Territorial Bancorp Inc.
Form 10-Q
November 08, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period ended September 30, 2011

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For transition period from to

Commission File Number 1-34403

TERRITORIAL BANCORP INC.

(Exact Name of Registrant as Specified in Charter)

Maryland	**26-4674701**
(State or Other Jurisdiction of Incorporation)	**(I.R.S. Employer Identification No.)**
1132 Bishop Street, Suite 2200, Honolulu, Hawaii	**96813**
(Address of Principal Executive Offices)	**(Zip Code)**

(808) 946-1400

Registrant s telephone number, including area code

Not Applicable

(Former name or former address, if changed since last report)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

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

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

Indicate the number of shares outstanding of each of the Issuer s classes of common stock as of the latest practicable date.

11,044,031 shares of Common Stock, par value $0.01 per share, were issued and outstanding as of October 31, 2011.

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TERRITORIAL BANCORP INC.

Form 10-Q Quarterly Report

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PART I

ITEM 1. FINANCIAL STATEMENTS

TERRITORIAL BANCORP INC. AND SUBSIDIARIES

Consolidated Balance Sheets (Unaudited)

(Dollars in thousands, except share data)

	September 30, 2011	December 31, 2010
ASSETS		
Cash and cash equivalents	$ 132,448	$ 194,435
Investment securities available for sale	0	15,010
Investment securities held to maturity, at amortized cost (fair value of $694,996 and $546,844 at September 30, 2011 and December 31, 2010, respectively)	658,574	530,555
Federal Home Loan Bank stock, at cost	12,348	12,348
Loans held for sale	2,987	3,234
Loans receivable, net	662,734	641,790
Accrued interest receivable	4,882	4,536
Premises and equipment, net	5,564	5,426
Real estate owned	162	0
Bank-owned life insurance	29,991	29,266
Deferred income taxes receivable	1,029	22
Prepaid expenses and other assets	5,247	6,790
Total assets	$ 1,515,966	$ 1,443,412
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities		
Deposits	$ 1,139,317	$ 1,076,470
Advances from the Federal Home Loan Bank	20,000	10,000
Securities sold under agreements to repurchase	120,200	105,200
Accounts payable and accrued expenses	19,727	20,430
Current income taxes payable	416	577
Advance payments by borrowers for taxes and insurance	2,088	3,376
Total liabilities	1,301,748	1,216,053
Commitments and contingencies		
Stockholders Equity		
Preferred stock, $.01 par value; authorized 50,000,000 shares, no shares issued or outstanding	0	0
Common stock, $.01 par value; authorized 100,000,000 shares; issued and outstanding 11,124,553 and 12,177,418 shares at September 30, 2011 and December 31, 2010, respectively	111	122
Additional paid-in capital	98,842	119,153
Unearned ESOP shares	(8,441)	(8,808)
Retained earnings	126,022	119,397
Accumulated other comprehensive loss	(2,316)	(2,505)

Total stockholders equity	214,218	227,359
Total liabilities and stockholders equity	$ 1,515,966	$ 1,443,412

See accompanying notes to consolidated financial statements.

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TERRITORIAL BANCORP INC. AND SUBSIDIARIES

Consolidated Statements of Income (Unaudited)

(Dollars in thousands, except per share data)

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Interest and dividend income:				
Investment securities	$ 6,907	$ 6,371	$ 20,167	$ 19,819
Loans	8,798	8,907	26,444	26,018
Other investments	85	115	258	290
Total interest and dividend income	15,790	15,393	46,869	46,127
Interest expense:				
Deposits	1,700	2,555	5,109	8,484
Advances from the Federal Home Loan Bank	105	54	295	99
Securities sold under agreements to repurchase	1,067	1,070	3,153	3,211
Total interest expense	2,872	3,679	8,557	11,794
Net interest income	12,918	11,714	38,312	34,333
Provision (reversal of allowance) for loan losses	(39)	118	83	276
Net interest income after provision for loan losses	12,957	11,596	38,229	34,057
Non-interest income:				
Total other-than-temporary impairment losses	0	0	0	(3,510)
Portion of loss recognized in other comprehensive income (before taxes)	0	0	0	1,106
Net other-than-temporary impairment losses	0	0	0	(2,404)
Service fees on loan and deposit accounts	534	546	1,690	1,834
Income on bank-owned life insurance	245	256	725	765
Gain on sale of investment securities	74	0	140	350
Gain on sale of loans	138	165	374	420
Other	177	76	588	224
Total non-interest income	1,168	1,043	3,517	1,189
Non-interest expense:				
Salaries and employee benefits	6,017	4,526	16,630	13,533
Occupancy	1,267	1,146	3,714	3,428
Equipment	792	734	2,366	2,184
Federal deposit insurance premiums	191	308	678	898
Other general and administrative expenses	954	952	2,887	2,843
Total non-interest expense	9,221	7,666	26,275	22,886

Income before income taxes		4,904		4,973		15,471		12,360
Income taxes		1,918		1,839		6,100		4,530
Net income	$	2,986	$	3,134	$	9,371	$	7,830
Basic earnings per share	$	0.28	$	0.28	$	0.85	$	0.69
Diluted earnings per share	$	0.28	$	0.28	$	0.84	$	0.69
Cash dividends declared per common share	$	0.09	$	0.07	$	0.25	$	0.17
Basic weighted average shares outstanding		10,659,532		11,334,058		10,969,320		11,321,912
Diluted weighted average shares outstanding		10,835,649		11,344,622		11,117,444		11,356,737

See accompanying notes to consolidated financial statements.

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TERRITORIAL BANCORP INC. AND SUBSIDIARIES

Consolidated Statements of Stockholders Equity

and Comprehensive Income (Unaudited)

(Dollars in thousands)

	Common Stock	Additional Paid-in Capital	Unearned ESOP Shares	Retained Earnings	Accumulated Other Comprehensive (Loss)/Income	Total Stockholders Equity
Balances at December 31, 2009	$ 122	118,823	(9,297)	111,082	(1,059)	219,671
Comprehensive income:						
Net income	0	0	0	7,830	0	7,830
Other comprehensive loss, net of tax:						
Investment securities:						
Noncredit related losses on securities not expected to be sold, net of taxes of $427	0	0	0	0	(679)	(679)
Total comprehensive income	0	0	0	0	0	7,151
Cash dividends declared	0	0	0	(1,922)	0	(1,922)
Stock compensation expense	0	233	0	0	0	233
Allocation of 36,699 ESOP shares	0	318	367	0	0	685
Balances at September 30, 2010	$ 122	119,374	(8,930)	116,990	(1,738)	225,818
Balances at December 31, 2010	$ 122	119,153	(8,808)	119,397	(2,505)	227,359
Comprehensive income:						
Net income	0	0	0	9,371	0	9,371
Other comprehensive loss, net of tax:						
Investment securities:						
Change in unrealized loss on securities, net of taxes of $119	0	0	0	0	189	189
Total comprehensive income						9,560
Cash dividends declared	0	0	0	(2,746)	0	(2,746)
Stock compensation expense	1	2,790	0	0	0	2,791
Allocation of 36,699 ESOP shares	0	362	367	0	0	729
Repurchase of 1,202,471 shares of company stock	(12)	(23,463)	0	0	0	(23,475)
Balances at September 30, 2011	$ 111	98,842	(8,441)	126,022	(2,316)	214,218

See accompanying notes to consolidated financial statements.

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TERRITORIAL BANCORP INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)

(Dollars in thousands)

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Cash flows from operating activities:		
Net income	$ 9,371	$ 7,830
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	83	276
Depreciation and amortization	835	681
Deferred income tax benefit	(1,126)	(1,315)
Amortization of fees, discounts, and premiums	(44)	50
Origination of loans held for sale	(34,600)	(31,686)
Proceeds from sales of loans held for sale	35,221	31,161
Gain on sale of loans, net	(374)	(420)
Net gain on sale of real estate owned	0	(1)
Other-than-temporary impairment loss on investment	0	2,404
Purchases of investment securities held for trading	(36,171)	(18,143)
Proceeds from sale of investment securities held for trading	36,311	18,244
Gain on sale of investment securities held for trading	(140)	(101)
Gain on sale of investment securities available for sale	0	(249)
Net (gain) loss on sale of premises and equipment	(5)	59
ESOP expense	729	685
Share-based compensation expense	2,791	233
(Increase) decrease in accrued interest receivable	(346)	43
Net increase in bank-owned life insurance	(725)	(765)
Net decrease in prepaid expenses and other assets	1,543	457
Net decrease in accounts payable and accrued expenses	(703)	(1,007)
Net decrease in income taxes payable	(161)	(174)
Net cash provided by operating activities	12,489	8,262
Cash flows from investing activities:		
Purchases of investment securities held to maturity	(211,257)	(81,730)
Purchases of investment securities available for sale	0	(49,206)
Principal repayments on investment securities held to maturity	97,289	104,872
Principal repayments on investment securities available for sale	525	90
Proceeds from sale of investment securities available for sale	0	49,365
Loan originations, net of principal repayments on loans receivable	(20,403)	(38,556)
Proceeds from sale of real estate owned	0	160
Proceeds from disposals of premises and equipment	5	0
Purchases of premises and equipment	(973)	(996)
Net cash used in investing activities	(134,814)	(16,001)

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TERRITORIAL BANCORP INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)

(Dollars in thousands)

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Cash flows from financing activities:		
Net increase in deposits	$ 62,847	$ 64,226
Proceeds from advances from the Federal Home Loan Bank	10,000	10,000
Proceeds from securities sold under agreements to repurchase	47,000	1,136
Repayments of securities sold under agreements to repurchase	(32,000)	(26,136)
Purchases of Fed Funds	10	10
Sales of Fed Funds	(10)	(10)
Net decrease in advance payments by borrowers for taxes and insurance	(1,288)	(716)
Repurchases of company stock	(23,475)	0
Cash dividends paid	(2,746)	(1,922)
Net cash provided by financing activities	60,338	46,588
Net increase (decrease) in cash and cash equivalents	(61,987)	38,849
Cash and cash equivalents at beginning of the period	194,435	135,953
Cash and cash equivalents at end of the period	$ 132,448	$ 174,802
Supplemental disclosure of cash flow information:		
Cash paid for:		
Interest on deposits and borrowings	$ 8,531	$ 11,917
Income taxes	7,388	6,019
Supplemental disclosure of noncash investing activities:		
Loans transferred to real estate owned	$ 162	$ 0

See accompanying notes to consolidated financial statements.

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TERRITORIAL BANCORP INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

(1) Basis of Presentation

The accompanying unaudited consolidated financial statements of Territorial Bancorp Inc. have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. These interim condensed consolidated financial statements and notes should be read in conjunction with Territorial Bancorp Inc. s consolidated financial statements and notes thereto filed as part of the Annual Report on Form 10-K for the year ended December 31, 2010. In the opinion of management, all adjustments necessary for a fair presentation have been made and include all normal recurring adjustments. Interim results of operations are not necessarily indicative of results to be expected for the year.

(2) Organization

On November 4, 2008, the Board of Directors of Territorial Mutual Holding Company approved a plan of conversion and reorganization under which Territorial Mutual Holding Company would convert from a mutual holding company to a stock holding company. The conversion to a stock holding company was approved by the depositors and borrowers of Territorial Savings Bank and the Office of Thrift Supervision (OTS) and included the filing of a registration statement with the U.S. Securities and Exchange Commission. Upon the completion of the conversion and reorganization on July 10, 2009, Territorial Mutual Holding Company and Territorial Savings Group, Inc. ceased to exist as separate legal entities and Territorial Bancorp Inc. became the holding company for Territorial Savings Bank. A total of 12,233,125 shares were issued in the conversion at $10 per share, raising $122.3 million of gross proceeds. $3.7 million of conversion expenses were offset against the gross proceeds. Territorial Bancorp Inc. s common stock began trading on the NASDAQ Global Select Market under the symbol TBNK on July 13, 2009.

Upon completion of the conversion and reorganization, a special liquidation account was established in an amount equal to the total equity of Territorial Mutual Holding Company as of December 31, 2008. The liquidation account is to provide eligible account holders and supplemental eligible account holders who maintain their deposit accounts with Territorial Savings Bank after the conversion with a liquidation interest in the unlikely event of the complete liquidation of Territorial Savings Bank after the conversion. The liquidation account will be reduced annually to the extent that eligible account holders and supplemental eligible account holders have reduced their qualifying deposits. Subsequent increases will not restore an eligible account holder s or supplemental eligible account holder s interest in the liquidation account. In the event of a complete liquidation of Territorial Savings Bank, and only in such event, each account holder will be entitled to receive a distribution from the liquidation account in an amount proportionate to the adjusted qualifying account balances then held.

(3) Recently Adopted Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (FASB) amended the Fair Value Measurements and Disclosures topic of the FASB Accounting Standards Codification (ASC). The amendment requires disclosures about the significant transfers in and out of Level 1 and Level 2 fair value measurements and the reasons for the transfers, and requires the reconciliation of activity in Level 3 fair value measurements be made on a gross basis. The amendment also clarifies the level of disaggregation required in disclosures and the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements for Level 2 or Level 3 items. The part of the amendment related to the reconciliation of Level 3 activity is effective for interim and annual periods beginning after December 15, 2010, and was adopted by the Company on January 1, 2011. The remaining parts of the amendment were effective for interim and annual periods beginning after December 15, 2009, and were adopted by the Company on January 1, 2010. The Fair Value of Financial Instruments footnote has been updated to include the revised disclosures.

In April 2011, the FASB amended the Receivables topic of the FASB ASC. The amendment helps creditors determine whether a troubled debt restructuring has occurred by clarifying whether a restructuring constitutes a concession and whether the debtor is experiencing financial difficulties. The amendment also requires disclosures related to troubled debt restructurings that were initially effective for periods ending after December 15, 2010, but deferred to make the effective date concurrent with this amendment. The amendment is effective for the first interim or annual period beginning on or after June 15, 2011, and was adopted by the Company on July 1, 2011. The adoption did not have a material effect on its consolidated financial statements.

In April 2011, the FASB amended the Transfers and Servicing topic of the FASB ASC. The amendment modifies the criteria used to determine whether a repurchase agreement is accounted for as a sale or as a secured borrowing. The amendment is effective for interim or annual periods beginning on or after December 15, 2011. Early adoption is not permitted. The Company does not expect the adoption of this amendment to have any effect on its consolidated financial statements.

In May 2011, the FASB amended the Fair Value Measurement topic of the FASB ASC. The amendment results in common fair value measurement and disclosure requirements in U.S. generally accepted accounting principles and International Financial Reporting Standards. The amendment both clarifies the intent about existing fair value measurements as well as changes the principle or requirement for measuring fair value or disclosing fair value information. The amendment is effective for interim or annual periods beginning after December 15, 2011. Early application is not permitted. The Company does not expect the adoption of this amendment to have a material effect on its consolidated financial statements.

In June 2011, the FASB amended the Comprehensive Income topic of the FASB ASC. The amendment eliminates the option of presenting components of other comprehensive income as part of the statement of changes in stockholders equity. Non-owner changes in stockholders equity must be presented either in a continuous statement of comprehensive income or in two separate but consecutive statements. The amendment is effective for interim or annual periods beginning after December 15, 2011, with early adoption permitted. The adoption of this amendment will affect the location of disclosures related to other comprehensive income, but the Company does not expect any other material effect on its consolidated financial statements.

(4) Cash and Cash Equivalents

The table below presents the balances of cash and cash equivalents:

(Dollars in thousands)	**September 30, 2011**	**December 31, 2010**
Cash and due from banks	$ 9,266	$ 8,827
Interest-earning deposits in other banks	123,182	185,608
Cash and cash equivalents	$ 132,448	$ 194,435

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(5) Investment Securities

The amortized cost and fair values of investment securities are as follows:

(Dollars in thousands)	Amortized cost	Gross unrealized Gains	Gross unrealized Losses	Estimated fair value
September 30, 2011:				
Held to maturity:				
U.S. government-sponsored mortgage-backed securities	$ 658,542	36,324	(38)	$ 694,828
Trust preferred securities	32	136	0	168
Total	$ 658,574	36,460	(38)	$ 694,996
December 31, 2010:				
Held to maturity:				
U.S. government-sponsored mortgage-backed securities	$ 530,523	18,191	(1,998)	$ 546,716
Trust preferred securities	32	96	0	128
Total	$ 530,555	18,287	(1,998)	$ 546,844
Available for sale:				
U.S. government-sponsored mortgage-backed securities	$ 15,540	0	(530)	$ 15,010
Total	$ 15,540	0	(530)	$ 15,010

$15.0 million of U.S. government-sponsored mortgage-backed securities were reclassified from available-for-sale to held-to-maturity during the three months ended June 30, 2011. Management considers the held-to-maturity classification of these securities to be appropriate as the Company has the positive intent and ability to hold these securities to maturity.

The amortized cost and estimated fair value of investment securities at September 30, 2011 are shown below. Incorporated in the maturity schedule are mortgage-backed and trust preferred securities, which are allocated using the contractual maturity as a basis. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollars in thousands)	Amortized cost	Estimated fair value
Held to maturity:		
Due after 5 years through 10 years	$ 8,018	$ 8,278
Due after 10 years	650,556	686,718
Total	$ 658,574	$ 694,996

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Realized gains and losses and the proceeds from sales of securities available for sale and trading are shown in the table below. All sales of securities were U.S. government-sponsored mortgage-backed securities.

(Dollars in thousands)	Three months ended September 30, 2011	Three months ended September 30, 2010	Nine months ended September 30, 2011	Nine months ended September 30, 2010
Proceeds from sales	$ 16,445	$ 0	$ 36,311	$ 67,609
Gross gains	74	0	140	350
Gross losses	0	0	0	0

Investment securities with carrying values of $296.2 million at September 30, 2011 were pledged to secure public deposits, securities sold under agreements to repurchase and transaction clearing accounts.

Provided below is a summary of investment securities which were in an unrealized loss position at September 30, 2011 and December 31, 2010. The Company has the ability to hold these securities until such time as the value recovers or the securities mature.

Description of securities (Dollars in thousands)	Less than 12 months Fair value	Less than 12 months Unrealized losses	12 months or longer Fair value	12 months or longer Unrealized losses	Number of securities	Total Fair value	Total Unrealized losses
September 30, 2011:							
Mortgage-backed securities	$ 2,599	23	676	15	9	3,275	38
Total	$ 2,599	23	676	15	9	3,275	38
December 31, 2010:							
Mortgage-backed securities	$ 98,524	2,480	2,962	48	17	101,486	2,528
Total	$ 98,524	2,480	2,962	48	17	101,486	2,528

Trust Preferred Securities. At September 30, 2011, the Company owns two trust preferred securities, PreTSL XXIII and XXIV, with a carrying value of $32,000. The difference between the carrying value of $32,000 and the remaining amortized cost basis of $1.1 million is included as a component of accumulated other comprehensive loss, net of taxes, and is related to non-credit factors such as the trust preferred securities market being inactive. The trust preferred securities represent investments in a pool of debt obligations issued primarily by holding companies for Federal Deposit Insurance Corporation-insured financial institutions. All of these securities are classified in the Bank s held-to-maturity investment portfolio.

The trust preferred securities market is considered to be inactive as there were only five transactions in the last 21 months in similar tranches to the securities owned by the Company. The

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Company used a discounted cash flow model to determine whether these securities are other-than-temporarily impaired. The assumptions used in preparing the discounted cash flow model include the following: estimated discount rates, estimated deferral and default rates on collateral, and estimated cash flows.

Based on the Company s review, the Company s investment in trust preferred securities did not incur additional impairment during the quarter ending September 30, 2011 as the present value of cash flows exceed the amortized cost basis of $1.1 million.

At September 30, 2011, PreTSL XXIII and XXIV are rated C by Fitch.

It is reasonably possible that the fair values of the trust preferred securities could decline in the near term if the overall economy and the financial condition of some of the issuers continue to deteriorate and the liquidity of these securities remains low. As a result, there is a risk that the Company s amortized cost basis of $1.1 million on its trust preferred securities could be other-than-temporarily impaired in the near term. The impairment could be material to the Company s consolidated statements of income.

The table below provides a cumulative roll forward of credit losses recognized in earnings for debt securities held and not intended to be sold:

(Dollars in thousands)	2011	2010
Balance at January 1	$ 5,885	$ 3,481
Credit losses on debt securities for which other-than-temporary impairment was not previously recognized	0	2,404
Balance at September 30	$ 5,885	$ 5,885

The table below shows the components of comprehensive loss, net of taxes, resulting from other-than-temporarily impaired securities:

(Dollars in thousands)	September 30, 2011	December 31, 2010
Non-credit losses on other-than-temporarily impaired securities	$ 679	$ 679

(6) Loans Receivable

The components of loans receivable are as follows:

(Dollars in thousands)	September 30, 2011	December 31, 2010
Real estate loans:		
First mortgages:		
One- to four-family residential	$ 626,719	$ 604,456
Multi-family residential	6,214	5,408
Construction, commercial, and other	14,993	14,412
Home equity loans and lines of credit	17,826	20,064
Total real estate loans	665,752	644,340
Other loans:		
Loans on deposit accounts	737	895

Consumer and other loans	4,787	4,740
Total other loans	5,524	5,635
Less:		
Net unearned fees and discounts	(5,767)	(5,585)
Undisbursed loan funds	(1,223)	(1,112)
Allowance for loan losses	(1,552)	(1,488)
	(8,542)	(8,185)
Loans receivable, net	$ 662,734	$ 641,790

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The activity in the allowance for loan losses on loans receivable is as follows:

(Dollars in thousands)	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Balance, beginning of period	$ 1,592	$ 1,737	$ 1,488	$ 1,681
Provision (reversal of allowance) for loan losses	(39)	118	83	276
	1,553	1,855	1,571	1,957
Charge-offs	(7)	(378)	(62)	(501)
Recoveries	6	94	43	115
Net charge-offs	(1)	(284)	(19)	(386)
Balance, end of period	$ 1,552	$ 1,571	$ 1,552	$ 1,571

The table below presents the activity in the allowance for loan losses by portfolio segment:

(Dollars in thousands)	Residential Mortgage	Construction Commercial and Other Mortgage Loans	Home Equity and Lines of Credit	Consumer and Other	Unallocated	Totals
Three months ended September 30, 2011:						
Balance, beginning of period	$ 615	$ 390	$ 277	$ 193	$ 117	$ 1,592
Provision (reversal of allowance) for loan losses	(13)	(32)	(9)	15	0	(39)
	602	358	268	208	117	1,553
Charge-offs	0	0	0	(7)	0	(7)
Recoveries	2	0	0	4	0	6
Net charge-offs	2	0	0	(3)	0	(1)
Balance, end of period	$ 604	$ 358	$ 268	$ 205	$ 117	$ 1,552
Nine months ended September 30, 2011:						
Balance, beginning of period	$ 583	$ 277	$ 305	$ 208	$ 115	$ 1,488
Provision (reversal of allowance) for loan losses	23	81	(37)	14	2	83
	606	358	268	222	117	1,571
Charge-offs	(27)	0	0	(35)	0	(62)
Recoveries	25	0	0	18	0	43
Net charge-offs	(2)	0	0	(17)	0	(19)

Balance, end of period	$ 604	$ 358	$ 268	$ 205	$ 117	$ 1,552

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The table below presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method:

(Dollars in thousands)	Residential Mortgage	Construction Commercial and Other Mortgage Loans	Home Equity and Lines of Credit	Consumer and Other	Unallocated	Totals
September 30, 2011:						
Allowance for loan losses:						
Ending allowance balance:						
Individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Collectively evaluated for impairment	604	358	268	205	117	1,552
Total ending allowance balance	$ 604	$ 358	$ 268	$ 205	$ 117	$ 1,552
Loans:						
Ending loan balance:						
Individually evaluated for impairment	$ 4,980	$ 0	$ 0	$ 53	$ 0	$ 5,033
Collectively evaluated for impairment	622,288	13,656	17,838	5,471	0	659,253
Total ending loan balance	$ 627,268	$ 13,656	$ 17,838	$ 5,524	$ 0	$ 664,286
December 31, 2010:						
Allowance for loan losses:						
Ending allowance balance:						
Individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Collectively evaluated for impairment	583	277	305	208	115	1,488
Total ending allowance balance	$ 583	$ 277	$ 305	$ 208	$ 115	$ 1,488
Loans:						
Ending loan balance:						
Individually evaluated for impairment	$ 3,401	$ 2	$ 0	$ 5	$ 0	$ 3,408
Collectively evaluated for impairment	600,981	13,185	20,079	5,625	0	639,870
Total ending loan balance	$ 604,382	$ 13,187	$ 20,079	$ 5,630	$ 0	$ 643,278

The table below presents the balance of impaired loans and the related amount of allocated loan loss allowances:

(Dollars in thousands)	September 30, 2011	December 31, 2010
Loans with no allocated allowance for loan losses	$ 5,033	$ 3,408
Loans with allocated allowance for loan losses	0	0
Total impaired loans	$ 5,033	$ 3,408
Amount of allocated loan loss allowance	$ 0	$ 0

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The table below presents the balance of impaired loans individually evaluated for impairment by class of loans:

(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance
September 30, 2011:		
With no related allowance recorded:		
One- to four-family residential mortgages	$ 4,980	$ 5,113
Consumer and other	53	53
Total	$ 5,033	$ 5,166
December 31, 2010:		
With no related allowance recorded:		
One- to four-family residential mortgages	$ 3,401	$ 3,413
Construction, commercial and other mortgages	2	2
Consumer and other	5	5
Total	$ 3,408	$ 3,420

The table below presents the average recorded investment and interest income recognized on impaired loans by class of loans:

	For the three months ended September 30		For the nine months ended September 30	
(Dollars in thousands)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
2011:				
With no related allowance recorded:				
One- to four-family residential mortgages	$ 4,292	$ 40	$ 4,982	$ 108
Consumer and other	29	0	54	0
Total	$ 4,321	$ 40	$ 5,036	$ 108
2010:				
With no related allowance recorded:				
One- to four-family residential mortgages	$ 2,911	$ 35	$ 3,018	$ 98
Construction, commercial and other mortgages	97	0	26	0
Consumer and other	5	0	150	0
Total	$ 3,013	$ 35	$ 3,194	$ 98

There were no loans individually evaluated for impairment with a related allowance for loan loss as of September 30, 2011 or December 31, 2010.

Impaired loans at September 30, 2011 and December 31, 2010 amounted to $5.0 million and $3.4 million, respectively, and included all nonaccrual and restructured loans. During the nine months ended September 30, 2011, the average recorded investment in impaired loans was $5.0 million and interest income recognized on impaired loans was $108,000. During the nine months ended September 30, 2010, the average recorded investment in impaired loans was $3.2 million and interest income recognized on impaired loans was $98,000.

The table below presents the aging of loans and accrual status by class of loans as of September 30, 2011 and December 31, 2010:

(Dollars in thousands)	30 59 Days Past Due	60 89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Loans Not Past Due	Total Loans	Nonaccrual Loans	Loans More Than 90 Days Past Due and Still Accruing
September 30, 2011:								
One- to four family residential mortgages	$ 629	$ 403	$ 2,384	$ 3,416	$ 617,680	$ 621,096	$ 2,384	$ 0
Multi-family residential mortgages	0	0	0	0	6,172	6,172	0	0
Construction, commercial and other mortgages	238	0	0	238	13,418	13,656	0	0
Home equity and lines of credit	0	0	0	0	17,838	17,838	0	0
Loans on deposit accounts	0	0	0	0	737	737	0	0
Consumer and other	19	7	53	79	4,708	4,787	53	0
Total	$ 886	$ 410	$ 2,437	$ 3,733	$ 660,553	$ 664,286	$ 2,437	$ 0
December 31, 2010:								
One- to four-family residential mortgages	$ 1,476	$ 0	$ 801	$ 2,277	$ 596,732	$ 599,009	$ 801	$ 0
Multi-family residential mortgages	0	0	0	0	5,373	5,373	0	0
Construction, commercial and other mortgages	0	0	2	2	13,185	13,187	2	0
Home equity and lines of credit	58	0	0	58	20,021	20,079	0	0
Loans on deposit accounts	0	0	0	0	895	895	0	0
Consumer and other	10	8	5	23	4,712	4,735	5	0
Total	$ 1,544	$ 8	$ 808	$ 2,360	$ 640,918	$ 643,278	$ 808	$ 0

The Company primarily uses the aging of loans and accrual status to monitor the credit quality of its loan portfolio. When a mortgage loan becomes seriously delinquent (90 days or more contractually past due), it displays weaknesses which may result in a loss. As a loan becomes more delinquent, the likelihood of the borrower repaying the loan decreases and the loan becomes more collateral dependent. A mortgage loan becomes collateral dependent when the proceeds for repayment can be expected to

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come only from the sale or operation of the collateral and not from borrower repayments. Generally, new appraisals are obtained after a loan becomes collateral dependent or is five months delinquent. The carrying value of collateral dependent loans is adjusted to the fair market value of the collateral less selling costs. Any commercial real estate, commercial, or construction loan that has a loan balance in excess of a specified amount is also periodically reviewed to determine whether the loan exhibits any weaknesses and is performing in accordance with its contractual terms.

The Company had 11 nonaccrual loans with a book value of $2.4 million at September 30, 2011 and seven nonaccrual loans with a book value of $808,000 as of December 31, 2010. The Company collected or recognized interest income on nonaccrual loans of $8,000 and $0 during the nine months ended September 30, 2011 and 2010, respectively. The Company would have recognized additional interest income of $84,000 and $19,000 during the nine months ended September 30, 2011 and 2010, respectively, had the loans been accruing interest. The Company did not have any loans 90 or more days past due and still accruing interest as of September 30, 2011 and December 31, 2010.

The table below presents information about the Company s new troubled debt restructurings by class of loans:

	2011			2010		
(Dollars in thousands)	Number of Loans	Pre-Modification Recorded Investment	Post-Modification Recorded Investment	Number of Loans	Pre-Modification Recorded Investment	Post-Modification Recorded Investment
Nine months ended September 30:						
One- to four-family residential	0	$ 0	$ 0	2	$ 417	$ 396
Total	0	$ 0	$ 0	2	$ 417	$ 396

There were no new troubled debt restructurings during the three months ended September 30, 2011 or 2010. There were also no new troubled debt restructurings within the past twelve months that subsequently defaulted.

The Company had nine troubled debt restructurings totaling $2.6 million as of September 30, 2011, all of which were one- to four-family residential mortgage loans and considered to be impaired. Eight of the nine loans are performing in accordance with their restructured terms and accruing interest at September 30, 2011. One loan was 29 days delinquent and still accruing interest at September 30, 2011. There were nine restructured one- to four-family residential mortgage loans totaling $2.6 million as of December 31, 2010 that were considered to be impaired. Eight of the nine loans were performing in accordance with their restructured terms and accruing interest as of December 31, 2010. One loan was 29 days delinquent and still accruing interest at December 31, 2010. Restructurings include deferrals of interest and/or principal payments and temporary or permanent reductions in interest rates due to the financial difficulties of the borrowers. We have no commitments to lend any additional funds to these borrowers. The troubled debt restructurings were individually evaluated for impairment and did not have a significant effect on the allowance for loan losses.

Nearly all of our real estate loans are collateralized by real estate located in the State of Hawaii. Loan-to-value ratios on these real estate loans generally do not exceed 80% at the time of origination.

During the nine months ended September 30, 2011 and 2010, the Company sold $35.3 million and $31.1 million, respectively, of residential mortgage loans held for sale and recognized gains of $374,000 and $420,000, respectively. During the three months ended September 30, 2011 and 2010, the Company sold $9.2 million and $12.4 million, respectively, of mortgage loans held for sale and recognized gains of

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$138,000 and $165,000, respectively. The Company had 13 residential mortgage loans held for sale totaling $3.0 million at September 30, 2011 and 13 residential mortgage loans held for sale totaling $3.2 million at December 31, 2010. We have not had to repurchase any loans from Freddie Mac for the nine months ended September 30, 2011 and 2010.

The Company serviced loans for others of $120.8 million at September 30, 2011 and $131.6 million at December 31, 2010. Of these amounts, $7.1 million and $8.1 million relate to securitizations for which the Company continues to hold the related mortgage-backed securities at September 30, 2011 and December 31, 2010, respectively. The amount of contractually specified servicing fees earned for the nine-month periods ended September 30, 2011 and 2010 was $266,000 and $302,000, respectively. The amount of contractually specified servicing fees earned for the three-month periods ended September 30, 2011 and 2010 was $87,000 and $100,000, respectively. The fees are reported in service fees on loan and deposit accounts in the consolidated statements of income.

(7) Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase are treated as financings and the obligations to repurchase the identical securities sold are reflected as a liability with the dollar amount of securities underlying the agreements remaining in the asset accounts. Securities sold under agreements to repurchase are summarized as follows:

	September 30, 2011		December 31, 2010	
(Dollars in thousands)	Repurchase Liability	Weighted Average Rate	Repurchase Liability	Weighted Average Rate
Maturing:				
1 year or less	$ 40,200	4.72%	$ 43,900	3.53%
Over 1 year to 2 years	33,000	3.91	28,300	4.75
Over 2 years to 3 years	0	0	33,000	3.91
Over 3 years to 4 years	47,000	2.11	0	0
	$ 120,200	3.48%	$ 105,200	3.98%

Below is a summary comparing the carrying value and fair value of securities pledged to secure repurchase agreements, the repurchase liability, and the amount at risk at September 30, 2011. The amount at risk is the greater of the carrying value or fair value over the repurchase liability. All the agreements to repurchase are with JP Morgan Chase Bank N.A. and JP Morgan Securities LLC. The securities pledged are issued and guaranteed by U.S. government-sponsored enterprises.

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(Dollars in thousands)	Carrying value of securities	Fair value of securities	Repurchase liability	Amount at risk	Weighted average months to maturity
Maturing:					
Over 90 days	$ 137,143	$ 145,209	$ 120,200	$ 25,009	24
	$ 137,143	$ 145,209	$ 120,200	$ 25,009	24

(8) Employee Benefit Plans

The Company has a noncontributory defined benefit pension plan (Pension Plan) that covers substantially all employees with at least one year of service. Effective December 31, 2008, under approved changes to the Pension Plan, there were no further accruals of benefits for any participants and benefits will not increase with any additional years of service. Net periodic benefit cost, subsequent to December 31, 2008, has not been significant and is not disclosed in the table below.

In addition, the Company sponsors a Supplemental Employee Retirement Plan (SERP), a noncontributory supplemental retirement benefit plan, which covers certain current and former employees of the Company for amounts in addition to those provided under the Pension Plan.

The components of net periodic benefit cost were as follows:

	SERP Three Months Ended September 30,		SERP Nine Months Ended September 30,	
(Dollars in thousands)	2011	2010	2011	2010
Net periodic benefit cost for the period				
Service cost	$ 111	$ 155	$ 332	$ 465
Interest cost	53	89	161	266
Expected return on plan assets	0	0	0	0
Amortization of prior service cost	0	0	0	0
Recognized actuarial loss	0	0	0	0
Recognized curtailment loss	0	0	0	0
Net periodic benefit cost	$ 164	$ 244	$ 493	$ 731

(9) Employee Stock Ownership Plan

Effective January 1, 2009, Territorial Savings Bank adopted an Employee Stock Ownership Plan (ESOP) for eligible employees. The ESOP borrowed $9.8 million from the Company and used those funds to acquire 978,650 shares or 8% of the total number of shares issued by the Company in its initial public offering. The shares were acquired at a price of $10.00 per share.

The loan is secured by the shares purchased with the loan proceeds and will be repaid by the ESOP over the 20-year term of the loan with funds from Territorial Savings Bank s contributions to the ESOP

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and dividends payable on the shares. The interest rate on the ESOP loan is an adjustable rate equal to the prime rate, as published in The Wall Street Journal. The interest rate adjusts annually and will be the prime rate on the first business day of the calendar year.

Shares purchased by the ESOP are held by a trustee in an unallocated suspense account, and shares are released annually from the suspense account on a pro-rata basis as principal and interest payments are made by the ESOP to the Company. The trustee allocates the shares released among participants on the basis of each participant s proportional share of compensation relative to all participants. As shares are committed to be released from the suspense account, Territorial Savings Bank reports compensation expense based on the average fair value of shares released with a corresponding credit to stockholders equity. The shares committed to be released are considered outstanding for earnings per share computations. Compensation expense recognized for the three months ended September 30, 2011 and 2010 amounted to $236,000 and $212,000, respectively. Compensation expense recognized for the nine months ended September 30, 2011 and 2010 amounted to $704,000 and $677,000, respectively.

Shares held by the ESOP trust were as follows:

	September 30, 2011	December 31, 2010
Allocated shares	134,564	97,865
Unearned shares	844,086	880,785
Total ESOP shares	978,650	978,650
Fair value of unearned shares, in thousands	$ 16,164	$ 17,536

The ESOP restoration plan is a non-qualified plan that provides supplemental benefits to certain executives who are prevented from receiving the full benefits contemplated by the employee stock ownership plan s benefit formula. The supplemental cash payments consist of payments representing shares that cannot be allocated to the participants under the ESOP due to IRS limitations imposed on tax-qualified plans. We accrue for these benefits over the period during which employees provide services to earn these benefits. For the three months ended September 30, 2011 and 2010, we accrued $1,000 and $3,000, respectively, for the ESOP restoration plan. For the nine months ended September 30, 2011 and 2010, we accrued $159,000 and $158,000, respectively, for the ESOP restoration plan.

(10) Share-Based Compensation

On August 19, 2010, Territorial Bancorp Inc. adopted the 2010 Equity Incentive Plan, which provides for awards of stock options and restricted stock to key officers and outside directors. In accordance with the Compensation Stock Compensation topic of the FASB ASC, the cost of the 2010 Equity Incentive Plan is based on the fair value of the awards on the grant date. The fair value of restricted stock is based on the closing price of the Company s stock on the grant date. The fair value of stock options is estimated using a Black-Scholes option pricing model using assumptions for dividend yield, stock price volatility, risk-free interest rate and option term. These assumptions are based on our judgments regarding future events, are subjective in nature, and cannot be determined with precision. The cost of the awards will be recognized on a straight-line basis over the six-year vesting period during which participants are required to provide services in exchange for the awards.

Shares of our common stock issued under the Plan shall be authorized but unissued shares. The maximum number of shares that will be awarded under the Plan will be 1,712,637 shares. Share-based compensation expense for the three months and nine months ended September 30, 2011 was $1.5 million and $3.0 million, respectively.

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Stock Options

The table below presents the stock option activity for the nine months ended September 30, 2011:

	Options	Weighted average exercise price	Remaining contractual life (years)	Aggregate intrinsic value (in thousands)
Balance at December 31, 2010	871,144	$ 17.36	9.67	$ 2,221
Granted	0	0	0	0
Exercised	0	0	0	0
Forfeited	0	0	0	0
Expired	0	0	0	0
Balance at September 30, 2011	871,144	$ 17.36	8.92	$ 1,559

As of September 30, 2011, the Company had $3.5 million of unrecognized compensation costs related to stock options. The cost of stock options will be amortized in equal annual installments over the six-year vesting period. There were 179,587 options vested in the nine months ending September 30, 2011.

The fair value of the Company s stock options was determined using the Black-Scholes option pricing formula. The following assumptions were used in the formula:

Expected volatility	31.98%
Risk-free interest rate	2.58%
Expected dividends	1.61%
Expected life (in years)	6.75
Grant price for the stock options	$ 17.36

Expected volatility - Based on the historical volatility of the Company s stock and a peer group of comparable thrifts.

Risk-free interest rate - Based on the U.S. Treasury yield curve and expected life of the options at the time of grant.

Expected dividends - Based on the quarterly dividend and the price of the Company s stock at the time of grant.

Expected life - Based on a weighted-average of the six-year vesting period and the 10-year contractual term of the stock option plan.

Grant price for the stock options - Based on the closing price of the Company s stock on the date of grant.

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Restricted Stock Awards

Restricted stock awards are accounted for as fixed grants using the fair value of the Company s stock at the time of grant. Unvested restricted stock awards may not be disposed of or transferred during the vesting period. Restricted stock awards carry with them the right to receive dividends.

The table below presents the restricted stock award activity for the six months ended September 30, 2011:

	Restricted stock awards	Weighted average grant date fair value
Non-vested at December 31, 2010	713,600	$ 17.36
Granted	0	0
Vested	149,606	0
Forfeited	0	0
Non-vested at September 30, 2011	563,994	$ 17.36

There were 149,606 shares vested in the nine months ending September 30, 2011.

As of September 30, 2011, the Company had $9.6 million of unrecognized compensation cost related to restricted stock awards. The cost of the restricted stock awards will be amortized in equal annual installments over the six-year vesting period.

(11) Earnings Per Share

The table below presents the information used to compute basic and diluted earnings per share:

(Dollars in thousands, except share data)	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Net income	$ 2,986	$ 3,134	$ 9,371	$ 7,830
Weighted average number of shares used in:				
Basic earnings per share	10,659,532	11,334,058	10,969,320	11,321,912
Dilutive common stock equivalents:				
Stock options and restricted stock units	176,117	10,564	148,124	34,825
Diluted earnings per share	10,835,649	11,344,622	11,117,444	11,356,737
Net income per common share, basic	$ 0.28	$ 0.28	$ 0.85	$ 0.69
Net income per common share, diluted	$ 0.28	$ 0.28	$ 0.84	$ 0.69

(12) Fair Value of Financial Instruments

In accordance with the Fair Value Measurements and Disclosures topic of the FASB ASC, the Company groups its financial assets and liabilities at fair value into three levels based on the markets in which the financial assets and liabilities are traded and the reliability of the assumptions used to determine fair value as follows:

Level 1 Valuation is based upon quoted prices (unadjusted) for identical assets or liabilities traded in active markets. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.

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Level 2 Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 Valuation is generated from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect management s own estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of discounted cash flow models and similar techniques that require the use of significant judgment or estimation.

In accordance with the Fair Value Measurements and Disclosures topic, the Company bases its fair values on the price that it would expect to receive if an asset were sold or the price that it would expect to pay to transfer a liability in an orderly transaction between market participants at the measurement date. Also as required, the Company maximizes the use of observable inputs and minimizes the use of unobservable inputs when developing fair value measurements.

The Company uses fair value measurements to determine fair value disclosures. Investment securities held for sale and derivatives are recorded at fair value on a recurring basis. From time to time, the Company may be required to record other financial assets at fair value on a nonrecurring basis, such as loans held for sale, impaired loans and investments, and mortgage servicing assets. These nonrecurring fair value adjustments typically involve application of the lower of cost or fair value accounting or write-downs of individual assets.

Cash and Cash Equivalents, Accrued Interest Receivable, Accounts Payable and Accrued Expenses (excluding interest rate contracts), Current Income Taxes Payable, and Advance Payments by Borrowers for Taxes and Insurance. The carrying amount approximates fair value because of the short maturity of these instruments.

Investment Securities. The fair values for investment securities were based on quoted market prices, if available, and were classified as Level 1. The estimated fair values of U.S. government-sponsored mortgage-backed securities are considered Level 1 inputs. If quoted market prices were not available, the valuation for investment securities utilized pricing models that varied based on asset class and included trade, bid and other observable market information. Securities priced using this information were classified as Level 2.

The trust preferred securities represent investments in a pool of debt obligations issued primarily by holding companies for Federal Deposit Insurance Corporation-insured financial institutions. The trust preferred securities market is considered to be inactive since there have been only five sales transactions of similar rated securities over the past 21 months and no new issues of pooled trust preferred securities have occurred since 2007. The fair value of our trust preferred securities was determined by an independent third-party pricing service which used a discounted cash flow model. Our pricing service used a discount rate of 23.00% and provided a fair value estimate of $4.75 per $100 of par value for PreTSL XXIII.

The discounted cash flow analysis included a review of all issuers within each collateral pool and incorporated higher deferral and default rates in the cash flow projections over the next three years and a forecast of lower deferral and default rates in later years. The fair value of the trust preferred securities are classified as Level 3 inputs because they are based on discounted cash flow models.

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FHLB Stock. FHLB stock, which is redeemable for cash at par value, is reported at its par value.

Loans. The fair value of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. The fair value of loans is not based on the concept of exit price.

Deposits. The fair value of checking and Super NOW savings accounts, passbook accounts, and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated by discounting future cash flows using the rates currently offered for deposits with similar remaining maturities.

Advances from the FHLB and Securities Sold Under Agreements to Repurchase. Fair value is estimated by discounting future cash flows using the rates currently offered to the Company for debt with similar remaining maturities.

Interest Rate Contracts. The Company may enter into interest rate lock commitments with borrowers on loans intended to be sold. To manage interest rate risk on the lock commitments, the Company may also enter into forward loan sale commitments. The interest rate lock commitments and forward loan sale commitments are treated as derivatives and are recorded at their fair value determined by referring to prices quoted in the secondary market for similar contracts. Interest rate contracts that are classified as assets are included with prepaid expenses and other assets on the consolidated balance sheet while interest rate contracts that are classified as liabilities are included with accounts payable and accrued expenses.

The estimated fair values of the Company s financial instruments are as follows:

(Dollars in thousands)	September 30, 2011 Carrying amount	September 30, 2011 Estimated fair value	December 31, 2010 Carrying amount	December 31, 2010 Estimated fair value
Assets				
Cash and cash equivalents	$ 132,448	132,448	194,435	194,435
Investment securities available for sale	0	0	15,010	15,010
Investment securities held to maturity	658,574	694,996	530,555	546,844
FHLB stock	12,348	12,348	12,348	12,348
Loans held for sale	2,987	3,093	3,234	3,234
Loans receivable, net	662,734	764,118	641,790	666,339
Accrued interest receivable	4,882	4,882	4,536	4,536
Interest rate contracts	199	199	456	456
Liabilities				
Deposits	$ 1,139,317	1,141,523	1,076,470	1,078,590
Advances from the Federal Home Loan Bank	20,000	20,637	10,000	10,274
Securities sold under agreement to repurchase	120,200	125,103	105,200	109,953
Accounts payable and accrued expenses	19,549	19,549	20,116	20,116
Interest rate contracts	178	178	314	314
Current income taxes payable	416	416	577	577
Advance payments by borrowers for taxes and insurance	2,088	2,088	3,376	3,376

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At September 30, 2011 and December 31, 2010, neither the commitment fees received on commitments to extend credit nor the fair value thereof was material to the consolidated financial statements of the Company.

The table below presents the balance of assets and liabilities measured at fair value on a recurring basis:

(Dollars in thousands)		Level 1	Level 2	Level 3	Total
September 30, 2011					
Interest rate contracts	assets	$ 0	199	0	199
Interest rate contracts	liabilities	0	(178)	0	(178)
December 31, 2010					
Interest rate contracts	assets	$ 0	456	0	456
Interest rate contracts	liabilities	0	(314)	0	(314)
Available-for-sale investments		0	15,010	0	15,010

The fair value of interest rate contracts was determined by referring to prices quoted in the secondary market for similar contracts. Gains and losses are included in gain on sale of loans in the consolidated statements of income. The fair value of available-for-sale investments was determined using quoted market prices for similar investments. The losses, net of taxes, are included in accumulated other comprehensive loss in the consolidated balance sheets.

The table below presents the balance of assets measured at fair value on a nonrecurring basis and the related gains and losses for the nine months ended September 30, 2011 and the year ended December 31, 2010:

(Dollars in thousands)	Level 1	Level 2	Level 3	Total	Total Gains (Losses)
September 30, 2011					
Impaired loans	$ 0	0	2,425	2,425	1
Mortgage servicing assets	0	0	1,008	1,008	(32)
December 31, 2010					
Impaired loans	$ 0	254	2,429	2,683	(183)
Trust preferred securities	0	0	128	128	(2,404)
Mortgage servicing assets	0	0	1,366	1,366	(64)

The fair value of impaired loans that are considered to be collateral dependent is determined using the value of collateral less estimated selling costs. The fair value of impaired loans that are not

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considered to be collateral dependent is determined based on the present value of expected future cash flows discounted at the loan s effective interest rate. Gains and losses on impaired loans are included in the provision for loan losses in the consolidated statements of income. The fair value of trust preferred securities was determined by an independent third-party pricing service using a discounted cash flow model. The assumptions used in the discounted cash flow model are discussed above. Losses on trust preferred securities are included in net other-than-temporary impairment losses in the consolidated statements of income. Mortgage servicing assets are valued using a cash flow model prepared by an independent third-party appraiser. Assumptions used in the model include mortgage prepayment speeds, discount rates, cost of servicing and ancillary income. Losses on mortgage servicing assets are included in service fees on loan and deposit accounts in the consolidated statements of income.

(13) Subsequent Events

On October 13, 2011, Territorial Bancorp Inc. announced that it completed its second repurchase program. The Company repurchased 581,265 shares of its common stock at an average price of $19.22 per share.

On November 3, 2011, the Board of Directors of Territorial Bancorp Inc. declared a quarterly cash dividend of $0.09 per share of common stock. The dividend is expected to be paid on December 1, 2011 to stockholders of record as of November 17, 2011.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Cautionary Statement Regarding Forward-Looking Information

This Quarterly Report contains forward-looking statements, which can be identified by the use of words such as estimate, project, believe, intend, anticipate, plan, seek, expect, will, may and words of similar meaning. These forward-looking statements include, but are not l

statements of our goals, intentions and expectations;

statements regarding our business plans, prospects, growth and operating strategies;

statements regarding the asset quality of our loan and investment portfolios; and

estimates of our risks and future costs and benefits.

These forward-looking statements are based on our current beliefs and expectations and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. In addition, these forward-looking statements are subject to assumptions with respect to future business strategies and decisions that are subject to change. We are under no duty to and do not take any obligation to update any forward-looking statements after the date of this Quarterly Report.

The following factors, among others, could cause actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements:

general economic conditions, either nationally or in our market areas, that are worse than expected;

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- competition among depository and other financial institutions;
- inflation and changes in the interest rate environment that reduce our margins or reduce the fair value of financial instruments;
- adverse changes in the securities markets;
- changes in laws or government regulations or policies affecting financial institutions, including changes in regulatory fees and capital requirements;
- our ability to enter new markets successfully and capitalize on growth opportunities;
- our ability to successfully integrate acquired entities, if any;
- changes in consumer spending, borrowing and savings habits;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission and the Public Company Accounting Oversight Board;
- changes in our organization, compensation and benefit plans;
- changes in our financial condition or results of operations that reduce capital available to pay dividends; and
- changes in the financial condition or future prospects of issuers of securities that we own.

Because of these and a wide variety of other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements.

Critical Accounting Policies

There are no material changes to the critical accounting policies disclosed in Territorial Bancorp Inc. s Annual Report on Form 10-K for the year ended December 31, 2010.

Comparison of Financial Condition at September 30, 2011 and December 31, 2010

Assets. At September 30, 2011, our assets were $1.516 billion, an increase of $72.6 million, or 5.0%, from $1.443 billion at December 31, 2010. The growth in assets was primarily the result of increases in investment securities and loans receivable, which were partially offset by a decrease in cash and cash equivalents.

Cash and Cash Equivalents. Cash and cash equivalents were $132.4 million at September 30, 2011, a decrease of $62.0 million since December 31, 2010. Cash and cash equivalents, along with the

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proceeds from a $62.8 million increase in deposits and a $25.0 million increase in borrowings, were primarily used to fund an increase of $113.0 million in investment securities and $20.7 million in total loans, repurchase Company shares costing $23.5 million, and pay dividends of $2.7 million to common shareholders.

Loans. Total loans, including $3.0 million of loans held for sale, were $665.7 million at September 30, 2011, or 43.9% of total assets. During the nine months ended September 30, 2011, the loan portfolio increased by $20.7 million, or 3.2%. The increase in the loan portfolio occurred as one- to four-family residential loan production exceeded principal repayments and loan sales.

Securities. At September 30, 2011, our securities portfolio totaled $658.6 million, or 43.4% of assets. At September 30, 2011, all of such securities were classified as held-to-maturity and none of the underlying collateral consisted of subprime or Alt-A (traditionally defined as non-conforming loans having less than full documentation) loans. During the nine months ended September 30, 2011, our securities portfolio increased by $113.0 million, or 20.7%, primarily due to purchases exceeding repayments.

$15.0 million of U.S. government-sponsored mortgage-backed securities were reclassified from available-for-sale to held-to-maturity during the nine months ended September 30, 2011. Management considers the held-to-maturity classification of these securities to be appropriate as the Company has the positive intent and ability to hold these securities to maturity.

At September 30, 2011, we owned trust preferred securities with a carrying value of $32,000. This portfolio consists of two securities (PreTSL XXIII and PreTSL XXIV), which represent investments in a pool of debt obligations issued primarily by holding companies for Federal Deposit Insurance Corporation-insured financial institutions. The difference between the carrying value of $32,000 and the remaining amortized cost basis of $1.1 million is included as a component of accumulated other comprehensive loss, net of taxes, and is related to non-credit factors such as the trust preferred securities market being inactive.

The trust preferred securities market is considered inactive as only five sales transactions of similarly rated securities have occurred over the past 21 months. In addition, there have been no new issues of pooled trust preferred securities since 2007. Because the trust preferred securities market is inactive, we use a discounted cash flow model to determine whether they are other-than-temporarily impaired. The assumptions used in preparing the discounted cash flow model include the following: estimated discount rates (using yields of comparable traded instruments adjusted for illiquidity and other risk factors), estimated deferral and default rates on collateral, and estimated cash flows.

Based on the Company s review, the Company s investment in trust preferred securities did not incur additional impairment during the quarter ending September 30, 2011 as the present value of cash flows exceeded the amortized cost basis of $1.1 million.

At September 30, 2011, PreTSL XXIII and XXIV are rated C by Fitch.

It is reasonably possible that the fair values of the trust preferred securities could decline in the near term if the overall economy and the financial condition of some of the issuers continue to deteriorate and the liquidity of these securities remains low. As a result, there is a risk that the Company s amortized cost basis of $1.1 million on its trust preferred securities could become other-than-temporarily impaired in the near term. Any such impairment could be material to the Company s consolidated statements of income.

Deposits. Deposits were $1.139 billion at September 30, 2011, an increase of $62.8 million, or 5.8%, since December 31, 2010. The increase in deposits was caused by opening two new branches and our continuing to promote higher-than-market rates for savings accounts.

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Borrowings. During the nine months ended September 30, 2011, our borrowings increased by $25.0 million, or 21.7%, to $140.2 million, due to a $15.0 million net increase in securities sold under agreements to repurchase and a $10.0 million increase in Federal Home Loan Bank advances. The increase in long-term borrowings was part of the Bank s strategy to control interest rate risk.

Stockholders Equity. Stockholders equity was $214.2 million at September 30, 2011, a decrease of $13.1 million, or 5.8%, since December 31, 2010. The decrease in stockholders equity occurred primarily because of the repurchase of shares costing $23.5 million and the payment of $2.7 million of dividends to shareholders. This decrease in stockholders equity was offset by current year s earnings of $9.4 million and a $2.8 million increase in paid-in-capital related to stock benefit plans.

Average Balances and Yields

The following tables set forth average balance sheets, average yields and rates, and certain other information at and for the periods indicated. No tax-equivalent yield adjustments were made, as the effect thereof was not material. All average balances are daily average balances. Non-accrual loans were included in the computation of average balances, but have been reflected in the table as loans carrying a zero yield. The yields set forth below include the effect of net deferred costs, discounts, and premiums that are amortized or accreted to interest income.

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	For the Three Months Ended September 30,					
	2011			2010		
	Average Outstanding Balance	Interest	Yield/ Rate (1)	Average Outstanding Balance	Interest	Yield/ Rate (1)
	(Dollars in thousands)					
Interest-earning assets:						