federal Reserve System and are true and correct to the best of my knowledge and belief.

With respect to information regarding individuals contained in this report, the Reporter certifies that it has the authority to provide this information to the Federal Reserve. The Reporter also certifies that it has the authority, on behalf of each individual, to consent or object to public release of information regarding that individual. The Federal Reserve may assume, in the absence of a request for confidential treatment submitted in accordance with the Board's "Rules Regarding Availability of Information," 12 C.F.R. Part 261, that the Reporter and individual consent to public release of all details in the report concerning that individual.

Signature of Holding Company Director and Official

Date of Signature

For holding companies not registered with the SEC—
 Indicate status of Annual Report to Shareholders:

- is included with the FR Y-6 report
- will be sent under separate cover
- is not prepared

For Federal Reserve Bank Use Only

RSSD ID
 C.I.

2929833

This report form is to be filed by all top-tier bank holding companies, top-tier savings and loan holding companies, and U.S. intermediate holding companies organized under U.S. law, and by any foreign banking organization that does not meet the requirements of and is not treated as a qualifying foreign banking organization under Section 211.23 of Regulation K (12 C.F.R. § 211.23). (See page one of the general instructions for more detail of who must file.) The Federal Reserve may not conduct or sponsor, and an organization (or a person) is not required to respond to, an information collection unless it displays a currently valid OMB control number.

Date of Report (top-tier holding company's fiscal year-end):

December 31, 2018

Month / Day / Year

54930053479GFRVTR22

Reporter's Legal Entity Identifier (LEI) (20-Character LEI Code)

Reporter's Name, Street, and Mailing Address

GrandSouth Bancorporation

Legal Title of Holding Company

PO Box 6548

(Mailing Address of the Holding Company) Street / P.O. Box

Greenville SC 29606

City State Zip Code

381 Halton Road, Greenville, SC 29607

Physical Location (if different from mailing address)

Person to whom questions about this report should be directed:

John B Garrett

CFO

Name

Title

864-527-7170

Area Code / Phone Number / Extension

864-527-7120

Area Code / FAX Number

jb.garrett@grandsouth.com

E-mail Address

www.grandsouth.com

Address (URL) for the Holding Company's web page

Is confidential treatment requested for any portion of this report submission?

0=No
 1=Yes 0

In accordance with the General Instructions for this report (check only one),

- 1. a letter justifying this request is being provided along with the report.....
- 2. a letter justifying this request has been provided separately ...

NOTE: Information for which confidential treatment is being requested must be provided separately and labeled as "confidential."

For Use By Tiered Holding Companies

Top-tiered holding companies must list the names, mailing address, and physical locations of each of their subsidiary holding companies below.

GrandSouth Bank

Legal Title of Subsidiary Holding Company

PO Box 6548

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

Greenville SC 29606

City State Zip Code

381 Halton Road, Greenville, SC 29607

Physical Location (if different from mailing address)

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

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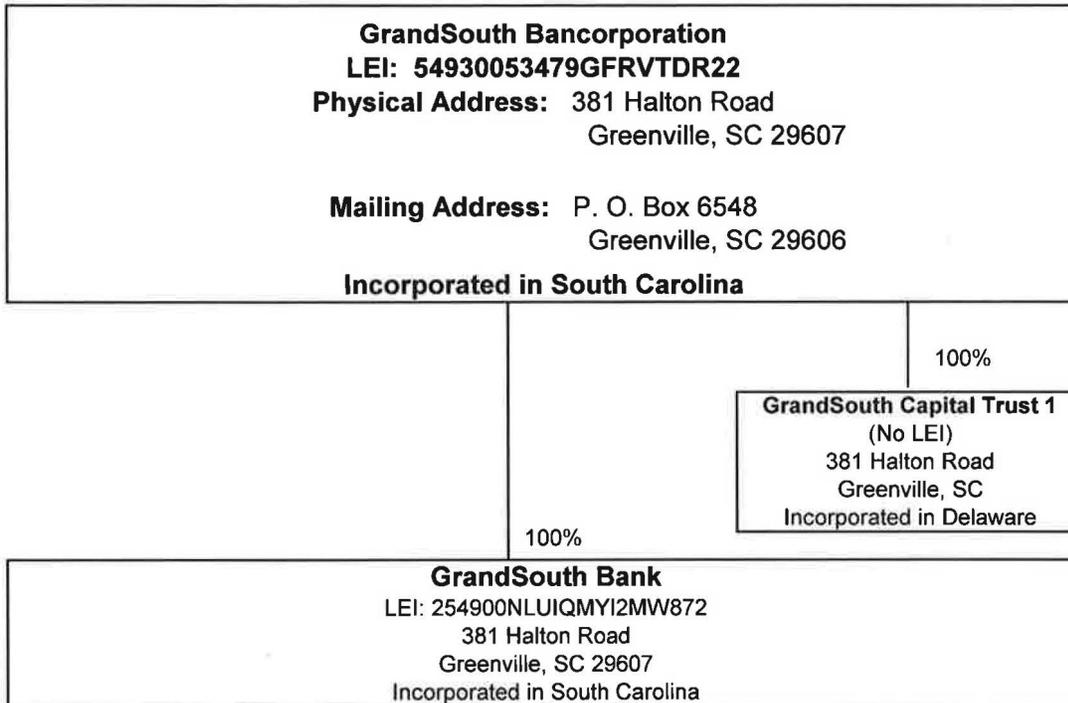
Form FR Y-6

GrandSouth Bancorporation, Inc.
381 Halton Road
Greenville, South Carolina 29607
Fiscal Year Ending December 31, 2018

Report Item

1: The BHC does not prepare form 10K with the SEC.
Enclosed are two copies of the company's audited financial statements.

2a: Organizational Chart



2b: Domestic branches

- Main Office: 381 Halton Road
Greenville, SC 29607
- Full service branch: 325 South Main Street
Fountain Inn, SC 29644
- Full service branch: 1601 North Fant Street
Anderson, SC 29621
- Full service branch: 501 West Wade Hampton Blvd.
Greer, SC 29650
- Full service branch: 1901 Assembly St
Columbia, SC 29201
- Full service branch: 1055 St Matthews Rd
Orangeburg, SC 29115

Results: A list of branches for your depository institution: GRANDSOUTH BANK (ID_RSSD: 2728661).
 This depository institution is held by GRANDSOUTH BANCORPORATION (2929833) of GREENVILLE, SC.
 The data are as of 12/31/2018. Data reflects information that was received and processed through 01/06/2019.

Reconciliation and Verification Steps

1. In the **Data Action** column of each branch row, enter one or more of the actions specified below
2. If required, enter the date in the **Effective Date** column

Actions

OK: If the branch information is correct, enter 'OK' in the **Data Action** column.
Change: If the branch information is incorrect or incomplete, revise the data, enter 'Change' in the **Data Action** column and the date when this information first became valid in the **Effective Date** column.
Close: If a branch listed was sold or closed, enter 'Close' in the **Data Action** column and the sale or closure date in the **Effective Date** column.
Delete: If a branch listed was never owned by this depository institution, enter 'Delete' in the **Data Action** column.
Add: If a reportable branch is missing, insert a row, add the branch data, and enter 'Add' in the **Data Action** column and the opening or acquisition date in the **Effective Date** column.

If printing this list, you may need to adjust your page setup in MS Excel. Try using landscape orientation, page scaling, and/or legal sized paper.

Submission Procedure

When you are finished, send a saved copy to your FRB contact. See the detailed instructions on this site for more information.
 If you are e-mailing this to your FRB contact, put your institution name, city and state in the subject line of the e-mail.

Note:

To satisfy the **FR Y-10 reporting requirements**, you must also submit FR Y-10 Domestic Branch Schedules for each branch with a **Data Action** of Change, Close, Delete, or Add.
 The FR Y-10 report may be submitted in a hardcopy format or via the FR Y-10 Online application - <https://y10online.federalreserve.gov>.

* FDIC UNINUM, Office Number, and ID_RSSD columns are for reference only. Verification of these values is not required.

Data Action	Effective Date	Branch Service Type	Branch ID_RSSD*	Popular Name	Street Address	City	State	Zip Code	County	Country	FDIC UNINUM*	Office Number*	Head Office	Head Office ID_RSSD*	Comments
OK		Full Service (Head Office)	2728661	GRANDSOUTH BANK	381 HALTON ROAD	GREENVILLE	SC	29607	GREENVILLE	UNITED STATES	Not Required	Not Required	GRANDSOUTH BANK	2728661	
Change	4/26/2006	Full Service	3678491	ANDERSON BRANCH	1601 NORTH FANT STREET	ANDERSON	SC	29621	ANDERSON	UNITED STATES	Not Required	Not Required	GRANDSOUTH BANK	2728661	
OK		Full Service	5040168	COLUMBIA BRANCH	1901 ASSEMBLY STREET, SUITE 100	COLUMBIA	SC	29201	RICHLAND	UNITED STATES	Not Required	Not Required	GRANDSOUTH BANK	2728661	
OK		Full Service	3281958	FOUNTAIN INN BRANCH	325 SOUTH MAIN STREET	FOUNTAIN INN	SC	29644	GREENVILLE	UNITED STATES	Not Required	Not Required	GRANDSOUTH BANK	2728661	
OK		Full Service	4932453	GREER BRANCH	501 WEST WADE HAMPTON BOULEVARD	GREER	SC	29650	GREENVILLE	UNITED STATES	Not Required	Not Required	GRANDSOUTH BANK	2728661	
OK		Full Service	5044719	ORANGEBURG BRANCH	1055 ST MATTHEWS ROAD	ORANGEBURG	SC	29115	ORANGEBURG	UNITED STATES	Not Required	Not Required	GRANDSOUTH BANK	2728661	

Form FR Y-6
 GrandSouth Bancorporation, Inc.
 December 31, 2018

Report Item 3: Securities holders

Current Shareholders with ownership, control or holdings of 5% or more with power to vote as of 12/31/2018

Shareholders not listed in (3)(1)(a) through (3)(1)(c) that had ownership, control or holdings of 5% or more with power to vote during the fiscal year ending 12/31/2018.

Name	City, State	Percentage of Voting Shares in Bank Holding Company
Mason Y. Garrett	Belton, SC United States Citizen	1,003,721 - 22.0% Common Stock 30,390 - 0.7% Options on Common Stock
John B. Garrett	Greenville, SC United States Citizen	449,015 - 9.9% Common Stock 25,840 - 0.6% Options on Common Stock

Name	City, State	Percentage of Voting Shares in Bank Holding Company
	<i>N/A</i>	

Form FR Y-6
GrandSouth Bancorporation, Inc.
December 31, 2018

Report Item 4: Insiders

(1) Names & Address (City, State, Country)	(2) Principal Occupation if other than with Bank Holding Company	(3)(a) Title & Position with Bank Holding Company	(3)(b) Title & Position with Subsidiaries (include names of subsidiaries)	(3)(c) Title & Position with Other Businesses (include names of other businesses)	(4)(a) Percentage of Voting Shares in Bank Holding Company	(4)(b) Percentage of Voting Shares in Subsidiaries (include names of subsidiaries)	(4)(c) List names of other companies (include partnerships) if 25% or more of voting securities are held (List names of companies and percentage of voting securities held)
Mason Y. Garrett Belton, SC	N/A	Chairman & CEO Director	Director & Chairman GrandSouth Bank	N/A	1,003,721 - 22.0% Common Stock 30,390 - 0.7% Options on Common Stock	N/A	Riverbend Shoals, LLC (34%) Grancono, LLC (50%)
James B. Schwiers Greenville, SC	N/A	President & COO Director	Chief Executive Officer GrandSouth Bank	N/A	23,683 - 0.5% Common Stock 48,000 - 1.1% Options on Common Stock	N/A	N/A
John B. Garrett Greenville, SC	N/A	Chief Financial Officer Director	Chief Financial Officer GrandSouth Bank	N/A	449,015 - 9.9% Common Stock 25,840 - 0.6% Options on Common Stock	N/A	Riverbend Shoals, LLC (20%)
Harold E. Garrett Fountain Inn, SC	Owner, Go With Garrett's Golf Cars and Specialty Vehicles	Director	Director GrandSouth Bank	Owner, Go With Garrett's Golf Cars and Specialty Vehicles	176,166 - 3.9% Common Stock 0 - 0.0% Options on Common Stock	N/A	Go With Garrett's Golf Cars and Specialty Vehicles (100%) Riverbend Shoals, LLC (25%) Grancono, LLC (50%)
Michael L. Gault Fountain Inn, SC	Retired	Director	Director GrandSouth Bank	N/A	69,931 - 1.5% Common Stock 0 - 0.0% Options on Common Stock	N/A	Upstate Investors (33%)
Baety O. Gross, Jr. Simpsonville, SC	Attorney, Baety O Gross, Jr. Attorney at Law	Director	Director & Secretary GrandSouth Bank	Attorney, Baety O Gross, Jr., Attorney at Law Fountain Inn, SC	30,745 - 0.7% Common Stock 0 - 0.0% Options on Common Stock	N/A	Baety O Gross, Jr., Attorney at Law (100%)
S. Hunter Howard, Jr Simpsonville, SC	Owner, CEO, The Springs at Simpsonville	Director	Director GrandSouth Bank	Owner, CEO, The Springs at Simpsonville, Simpsonville, SC	38,437 - 0.8% Common Stock 0 - 0.0% Options on Common Stock	N/A	Curtis Group (70%) Professional Buildings (50%) Howard Development Corp (50%) Hillcrest Centre (50%) HK Realty (99%) Captain Hook LLP (34%) Oceanview III (45%) Jiter Holdings LLC (34%)
Anthony Morgan Easley, SC	President/CEO, A.P. Morgan Investments, LLC	Director	Director GrandSouth Bank	President/CEO, A.P. Morgan Investments, LLC, Easley, SC	8,333 - 0.2% Common Stock 0 - 0.0% Options on Common Stock	N/A	A.P. Morgan Investments, LLC (100%) Due West Farms, LLC (100%) East Butler LLC (20%)
J. Calhoun Pruitt Anderson, SC	Attorney, Pruitt & Pruitt, Anderson, SC	Director	Director GrandSouth Bank	Attorney, Pruitt & Pruitt, Anderson, SC	9,667 - 0.2% Common Stock 0 - 0.0% Options on Common Stock	N/A	Pruitt & Pruitt, Attorneys (100%) McDuffie II, Inc. (100%) Estates at North Hampton, LLC (50%) Fish Camp Associates, LLC (25%) PLUMM, LLC (90%) 24 Properties, LLC (50%)
John Shealy Lexington, SC	Owner, Capital Concrete Company	Director	Director GrandSouth Bank	Owner, Capital Concrete Company	1,500 - 0.0% Common Stock 0 - 0.0% Options on Common Stock	N/A	Capital Concrete Holdings, Inc. (75%) Peak 4, LLC (50%)
Edward Monts Rast, Jr. St. Matthews, SC	Owner, Cameron Ag Products, LLC	Director	Director GrandSouth Bank	Owner, Cameron Ag Products, LLC Cameron, SC	1,000 - 0.0% Common Stock 0 - 0.0% Options on Common Stock	N/A	Cameron Ag Products, LLC (50%) Cameron Ag Services< LLC (33%) Carolina Peanut (25%) Top Dollar Cotton (50%)

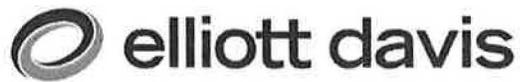
GrandSouth Bancorporation and Subsidiary

Report on Consolidated Financial Statements

For the years ended December 31, 2018 and 2017

GrandSouth Bancorporation and Subsidiary
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Independent Auditor's Report

To the Board of Directors and Shareholders
GrandSouth Bancorporation
Greenville, South Carolina

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of GrandSouth Bancorporation and its Subsidiary which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended and the related notes to the consolidated financial statements (collectively, the financial statements).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of GrandSouth Bancorporation and its Subsidiary as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in cursive script that reads "Elliott Davis, LLC".

Greenville, South Carolina
March 20, 2019

GrandSouth Bancorporation and Subsidiary**Consolidated Balance Sheets****As of December 31, 2018 and 2017**

	<u>2018</u>	<u>2017</u>
	(Dollars in thousands)	
Assets		
Cash and due from banks	\$ 21,048	\$ 22,799
Interest bearing transaction accounts with other banks	7,658	14,290
Federal funds sold	4,250	4,368
Restricted cash	2,060	-
Cash, cash equivalents and restricted cash	35,016	41,457
Certificates of deposit with other banks	13,750	13,500
Securities available-for-sale	40,329	21,440
Other investments, at cost	1,183	1,271
Loans, net of allowance for loan losses of \$9,188 for 2018 and \$7,414 for 2017	654,091	543,980
Premises and equipment, net	12,105	12,215
Bank owned life insurance	6,686	6,543
Assets acquired in settlement of loans	3,564	4,923
Interest receivable	5,185	4,728
Deferred income taxes	1,896	1,664
Goodwill	737	737
Other assets	1,664	1,275
Total assets	<u>\$ 776,206</u>	<u>\$ 653,733</u>
Liabilities and Shareholders' Equity		
Deposits		
Noninterest bearing	\$ 108,828	\$ 89,688
Interest bearing	569,967	480,310
Total deposits	678,795	569,998
Federal Home Loan Bank advances	14,000	19,000
Other borrowings	-	550
Junior subordinated debentures	18,047	8,247
Interest payable	416	208
Other liabilities	7,506	5,097
Total liabilities	<u>718,764</u>	<u>603,100</u>
Commitments and Contingencies - Notes 11 and 14		
Shareholders' equity		
Preferred stock - Series A - no par value; shares issued and outstanding - 287,895	1,298	1,298
Common stock - no par value; 20,000,000 shares authorized; shares issued and outstanding - 4,553,490 for 2018 and 4,502,190 for 2017	33,374	32,650
Retained earnings	23,218	16,921
Accumulated other comprehensive loss	(448)	(236)
Total shareholders' equity	<u>57,442</u>	<u>50,633</u>
Total liabilities and shareholders' equity	<u>\$ 776,206</u>	<u>\$ 653,733</u>

See Notes to Consolidated Financial Statements

GrandSouth Bancorporation and Subsidiary
Consolidated Statements of Income
For the years ended December 31, 2018 and 2017

	2018	2017
	(Dollars in thousands, except per share)	
Interest income		
Interest and fees on loans	\$ 43,168	\$ 36,073
Investment securities:		
Taxable	576	359
Nontaxable	118	114
Dividends	62	56
Other	908	553
Total interest income	<u>44,832</u>	<u>37,155</u>
Interest expense		
Deposits	8,050	4,436
Federal Home Loan Bank advances	228	238
Junior subordinated debt	437	263
Total interest expense	<u>8,715</u>	<u>4,937</u>
Net interest income	36,117	32,218
Provision for loan losses	2,632	6,089
Net interest income after provision for loan losses	<u>33,485</u>	<u>26,129</u>
Noninterest income		
Service charges on deposit accounts	683	529
Gain on sale of securities	-	10
Net gain on sale of premises and equipment	151	19
Increase in value of life insurance assets	143	153
Other	218	172
Total noninterest income	<u>1,195</u>	<u>883</u>
Noninterest expenses		
Salaries and employee benefits	16,734	15,218
Premises and equipment	2,030	1,808
Net loss on sale and impairment of assets acquired in settlement of loans	282	205
Data processing	1,423	1,248
Insurance	849	690
Printing, postage and supplies	478	449
Professional fees	1,518	1,740
Miscellaneous loan expense	1,727	1,739
Other operating	1,432	1,126
Total noninterest expenses	<u>26,473</u>	<u>24,223</u>
Income before income taxes	8,207	2,789
Income tax provision	1,910	1,999
Net income	<u>6,297</u>	<u>790</u>
Deductions for amounts not available to common shareholders:		
Dividends declared or accumulated on preferred stock	-	(91)
Net income available to common shareholders	<u>\$ 6,297</u>	<u>\$ 699</u>
Per common share		
Net income, basic	\$ 1.39	\$ 0.16
Net income, assuming dilution	\$ 1.28	\$ 0.16

See Notes to Consolidated Financial Statements

GrandSouth Bancorporation and Subsidiary
Consolidated Statements of Comprehensive Income
For the years ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
	(Dollars in thousands)	
Net income	\$ 6,297	\$ 790
Other comprehensive income (loss)		
Change in unrealized gain (loss) on securities available for sale		
Unrealized holding gain (loss) arising during the period	(274)	21
Tax expense	62	(11)
Reclassification of realized gain	-	(10)
Tax expense	-	3
Other comprehensive income (loss)	<u>(212)</u>	<u>3</u>
Comprehensive income	<u>\$ 6,085</u>	<u>\$ 793</u>

See Notes to Consolidated Financial Statements

GrandSouth Bancorporation and Subsidiary
Consolidated Statements of Changes in Shareholders' Equity
For the years ended December 31, 2018 and 2017

	Shares of common stock	Common stock	Preferred stock	Retained earnings	Accumulated other comprehensive income (loss)	Total
	(Dollars in thousands)					
Balance, December 31, 2016	4,483,990	\$ 32,058	\$ 1,298	\$ 17,528	\$ (195)	\$ 50,689
Net income	-	-	-	790	-	790
Other comprehensive income	-	-	-	-	3	3
Dividends on preferred stock	-	-	-	(91)	-	(91)
Dividends on common stock	-	-	-	(1,350)	-	(1,350)
Reclassification of income tax effect to retained earnings	-	-	-	44	(44)	-
Exercise of stock options	18,200	103	-	-	-	103
Share-based compensation	-	489	-	-	-	489
Balance, December 31, 2017	4,502,190	\$ 32,650	\$ 1,298	\$ 16,921	\$ (236)	\$ 50,633
Net income	-	-	-	6,297	-	6,297
Other comprehensive loss	-	-	-	-	(212)	(212)
Exercise of stock options	51,300	213	-	-	-	213
Share-based compensation	-	511	-	-	-	511
Balance, December 31, 2018	4,553,490	\$ 33,374	\$ 1,298	\$ 23,218	\$ (448)	\$ 57,442

See Notes to Consolidated Financial Statements

GrandSouth Bancorporation and Subsidiary

Consolidated Statements of Cash Flows

For the years ended December 31, 2018 and 2017

	2018	2017
	(Dollars in thousands)	
Operating activities		
Net income	\$ 6,297	\$ 790
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	2,632	6,089
Writedowns of assets acquired in settlement of loans	328	288
Depreciation	861	772
Securities accretion and premium amortization, net	153	157
Gain on sale and call of available-for-sale securities	-	(10)
Gain on sale or other disposition of premises and equipment	(151)	(19)
Gain on sale of assets acquired in settlement of loans	(39)	(83)
Increase in cash surrender value of bank owned life insurance	(143)	(153)
Deferred income tax benefit	(170)	(142)
Increase in interest receivable	(457)	(973)
Increase in interest payable	208	97
(Increase) decrease in other assets	(389)	401
Increase in other liabilities	2,409	958
Share-based compensation expense	511	489
Net cash provided by operating activities	<u>12,050</u>	<u>8,661</u>
Investing activities		
Purchases of available-for-sale securities	(21,876)	(2,830)
Purchases of certificates of deposit	(3,500)	(12,250)
Maturities and calls of available-for-sale securities	435	4,860
Paydowns of available-for-sale mortgage-backed securities	2,125	1,937
Proceeds from sale of certificates of deposit	3,250	1,250
Purchase of other investments	(783)	(590)
Proceeds from redemptions of other investments	871	638
Purchases of student loans	-	20,000
Net increase in loans made to customers	(113,969)	(157,390)
Purchases of premises and equipment and construction in progress	(811)	(2,819)
Proceeds from sale of premises and equipment	211	62
Proceeds from sale of assets acquired in settlement of loans	2,296	727
Net cash used for investing activities	<u>(131,751)</u>	<u>(146,405)</u>
Financing activities		
Net increase in deposits	106,737	139,671
Proceeds from other borrowings	75	550
Repayment of other borrowings	(625)	-
Proceeds from Federal Home Loan Bank advances	16,000	54,000
Repayment of Federal Home Loan Bank advances	(21,000)	(57,000)
Cash dividends paid on preferred stock	-	(91)
Cash dividends paid on common stock	-	(1,350)
Net proceeds from issuance of subordinated debentures	9,800	-
Proceeds from capital raise in-process	2,060	-
Exercise of stock options	213	103
Net cash provided by financing activities	<u>113,260</u>	<u>135,883</u>
Decrease in cash, cash equivalents, and restricted cash	<u>(6,441)</u>	<u>(1,861)</u>
Cash, cash equivalents, and restricted cash, beginning	<u>41,457</u>	<u>43,318</u>
Cash, cash equivalents, and restricted cash, ending	<u>\$ 35,016</u>	<u>\$ 41,457</u>
Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Interest	\$ 8,507	\$ 4,840
Income taxes	2,361	1,972
Noncash investing and financing activities:		
Transfer of loans to assets acquired in settlement of loans	1,226	954
Change in unrealized gain or loss on available for sale securities	(274)	21
Charge offs of loans	(2,297)	(4,295)

See Notes to Consolidated Financial Statements

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 1. Organization and Significant Accounting Policies

GrandSouth Bancorporation (the "Company") is a South Carolina corporation organized in 2000 for the purpose of being a holding company for GrandSouth Bank (the "Bank"). On October 2, 2000, pursuant to a Plan of Exchange approved by the shareholders, all of the outstanding shares of \$2.50 par value common stock of the Bank were exchanged for shares of no par value common stock of the Company. The Company presently engages in no business other than that of owning the Bank, has no employees, and operates as one business segment. The Company is regulated by the Federal Reserve Board. The consolidated financial statements include the accounts of the Company and the Bank. All significant intercompany transactions and accounts have been eliminated in consolidation. The GrandSouth Capital Trust 1 (see Note 10) is an unconsolidated subsidiary.

The Bank was incorporated in 1998 and operates as a South Carolina chartered bank providing full banking services to its customers. The Bank is subject to regulation by the South Carolina State Board of Financial Institutions and the Federal Deposit Insurance Corporation ("FDIC").

Basis of presentation:

The accounting and reporting policies conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The Company uses the accrual basis of accounting. In certain instances, amounts reported in prior years' consolidated financial statements have been reclassified to conform to the current presentation. Such reclassifications had no effect on previously reported shareholders' equity or net income.

Estimates:

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amounts of income and expenses during the reporting periods. Actual results could differ from those estimates.

Concentrations of credit risk:

The Company makes loans to individuals and small businesses for various personal and commercial purposes primarily in South Carolina. The Company's loan portfolio is not concentrated in loans to any single borrower or in a relatively small number of borrowers; however, 63% of the loan portfolio is secured by real estate. The market risk associated with declining real estate values exposes the Company to potential losses in the event of borrower default. An additional 12% of the Company's loan portfolio is collateralized by automobiles; this concentration is somewhat mitigated by low per-borrower exposure and by the geographical diversity of the borrowers. Management is not aware of any other concentrations of loans to classes of borrowers or industries.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 1. Organization and Significant Accounting Policies, Continued

Concentrations of credit risk, continued:

In addition to monitoring potential concentrations of loans to particular borrowers or groups of borrowers, industries and geographic regions, management monitors exposure to credit risks that could arise from potential concentrations of lending products and practices such as loans that subject borrowers to substantial payment increases (e.g., principal deferral periods, loans with initial interest-only periods, etc.), and loans with high loan-to-value ratios. Additionally, there are industry practices that could subject the Company to increased credit risk should economic conditions change over the course of a loan's life. For example, the Company makes variable rate loans and fixed rate principal-amortizing loans with maturities prior to the loan being fully paid (i.e., balloon payment loans). These loans are underwritten and monitored to manage the associated risks. Management has determined that there is no concentration of credit risk associated with its lending policies or practices.

The Company's investment portfolio consists principally of obligations of the United States of America, government-sponsored entities and general obligation municipal securities. In the opinion of management, there is no concentration of credit risk in its investment portfolio. The Company places its deposits and correspondent accounts with and sells its federal funds to high quality institutions. Management believes credit risk associated with correspondent accounts is not significant.

Cash, cash equivalents, and restricted cash:

The Company considers all highly liquid assets such as cash on hand, noninterest-bearing and interest-bearing amounts due from banks and fed funds sold to be cash equivalents. Restricted cash is cash received for the stock offering in-process as of year-end. In the event that the offering is terminated without closing, all funds in the escrow account will be returned, without interest, to the subscribers.

Investment securities:

The Bank's investments in equity and debt securities are classified into one of three categories:

1. Available-for-sale: Securities that are not classified as either held-to-maturity or as trading securities and are reported at fair value, which is determined using quoted market prices. Unrealized gains and losses are reported, net of income taxes, as separate components of shareholders' equity (accumulated other comprehensive income). Gains or losses on dispositions of securities are based on the difference between the net proceeds and the adjusted carrying amounts of the securities sold using the specific identification method. Premiums and discounts are amortized into interest income by a method that approximates a level yield.
2. Held-to-maturity: Securities that the Company has the ability and intent to hold until maturity. These securities are stated at cost, adjusted for the amortization of premiums and the accretion of discounts. Premiums and discounts are included in interest income using a method that approximates a level yield. The Company has no held-to-maturity securities.
3. Trading: Securities that are bought and held principally for the purpose of selling in the near future. Trading securities are reported at fair value, and related unrealized gains and losses are recognized in the income statement. The Company has no trading securities.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 1. Organization and Significant Accounting Policies, Continued

Investment securities, continued:

Securities are evaluated for other-than-temporary impairment on a quarterly basis or more often if a potential loss-triggering event occurs. Impairment is considered to be other-than-temporary if it is more likely than not that a security will mature or be sold before its amortized cost can be recovered. In determining if there is evidence of credit deterioration, various factors are considered, including the severity of decline in market value below cost, the period of time over which the decline in fair value has existed, and the financial condition and near-term prospects of the issuer, including any specific events that may influence the operations of the issuer.

Investment securities are considered to be other-than-temporarily impaired if it is probable that the issuer will be unable to make contractual payments as required or if management believes that the security's value will not recover within the estimated recovery period. For debt securities, management also considers the causes of the decline in value including changes in the general level of interest rates, as well as industry and issuer-specific factors, the issuer's financial condition, its near-term prospects and current ability to make future payments in a timely manner, changes in rating agencies' ratings at the evaluation date as compared with such ratings at the date of acquisition, and any likely action by such agencies. In addition, for asset-backed securities, the credit performance of the underlying collateral, including delinquency rates, cumulative losses to date, and any remaining credit enhancements is compared with expected credit losses. Other-than-temporary impairments related to credit issues are recognized through earnings.

Other investments:

Other investments include the Bank's investment in the Federal Home Loan Bank of Atlanta ("FHLB") in which, as a member institution, the Bank is required to own stock. The stock is generally pledged against any borrowings from the FHLB. No ready market exists for the stock and it has no quoted market value. However, redemption of the stock historically has been at par value.

Loans and interest income on loans:

Loans are stated at the principal balance outstanding, increased or reduced by deferred net loan costs or fees. The allowance for loan losses is deducted from total loans in the consolidated balance sheets. Loan origination and commitment fees and certain direct loan origination costs (principally salaries and employee benefits) are deferred and amortized as an adjustment of the related loan's yield. Generally, these amounts are amortized over the contractual life of the related loans or commitments. Interest income is recognized on an accrual basis over the term of the loan based on the principal amount outstanding.

Loans are generally placed on nonaccrual status when principal or interest becomes ninety days past due, or when payment in full is not anticipated. When a loan is placed on nonaccrual status, interest accrued but not received is generally reversed against interest income. If collectability is in doubt, cash receipts on nonaccrual loans are not recorded as interest income, but are used to reduce principal. Loans are not returned to accrual status until the borrower demonstrates the ability to pay principal and interest.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 1. Organization and Significant Accounting Policies, Continued

Allowance for loan losses:

The provision for loan losses charged to earnings reflects the amount deemed appropriate by management to establish an adequate allowance to meet the present estimated loss characteristics of the current loan portfolio. Management's estimate is based on periodic and regular evaluation of individual loans, the overall risk characteristics of the various portfolio segments, past experience with losses, and prevailing and anticipated economic conditions. Loans that are determined to be uncollectible are charged against the allowance. The provision for loan losses and recoveries on loans previously charged off are added to the allowance.

The Company accounts for impaired loans at the loan's fair value if it is probable that the lender will be unable to collect all amounts due in accordance with the terms of the loan agreement. Fair value may be determined based upon the present value of expected cash flows, market price of the loan, if available, or value of the underlying collateral. Expected cash flows are required to be discounted at the loan's effective interest rate.

When the ultimate collectability of an impaired loan's principal is in doubt, wholly or partially, all cash receipts are applied to principal. Once the reported principal balance has been reduced to zero, future cash receipts are recoveries of any amounts previously charged off. Further cash receipts are applied to interest income to the extent that any interest has been foregone.

The Company designates loan modifications as troubled debt restructurings ("TDRs") when, for economic or legal reasons related to the borrower's financial difficulties, a concession is granted to the borrower that would not otherwise be considered. Once a loan is classified as a TDR, it is also classified as an impaired loan. If a loan demonstrated performance under the previous terms and shows capacity to continue performing under the restructured terms, the loan will remain on accrual status. If the loan does not perform under the modified terms, the loan is placed on nonaccrual status. However, if a loan is materially delinquent on payments prior to the restructuring, but shows capacity to perform under the modified terms, the loan will be placed on nonaccrual status.

A loan currently on nonaccrual status will return to accrual status when there is economic substance to the restructuring, the remaining note is reasonably assured of repayment in accordance with its modified terms, and the borrower has demonstrated sustained repayment performance in accordance with the modified terms for a reasonable period of time (typically six months).

Premises and equipment:

Premises and equipment are stated at cost, less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets. Maintenance and repairs are charged to operations while major improvements are capitalized. Upon retirement, sale or other disposition of premises and equipment, the cost and accumulated depreciation are eliminated from the accounts and any gain or loss is included in income from operations.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 1. Organization and Significant Accounting Policies, Continued

Bank owned life insurance:

The Company has entered into arrangements that provide for deferred compensation for certain officers. Bank owned life insurance policies provide an informal and indirect method for funding those arrangements. The amounts recorded as bank owned life insurance in the consolidated balance sheets represent the cash surrender value of the policies. The deferred compensation liability is included in other liabilities at the present value of the obligation.

Assets acquired in settlement of loans:

Assets acquired in settlement of loans include real estate acquired through foreclosure or deed taken in lieu of foreclosure and repossessed assets. These assets are recorded at fair value, less estimated costs to sell, at the date of foreclosure, establishing a new cost basis. Loan losses arising from the acquisition of such property as of that date are charged against the allowance for loan losses. Subsequent to foreclosure, valuations are periodically performed by management, and the assets are carried at the lower of the new cost basis or fair value, less estimated costs to sell. Revenues and expenses from operations and changes in any subsequent valuation allowance are included in other noninterest expense in the Consolidated Statements of Income.

Goodwill:

Goodwill is calculated as the purchase premium after adjusting for the fair value of net assets acquired. Goodwill is not amortized but is reviewed for potential impairment on an annual basis, or when events or circumstances indicate a potential impairment, at the reporting unit level. The impairment test is performed in two phases. The first step of the goodwill impairment test compares the fair value of the reporting unit with its carrying amount, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered impaired; however, if the carrying amount of the reporting unit exceeds its fair value, an additional step has to be performed. This additional step compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. An impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. As of December 31, 2018 and 2017, it was determined that the Company's recorded goodwill was not impaired.

Income taxes:

The Company uses an asset and liability approach for financial accounting and reporting of deferred income taxes. Deferred tax assets and liabilities are determined based on the difference between the financial statement and income tax bases of assets and liabilities as measured by the currently enacted tax rates which are assumed will be in effect when these differences reverse. If it is more likely than not that some portion or all of a deferred tax asset will not be realized, a valuation allowance is recognized. Deferred income tax expense or credit is the result of changes in deferred tax assets and liabilities.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 1. Organization and Significant Accounting Policies, Continued

Advertising and public relations expense:

The Company generally expenses advertising and promotion costs as they are incurred. External costs incurred in producing media advertising are expensed the first time the advertising takes place. External costs relating to direct mailings are expensed in the period in which the direct mailings are sent.

Earnings per common share:

Net income available to common shareholders per share is computed on the basis of the weighted average number of common shares outstanding. The treasury stock method is used to compute the effect of stock options on the weighted average number of common shares outstanding for diluted earnings per common share.

As it relates to the Series A Preferred Stock, for diluted earnings per share, it is assumed that the preferred stock was converted to common stock during the reporting period. Dividends on the preferred stock are added back to net income and the shares assumed to be converted are included in the number of shares outstanding.

Statement of cash flows:

For purposes of reporting cash flows, cash, cash equivalents, and restricted cash are defined as those amounts included in the balance sheet caption "Cash and cash equivalents". Cash and cash equivalents have an original maturity of three months or less.

Retirement plan:

The Company has a salary reduction profit sharing plan pursuant to Section 401(k) of the Internal Revenue Code as more fully described in Note 15. The Company does not sponsor any postretirement or postemployment benefits, except with respect to certain supplemental benefits that were provided to certain executive officers by the Board of Directors, as more fully described in Note 15.

Fair value of financial instruments:

The Company is required to provide disclosures of fair value information for financial instruments, whether or not recognized in the consolidated balance sheets, when it is practicable to estimate the fair value. Financial instruments are defined as cash, evidence of an ownership interest in an entity or contractual obligations, which require the exchange of cash or other financial instruments. Certain items are specifically excluded from the disclosure requirements, including the Company's common stock and other nonfinancial instruments such as property and equipment and other assets and liabilities. See Note 18 for fair value disclosures.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 1. Organization and Significant Accounting Policies, Continued

Risks and uncertainties:

In the normal course of business the Company encounters two significant types of risks: economic and regulatory. There are three main components of economic risk: interest rate risk, credit risk and market risk. The Company is subject to interest rate risk to the degree that its interest-bearing liabilities reprice or mature at different times, or on different bases, than its interest-earning assets. Credit risk is the risk of default on the Company's loan and investment securities portfolios that results from a borrower's inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of collateral underlying loans receivable and the valuation of real estate held by the Company.

The Company is subject to the regulations of various governmental agencies (regulatory risk). These regulations can and do change significantly from period to period. The Company undergoes periodic examinations conducted by the regulatory agencies which may subject it to further changes with respect to asset valuations, amounts of required loan loss allowance, and operating restrictions resulting from the regulators' judgments based on information available to them at the time of their examination.

Share-based compensation:

The Company has a share-based employee compensation plan, which is described more fully in Note 16.

Comprehensive income (loss):

Comprehensive income (loss) consists of net income or loss for the current period and other comprehensive income (loss), defined as income, expenses, gains and losses that bypass the consolidated statements of income and are reported directly in a separate component of shareholders' equity. The Company classifies and reports items of other comprehensive income (loss) according to their nature, reports total comprehensive income or loss in the consolidated statements of comprehensive income and displays the accumulated balance of other comprehensive income or loss separately in consolidated statements of changes in shareholders' equity and in the shareholders' equity section of the consolidated balance sheets. See Note 17 for further discussion.

Revenue from contracts with customers:

The Company records revenue from contracts with customers in accordance with Accounting Standards Codification Topic 606, "Revenue from Contracts with Customers" ("Topic 606"). Under Topic 606, the Company must identify the contract with a customer, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when (or as) the Company satisfies a performance obligation. Significant revenue has not been recognized in the current reporting period that results from performance obligations satisfied in previous periods.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 1. Organization and Significant Accounting Policies, Continued

Revenue from contracts with customers, continued:

The Company's primary sources of revenue are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of Topic 606. The Company has evaluated the nature of its contracts with customers and determined that further disaggregation of revenue from contracts with customers into more granular categories beyond what is presented in the Consolidated Statements of Income was not necessary. The Company generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed; charged either on a periodic basis or based on activity. The Company's accounting policies will not change materially since the principles of revenue recognition from the Accounting Standards Update are largely consistent with existing guidance and current practices applied by our business. The following is a discussion of revenues within the scope of the new guidance:

- Service charges on deposit accounts – The Company earns fees from its deposit clients for various transaction-based, account maintenance, and overdraft or non-sufficient funds (“NSF”) services. Transaction-based fees, which include services such as stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Company fulfills the client's request. Account maintenance fees, which relate primarily to monthly maintenance and account management, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Overdraft and NSF fees are recognized at the point in time that the overdraft occurs or the NSF item is presented. Service charges on deposits are withdrawn from the client's account balance.
- ATM and debit card income – The Company earns interchange fees from debit cardholder transactions conducted through the payment networks. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder.
- Gains and losses on assets acquired in the settlement of loans – Prior to the adoption of ASU 2014-09, an institution is required to follow the prescriptive guidance of Topic 360 for sales of assets acquired in the settlement of loans, which might preclude gain recognition when a seller has continuing involvement with a property. For financial institutions, continuing involvement often takes the form of seller financing. However, upon adoption of ASU 2014-09, an institution will follow Subtopic 610-20 for sales of assets acquired in the settlement of loans that are not a business. The central principal of Subtopic 610-20 is that a gain or loss should be recognized upon transfer of control of the asset to the buyer, and Subtopic 610-20 relies on certain recognition and measurement principals in Topic 606 for guidance. Topic 606 provides the following indicators of when control transfers:
 - The seller has a present right to payment for the asset.
 - The buyer has legal title of the asset.
 - The seller has transferred physical possession of the asset.
 - The buyer has the significant risks and rewards of ownership of the asset.
 - The buyer has accepted the asset.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 1. Organization and Significant Accounting Policies, Continued

Recently issued accounting pronouncements:

The following is a summary of recent authoritative pronouncements:

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

In February 2016, the FASB amended the Leases topic of the Accounting Standards Codification. The FASB issued this guidance to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet by lessees for those leases classified as operating leases under current U.S. GAAP and disclosing key information about leasing arrangements. The Company expects that the adoption of the guidance will result in the recognition of lease liabilities totaling approximately \$1.7 million and the recognition of right-of-use assets totaling approximately \$1.7 million. The initial balance sheet gross up upon adoption is primarily related to operating leases of certain real estate properties. The amendments in this guidance are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018. The Company expects to apply this guidance as of the beginning of the period of adoption (January 1, 2019) using the modified retrospective approach and practical expedients for transition and will not restate comparative periods. The practical expedients allow us to largely account for our existing leases consistent with current guidance except for the incremental balance sheet recognition for lessees. We have started an initial evaluation of our leasing contracts and activities. We have also started developing our methodology to estimate the right-of use assets and lease liabilities, which is based on the present value of lease payments (the December 31, 2018 future minimum lease payments were \$1.4 million). We do not expect a material change to the timing of expense recognition but we will continue to evaluate the financial impact as implementation occurs. We are evaluating our existing disclosures and may need to provide additional information as a result of adoption of the guidance.

In June 2016, the FASB issued guidance to change the accounting for credit losses and modify the impairment model for certain debt securities. The amendments will be effective for the Company for reporting periods beginning after December 15, 2020. Early adoption is permitted for all organizations for periods beginning after December 15, 2018.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 1. Organization and Significant Accounting Policies, Continued

Recently issued accounting pronouncements, continued:

The Company will apply the amendments from the ASU through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption. While early adoption is permitted beginning in first quarter 2019, we do not expect to elect that option. We are evaluating the impact of the ASU on our consolidated financial statements. We expect the ASU will result in an increase in the recorded allowance for loan losses given the change to estimated losses over the contractual life of the loans adjusted for expected prepayments. The majority of the increase results from longer duration portfolios. In addition to our allowance for loan losses, we will also record an allowance for credit losses on debt securities instead of applying the impairment model currently utilized. The amount of the adjustments will be impacted by each portfolio's composition and credit quality at the adoption date as well as economic conditions and forecasts at that time.

In November 2016, the FASB amended the Statement of Cash Flows topic of the Accounting Standards Codification to clarify how restricted cash is presented and classified in the statement of cash flows. The amendments were effective for the Company for fiscal years beginning after December 15, 2017 including interim periods within those fiscal years. These amendments did not have a material effect on the Company's financial statements.

In January 2017, the FASB amended the Goodwill and Other Topic of the Accounting Standards Codification to simplify the accounting for goodwill impairment for public business entities and other entities that have goodwill reported in their financial statements and have not elected the private company alternative for the subsequent measurement of goodwill. The amendment removes Step 2 of the goodwill impairment test. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The effective date and transition requirements for the technical corrections will be effective for the Company for reporting periods beginning after December 15, 2020. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not expect these amendments to have a material effect on its financial statements.

In March 2017, the FASB amended the requirements in the Receivables—Nonrefundable Fees and Other Costs Topic of the Accounting Standards Codification related to the amortization period for certain purchased callable debt securities held at a premium. The amendments shorten the amortization period for the premium to the earliest call date. The amendments will be effective for the Company for interim and annual periods beginning after December 15, 2018. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

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

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 1. Organization and Significant Accounting Policies, Continued

Recently issued accounting pronouncements, continued:

In October 2018, the FASB amended the Derivatives and Hedging Topic of the Accounting Standards Codification to expand the list of U.S. benchmark interest rates permitted in the application of hedge accounting. The amendments will be effective for the Company for fiscal years beginning after December 15, 2018. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

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

Note 2. Restrictions on Cash and Due from Banks

The Bank is required by regulation to maintain average cash reserve balances, computed by applying prescribed percentages to its various types of deposits, either at the Bank or in an account maintained with the Federal Reserve Bank. The average amounts of the cash reserve balances required at December 31, 2018 and 2017 were approximately \$1,091,000 and \$56,000, respectively.

Note 3. Investment Securities

The aggregate amortized cost and estimated fair values of securities, as well as gross unrealized gains and losses of securities were as follows:

	December 31							
	2018				2017			
	Amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Estimated fair value	Amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Estimated fair value
	(Dollars in thousands)							
Available-for-sale								
Government-sponsored enterprises (GSEs)	\$ 6,000	\$ -	\$ 162	\$ 5,838	\$ 6,000	\$ -	\$ 137	\$ 5,863
State, county and municipal	7,095	-	77	7,018	2,844	-	32	2,812
Treasury securities	8,941	-	10	8,931	-	-	-	-
Mortgage-backed securities Issued by GSEs	18,873	10	341	18,542	12,902	29	166	12,765
Total	<u>\$ 40,909</u>	<u>\$ 10</u>	<u>\$ 590</u>	<u>\$ 40,329</u>	<u>\$ 21,746</u>	<u>\$ 29</u>	<u>\$ 335</u>	<u>\$ 21,440</u>

Securities issued by government-sponsored enterprises include debt instruments issued by the FHLB, Federal Home Loan Mortgage Company, and the Federal National Mortgage Association. The amortized cost and estimated fair value of securities by contractual maturity are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 3. Investment Securities, continued

	<u>Available-for-sale</u>	
	<u>Amortized cost</u>	<u>Estimated fair value</u>
	(Dollars in thousands)	
Due within one year	\$ 11,442	\$ 11,425
Due after one through five years	2,501	2,438
Due after five through ten years	6,876	6,722
Due after ten years	<u>20,090</u>	<u>19,744</u>
	<u>\$ 40,909</u>	<u>\$ 40,329</u>

The estimated fair values and gross unrealized losses of all of the Company's investment securities whose estimated fair values were less than amortized cost as of December 31, 2018 and 2017 which had not been determined to be other-than-temporarily impaired are presented below. The securities have been aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position.

	<u>Continuously in Unrealized Loss Position for a Period of</u>					
	<u>Less than 12 Months</u>		<u>12 Months or more</u>		<u>Total</u>	
	<u>Estimated fair value</u>	<u>Unrealized loss</u>	<u>Estimated fair value</u>	<u>Unrealized loss</u>	<u>Estimated fair value</u>	<u>Unrealized loss</u>
Available-for-sale, December 31, 2018:	(Dollars in thousands)					
Government-sponsored enterprises	\$ -	\$ -	\$ 5,838	\$ 162	\$ 5,838	\$ 162
State, county and municipal securities	4,691	17	2,328	60	7,019	77
Treasury securities	8,931	10	-	-	8,931	10
Mortgage-backed securities issued by GSEs	<u>8,801</u>	<u>46</u>	<u>9,155</u>	<u>295</u>	<u>17,956</u>	<u>341</u>
Total	<u>\$ 22,423</u>	<u>\$ 73</u>	<u>\$ 17,321</u>	<u>\$ 517</u>	<u>\$ 39,744</u>	<u>\$ 590</u>
Available-for-sale, December 31, 2017:	(Dollars in thousands)					
Government-sponsored enterprises	\$ -	\$ -	\$ 5,863	\$ 137	\$ 5,863	\$ 137
State, county and municipal securities	694	1	1,683	31	2,377	32
Mortgage-backed securities issued by GSEs	<u>5,046</u>	<u>29</u>	<u>5,847</u>	<u>137</u>	<u>10,893</u>	<u>166</u>
Total	<u>\$ 5,740</u>	<u>\$ 30</u>	<u>\$ 13,393</u>	<u>\$ 305</u>	<u>\$ 19,133</u>	<u>\$ 335</u>

The Company individually evaluated the above noted securities that were in an unrealized loss position at December 31, 2018 and 2017, noting that the securities are primarily in an unrealized loss position due to interest rate factors and the broader economy in general. Based on this evaluation of these securities, no other-than-temporary impairment was noted at December 31, 2018 and 2017.

The Bank is a member of the FHLB and, accordingly, is required to own restricted stock in that institution in amounts that may vary from time to time. The FHLB stock is carried at cost because it has no quoted market value and no ready market exists. Investment in FHLB stock is a condition of borrowing from the FHLB, and the stock is pledged to collateralize the borrowings. Dividends received on FHLB stock are included in other interest income.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 3. Investment Securities, Continued

During 2018, the Bank purchased \$783,000 and redeemed \$871,000 in FHLB stock. At December 31, 2018 and 2017, the investment in FHLB stock was \$1,183,000 and \$1,271,000, respectively.

At December 31, 2018 and 2017 respectively, securities with a carrying value of \$500,000 and \$250,000 were pledged as collateral to secure FHLB advances, public deposits and other purposes.

Note 4. Loans

Loans consisted of the following as of December 31:

	<u>2018</u>	<u>2017</u>
	(Dollars in thousands)	
Commercial, financial and agricultural	\$ 199,993	\$ 157,074
Real estate - construction, land development and other land loans	57,206	54,580
Real estate - mortgage	359,798	289,029
Installment loans to individuals	<u>46,282</u>	<u>50,711</u>
Loans, gross	663,279	551,394
Allowance for loan losses	<u>(9,188)</u>	<u>(7,414)</u>
Loans - net	<u>\$ 654,091</u>	<u>\$ 543,980</u>

Variable rate and fixed rate loans totaled \$244,604,000 and \$418,675,000, respectively, at December 31, 2018.

At December 31, 2018, approximately \$30,306,000 of loans were pledged as collateral to secure amounts borrowed from the FHLB.

The Company has purchased a portfolio of student loans with a carrying value of \$36,596,000 and \$43,500,000 at December 31, 2018 and 2017, respectively. The carrying value and accrued interest of these loans is 98% guaranteed by the issuing guarantee agency. These loans are included above in Installment loans to individuals.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 4. Loans, continued

Credit quality:

The following table summarizes delinquencies and nonaccruals, by portfolio class, as of December 31, 2018.

	<u>Commercial, financial and agricultural</u>	<u>Real estate - construction, land development and other land loans</u>	<u>Real estate- mortgage</u>	<u>Installment loans to individuals</u>	<u>Total</u>
	(Dollars in thousands)				
30-59 days past due	\$ 175	\$ -	\$ 556	\$ 1,770	\$ 2,501
60-89 days past due	-	-	1,265	1,159	2,424
90 days, still accruing	-	-	-	4,087	4,087
Nonaccrual	491	-	-	-	491
Total past due and nonaccrual	666	-	1,821	7,016	9,503
Current	199,327	57,206	357,977	39,266	653,776
Total loans	<u>\$ 199,993</u>	<u>\$ 57,206</u>	<u>\$ 359,798</u>	<u>\$ 46,282</u>	<u>\$ 663,279</u>

Of the amounts listed above, \$1,724,000 of the 30-59 days past due, \$1,158,000 of the 60-89 days past due and \$4,087,000 of the greater than 90 days past due, still accruing are 98% guaranteed as to principal and interest by the issuing guarantee agency, and therefore have continued to be accounted for as accruing loans. After 270 days of the borrower's default, the third-party loan servicer will file a claim. The guarantee payment will be for the guaranteed percentage of principal and interest through the date the claim is paid.

The following table summarizes delinquencies and nonaccruals, by portfolio class, as of December 31, 2017.

	<u>Commercial, financial and agricultural</u>	<u>Real estate - construction, land development and other land loans</u>	<u>Real estate- mortgage</u>	<u>Installment loans to individuals</u>	<u>Total</u>
	(Dollars in thousands)				
30-59 days past due	\$ 43	\$ -	\$ -	\$ 1,342	\$ 1,385
60-89 days past due	58	-	66	1,597	1,721
90 days, still accruing	-	-	-	3,417	3,417
Nonaccrual	476	-	1,268	-	1,744
Total past due and nonaccrual	577	-	1,334	6,356	8,267
Current	156,497	54,580	287,695	44,355	543,127
Total loans	<u>\$ 157,074</u>	<u>\$ 54,580</u>	<u>\$ 289,029</u>	<u>\$ 50,711</u>	<u>\$ 551,394</u>

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 4. Loans, Continued

Credit quality, continued:

Of the amounts listed above, \$1,317,000 of the 30-59 days past due, \$1,561,000 of the 60-89 days past due and \$3,417,000 of the greater than 90 days past due, still accruing are 98% guaranteed as to principal and interest by the issuing guarantee agency, and therefore have continued to be accounted for as accruing loans. After 270 days of the borrower's default, the third-party loan servicer will file a claim. The guarantee payment will be for the guaranteed percentage of principal and interest through the date the claim is paid.

The gross interest income that would have been recorded under the original terms of the nonaccrual loans was \$34,000 and \$227,000 for 2018 and 2017, respectively.

As part of the loan review process, loans are given individual credit grades, representing the risk the Company believes is associated with the loan balance. Credit grades are assigned based on factors that impact the collectability of the loan, the strength of the borrower, the type of collateral, and loan performance. Commercial loans are individually graded at origination and credit grades are reviewed on a regular basis in accordance with our loan policy. Consumer loans are assigned a "pass" credit rating (grade 5 or better) unless something within the loan warrants a specific classification grade.

The following table summarizes management's internal credit risk grades, by portfolio class, as of December 31, 2018.

	<u>Commercial, financial and agricultural</u>	<u>Real estate - construction, land development and other land loans</u>	<u>Real estate- mortgage</u>	<u>Installment loans to individuals</u>	<u>Total</u>
	(Dollars in thousands)				
Grade 1 – Minimum risk	\$ 478	\$ -	\$ -	\$ 151	\$ 629
Grade 2 – High quality	1,949	-	313	58	2,320
Grade 3 – Above average	1,326	1,190	4,184	30	6,730
Grade 4 – Average	25,782	13,905	116,982	1,938	158,607
Grade 5 – Acceptable	167,977	41,670	224,528	44,051	478,226
Grade 6 – Watch list	306	33	4,402	38	4,779
Grade 7 – Substandard	2,175	408	9,389	16	11,988
Total loans	<u>\$ 199,993</u>	<u>\$ 57,206</u>	<u>\$ 359,798</u>	<u>\$ 46,282</u>	<u>\$ 663,279</u>

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 4. Loans, Continued

Credit quality, continued:

The following table summarizes management's internal credit risk grades, by portfolio class, as of December 31, 2017.

	<u>Commercial, financial and agricultural</u>	<u>Real estate - construction, land development and other land loans</u>	<u>Real estate- mortgage</u>	<u>Installment loans to individuals</u>	<u>Total</u>
	(Dollars in thousands)				
Grade 1 – Minimum risk	\$ 196	\$ -	\$ -	\$ 232	\$ 428
Grade 2 – High quality	1,151	-	335	10	1,496
Grade 3 – Above average	1,100	59	5,927	32	7,118
Grade 4 – Average	20,187	9,738	84,793	962	115,680
Grade 5 – Acceptable	131,947	43,293	183,213	49,409	407,862
Grade 6 – Watch list	1,421	1,066	4,370	56	6,913
Grade 7 – Substandard	<u>1,072</u>	<u>424</u>	<u>10,391</u>	<u>10</u>	<u>11,897</u>
Total loans	<u>\$ 157,074</u>	<u>\$ 54,580</u>	<u>\$ 289,029</u>	<u>\$ 50,711</u>	<u>\$ 551,394</u>

At December 31, 2018 and 2017, approximately 97%, respectively, of the loan portfolio, had a credit grade of Acceptable or better. For loans to qualify for this grade, they must be performing relatively close to expectations, with no significant departures from the intended source and timing of repayment. Loans totaling \$4.8 million and \$6.9 million were classified as watch list at December 31, 2018 and 2017, respectively. This classification is utilized for loans with an elevated credit risk to borrowers with an adequate credit history and financial strength and are experiencing declining trends (e.g., financial, economic, or industry specific). Loans are designated as such in order to be monitored more closely than other credits in the loan portfolio. At December 31, 2018 and 2017, substandard loans totaled \$12.0 million and \$11.9 million, respectively. This classification is employed when loans are inadequately protected by the current sound worth and paying capacity of the borrower or of the collateral pledged; have well-defined weaknesses that jeopardize the liquidation of the loan; and there is a distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 4. Loans, Continued

Credit quality, continued:

The following tables summarize information relative to impaired loans individually evaluated for impairment, by portfolio class, at December 31, 2018 and 2017. The recorded investment in impaired loans is the unpaid principal balance, net of loan principal charged off.

	<u>December 31, 2018</u>		
	<u>Unpaid principal balance</u>	<u>Recorded investment</u>	<u>Related allowance</u>
	(Dollars in thousands)		
With no related allowance recorded:			
Commercial, financial and agricultural	\$ 1,462	\$ 1,462	\$ -
Real estate- construction, land development and other land loans	201	201	-
Real estate - mortgage	6,704	6,704	-
Installment loans to individuals	-	-	-
With related allowance recorded:			
Commercial, financial and agricultural	563	563	216
Real estate- construction, land development and other land loans	-	-	-
Real estate - mortgage	155	155	55
Installment loans to individuals	-	-	-
Total:			
Commercial, financial and agricultural	2,025	2,025	216
Real estate- construction, land development and other land loans	201	201	-
Real estate - mortgage	6,859	6,859	55
Installment loans to individuals	-	-	-
	<u>\$ 9,085</u>	<u>\$ 9,085</u>	<u>\$ 271</u>

GrandSouth Bancorporation and Subsidiary**Notes to Consolidated Financial Statements****December 31, 2018 and 2017**

Note 4. Loans, ContinuedCredit quality, continued:

	<u>December 31, 2017</u>		
	<u>Unpaid principal balance</u>	<u>Recorded investment</u>	<u>Related allowance</u>
	(Dollars in thousands)		
With no related allowance recorded:			
Commercial, financial and agricultural	\$ -	\$ -	\$ -
Real estate- construction, land development and other land loans	202	202	-
Real estate - mortgage	5,412	5,412	-
Installment loans to individuals	-	-	-
With related allowance recorded:			
Commercial, financial and agricultural	585	585	230
Real estate- construction, land development and other land loans	-	-	-
Real estate - mortgage	1,812	1,812	302
Installment loans to individuals	-	-	-
Total:			
Commercial, financial and agricultural	585	585	230
Real estate- construction, land development and other land loans	202	202	-
Real estate - mortgage	7,224	7,224	302
Installment loans to individuals	-	-	-
	<u>\$ 8,011</u>	<u>\$ 8,011</u>	<u>\$ 532</u>

The average amounts of impaired loans were \$8,832,000 and \$11,266,000 for 2018 and 2017, respectively. Interest income recognized on impaired loans during the time that the loans were impaired in 2018 and 2017 was \$634,000 and \$486,000, respectively.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 4. Loans, Continued

Provision and allowance for loan losses:

The following tables summarize activity related to our allowance for loan losses for the years ended December 31, 2018 and 2017 by portfolio segment.

	December 31, 2018				
	Commercial, financial and agricultural	Real estate - construction, land development and other land loans	Real estate- mortgage	Installment loans to individuals	Total
	(Dollars in thousands)				
Allowance for loan losses:					
Balance, beginning of year	\$ 4,180	\$ 595	\$ 2,509	\$ 130	\$ 7,414
Provision for loan losses	2,000	(243)	828	47	2,632
Loan charge-offs	(2,083)	(13)	(179)	(22)	(2,297)
Loan recoveries	475	318	646	-	1,439
Balance, end of year	<u>\$ 4,572</u>	<u>\$ 657</u>	<u>\$ 3,804</u>	<u>\$ 155</u>	<u>\$ 9,188</u>
Individually reviewed for impairment	\$ 216	\$ -	\$ 55	\$ -	\$ 271
Collectively reviewed for impairment	<u>4,356</u>	<u>657</u>	<u>3,749</u>	<u>155</u>	<u>8,917</u>
Total allowance for loan losses	<u>\$ 4,572</u>	<u>\$ 657</u>	<u>\$ 3,804</u>	<u>\$ 155</u>	<u>\$ 9,188</u>
Gross loans, end of period:					
Individually reviewed for impairment	\$ 2,025	\$ 201	\$ 6,859	\$ -	\$ 9,085
Collectively reviewed for impairment	<u>197,968</u>	<u>57,005</u>	<u>352,939</u>	<u>46,282</u>	<u>654,194</u>
Total loans	<u>\$ 199,993</u>	<u>\$ 57,206</u>	<u>\$ 359,798</u>	<u>\$ 46,282</u>	<u>\$ 663,279</u>

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 4. Loans, Continued

Provision and allowance for loan losses, continued:

	December 31, 2017				
	Commercial, financial and agricultural	Real estate - construction, land development and other land loans	Real estate- mortgage	Installment loans to individuals	Total
	(Dollars in thousands)				
Allowance for loan losses:					
Balance, beginning of year	\$ 3,504	\$ 578	\$ 940	\$ 136	\$ 5,158
Provision for loan losses	4,241	398	1,456	(6)	6,089
Loan charge-offs	(3,847)	(438)	-	(10)	(4,295)
Loan recoveries	282	57	113	10	462
Balance, end of year	<u>\$ 4,180</u>	<u>\$ 595</u>	<u>\$ 2,509</u>	<u>\$ 130</u>	<u>\$ 7,414</u>
Individually reviewed for impairment	\$ 230	\$ -	\$ 302	\$ -	\$ 532
Collectively reviewed for impairment	<u>3,950</u>	<u>595</u>	<u>2,207</u>	<u>130</u>	<u>6,882</u>
Total allowance for loan losses	<u>\$ 4,180</u>	<u>\$ 595</u>	<u>\$ 2,509</u>	<u>\$ 130</u>	<u>\$ 7,414</u>
Gross loans, end of period:					
Individually reviewed for impairment	\$ 585	\$ 202	\$ 7,224	\$ -	\$ 8,011
Collectively reviewed for impairment	<u>156,489</u>	<u>54,378</u>	<u>281,805</u>	<u>50,711</u>	<u>543,383</u>
Total loans	<u>\$ 157,074</u>	<u>\$ 54,580</u>	<u>\$ 289,029</u>	<u>\$ 50,711</u>	<u>\$ 551,394</u>

There were no irrevocable commitments to lend additional funds to debtors owing amounts on impaired loans at December 31, 2018.

Troubled debt restructurings are loans which have been restructured from their original contractual terms and include concessions that would not otherwise have been granted outside of the financial difficulty of the borrower. Concessions can relate to the contractual interest rate, maturity date, or payment structure of the note. As part of our workout plan for individual loan relationships, we may restructure loan terms to assist borrowers facing challenges in the current economic environment. The purpose of a troubled debt restructuring is to facilitate ultimate repayment of the loan.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 4. Loans, Continued

Provision and allowance for loan losses, continued:

At December 31, 2018 and 2017, the principal balance of troubled debt restructurings totaled \$3.3 million and \$2.1 million, respectively. All troubled debt restructurings were considered classified and impaired. Of the balance outstanding at December 31, 2018 and 2017, \$0 and \$81,000 were on nonaccrual, respectively. The remaining loans are currently performing in accordance with the new terms.

	<u>Year Ended December 31, 2018</u>		
	<u>Number of contracts</u>	<u>Pre- Modification Outstanding Recorded Investment</u>	<u>Post- Modification Outstanding Recorded Investment</u>
		(Dollars in thousands)	
Troubled Debt Restructurings:			
Real estate-mortgage	13	2,213	2,213

During the year ended December 31, 2018, the Company modified thirteen loans that were considered to be troubled debt restructurings. The terms were extended for thirteen of these loans, interest rate was lowered for none of these loans and payments were changed from principal and interest payments to interest only payments for none of these loans.

As of December 31, 2018, five loans that had previously been restructured prior to December 31, 2017, were in default. No loan restructured in the 12 months prior to December 31, 2018 went into default during the period.

	<u>Year Ended December 31, 2017</u>		
	<u>Number of contracts</u>	<u>Pre- Modification Outstanding Recorded Investment</u>	<u>Post- Modification Outstanding Recorded Investment</u>
		(Dollars in thousands)	
Troubled Debt Restructurings:			
Commercial, financial and agricultural	3	\$ 194	\$ 194
Real estate-construction, land development and other land loans	2	202	202
Real estate-mortgage	1	239	239

During the year ended December 31, 2017, the Company modified six loans that were considered to be troubled debt restructurings. The terms were extended for one of these loans, interest rate was lowered for two of these loans and payments were changed from principal and interest payments to interest only payments for five of these loans.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 4. Loans, Continued

Provision and allowance for loan losses, continued:

As of December 31, 2017, no loans that had previously been restructured prior to December 31, 2016, were in default. One loan restructured in the 12 months prior to December 31, 2017 went into default during the period.

Note 5. Assets Acquired In Settlement of Loans

Activity in the accounts for assets acquired in settlement of loans is as follows:

	<u>2018</u>	<u>2017</u>
	(Dollars in thousands)	
Balance, beginning of year	\$ 4,923	\$ 4,902
Additions	1,226	954
Sales	(2,257)	(645)
Impairment write downs	(328)	(288)
Balance, end of year	<u>\$ 3,564</u>	<u>\$ 4,923</u>

Note 6. Premises and Equipment

Premises and equipment consisted of the following as of December 31:

	<u>2018</u>	<u>2017</u>
	(Dollars in thousands)	
Land and land improvements	\$ 4,338	\$ 4,338
Building and leasehold improvements	8,451	8,451
Furniture and equipment	2,657	2,323
Vehicles	938	832
Construction-in-progress	5	91
Total	<u>16,389</u>	<u>16,035</u>
Accumulated depreciation	<u>(4,284)</u>	<u>(3,820)</u>
Premises and equipment, net	<u>\$ 12,105</u>	<u>\$ 12,215</u>

The balance of construction-in-progress as of December 31, 2018 was primarily related to equipment upgrades. Additional commitments related to the equipment upgrades amount to \$26,000.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 6. Premises and Equipment, continued

Depreciation expense was \$861,000 and \$772,000 for the years ended December 31, 2018 and 2017, respectively. Estimated useful lives and methods of depreciation for the principal items follow:

Type of Asset	Life in Years	Depreciation Method
Software	3	Straight-line
Furniture and equipment	5 to 7	Straight-line
Buildings and improvements	5 to 40	Straight-line
Vehicles	3	Straight-line

Note 7. Deposits

A summary of deposits follows as of December 31:

	<u>2018</u>	<u>2017</u>
	(Dollars in thousands)	
Noninterest bearing demand	\$ 108,828	\$ 89,688
Interest bearing:		
Demand accounts	13,599	7,679
Money market accounts	233,664	226,787
Savings	<u>5,256</u>	<u>4,141</u>
	<u>361,347</u>	<u>328,295</u>
Time certificates of deposit, less than \$100,000	104,908	76,869
Time certificates of deposit, \$100,000 and over	<u>212,540</u>	<u>164,834</u>
	<u>317,448</u>	<u>241,703</u>
Total deposits	<u>\$ 678,795</u>	<u>\$ 569,998</u>

Interest expense on time deposits greater than \$100,000 was \$3,517,000 and \$1,532,000 in 2018 and 2017, respectively. Brokered deposits were \$6,316,000 and \$11,104,000 as of December 31, 2018 and 2017, respectively. As of December 31, 2018 and 2017, \$32,000 and \$19,000, respectively, of overdrawn demand deposit balances were reclassified as loans.

At December 31, 2018, the scheduled maturities of time deposits are as follows (dollars in thousands):

2019	\$ 182,573
2020	133,465
2021	769
2022	395
2023	224
Thereafter	<u>22</u>
Total time deposits	<u>\$ 317,448</u>

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 7. Deposits, continued

Time deposits that meet or exceed the FDIC insurance limit of \$250,000 as of December 31, 2018 and 2017 were \$73,535,000 and \$53,655,000 respectively. These amounts do not include brokered deposits greater than \$250,000 which are fully insured.

Note 8. Short-Term Borrowings

As of December 31, 2018, the Bank had unused short-term credit accommodations available from four unrelated banks which allows the Bank to purchase up to \$41 million of federal funds. The lenders reserve the right to withdraw the lines at their option. As of December 31, 2018 and 2017, respectively there were no federal funds purchased under these lines.

The other borrowings are secured with 100% of the capital stock of the Bank. The borrowings had an interest rate of 5.25% at December 31, 2018.

The Company's other borrowings as of December 31, 2018 and 2017 with a variable rate are as follows:

	<u>2018</u>	<u>2017</u>
	(Dollars in thousands)	
Interest rate of Wall Street Journal Prime Rate minus 0.25% (5.25% at December 31, 2018 and 4.25% at December 31, 2017) with a floor of 3.75%, maturing September 6, 2019	\$ _____ -	\$ _____ 550
Total	<u>\$ _____ -</u>	<u>\$ _____ 550</u>

Note 9. Federal Home Loan Bank Advances

The FHLB advances are secured with approximately \$30,306,000 of mortgage loans and \$1,183,000 of stock in the FHLB. The FHLB advances had a weighted average interest rate of 2.50% and 1.87% as of December 31, 2018 and 2017, respectively.

The Company's FHLB Advances as of December 31, 2018 and 2017 with fixed rates are as follows:

	<u>2018</u>	<u>2017</u>
	(Dollars in thousands)	
Interest rate 2.341%, maturing March 3, 2022	\$ _____ 7,000	\$ _____ 7,000
Total	<u>\$ _____ 7,000</u>	<u>\$ _____ 7,000</u>

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 9. Federal Home Loan Bank Advances, continued

The Company's FHLB Advances as of December 31, 2018 and 2017 with variable rates are as follows:

	<u>2018</u>	<u>2017</u>
	(Dollars in thousands)	
Interest rate of the FHLB Daily Rate (2.65% at December 31, 2018), maturing December 30, 2019	\$ 7,000	\$ -
Interest rate of the FHLB Daily Rate (1.59% at December 31, 2017), maturing December 28, 2018	\$ -	\$ 12,000
Total	<u>\$ 7,000</u>	<u>\$ 12,000</u>

At December 31, 2018, the Bank had unused credit availability of up to \$207,834,000 under the FHLB's various credit programs, subject to pledging and other requirements. The amount of eligible collateral instruments available as of December 31, 2018 to secure any additional FHLB borrowings totaled approximately \$7,734,000.

Note 10. Capital Trust and Junior Subordinated Debentures

On May 3, 2006, the Company sponsored the creation of a Delaware statutory trust, GrandSouth Capital Trust I, (the "Trust") and is the sole owner of the \$247,000 of common securities issued by the Trust. On May 10, 2006, the Trust issued \$8,000,000 in floating rate capital securities. The proceeds of this issuance, and the amount of the Company's investment in the common securities, were used to acquire \$8,247,000 principal amount of the Company's floating rate junior subordinated debt securities due in 2036 ("Debentures"). These securities, and the accrued interest thereon, now constitute the Trust's sole assets. The interest rate associated with the debt securities, and the distribution rate on the common securities of the Trust, is adjustable quarterly at 3-month LIBOR plus 185 basis points (aggregating 4.58613% at December 31, 2018). The Company may defer interest payments on the Debentures for up to 20 consecutive quarters, but not beyond the stated maturity of the Debentures. In the event that such interest payments are deferred by the Company, the Trust may defer distributions on the capital and common securities. In such an event, the Company would be restricted in its ability to pay dividends on its common stock and perform under obligations that are not senior to the Debentures. The Company has not elected to defer any distributions.

The Debentures are redeemable at par at the option of the Company, in whole or in part, on any interest payment date on or after June 23, 2011. Upon repayment or redemption of the Debentures, the Trust will use the proceeds of the transaction to redeem an equivalent amount of capital securities and common securities. The Trust's obligations under the capital securities are unconditionally guaranteed by the Company. In accordance with applicable accounting standards, the Trust is not consolidated in the Company's financial statements.

On November 20, 2018, the Company issued \$10,000,000 in Subordinated Debt to enhance the capital structure of the Bank. The debt has a maturity date of November 30, 2028 and bears a fixed interest rate of 6.50% until November 30, 2023, at which time the interest rate will become variable, adjustable quarterly at 3-month LIBOR plus 343 basis points. The Company may, at its option, at any time on an interest payment date on or after November 30, 2023, redeem the notes, in whole or in part, at par plus accrued interest to the date of redemption.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 11. Commitments and Contingencies

The Company incurred \$204,000 of debt issuance costs related to the issuance of this debt. As of December 31, 2018, the unamortized portion of the debt issuance costs was \$201,000 and is reported as a direct deduction from the face amount of the subordinated debt on the balance sheet.

During 2018 and 2017, the Company incurred approximately \$264,000 and \$286,000, respectively, in legal and consulting fees associated with an investigation into possible wrongdoing by a former customer of the Company and three former employees of the Company. The Company is a victim and not a defendant in the case. Investigation of the matter is currently ongoing. In February 2019, all three former employees were found not guilty.

The Company is a named defendant in a lawsuit whereby the Plaintiff alleges wrongdoing related to non-solicitation agreements and hiring practices of certain employees. The outcome is not known or determinable at this time.

The Company is party to other litigation and claims arising in the normal course of business, other than that noted above. Management, after consultation with legal counsel, believes that the liabilities, if any, arising from such litigation in the normal course of business and claims will not be material to the Company's financial position or results of operations.

The Company leases land upon which it constructed a branch office under a non-cancelable operating lease which expires in March 2038. The lease requires monthly lease payments of \$1,200 and contains four renewal options of five years each which contain provisions for adjustments to the monthly lease payments. The lease agreement requires the Company to pay all property taxes.

The future minimum lease payments due under the current operating leases as of December 31, 2018, are as follows (dollars in thousands):

2019	\$	336
2020		344
2021		206
2022		139
2023		144
Thereafter		240
Total	\$	<u>1,409</u>

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 12. Income Taxes

The following summary of the provision for income taxes includes tax deferrals, which arise from temporary differences in the recognition of certain items of revenues and expense for tax and financial reporting purposes:

	<u>2018</u>	<u>2017</u>
	(Dollars in thousands)	
<u>Current</u>		
Federal expense	\$ 1,873	\$ 2,006
State expense	<u>207</u>	<u>136</u>
Total current	2,080	2,142
<u>Deferred</u>		
Federal expense/(benefit)	(211)	(51)
State expense/(benefit)	<u>19</u>	<u>(128)</u>
	(192)	(179)
Change in valuation allowance	<u>22</u>	<u>36</u>
Total income tax expense	<u>\$ 1,910</u>	<u>\$ 1,999</u>

The income tax effects of cumulative temporary differences at December 31 are as follows:

	<u>2018</u>	<u>2017</u>
	(Dollars in thousands)	
Deferred tax assets		
Allowance for loan losses	\$ 1,622	\$ 915
Other real estate owned	344	563
Amortization of intangibles	101	176
Nonaccrual loan interest	-	40
State net operating loss carryforward	208	186
Deferred compensation	301	273
Unrealized net holding losses on available-for-sale securities	131	69
Other	<u>15</u>	<u>86</u>
Gross deferred tax assets	2,722	2,308
Valuation allowance	<u>(208)</u>	<u>(186)</u>
Total	<u>\$ 2,514</u>	<u>\$ 2,122</u>
Deferred tax liabilities		
Accelerated depreciation	\$ 582	\$ 391
Other	<u>36</u>	<u>67</u>
Gross deferred tax liabilities	618	458
Net deferred income tax assets	<u>\$ 1,896</u>	<u>\$ 1,664</u>

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 12. Income Taxes, continued

Deferred income taxes are measured at the enacted tax rate for the period in which they are expected to reverse. In December 2017 the U.S. Congress passed and the President signed legislation which reduced the statutory corporate tax rate to 21% effective January 1, 2018 and for all taxable years ending after that date. Therefore, deferred income taxes as of December 31, 2017 have been measured using the tax rate enacted for subsequent years of 21%. The impact of this change in tax rate is additional income tax expense of \$932,000. \$44,000 of the impact was related to unrealized net holding losses on available-for-sale securities and was charged to income tax expense. This resulted in an amount of deferred tax "stranded" in Other Comprehensive Income. A one-time reclassification of \$44,000 between Other Comprehensive Income and Retained Earnings was posted to eliminate the "stranded" deferred tax.

Deferred tax assets represent the future benefit of deductible differences, and if it is more likely than not that a tax asset will not be realized, a valuation allowance is required to reduce the recorded deferred tax assets to net realizable value. The deferred tax asset valuation allowance for 2018 and 2017 is related to the Company's stand-alone state net operating loss carryforwards for which realizability is uncertain. Management believes realization of all other deferred tax assets is more likely than not and accordingly has not recorded any other valuation allowance.

The Company has state net operating losses for income tax purposes of approximately \$5,280,000 as of December 31, 2018. These state net operating losses expire 2020 through 2038.

The provision for income taxes is reconciled to the amount of income tax computed at the federal statutory rate of 21% on income before income taxes as follows for the year ended December 31:

	<u>2018</u>	<u>2017</u>
	(Dollars in thousands)	
Tax expense at statutory rate	\$ 1,723	\$ 948
State income tax, net of federal income tax benefit	178	5
Tax-exempt interest income	(12)	(30)
Bank-owned life insurance increase	(22)	(41)
Change in valuation allowance	22	36
Change in enacted income tax rate	-	932
Other, net	21	149
Total	<u>\$ 1,910</u>	<u>\$ 1,999</u>

The Company has analyzed the tax positions taken or expected to be taken in its tax returns and concluded it has no liability related to uncertain tax positions in accordance with current accounting guidance.

The Company and its subsidiary file income tax returns with the federal government and various states. With few exceptions, the Company is no longer subject to federal or state income tax examinations by tax authorities for years before 2015.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 13. Related Party Transactions

Certain directors, executive officers and companies with which they are affiliated are customers of and have banking transactions, including loans and commitments to lend, with the Bank in the ordinary course of business.

Such transactions are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable arms-length transactions. A summary of loan and commitment transactions with directors and executive officers, including their affiliates, follows:

	<u>2018</u>	<u>2017</u>
	(Dollars in thousands)	
Balance, beginning of year	\$ 8,667	\$ 3,984
Existing loans of directors and officers newly appointed during the year	2,597	2,953
New loans	5,499	3,825
Less loan payments	<u>(2,263)</u>	<u>(2,095)</u>
Balance, end of year	<u>\$ 14,500</u>	<u>\$ 8,667</u>

Deposits of directors and their related interests at December 31, 2018 and 2017 approximated \$13,649,000 and \$6,944,000, respectively.

Of the Subordinated Debt issued on November 20, 2018 discussed in Note 10, \$600,000 was issued to directors and their family.

The Company leases land from a relative of a director, shareholder and executive officer of the Company (see Note 11). Lease expenses charged to operations under these arrangements totaled \$14,000 and \$12,000 in 2018 and 2017, respectively.

Note 14. Financial Instruments with Off-Balance Sheet Risk

In the ordinary course of business, and to meet the financing needs of its customers, the Bank is party to various financial instruments with off-balance sheet risk. These financial instruments, which include commitments to extend credit and standby letters of credit, involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the balance sheets. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 14. Financial Instruments with Off-Balance Sheet Risk, continued

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual amounts of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any material condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a fee. At December 31, 2018 and 2017, unfunded commitments to extend credit were \$214,083,000 and \$214,598,000, respectively. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the borrower. Collateral varies but may include accounts receivable, inventory, property, plant and equipment, and commercial and residential real estate. At December 31, 2018 and 2017, there were outstanding letters of credit totaling \$2,717,000 and \$3,203,000, respectively.

Note 15. Employee Benefit Plan

The Bank sponsors the GrandSouth Bank Profit Sharing Section 401(k) Plan (the "Plan") for the benefit of all eligible employees. The Bank contributes 100% of the first 3% and 50% of the next 2% of the employee's compensation contributed to the Plan. Contributions made to the Plan in 2018 and 2017 were \$438,000 and \$386,000, respectively.

In 2001, supplemental benefits were approved by the Board of Directors for an executive officer, who is no longer with the Bank. These benefits are not qualified under the Internal Revenue Code, and they are not funded. However, certain funding is provided informally and indirectly by life insurance policies owned by the Bank. The Company recorded net expense related to these benefits of \$122,000 and \$117,000 in 2018 and 2017, respectively.

Note 16. Stock Option Plan

During 1998, the Board of Directors approved a stock option plan for the benefit of the directors, officers and employees (the "1998 Plan"). The plan provided that the Board could grant options to purchase up to 856,028 shares of common stock (after the shareholders approved an amendment to increase the number of shares in the plan at the 2005 Annual Meeting) at an exercise price per share not less than the fair market value on the date of grant. The Company issues new shares to satisfy option exercises. The stock option plan expired in 2008. Consequently, all options granted under the 1998 Plan were expired as of December 31, 2018 and no more options may be granted under the Plan.

Upon the expiration of the 1998 Plan, the Board of Directors approved a stock option plan for the benefit of the directors, officers and employees effective June 17, 2009 (the "2009 Plan"). The plan provided that the Board could grant options to purchase up to 275,000 shares of common stock at an exercise price per share not less than the fair market value on the date of grant. Consistent with the 1998 Plan, the Company will issue new shares to satisfy option exercises under the 2009 Plan.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 16. Stock Option Plan, Continued

See summary of option activity in table below. In 2012, the 2009 Plan was amended, allowing the Board to increase the number of options to purchase up to 487,000 shares of common stock. In 2015, the 2009 Plan was amended, allowing the Board to increase the number of options to purchase up to 737,000 shares of common stock. In 2016, an amendment to the 2009 Plan was approved by the Board of Directors, allowing the Board to increase the number of options to purchase up to 987,000 shares of common stock.

In 2018, the Company granted 8,000 options to directors, officers and employees that vest 20 percent each year for five years and expire 10 years from the grant date. The related compensation expense of the options is recognized over the vesting period. In 2017, the Company granted 40,000 options to directors, officers and employees that vest 20 percent each year for five years and expire 10 years from the grant date. The related compensation expense of the options is recognized over the vesting period. The Company measures the fair value of each option award on the date of the grant using the Black-Scholes option-pricing model with the following assumptions used for awards granted in 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Assumptions:		
Dividend yield	0.00%	2.76%
Weighted average risk-free interest rate	2.80%	2.07%
Weighted average expected volatility	38.09%	54.02%
Weighted average expected life in years	6.50	6.50
Weighted average grant date fair value	\$5.94	\$6.03

The Company determines the assumptions used in the Black-Scholes option-pricing model as follows:

Based on the historical dividend yield of the Company's stock, adjusted to reflect the expected dividend yield over the expected life of the option, the risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of the grant; volatility is based on the historical volatility adjusted to reflect the ways in which current information indicates that the future is reasonably expected to differ from the past; and the average life is based on historical behaviors of employees related to exercises, forfeitures and cancellations.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 16. Stock Option Plan, Continued

The following table summarizes the activity during 2018 related to stock options awarded by the Company:

	Year Ended December 31, 2018			
	Shares	Weighted average exercise price per share	Weighted average remaining contractual life (years)	Intrinsic value
Outstanding at beginning of year	392,418	\$ 9.94	6.95	\$ 1,613,277
Granted	8,000	12.66	5.72	
Exercised	(51,300)	4.15	-	658,526
Forfeited or expired	-	-	-	-
Outstanding at end of year	<u>349,118</u>	10.85	6.45	2,142,747
Options outstanding and expected to vest	349,118	10.85	6.45	2,142,747
Options exercisable at year-end	192,181	9.18	5.69	1,500,579

The following table summarizes the activity during 2017 related to stock options awarded by the Company:

	Year Ended December 31, 2017			
	Shares	Weighted average exercise price per share	Weighted average remaining contractual life (years)	Intrinsic value
Outstanding at beginning of year	382,618	\$ 9.43	7.23	\$ 1,587,197
Granted	40,000	14.50	9.32	
Exercised	(18,200)	5.64	-	152,080
Forfeited or expired	<u>(12,000)</u>	15.55	-	-
Outstanding at end of year	<u>392,418</u>	9.94	6.95	1,613,277
Options outstanding and expected to vest	392,418	9.94	6.95	1,613,277
Options exercisable at year-end	178,141	6.73	5.42	1,294,492

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 16. Stock Option Plan, Continued

The following table summarizes the vesting activity during 2018 related to stock options awarded by the Company:

	<u>Year Ended December 31, 2018</u>	
	<u>Shares</u>	<u>Weighted average grant date fair values per share</u>
Nonvested at beginning of year	214,277	\$ 7.83
Granted	8,000	4.91
Vested	(65,340)	7.53
Forfeited or expired	-	-
Nonvested at end of year	<u>156,937</u>	7.81

The following table summarizes the vesting activity during 2017 related to stock options awarded by the Company:

	<u>Year Ended December 31, 2017</u>	
	<u>Shares</u>	<u>Weighted average grant date fair values per share</u>
Nonvested at beginning of year	227,617	\$ 8.19
Granted	40,000	6.03
Vested	(53,340)	7.99
Forfeited or expired	-	-
Nonvested at end of year	<u>214,277</u>	7.83

As of December 31, 2018, total compensation costs of unvested options that have not yet been recognized were \$978,000. Those compensation costs will be recognized over the remaining weighted average vesting period of 2.45 years.

Intrinsic value is calculated for shares outstanding and exercisable by taking the closing price of the Company's common stock as of December 31, 2018, as reported by the Over the Counter Bulletin Board (OTCQX), and subtracting the exercise price of each stock option grant. When the result is a positive number, the difference is multiplied by the number of options outstanding for each such grant and the total of those values is shown in the table. Intrinsic value for shares exercised represents the closing price of the stock on the date of exercise as reported by the OTCQX less the actual exercise price of the options exercised multiplied by the number of options exercised. These intrinsic values are calculated for each exercise during the year, and the resulting total is presented.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 17. Shareholders' Equity

Preferred stock:

On January 20, 2010, the Company's shareholders approved amendments of its Articles of Incorporation authorizing the issuance of up to 287,895 shares of Series A Preferred Stock in one or more series. The Series A Preferred Stock has rights equal to common stock with regard to dividends and rights upon liquidation. Unlike common stock, the Series A Preferred Stock will not have voting rights except under very limited circumstances. The Series A Preferred Stock pays dividends at the rate of 5% greater than common stock per share dividends.

Restrictions on subsidiary dividends, loans or advances:

In addition to the restrictions specified under the heading "Preferred Stock," South Carolina banking regulations restrict the amount of dividends that banks can pay to shareholders. Any of the banking subsidiary's dividends to the parent company are subject to the prior approval of the South Carolina Commissioner of Banking based on the current regulatory agreement with the subsidiary bank. In addition, dividends paid by the banking subsidiary to the parent company would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements. Under Federal Reserve Board regulations, the amounts of loans or advances from the banking subsidiary to the parent company are generally limited to 10% of the Bank's capital stock and surplus on a secured basis. Furthermore, in the event that interest payments on the junior subordinated debentures (see Note 10) are deferred by the Company, the Company would be restricted in its ability to pay dividends on its common stock. The terms of the Company's preferred stock also impose limits on its ability to pay dividends.

Accumulated other comprehensive income:

As of December 31, 2018 and 2017, accumulated other comprehensive income included as a component of shareholders' equity in the Consolidated Balance Sheets consisted of accumulated changes in the unrealized holding gains and (losses) on available-for-sale securities, net of income tax effects, amounting to (\$448,000) and (\$236,000), respectively.

Earnings per common share:

Net income available to common shareholders per share, basic and net income available to common shareholders per share, assuming dilution, were computed as follows:

	<u>2018</u>	<u>2017</u>
	(Dollars in thousands except share amounts)	
Earnings per common share, basic		
Numerator - net income available to common shareholders	\$ <u>6,297</u>	\$ <u>699</u>
Denominator		
Weighted average common shares issued and outstanding	<u>4,522,127</u>	<u>4,498,555</u>
Earnings per common share, basic	\$ <u>1.39</u>	\$ <u>0.16</u>

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 17. Shareholders' Equity, continued

Earnings per common share, continued:

Earnings per common share, assuming dilution		
Numerator - net income available to common shareholders	\$ 6,297	\$ 699
Dividends on Series A preferred stock	-	91
	<u>\$ 6,297</u>	<u>\$ 790</u>
Denominator		
Weighted average common shares issued and outstanding	4,522,127	4,498,555
Effect of dilutive stock options	95,375	95,109
If-converted shares of Series A preferred stock	<u>287,895</u>	<u>287,895</u>
Total shares outstanding diluted	<u>4,905,397</u>	<u>4,881,559</u>
Earnings per common share, assuming dilution	<u>\$ 1.28</u>	<u>\$ 0.16</u>

Regulatory capital:

All bank holding companies and banks 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 direct material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, bank holding companies and banks must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and its banking subsidiary to maintain minimum amounts and ratios (set forth in the table below) of Tier 1, Common Equity Tier 1 ("CET1"), and Total Capital (as defined in the regulations) to risk-weighted assets and average assets (as defined). Management believes, as of December 31, 2018 and 2017, that the Company and its subsidiary bank exceeds all capital adequacy requirements to which it is subject.

Effective March 31, 2015, quantitative measures established by applicable regulatory standards, including the newly implemented Basel III revised capital adequacy standards and relevant provisions of the Dodd-Frank All Street Report and Consumer Protection Act ("Dodd-Frank Act"), require the Bank to maintain (i) a minimum ratio of Tier 1 capital to average total assets, after certain adjustments, of 4.00%, (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of 6.00%, (iii) a minimum ratio of total-capital to risk-weighted assets of 8.00% and (iv) a minimum ratio of CET1 to risk-weighted assets of 4.50%. A "well-capitalized" institution must generally maintain capital ratios 2.00% higher than the minimum guidelines.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 17. Shareholders' Equity, continued

Regulatory capital, continued:

In order to avoid restrictions on capital distributions or discretionary bonus payments to executives, the Bank will also be required to maintain a "capital conservation buffer" in addition to its minimum risk-based capital requirements. The buffer will be required to consist solely of CET1, but the buffer will apply to all three risk-based measurements (CET1, Tier 1 and total capital). The capital conservation buffer will be phased in incrementally over time, beginning January 1, 2016 and becoming fully effective on January 1, 2019, and will ultimately consist of an additional amount of Tier 1 capital equal to 2.50% of risk-weighted assets.

As of December 31, 2018, the most recent notification from the FDIC categorized the Bank as well capitalized under the capital adequacy guidelines and regulatory framework for prompt corrective action. To be categorized as well capitalized as defined in the Federal Deposit Insurance Act, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the Bank's category. Bank holding companies with higher levels of risk, or that are experiencing or anticipating significant growth, are expected by the Federal Reserve to maintain capital well above the minimums. The Company's and Bank's actual capital amounts and ratios are also presented in the table.

	<u>Actual</u>		<u>Minimum for capital adequacy</u>		<u>Minimum to be well capitalized</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
(Dollars in thousands)						
December 31, 2018						
Tier 1 Capital (to Average Assets)						
Company	\$ 74,951	9.9%	\$ 30,405	4.0%	NA	NA
GrandSouth Bank	73,112	9.6%	30,395	4.0%	\$ 37,993	5.0%
Tier 1 Capital (to Risk Weighted Assets)						
Company	\$ 74,951	11.4%	\$ 39,551	6.0%	NA	NA
GrandSouth Bank	73,112	11.1%	39,577	6.0%	\$ 52,769	8.0%
Total Capital (to Risk Weighted Assets)						
Company	\$ 83,203	12.6%	\$ 52,735	8.0%	NA	NA
GrandSouth Bank	81,369	12.3%	52,769	8.0%	\$ 65,961	10.0%
Common Equity Tier 1 Capital (to Risk Weighted Assets)						
Company	\$ 57,152	8.7%	\$ 29,667	4.5%	NA	NA
GrandSouth Bank	73,112	11.1%	29,683	4.5%	\$ 42,875	6.5%

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 17. Shareholders' Equity, Continued

Regulatory capital, continued:

	<u>Actual</u>		<u>Minimum for capital adequacy</u>		<u>Minimum to be well capitalized</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
(Dollars in thousands)						
December 31, 2017						
Tier 1 Capital (to Average Assets)						
Company	\$ 58,132	9.1%	\$ 25,422	4.0%	NA	NA
GrandSouth Bank	57,906	9.1%	25,412	4.0%	\$ 31,765	5.0%
Tier 1 Capital (to Risk Weighted Assets)						
Company	\$ 58,132	10.5%	\$ 33,308	6.0%	NA	NA
GrandSouth Bank	57,906	10.4%	33,293	6.0%	\$ 44,391	8.0%
Total Capital (to Risk Weighted Assets)						
Company	\$ 65,077	11.7%	\$ 44,411	8.0%	NA	NA
GrandSouth Bank	64,848	11.7%	44,391	8.0%	\$ 55,488	10.0%
Common Equity Tier 1 Capital (to Risk Weighted Assets)						
Company	\$ 50,132	9.0%	\$ 24,981	4.5%	NA	NA
GrandSouth Bank	57,906	10.4%	24,970	4.5%	\$ 36,068	6.5%

Note 18. Disclosures about Fair Values of Financial Instruments

FASB ASC 820, "Fair Value Measurement and Disclosures Topic," defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 – Quoted prices in active markets for identical assets

Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include certain debt and equity securities that are traded in an active exchange market.

Level 2 – Significant other observable inputs

Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include fixed income securities and mortgage-backed securities that are held in the Company's available-for-sale portfolio and valued by a third-party pricing service, as well as certain impaired loans.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 18. Disclosures about Fair Values of Financial Instruments, continued

Level 3 – Significant unobservable inputs

Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. These methodologies may result in a significant portion of the fair value being derived from unobservable data.

Fair Value of Financial Instruments

Financial instruments require disclosure of fair value information, whether or not recognized in the consolidated balance sheets, when it is practical to estimate the fair value. A financial instrument is defined as cash, evidence of an ownership interest in an entity or a contractual obligation which requires the exchange of cash. Certain items are specifically excluded from the disclosure requirements, including the Company's common stock, premises and equipment and other assets and liabilities.

The following is a description of valuation methodologies used to estimate fair value for assets recorded at fair value. Fair value approximates carrying value for the following financial instruments due to the short-term nature of the instrument: cash and due from banks, federal funds sold, other investments, federal funds purchased, and securities sold under agreement to repurchase.

Investment securities: Securities available for sale are valued on a recurring basis at quoted market prices where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable securities. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange or U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities and debentures issued by government sponsored entities, municipal bonds and corporate debt securities. In certain cases where there is limited activity or less transparency around inputs to valuations, securities are classified as Level 3 within the valuation hierarchy. Securities held to maturity are valued at quoted market prices or dealer quotes similar to securities available for sale. The carrying value of Other Investments, such as Federal Reserve Bank and FHLB stock, approximates fair value based on their redemption provisions.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 18. Disclosures about Fair Values of Financial Instruments, continued

Fair Value of Financial Instruments, continued

Impaired loans: The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan may be considered impaired and an allowance for loan losses may be established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures the impairment in accordance with FASB ASC 310, "Receivables." The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. In accordance with FASB ASC 820, "Fair Value Measurement and Disclosures," impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company considers the impaired loan as non-recurring Level 2. The Company may require a new appraisal at renewal but may also accept an existing appraisal or perform an internal valuation on the collateral. When a loan is identified as impaired, the Company typically obtains an updated valuation of the collateral via a new appraisal or evaluation. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company considers the impaired loan as non-recurring Level 3. The fair value of impaired loans may also be estimated using the present value of expected future cash flows to be realized on the loan, which is also considered a Level 3 valuation. These fair value estimates are subject to fluctuations in assumptions about the amount and timing of expected cash flows as well as the choice of discount rate used in the present value calculation.

Assets acquired in the settlement of loans: Consisting of properties obtained through foreclosure or in satisfaction of loans, assets acquired in the settlement of loans are reported at the lower of cost or fair value, determined on the basis of current appraisals, comparable sales, and other estimates of value obtained principally from independent sources, adjusted for estimated selling costs (Level 2). At the time of foreclosure, any excess of the loan balance over the fair value of the real estate held as collateral is treated as a charge against the allowance for loan losses. Gains or losses on sale and generally any subsequent adjustments to the value are recorded as a component of real estate owned activity. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company considers assets acquired in the settlement of loans as non-recurring Level 3.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 18. Disclosures about Fair Values of Financial Instruments, continued

Assets and Liabilities Recorded at Fair Value on a Non-recurring Basis, continued

	<u>Fair value measurement at reporting date using</u>			
	<u>Quoted prices in active markets for identical assets (Level 1)</u>	<u>Significant other observable inputs (Level 2)</u>	<u>Significant unobservable inputs (Level 3)</u>	<u>Total</u>
	(Dollars in thousands)			
December 31, 2018				
Financial assets				
Loans individually reviewed for impairment	\$ -	\$ -	\$ 8,814	\$ 8,814
Assets acquired in settlement of loans	-	-	3,564	3,564
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 12,378</u>	<u>\$ 12,378</u>
December 31, 2017				
Financial assets				
Loans individually reviewed for impairment	\$ -	\$ -	\$ 7,479	\$ 7,479
Assets acquired in settlement of loans	-	-	4,923	4,923
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 12,402</u>	<u>\$ 12,402</u>

The Company had no liabilities carried at fair value or measured at fair value on a non-recurring basis at December 31, 2018 or 2017.

For Level 3 assets and liabilities measured at fair value on a recurring or non-recurring basis as of December 31, 2018 and 2017, the significant unobservable inputs used in the fair value measurements were as follows:

<u>Description</u>	<u>Significant Valuation Technique</u>	<u>General Range of Significant Unobservable Unobservable Inputs</u>	<u>Input Values</u>
Loans individually reviewed for impairment	Appraisal value; Present value of discounted cash flows	Discounts to appraisals or cash flows for estimated holdings and/ or selling costs	0 – 15%
Assets acquired in settlement of loans	Appraisal value; List or contract price	Discounts to appraisals for estimated holding or selling costs	0 – 15%

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 18. Disclosures about Fair Values of Financial Instruments, continued

Fair Value of Financial Instruments

Financial instruments require disclosure of fair value information, whether or not recognized in the consolidated balance sheets, when it is practical to estimate the fair value. A financial instrument is defined as cash, evidence of an ownership interest in an entity or a contractual obligation which requires the exchange of cash. Certain items are specifically excluded from the disclosure requirements, including the Company's common stock, premises and equipment and other assets and liabilities.

The following is a description of valuation methodologies used to estimate fair value for certain other financial instruments.

Fair value approximates carrying value for the following financial instruments due to the short-term nature of the instrument: cash and due from banks, interest bearing transaction accounts with other banks, restricted cash, federal funds sold and other investments. The carrying amounts of interest receivable and interest payable approximate their fair values.

Certificates of deposit with other banks – The fair value is estimated using discounted cash flow analyses, using interest rates currently offered for instruments with the same remaining maturity.

Loans – The valuation of loans held for investment was impacted by the adoption of ASU 2016-01 during 2018. Prior to adopting the amendments included in the standard, the Company was allowed to measure fair value under an entry price notion. The entry price notion previously applied by the Company used a discounted cash flows technique to calculate the present value of expected future cash flows for a financial instrument. The exit price notion uses the same approach, but also incorporates other factors, such as enhanced credit risk, illiquidity risk and market factors that sometimes exist in exit prices in dislocated markets. As of December 31, 2018, the technique used by the Company to estimate the exit price of the loan portfolio consists of similar procedures to those used as of December 31, 2017, but with added emphasis on both illiquidity risk and credit risk not captured by the previously applied entry price notion. This credit risk assumption is intended to approximate the fair value that a market participant would realize in a hypothetical orderly transaction. Loans are considered a Level 3 classification.

Deposits – Fair value for demand deposit accounts and interest-bearing accounts with no fixed maturity date is equal to the carrying value. The fair value of certificate of deposit accounts are estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

FHLB Advances and junior subordinated debentures – Fair value is estimated by discounting cash flows from expected maturities using current interest rates on similar instruments.

The Company has used management's best estimate of fair value based on the above assumptions. Thus, the fair values presented may not be the amounts that could be realized in an immediate sale or settlement of the instrument. In addition, any income taxes or other expenses, which would be incurred in an actual sale or settlement, are not taken into consideration in the fair value presented.

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Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 18. Disclosures about Fair Values of Financial Instruments, continued

Fair Value of Financial Instruments, continued

The estimated fair values of the Company's financial instruments at December 31, 2018 and 2017 are as follows:

	Carrying Amount	Fair value measurement at reporting date using			Total
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
(Dollars in thousands)					
December 31, 2018					
Financial assets					
Cash and due from banks	\$ 21,048	\$ 21,048	\$ -	\$ -	\$ 21,048
Interest bearing transaction accounts with other banks	7,658	7,658	-	-	7,658
Restricted cash	2,060	2,060	-	-	2,060
Federal funds sold	4,250	4,250	-	-	4,250
Certificates of deposit with Other banks	13,750	-	13,826	-	13,826
Other investments	1,183	-	1,183	-	1,183
Loans, net (a)	645,277	-	-	641,776	641,776
Interest receivable	5,185	5,185	-	-	5,185
Financial liabilities					
Deposits	\$ 678,795	\$ -	\$ 686,962	\$ -	\$ 686,962
FHLB advances and junior subordinated debt	32,047	-	31,786	-	31,786
Interest payable	416	416	-	-	416

(a) Balances do not include loans captured in the Assets and Liabilities Recorded at Fair Value on a Non-recurring Basis table above.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 18. Disclosures about Fair Values of Financial Instruments, continued

Fair Value of Financial Instruments, continued

	Carrying Amount	Fair value measurement at reporting date using			Total
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
(Dollars in thousands)					
December 31, 2017					
Financial assets					
Cash and due from banks	\$ 22,799	\$ 22,799	\$ -	\$ -	\$ 22,799
Interest bearing transaction accounts with other banks	14,290	14,290	-	-	14,290
Federal funds sold	4,368	4,368	-	-	4,368
Certificates of deposit with Other banks	13,500	-	13,830	-	13,830
Other investments	1,271	-	1,271	-	1,271
Loans, net (a)	536,501	-	-	534,800	534,800
Interest receivable	4,728	4,728	-	-	4,728
Financial liabilities					
Deposits	\$ 569,998	\$ -	\$ 572,034	\$ -	\$ 572,034
FHLB advances, other borrowings and junior subordinated debt	27,797	-	27,590	-	27,590
Interest payable	208	208	-	-	208

(a) Balances do not include loans captured in the Assets and Liabilities Recorded at Fair Value on a Non-recurring Basis table above.

Note 19. Subsequent Events

On January 10, 2019, the Company purchased a building and real estate that it intends to open as a branch for \$1,664,000.

Subsequent to year end, the Company has incurred approximately \$164,000 in legal and consulting fees associated with the case discussed in Note 11. Also in February 2019, all three former employees involved in the case were found not guilty.

GrandSouth Bancorporation and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 19. Subsequent Events, continued

During 2018, the Company's Board of Directors approved a resolution authorizing the issuance of up to 800,000 shares of common stock. On March 15, 2019, the Company issued 510,017 of the shares, with net proceeds of \$8,415,000. The Company intends to issue additional shares related to this issuance at a later date. As of December 31, 2018, the Company had received \$2,060,000 in connection with the capital raise which was recorded as restricted cash and included in other liabilities in the balance sheet pending completion of the capital raise.

The Company has evaluated subsequent events through March 20, 2019, the date the financial statements were available for distribution. No further matters are deemed necessary to report.