Territorial Bancorp Inc.
Form 10-Q
August 08, 2012
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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 June 30, 2012

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

10,811,820 shares of Common Stock, par value $0.01 per share, were issued and outstanding as of July 31, 2012.

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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)

	June 30, 2012	December 31, 2011
ASSETS		
Cash and cash equivalents	$ 156,373	$ 131,937
Investment securities held to maturity, at amortized cost (fair value of $655,681 and $687,319 at June 30, 2012 and December 31, 2011, respectively)	620,965	653,871
Federal Home Loan Bank stock, at cost	12,348	12,348
Loans held for sale	1,915	3,231
Loans receivable, net	726,245	688,095
Accrued interest receivable	4,686	4,780
Premises and equipment, net	5,161	5,450
Real estate owned	184	408
Bank-owned life insurance	30,701	30,234
Deferred income taxes receivable	3,297	2,648
Prepaid expenses and other assets	4,160	4,569
Total assets	$ 1,566,035	$ 1,537,571
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Deposits	$ 1,213,282	$ 1,166,116
Advances from the Federal Home Loan Bank	20,000	20,000
Securities sold under agreements to repurchase	90,300	108,300
Accounts payable and accrued expenses	21,151	22,816
Current income taxes payable	1,679	3,114
Advance payments by borrowers for taxes and insurance	3,305	3,264
Total liabilities	1,349,717	1,323,610
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 10,811,820 and 11,022,309 shares at June 30, 2012 and December 31, 2011, respectively	108	110
Additional paid-in capital	94,617	97,640
Unearned ESOP shares	(8,074)	(8,319)
Retained earnings	133,427	128,300
Accumulated other comprehensive loss	(3,760)	(3,770)
Total stockholders equity	216,318	213,961

Total liabilities and stockholders equity	$ 1,566,035	$ 1,537,571

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 June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Interest and dividend income:				
Investment securities	$ 6,293	$ 6,889	$ 12,809	$ 13,260
Loans	9,110	8,763	18,139	17,646
Other investments	87	81	171	173
Total interest and dividend income	15,490	15,733	31,119	31,079
Interest expense:				
Deposits	1,582	1,701	3,152	3,409
Advances from the Federal Home Loan Bank	104	104	208	190
Securities sold under agreements to repurchase	831	1,052	1,735	2,086
Total interest expense	2,517	2,857	5,095	5,685
Net interest income	12,973	12,876	26,024	25,394
Provision (reversal of allowance) for loan losses	(79)	14	5	122
Net interest income after provision for loan losses	13,052	12,862	26,019	25,272
Noninterest income:				
Service fees on loan and deposit accounts	480	598	1,030	1,156
Income on bank-owned life insurance	234	241	467	480
Gain on sale of investment securities	172	0	300	66
Gain on sale of loans	406	92	847	236
Other	115	292	205	411
Total noninterest income	1,407	1,223	2,849	2,349
Noninterest expense:				
Salaries and employee benefits	5,041	5,487	10,214	10,613
Occupancy	1,290	1,226	2,614	2,447
Equipment	811	808	1,623	1,574
Federal deposit insurance premiums	192	191	382	487
Loss on extinguishment of debt	198	0	198	0
Other general and administrative expenses	966	933	2,105	1,933
Total noninterest expense	8,498	8,645	17,136	17,054
Income before income taxes	5,961	5,440	11,732	10,567
Income taxes	2,115	2,055	4,346	4,182

Net income	$ 3,846	$ 3,385	$ 7,386	$ 6,385
Basic earnings per share	$ 0.38	$ 0.31	$ 0.73	$ 0.57
Diluted earnings per share	$ 0.37	$ 0.30	$ 0.72	$ 0.57
Cash dividends declared per common share	$ 0.11	$ 0.09	$ 0.21	$ 0.16
Basic weighted-average shares outstanding	10,135,179	10,992,653	10,163,647	11,126,781
Diluted weighted-average shares outstanding	10,303,363	11,120,248	10,305,751	11,239,913

See accompanying notes to consolidated financial statements.

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TERRITORIAL BANCORP INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Unaudited)

(Dollars in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net income	$ 3,846	$ 3,385	$ 7,386	$ 6,385
Change in unrealized loss on securities	6	252	10	187
Other comprehensive income	6	252	10	187
Comprehensive income	$ 3,852	$ 3,637	$ 7,396	$ 6,572

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, 2010	$ 122	$ 119,153	$ (8,808)	$ 119,397	$ (2,505)	$ 227,359
Net income	0	0	0	6,385	0	6,385
Other comprehensive income	0	0	0	0	187	187
Cash dividends declared	0	0	0	(1,787)	0	(1,787)
Share-based compensation	0	1,389	0	0	0	1,389
Allocation of 24,466 ESOP shares	0	239	245	0	0	484
Repurchase of 584,828 shares of company common stock	(6)	(11,487)	0	0	0	(11,493)
Balances at June 30, 2011	$ 116	$ 109,294	$ (8,563)	$ 123,995	$ (2,318)	$ 222,524
Balances at December 31, 2011	$ 110	$ 97,640	$ (8,319)	$ 128,300	$ (3,770)	$ 213,961
Net income	0	0	0	7,386	0	7,386
Other comprehensive income	0	0	0	0	10	10
Cash dividends declared	0	0	0	(2,259)	0	(2,259)
Share-based compensation	0	1,323	0	0	0	1,323
Allocation of 24,466 ESOP shares	0	274	245	0	0	519
Repurchase of 251,739 shares of company common stock	(2)	(5,336)	0	0	0	(5,338)
Exercise of 41,275 options on common stock	0	716	0	0	0	716
Balances at June 30, 2012	$ 108	$ 94,617	$ (8,074)	$ 133,427	$ (3,760)	$ 216,318

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)

	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Cash flows from operating activities:		
Net income	$ 7,386	$ 6,385
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	5	122
Depreciation and amortization	571	557
Deferred income tax benefit	(655)	(1,186)
Amortization of fees, discounts, and premiums	(133)	(22)
Origination of loans held for sale	(44,376)	(27,541)
Proceeds from sales of loans held for sale	46,539	26,013
Gain on sale of loans, net	(847)	(236)
Net gain on sale of real estate owned	(38)	0
Purchases of investment securities held for trading	0	(19,800)
Proceeds from sale of investment securities held for trading	0	19,866
Gain on sale of investment securities held for trading	0	(66)
Gain on sale of investment securities held to maturity	(300)	0
Net gain on sale of premises and equipment	0	(5)
ESOP expense	519	484
Share-based compensation expense	1,323	1,389
Excess tax benefits from share-based compensation	(54)	0
(Increase) decrease in accrued interest receivable	94	(406)
Net increase in bank-owned life insurance	(467)	(481)
Net decrease in prepaid expenses and other assets	409	1,901
Net decrease in accounts payable and accrued expenses	(1,665)	(1,425)
Net increase (decrease) in income taxes payable	(1,435)	839
Net cash provided by operating activities	6,876	6,388
Cash flows from investing activities:		
Purchases of investment securities held to maturity	(67,354)	(165,833)
Principal repayments on investment securities held to maturity	95,378	68,558
Principal repayments on investment securities available for sale	0	525
Proceeds from sale of investment securities held to maturity	4,559	0
Loan originations, net of principal repayments on loans receivable	(37,383)	(16,138)
Proceeds from sale of real estate owned	262	0
Proceeds from disposals of premises and equipment	0	5
Purchases of premises and equipment	(282)	(628)
Net cash used in investing activities	(4,820)	(113,511)

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TERRITORIAL BANCORP INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Unaudited)

(Dollars in thousands)

	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Cash flows from financing activities:		
Net increase in deposits	$ 47,166	$ 30,551
Proceeds from advances from the Federal Home Loan Bank	100	10,000
Repayments of advances from the Federal Home Loan Bank	(100)	0
Proceeds from securities sold under agreements to repurchase	0	42,000
Repayments of securities sold under agreements to repurchase	(18,000)	(32,000)
Purchases of Fed Funds	10	10
Sales of Fed Funds	(10)	(10)
Net increase (decrease) in advance payments by borrowers for taxes and insurance	41	(333)
Excess tax benefits from share-based compensation	54	0
Proceeds from issuance of common stock	716	0
Repurchases of company stock	(5,338)	(11,493)
Cash dividends paid	(2,259)	(1,787)
Net cash provided by financing activities	22,380	36,938
Net increase (decrease) in cash and cash equivalents	24,436	(70,185)
Cash and cash equivalents at beginning of the period	131,937	194,435
Cash and cash equivalents at end of the period	$ 156,373	$ 124,250
Supplemental disclosure of cash flow information:		
Cash paid for:		
Interest on deposits and borrowings	$ 5,162	$ 5,684
Income taxes	6,436	4,529
Supplemental disclosure of noncash investing activities:		
Loans transferred to real estate owned	$ 0	$ 162

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, 2011. 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 the 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 have been 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 April 2011, the Financial Accounting Standards Board (FASB) amended the Transfers and Servicing topic of the FASB Accounting Standards Codification (ASC). The amendment modified the criteria used to determine whether a repurchase agreement is accounted for as a sale or as a secured borrowing. The amendment was effective for interim or annual periods beginning on or after December 15, 2011. Early adoption was not permitted. The Company adopted this amendment on January 1, 2012, and the adoption did not have any effect on its consolidated financial statements.

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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 changed the principle or requirement for measuring fair value or disclosing fair value information. The amendment was effective for interim or annual periods beginning after December 15, 2011. Early application was not permitted. The Company adopted this amendment on January 1, 2012, and the adoption did not 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 eliminated the option of presenting components of other comprehensive income as part of the statement of changes in stockholders equity. Nonowner changes in stockholders equity must be presented either in a continuous statement of comprehensive income or in two separate but consecutive statements. The amendment was effective for interim or annual periods beginning after December 15, 2011, with early adoption permitted. In December 2011, the FASB deferred the effective date of the part of this amendment requiring reclassifications out of accumulated other comprehensive income to be shown on the face of the financial statements. Pending a final decision on this issue by the FASB, previous disclosure requirements will remain in effect. The Company adopted this amendment on January 1, 2012, and other than the location of disclosures related to other comprehensive income, the adoption did not have a material effect on its consolidated financial statements.

In December 2011, the FASB amended the Balance Sheet topic of the FASB ASC. The amendment requires disclosures about the gross and net information related to instruments and transactions eligible for offset in the statement of financial position. The disclosures are meant to assist users of financial statements to more easily compare information that is presented based on the differing offsetting requirements of U.S. generally accepted accounting principles and International Financial Reporting Standards. The amendment is effective for interim and annual periods beginning on or after January 1, 2013. The Company does not expect the adoption of this amendment to have a 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)	June 30, 2012	December 31, 2011
Cash and due from banks	$ 12,041	$ 8,692
Interest-earning deposits in other banks	144,332	123,245
Cash and cash equivalents	$ 156,373	$ 131,937

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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
June 30, 2012:				
Held to maturity:				
U.S. government-sponsored mortgage-backed securities	$ 620,933	$ 34,720	$ (284)	$ 655,369
Trust preferred securities	32	280	0	312
Total	$ 620,965	$ 35,000	$ (284)	$ 655,681
December 31, 2011:				
Held to maturity:				
U.S. government-sponsored mortgage-backed securities	$ 653,839	$ 33,490	$ (269)	$ 687,060
Trust preferred securities	32	227	0	259
Total	$ 653,871	$ 33,717	$ (269)	$ 687,319

The amortized cost and estimated fair value of investment securities at June 30, 2012 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	$ 4,830	$ 4,950
Due after 10 years	616,135	650,731
Total	$ 620,965	$ 655,681

Realized gains and losses and the proceeds from sales of securities available for sale, held to maturity 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 June 30, 2012	Three months ended June 30, 2011	Six months ended June 30, 2012	Six months ended June 30, 2011
Proceeds from sales	$ 2,926	$ 0	$ 4,559	$ 19,866
Gross gains	172	0	300	66
Gross losses	0	0	0	0

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During the three months ended June 30, 2012, all sales were related to $2.8 million of held-to-maturity debt securities. During the six months ended June 30, 2012, all sales were related to $4.3 million of held-to-maturity debt securities. The sale of these securities, for which the Company had already collected a substantial portion of the outstanding principal (at least 85%), is in accordance with the Investment topic of the FASB ASC and will not affect the historical cost basis used to account for the remaining securities in the held-to-maturity portfolio. There were no sales of held-to-maturity securities during the three months or six months ended June 30, 2011.

Investment securities with carrying values of $250.5 million and $281.0 million at June 30, 2012 and December 31, 2011, respectively, 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 June 30, 2012 and December 31, 2011. The Company does not intend to sell these securities until such time as the value recovers or the securities mature and it is not more likely than not that the Company will be required to sell the securities prior to recovery of value or the securities mature.

	Less than 12 months		12 months or longer			Total	
Description of securities (Dollars in thousands)	**Fair value**	**Unrealized losses**	**Fair value**	**Unrealized losses**	**Number of securities**	**Fair value**	**Unrealized losses**
June 30, 2012:							
Mortgage-backed securities	$ 21,519	$ 283	$ 62	$ 1	12	$ 21,581	$ 284
December 31, 2011:							
Mortgage-backed securities	$ 17,697	$ 268	$ 122	$ 1	7	$ 17,819	$ 269

Trust Preferred Securities. At June 30, 2012, 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 noncredit 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 six transactions in the last 18 months in similar tranches to the securities owned by the Company. The 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 June 30, 2012 as the present value of cash flows exceed the amortized cost basis of $1.1 million.

At June 30, 2012, 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)	2012	2011
Balance at January 1	$ 5,885	$ 5,885
Credit losses on debt securities for which other-than-temporary impairment was not previously recognized	0	0
Balance at June 30	$ 5,885	$ 5,885

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

	June 30,	
(Dollars in thousands)	2012	2011
Noncredit losses on other-than-temporarily impaired securities	$ 679	$ 679

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(6) Loans Receivable and Allowance for Loan Losses

The components of loans receivable are as follows:

(Dollars in thousands)	June 30, 2012	December 31, 2011
Real estate loans:		
First mortgages:		
One- to four-family residential	$ 694,539	$ 654,412
Multi-family residential	6,859	6,956
Construction, commercial, and other	13,789	12,741
Home equity loans and lines of credit	15,292	17,253
Total real estate loans	730,479	691,362
Other loans:		
Loans on deposit accounts	458	756
Consumer and other loans	4,329	4,732
Total other loans	4,787	5,488
Less:		
Net unearned fees and discounts	(5,425)	(5,613)
Undisbursed loan funds	(2,139)	(1,601)
Allowance for loan losses	(1,457)	(1,541)
	(9,021)	(8,755)
Loans receivable, net	$ 726,245	$ 688,095

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

(Dollars in thousands)	Three Months Ended June 30, 2012	2011	Six Months Ended June 30, 2012	2011
Balance, beginning of period	$ 1,529	$ 1,566	$ 1,541	$ 1,488
Provision (reversal of allowance) for loan losses	(79)	14	5	122
	1,450	1,580	1,546	1,610
Charge-offs	(22)	(15)	(136)	(55)
Recoveries	29	27	47	37
Net charge-offs	7	12	(89)	(18)
Balance, end of period	$ 1,457	$ 1,592	$ 1,457	$ 1,592

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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 Loans and Lines of Credit	Consumer and Other	Unallocated	Totals
Three months ended June 30, 2012:						
Balance, beginning of period	$ 544	$ 641	$ 34	$ 174	$ 136	$ 1,529
Provision (reversal of allowance) for loan losses	(12)	8	0	(61)	(14)	(79)
	532	649	34	113	122	1,450
Charge-offs	(4)	(8)	0	(10)	0	(22)
Recoveries	24	0	1	4	0	29
Net charge-offs	20	(8)	1	(6)	0	7
Balance, end of period	$ 552	$ 641	$ 35	$ 107	$ 122	$ 1,457
Six months ended June 30, 2012:						
Balance, beginning of period	$ 631	$ 285	$ 258	$ 291	$ 76	$ 1,541
Provision (reversal of allowance) for loan losses	(6)	364	(224)	(175)	46	5
	625	649	34	116	122	1,546
Charge-offs	(108)	(8)	(1)	(19)	0	(136)
Recoveries	35	0	2	10	0	47
Net charge-offs	(73)	(8)	1	(9)	0	(89)
Balance, end of period	$ 552	$ 641	$ 35	$ 107	$ 122	$ 1,457

Beginning with the quarter ended March 31, 2012, the Company enhanced its methodology for reviewing its loan portfolio when calculating the general portion of the allowance for loan losses. The modification consisted of additional segmentation of the residential mortgage loan portfolio by items such as year of origination, loan-to-value ratios, owner or nonowner occupancy status and the purpose of the loan (purchase, cash-out refinance, no cash-out refinance or construction). As under our prior methodology, the allowance for loan loss for each segment of the loan portfolio is determined by calculating the historical loss of each segment for a two- to three-year look-back period and adding a qualitative adjustment for the following factors:

- Changes in lending policies and procedures;
- Changes in economic trends;
- Changes in types of loans in the loan portfolio;

- Changes in experience and ability of personnel in the loan origination and loan servicing departments;
- Changes in the number and amount of delinquent loans and classified assets;
- Changes in our internal loan review system;
- Changes in the value of underlying collateral for collateral dependent loans;
- Changes in any concentrations of credit; and
- External factors such as competition, legal and regulatory requirements on the level of estimated credit losses in the existing loan portfolio.

The Company also revised the qualitative factors which were used to determine the allowance for loan losses on construction, commercial and other mortgage loans, home equity loans and lines of credit and consumer and other loans. As a result of these modifications, the Company increased the portion of the allowance for loan losses attributable to construction, commercial and other mortgage loans and decreased the portion of the allowance for loan losses attributable to residential mortgage, home equity loans and lines of credit and consumer and other loans. The allocation of a portion of the allowance from one category of loans does not preclude its availability to absorb losses in other categories. The unallocated allowance is established for probable losses that have been incurred as of the reporting date but are not reflected in the allocated allowance.

Management considers the allowance for loan losses at June 30, 2012 to be at an appropriate level to provide for probable losses that can be estimated based on general and specific conditions. While the Company uses the best information it has available to make evaluations, future adjustments to the allowance may be necessary if conditions differ substantially from the information used in making the evaluations. To the extent actual outcomes differ from the estimates, additional provisions for credit losses may be required that would reduce future earnings. In addition, as an integral part of their examination process, the Office of the Comptroller of the Currency will periodically review the allowance for loan losses. The Office of the Comptroller of the Currency may require the Company to increase the allowance based on their analysis of information available at the time of their examination.

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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 Loans and Lines of Credit	Consumer and Other	Unallocated	Totals
June 30, 2012:						
Allowance for loan losses:						
Ending allowance balance:						
Individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Collectively evaluated for impairment	552	641	35	107	122	1,457
Total ending allowance balance	$ 552	$ 641	$ 35	$ 107	$ 122	$ 1,457
Loans:						
Ending loan balance:						
Individually evaluated for impairment	$ 4,865	$ 176	$ 160	$ 1	$ 0	$ 5,202
Collectively evaluated for impairment	691,160	11,411	15,142	4,787	0	722,500
Total ending loan balance	$ 696,025	$ 11,587	$ 15,302	$ 4,788	$ 0	$ 727,702
December 31, 2011:						
Allowance for loan losses:						
Ending allowance balance:						
Individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Collectively evaluated for impairment	631	285	258	291	76	1,541
Total ending allowance balance	$ 631	$ 285	$ 258	$ 291	$ 76	$ 1,541
Loans:						
Ending loan balance:						
Individually evaluated for impairment	$ 4,926	$ 184	$ 159	$ 3	$ 0	$ 5,272
Collectively evaluated for impairment	650,901	10,872	17,105	5,486	0	684,364
Total ending loan balance	$ 655,827	$ 11,056	$ 17,264	$ 5,489	$ 0	$ 689,636

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

(Dollars in thousands)	June 30, 2012	December 31, 2011
Loans with no allocated allowance for loan losses	$ 5,202	$ 5,272
Loans with allocated allowance for loan losses	0	0
Total impaired loans	$ 5,202	$ 5,272
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
June 30, 2012:		
With no related allowance recorded:		
One- to four-family residential mortgages	$ 4,865	$ 5,182
Construction, commercial and other mortgages	176	241
Home equity loans and lines of credit	160	165
Consumer and other	1	1
Total	$ 5,202	$ 5,589
December 31, 2011:		
With no related allowance recorded:		
One- to four-family residential mortgages	$ 4,926	$ 5,206
Construction, commercial and other mortgages	184	241
Home equity loans and lines of credit	159	165
Consumer and other	3	3
Total	$ 5,272	$ 5,615

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

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
(Dollars in thousands)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
2012:				
With no related allowance recorded:				
One- to four-family residential mortgages	$ 4,869	$ 41	$ 4,918	$ 84
Construction, commercial and other mortgages	180	0	180	0
Home equity loans and lines of credit	160	2	160	3
Consumer and other	1	0	2	0
Total	$ 5,210	$ 43	$ 5,260	$ 87
2011:				
With no related allowance recorded:				
One- to four-family residential mortgages	$ 3,606	$ 35	$ 3,606	$ 68
Consumer and other	5	0	5	0
Total	$ 3,611	$ 35	$ 3,611	$ 68

There were no loans individually evaluated for impairment with a related allowance for loan loss as of June 30, 2012 or December 31, 2011.

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Impaired loans at June 30, 2012 and December 31, 2011 amounted to $5.2 million and $5.3 million, respectively, and included all nonaccrual and restructured loans. During the six months ended June 30, 2012, the average recorded investment in impaired loans was $5.3 million and interest income recognized on impaired loans was $87,000. During the six months ended June 30, 2011, the average recorded investment in impaired loans was $3.6 million and interest income recognized on impaired loans was $68,000.

The table below presents the aging of loans and accrual status by class of loans:

(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
June 30, 2012:								
One- to four-family residential mortgages	$ 595	$ 0	$ 1,768	$ 2,363	$ 686,844	$ 689,207	$ 2,535	$ 0
Multi-family residential mortgages	0	0	0	0	6,818	6,818	0	0
Construction, commercial and other mortgages	0	0	176	176	11,411	11,587	176	0
Home equity loans and lines of credit	0	0	0	0	15,302	15,302	161	0
Loans on deposit accounts	0	0	0	0	458	458	0	0
Consumer and other	5	1	1	7	4,323	4,330	1	0
Total	$ 600	$ 1	$ 1,945	$ 2,546	$ 725,156	$ 727,702	$ 2,873	$ 0
December 31, 2011:								
One- to four-family residential mortgages	$ 499	$ 0	$ 2,148	$ 2,647	$ 646,268	$ 648,915	$ 2,582	$ 0
Multi-family residential mortgages	0	0	0	0	6,912	6,912	0	0
Construction, commercial and other mortgages	0	0	184	184	10,872	11,056	184	0
Home equity loans and lines of credit	168	0	0	168	17,096	17,264	159	0
Loans on deposit accounts	0	0	0	0	756	756	0	0
Consumer and other	11	2	3	16	4,717	4,733	3	0
Total	$ 678	$ 2	$ 2,335	$ 3,015	$ 686,621	$ 689,636	$ 2,928	$ 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 come only from the sale or operation of the collateral and not from borrower repayments. Generally, 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, construction or equity 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.

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The Company had 14 nonaccrual loans with a book value of $2.9 million at June 30, 2012 and 12 nonaccrual loans with a book value of $2.9 million as of December 31, 2011. The Company collected or recognized interest income on nonaccrual loans of $27,000 and $2,000 during the six months ended June 30, 2012 and 2011, respectively. The Company would have recognized additional interest income of $123,000 and $45,000 during the six months ended June 30, 2012 and 2011, respectively, had the loans been accruing interest. The Company did not have any loans more than 90 days past due and still accruing interest as of June 30, 2012 and December 31, 2011.

There were no loans modified in a troubled debt restructuring during the six months ended June 30, 2012 or 2011. The Company had 11 troubled debt restructurings totaling $2.9 million as of June 30, 2012 that were considered to be impaired. This total included ten one- to four-family residential mortgage loans totaling $2.8 million and one home equity loan for $161,000. Eight of the loans, totaling $2.3 million, are performing in accordance with their restructured terms and accruing interest at June 30, 2012. Three of the loans, totaling $589,000, are performing in accordance with their restructured terms but not accruing interest at June 30, 2012. There were 11 troubled debt restructurings totaling $2.9 million as of December 31, 2011 that were considered to be impaired. This total included ten one- to four-family residential mortgage loans totaling $2.8 million and one home equity loan for $159,000. Eight of the loans, totaling $2.3 million, are performing in accordance with their restructured terms and accruing interest at December 31, 2011. Two of the loans, totaling $344,000, are performing in accordance with their restructured terms but not accruing interest at December 31, 2011. One of the loans, for $248,000, is 59 days delinquent and not accruing interest at December 31, 2011. 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.

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 six months ended June 30, 2012 and 2011, the Company sold $46.2 million and $26.1 million, respectively, of mortgage loans held for sale and recognized gains of $847,000 and $236,000, respectively. During the three months ended June 30, 2012 and 2011, the Company sold $22.3 million and $6.9 million, respectively, of mortgage loans held for sale and recognized gains of $406,000 and $92,000, respectively. The Company had seven loans held for sale totaling $1.9 million at June 30, 2012 and 12 loans held for sale totaling $3.2 million at December 31, 2011.

The Company serviced loans for others of $101.2 million at June 30, 2012 and $115.3 million at December 31, 2011. Of these amounts, $5.2 million and $6.2 million relate to securitizations for which the Company continues to hold the related mortgage-backed securities at June 30, 2012 and December 31, 2011, respectively. The amount of contractually specified servicing fees earned for the six-month periods ended June 30, 2012 and 2011 was $145,000 and $179,000, respectively. The amount of contractually specified servicing fees earned for the three-month periods ended June 30, 2012 and June 30, 2011 was $73,000 and $88,000, 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:

	June 30, 2012		December 31, 2011	
(Dollars in thousands)	Repurchase liability	Weighted average rate	Repurchase liability	Weighted average rate
Maturing:				
1 year or less	$ 25,300	3.64%	$ 28,300	4.75%
Over 1 year to 2 years	18,000	4.87	33,000	3.91
Over 2 years to 3 years	42,000	2.13	0	0.00
Over 3 years to 4 years	5,000	1.90	47,000	2.11
	$ 90,300	3.09%	$ 108,300	3.35%

During the quarter ended June 30, 2012, the Company prepaid $15 million of securities sold under agreements to repurchase and incurred a $198,000 prepayment penalty.

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 June 30, 2012. 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 Securities and the securities pledged are issued and guaranteed by U.S. government-sponsored enterprises.

(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	$ 105,148	$ 111,498	$ 90,300	$ 21,198	21

(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.

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The components of net periodic benefit cost were as follows:

(Dollars in thousands)	SERP Three Months Ended June 30, 2012	2011	SERP Six Months Ended June 30, 2012	2011
Net periodic benefit cost for the period				
Service cost	$ 49	$ 111	$ 98	$ 221
Interest cost	24	54	49	108
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	$ 73	$ 165	$ 147	$ 329

(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 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 June 30, 2012 and 2011 amounted to $248,000 and $234,000, respectively. Compensation expense recognized for the six months ended June 30, 2012 and 2011 amounted to $488,000 and $468,000, respectively.

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Shares held by the ESOP trust were as follows:

	June 30, 2012	December 31, 2011
Allocated shares	169,369	145,775
Unearned shares	807,387	831,853
Total ESOP shares	976,756	977,628
Fair value of unearned shares, in thousands	$ 18,384	$ 16,429

The ESOP restoration plan is a nonqualified 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 June 30, 2012 and 2011, we accrued $18,000 and $85,000, respectively, for the ESOP restoration plan. For the six months ended June 30, 2012 and 2011, we accrued $104,000 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 over the six-year vesting period.

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 six months ended June 30, 2012 was $660,000 and $1,323,000, respectively.

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Stock Options

The table below presents the stock option activity for the six months ended June 30, 2012:

	Options	Weighted average exercise price	Remaining contractual life (years)	Aggregate intrinsic value (in thousands)
Options outstanding at December 31, 2011	871,144	$ 17.36	8.67	$ 2,082
Granted	0	0.00	0.00	0
Exercised	41,275	17.36	0.00	0
Forfeited	0	0.00	0.00	0
Expired	0	0.00	0.00	0
Options outstanding at June 30, 2012	829,869	$ 17.36	8.17	$ 4,490

As of June 30, 2012, the Company had $2.9 million of unrecognized compensation costs related to stock options. The cost of stock options will be amortized over the six-year vesting period. There were no options vested in the six months ending June 30, 2012.

The fair value of the Company s stock options granted in 2010 was determined using the Black-Scholes option pricing formula. The following assumptions were used in the formula in 2010:

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

There were no options granted in 2011 or the six months ended June 30, 2012.

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.

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.

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The table below presents the restricted stock award activity for the six months ended June 30, 2012:

	Restricted stock awards	Weighted average grant date fair value
Nonvested at December 31, 2011	563,994	$ 17.36
Granted	0	0.00
Vested	0	0.00
Forfeited	0	0.00
Nonvested at June 30, 2012	563,994	$ 17.36

As of June 30, 2012, the Company had $8.2 million of unrecognized compensation cost related to restricted stock awards. The cost of the restricted stock awards will be amortized 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 June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Net income	$ 3,846	$ 3,385	$ 7,386	$ 6,385
Weighted-average number of shares used in:				
Basic earnings per share	10,135,179	10,992,653	10,163,647	11,126,781
Dilutive common stock equivalents:				
Stock options and restricted stock units	168,184	127,595	142,104	113,132
Diluted earnings per share	10,303,363	11,120,248	10,305,751	11,239,913
Net income per common share, basic	$ 0.38	$ 0.31	$ 0.73	$ 0.57
Net income per common share, diluted	$ 0.37	$ 0.30	$ 0.72	$ 0.57

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(12) Other Comprehensive Loss

The table below presents the changes in the components of other comprehensive loss:

	Three Months Ended June 30,					
	2012			2011		
(Dollars in thousands)	Beginning Balance	Current Income	Ending Balance	Beginning Balance	Current Income	Ending Balance
Unfunded pension liability	$ 2,966	$ 0	$ 2,966	$ 1,504	$ 0	$ 1,504
Noncredit related losses on securities not expected to be sold	679	0	679	679	0	679
Unrealized loss on securities	121	(6)	115	387	(252)	135
	$ 3,766	$ (6)	$ 3,760	$ 2,570	$ (252)	$ 2,318

	Six Months Ended June 30,					
	2012			2011		
(Dollars in thousands)	Beginning Balance	Current Income	Ending Balance	Beginning Balance	Current Income	Ending Balance
Unfunded pension liability	$ 2,966	$ 0	$ 2,966	$ 1,504	$ 0	$ 1,504
Noncredit related losses on securities not expected to be sold	679	0	679	679	0	679
Unrealized loss on securities	125	(10)	115	322	(187)	135
	$ 3,770	$ (10)	$ 3,760	$ 2,505	$ (187)	$ 2,318

The table below presents the tax effect on each component of other comprehensive loss:

	Six Months Ended June 30,					
	2012			2011		
(Dollars in thousands)	Pretax Amount	Tax	After Tax Amount	Pretax Amount	Tax	After Tax Amount
Unfunded pension liability	$ 4,954	$ (1,988)	$ 2,966	$ 2,488	$ (984)	$ 1,504
Noncredit related losses on securities not expected to be sold	1,106	(427)	679	1,106	(427)	679
Unrealized loss on securities	193	(78)	115	225	(90)	135
	$ 6,253	$ (2,493)	$ 3,760	$ 3,819	$ (1,501)	$ 2,318

(13) 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.

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 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, 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 estimated fair values of U.S. government-sponsored mortgage-backed securities are considered Level 2 inputs because the valuation for investment securities utilized pricing models that varied based on asset class and included trade, bid and other observable market information.

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 six sales transactions of similar rated securities over the past 18 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 three-month LIBOR plus 20.00% and provided a fair value estimate of $8.82 per $100 of par value for PreTSL XXIII.

The discounted cash flow analysis was prepared by an independent third party and included a review of all issuers within the pool. The fair value of the trust preferred securities are classified as Level 3 inputs because they are based on discounted cash flow models.

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.

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

(Dollars in thousands)	Carrying amount	Fair value	Fair Value Measurements Using Level 1	Level 2	Level 3
June 30, 2012					
Assets					
Cash and cash equivalents	$ 156,373	$ 156,373	$ 156,373	$ 0	$ 0
Investment securities held to maturity	620,965	655,681	0	655,369	312
FHLB stock	12,348	12,348	12,348	0	0
Loans held for sale	1,915	2,007	0	2,007	0
Loans receivable, net	726,245	769,059	0	0	769,059
Accrued interest receivable	4,686	4,686	4,686	0	0
Interest rate contracts	156	156	0	156	0
Liabilities					
Deposits	1,213,282	1,214,966	996,626	0	218,340
Advances from the Federal Home Loan Bank	20,000	20,512	0	0	20,512
Securities sold under agreements to repurchase	90,300	93,402	0	0	93,402
Accounts payable and accrued expenses	21,151	21,151	21,151	0	0
Interest rate contracts	140	140	0	140	0
Current income taxes payable	1,679	1,679	1,679	0	0
Advance payments by borrowers for taxes and insurance	3,305	3,305	3,305	0	0
December 31, 2011					
Assets					
Cash and cash equivalents	$ 131,937	$ 131,937	$ 131,937	$ 0	$ 0
Investment securities held to maturity	653,871	687,319	0	687,060	259
FHLB stock	12,348	12,348	12,348	0	0
Loans held for sale	3,231	3,352	0	3,352	0
Loans receivable, net	688,095	790,220	0	0	790,220
Accrued interest receivable	4,780	4,780	4,780	0	0
Interest rate contracts	156	156	0	156	0
Liabilities					
Deposits	1,166,116	1,167,855	942,365	0	225,490
Advances from the Federal Home Loan Bank	20,000	20,525	0	0	20,525
Securities sold under agreements to repurchase	108,300	112,306	0	0	112,306
Accounts payable and accrued expenses	22,816	22,816	22,816	0	0
Interest rate contracts	139	139	0	139	0
Current income taxes payable	3,114	3,114	3,114	0	0
Advance payments by borrowers for taxes and insurance	3,264	3,264	3,264	0	0

At June 30, 2012 and December 31, 2011, 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.

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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
June 30, 2012					
Interest rate contracts	assets	$ 0	$ 156	$ 0	$ 156
Interest rate contracts	liabilities	0	(140)	0	(140)
December 31, 2011					
Interest rate contracts	assets	$ 0	$ 156	$ 0	$ 156
Interest rate contracts	liabilities	0	(139)	0	(139)

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 table below presents the balance of assets measured at fair value on a nonrecurring basis as of June 30, 2012 and December 31, 2011 and the related losses for the six months ended June 30, 2012 and the year ended December 31, 2011:

(Dollars in thousands)	Level 1	Level 2	Level 3	Total	Total Losses
June 30, 2012					
Impaired loans	$ 0	$ 349	$ 2,749	$ 3,098	$ 90
Mortgage servicing assets	0	0	832	832	74
December 31, 2011					
Impaired loans	$ 0	$ 885	$ 2,766	$ 3,651	$ 219
Mortgage servicing assets	0	0	970	970	34

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 considered to be collateral-dependent is determined using a discounted cash flow analysis. Assumptions used in the analysis include the discount rate and projected cash flows. Gains and losses on impaired loans are included in the provision for loan 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.

The table below presents the significant unobservable inputs for Level 3 nonrecurring fair value measurements:

(Dollars in thousands)	Fair Value	Valuation Technique	Unobservable Input	Value
June 30, 2012:				
Impaired loans non-collateral dependent	$ 2,749	Discounted cash flow	Discount rate (1)	3.73% - 6.94%
Mortgage servicing assets	832	Discounted cash flow	Discount rate	10.00%
			Prepayment speed (PSA)	173.0 - 275.3
			Cost to service (Basis points)	40
December 31, 2011:				
Impaired loans non-collateral dependent	$ 2,766	Discounted cash flow	Discount rate (1)	3.73% - 6.94%
Mortgage servicing assets	970	Discounted cash flow	Discount rate	10.00%
			Prepayment speed (PSA)	180.1 - 437.9
			Cost to service (Basis points)	40

(1) Represents the yield on contractual cash flows prior to modification in troubled debt restructurings.

(14) Subsequent Events
On August 2, 2012, the Board of Directors of Territorial Bancorp Inc. declared a quarterly cash dividend of $0.11 per share of common stock. The dividend is expected to be paid on August 30, 2012 to stockholders of record as of August 16, 2012.

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.

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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 internationally, nationally or in our market areas, that are worse than expected;
- 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, 2011.

Comparison of Financial Condition at June 30, 2012 and December 31, 2011

Assets. At June 30, 2012, our assets were $1.566 billion, an increase of $28.5 million, or 1.9%, from $1.538 billion at December 31, 2011. The growth in assets was primarily the result of an increase in loans receivable and cash and cash equivalents, which was partially offset by a decrease in investment securities.

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Cash and Cash Equivalents. Cash and cash equivalents were $156.4 million at June 30, 2012, an increase of $24.4 million since December 31, 2011. The growth in cash and cash equivalents resulted primarily from a $47.2 million increase in deposits.

Loans. Total loans, including $1.9 million of loans held for sale, were $728.2 million at June 30, 2012, or 46.5% of total assets. During the six months ended June 30, 2012, the loan portfolio increased by $36.8 million, or 5.3%. The increase in the loan portfolio occurred as the production of new one- to four-family residential loans exceeded principal repayments and loan sales. The continued high level of loan originations is due primarily to the current interest rate environment.

Securities. At June 30, 2012, our securities portfolio totaled $621.0 million, or 39.7% of total assets. At June 30, 2012, 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 nonconforming loans having less than full documentation) loans. During the six months ended June 30, 2012, our securities portfolio decreased by $32.9 million, or 5.0%, as repayments exceeded purchases.

At June 30, 2012, we owned trust preferred securities with a carrying value of $32,000. This portfolio consists of two securities, which represent investments in a pool of debt obligations issued by Federal Deposit Insurance Corporation-insured financial institutions, insurance companies and real estate investment trusts.

The trust preferred securities market is considered to be inactive as only six transactions have occurred over the past 18 months in similar tranches to the securities owned by the Company. The 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. The Company used a discount rate equal to three-month LIBOR plus 20.00% and determined fair value to be $8.82 per $100 of par value.

Based on the Company s review, the Company s investment in trust preferred securities did not incur additional impairment during the quarter ending June 30, 2012, as the present value of cash flows exceeded the amortized cost basis of $1.1 million.

At June 30, 2012, these trust preferred securities 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. The impairment could be material to the Company s consolidated statements of income.

Deposits. Deposits were $1.213 billion at June 30, 2012, an increase of $47.2 million, or 4.0%, since December 31, 2011. The increase in deposits was caused by our continuing to promote higher-than-market rates for our savings accounts.

Borrowings. Our borrowings consist primarily of advances from the Federal Home Loan Bank of Seattle and funds borrowed under securities sold under agreements to repurchase. During the six months ended June 30, 2012, our borrowings decreased by $18.0 million, or 14.0%, to $110.3 million, due to the pay off of $18.0 million of securities sold under agreements to repurchase. We have not required any other borrowings to fund our operations. Instead, we have primarily funded our operations with the net proceeds from our stock offering, additional deposits, proceeds from loan sales and principal repayments on loans and mortgage-backed securities.

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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. Nonaccrual 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 June 30, 2012			2011		
	Average Outstanding Balance	Interest	Yield/ Rate (1)	Average Outstanding Balance	Interest	Yield/ Rate (1)
	(Dollars in thousands)					
Interest-earning assets:						
Loans:						
Real estate loans:						
First mortgage:						
One- to four-family residential (2)	$ 681,732	$ 8,521	5.00%	$ 615,677	$ 8,075	5.25%
Multi-family residential	6,896	106	6.15	6,139	98	6.39
Construction, commercial and other	12,724	172	5.41	14,481	222	6.13
Home equity loans and lines of credit	16,023	235	5.87	18,608	283	6.08
Other loans	5,010	76	6.07	5,332	85	6.38
Total loans	722,385	9,110	5.04	660,237	8,763	5.31
Investment securities:						
U.S. government sponsored mortgage-backed securities (2)	639,096	6,293	3.94	637,814	6,889	4.32
Trust preferred securities	32	0	0.00	32	0	0.00
Total securities	639,128	6,293	3.94	637,846	6,889	4.32
Other	158,320	87	0.22	147,756	81	0.22
Total interest-earning assets	1,519,833	15,490	4.08	1,445,839	15,733	4.35
Non-interest-earning assets	54,369			50,105		
Total assets	$ 1,574,202			$ 1,495,944		
Interest-bearing liabilities:						
Savings accounts	$ 842,987	$ 1,155	0.55%	$ 761,757	$ 1,177	0.62%
Certificates of deposit	218,181	417	0.76	214,141	509	0.95
Money market accounts	497	1	0.80	607	1	0.66
Checking and Super NOW accounts	115,316	9	0.03	108,862	14	0.05
Total interest-bearing deposits	1,176,981	1,582	0.54	1,085,367	1,701	0.63
Federal Home Loan Bank advances	20,002	104	2.08	19,999	104	2.08
Securities sold under agreements to repurchase	100,300	831	3.31	117,354	1,052	3.59